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## Disclaiming Consequential Damages and Lost Profits

On March 27, 2014, the New York's Court of Appeals ruled, in apparent contravention of most practitioners' understanding of New York law, that a contract's consequential damages disclaimer did not preclude recovery of the lost profits. The relevant clause stated that "neither party is liable to the other for any indirect, special, consequential, incidental or punitive damages with respect to any claim arising out of the agreement..." This disclaimer did not, however, expressly list "lost profits" or otherwise define "consequential damages."

### THE NEW YORK COURT OF APPEALS DECISION

Biotronik and Conor Medsystems Ireland executed a distribution contract in 2004, by which Biotronik became the exclusive distributor of "CoStar," a drug-eluting stent. In 2007, Conor informed Biotronik that it would no longer produce CoStar, and did not offer any substitute. Biotronik was unable to find a replacement product. Thereafter, Biotronik sued Conor for breach of contract.

Biotronik argued that the lost profits were not consequential damages, but general damages (the anticipated direct and immediate fruit of the contract), since under its terms, the contract provided for a fixed percentage of the gross profit from Biotronik's resale of CoStar to go to Conor with the rest going to Biotronik. Conor not only argued that the damage was consequential, but further, that the normal measure of damage would be to cover the cost of obtaining a comparable product, a

risk that Biotronik should have foreseen and addressed during contract negotiations. Thus, the central issue before the Court of Appeals was whether Biotronik's claimed lost profit damages should be considered general damages that could be recovered, or consequential damages that were precluded by the contract. In a 4-3 decision, the Court of Appeals ruled that the lost profits were the direct and probable result of the breach, and thus constituted general damages. The majority explained that the issue of whether claimed damages are general or consequential must be evaluated in the context of each specific agreement, and when a contract does not exclude lost profits or define consequential damages, lost profits may be considered general damages where the plaintiff bargained for such profits or the profits were the direct and immediate fruits of the contract.

While the general rule in New York has been understood to be that lost profits are treated as consequential damages, the Court of Appeals has, in prior cases, held that lost profits can be categorized as direct damages when the profits lost are those that the contract expressly provided that the plaintiff would collect directly from the defendant. Still, the Biotronik ruling arguably allowed what the dissent termed a "creative reading" of the contract, as a plaintiff's lost profits that would have been realized as a collateral consequence of the contract (i.e., resales to third parties) have consistently been regarded as consequential damages. The Biotronik majority reasoned that the complex pricing and profit sharing

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provisions of the subject distribution contract, even if further transactions (with third parties) were required to generate revenue, signified that the damages flowed directly from the contract itself, rather than from collateral transactions with third parties.

### PRACTICAL LESSONS

In drafting limitation of liability clauses, contracting parties should specifically consider the allocation of risk for lost profits. Since lost profits may reflect either general or consequential damages, contracting parties can find clarity in specifically defining lost profits as one or the other, and should consider analogously defining “anticipated savings” and other damages normally thought to be consequential in nature. Finally, the importance of the limitation of liability provision mandates the usual practice of locating it in its own section and conspicuously placing it in the agreement.

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