Consequential Damages Redux: An Updated Study of the Ubiquitous and Problematic "Excluded Losses" Provision in Private Company Acquisition Agreements

*By Glenn D. West**

An "excluded losses" provision is standard fare as an exception to the scope of indemnification otherwise available for the seller's breach of representations and warranties in private company acquisition agreements. Sellers' counsel defend these provisions on the basis of their being "market" and necessary to protect sellers from unreasonable and extraordinary post-closing indemnification claims by buyers. Buyers' counsel accept such provisions either without much thought or on the basis that the deal dynamics are such that they have little choice but to accept these provisions, notwithstanding serious questions about whether such provisions effectively eviscerate the very benefits of the indemnification (with the negotiated caps and deductibles) otherwise bargained for by buyers. For buyers' counsel who have given little thought to (or who need better responses to the insistent sellers' counsel regarding) the potential impact of the exclusion from indemnifiable losses of "consequential" or "special" damages, "diminution in value," "incidental" damages, "multiples of earnings," "lost profits," and the like, this article is intended to update and supplement (from a practitioner's perspective) the legal scholarship on these various types of damages in the specific context of the indemnification provisions of private company acquisition agreements.

I. Introduction

While "[i]t may seem like threshing old straw" to again be writing about the consequential damages waiver and its supposed equivalents, the extensive and continued use of excluded losses provisions is so ubiquitous in the mergers and acquisitions (M&A) deal world that this author has determined that a little re-threshing of this old straw may well be justified if even a few remaining grains

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of insight can yet be derived.[1] In the process of threshing anew this old straw, it is hoped there will be a renewed focus by both buyers and sellers on the consequences of these provisions, as well as a change in practice regarding the entire concept of excluded losses, in the context of the indemnification provisions of private company acquisition agreements.

In 2008, *The Business Lawyer* published an article,[2] which for the first time examined the use of excluded losses provisions in the context of private company acquisition agreements and which concluded that the term "consequential damages" was "shockingly ambiguous,"[3] had no "clearly established meaning,"[4] was "misunderstood and fraught with uncertain application in the merger and acquisition context,"[5] and should "be stricken from the deal lexicon."[6] The article also suggested that many of the other terms often found in excluded losses provisions were potentially horrifying waivers of the basic measures of compensatory, contract-based damages in the specific context of the breach of a bargained-for representation and warranty in a private company acquisition agreement.[7] The overall conclusion of the article was that there was simply no justification for an excluded losses provision to preclude recovery for the vast majority of the enumerated types of damages.[8] Yet, as predicted in the article,[9] these provisions continue to find their way into many private company acquisition agreements.[10] And when disputes arise regarding such provisions, a court is required to determine their meaning, even though the resulting "laundry list of precluded damages might have been put in the . . . [a]greement by lawyers who themselves were unclear on what those terms actually mean."[11]

Since the publication of *The Business Lawyer* article in 2008, practitioners and academics in the United States and many other common law jurisdictions have continued to note the problematic and uncertain meaning of consequential damages waivers in a variety of contexts.[12] Furthermore, a number of new cases have

1. *See* Fowler V. Harper & Mary Coate McNeely, *A Re-Examination of the Basis for Liability for Emotional Distress*, 1938 Wis. L. Rev. 426, 426.

2. Glenn D. West & Sara G. Duran, *Reassessing the "Consequences" of Consequential Damage Waivers in Acquisition Agreements*, 63 Bus. Law. 777 (2008).

3. *Id.* at 780.

4. *Id.* at 781.

5. *Id.* at 807.

6. *Id.*

7. *Id.* at 779–80, 805–06.

8. *Id.* at 805–07.

9. *Id.* at 807 n.105.

10. *See* Subcomm. on Mkt. Trends of the Bus. Law Section Mergers & Acquisitions Comm., 2013 Private Target Mergers & Acquisitions Deal Points Study 89 (2013); Daniel Avery & Kevin Lin, *Trends in M&A Provisions: Exclusion of Consequential Damages*, 17 Mergers & Acquisitions L. Rep. (BNA) 414 (2014), *available at* http://goo.gl/FtvYr2.

11. Pharm. Prod. Dev., Inc. v. TVM Life Sci. Ventures VI, L.P., Civ. A. No. 5688-VCS, 2011 WL 549163, at *7 (Del. Ch. Feb. 16, 2011).

12. *See, e.g.*, Phillip Spencer Ashley, Bob Palmer & Judith Aldersey-Williams, *An International Issue: "Loss of Profits" and "Consequential Loss,"* 15 Bus. L. Int'l 261 (2014); J.W. Carter, *Exclusion of Liability for Consequential Loss*, 25 J. Cont. L. 118 (2009) (Austl.); Megan A. Ceder & Travis J. Distaso, *Consequential Damages Waivers: How to Consequentially and Incidentally (Including Indirectly) Waive Your Remedy*, 6 HLRe 1 (2015), *available at* http://goo.gl/4Op552; Joshua Glazov, *Direct vs. Consequential*

been decided since 2008 that illustrate the continued dangers of consequential damages waivers for both parties to an agreement. Few of these articles, practice notes, or cases, however, deal with the specific context of an M&A transaction. And the appropriate measure of damages for breach of a contract to deliver goods, or to repair a computer system or pipeline, may not be the appropriate measure of damages for a breach of representations and warranties made in connection with the acquisition of a business and vice versa. Indeed, loss exclusion clauses developed to limit liability in the construction and carriage industries may not be appropriate or even applicable in the M&A context. Context matters.[13] Accordingly, this article is intended to update and supplement the 2008 *The Business Lawyer* article by (1) further defining many of the terms that continue to be used in the excluded losses provisions of private company acquisition agreements, (2) studying the current market regarding the prevalence of various types of excluded loss provisions, (3) reasserting that in the context of an indemnification provision for breaches of representations and warranties regarding a purchased business, with a bargained-for deductible and cap, the vast majority of the exclusions set forth in the standard loss exclusion provision are simply inappropriate, and (4) proposing some alternative approaches to addressing limitations on recoverable losses in the private company acquisition context.

II. Unpacking an Excluded Losses Provision

An example of an aggressive definition of "Losses" (in the sense of what it purports to exclude), which is often served up in the seller bid forms provided in the data room in connection with an auction of a private company, reads as follows:

> "Losses" means losses, damages, liabilities, Actions, judgments, interest, awards, fines, costs or expenses, including reasonable attorneys' fees and the cost of enforcing any right to indemnification hereunder and the cost of pursuing any insurance providers; *provided, however, that "Losses" shall not include special, consequential, multiple of earnings, indirect, punitive damages or other similar damages, including declines in value, lost opportunities, lost profits, business interruptions or lost reputation, except, in the*

Damages: Use the Road Sign Test to Tell the Difference, Am. B. Ass'n (Apr. 2013), http://goo.gl/g1U9OJ; Jacques Herbots, *Why It Is Ill-Advised to Translate Consequential Damages by* Dommage Indirect, 19 Eur. Rev. Priv. L. 931 (2011); Richard Hill, *Limiting Exposure to Contractual Claims in Uncertain Times: Excluding Liability for "Consequential Loss" Under Australian and English Law*, Asia Pac. F. News, May 2009, at 24, 24–29; Wifa Eddy Lenusira, *Conflicts and Uncertainties in English and Scottish Judicial Interpretation of Consequential Loss and Its Application to the United Kingdom's Oil and Gas Industry*, 34 Int'l Energy L. Rev. 55 (2015); Robert Little & Chris Babcock, *Avoiding Unintended Consequences of Damage Waiver Provisions in M&A Agreements,* Gibson Dunn (July 10, 2012), http://goo.gl/om979t; Gregory Odry, *Exclusion of Consequential Damages: Write What You Mean*, 29 Int'l Construction L. Rev. 142 (2012); Mary Sabina Peters, *Hermeneutics of the Term "Consequential Loss,"* 32 Int'l Energy L. Rev. 263 (2013); Michael Polkinghorne, *Exclusion Clauses: Navigating the Minefield*, White & Case LLP (Dec. 2012), http://www.whitecase.com/parisenergyseriesno6/; E. Jane Sidnell, *Consequential Damages: Are Exclusions of Consequential Damages Inconsequential?*, 2010 J. Can. C. Construction Law. 109 (Can.); Practice Note, *Understanding Damage Waivers: Consequential, Incidental, Lost Profits and More*, Prac. L. Co. (July 8, 2014), http://us.practicallaw.com/3-571-4285.

13. *See Pharm. Prod. Dev., Inc.*, 2011 WL 549163, at *7; *see generally* J.W. Carter, *Context and Literalism in Construction*, 31 J. Cont. L. 100 (2014) (Austl.).

> *case of punitive damages, to the extent actually awarded to a Governmental Authority or other third party*.[14]

It does not take much of an astute reader to realize quickly that this provision threatens to effectively gut the entire benefit of the indemnification provision with respect to any losses arising from a breach of the bargained-for representations and warranties. Most deal lawyers make the more obvious fixes—i.e., (1) eliminate the potential exclusion of "declines in value," or its cousin "diminution in value," because one of the more obvious bases upon which any recovery for a breach of the representations and warranties respecting the purchased business would be calculated is the difference between the value of the business as represented and the value of the business as a result of the representations having been untrue;[15] (2) eliminate the potential exclusion of "business interruptions" because losses resulting from an interruption in the ongoing operation of the purchased business as a result of an inaccurate representation and warranty is part of the basic benefit of the bargain in buying a going concern;[16] and (3) make sure that none of the enumerated damages (not just punitive damages) are excluded from the scope of indemnification to the extent those damages are actually recovered from the purchased company or the buyer by a third party as a result of the inaccuracy of any representation or warranty of the seller.[17]

A fairly typical resulting clause is the following provision borrowed from the agreement governing New Source Energy Partners L.P.'s 2014 acquisition of equity interests in Erick Flowback Services LLC and Rod's Production Services, L.L.C.:

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14. Agreement and Plan of Merger, dated July 18, 2014, by and among Autocam Corporation, PMC Global Acquisition Corporation, NN, Inc., Newport Global Advisors, L.P., and John C. Kennedy, PRAC. L. CO. art. I ("Losses"), at 10 (July 18, 2014), http://us.practicallaw.com/1-575-9307 (emphasis added).

15. *See* Gusmao v. GMT Grp., Inc., No. 06 Civ. 5113 (GEL), 2008 WL 2980039, at *11 (S.D.N.Y. Aug. 1, 2008) ("Where a party purchased a company on the basis of inaccurate warranties, the injured party is normally 'entitled to the benefit of its bargain, measured as the difference between the value of [company] as warranted by [sellers] and its true value at the time of the transaction.'" (quoting Merrill Lynch & Co. v. Allegheny Energy, Inc., 500 F.3d 171, 185 (2d Cir. 2007))). This author uses the term "potential" in referencing the exclusion of diminution in value damages because there are a number of cases that treat precluded damages types that are listed as a subcategory of broader damages types as only excluding the subcategories to the extent that such subcategories of precluded damages are first determined to be included in the broader excluded categories. *See, e.g.*, Westlake Fin. Grp., Inc. v. CDH-Delanor Health Sys., 25 N.E.3d 1166, 1175–78 (Ill. App. Ct. 2015) (an excluded losses provision that precluded claims for consequential or special damages "such as, but not limited to, loss of revenue or anticipated profits or lost business" only excluded the listed examples to the extent they did in fact first constitute consequential or special damages); *see also infra* note 135. Accordingly, it could be that all of the damages types that are listed after the phrase "or other similar damages, including" are only excluded to the extent they are first determined to be included in the initial list of precluded damages types—i.e., "special, consequential, multiple of earnings, indirect, punitive damages or other similar damages." *See* Polkinghorne, *supra* note 12, at 5.

