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Consequential Damages and Exclusion Clauses

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What's in a name? Should it matter if a claim in a contract dispute were labeled consequential damages rather than direct damages? If the contract included a clause that would deny recovery for consequential damages the definition would indeed matter.[1] I confess that I did not think the distinction was much of a problem until I ran into two practitioners in the same week who raised the issue. The first, a transactional lawyer, claimed he no longer knew what consequential damages meant, citing two opinions: *Biotronik A.G. v. Conor Medsystems Ireland, Ltd.,*[2] and *Pharmaceutical Product Development, Inc. v. TVM Life Science Ventures VI L.P.*[3] The second was the losing litigator in *Biotronik.*

In *Biotronik,* the manufacturer of stents terminated an exclusive distribution contract. The distributor sued, claiming that it suffered substantial lost profits. The defendant asserted that the lost profits were consequential damages and invoked a clause in the contract excluding consequential damages. The plaintiff argued that the lost profits were direct damages, so the exclusion would not apply, and the New York Court of Appeals, in a 4-3 decision, agreed.[4]

In the second case, the claim was that the seller of a company had breached a warranty about a drug's efficacy and as a result the acquirer had incurred costs of millions of dollars in a fruitless attempt to develop the drug. The seller argued that the clause excluding consequential damages precluded recovery for these losses. Rejecting this argument, at the motion to dismiss stage, then Vice Chancellor Leo Strine noted that the "laundry list of precluded damages might have been put in the Merger Agreement by lawyers who themselves were unclear on what those terms actually mean."[5] He did not elaborate on how, if the transactional lawyers were unclear, the litigating lawyers would find clarity.[6]

A search through the case law and commentary for the boundary between direct and consequential damages is unhelpful. A number of Courts have held that general damages are direct and special damages are consequential. A Westlaw search for ["consequential damages" and synonymous and "special damages"] yielded 35 cases,[7]

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[1] There is a second reason for concern about the distinction between consequential and direct damages. Some case law suggests that the standard of proof is higher for consequential damages. Two of those cases will be discussed below: *Tractebel Energy Marketing, Inc. v. AEP Power Marketing, Inc.* 487 F.3d 89, (2007); and *Compania Embotelladora Del Pacifico, S.A. v. Pepsi Cola Co*., 650 F.Supp.2d 314 (2009).
[2] 22 N.Y.3d 799 (2014).
[3] 2011 Court Of Chancery Of Delaware WL 549163.
[4] The case will be discussed in Part I. B.
[5] At 7.
[6] The case will be discussed in Part III.
[7] Some examples: "Consequential," "special" and "indirect" damages are synonymous terms, see Black's at 445–46 ("[C]onsequential damages ... [are a]lso termed indirect damages."); 3 Dobbs § 12.2(3), at 38 ("[S]pecial damages is also referred to as consequential damages….") *In re CCT Commc'ns, Inc*., 464 B.R. 97, 117 (Bankr. S.D.N.Y. 2011); The term "special damages" is synonymous with "consequential damages," and both refer to damages that do not flow directly from the breach of the contract, but are still caused by the breach. *In re Lyondell Chem. Co.*, 544 B.R. 75, 91 (Bankr. S.D.N.Y. 2016);The term

and a similar search for [“general damages” and synonymous and “direct damages”] yielded 40.[8] The Restatement (Second) is unhelpful: “Loss that results from a breach in the ordinary course of events is foreseeable as the probable result of the breach. . . . Such loss is sometimes said to be the ‘natural’ result of the breach, in the sense that its occurrence accords with the common experience of ordinary persons . . . . *The damages recoverable for such loss that results in the ordinary course of events are sometimes called ‘general’ damages*.”[9] It continues by blurring the categories: “The damages recoverable for loss that results other than in the ordinary course of events are sometimes called ‘special’ or ‘consequential’ damages. These terms are often misleading, however, and it is not necessary to distinguish between ‘general’ and ‘special’ or ‘consequential’ damages for the purpose of the rule stated in this Section.”[10] But, obviously, it would be necessary if the question were whether the damages were recoverable given the existence of an exclusion clause.

The Restatement invoked foreseeable, probable, and natural. Were the lost profits when a factory was shut down foreseeable? Did the damages flow naturally and necessarily from the breach? Was the loss a natural result in the ordinary course of events? These questions define a different boundary—the boundary between consequential damages that are recoverable and those that are not. It makes little sense to have them also define the boundary between direct and consequential damages. Yet some courts follow the Restatement. Judge Posner, for example, purported to distinguish between direct and consequential damages, “the difference lying in the degree to which the damages are a foreseeable (that is, a highly probable) consequence of a breach.”[11]

Instead of invoking concepts like foreseeability and naturalness, I propose that we view the contract as an asset and that direct damages be defined as the change in the value of that asset.[12] Consider a simple example. Suppose that the seller promises to deliver 1,000 bushels of wheat at $3; at the time of delivery the price is $4 and the seller breaches. Everyone, I believe, will agree that the damages would be $1,000 and would be

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“consequential damages” is synonymous with special damages. *Progress Energy, Inc. v. U.S. Glob., LLC*, 102 So. 3d 768, 771 (Fla. Dist. Ct. App. 2012).

[8] Some examples: “ General damages are synonymous with ‘direct’ damages, see Black's Law Dictionary 446 (9th ed. 2009) (‘Black’s’) (noting that ‘general damages’ are also termed ‘direct damages’), and provide the aggrieved party with the difference between the price he agreed to pay and the value he was to receive through performance. 15 3 Dobbs § 12.2(1), at 21.” *In re CCT Commc'ns, Inc.*, 464 B.R. 97, 116 (Bankr. S.D.N.Y. 2011); “The damages contemplated by UCC § 2–714 are referred to as direct or general damages. See *Am. Elec. Power Co.*, 418 F.Supp. at 454; General damages are synonymous with “direct” damages. *KSW Mech. Servs. v. Johnson Controls, Inc.*, 992 F. Supp. 2d 135, 145 (E.D.N.Y. 2014); General damages are synonymous with ‘direct’ damages, *In re Lehman Bros. Holdings Inc.*, 544 B.R. 62, 72 (Bankr. S.D.N.Y. 2015).

[9] Restatement 351, Comment b. (emphasis added)

[10] Id.

[11] *Rexnord*, p1004. The outcome of the case did not depend on this demarcation.

[12] See my Reckoning Contract Damages: Valuation Of The Contract As An Asset, Wash & Lee.

direct. The change in the value of the asset in this simple case is the contract/market differential. For more complex transactions ascertaining the change in the contract value would be difficult, but that is only a measurement problem. Those complex transactions will be the focus of the remainder of the paper.

One component of damages—lost profits—has been particularly controversial. Disclaimers typically include lost profits as a component of consequential damages.[13] If the damages could be classified as direct damages, the disclaimer would fail to protect the seller. Some courts have concluded that all lost profits claims are for consequential damages. "Although [plaintiff] suggests that the issue of whether lost profits may be considered direct damages has yet to be decided by an Iowa court, the Court finds that a fair reading of Iowa law reveals that lost profits are routinely regarded as consequential damages and not as direct damages."[14] That, however, is a minority view. There remains, however, substantial disagreement as to how to characterize claims for lost profits. One proffered distinction is to treat claims for "collateral business" as consequential. In *Tractebel Energy Marketing, Inc. v. AEP Power Marketing, Inc.*,[15] the New York Court of Appeals said:

> Lost profits are consequential damages when, as a result of the breach, the non-breaching party suffers loss of profits on *collateral business arrangements.* In the typical case, the ability of the non-breaching party to operate his business, and thereby generate profits on collateral transactions, is contingent on the performance of the primary contract. When the breaching party does not perform, the non-breaching party's business is in some way hindered, and the profits from potential collateral exchanges are "lost."
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> By contrast, 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. . . . The damages may still be characterized as lost profits since, had the contract been performed, the non-breaching party would have profited to the extent that his cost of performance was less than the total value of the breaching party's promised payments. But, in this case, the lost profits are the direct and probable consequence of the breach. The profits are precisely what the non-breaching party bargained for, and only an award of damages equal to lost profits will put the non-breaching party in the same position he would have occupied had the contract been performed.[16]

Courts have, in a number of instances, used the "collateral business" language to

[13] Here is a fairly typical disclaimer: "Under no circumstances whatsoever will either party be liable under any theory of liability for special, incidental or consequential damages *including, without limitation, lost profits* or revenues, even if such party has been advised of the possibility or likelihood of such damages." (Optimal Interiors, LLC v. HON Co., 774 F.Supp.2d 993, 1008 (2011)). (emphasis added)
[14] Optimal Interiors, p. 1012.
[15] 487 F.3d 89, (2007). The case will be discussed below in Section I.A.
[16] 487 F.3d 89, 109-110 (2007). (emphasis added)

conclude that a claim was for consequential damages,[17] but it is over-inclusive. Suppose, for example, that a licensee were to breach a patent license. If the license called for annual payments, the damages would be direct—the present value of the future stream of payments offset by any mitigation. No one questions that. What if the payments were a royalty based on sales? If the licensee were to breach, the future stream of payments would be the royalty on the future sales—losses on collateral business. Would the change in the form of compensation convert the damages from direct to consequential? That issue will be significant when we consider below claims by terminated distributors, like Biotronik.