16. *See* West & Duran, *supra* note 2, at 800–04 (discussing the shutdown of the plant in the *Widget Manufacturing Plant* hypothetical). The term "potential" is again used in recognition of the placement of this excluded damages type in the proviso. *See supra* note 15.

17. *See* West & Duran, *supra* note 2, at 779 n.6.

> In no event shall any party be liable under this *Article IX* for incidental, consequential, punitive, indirect or exemplary damages or any damages measured by lost profits or a multiple of earnings; *provided*, *however*, that this *Section 9.06(h)* shall not limit a party's right to recover under this *Article IX* for any such damages to the extent such party is required to pay such damages to a third party in connection with a matter for which such party is otherwise entitled to indemnification under this *Article IX*.[18]

This agreement also specifically included, in the definition of the "[d]amages" that were otherwise recoverable absent the excluded losses provision noted above, the phrase "diminution of value."[19] While this approach is certainly preferable to the standard fare served up by sellers in their initial drafts, it still contains a laundry list of exclusions that seem to defy logic. For example, are not the profits earned by a business the appropriate means of valuing that business?[20] Is not a multiple of earnings the typical means of pricing a business acquisition?[21] Accordingly, how would the normal market-based damages for breach of a representation and warranty regarding a purchased business actually be measured if the agreement excludes "any damages measured by lost profits or a multiple of earnings"?[22]

A more appropriate starting point for negotiating an excluded losses provision is the definition of "Losses" in Samsonite, LLC's 2014 purchase of the assets of Gregory Mountain Products, LLC:

> "Losses" means any damages, losses, charges, Liabilities, claims, demands, actions, suits, judgments, settlements, awards, interest, penalties, fees, costs, Liens, Taxes

18. Contribution Agreement, dated June 26, 2014, by and among New Source Energy Partners L.P. and J. Mark Snodgrass, Brian N. Austin, Rod's Holdings, LLC, Erick's Holdings, LLC, PRAC. L. CO. § 9.06(h), at 42 (June 26, 2014), http://us.practicallaw.com/6-574-3427 (bolding and capitalization omitted).

19. *Id.* exh. A-4 ("'Damages' means all debts, liabilities, obligations, losses, *including diminution of value*, damages (including, without limitation, prejudgment interest), penalties, fines, reasonable legal fees, disbursements and costs of investigations, deficiencies, levies, duties and imposts." (emphasis added)).

20. *See* Kenneth M. Kolaski & Mark Kuga, *Measuring Commercial Damages via Lost Profits or Loss of Business Value: Are These Measures Redundant or Distinguishable?*, 18 J.L. & COM. 1, 1 (1998) ("the value of a business is ultimately determined by the profits that can be earned by the business"); *see also* J.W. Carter, Wayne Courtney & G.J. Tolhurst, *Issues of Principle in Assessing Contract Damages*, 31 J. CONT. L. 171, 190 (2014) (Austl.) ("In the negotiation of the price at which the vendor will be willing to sell the business, the judgment of the purchaser is about the earning power of the business. Where there is a sale of a business as a going concern, the usual basis for working out the price is therefore projected earnings.").

21. *See, e.g.*, Cobalt Operating, LLC v. James Crystal Enter., LLC, Civ. A. No. 714-VCS, 2007 WL 2142926, at *26 (Del. Ch. July 20, 2007; judgment entered Aug. 15, 2007), *aff'd*, 945 A.2d 594 (Del. 2008); *see also* ASWATH DAMODARAN, INVESTMENT VALUATION: TOOLS AND TECHNIQUES FOR DETERMINING THE VALUE OF ANY ASSET 453 (3d ed. 2012).

22. *See* Leach Farms, Inc. v. Ryder Integrated Logistics, Inc., No. 14-C-0001, 2014 WL 4267455, at *3 (E.D. Wis. Aug. 28, 2014) (noting the difficulty in determining the market value of goods for the purposes of a damages calculation if an exclusion of lost profits provision literally required market value to be determined such that it "does not include any element that could be described as profit"). It should also be noted that the use of the term "incidental damages" is an equally problematic exclusion given that such damages could potentially include the expenses incurred by a non-breaching party in attempting to mitigate the injury caused by the breach. *See* West & Duran, *supra* note 2, at 789.

> and expenses (including reasonable attorneys' fees and disbursements); provided that *"Losses" shall not include* (i) exemplary or punitive damages or (ii) *any damages or Losses that were not the reasonably foreseeable result of such breach without regard to any special circumstances of the non-breaching party.*[23]

This provision, while far from perfect from a buyer's perspective, at least avoids the use of a laundry list of misunderstood damages limitation terms and attempts to conform the indemnification obligations in the agreement to the general theory of compensatory, contract-based damages. In other words, the only losses that appear to be intended for exclusion by this provision are those losses that contract law has long held are not recoverable for breach of contract in any event (i.e., remote losses that are not foreseeable as the probable result of the breach).[24]

But why is it necessary to expressly exclude types of losses for purposes of an indemnification provision that the common law would not include as recoverable damages for breach of contract? The answer is because indemnification for losses and damages available for breach of contract are not necessarily the same thing.[25] Understanding contract-based damages and how they interface with an indemnification framework, therefore, is critical to understanding what, if any, limitations on indemnifiable losses are actually appropriate in a private company acquisition agreement setting.

III. A Basic Primer on Contract-Based Damages

In most contracts, the extent of the compensation that will be payable in the event of a breach of the bargained-for exchange between the parties is seldom dealt with explicitly.[26] As a result, courts are forced to apply default rules that

23. Asset Purchase Agreement dated June 18, 2014, by and among Samsonite LLC, as Buyer, Black Diamond, Inc., as Parent, and Gregory Mountain Products, LLC, as Seller, Prac. L. Co. app. A ("Losses"), at A-6 (June 18, 2014), http://us.practicallaw.com/7-573-9967 (emphasis added). It should be noted, however, that this provision fails to exclude third-party claims from the proviso. *See infra* note 155.

24. It is worth noting, however, that the phrase "without regard to any special circumstances of the non-breaching party" is a bit unclear. It is obviously a reference to the second prong of the *Hadley v. Baxendale* contract damages limitation construct. *See infra* notes 81–88 and accompanying text. But does that phrase mean that foreseeability is to be determined as if there were no special circumstances (i.e., as long as the resulting damages were reasonably foreseeable there is no requirement for the non-breaching party to prove that its special circumstances and the resulting damages from a breach occasioned thereby were specifically "contemplated" by both the parties at the time of contracting), or does it mean that any damages resulting from special circumstances are actually excluded from foreseeable losses? Similarly, this provision uses the phrase "reasonably foreseeable result" as the operative limitation on losses, which may be viewed as encompassing greater losses than the common law's apparent standard of "reasonably foreseeable as a probable result of the breach." *See* Melvin Aron Eisenberg, *The Principle of* Hadley v. Baxendale, 80 Calif. L. Rev. 563, 567 (1992). Finally, this provision also fails to specify when the losses must have been foreseeable. This author suggests better provisions to accomplish the apparently intended limitation later in this article. *See infra* Part VII.

25. *See infra* Part VI.

26. *See* Globe Refining Co. v. Landa Cotton Oil Co., 190 U.S. 540, 543 (1903) ("It is true that, as people when contracting contemplate performance, not breach, they commonly say little or nothing as to what shall happen in the latter event, and the common rules have been worked out by common sense, which has established what the parties probably would have said if they had spoken about the

supposedly "reflect how the parties would likely have allocated the risks had they expressly so provided"[27] but that in fact act as "a gap-filling device which provides a method by which the courts can allocate risks which the contracting parties have failed to allocate."[28] Thus, even though contract law is based on the principle that the parties are masters of their own contractual bargain, and it is the express terms of the resulting written agreement that will govern the resolution of any dispute, an award of damages for breach of contract is typically based on judge-made rules, developed by the common law, to reasonably compensate the non-breaching party for the breaching party's failure to perform the contract as promised.

In contract law, as opposed to tort law, "'[t]he purpose[] of awarding contract damages is to compensate the injured party and not to punish the breaching party.'"[29] But what has the common law determined is the non-breaching party's injury in the event a contract has been breached by the other party? The answer is that the injury can be viewed from one of two perspectives: either the non-breaching party is now (1) "worse off than if the contract had been performed";[30] or (2) "worse off than if the contact had not been made."[31] Damages awarded based on the first perspective are designed to protect what is referred to as the expectation interest, while damages awarded based on the second perspective are designed to protect what is referred to as the reliance interest.[32] Thus:

> Under the expectation conception, compensation is the amount required to put the victim in a state just as good as if the breaching party had performed the contract. Under the reliance conception, compensation is the amount required to put the victim in a state just as good as if he had not made the contract with the breaching party.[33]

The expectation measure of damages has also been referred to as the "benefit of the bargain" measure of damages,[34] while the reliance measure of damages has

matter."); *see also* Francis Dawson, *Reflections on Certain Aspects of the Law of Damages for Breach of Contract*, 9 J. Cont. L. 125, 125 (1995) (Austl.). In the M&A context, of course, the indemnification provisions (with the negotiated deductible and cap) do reflect an effort to specifically provide for the extent of compensation that will be payable in the event of a breach. But the existence of an excluded losses provision containing misunderstood terms may well cast doubt on how clearly that has been accomplished.

27. Thomas A. Diamond & Howard Foss, *Consequential Damages for Commercial Loss: An Alternative to* Hadley v. Baxendale, 63 Fordham L. Rev. 665, 690 (1994).

28. Andrew Robertson, *The Basis of the Remoteness Rule in Contract*, 28 Legal Stud. 172, 196 (2008).

29. Jill Wieber Lens, *Honest Confusion: The Purpose of Compensatory Damages in Tort and Fraudulent Misrepresentation*, 59 Kan. L. Rev. 231, 233 (2011) (quoting Restatement (Second) of Contracts § 355 cmt. a (1981)).

30. Robert Cooter & Melvin Aron Eisenberg, *Damages for Breach of Contract*, 73 Calif. L. Rev. 1432, 1435 (1985).

31. *Id.*

32. *Id.*

33. *Id.* at 1436.

34. *See, e.g.*, Daimler-Chrysler Motors Co. v. Manuel, 362 S.W.3d 160, 180 (Tex. App. 2012) ("the 'benefit of the bargain' measure . . . utilizes an expectancy theory"); *see also* Hoffman v. L & M Arts, No. 3:10-cv-0953-D, 2013 WL 4511473, at *6 (N.D. Tex. Aug. 26, 2013).

been referred to as the "out-of-pocket" measure of damages.[35] In awarding market-measured damages in the context of the breach of a representation and warranty in the acquisition of a business, the distinction between these two means of assessing general damages is that the benefit of the bargain method measures the difference between "the value as represented and the value actually received,"[36] while the out-of-pocket method measures "the difference between the value the buyer has paid and the value of what he has received."[37] For all practical purposes, the difference between these two approaches in a post-closing damages claim would only matter if the price paid by the buyer exceeds or is less than the value of the business as represented.[38] It would be rare in most business acquisitions subjected to a market process that the price paid for the business would not be equal to its market value as represented because, by virtue of the market dynamics, the "contract price is a fair representation of the market price of the business as warranted."[39]

35. *See* Hart v. Moore, 952 S.W.2d 90, 97 (Tex. App. 1997) (determining that out-of-pocket damages and reliance damages are the same type of damages and that an award of both would be a prohibited double recovery); Kenneth M. Lodge & Thomas J. Cunningham, *Reducing Excessive and Unjustified Awards in Lender Liability Cases*, 98 DICK. L. REV. 25, 29 (1993) ("Some jurisdictions refer to what is called an 'out-of-pocket' measure of damages, based purely upon the extent of the borrower's reliance.").