Even if a court were to find the claimant entitled to direct damages, reckoning those damages would be problematic. The lost profits remedy can, if not tightly cabined, result in substantial overcompensation. That adds an additional layer of complexity to the analysis. I have argued in recent papers against allowing recovery for two classes of claims. One involves the plaintiff who claims that if the defendant had not breached, it would have had an additional sale, the so-called lost volume seller.[18] The other involves the new business rule, in particular claims of the sort "if you had performed, my project would have been a success and I would have made a lot of money."[19] So, while I will argue that in some of the cases analyzed below that the court should have found the damages direct, I will not necessarily endorse how courts had reckoned those damages.

The direct versus consequential damages question arises in a number of different contexts. Suppose that a seller were to wrongfully terminate a contract. In the simplest case, the market price had risen and the seller breached. The buyer's claim would be for the difference between the contract price and the market price. Labeling this measure lost profits would seem to be a pretty strained terminology. Indeed, Mr. Justice Cooke rejected such language: "The contract price/market price differential is not a computation of lost profit . . . . In my judgment, no-one who understood the way in which the Sale of Goods Act works, would refer to this measure of loss as 'lost profits' or 'loss of anticipated profits' and clause 32.1 cannot operate to exclude the loss claimed here."[20] Nonetheless, courts frequently do characterize such claims as lost profits. We shall see, in Section I.A, in cases involving the repudiation of a long-term contract, the lost profits language is routinely used. In these cases, lost profits would clearly be direct damages. A blanket disclaimer of lost profits would risk excluding claims for the contract/market differential.

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[17] See, for example, *Compania Embotelladora Del Pacifico, S.A. v. Pepsi Cola Co*., 650 F.Supp.2d 314 (2009). (discussed below in Section I.B)

[18] Victor P. Goldberg, The Lost Volume Seller, R.I.P., 2 *The Criterion Journal on Innovation*, 205-231.

[19] Victor P. Goldberg, The New Business Rule and Compensation for Lost Profits, 1 *The Criterion Journal on Innovation*, 341-372

[20] Glencore Energy UK Ltd v Cirrus Oil Services Ltd, 2014 WL 16577 (2014), ¶¶98-100. An American court made a similar argument: "Nor is defendant correct in describing as lost profits the gain that Western Union could have expected to realize from the sale of the launch contract. That gain—the difference between the contract price and the market price (or more specifically, the price Hughes Communications would have been willing to pay)—is synonymous with the very value of the performance for which Western Union had bargained. Such a value, by definition, constitutes general damages rather than lost profits." *New Valley Corp. v. United States*, 72 Fed. Cl. 411, 414 (2006).

Suppose that instead of the contract having an explicit price, the complainant's compensation were indirect. It might, for example, be a wrongfully terminated distributor, like Biotronik. There would have been no explicit promise to pay the distributor any amount. Whether its loss should be treated as direct is a harder question, and the courts have gone both ways. I will argue that the damages in this case as well should be classified as direct. The trick will be recognizing that the distributor is selling a service to the manufacturer and the price is determined by the difference between the wholesale and retail price. These cases will be considered in Section I.B.

Wrongful termination is but one way of breaching a contract. Delay presents different issues. Delay might give rise to a claim for lost profits while a factory is closed (*Hadley v Baxendale*). Or the claimant might argue that it had incurred additional costs because of the seller's delay, perhaps in an attempt to mitigate losses.[21] Whether these consequential damages would be recoverable in the absence of a disclaimer would be contestable. Might any delay damages be direct? In Section II I will consider two cases. In the first the court incorrectly labeled some of the damages as direct; in the second it correctly labeled them correct, but for the wrong reason.

The breach of warranty cases are, I believe, the most complicated ones. If, for example, a manufacturer warrants that a machine will perform at a level of 100, but it only performs at 80, would the buyer's additional expenses be classified as consequential damages or direct? What about the additional research expenditures alluded to in *Pharmaceutical Product*? The warranty cases will be analyzed in Section III.

Rather than producing a compilation of cases, my approach has been to focus on a few cases in each category. There is a tradeoff between depth and breadth; whether I have struck the proper balance I leave to the reader's judgment. I do not claim that my categories capture the entire range of issues. There are, no doubt, other contexts in which the direct versus consequential damage question arises but I believe that I have captured the most significant categories.

I. Termination and Lost Profits

A. Change in Market Conditions

Contracts assign the risks of market change. If the market price goes up and the seller breaches, the buyer's damages are the difference between the contract and market price. In a simple commodity sale, these "lost profits" are clearly direct damages. They give the claimant the benefit of the bargain.

Cherokee Cty. Cogeneration Partners, L.P. v. Dynegy Mktg. & Trade[22] adds one wrinkle to the contract-market differential story. The contract called for Dynegy to sell a fixed quantity of natural gas each day to Cherokee. The contract gave Cherokee the option of using the gas for its own cogeneration facility or to resell the gas to third parties. The contract included a clause that would award Cherokee the contract-market

[21] See, for example, Spang Industries, Inc. Ft. Pitt Div. v. Aetna, 512 F.2d 365 (1975).
[22] 305 S.W.3d 309 (Tex. App. 2009).

differential for any shortfall (the standard remedy for direct damages),[23] and a no consequential damages clause.[24] After Hurricane Katrina, Dynegy attempted to invoke the force majeure clause for a five-week period. During that time, the market price of natural gas jumped to about five to ten times the contract price. Dynegy managed to provide sufficient gas to operate Cherokee's facility, but fell short of delivering the contract quantity. Cherokee contested Dynegy's force majeure claim and sued claiming that Dynegy had breached, asking for the shortfall multiplied by the difference between the contract and market price—almost $5 million.[25]

Dynegy moved for partial summary judgment contending that the damages were consequential lost-profits damages. If Dynegy had failed to provide enough gas to run Cherokee's facility, then, it conceded, it would have been liable for direct damages. However, Cherokee was asking for "[p]rofits lost due to the loss of other contracts, and similar collateral opportunities, [which] are the classic 'consequential' damages."[26] Since the contract excluded recovery of consequential damages, Cherokee should get nothing. The trial court agreed.

The Court of Appeals reversed. Because Cherokee was free to resell to anyone, the court concluded, it was free "to profit from increases in the market-price of natural gas, by purchasing the commodity from Dynegy at the contract price and then reselling the purchased gas at a higher price."[27] Thus, "Dynegy's alleged breach would naturally and necessarily cause Cherokee to suffer direct damages in the form of profits *on the Agreement itself*."[28] Two points are worth noting. First, the defendant tried (unsuccessfully) to invoke the collateral business defense; second, the contract-market differential was characterized by the Court as Cherokee's lost profits. The contract assigned the market risk; it was for the delivery of a specific quantity at a fixed price. Whether Cherokee intended to use the gas for its own facility or to sell it to others should have been irrelevant, as the Court of Appeals held.

Cherokee was pretty easy; the lost profits were simply the contract-market differential for goods not delivered. The anticipatory repudiation of a long-term contract is more complicated, but the principles are the same. The contract should be viewed as an asset and the damages would be the decline in the value of the asset at the time of the

23 "Seller's Failure to Make Gas Available. If Seller fails, in whole or in part, to make available to Buyer the then-effective Nominated Purchase Quantity on any day, and if such failure is not excused by an event of force majeure or Buyer's failure to take gas nominated, Buyer's right to recover damages for such failure shall be limited to an amount equal to the shortfall in delivery from the Nominated Purchase Quantity, multiplied by the amount, if any, by which the Gas Daily Spot Price (hereinafter defined) exceeds the applicable Commodity Charge." (At 312-313)
24 "Neither party shall be liable in any event for consequential, incidental, special or punitive damages or losses which may be suffered by the other as a result of the failure to deliver . . . the required quantities of gas." (At 313)
25 Dynegy brief, p. 6. This was only a partial breach—the contract remained in force after the alleged force majeure period.
26 Dynegy brief, p. 8.
27 At 315.
28 At 315 (emphasis in the original).

repudiation.[29] In *Tractebel*, after the market price for electricity collapsed, the buyer repudiated a 20-year agreement for the purchase of electric power from American Electric Power (AEP).[30] As in many long-term contracts, both price and quantity were variable. The court concluded that Tractebel (TEMI) had repudiated and was then confronted with the issue of damages.

The contract included a termination clause. If TEMI defaulted, AEP may "accelerate all amounts owing between the Parties and . . . liquidate and terminate all obligations under this Agreement;"[31] the termination payment would be the difference between the payments TEMI was required to make and the market value of the products it was supposed to purchase.[32] Even if the contract were silent on the matter, this would be how damages would be defined. Damages would be the present value at the time of the repudiation of the difference between the value of the contract before and after the market decline—characterized by the court and the economic experts as lost profits. The trial judge asked whether the lost profits were general (direct) damages or special (consequential) damages. He concluded the latter:

> General damages are usually measured by the difference between the market value for a product and the contract price. On the other hand, "special" or "consequential" damages "seek to compensate a plaintiff for additional losses (other than the value of the promised performance) that are incurred as a result of the defendant's breach. The type of consequential damages most often sought is lost operating profits of a business." . . . In this case, the amount of damages sought by AEP resembles most closely consequential damages. . . . AEP's claim is appropriately characterized as one for consequential damages because it is a measure of "income or loss, or cash flow, including losses that may result far into the future."[33]

The Court of Appeals disagreed. "In characterizing AEP's claim as one for consequential damages, the district court confused the benefit of the bargain with speculative profits on collateral transactions . . . . AEP seeks only what it bargained for—the amount it would have profited on the payments TEMI promised to make for the remaining years of the contract. This is most certainly a claim for general damages."[34] The value of the contract to the seller had increased because of the market collapse, just as the value of the Cherokee contract to the buyer had increased when the price of gas soared. Measurement was much easier in *Cherokee*, but in each case the damage claim was for direct damages.

Why did it matter? The concern was not whether a damage claim was excluded.

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[29] See Victor P. Goldberg, Reckoning Contract Damages: Valuation Of The Contract As An Asset Washington & Lee L. Rev. (forthcoming)
[30] For additional detail on the contract, see Contract as an Asset.
[31] Tractebel Energy Marketing, Inc. v. AEP Power Marketing, Inc. 2006 WL 147586, p. 1.
[32] At p. 2
[33] At p. 2. Internal quotations are to AEP's claim is appropriately characterized as one for consequential damages because it is a measure of "income or loss, or cash flow, including losses that may result far into the future."
[34] Tractebel Energy Marketing, Inc. v. AEP Power Marketing, Inc., 487 F.3d 89, 110 (2007).

Rather, the issue was the standard of proof:

> While certainty of amount is not an element of general damages in New York, it is an element of consequential damages. In addition to proving that the *existence* of damage is reasonably certain, and that the damages were foreseeable and within the contemplation of both parties, a party claiming consequential damages must also prove the *amount* of damage with "reasonable certainty." . . . Thus, there exists a higher burden for proving consequential damages than for general damages. This is the burden that the district court erroneously imposed on AEP.[35]

Had the Court of Appeals concluded that the lost profits should be labeled consequential damages, it would presumably have refused to award expectation damages. The trial judge was dissatisfied with the economic expert reports and held that even with the lower standard of proof for direct losses, their estimates were too speculative. "With so many unknown variables, these experts might have done as well had they consulted tea leaves or a crystal ball."[36] (The experts differed by around $500 million.) As a result, he would have awarded no damages. Again, the Court of Appeals disagreed. If proof were disallowed because of all the unknown variables, it said, no victims of a repudiation of a long-term contract could ever be compensated.

When a buyer repudiates a contract the seller can mitigate damages in one of two ways. It could continue to produce with damages being the expected difference in revenues in the pre- and post-repudiation worlds—that is how the Court of Appeals would have damages reckoned in *Tractebel*. But what if the expected future unit costs of production exceeded the expected prices? Then mitigation would entail shutting the project down. The seller's loss would be the expected future revenues less the expected cost of producing that revenue (the costs saved). Courts have recognized this measure, treating it as obvious that the remedy would be labeled lost profits. For example, in a casebook favorite, *Northern Indiana Public Service Co. v. Carbon County Coal Co.,*[37] Judge Posner noted: "With the collapse of oil prices, which has depressed the price of substitute fuels as well, this coal costs far more to get out of the ground than it is worth in the market."[38] He concluded: "The loss to Carbon County from the breach of contract is simply the difference between (1) the contract price (as escalated over the life of the contract in accordance with the contract's escalator provisions) times quantity, and (2) the cost of mining the coal over the life of the contract."[39] That difference, he says, is the seller's lost profits.[40]

In *New Valley Corp. v. U.S.*[41] the court did a good job distinguishing the direct damages from the consequential damages. Western Union (renamed New Valley in 1991) had a contract with NASA to receive launch services for a communications satellite.

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[35] At 111.
[36] 5 WL 1863853 (S.D.N.Y. Aug. 8, 2005) at p. 11-12.
[37] 799 F.2d 265 (1986)
[38] At 279.
[39] At 279.
[40] "Hence by offering Carbon County more than contract damages (i.e., more than Carbon County's lost profits). . . " At 279.
[41] 72 Fed. Cl. 411 (2006).

After the Challenger disaster, President Reagan announced that "NASA will no longer be in the business of launching private satellites."[42] The court held that this violated NASA's best efforts obligation and therefore NASA had repudiated. Western Union had gone into bankruptcy and its communications satellite business had been sold to Hughes Communications. At trial the government argued that there should be no damages since Western Union's precarious financial condition meant that it would not have been able to perform. The court rejected that argument holding that its financial capacity was irrelevant since it could have assigned the launch contract, thereby allowing Western Union to realize the market value of the contract. The court left for future determination the question of "how much more Hughes Communication would have paid for the Westar Division assets had they included a NASA launch contract."[43] That is, the launch contract was an asset and, as in *Tractebel*, the damages would be the change in the value of that asset.

In the next phase, both parties asked for summary judgment. NASA claimed that all the damages were consequential damages and recovery was precluded by the disclaimer: "liability to the Customer . . . shall be limited to direct damages only and shall not include any loss of revenue, profits or other indirect or consequential damages."[44] Why might they be consequential? The government's reasoning strikes me as incoherent:

> In support of this argument, defendant asserts that Western Union did not sell the Westar Division assets because of the breach but rather because it was confronting a liquidity crisis that left it without sufficient funds to satisfy its day-to-day operations and also meet its debt service obligations. Defendant thus maintains that plaintiff's damages cannot be said to flow directly from the breach but are instead the result of a collateral undertaking and therefore constitute consequential damages. More particularly, defendant identifies plaintiff's damages claim as a claim for lost profits, *i.e.*, monies that Western Union claims it would have realized had it been able to sell its favorably priced NASA launch contract for its much higher market value.[45]

The government appears to be arguing that the change in value of the launch contract could be characterized as lost profits (true), and since the disclaimer mentions lost profits (true), lost profits cannot be recovered (not true). The court rightly rejected the motion. The sale was not caused by the breach. Rather, "the sale was simply the focal point of the loss, *i.e.*, the occasion when the market value of the launch contract could have been realized by Western Union had there in fact been no breach."[46] Damages would have been the difference between what Hughes would have paid had it purchased the Western assets with and without the launch contract.

There were complementary assets that also diminished in value as a result of the

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[42] New Valley Corp. v. U.S., 119 F.3d 1576, 1578 (1997). (citing 22 Weekly Comp. Pres. Doc. 1103, 1104 (Aug. 15, 1986)).
[43] At 413.
[44] At 413.
[45] At 413-414.
[46] At 414.

repudiation--notably a satellite, which accounted for about half of the $40 million Hughes paid for Western's assets. The plaintiff asked for $11.7 million for the diminution in value of the satellite. The court properly rejected that claim since the satellite's lost value, and that of other assets, were simply a consequence of the breach. The court did, in passing, raise one troublesome point. In determining the damages it suggested that Western Union's financial situation should be taken into account referring to "the sale price Western Union reasonably might have expected to receive given its distressed financial position and Hughes Communications' awareness of that condition."[47] Damages arising from the unique characteristics of the claimant (Western's financial position, Hadley's shaft inventory) would be consequential. In the instant case, there should be no impact since Western's financial position would likely have had the same effect on the sale price with and without the launch contract.

In the previous cases the breach was precipitated by changed market conditions. In *Penncro Associates, Inc. v. Sprint Spectrum, L.P.*[48] there was no indication of a change in the market. Nonetheless, the court concluded correctly that the claimant's lost profits were direct, not consequential. Sprint, having decided to outsource the collection of overdue payments, entered into contracts with three providers, one of the contracts being a three-year agreement with Penncro. The agreement required that Penncro maintain a staffing level sufficient to provide Sprint with 80,625 productive hours per month and Sprint agreed to pay for 80,625 productive hours per month.[49] The court interpreted this as a contract for capacity—it would have to pay "whether or not Penncro's phones were ringing."[50] It did not go well. After a few months in which usage fell short of 80,625 hours, Sprint invoked the termination clause, which allowed it to terminate after six consecutive months of poor performance. Specifically, if Penncro ranked last of the three providers in certain performance metrics, Sprint could terminate. However, the court concluded, Penncro did not rank last and therefore the termination was wrongful. Sprint did not contest liability; it only contested damages.[51]

Penncro did not claim damages for the period prior to the termination, but it did sue for the "lost profits" for the remainder of the contract period. The trial court awarded Penncro $53,109,386 in lost contractual revenues, minus $28,307,302 in costs avoided by not having to perform and $7,665,472 in losses avoided due to the breach for a final total of $17,136,612. Both parties appealed. Sprint argued that recovery for lost profits was barred by the contractual disclaimer of liability for consequential damages, "includ[ing], but ... not limited to, lost profits, lost revenues and lost business opportunities."[52] Penncro

[47] At 414.
[48] 499 F.3d 1151 (2007).
[49] A productive hour was defined as time spent by a fully trained Penncro employee handling calls, waiting for calls, training, or waiting due to system downtime. Cite. The contract set the hourly rate at $22; in addition, the contract required that Penncro assign, and Sprint pay for, 40 managers per month at $4,500 per manager.
[50] At 1159.
[51] "But Sprint long ago made the tactical decision not to contest liability on this or any other basis—such as mutual breach, anticipatory breach, mistake, fraud, or material misrepresentation—and its decision to hang its hat at trial solely on the nature and quantum of Penncro's damages cannot be reconsidered on appeal." At 1159.
[52] At 1155.

disputed the reduction for losses avoided. In an opinion written by then Circuit Judge Neil Gorsuch, the trial court decision was affirmed on all counts.