36. Henry S. Miller Co. v. Bynum, 836 S.W.2d 160, 163 (Tex. 1992); U.S. Rest. Props. Operating L.P. v. Motel Enters., Inc., 104 S.W.3d 284, 291 (Tex. App. 2003) ("Typically, the 'benefit of the bargain' measure, based on an expectancy theory, is the difference between the value represented and the value received."); *see also* Carrier Corp. v. Performance Props. Corp., CIV. A. No. 3:93-CV-0814-P, 1997 WL 527313, at *2 (N.D. Tex. Aug. 19, 1997) ("benefit of the bargain measure of damages refers to the difference between the value represented and the value received").

37. Arthur Andersen & Co. v. Perry Equip. Corp., 945 S.W.2d 812, 817 (Tex. 1997); *see also* Geis v. Colina Del Rio, LP, 362 S.W.3d 100, 112 (Tex. App. 2011) ("Out-of-pocket damages measure the difference between the value the buyer has paid and the value of what he has received.").

38. For example, if the business was worth $100 if all the representations and warranties had been true and the business is only worth $50 as a result of the inaccuracy of one of more of the representations and warranties, then even if the buyer only paid $50 for the business, the damages calculation under the "benefit of the bargain" methodology would result in an award of $50 in damages, but no award under the "out-of-pocket" methodology. Similarly, if the business was worth $100 if all the representations and warranties had been true and the business is worth $50 as a result of the inaccuracy of one of more of the representations and warranties, and the buyer paid $150 for the business, the damage calculation under the "benefit of the bargain" methodology would result in an award of $50 in damages, but an award of $100 under the "out-of-pocket" methodology. If the amount the buyer paid for the business equals its value as represented there would be no difference in the outcome under either approach. *See* Lens, *supra* note 29, at 248.

39. *See* Carter, Courtney & Tolhurst, *supra* note 20, at 190; *see also* Merlin Partners LP v. AutoInfo, Inc., Civ. A. No. 8509-VCN, at *45 (Del. Ch. Apr. 30, 2015) ("Where, as here, the market prices a company as the result of a competitive and fair auction, the use of alternative valuation techniques is necessarily a second-best method to derive value."). But the market-measured approach to determining damages is not necessarily the only means of assessing damages that were incurred under either the out-of-pocket or benefit of the bargain methodologies. *See* Gusmao v. GMT Grp., Inc., No. 06 Civ. 5113 (GEL), 2008 WL 2980039, at *11 (S.D.N.Y. Aug. 1, 2008) ("An injured party is also entitled to consequential damages in compensation 'for additional losses (other than the value of the promised performance) that are incurred as a result of the . . . breach,' . . . and that 'were within the contemplation of the parties when the contract was made.'"); West & Duran, *supra* note 2, at 790 (noting that while it is often assumed that direct (or general) damages are limited to the market-measured approach, direct (or general) damages are not so limited—the only limit being that the damages

While there have been advocates of the reliance interest as the interest most worthy of protection by the courts,[40] and therefore the most appropriate method of calculating contract-based damages, it is generally the expectancy interest that gets the most attention and is the basis for most awards of damages arising from a breach of contract.[41] But notwithstanding the expectancy interest's mandate to award to the injured, non-breaching party "the amount required to put the injured party where he would have been if the contract had been performed,"[42] contract-based damages rules have always been concerned with making sure that liability was limited by a rule of reasonableness.[43] In other words, full expectancy or reliance-based damages awards have never been the norm. Instead, the rule of reasonableness limits damages awards to those that would compensate the non-breaching party for the types of losses that were foreseeable by the breaching party as the probable result of a breach at the time the contract was made; it also denies damages awards that would compensate the non-breaching party for the types of losses that were deemed too remote to have been fairly contemplated by the parties at the time the contract was made.[44]

The concept of limiting damages awards to those that compensate only for losses that were of a type (although not necessarily of an amount) that were foreseeable as a probable result of the breach finds its purported origin in an English case decided more than 160 years ago: *Hadley v. Baxendale*.[45] *Hadley* continues to be "cited with approval" throughout the United States,[46] and its basic facts are

must of a type that would ordinarily be expected to result from a breach of the contract at the time the contract was entered into by the parties).

40. *See generally* L.L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages: 1*, 46 Yale L.J. 52 (1936); L.L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages: 2*, 46 Yale L.J. 373 (1937); *see also* Victor P. Goldberg, Essay, *Protecting Reliance*, 114 Colum. L. Rev. 1033 (2014).

41. *See* Diamond & Foss, *supra* note 27, at 678 n.59.

42. Cooter & Eisenberg, *supra* note 30, at 1434. This mandate can be traced to the early English case of *Robinson v. Harman*, (1848) 1 Exch. 850, 855 (Eng.) ("where a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation with respect to damages, as if the contract had been performed"); *see also* Adam Kramer, *An Agreement-Centered Approach to Remoteness and Contract Damages*, *in* Comparative Remedies for Breach of Contract 251, 257 (Nili Cohen & Ewan McKendrick eds., 2005).

43. West & Duran, *supra* note 2, at 783–84; *see also* David McLauchlan, *Remoteness Re-invented?*, 9 Oxford U. Commonwealth L.J. 109, 130 (2009) ("the essential question in remoteness cases has always been whether allowing the plaintiff's claim would represent a fair and reasonable allocation of the risks of the transaction as between the parties").

44. *See* West & Duran, *supra* note 2, at 782–85.

45. Hadley v. Baxendale, 9 Exch. 341, 156 Eng. Rep. 145 (1854). This author uses the term "purported" because despite the constant veneration of *Hadley v. Baxendale* as the original source of the contract damages limitation rule based upon foreseeability, it has been noted that the famous French scholar, Robert Pothier, was the actual originator of the idea and there is evidence of this concept in American cases (that refer to Pothier or civil law in general) that predate *Hadley*. *See* Franco Ferrari, *Comparative Ruminations on the Foreseeability of Damages in Contract Law*, 53 La. L. Rev. 1257, 1265 (1993); *see also* Wayne Barnes, *The Boundaries of Contract in a Global Economy:* Hadley v. Baxendale *and Other Common Law Borrowings from the Civil Law*, 11 Tex. Wesleyan L. Rev. 627 (2005); Robert M. Lloyd & Nicholas J. Chase, Recovery of Damages for Lost Profits: The Historical Development 2 (2015) (unpublished manuscript available at http://works.bepress.com/robert_lloyd/5).

46. *See, e.g.*, Sunnyland Farms, Inc. v. Cent. New Mexico Elec. Coop., Inc., 301 P.3d 387, 392–95 (N.M. 2013); Basic Capital Mgmt., Inc. v. Dynex Commercial, Inc., 348 S.W.3d 894, 901–02 (Tex.

known by most lawyers practicing in common law countries: A mill owner needed a new crankshaft because the mill's existing shaft was broken. The mill owner hired a carrier firm to transport the broken shaft to a facility that would use the broken shaft as a model from which to build a replacement shaft. The carrier firm apparently agreed to transport the shaft the next day but then delayed the shipment for five days. In the meantime, the mill owner, who was without a replacement shaft to operate his mill, was left with an idle mill and the consequent loss of the profits he would have made had the mill been in operation. Accordingly, the mill owner sought to be placed in the position he would have been in had the carrier fulfilled the contract and delivered the broken crankshaft the next day rather than waiting five days (i.e., by obtaining damages from the carrier equal to that portion of the mill owner's lost profits that were attributable to the five-day delay).[47] In denying the mill owner recovery for his claimed lost profits, the court adopted a two-prong rule that remains "a fixed star in the jurisprudential firmament"[48]—i.e., contract-based damages are limited to those damages that are foreseeable either because (1) they result normally and naturally from the breach "according to the usual course of things,"[49] or (2) they result from special circumstances that were communicated to or known by the breaching party in such a manner that they "may reasonably be supposed to have been in contemplation of both parties, at the time they made the contract, as the probable result of the breach of it."[50] It is this second prong of the *Hadley* contract damages limitation rule that is traditionally associated with the concept of consequential or special damages, while it is the first prong that is associated with general or direct damages.[51] But as will be seen, defining "consequential damages" according to the degree of foreseeability, as opposed to the degree of causality, does not necessarily reflect what the parties entering into a contract actually intend by the term, nor does it ensure the approach a court will take in interpreting a provision purporting to exclude such damages.[52]

2011); *see also* Ashley, Palmer & Aldersey-Williams, *supra* note 12, at 262 ("As far back as 1894, the United States Supreme Court accepted *Hadley v. Baxendale* as a leading case on both sides of the Atlantic. *Hadley v Baxendale* has been cited with approval by the highest court in 43 states and it has since been referred to by academic commentators as recognised in American jurisprudence as the definitive source of determining when consequential damages may be recoverable for breach of contract." (internal quotations and citations omitted)); Howard Hunter, *Has the Achilleas Sunk?*, 31 J. CONT. L. 120, 120 n.4 (2014) (Austl.) ("Despite the occasional article about American exceptionalism and independence, the common law courts in the United States remain deeply committed to many of the core principles of the English common law of contracts. With just a cursory survey, one can read careful discussions of the *Hadley* precedent from states as different as Maryland, Oklahoma and New Mexico.").

47. West & Duran, *supra* note 2, at 784–85; *see generally* Eisenberg, *supra* note 24.

48. Diamond & Foss, *supra* note 27, at 665 (quoting GRANT GILMORE, THE DEATH OF CONTRACT 83 (1974)).

49. *Hadley*, 9 Exch. at 355, 156 Eng. Rep. at 151.

50. *Id.*; *see also* West & Duran, *supra* note 2, at 785.

51. West & Duran, *supra* note 2, at 790–91.

52. *See* Carter, *supra* note 12, at 123–25; *see also infra* Part IV.