The damages, he held, were direct damages, not consequential. This was, in effect, a take-or-pay contract. In an anticipatory repudiation of a capacity contract, the damages reflect the claimant's mitigation.[53] Sprint had promised to pay for 80,625 hours per month for the duration of the contract. Its breach released Penncro from its obligation to incur the costs of maintaining that staffing level (the costs avoided) and it was now free to use those resources for other purposes (the losses avoided).[54]

Penncro claimed that it would have been able to fulfill the other contracts it had subsequently entered into, even if this one had remained in effect. It was, it claimed, a lost volume seller, so the profits it made on these other contracts should not be used to partially offset the assessed damages.[55] The trial court found that Penncro did enter into two contracts afterwards, but concluded that it could not have performed these while performing this contract. It therefore rejected the lost volume argument and deducted those earnings (the loss avoided) from the assessed damages.

B. Indirect Compensation

Compania Embotelladora Del Pacifico, S.A. v. Pepsi Cola Co.,[56] did not involve a termination, but it is an indirect-compensation case that is cited in a number of the termination cases. In *Compania*, Judge Rakoff denied recovery on a number of grounds, one of which was the higher standard of proof for a consequential damage claim. Compania (CEPSA) would "bottle sell and distribute the [Pepsi–Cola] beverage only in the [appointed territory]," and it would "not, directly or indirectly, bottle, sell or distribute the Beverage in any other Territory."[57] It had been a Pepsi bottler for over 40 years. Since the agreement had no definite term it was terminable at will by either party. CEPSA claimed that Pepsi had breached the exclusivity agreement by failing to police "transshipping," *i.e.*, the sale by third parties (other Pepsi bottlers) into CEPSA's exclusive territory.

Judge Rakoff ruled against the bottler on a number of grounds. First, he held that there was no breach. The contract granted CEPSA an exclusive territory, but Pepsi did not promise to police transshipping. It had no obligation to take affirmative steps to prevent other bottlers from selling in the exclusive territory. That should have been enough—no breach, no damages.

However, Judge Rakoff piled on with additional grounds for rejection. He granted Pepsi's summary judgment motion on the admissibility of the CEPSA experts' damage report.[58] CEPSA's expert witnesses estimated lost profits by projecting the dollar sales that CEPSA would have made but for the transshipment, and then applying CEPSA's historical profit margin rate. The damages, claimed the experts, were over $236 million.

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[53] See Contract as an Asset.
[54] This is a mix of *Tractebel* (losses avoided) and *NIPSCO* (costs avoided).
[55] For a more complete analysis of why there should be no recovery for the lost volume seller, see my The Lost Volume Seller, R.I.P., 2 *The Criterion Journal on Innovation*, 205-231.
[56] 650 F.Supp.2d 314 (2009).
[57] At 318.
[58] This is the longest part of the opinion. At 318-321.

"An even cursory review of these damages calculations demonstrates that they are based on what [the expert] himself concedes to be unreliable and inaccurate data, together with a series of assumptions that have no basis in fact or reality."[59] (The reports appear to have some problems, but I confess that I have seen courts accept a lot worse.)

Citing *Tractebel*, he asked whether "the damages sought by CEPSA are general, thus merely requiring a 'reasonable estimate' of damages before an award can be made, or instead consequential, thus requiring CEPSA to prove such damages "with reasonable certainty."[60] He answered: consequential. "Here, CEPSA is plainly not seeking to recover money that PepsiCo agreed to pay under the EBA. Instead, CEPSA is seeking to recover lost profits from lost sales to third-parties that are not governed by the [contract]. Such damages are properly characterized as consequential damages, because, as a result of PepsiCo's alleged breach, CEPSA suffered lost profits on collateral business arrangements (*i.e.*, sales of PepsiCo products to its customers throughout its exclusive territory)."[61] CEPSA fell short of the "reasonable certainty" standard. "In the absence of any admissible expert testimony concerning causation or damages, and without any evidence indicating that CEPSA would have made *any* additional sales in the absence of transshipment, CEPSA plainly falls short of this standard, and summary judgment dismissing its breach of contract claim is thus warranted."[62] The experts' damage reports were inadmissible regardless of what standard they were held to, so it should not have mattered whether the damages were classified as consequential or direct. CEPSA should lose because Pepsi hadn't breached and, anyway, CEPSA could not prove any damages.

So, it really wasn't necessary for him to determine whether the claimed damages were direct or consequential. But what if he had found that Pepsi had promised not to police transshipping and failed to do so? CEPSA's claim was for sales that would have been made, but for the breach. Judge Rakoff characterized these as lost profits for sales to third parties invoking the collateral business standard, discussed above;[63] therefore, he concluded, the damages were consequential. His argument appears to be that even if every sale by a transshipper would have been made instead by CEPSA, its hypothesized sales would be to third parties, and the lost profits would therefore be consequential damages.

Judge Rakoff might not have been willing to go quite that far. Perhaps his concern was that there was not a one-to-one relationship between the sales made by others (the transshipping bottlers) and the sales that would have been made by CEPSA. The lost profits were too uncertain and therefore, he presumably thought, they did not flow directly from the breach. However, that would just present a measurement problem (one a lot easier than the one in *Tractebel*). CEPSA's losses would be of the same type as Otis Wood's losses when Lucy, Lady Duff Gordon breached her agreement and entered into endorsement agreements directly with Sears and others.[64] That is, the contract gave

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[59] At 319.
[60] At 322.
[61] At 322.
[62] At 322. (emphasis added)
[63] At 322.
[64] Wood v. Lucy, Lady Duff Gordon 118 N.E. 214 (N.Y. 1917); for more detail on the case, see Goldberg, Framing Contract Law, ch. 2.

CEPSA (and Wood) all the revenue it could generate in its exclusive arrangement, but the breach resulted directly in a reduction of those revenues (subject to mitigation); the damages were direct.

I want to turn to a different type of case involving a distributor. What if a manufacturer wrongly terminated a distributor who then claims that it had lost future profits? *Biotronik*, which will be discussed below, is one such case. Consider first a stylized example. A manufacturer, M1, buys retailing services from a retailer, R1. M1 agrees to pay to R1 a flat rate of $10,000 per month for retailing services for ten years. After two years M1 is dissatisfied and breaches the agreement. There should be no doubt that the damages would be direct. Damages would be for lost profits, calculated in the same way as Tractebel's and Carbon County's were—the future revenue stream ($10,000 per month), taking into account reasonable mitigation.

Of course, distribution contracts usually are not flat rate. In most instances, that would be inefficient. Instead, when manufacturers buy retailing services, they typically pay for them indirectly—the difference between the wholesale and retail price—so there would be no explicit price term.[65] Suppose that M2 were to wrongfully terminate such a contract with R2. While the contract would be written in terms of the sale of goods from M2 to R2, functionally it is the sale of retailing services from R2 to M2. If M2 were to breach, R2's damages would be its future lost profits. There would be no reason to distinguish between the claims of R1 and R2 since both would be for a future stream of payments, a direct result of the termination. The fact that R2's claim was based on "collateral business" ought to be irrelevant.

Returning to CEPSA, suppose that Pepsico had breached, that the contract was for a fixed time period, and the damage claim was for future lost profits. (The court had found that the actual contract was terminable at will in which case there would have been no future lost profits.) CEPSA's claim would be the same as R2's. But for the breach it would have made future sales and incurred future costs. Perhaps, it would have mitigated by using its facilities for some other purpose.[66] Measurement would have been difficult, but that does not change the conclusion that those losses would have been direct, not consequential.

In *CEPSA* there was no disclaimer of consequential damages. Judge Rakoff's concern was the higher standard of proof for consequential damages. In some other cases in which a distributor sued for lost profits, there was a disclaimer and the courts labeled the damages consequential, thereby denying recovery. Two examples: "Because those damages rely on future deals with a business that is not a party to the [contract], and are contingent on anticipated prices and demand that are not determined by the contract itself, the damages are not 'necessarily inherent in the contract."[67] "Because the remainder of the profit Optimal alleges it would have earned under the Agreement was entirely contingent on collateral third-party agreements, the Court must find

[65] In some instances, for example cosmetics departments, a manufacturer will rent space in a department store, essentially paying a fixed monthly fee.
[66] In fact, CEPSA was in bankruptcy, but that should not matter.
[67] Atlantech Inc. v. American Panel Corp., 743 F.3d 287, 294. (2014).

that the remainder of Optimal's claim is a claim for consequential damages."[68] Not all courts reasoned this way. "Unquestionably the Distributorship Agreement contemplated DP's selling of AM's machines for a profit. Alleged damages in the form of loss of profits and the disruption of day to day business, for example, could be viewed as flowing directly and immediately from the breach of the claimed contract."[69]

The facts in *Biotronik* are a bit more complicated than the simple manufacturer-retailer example. Conor was the developer and manufacturer of CoStar, a drug-eluting coronary stent.[70] The agreement gave Biotronik the exclusive right to distribute CoStar in a worldwide market territory excluding the United States and certain other countries. Biotronik promised to use commercially reasonable efforts to promote and distribute CoStar. Biotronik began distributing the product in 2006 after receiving regulatory approval. In the next year two things happened that led to Conor recalling all the stents and stopping production. In an FDA trial it could not establish that CoStar was equivalent to Taxus, a stent produced by a competitor. In addition, Conor was purchased by Johnson & Johnson which marketed a competing stent, Cypher. Conor then recalled CoStar and notified Biotronik that it was removing it from the market. Biotronik sued claiming that the recall was a sham motivated by J&J's interest in promoting its competing product. It asked for its lost profits (which its expert said were $85 million). The contract included a disclaimer of consequential damages: "Neither party shall be liable to the other for any indirect, special, consequential, incidental or punitive damage with respect to any claim arising out of this agreement (including without limitation its performance or breach of this agreement) for any reason."[71]

Conor moved for summary judgment on liability and damages. Summary judgment on liability was denied. The trial court granted its motion on damages, holding that the lost profits were consequential and therefore precluded. A unanimous Appellate Court (6-0) agreed; however, in a 4-3 decision, the Court of Appeals reversed holding that the damages were direct and therefore the claim was not barred by the disclaimer.[72] So, although the final decision held that the damages were direct, ten of the fourteen judges ruling on the case held otherwise. The case subsequently settled for an undisclosed amount (but, I am told, for substantially less than $85 million).

The contract mechanics were somewhat complicated. Quantity was to be determined by a process. Biotronik would make a forecast of the upcoming 12-month period, updating it monthly. The contract established a mechanism for determining a minimum order for each month. Biotronik was obligated to take, and pay for, the minimum quantity. Conor's maximum commitment in any month was to provide up to

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[68] Optimal Interiors, LLC v. HON Co., 774 F. Supp. 2d 993, 1013 n.18 (S.D. Iowa 2011)
[69] DP Serv., Inc. v. AM Int'l, 508 F. Supp. 162, 167 (N.D. Ill. 1981)
[70] "A stent is a tiny tube placed into a hollow structure in your body. This structure can be an artery, a blood vessel, or something such as the tube that carries urine (ureter). The stent holds the structure open… A drug-eluting stent is coated with a medicine. This medicine helps further prevent the arteries from re-closing," MedlinePlus Medical Encyclopedia. https://medlineplus.gov/ency/article/002303.htm.
[71] At 803. The disclaimer did not include a reference to lost profits as a type of consequential damage.
[72] Biotronik, A.G. v. Conor Medsystems Ireland, Ltd., 33 Misc. 3d 1219(A), 939 N.Y.S.2d 739 (Sup. Ct. 2011); Biotronik A.G. v. Conor Medsystems Ireland, Ltd., 95 A.D.3d 724, 945 N.Y.S.2d 258 (2012), rev'd, 22 N.Y.3d 799, 11 N.E.3d 676 (2014); Biotronik A.G. v. Conor Medsystems Ireland, Ltd., 22 N.Y.3d 799, 11 N.E.3d 676 (2014).

30% more than the forecast amount; it had the option, but not the obligation, of supplying more. Nor did the agreement specify price. Biotronik was free to charge its customers any price. An essential aspect of Biotronik's role was to negotiate with customers for the best prices. Unlike in the simple retailer arrangement described above, the wholesale price was not fixed, it depended on the prices Biotronik succeeded in obtaining. It would then pay to Conor a transfer price of 61% of its net sales.[73] At the end of each quarter the parties would meet to agree upon a minimum transfer price for the following quarter. The transfer price would be determined by dividing the net sales by the quantity of stents sold in the period. At the end of the quarter there would be a reconciliation; if the actual transfer price exceeded the minimum, Biotronik would pay the difference to Conor; if it fell short, then Conor would receive the minimum; it would not have to compensate Biotronik for the shortfall.

The trial judge held that "Biotronik is claiming damages in the form of lost profits on collateral business arrangements, and that these are consequential damages."[74] It then invoked Comment 6 to UCC 2-715: "In the case of sale of wares to one in the business of reselling them, resale is one of the requirements of which the seller has reason to know within the meaning of subsection (2)(a)." This, it said, "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."[75] However, this misinterprets 2-715. It allows for recovery as consequential damages, but it does not mean that all such cases must be for consequential damages. As White and Summers say: "section 2–715(2) is not an exhaustive specification of the necessary and sufficient conditions for application of the concept of consequential damages"[76] The Appellate Court, invoking *CRESPA* and the "collateral business" argument, affirmed.

The Court of Appeals majority held that the damages were general. "This distinction does not mean that lost resale profits can never be general damages simply because they involve a third-party transaction. Such a bright-line rule violates the case specific approach we have used to distinguish general damages from consequential . . . . The present case illustrates the wisdom of our traditional approach."[77] The profits flowed directly from the pricing formula. The purpose of the agreement was to resell and this distinguished it from "a situation where the buyer's resale to a third party is independent of the underlying agreement."[78] Rather than having Conor pay Biotronik, the contract required that Biotronik pay Conor the minimum transfer price, a distinction emphasized by the dissent.[79] However, the majority argued, "Whether lost profits are the natural and probable result of a breach does not turn on which party actually takes out the checkbook

[73] If a subdistributor or affiliate made the sales in the markets that Biotronik did not directly serve, Conor would receive 75% of Biotronik's net sales.
[74] At 13.
[75] At 14. Comment 6.
[76] 1 James J. White et al., Uniform Commercial Code § 11:7 at 987 [Practitioner's 6th ed. 2010]. (check cite)
[77] At 532-533.
[78] At 534.
[79] "Notably, under no circumstance do the Agreement's pricing provisions require Conor (the breaching party) to pay any moneys to Biotronik (the non-breaching party); rather, under certain circumstances Biotronik (the non-breaching party) must pay additional moneys to Conor (the breaching party) for the purchase of the stents." At 538.

at the end of the fiscal quarter."[80]

Biotronik was providing a package of services to Conor, indirectly charging a price for these services. The price was the future stream of payments, If Conor wrongfully terminated the agreement[81] Biotronik suffered a direct loss—the revenues it would have received less the costs saved, which would include the possibility that the resources that would have been used to perform this contract could be deployed elsewhere.[82] The measurement problem, difficult in any event, would have been compounded by the fact that there were competing stents that were, arguably, superior to Conor's. Taking all these factors into account, direct damages would have been very difficult to determine and, I suspect, would have been substantially less than Biotronik's expert's $85 million figure.[83] But measurement problems should not deflect attention from the basic point: the loss was the direct result of the (alleged) breach.

II. Delay

In the typical delay case (e.g., *Hadley*) the buyer's loss would be consequential damages and would be excluded by a standard disclaimer. In this Section I want to consider two more complicated cases in which the court did find some delay costs to be direct. In the former, *Tennessee Gas Pipeline Co. v. Technip USA Corp.,*[84] the court rejected most of the claims that the damages were direct, but held one subset to be direct. In the latter, *DaimlerChrysler Motors Co., LLC v. Manuel,*[85] the damages were direct, but the court's rationale was faulty.

Tennessee Gas Pipeline Co. (TGP) entered into an agreement with Technip USA for the replacement and upgrade of six compressors on one of TGP's main transmission lines, for a "lump sum, fixed amount" of $86,740,000.[86] The project was expected to take 17 months, but ended up taking three years. TGP claimed that Technip's delay was a breach and it sued to recover its increased costs.[87] The agreement had a standard consequential damages exclusion:"[88] An early draft of the contract had included a

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[80] At 533.
[81] The court remanded on the liability question.
[82] The dissent noted the possibility of substitution: "The record clearly shows there were at least three other brands of drug-eluting coronary stents commercially available when Conor breached the Agreement . . . But this should not relieve Biotronik . . . of the obligation imposed by that case to show first that a good faith but ultimately unavailing effort was made in the marketplace to secure a substitute for the stent." At 542.
[83] I have not been able to get access to the expert's report.
[84] No. 01-06-00535-CV, 2008 WL 3876141, (Tex. App. Aug. 21, 2008).
[85] 362 S.W.3d 160 (2012).
[86] There was testimony that the project involved cutting-edge technology and that there had been a number of change orders during the project. (Testimony of William Ellison, p. 13)
[87] No. 01-06-00535-CV, 2008 WL 3876141, at *3 (Tex. App. Aug. 21, 2008).
[88] "Notwithstanding any other provisions of this Agreement to the contrary, in no event shall Owner or Contractor be liable to each other for any indirect, special, incidental or consequential loss or damage including, but not limited to, loss of profits or revenue, loss of opportunity or use incurred by either Party to the other, or like items of loss or damage; and each Party hereby releases the other Party therefrom." At*3. The contract also capped Technip's liability for any claim arising out of or relating to the contract at "50% of the Contract Price, regardless of whether the liability arises out of contract, ... or any other legal or equitable theory." At *8.

liquidated damages provision (which specified damages for delay), but it was dropped in the final draft in exchange for a $1.5 million reduction in the price. At a pre-trial hearing the court instructed the parties to put all their evidence on damages to the jury and that it would decide subsequently which damages were excluded as a matter of law. The jury found that the delay was a breach of the contract and found damages for over $18 million. Technip argued that all the damages should have been excluded.

The Court of Appeals broke down the claims into three broad categories, finding only one of them to be direct damages and, therefore compensable. The net result was a reduction in damages by about 80%. The ostensible ground for the reduction was application of the "naturally and necessarily flow directly from the breach" test. TGP compared the cost of gas and oil and labor used in the old compressors with what it anticipated it would have expended had the new, more efficient compressors been timely installed. The claim was rejected on the ground that it fell outside the contract; the costs were too remote for Technip to have foreseen or contemplated them, said the court. Whether these costs were really unforeseeable is disputable. But that dispute goes to the distinction between consequential damages that are recoverable and ones that are not.