Because the foreseeability standard only restricts the type of damages, not necessarily the amount,[53] the foreseeability standard is subject to practical, context-based constraints as well. Indeed, the *Restatement (Second) of Contracts* includes a controversial provision that expressly permits a court to limit damages even in the face of clearly foreseeable losses whenever "justice so requires in order to avoid disproportionate compensation."[54] Using a particularly compelling example, the fact that a customer hails a taxi and specifically informs the driver that, unless they arrive by a set time, the customer will lose a contract worth millions of dollars, even if followed by the driver's specific promise to deliver the customer to the designated address at the designated time for the posted fare, plus tip, does not mean that the taxi driver or the driver's company is liable for the customer's resulting losses when the driver, for whatever reason, fails to fulfill the promise.[55] Commentators suggest that U.S. courts have tended to deny "recovery even for (foreseeable) consequential loss where the damages 'are so large as to be out of proportion to the consideration agreed' unless plaintiff proves that defendant 'at the time of the contract tacitly consented to be bound to more than ordinary damages in the case of default on his part.'"[56] Furthermore, a 2008 English case demonstrates that, even in the birthplace of

53. *See* Andrew Tettenborn, Hadley v. Baxendale *Foreseeability: A Principle Beyond Its Sell-by Date?*, 23 J. CONT. L. 1, 2 n.5 (2007) (Austl.) ("As Lord Hope put it, 'there is no arbitrary limit that can be set to the amount of the damages once the test of remoteness according to one or the other of the rules in *Hadley v. Baxendale* has been satisfied.'" (internal citations omitted)); *see also* Roy Ryden Anderson, *Incidental and Consequential Damages*, 7 J.L. & COM. 327, 364 (1987); *but see* ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 12.14 (3d ed. 2004) ("The magnitude of the loss need not have been foreseeable, and a party is not disadvantaged by its failure to disclose the profits that it expected to make from the contract. However, the mere circumstance that some loss was foreseeable may not suffice to impose liability for a particular type of loss that was so unusual as not to be foreseeable."). The *Victoria Laundry* case is a good example of the extent or magnitude of loss being limited by the court's reclassification of a type of loss (profits from a particularly lucrative contract not being a foreseeable type of loss, but normal profits being a foreseeable type of loss, even though they both were types of profits derived from the business). *See* West & Duran, *supra* note 2, at 792 n.74; Paul C.K. Wee, *Contractual Interpretation and Remoteness*, 2010 LLOYD'S MARITIME & COM. L.Q. 150, 170–71 (Eng.).

54. RESTATEMENT (SECOND) OF CONTRACTS § 351(3) (1981). Practitioners should not take much comfort from this provision as it has not received significant recognition and there have been suggestions that its applicability is limited to unique circumstances that would not include a written agreement among sophisticated parties. *See, e.g.*, Pereni Corp. v. Greate Bay Hotel & Casino, Inc., 610 A.2d 364, 381 (N.J. 1992), *abrogated on other grounds by* Tretina Printing, Inc. v. Fitzpatrick & Assocs., Inc., 640 A.2d 788 (N.J. 1994).

55. *See* Kramer, *supra* note 42, at 269–70; Lord Hoffman, *The Achilleas: Custom and Practice or Foreseeability?*, 14 EDINBURGH L. REV. 47, 53 (2010). It has been suggested that the common sense result in the taxi driver and similar examples can be explained based on the proposition that "since the 'primary function of the rule of remoteness . . . is to prevent unfair surprise to the defendant, to ensure a fair allocation of the risks of the transaction and to avoid any overly chilling effects on useful activities by the threat of unlimited liability,' a substantial disproportion between the foreseeability of loss suffered by the promisee and the consideration received by the promisor may make it entirely unreasonable to infer that the latter was assuming responsibility for the loss." McLauchlan, *supra* note 43, at 130 (internal citations omitted).

56. Joseph M. Lookofsky, *Consequential Damages in CISG Context*, 19 PACE INT'L L. REV. 63, 69 (2007); *see also* Eric C. Schneider, *Consequential Damages in the International Sale of Goods: Analysis of Two Decisions*, 16 U. PA. J. INT'L BUS. L. 615, 632 (1995) ("The 'tacit agreement' test has been rejected by most states and the U.C.C., but its underlying justification—that the obligor should not be responsible for damages beyond the risk assumed at the time of contracting—continues to affect

Hadley v. Baxendale, some judges are inclined to consider the contextual business expectations of the parties rather than just the foreseeability of the types of damages in determining the limitations on the extent of a damages award for a breach of contract.[57] Thus, despite the apparent rejection of the tacit-agreement test as a further restriction on *Hadley's* foreseeability standard,[58] some commentators argue that the foreseeability standard is manipulated by courts on both sides of the Atlantic to effectively determine the appropriate limits of damages that ought to be payable based on the bargain that the parties made.[59] As a result, it has been suggested that a more appropriate approach to limiting damages to reasonable levels (and one more consistent with the various outcomes of the cases applying foreseeability criteria) is to take each contract on its own merits, and in its own context, to determine what the object of the promised performance was and the extent to which the non-breaching party has been deprived of the value of that promised performance.[60]

One of the best summaries of the foreseeability standard, derived from *Hadley* and recognized and applied in the various common law jurisdictions around the world, is the following from a 2013 decision of the Court of Appeal of Singapore:

> The rules as to remoteness of damage serve to impose a horizon on the extent of the contract breaker's liability. Losses that are within this notional boundary are in principle recoverable while those beyond it are not. But although this horizon is not illusory, equally it is not a rigid or empirically precise boundary. Rather, like the horizon of human experience, its range depends on the circumstances. For this purpose, the relevant circumstances include those in which the contract was entered into and what both parties knew or must be taken to have known about the venture

decision making in the United States."); *see generally* M.N. Kniffin, *Newly Identified Contract Unconscionability: Unconscionability of Remedy*, 63 Notre Dame L. Rev. 247 (1988).

57. Transfield Shipping Inc. v. Mercator Shipping Inc., [2008] UKHL 48, at paras. 22–26 (Hoffman L.) (Eng.); *see also* Lord Hoffman, *supra* note 55; Max Harris, *Fairness and Remoteness of Damages in Contract Law: A Lexical Ordering Approach*, 28 J. Cont. L. 1 (2011) (Austl.); *but see* Hunter, *supra* note 46 (suggesting that this decision did not change the basic *Hadley* rule but simply applied the established principles to the specific facts).

58. *See* Howard O. Hunter, Modern Law of Contracts § 14.11 (2014). The "tacit-agreement test" was a test that added to the *Hadley* requirement that the special circumstances of the non-breaching party must have been communicated to the breaching party at the time of contracting an additional requirement that the breaching party "must also expressly or impliedly manifest intent to assume responsibility for the foreseeable consequential damages." *See* Phillip M. Brick, Jr., *Agree to Disagree: The Inequity of Arkansas's Tacit Agreement Test as Seen in* Deck House, Inc. v. Link, 62 Ark. L. Rev. 361, 366 (2009). England and the vast majority of states (Arkansas being a notable exception) have now rejected the tacit-agreement test. *Id.* at 367. New York is also on the list of states that may still adhere to the tacit-agreement test. *See* Larry T. Garvin, Globe Refining Co. v. Landa Cotton Oil Co. *and the Dark Side of Reputation*, 12 Nev. L. Rev. 659, 686 (2012); Clayton P. Gillette, *Tacit Agreement and Relationship-Specific Investment*, 88 N.Y.U. L. Rev. 128, 139–44 (2013).

59. *See, e.g.*, Richard A. Epstein, *Beyond Foreseeability: Consequential Damages in the Law of Contract*, 18 J. Legal Stud. 105 (1989); Harris, *supra* note 57, at 18; Kniffin, *supra* note 56, at 268–75; Kramer, *supra* note 42, at 251–86; Robertson, *supra* note 28; *see also* McLauchlan, *supra* note 43, at 139 ("it may then be fair to say that *in practice* the common law of remoteness in contract covertly imposes limits on the recoverability of damages of the kind overtly recognized in 351(3) of the *Restatement (Second) of Contracts*"); *see generally* Larry T. Garvin, *Disproportionality and the Law of Consequential Damages: Default Theory and Cognitive Reality*, 59 Ohio St. L.J. 339 (1998).

60. *See* Tettenborn, *supra* note 53; *cf.* Wee, *supra* note 53 (expressing concern with this approach).

> they were about to undertake. According to these circumstances, the horizon may sometimes extend further than at other times.[61]

This statement effectively sums up more than 160 years of the common law's struggle with the *Hadley* foreseeability standard and the concept of reasonableness in awarding damages for breach of contract. Each agreement must be approached on its own terms to determine "a reasonable horizon . . . for the scope of . . . liability" because "[p]arties to similar contracts often have differing expectations."[62] And, as will be demonstrated in this article, the expectations of a buyer of a business, with a negotiated set of representations and warranties, subject to a bargained-for cap and deductible on its available claims for damages, are much different than a party entering into a construction contract with a contractor.

But to complete the review of the common law's concern with not imposing unreasonable damages upon a defaulting party, we must also note a few of the additional constraints imposed on contract-based damages awards besides the concept of foreseeability. First, the non-breaching party in a breach of contract claim must prove such party's damages with reasonable certainty.[63] Because "[d]amages that are contingent, speculative, and uncertain cannot be established with reasonable certainty," such purported damages cannot be recovered in a breach of contract action notwithstanding any failure to exclude such damages in the contract.[64] Second, contract-based damages awards are subject to the principle that a breaching party is not liable for damages that the non-breaching party could have reasonably avoided (i.e., the concept of mitigation).[65] Finally, the concern with excess damages awards is so firmly entrenched in the common law that parties who agree to a specified amount of damages for a breach are subject to having such an agreed-upon damages provision declared void as a penalty, unless such an agreed-upon amount of damages was a reasonable estimate of the actual amount of contract-based damages that would have otherwise been awarded.[66]

With this basic understanding of the theories underlying contract-based damages awards, we now turn to the more difficult task of attempting to define the various terms used in an excluded losses provision to preclude certain damages types. Appreciating the meaning of each of these terms is critical because, whether or not these terms are fully understood by the parties to the contract,

61. Out of the Box Pte Ltd v. Wanin Industries Pte Ltd, [2013] SGCA 15, at para. 13 (Sing.).

62. Hunter, *supra* note 46, at 130.

63. Banker Steel Co. v. Hercules Bolt Co., Civ. A. No. 6:10CV00005, 2011 WL 175224, at *9 (W.D. Va. May 6, 2011). Indeed, the reasonable certainty requirement has been described as "[f]ar more important in modern law . . . [than] the *Hadley* rule." Lloyd & Chase, *supra* note 45, at 2.

64. *See Banker Steel*, 2011 WL 175224, at *9.

65. *See generally* Charles J. Goetz & Robert E. Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligation*, 69 Va. L. Rev. 967 (1983); Note, *Why There Should Be a Duty to Mitigate Liquidated Damages Clauses*, 38 Hofstra L. Rev. 285 (2009).

66. *See, e.g.*, FPL Energy, LLC v. TXU Portfolio Mgmt. Co., 426 S.W.3d 59, 72 (Tex. 2014) ("When the liquidated damages provisions operate with no rational relationship to actual damages, thus rendering the provisions unreasonable in light of actual damages, they are unenforceable."); *see also* Robert A. Hillman, *The Limits of Behavioral Decision Theory in Legal Analysis: The Case of Liquidated Damages*, 85 Cornell L. Rev. 717, 725–27 (2000).

an excluded losses provision "is generally enforced against a counterparty to a contract, even if the effect is to exclude all damages resulting from a breach of the affected agreement."[67]

IV. An Update on the Meaning of "Consequential Damages"

In 1984, an Atlantic City casino entered into a contract with a construction manager respecting the casino's renovation.[68] The construction manager was to be paid a $600,000 fee for its construction management services. In breach of the agreement, completion of construction was delayed by several months. As a result, the casino was unable to open on time and lost profits, ultimately determined by an arbitration panel to be in the amount of $14,500,000. There was no consequential damages waiver in the contract at issue in this case. Although the court considering this award on appeal was troubled by its size, after applying the traditional foreseeability analysis of *Hadley*, the court determined that it had no basis to overturn the arbitrator's award because the importance of completing the project on time and the consequences of not doing so were clearly known to the construction manager at the time that the contract was made.[69] The award in this case was considered so out of proportion to the fee paid and the risk supposed to be assumed that the construction industry adopted a new form agreement that contained a mutual waiver of consequential damages that specifically noted that any losses of income or profit were considered consequential damages.[70]

While this author has been unable to determine the true origin of the pervasive use of consequential damages waivers in private company acquisition agreements, it is cases like this from other contexts that were surely responsible. And it is this author's contention that, by importing these provisions from the construction industry (with a different set of issues and worries), the appropriate types of damages that should be available for breaches of representations and warranties in the private company acquisition deal context (subject to the applicable caps and deductibles) have been compromised. Indeed, a contractor's concerns over potential liability for an owner's loss of profits arising from the contractor's failure to timely complete construction, under a contract providing for a fixed fee, do not translate into the context of a purchase of a business, where the liability arises from the breach of bargained-for representations and warranties intended to ensure the ongoing ability to generate profits from that purchased business.

67. West & Duran, *supra* note 2, at 781.

68. Perini Corp. v. Greate Bay Hotel & Casino, Inc., 610 A.2d 364 (N.J. 1992), *abrogated on other grounds by* Tretina Printing, Inc. v. Fitzpatrick & Assocs., Inc., 640 A.2d 788 (N.J. 1994); *see* Jason L. Richey & William D. Wickard, *Waiving Good-Bye to Consequential Damages: Drafting Effective Waivers in Today's Marketplace*, K & L Gates Construction L. Blog (Dec. 1, 2007), http://goo.gl/EZA2yU.

69. *Perini Corp.*, 610 A.2d at 373–74.

70. Richey & Wickard, *supra* note 68.

A. Continued Confusion Concerning What Does and Does Not Constitute "Consequential Damages"

As noted in the 2008 *The Business Lawyer* article, the term "consequential damages" is inherently ambiguous when used in an excluded losses provision.[71] Indeed, "consequential" is an adjective that has been defined in one dictionary to simply mean "following, especially as an (immediate or eventual) effect."[72] Still another meaning attributed to the term "consequential" is "important."[73] As a result, "[t]he word 'consequential' is not very illuminating, as all damage is in a sense consequential."[74] Nevertheless, this article will attempt to frame the distinction between consequential and direct or general damages as those damages types have been commonly understood by most common law courts.

Some courts define "consequential damages" by referring to the distinction between damages based on the "present value of the promised performance" that was breached (i.e., general or direct damages) and the benefits that performance would have produced or the losses that the failure of that performance produced (i.e., consequential damages).[75] Under this formulation, consequential damages are essentially all losses other than the difference between the represented value of the products, services, or assets purchased or contracted for and the value of such products, services, or assets as actually delivered or provided.[76]

A more common understanding of the term "consequential," and the meaning attributed by many lawyers to the term, is "of the nature of a secondary result; indirect."[77] This is also the meaning that is given to the term "consequential damages" by some courts without any reference to the second prong of the *Hadley* rule. Thus, some courts define "consequential damages" as "such damages that do not flow directly and immediately from the injurious act, but that result indirectly from the act."[78] In other words, some courts have equated consequential damages with the concept of indirect damages.[79] Equating consequential damages with indirect damages may result from the fact that normal, natural, or-

71. *See* West & Duran, *supra* note 2, at 780–82; *see also* Herbots, *supra* note 12, at 932 ("The term *consequential damages* . . . is bluntly ambiguous and contract drafters of waivers in common law jurisdictions would be well advised to avoid it."); Peters, *supra* note 12, at 265 ("the term 'consequential loss' should be avoided completely and the draftsman should state what liabilities the parties intend to exclude").

72. Shorter Oxford English Dictionary 492 (5th ed. 2002); *see also* Carter, *supra* note 12, at 124–25.

73. Shorter Oxford English Dictionary 492 (5th ed. 2002).

74. Saint Line Ltd v. Richardsons Westgarth & Co, [1940] 2 KB 99, 103 (Eng.), *as quoted in* Carter, *supra* note 12, at 125 n.30.

75. *See In re* CCT Commc'ns, Inc., 464 B.R. 97, 117 (Bankr. S.D.N.Y. 2011).

76. *See, e.g.*, *In re* Heartland Payment Serv. Sys., Inc. Customer Data Sec. Breach Litig., 834 F. Supp. 2d 566, 580 (S.D. Tex. 2011).

77. Merriam-Webster's Collegiate Dictionary 245 (11th ed. 2008).

78. *See, e.g.*, Riley v. Stafford, 896 A.2d 701, 703 (R.I. 2006) (internal quotations and citations omitted).

79. *CCT Commc'ns*, 464 B.R. at 117 ("'Consequential,' 'special' and 'indirect' damages are synonymous terms.").

dinary, and general damages are referred to most commonly as direct damages, when contrasting them with consequential damages.[80]

But despite these other understandings, consequential or special damages have been understood by a majority of courts as being damages that arise from the second prong of the *Hadley* damages limitation rule (i.e., from the non-breaching party's special circumstances that were known or knowable to the breaching party at the time of contracting but which would not normally be expected to arise as a result of a breach of the particular type of contract being made).[81] As a result, consequential or special damages have an enhanced foreseeability requirement because they are viewed as damages beyond the normal expectations of the parties. Because the determination of damages as direct/general or consequential/special under *Hadley* is based on foreseeability criteria, not causality differentiations,[82] consequential or special damages can include losses directly caused by the breach, and that are the "probable result of the breach when the contract was made," but that are nevertheless beyond the ordinary course of events normally expected from a breach of this type of contract.[83] Commentators have proposed a definition of the "special circumstances" giving rise to this enhanced foreseeability requirement as follows:

> The term "special circumstances" refers to the information known by the buyer that differentiates the buyer's vulnerability to economic loss on account of breach from that of other buyers and is of such significance that disclosure might have reasonably induced the seller to take additional protective measures in response.[84]

This proposed definition is consistent with the holding of *Hadley,* which denied the mill owner's damages in the form of lost profits caused by the late delivery of the mill's broken shaft because the mill's owner had apparently failed to specifically communicate to the carrier the fact that the mill had no spare shaft with which to operate.[85] According to one commentator, the "function of the communication of the circumstances is to allow the defendant to insist on a variation of the terms of the contract as regards the damage issue."[86] After all, if there are special circumstances and they have not been communicated, the waiver of damages arising from those special circumstances is completely unnecessary because

80. *See* Eisenberg, *supra* note 24, at 565 n.12 ("'General' is preferable to 'direct' in this context because even consequential damages are usually the direct result of breach.").

81. Diamond & Foss, *supra* note 27, at 668.

82. *See* Carter, *supra* note 12, at 125–26; Odry, *supra* note 12, at 147.

83. *See* Diamond & Foss, *supra* note 27, at 669.

84. *Id.* at 693.

85. Kniffin, *supra* note 56, at 259. *But see* Dawson, *supra* note 26, at 131 (discussing the fact that when *Hadley* was decided businesses operated without the benefit of limited liability and, as a result, the law may not have recognized as fully as now the ability of employees of a business—such as Baxendale's clerk—to bind that business to extra liability based on what such employees may have been told); Eisenberg, *supra* note 24, at 570 (discussing the controversy as to what was in fact communicated to the carrier's clerk by Hadley).

86. Epstein, *supra* note 59, at 122 (quoting Hadley v. Baxendale, 9 Exch. 341, 355, 156 Eng. Rep. 145, 151 (1854) ("[H]ad the special circumstances been known, the parties might have specifically provided for the breach of contract by special terms as to the damages in that case.")).

they are unrecoverable remote damages.[87] Indeed, it is only where the special circumstances have been communicated to the breaching party at the time the contract was made that damages arising from those special circumstances are deemed recoverable consequential damages under the second prong of *Hadley*. Applying these rules, even in the absence of an excluded losses provision that uses the term "consequential damages," could result in the denial of damages that one may well view as direct but that nonetheless involve uncommunicated special circumstances. Therefore, a waiver of consequential damages always involves a waiver of damages arising from circumstances that were in fact fully foreseeable (as a result of the communication of those special circumstances that would not otherwise have been deemed foreseeable in an ordinary situation).[88]

So, when the term "consequential damages" is used in an excluded losses provision, what does it really mean?[89] Does it mean all damages other than market-measured damages? Or does it mean indirect damages? Or does it instead mean communicated special circumstances? Regardless of the chosen approach to interpreting its meaning generally, how is that meaning going to apply in the specific context of the breach of a bargained-for representation and warranty involving a purchased business? Given the uncertainty of the term's meaning, the risk of getting this wrong is not only on the buyer but also on the seller.

Cases from a variety of common law jurisdictions would appear to support the view that the term "consequential loss," when used in an excluded losses provision, is not necessarily as far reaching as sellers may hope or buyers may fear. For example, one commentator has provided a convenient listing of losses that many would have supposed were consequential losses that would have been excluded by a consequential loss waiver, but which English and Australian courts have found were nonetheless direct or general losses in the context of the specific contract breached, as follows:

- increased production costs and loss of profits caused by defective power station equipment;
- wasted overheads and loss of profit caused by the destruction of a methanol plant;

87. *See supra* note 44 and accompanying text.

88. *See, e.g.*, Rexnord Indus., LLC v. Bigge Power Constructors, 947 F. Supp. 2d 951, 957 (E.D. Wis. 2013) ("Under the rule of *Hadley*, [the defendant] would be liable for such consequential damages if [the plaintiff] had communicated its special circumstances to [the defendant] at the time of contracting. However, because in this case the parties have agreed to exclude all consequential damages, [the defendant] is not liable for consequential damages even if [the plaintiff] is able to prove that [the defendant] knew about its special circumstances."); *see also* Carter, *supra* note 12, at 126 ("If a loss which would be recoverable under the second limb has been communicated prior to the entry into the contract the basis for holding the promisor-defendant liable is 'the defendant's conduct in entering into the contract without disclaiming liability for the enhanced loss which he can foresee gives rise to implication that he undertakes to bear it.' Since the possibility of the loss has been communicated, the promisor may not be willing to enter into the contract unless the promisee agrees to the exclusion." (internal citations omitted)).

89. *See generally* Carter, *supra* note 12, at 130–32.

- the costs of removing and storing defective mini-bar chiller units and cabinets, and the loss of profits associated with their use caused by the defective mini-bar systems;
- loss of sales, loss of opportunity to increase margins, loss of opportunity to make staff cost savings, and wasted management time caused by the breach of contract to supply computer hardware and associated services;
- increased project costs and reduced cost benefit . . . caused by the breach of a contract to supply and develop computer software; and
- loss of revenue caused by the failure to supply a gas energy flow at the contracted amount for the contract period.[90]

Add to this list the more recent 2011 English case of *McCain Foods GB Ltd v. Eco-Tec (Europe) Ltd*,[91] in which the court held that a clause excluding liability for "indirect, special, incidental and consequential damages" did not exclude liability for the lost revenue that would have been generated by a properly working system, nor the cost of purchasing electricity that would have been produced if the system had worked properly, nor the cost of additional manpower to address the issues arising from the breach. This was because each of these losses, together with the cost of replacing the defective system itself, arose naturally from the fact that the system did not perform as contracted and thus were direct losses, not consequential losses.