TGP also argued that it should be compensated for interest on the project for the delay period. It had financed the project from its own funds, so its interest costs were not actual payments, but only imputed interest for the delay period. The court distinguished this case from one in which the plaintiff had borrowed funds so that the interest was not imputed. There is, however, no good reason to treat the two cases differently. In either case the loss (interest o money already paid to Technip) would be consequential. The court concluded: "The lost use of money represents an indirect loss to TGP because any return that might be attributable to theoretical investments TGP might have made falls outside its Contract with Technip."[89]

The Court found one category of claims to be direct damages: the additional expenses for labor, travel, and other costs that would not have been incurred but for the delay. These costs included payments for such things as environmental contractors and administration of the contract. The exclusion, it held,

> [did[not preclude recovery of direct damages involving loss of use, opportunity, or profits . . . because they naturally and necessarily flow directly from the breach . . . . The parties clearly contemplated that TGP would incur these costs throughout the Project and a breach of the Contract by delay naturally and necessarily would cause these costs to be extended over a longer period of time. . . . It can be conclusively presumed to have been foreseen or contemplated by Technip that, as a consequence of its breach of the Contract by delay, TGP would have to continue paying these ongoing costs.[90]

Were these expenses more foreseeable than the additional costs incurred by using the old compressors? Do they flow more naturally from the breach? In either case, TGP incurred costs that it would not, had Technip finished on time. The criteria—foreseeability or naturalness—are inappropriate. The Court is again distinguishing between consequential

[89] At 10.
[90] At p. 8.

damages that would be compensable and those that would not be. But since all consequential damages were excluded, TGP should have received nothing. In effect, the damages were prepaid when the parties traded the liquidated damages for a price cut.

The case suggests an interesting paradox. Recall that prior to revision the contract included a liquidated damage clause. The liquidated damages would be, as per 2-718(1), a reasonable measure of damages "in the light of the anticipated or actual harm."[91] What would the anticipated harm have been? Consequential damages.[92] Nonetheless, the liquidated damages should be viewed as direct. Otherwise, we would end up with the absurd result of the consequential damages exclusion negating the liquidated damages clause.

The facts in the second case were unusual. Texas, like many other states, had an auto dealer protection statute. One aspect of the law was of particular importance in this case. Dealers had the right to protest the establishment or relocation of other dealerships selling the same line or make of vehicles in the same county or within fifteen miles of the existing dealership. By filing a notice of protest a dealer would trigger an administrative proceeding in which the applicant for the new dealership has the burden of establishing "good cause." Until the proceeding is resolved, the new dealership could not proceed and the final resolution of protests could take years.

The plaintiff, Tommy Manuel, had been a franchised auto dealer in the Dallas-Fort Worth area for 47 years, 25 for Chrysler. Chrysler wanted to reorganize its dealership arrangement in the area and it entered into a franchise dealership with Manuel in an "Agreement to Enter into Sales and Service Agreement" (the AESSA). Chrysler paid Manuel about $15 million (some of which was to settle previous litigation between them) to give up his previous franchise; it gave him a new one in a different location. The agreement recognized that there was a possibility that another dealer may protest the new location. In the event of a protest Chrysler promised to "use its best efforts to litigate or settle the protest or lawsuit in order to allow the establishment of the dealership."[93] Another dealer, Meador, did file a protest against this dealership and the filing triggered a statutory stay against Manuel's attempt to open his dealership.

Eight months after the protest was filed Chrysler settled with Meador. Manuel sued Chrysler for the delay, arguing that Chrysler had not used its best efforts to settle Meador's protest. The trial court found in Manuel's favor on the liability issue (Chrysler did not use its best efforts) and the Court of Appeals upheld that finding. The jury found damages of $370,000 for lost profits due to the one-year delay in opening his dealership. Manuel's claim was that he had lost one year's worth of profits. He argued that the year he missed was a particularly good year for selling cars; when he finally opened, the market had soured and he suffered losses.[94]

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[91] UCC 2-718(1).
[92] The decision does not say, but most likely the liquidated damages would have been for delay, setting a price per day.
[93] At 168.
[94] "It was undisputed that the years 2000 and 2001 were exceptionally good years for car sales in the Dallas–Fort Worth market, but Manuel was not able to complete and open the South Arlington dealership until February 2002. A significant downturn in sales and a steep decline of the American market share of automobiles began in 2002. They were continuing at the time of trial, and the new dealership sustained a

The damage issue was complicated by the fact that there were two linked agreements and their language was inconsistent. The AESSA limited liability to "out-of-pocket expenses that cannot be mitigated."[95] In the Settlement Agreement the dealer waived consequential damages but said that both parties would be liable for actual damages.[96] In the event that terms conflicted, the Settlement Agreement terms would control.[97] The best efforts promise appeared only in the AESSA, adding an additional complication. The Court concluded that the Settlement Agreement governed. Manuel clearly could not recover consequential damages. But the court was then left with the question: what were "actual damages" and were they recoverable? Actual damages, it concluded, would include both direct and consequential damages.

The Court relied on *Cherokee County* in reaching the conclusion that lost profits could be direct losses, not consequential damages. Chrysler argued that the damage claim was for lost income from collateral contracts (retail sales the dealership would have made to third parties). The Court emphatically rejected that: "The recent *Cherokee County* case supports recovery of lost profits for resale to third parties as direct damages in the face of a limitation-of-damages clause, similar to the one in this case, which waived recovery of consequential damages without mentioning lost profits. . . . It bears repeating that lost profits are not per se consequential damages solely because there will be a subsequent sale to third parties."[98] But, as shown above, in *Cherokee County* the direct damages were simply the contract-market differential; resale was (or, at least, should have been) irrelevant.

Nonetheless, Manuel did suffer direct damages. Like Biotronik, he was selling retailing services to a manufacturer. Unlike Biotronik, he was not terminated, he only lost sales for the period of delay. His payment for that period would have been the difference between the wholesale and retail price. The damages would have been determined by subtracting the costs avoided, just as in *NIPSCO* or *Biotronik*. There could be a dispute over whether the damages should be based on his actual performance (the losses he

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loss for 2002 and subsequent years." (At 169)

[95] "In the event of a default under this Agreement, the sole liability of the defaulting party is payment of the other parties' out-of-pocket expenses that cannot be mitigated. Both You and DCMC waive any rights to other compensatory damages or to consequential or punitive damages under any theory of law or cause of action, including any applicable motor vehicle dealer-manufacturer statute. Both You and DCMC waive any right to trial by jury in any litigation to enforce the terms of this Agreement." (Manuel Brief, p. 28)

[96] "Manuel and his subsidiary dealership corporations, including MCDI and West Loop, and DCMC, waive any claims they may have for incidental or consequential damages, for punitive or exemplary damages, and for jury trial, that may arise by virtue of any breach of this Agreement or the AESSA, or by virtue of any transaction based in whole or in part upon a provision of this Agreement or the AESSA. The parties remain liable for any actual damages. (Manuel Brief, p. 28)

[97] "This Agreement is not a part of the Sales and Service Agreement of any dealership. The terms of any Sales and Service Agreement prevail if there is any conflict. To the extent that there is any conflict between this Agreement and any other agreement or document other than a Sales and Service Agreement between DCMC and a dealership owned or controlled by Manuel . . . the terms of this Agreement prevail." (Manuel Brief, p. 29)

[98] At 185, citing *Cherokee County).* For some reason the Court claimed that the *Cherokee County* court had held that the contract was not for the sale of goods, controlled by the UCC, but was decided on common law grounds. (At 184) This was obviously false.

actually suffered) or performance in the boom year that he missed. But the answer to that does not affect the conclusion that the damages were direct.

III. Breach of Warranty

When a seller breaches a warranty the buyer can suffer a number of different types of losses. Some, but not all, would clearly fall in the consequential damages category, for example delay and lost profits arising because of the failure. Others would clearly not be. If, for example, a seller promised a product that produced 100 units and delivered one that only produced 80, the damages would be based on the difference.[99] Whether that would be the difference in value or the cost of achieving the promised amount is a difficult question, but that has nothing to do with the fact that these would not be consequential damages. If the promisee incurred (wasted) expenses before it learned that the goods were not as warranted, the damages would be neither direct nor consequential—they would be for reliance. They might not be compensable, but that would not be because of the exclusion clause.

In *American Elec. Power Co., Inc. v. Westinghouse Elec. Corp.*[100] AEP sued Westinghouse for breach of warranty.[101] Westinghouse sold a turbine generator for about $12 million (over $60 million in current prices). The generator was not an off-the-shelf product; the technology was evolving. The trial judge characterized the turbine as "a highly complex, sophisticated, and in some ways experimental piece of equipment,"[102] and noted "that Westinghouse engineers are engaged in a continuous process of research and development in order to update and improve the design and functioning of their turbine-generators."[103] The unit was guaranteed to produce 760,000 kilowatts. Westinghouse manufactured and installed the generator over a period of about two years. After installation there were two separate failures; repairing each entailed a five-month delay. In addition, AEP claimed (and for summary judgment purposes the court took to be true) that the generator was only capable of producing 690,000 kilowatts.

The agreement included a number of restrictions on AEP's potential recovery. Westinghouse promised that if there were defects its responsibility would be limited to repair and replacement; it disclaimed liability for consequential damages and capped its total liability at the price of the defective equipment:

> The Seller warrants that the equipment to be delivered will be of the kind and quality described in this contract and will be free of defects in workmanship and material. Should any failure to conform to this warranty appear within one year after the initial date of synchronization, the Seller shall, upon notification thereof and substantiation that the equipment has been stored, installed, maintained and operated in accordance with the company's recommendations and standard industry practice, correct such

[99] "The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted." (UCC 2-714(2)

[100] 418 F.Supp. 435 (1976).