Shifting gears to the buyer's perspective, consider the 2012 Australian case of *Alstom Ltd v. Yokogawa Australia Pty Ltd & Anor (No 7)*.[92] In *Altsrom*, the court determined that restricting the scope of a waiver of consequential losses to only those losses falling within the second prong of the *Hadley* damages limitation rule was "unduly restrictive" and "failed to do justice to the language used" in the specific contract being considered.[93] Instead, the court was prepared to allow the term "consequential" to have its normal dictionary meaning. Referring to the *Shorter Oxford English Dictionary*, the court noted that the term "consequential" could be understood to simply mean "following as an effect." Given the context of the specific contract being considered, and the remedies otherwise specifically provided for certain types of contract breaches,[94] the court inter-

90. Anthony Jucha, Developments in the Law Relating to "Consequential Loss" 10–11 (2011) (unpublished manuscript available at http://goo.gl/KTYjGY); *see also* Sidnell, *supra* note 12, at 114–19 (containing a similar chart for English and Canadian decisions).

91. [2011] EWHC 66 (Eng.).

92. [2012] SASC 49 (Austl.).

93. *Id.* at para. 281.

94. The agreement at issue in *Alstom* was described by the judge as being "poorly drafted." *Astrom*, [2012] SASC at para. 92. So that criticism must be taken into account in the court's ruling. But it appears that the contract had liquidated damages and reimbursement of performance guarantee payments as the exclusive remedy for certain specified breaches of the contract, but those provisions did not otherwise eliminate remedies for other unspecified breaches of the contract. *Id.* at paras. 238–41. The court nevertheless held that the provision of the agreement containing a consequential damages waiver effectively waived all other damages claims from any breach of the contract not included in the

preted the clause to exclude "all damages suffered as a consequence of a breach of contract."[95]

Since the 2008 Australian case of *Environmental Systems Pty Ltd v. Peerless Holdings Pty Ltd*,[96] the Australian courts appear to have rejected the English approach of limiting the term "consequential loss" to only the second prong of the *Hadley* damages limitation rule in the context of a loss exclusion provision.[97] In *Environmental Systems*, the court was willing to treat even damages coming within the first prong of the *Hadley* rule as being consequential[98] by equating consequential loss with anything beyond the "normal loss," which the court noted would almost always exclude lost profits.[99] In 2013, however, another Australian court, in *Regional Power Corporation v. Pacific Hydro Group Two Pty Ltd [No 2]*,[100] seemingly rejected both the *Environmental Systems* and *Hadley* approaches to determining the meaning of "consequential loss":

> To reject the rigid construction approach towards the term "consequential loss" predicated upon a conceptual inappropriateness of invoking the *Hadley v. Baxendale* dichotomy as to remoteness of loss, only then to replace that approach by a rigid touchstone of the "normal measure of damages" and which always automatically eliminates profits lost and expenses incurred, would pose equivalent conceptual difficulties. Accordingly, I doubt whether the observations in *Environmental Systems* were intended to carry any general applicability towards establishing a rigid new construction principle for limitation clauses going much beyond the presenting circumstances of that case.[101]

Accordingly, examining the contract as a whole to determine its intended purpose rather than following artificial rules that "fettered toward assessing the character of an economic loss by rather vague criteria of whether or not the loss arose 'in the ordinary course of things' . . . [or from] the equally porous concept of a normal measure of damage," the court found that the damages in question—the cost of providing replacement power when a hydroelectric plant ceased operating in breach of a contract—were direct damages that went to the very purpose

liquidated damages and reimbursement of performance guarantee payments provisions. *Id.* at para. 290.

95. *Id.* at para. 281; *see also* Mal Cooke & Aaron Chiong, *Developing Certainty Around 'Consequential Loss,'* Herbert Smith Freehills (Dec. 7, 2012), http://goo.gl/WiMIFY; Peter Mulligan & Carla McDermott, *Consequential Loss and Good Faith Under the Microscope*, Henry Davis York (Aug. 2012), http://goo.gl/UiB7bU.

96. [2008] VSCA 26 (Austl.); *see also* West & Duran, *supra* note 2, at 791 n.66.

97. *See* Michael Bywell & Scott Cummins, *Exclusions of Consequential Loss: An Australian Perspective*, Johnson Winter & Slattery (Aug. 2013), http://goo.gl/0xwJPn; Jenifer Varzaly, *Australian Developments in Consequential Loss*, 31 Comp. Law. 31 (2010).

98. *See* Paul Brown & Warren Davis, *Consequential Loss in Commercial Contracts: NSW Court of Appeal in* Allianz *Agrees with Victorian Court of Appeal in* Peerless, Gadens (May 1, 2010), http://goo.gl/DPHNxI.

99. *See Peerless Holdings Pty Ltd*, [2008] VSCA at para. 87.

100. [2013] WASC 356 (Austl.).

101. *Id.* at para. 96.

for which the contract had been made, not consequential losses.[102] Interestingly, the court reached its decision by referring to an earlier unreported decision in which the court approached the issue from the same vantage point and found that the excluded consequential loss was "confined to that loss which [the non-breaching party] might incur as a result of using or being unable to use its plant or capital investment for a purpose extraneous to that directly contemplated by the transaction documents."[103]

Similarly, American courts do not appear to follow a bright-line rule that certain types of losses are always consequential and certain other types of losses are always direct or general. A sampling of holdings across the United States regarding the types of damages that are and are not excluded by a waiver of consequential damages is illustrative:

- damages for a construction company's losses attributable to idle equipment and unused materials were general damages not consequential damages, as such damages followed naturally from the breach of the construction contract;[104]
- late fees incurred by a buyer of component parts for failing to timely complete a project under a separate contract with a third party, that were the direct result of the seller's failure to timely deliver the purchased parts, were consequential damages precluded by the purchase agreement's excluded loss provision;[105]
- loss of fees on unused hospital rooms arising out of the breach of a contract to install elevators to service those newly constructed hospital rooms were consequential damages precluded by the waiver provision of the elevator installation agreement;[106]
- lost income caused by receivables allegedly becoming uncollectable, due to an inability to timely submit invoices as a result of the breach of a contract to install and implement a billing program, were consequential damages precluded by the parties' contract because such loss of income was "attributable to special circumstances";[107]
- costs incurred by issuing banks to cover fraudulent charges as a result of a credit card processor's breach of contract that resulted in a computer system being compromised by hackers were consequential damages that were not recoverable due to the contract's exclusion of such damages;[108]

102. *Id.* at para. 116.
103. *Id.* at para. 109 (internal quotation omitted).
104. City of Milford v. Coppola Constr. Co., 891 A.2d 31, 40 (Conn. App. Ct. 2006).
105. Marley Cooling Tower Co. v. Caldwell Energy & Envtl., Inc., 280 F. Supp. 2d 651, 658–59 (W.D. Ky. 2003).
106. Otis Elevator Co. v. Standard Constr. Co., 92 F. Supp. 603, 607 (D. Minn. 1950).
107. Creighton Univ. v. Gen. Elec. Co., 636 F. Supp. 2d 940, 943 (D. Neb. 2009).
108. *In re* Heartland Payment Sys., Inc. Customer Data Sec. Breach Litig., 834 F. Supp. 2d 566, 580 (S.D. Tex. 2011).

- back charges for which a subcontractor became liable under a separate agreement with the prime contractor as a result of the default of a supplier in providing defective parts were direct damages, not consequential damages, under the supply agreement, even though they arose out of the separate subcontract between the prime contractor and the subcontractor;[109] and
- additional interest costs incurred by an owner due to the contractor's delay in completion of a project, together with lost interest revenues that could have been earned on the owner's capital invested in the project if a permanent loan would have closed upon timely completion of the project, were direct damages, but increased costs of permanent financing due to increased interest rates at the time of the actual closing of the permanent loan were consequential damages.[110]

The only conclusion that can be drawn from all of these cases from the various common law jurisdictions is that "[d]amages that might be considered 'consequential' in one contract might be direct damages in another."[111] Note, moreover, that none of these cases address the specific context of a purchase of a business.

B. Lost Profits that Are and Are Not Consequential Damages

Damages based on the "loss of profits are often thought of as consequential losses."[112] While some cases do tend to generally classify all lost profits as consequential damages,[113] "[i]f the language of the contract indicates that the parties contemplated lost profits as the probable result of the breach, then those lost profits are more properly seen as part of the contract itself, and thus a form of direct damages."[114] Stated differently, lost profits are considered general or direct damages when a review of the contract indicates that "the non-breaching party bargained for such profits and they are 'the direct and immediate fruits of the contract,'" whereas lost profits are considered consequential damages when they are the result of a "collateral business arrangement."[115] But deriving profits from a collateral business arrangement may well be the primary purpose of the contract between the parties and, therefore, the loss of profits from that collateral business arrangement could be "the direct and immediate fruits of the contract."

109. Banker Steel Co. v. Hercules Bolt Co., No. 6:10CV00005, 2011 WL 1752224, at *8 (W.D. Va. May 6, 2011).

110. Roanoke Hosp. Ass'n v. Doyle & Russell, Inc., 214 S.E.2d 155, 161–62 (Va. 1975).

111. DaimlerChrysler Motors Co. v. Manuel, 362 S.W.3d 160, 180 (Tex. App. 2012); *see also* Polkinghorne, *supra* note 12, at 5 ("The first problem with the term 'indirect and consequential loss' is a fundamental one: no one agrees on what it means. Not even between common law jurisdictions, not even within common law jurisdictions.").

112. Regus (UK) Ltd v. Epcot Solutions Ltd, [2008] EWCA Civ. 361, at [28] (Eng.), *as cited in* Carter, *supra* note 12, at 129 n.51.

113. West & Duran, *supra* note 2, at 793 n.77.

114. *DaimlerChrysler*, 362 S.W.3d at 180.

115. Biotronik A.G. v. Conor Medsystems Ireland, Ltd., 22 N.Y.3d 799, 806 (2014).

The 2014 New York case of *Biotronik A.G. v. Conor Medsystems Ireland Ltd.*[116] is illustrative of this distinction. In *Biotronik*, the defendant, a manufacturer of a specialized medical device, entered into an exclusive distributorship agreement with the plaintiff. Under the terms of the distributorship agreement, the plaintiff was required to pay the defendant a transfer price for the resales of the device that was based upon the actual net sales price received by the plaintiff, meaning that the very essence of the deal was for the plaintiff to realize the spread between the transfer price and the sales price to third parties as its profit. When, in breach of this distributorship agreement, the defendant ceased manufacturing the device and recalled the entire product (to favor another product of its new owner), the plaintiff sued for lost profits. The distributorship agreement had an excluded losses provision that precluded "any indirect, special, consequential, incidental or punitive damages."[117] It did not, however, specifically exclude lost profits. Hence, the issue was whether the lost profits caused by the breach of the distribution agreement that clearly arose from independent resale agreements between the non-breaching party and third-party purchasers were consequential damages or general damages that were the natural result of the breach of the distribution agreement.

Concluding that there was no bright-line rule that declares that "lost profits can never be general damages simply because they involve a third party transaction," the *Biotronik* court found that the lost profits in this case were, in fact, general or direct damages because "the very essence of the contract" was that the non-breaching party would resell the breaching party's device and the pricing formula payable to the breaching party by the non-breaching party contemplated such resales.[118] Accordingly, the court concluded that "the agreement reflects an arrangement significantly different from a situation where the buyer's resale to a third party is independent of the underlying agreement."[119] The fact, however, that there was a significant dissent in this case is further evidence of the danger of using terms like "consequential damages" in an excluded losses provision because there is no certainty as to how a particular court will interpret this term in the context of a specific agreement.

C. The Term "Consequential Damages" Remains Mutable

Not much has changed since 2008 in terms of the mutability of the term "consequential damages"—it can mean different things in different agreements, depending on the specific context of the agreement in which it is used. Whether the courts construing the term are in the United States or in any of the other commonwealth nations that inherited their common law from England, there is simply no clearly established, immutable meaning for the term "consequential damages." The truth is that "[d]espite the vast number of cases purporting to de-

116. *Id.* at 799.
117. *Id.* at 803.
118. *Id.* at 808.
119. *Id.* at 810.

fine 'consequential damages' by repeating the same time honored but general definitions and distinctions between consequential and direct damages, the meaning remains elusive."[120] The losses excluded by the inclusion of the term "consequential damages" in an excluded losses provision are simply not easily known or categorized by the seller or the buyer in a private company acquisition agreement. As a result, many practitioners learn about whether a particular loss is consequential or general in much the same manner "as road bugs learn about Mack trucks"[121] (i.e., after it is too late to do anything about it).

V. Updating the Definition of Other Common Damages Limitation Terms

"Consequential damages" may be the most common term used in an excluded losses provision, but it is far from the most problematic. The 2008 *The Business Lawyer* article briefly dealt with many of the other terms commonly employed in excluded losses provisions, and in most cases this author did not feel a need to re-thresh all of that old straw.[122] Nevertheless, the following terms merit a new review in light of some new cases reconfirming or slightly altering the view originally expressed in the article.

A. "Direct Damages"

The cases tend to treat the term "direct damages" as synonymous with the term "general damages."[123] Furthermore, the term "direct damages" is sometimes used as an attempted means of limiting indemnifiable losses so that consequential damages are effectively excluded. In other words, some transactional lawyers like to avoid the fight over consequential damages waivers by limiting indemnifiable losses only to claims for direct damages. But are direct damages in this context the same as in the common law distinction between the first and second prong of *Hadley's* damages limitation regime? Are direct damages the same as general damages, which are limited to those damages that constitute the normal, natural, and usual result of a breach, and therefore necessarily exclude any damages that arise from the non-breaching party's special circumstances, even if they have been communicated to the breaching party at the time of contracting? Or are direct damages in this context simply an indication of causal connection (i.e., direct means the absence of any intervening causes other than the breach itself)? If the former meaning is intended, then consequential damages have, in fact, been excluded, but if the latter meaning is intended, then consequential

120. DaimlerChrysler Motors Co. v. Manuel, 362 S.W.3d 160, 181 n.20 (Tex. App. 2012).

121. Anderson, *supra* note 53, at 353.

122. For example, the 2008 *The Business Lawyer* article contains a current and useful definition of "incidental damages," not requiring any update. *See* West & Duran, *supra* note 2, at 789. This author also continues to recommend the examples of how all of the various damages types work in both the *Infectious Infertility Syndrome* and the *Widget Manufacturing Plant* hypotheticals. *Id.* at 795–804.

123. *See, e.g.*, *In re* CCT Commc'ns, Inc., 464 B.R. 97, 116 (Bankr. S.D.N.Y. 2011) ("General Damages are synonymous with 'direct' damages."); *see also* West & Duran, *supra* note 2, at 789.

damages would still be included in direct damages because most consequential damages are, in fact, the direct result of the breach. What makes them consequential, according to most courts, is not that they are indirect but that they are not the normal result of a breach in the usual situation absent the special circumstance of this specific non-breaching party. A good example of where the use of the term "direct damages" may have effectively re-included otherwise excluded consequential damages is the following provision borrowed from the stock purchase agreement governing Catalent Pharma Solutions, Inc.'s acquisition of the stock of Aptuit Holdings, Inc.:

> Notwithstanding any provision herein, neither Seller nor Purchaser shall in any event be liable to the other party or its Affiliates, officers, directors, employees, agents or representatives on account of any indemnity obligation set forth in Section 10.01 or Section 10.02 for any indirect, consequential, special, incidental or punitive damages (including lost profits, loss of use, damage to goodwill or loss of business); *provided, in each case, that such limitation shall not limit recovery (x) for any direct damages*, (y) for diminution in the value of any asset of the Business, as of immediately prior to Closing (before giving effect to the Acquisition but after giving effect to the Restructuring), to the extent relating to, arising out of or resulting from the item giving rise to the applicable indemnity obligation or (z) to the extent arising from payments made to a claimant in a Third Party Claim.[124]

If the term "direct damages" in this provision is simply a causal distinction rather than a reference to the first prong of the *Hadley* damages limitation regime, the waiver of consequential damages has effectively been neutered by allowing the recovery of consequential damages that are the direct result of the breach giving rise to the indemnity obligation. Given that many lawyers believe consequential damages are synonymous with indirect damages rather than with special damages, then perhaps the intention is only to exclude indirect damages, not consequential (i.e., special) damages that directly result from the breach.[125]

124. Stock Purchase Agreement, dated August 19, 2011, between Aptuit, LLC, and Catalent Pharma Solutions, Inc., PRAC. L. CO. § 10.04, at 65–66 (Aug. 19, 2011), http://us.practicallaw.com/9-508-9021.

125. An interesting formulation using "direct" in a clearly causal connection is the following provision borrowed from the 2013 Asset Purchase Agreement, between GILA River LLC and Tucson Electric Power Company and UNS Electric, Inc.:

> . . . no party shall be liable to any other party or any of its contractors, subcontractors, agents or affiliates, for any damages, whether in contract, tort (including negligence), warranty, strict liability or any other legal theory, arising from this agreement or any of the actions or transactions provided for herein, other than damages that are the natural and probable consequence of any breach and flow directly from such breach. Purported damages not flowing directly from the breach, including but not limited to punitive damages, exemplary damages and damages that are speculative, indirect, unforeseen or improbable, are not recoverable (it being understood that lost profits that are the natural and probable consequence of any breach and that flow directly from such breach are not waived hereby). Each party hereby releases the other parties and their contractors, subcontractors, agents and affiliates from any such damages (except to the extent paid to a third party in a Third Party Claim).

Asset Purchase Agreement, dated December 23, 2013, between GILA River LLC and Tucson Electric Power Company and UNS Electric, Inc., PRAC. L. CO. § 12.14, at 79 (Dec. 23, 2013), http://us.practicallaw.com/8-554-3272 (provision was in all caps in original).

B. "Diminution in Value"

"Diminution in value," as a measure of damages arising from a breach of a representation and warranty in a private company acquisition agreement, is best understood as damages based on the difference between the value of the business if the representations and warranties had been accurate, and the value of the business as a result of one or more representations and warranties proving to have been inaccurate.[126] This is similar to the standard measure of damages in a securities fraud case (i.e., "the difference between the price of the stock and its actual value if the truth were known").[127] It is also used as the basic measure of out-of-pocket damages in a Delaware breach of fiduciary duty case.[128] But harking back to the discussion of basic contract damages rules,[129] all damages recoveries are subject to the rule that they should not do more than provide the benefit of the promised performance. In other words, "[a] remedy for a breach should seek [only] to give the non-breaching party the benefit of its bargain by putting that party in the position it would have been but for the breach."[130] Thus, if the breach of contract (i.e., the inaccurate representation and warranty) is capable of being remedied by expending sums to correct the breach, and such expenditure is less than the diminution in value as a result of the breach, then diminution in value damages are generally not available. Indeed, it is only when the amount required to remedy defective performance (or to correct the harm resulting from a representation and warranty having been inaccurate when made) is "(i) 'disproportionate to the probable loss in value,' (ii) constitute[s] 'economic waste,' or (iii) bestow[s] a windfall on the plaintiff,"[131] that diminution in value damages is considered an appropriate substitute for an award of damages based on the promised performance.[132] Would a waiver of diminution in value damages cause a court to award damages to remedy an inaccurate representation and warranty that were disproportionate to the loss of value because the waiver rendered the option of awarding a lesser sum equal to the diminution in value unavailable? Indeed, in some cases a seller may well be better off limiting damages to only diminution in value.

126. *See* cases cited at *supra* notes 36–39.

127. Polmer v. Medtest Corp., 961 F.2d 620, 628 (7th Cir. 1992); *see also* Laurence M. Smith, *Diminution in Value Indemnification: Is It Worth the Fight?*, J. Priv. Equity, Spring 2011, at 100, *available at* http://goo.gl/oYxZmx.

128. Strassburger v. Earley, 752 A.2d 557, 579 (Del. Ch. 2000) ("where a merger is found to have been effected at an unfairly low price, the shareholders are normally entitled to out-of-pocket (i.e., compensatory) money damages equal to the 'fair' or 'intrinsic' value of their stock at the time of the merger, less the price per share that they actually received").

129. *See supra* Part III.

130. Preferred Inv. Servs., Inc. v. T.H. Bail Bonds, Inc., C.A. No. 5886-VCP, 2013 WL 3934992, at *24 (Del. Ch. July 24, 2013); *aff'd*, Preferred Inv. Servs., Inc. v. T.H. Bail Bonds, Inc., 108 A.3d 1225 (Del 2015).

131. Universal Entm't Grp., L.P. v. Duncan Petroleum Corp., No. CV 4948-VCL, 2013 WL 3353743, at *20 (Del. Ch. July 1, 2013).

132. *Id.* at *20–21.

C. "Multiples of Earnings"

"Multiples of earnings" are a basic means of valuing a business.[133] Buyers price a business based on its ability to generate cash flow and make profits from that cash flow. And many of the representations and warranties carefully bargained for in a private company acquisition agreement are specifically designed to ensure that the earnings against which the agreed multiple has been applied in determining the price are and will continue to be available to the business post-closing. If the price paid was based on the previous twelve months' earnings (or go-forward projections), and the buyer specifically bargains for a representation that the seller has not received notice that any material supplier or customer will terminate the current supply agreement or reduce its current level of purchases, and that representation proves inaccurate, then the buyer's damages are not simply the amount of cash flow or margin loss from that customer or supplier that cannot be replaced but the multiple on that cash flow or margin loss that was used as the basis for pricing the company. Indeed, to the extent that the lost earnings are not replaceable or are only replaceable with cash flow that generates lower margins, then that multiple is the basis for determining the diminution in value. Thus, diminution in value and multiples of earnings go hand in hand.[134]

D. "Lost Profits"

As previously discussed in the context of consequential damages and multiples of earnings damages, profits that were presumed to be part of the go-forward business are "the direct and immediate fruits" of a private company acquisition agreement and should be available as a means of determining the appropriate damages award where a breached representation and warranty results in actual loss of those profits. Profits lost from new arrangements made by the buyer that could not have reasonably been anticipated by the seller when the representations and warranties were made, or which were clearly extraneous to the purchased business itself, should be deemed unrecoverable remote damages under the general contract damages regime, even in the absence of an express waiver. But that distinction is simply the basis for determining whether lost profits are part of a waiver of consequential or special damages. When the excluded losses provision expressly excludes lost profits as a separate category of excluded damages and not simply as an

133. *See* Damodaran, *supra* note 21, at 6.