[101] It added complaints of fraudulent inducement and misrepresentation, which I will ignore. Westinghouse counterclaimed for the last installment payment of about $1.4 million.

[102] At 458.

[103] At 452.

> defects including non-conformance with the specification, by suitable repair or replacement at its own expense.[104]
>
> Correction of non-conformities, in the manner and for the period of time provided above, shall constitute fulfillment of all liabilities of the Company to the purchaser, whether based on contract, negligence or otherwise with respect to, or arising out of such equipment.[105]
>
> Except as otherwise agreed herein, the Seller shall not be liable for special, or consequential damages, such as, but not limited to, damage or loss of other property or equipment, loss of profits or revenue, loss of use of power system, cost of capital, cost of purchased or replacement power, or claims of customers of purchaser for service interruptions. The remedies of the purchaser set forth herein are exclusive, and the liability of Seller with respect to any contract, or anything done in connection therewith such as the performance or breach thereof, or from the manufacture, sale, delivery, resale, installation or technical direction of installation, repair or use of any equipment covered by or furnished under this contract whether in contract, in tort, under any warranty, or otherwise, shall not, except as expressly provided herein, exceed the price of the equipment of (or) part on which such liability is based.[106]

AEP sought damages for costs of replacement electricity, increased costs of operating less efficient units, increased fuel costs, lost profits, and loss of return on their capital investment. It argued that in reliance on Westinghouse's representations regarding the generator it constructed ancillary plant equipment at a cost of over $100 million.[107] These delay damages were clearly covered by the disclaimer.

But what of the failure to repair and replace? Since the generator was installed at AEP's plant and it had accepted delivery, it could not invoke perfect tender. If, indeed, it had received less than it had bargained for, its damages were direct and would not be covered by the disclaimer. (Westinghouse argued that it had fully complied and therefore damages on this issue should be zero.[108]) It is less clear how the damages should be measured. Should the remedy be the difference between a 760,000 kw generator and a 690,000 kw generator? If so, would it be based on the difference in capacity (roughly ten per cent), the difference in costs of new generators with those capacities, or the cost of bringing the generator up to the contract specifications? The contract does not say. Nor does it deal with the possibility of rapid technological change which could mean that the generator, even if it had met the specifications, would now be obsolete. It only treats these questions indirectly by capping liability at the price of the equipment

AEP argued that "Westinghouse has acted in bad faith in repairing the Unit, has been willfully dilatory in rendering repairs, and has not merely failed to repair or replace but has repudiated its obligation to repair and replace. As such, plaintiffs argue, the

[104] At 440.
[105] At 440.
[106] At 440-441.
[107] At 460 (fn 44).
[108] That was a fact question that could not be resolved on summary judgment.

limited and exclusive remedy of repair or replacement provided for in the contract has failed of its essential purpose."[109] Citing UCC 2-719(2), AEP claimed that because the remedy had failed in its essential purpose, the limitation was voided.[110] While the court cited a number of cases in which the "failure of essential purpose" allowed a plaintiff to avoid the consequential damages disclaimer, it chose not to do so. The repair & replace provision was independent of the consequential damages remedy and since the court found that the disclaimer was not unconscionable, it was given effect.[111] The court concluded:

> In the event that this court finds that the defendant has totally failed to perform its warranty to repair or replace, damages at least in an amount equal to the price of all uncorrected parts will be recoverable. Thus, if the generator, as a unit, cannot or has not been repaired so as to meet contract specifications, and has not been replaced by a generator that can, the full purchase price of the generator may be recovered as damages by the plaintiff. Moreover, if plaintiffs' direct damages exceed this amount they may be recoverable as well, since the contract precludes the recovery of consequential damages only.[112]

The court did not explain why the direct damages could exceed the replacement cost, nor why such additional compensation should be recoverable. The cap would seem to limit recovery to the cost of the replacement generator. Nor did the court determine which claims would be for direct damages, leaving that to be determined at trial. It is not clear how the damages should be measured. Should the remedy be the difference between a 760,000 kw generator and a 690,000 kw generator? If so, would it be based on the difference in capacity (roughly ten per cent), the difference in costs of new generators with those capacities, or the cost of bringing the generator up to the contract specifications? The contract does not say. The UCC suggests that it be based on the difference in value: "The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount."[113]

Consequential damage exclusions sometimes appear in corporate acquisitions. A study of private target acquisitions completed in 2014 found that they were included in about half.[114] In one such deal, Pharmaceutical Product Development, Inc. (PPD)

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[109] At 453.

[110] At 456. UCC 2-719(2): "where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act."

[111] The court added one caveat regarding fraud: "the contractual limitation of liability precluding the recovery of consequential damages cannot be effective if plaintiffs' claims of fraudulent inducement are sustained at trial. The defendant cannot be heard to rely on the provisions of a contract which was entered into as a result of fraudulent actions on defendant's part." At 460.

[112] At 459.

[113] UCC 2-714(2). Comment 3 qualifies this: It is "the usual, standard, and reasonable method of ascertaining damages in the case of breach of warranty but it is not intended as an exclusive measure."

[114] Private Target M&A Deal Points Study, slide 74. If acquirers are substantially larger than the sellers, the agreement would be less likely to include a consequential damages exclusion. Impact of "Buyer Power

purchased Magen Biosciences for $14.866 million.[115] Magen had a product (MAG-131), a Vitamin D Receptor Modulator (VDRM) that was intended to treat psoriasis. Magen represented that the product was 60-130 fold more potent than the currently FDA-approved VDRM. In fact, it was barely, if at all, more potent. The merger agreement provided that the sellers were liable for losses resulting from "any breach or inaccuracy of a representation or warranty of the Company contained in [the Merger Agreement]."[116] PPD sued, asserting that Magen had breached a representation that "The Company [Magen] has provided to PPD all information and data known to the Company relating to safety, efficacy, and toxicity of all Company Products."[117]

Magen attempted to have the claim dismissed, arguing that it had not breached because the drug met the efficacy standard; potency, it claimed, was irrelevant. Vice Chancellor Strine rejected this argument, although he did hold out the possibility that efficacy could be ambiguous and that it could be a question of fact. Magen also objected to some components of the damage claim. It did not object to PPD's claim for a return of the purchase price. It did, however, object to two other claims.

PPD argued that after the purchase it made additional fruitless expenditures for R&D on MAG-31 (($7.4 million) and that, once it became clear that it had bought a worthless company it incurred costs in shutting down the project ($2 million). The issue was whether these costs were consequential damages that were excluded by the contract. Section 7.4(c) of the Merger Agreement (*"Limits on Indemnification"*) stated:

> In no event shall the indemnification obligations under this article vii or the term "losses" cover or include (x) consequential, incidental, special, indirect, or punitive damages, unless such damages are actually paid to a third party claimant by an indemnified party, whether based on statute, contract, tort or otherwise, and whether or not arising from the indemnifying party's sole, joint or concurrent negligence, strict liability or tort, or (y) lost profits.[118]

This is one of the few cases in which the contract treated lost profits damages as being independent of consequential damages.[119] Citing earlier case law and Black's Law Dictionary, Magen argued that special damages were natural, "but not the necessary result of the act complained of . . . . [They] do not flow directly and immediately from an injurious act, but that result indirectly from the act."[120]

> The alleged losses resulting from PPD's research and development costs or its expenses relating to winding down PPD Dermatology, even if purportedly foreseeable at the time of the alleged breach, are thus not recoverable from Stockholder Defendants under the Merger Agreement. Costs associated with winding down PPD Dermatology are merely

Ratio" on Selected M&A Deal Terms in Acquisitions of Privately Held Target Companies by Publicly Traded Buyers, ABA Mergers & Acquisitions Committee (July 2017)

[115] Pharmaceutical Product Development, Inc. v. TVM Life Science Ventures VI 2011 WL 549163 (2011)

[116] At 1.

[117] At 1.

[118] Opening Brief in Support of Stockholder Defendants' Motion to Dismiss, 6.

[119] See the next Section.

[120] Defendant Brief, p. 12.

> incidental to the rescission sought by PPD and PPD's expenditures on research and development of MAG-131 prior to discovering the alleged breach are not the "necessary result" of Magen's alleged misrepresentations but rather a consequence of PPD's own actions. Accordingly, PPD is explicitly prohibited from recovering such losses from the Stockholder Defendants in their capacity as indemnitors.[121]

PPD responded by arguing that direct damages are those that arise naturally and ordinarily while consequential damages "arise from the intervention of special circumstances."[122] The expenses before it discovered the breach for employee salaries, toxicology studies, etc. were

> characteristic of the investment that would occur after the purchase of any biotechnology company developing pre-clinical compounds. In other words, PPD's routine investment in the further development of MAG-131 was not due to a unique circumstance attributable to PPD. Similarly, PPD's expenses in winding down PPD Dermatology were costs that would naturally be incurred by any party that acquired a company that lacked any viable products. Thus, these losses are direct damages, not indirect or consequential ones, and are therefore recoverable under Section 7.4(a).[123]

PPD also argued that if the seller had knowledge of the falsity of the representation at the time of the breach (had committed fraud), then the exclusion should be unenforceable as a matter of public policy.[124]

Vice Chancellor Strine accepted, at the motion dismiss stage, the possibility that PPD could show that the damages were direct and therefore recoverable:

> I am chary to make the context-specific determination about the Drug Development Costs given the necessarily limited record. For one thing, it is not at all obvious, especially at the pleadings stage, that the $7.4 million spent on further researching and developing MAG–131 is unique to PPD in the sense that it seems reasonable to infer that any acquiring drug company in PPD's position would want, and most likely need, to continue investing resources in the research and development of the acquired experimental compounds that were the reason the acquirer purchased the company. The situation with respect to the $2 million allegedly spent in winding up PPD Dermatology, Inc. is similar in that it seems plausible that a close down of PPD, Dermatology, Inc. was the only logical step available to PPD, who claims to have been defrauded into buying what turned out to be a worthless company and that such shut-down costs would be a component of a full rescissory damages award. In sum, on a motion to dismiss, I am not able to make the determination that the Magen Stockholders' urge—that the Drug Development Costs are indisputably

[121] Defendant's Brief, pp. 12-13

[122] Plaintiff Brief, at 25, citing Restatement Second of contracts, 351 comment b.

[123] Plaintiff Brief, at 25.

[124] They drew upon an earlier opinion by Vice Chancellor Strine, ABRY Partners. PPD had not yet found evidence of fraud, but argued that it might show up in the course of discovery.

special damages.[125]

PPD's claim is analogous to a repair and replace claim in a contract for goods. If the expenditures had succeeded in restoring MAG 31's efficacy/potency (and if the court found the expenditures reasonable) the costs would no doubt have been compensable. But it failed. If the court were to conclude that the effort had been in good faith, I believe that it ought to have found in favor of PPD. By analogy, had AEP insisted on removal of the flawed generators, Westinghouse would have borne the cost of removal.

IV. Lost Profits Exclusions

Lost profits typically appear in limitation clauses in the laundry list of consequential damages. Lost profits that were not a form of consequential damages would normally be recoverable, despite the limitation clauses. There is good reason for that since the purest version of direct damages, the contract/market differential, is often referred to as lost profits. Nevertheless, there are some exceptions. The PPD-Magen contract, discussed above, was one of the few exceptions. In a second, *Progress Energy, Inc. v. U.S. Global, LLC*,[126] also a corporate acquisition, the clause clearly treated lost profits as a separate category: "In no event shall any party be liable to any other party under any provision of this Agreement for any lost profits, lost sales, business interruption, lost business opportunities, lost Tax Credits, lost Tonnage Fees or consequential, incidental, punitive or exemplary damages incurred or suffered by a party."[127] The trial court and the dissent both claimed that only consequential damages were barred, but benefit-of-the-bargain claims were not. However, the majority found the language unambiguous and remanded to determine whether the claimant's sole remedy, specific performance, would be available.

In *Imaging Systems Intern., Inc. v. Magnetic Resonance Plus, Inc*.,[128] the court upheld a limitation on liability for lost profits. The clause was unambiguous: "Limitation of liability [:] neither the customer nor MRP will be liable to each other or any other party for any lost profits or any incidental, special, or consequential damages relating to this agreement."[129] The plaintiff tried to argue that the clause only related to consequential damages, but the court properly held otherwise:

> Thus there are two types of lost profits: (1) lost profits which are direct damages and represent the benefit of the bargain (such as a general contractor suing for the remainder of the contract price less his saved expenses), and (2) lost profits which are indirect or consequential damages such as what the user of the MRI would lose if the machine were not working and he was unable to perform diagnostic services for several patients. The contract at issue did not distinguish between the two types; it forbade the recovery of "ANY LOST PROFITS." No exceptions were provided for. The meaning of "any" in context is "all." Both consequential

[125] At 7.
[126] 102 So.3d 768 (2012).
[127] At 769.
[128] 227 Ga.App. 641 (1997
[129] At 642.

> damages *and* direct damages (to the extent direct damages concern lost profits) are not recoverable under the contract.[130]

In *SOLIDFX, LLC v. Jeppesen Sanderson,* Inc.,[131] the court interpreted the liability limitation clause to exclude lost profits separately. There the language was ambiguous, at best.

> 8.2 exclusion of consequential and other damages: except to the extent of the indemnification obligations set forth in section 9, neither party will have any obligation or liability whatsoever, whether arising in contract (including warranty), tort (whether or not arising from the negligence of either party), strict liability or otherwise,
>
> 8.2.1 for loss of use, revenue or profit; or
>
> 8.2.2 for *any other* indirect, incidental, consequential, special, exemplary, punitive, or other damages with respect to the Jeppesen data, the Jit, and other products and services provided hereunder;[132]

The court interpreted the lost profits of 8.2.1 as being independent of the consequential damages of 8.2.2. The italicized phrase—*any other*—should, I think, be interpreted to mean that lost profits was a subcategory of the damages listed in 8.2.2. Ultimately, it did not matter since the court concluded that the claimed damages were consequential so that 8.2.1 did not apply.

For another case close to the boundary (but I think this time on the other side), consider *In re CCT Communications, Inc.*[133] The language seemed pretty clear: "In no circumstances shall either we or you be liable for indirect, consequential, reliance, or special loss or damages or for lost revenues, lost savings, lost business opportunity or lost profits of any kind."[134] The defendant's interpretation was straightforward: "by separating the second part of the clause from the first with the conjunction 'or,' and by including in it the words 'of any kind,' the parties meant to bar claims for both direct and consequential lost revenues, lost savings, lost business opportunity, and lost profits. Specifically, the 'or' is disjunctive, and the various 'lost' categories following it stand in contrast to the 'broad' categories of damages in the first clause."[135] Nonetheless, the court found the language sufficiently ambiguous to postpone its decision: "I decline to interpret the full scope of § 6.2 as a matter of law, except to the extent that I conclude, as both sides agree, that it bars claims for consequential, indirect or special damages. . . . I expressly decline to conclude as a matter of law that § 6.2 bars general or direct damage claims, but recognize the possibility that extrinsic evidence, including trade usage, may explain its meaning."[136] The rationale was that "lost revenues, lost savings, lost business opportunity or lost profits of any kind" could have left some wiggle room—there might

[130] At 644.
[131] 841 F.3d 827 (2016),
[132] At 833 (emphasis added)
[133] 464 B.R. 97 (2011).
[134] At 102.
[135] At 118.
[136] At 120.

be some category of general or direct damages that was not included. The court at least left open the possibility that the contract/market differential was not included in the laundry list. Had the court accepted the defendant's interpretation, there could have been no recovery for the contract/market differential. That surely is a plausible interpretation of the language.[137]

The plaintiff did not need the wiggle room. The contract explicitly priced termination by Global Crossing:

> If Global Crossing terminated the RCA based on a CCT breach, CCT was required to pay Global Crossing 100% of the Monthly Recurring Charges ("MRC") remaining for the service term in addition to charges, if any, relating to the early termination of any local access circuits. . . . The parties agreed that the termination fees provided for in § 5 of the RCA "are based on agreed *revenue* expectation and are not a penalty." . . . The MRC was $71 per concurrent call session, . . . and CCT "purchased" 1,344 concurrent call sessions for a period of three years ending in December 2009. Hence, if CCT breached the parties' contract and Global Crossing terminated it, CCT still had to pay $95,424 per month until December 2009. This amount reflected direct damages—the lost revenues under the parties' contract.[138]

In effect, the contract could be interpreted as saying that Global Crossing waived the right to collect any damages *in addition to* the liquidated damages defined in the contract.

V. Concluding Remarks

"When *I* use a word," Humpty Dumpty said, in rather a scornful tone, "it means just what I choose it to mean—neither more nor less." "The question is," said Alice, "whether you *can* make words mean so many different things." "The question is," said Humpty Dumpty, "which is to be master—that's all."[139]

Humpty would, no doubt, have appreciated the definitional flexibility courts have given to "general damages." They could be a component of consequential damages, and therefore excluded under a clause limiting recovery of consequential damages. Or they could be direct damages and recoverable. The criterion in either case would be the naturalness or foreseeability of the result. The courts, like Humpty, have been free to choose.

I have argued that concepts like foreseeability, naturalness and collateral business have not been useful in determining whether a particular claim could be excluded under a consequential damages limitation. The outer edges of consequential damages might be blurry, but I believe that I have somewhat sharpened the definition. I have approached the problem by analyzing three different categories of claims. First, if the claim arose from a wrongful termination, the loss of value of the claimant's contract—the lost profits—

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[137] The inordinate number of "or's" in the clause suggest that this might only be a case of bad grammar.
[138] At 120.
[139] LEWIS CARROLL (Charles L. Dodgson), *Through the Looking-Glass,* chapter 6, p. 205 (1934). First published in 1872.

would be direct damages. Properly calculated that would reflect the claimant's reasonable mitigation; in the simplest version it is just the contract/market differential. The more controversial version of this argument concerns contracts in which the claimant would not be paid directly for its services—distribution contracts in which the distributor's compensation is a function of the sales.

Second, I argued that in most instances losses arising out of a delay (like *Hadley*) should be treated as consequential damages. Courts have generally been consistent about this; I discussed two, instances in which courts concluded otherwise. In the first, I suggested that the costs should have been treated as consequential; in the latter, I reinterpreted the contract as the manufacturer buying distribution services; the court, I suggested got the right result but for the wrong reason. Finally, if the complaint concerns the breach of a warranty, the direct damages would not be future lost profits; rather they would be the costs of providing the claimant with what it had been promised. That could entail the costs of achieving what had been warranted. Whether the costs would be borne by the breacher (*AEP v. Westinghouse*) or the non-breacher (*PPD v TVM*) should not matter; in both cases the damages would be direct.