134. *See* Smith, *supra* note 127, at 101; *see also* The Hut Group Ltd v. Oliver Nobahar-Cookson, [2014] EWHC 3482, at paras. 159–74 (QB) (Eng.) (discussing a multiple of EBITDA as the proper means of determining damages based on a breach of warranty regarding a purchased company's financial statements); Augean plc v. Hutton, [2014] EWHC 2972, at para. 70 (Comm.) (Eng.) ("I accept Augean's evidence that the Company was valued using a multiple of eight times projected EBITDA for the year ended 31 May 2009. I also accept on the evidence in this particular case that that approach to valuation is an appropriate one, subject always to due allowance where (in particular) any impact on projected EBITDA is likely to be short-term. With that qualification, in the present case the core question is by what amount (if any) was EBITDA over-projected if one takes into account the true costs of compliant operation overall.").

example of otherwise excluded consequential damages, it is much more difficult to determine exactly what effect the exclusion has on the normal measures of direct damages.[135]

Some have argued that an independent waiver of lost profits also constitutes a waiver of diminution in value or market-measured damages for breach of a representation and warranty because the determination of market value depends on a determination of profitability.[136] In *The Business Lawyer* article from 2008, it was suggested that such a result was a real possibility.[137] The better-reasoned view, however, is that the mere exclusion of lost profits in an excluded losses provision does not mean that diminution in value damages have been indirectly excluded. An independent waiver of lost profits is more rationally viewed as a waiver of anticipated profits that could be earned in the future based on the buyer's efforts to consolidate or change the purchased business in some manner different than the manner in which the business is currently operated,[138] rather than a waiver of the basic profitability equation that was used to price the business in connection with the sale.[139] Indeed, the few courts that have considered

135. For a discussion of the language nuances in an excluded losses provision that can make lost profits a subcategory of consequential damages or an independent category that will be excluded regardless of whether lost profits are otherwise determined to be consequential or general damages, see Odry, *supra* note 12, at 148–50, 152–54; Polkinghorne, *supra* note 12, at 5; Edward P. Smith & Patrick J. Narvaez, *Lost Profit Waivers: Beware of Unintended Consequences*, Chadbourne & Parke LLP (Apr. 28, 2014), http://goo.gl/kRICT4; West & Duran, *supra* note 2, at 793 n.77; *see also* ATP Oil & Gas Corp. v. Bluewater Indus., L.P., No. 12-36187, 2014 WL 4676592, at *5 (Bankr. S.D. Tex. Sept. 18, 2014) (because the agreement specifically defined "consequential damages" as including "lost revenues" in the excluded losses clause, all lost revenues were excluded as a matter of law regardless of their actual characterization); Fujitsu Services Limited v. IBM United Kingdom Limited, [2014] EWHC 752, at paras. 76–82 (TCC) (Eng.) (clearly excluding lost profits as an independent exclusion means exactly that—all lost profits are excluded whether direct or consequential); *but see* Westlake Fin. Grp., Inc. v. CDH-Delanor Health Sys., 25 N.E.3d 1166, 1175–78 (Ill. App. Ct. 2015) (an excluded losses provision that precluded claims for consequential or special damages "such as, but not limited to, loss of revenue or anticipated profits or lost business" only excluded the listed examples to the extent they did in fact first constitute consequential or special damages); Polypearl Ltd v. E. on Energy Solutions Ltd, [2014] EWHC 3045, at para. 68 (QB) (Eng.) (construction of an excluded losses provision that would require the court to "deem" all lost profits as indirect or consequential loss even if such lost profits would have otherwise constituted direct loss was to be rejected as contrary to "business common sense").

136. *See, e.g.*, Memorandum of Law in Opposition to Stanley Black & Decker, Inc.'s Motion for Partial Summary Judgment at 21, Powers v. Stanley Black & Decker, Inc., No. 14 Civ. 02052 (PAE) (SN), 2014 WL 5525341 (S.D.N.Y. Oct. 15, 2014) ("Permitting [the buyer] to utilize a 'lost profits' calculation to estimate diminution in value would render the bar on lost profits meaningless by awarding 'lost profits' in substance if not in name." (citing West & Duran, *supra* note 2, at 793)); *see also* Leach Farms, Inc. v. Ryder Integrated Logistics, Inc., No. 14-C-0001, 2014 WL 4267455, at *3–4 (E.D. Wis. Aug. 28, 2014) (describing the breaching parties' efforts to argue for an exclusion of lost profits from the calculation of market value); *see also* Hill, *supra* note 12, at 28–29.

137. *See* West & Duran, *supra* note 2, at 793.

138. *See* Tettenborn, *supra* note 53, at 59 ("[I]n many remoteness cases the real objection to the plaintiff's claim is that he is in effect seeking to burden the defendant with costs arising out of the way he himself chooses to run his affairs. In such cases it is highly arguable that we should regard losses of this sort as not really caused by the defendant's breach at all.").

139. And some transactional lawyers have adopted this approach by specifically including lost profits in indemnifiable losses but limiting those lost profits to only those lost profits that "are the reasonably foreseeable consequences of the relevant misrepresentation or breach, and are proximately caused by such misrepresentation or breach, and in any event measured relative to the businesses of

this distinction since 2008 appear to agree that an independent exclusion of lost profits does not constitute an indirect waiver of the normal market-measured damages methodology in connection with a breach of a representation and warranty.[140] That is still no reason, however, to blindly permit the waiver of all lost profits in the excluded losses provision of a private company acquisition agreement.

VI. Overlaying the Concept of Indemnification for Losses on the Contract Damages Regime

Thus far we have been discussing damages awards for breach of contract, not indemnification for losses arising from a breach of contract. Is there a difference? The answer was far from clear in 2008 when the original *The Business Lawyer* article was published, and it remains unclear today. But it bears repeating that there is, in fact, a very clear distinction (whether or not there is an ultimate difference) between a claim for indemnification and a claim for damages for breach of a representation and warranty in an acquisition agreement.

A claim for damages arising from a breach of a contractual representation and warranty is limited by the default rules of reasonableness and foreseeability that were developed to cover the fact that the contracting parties typically fail to specifically delineate the amount that a breaching party would pay in the event of such a breach. On the other hand, a claim for indemnification is based on a separate contractual undertaking by a party to specifically make good all defined losses that arise as a result of a specified triggering event: either a third-party claim or a breach of the contract itself without an attendant third-party claim.[141] While there are cases that suggest that a claim for indemnification for breach of contract should be subject to the same default contract rules as a claim for damages arising from a breach of contract,[142] an indemnification for "all losses," with the typically expansive litany of costs, expenses, and liabilities that can be the subject of such indemnification, could certainly give rise to the argument that the indemnification provision specifically overrides the common law's limits on damages otherwise available for breach of contract.[143] In-

the Company, the Company Subsidiaries and the Unconsolidated Joint Ventures as they exist as of the Closing Date." Agreement & Plan of Merger, dated June 13, 2014, among Symbion Holdings Corporation, Surgery Center Holdings, LLC, SCH Acquisition Corp., and Crestview Symbion Holdings, LLC, Prac. L. Co. § 9.02(a), at 79 (June 13, 2014), http://us.practicallaw.com/5-573-2085.

140. *See* TCO Metals, LLC v. Dempsey Pipe & Supply, Inc., 592 F.3d 329, 340 (2d Cir. 2010) ("There is a difference between the loss of the inherent economic value of the contractual performance as warranted, . . . and the loss of profits that the buyer anticipated garnering from the transactions that were to follow the contractual performance."); Glencore Energy UK Ltd v. Cirrus Oil Services Ltd, [2014] 2 Lloyd's Rep. 1, [2014] 1 All ER (Comm.) 513, [2014] EWHC 87, at para. 98 (Comm.) (Eng.) ("The contract price/market price differential is not a computation of lost profit.").

141. West & Duran, *supra* note 2, at 786–88; *see also* Denise Agnew, *Warranties and Indemnitees: What's the Difference?*, In-House Law. (Feb. 5, 2010), http://goo.gl/NLqzrM.

142. West & Duran, *supra* note 2, at 787.

143. *Id.*; *see also* J.W. Carter & W. Courtney, *Indemnities Against Breach of Contract as Agreed Damages Clauses*, 7 J. Bus. L. 555, 573 (2012) (Austl.) ("The adoption of an 'indemnity' may indicate . . . that the promisee is to be protected against all losses flowing from breach, including loss that is unpredictable or improbable."). And it is important to note that an indemnification for a known spec-

deed, in England and Australia, practitioners appear to assume that an indemnity eliminates the *Hadley* remoteness limits and the duty to mitigate.[144] Although some practitioners in the United States appear to assume that the contract damages limitation regime applies equally to claims for breach of contract and indemnification,[145] it has been noted that:

> Courts have not definitively determined whether *Hadley's* foreseeability rule would apply to an indemnity claim based on breach of the agreement. Therefore, if appropriate, parties should include reasonably foreseeable language in the indemnity provision to ensure that the common law rule of reasonableness applies.[146]

This author believes that much of this confusion is caused by the use of the term "indemnification" itself. In the specific context of a U.S.-style private company acquisition agreement, "[t]he term 'indemnification' is used . . . as a contractual term of art to describe [a] contractual remedy . . . for breaches of representations and warranties."[147] It is not the same as "the common law right known as 'indemnity,'"

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ified matter that is not dependent upon there having been a breach of contract is more akin to an indemnification for third-party claims (i.e., not subject to the contract damages limitation regime) than is an indemnification for direct claims (which arguably is).

144. *See, e.g.*, David Gerber & Craig Hine, *Contractual Indemnities—Drafting Effective Clauses*, CLAYTON UTZ (May 1, 2013), http://goo.gl/Ni8flV; BRUCE HANTON, WARRANTIES AND INDEMNITIES (Mar. 2010), *available at* https://www.ashurst.com/doc.aspx?id_Resource=4639; Andrew Kelly, *Recent Developments in Indemnities*, THOMSONS LAW. (June 3, 2011), http://goo.gl/LC2hC4. In England, however, there is at least one reported decision that distinguishes indemnities for direct claims under a contract from indemnities for third-party claims, suggesting that the former remain subject to the general contractual limitation on damages rules:

> It would be odd in such circumstances if [a party] were legally liable to indemnify a loss which was not recoverable for breach of contract, and vice versa. . . . [U]nder a clause where the indemnity is triggered by a breach of contract, the indemnity is subject to the same rules of remoteness as are damages, including the rules under Hadley v. Baxendale.
>
> Thus "all consequences" would mean "all consequences within the reasonable contemplation of the parties." If the law is prepared to select some consequences as relevant and others not, and in contract to do so in accordance with the reasonable contemplation of the parties, then absent clear language to the contrary I do not see why the parties should not be viewed as intending to cover only consequences which are reasonably foreseeable and not consequences which are wholly unforeseeable. . . .
>
> [W]here the indemnity is triggered by a breach of contract, the indemnity as a matter of construction, absent contrary provision of which "all consequences" is not to my mind an example, only covers foreseeable consequences caused by that trigger.

Total Transport Corporation v. Arcadia Petroleum Ltd (The Eurus), [1996] 2 Lloyd's Rep. 408, 432 (QBD Comm.), *aff'd*, [1998] 1 Lloyd's Rep. 351 (CA Civ), *discussed in* West & Duran, *supra* note 2, at 787; *see also* HANTON, *supra* note 144. For a thorough examination of the issue, see Carter & Courtney, *supra* note 143.

145. *See* David Shine, *Mitigation of Indemnified Losses: An Obligation Undefined*, M&A LAW., Mar. 2011.

146. Practice Note, *Indemnification Clauses in Commercial Contracts*, PRAC. L. CO., http://us.practicallaw.com/5-517-4808 (last visited June 16, 2015); *see also* West & Duran, *supra* note 2, at 785–88. And it could be that some practitioners in the United States are intentionally using indemnification provisions containing language such as "all losses, directly or indirectly, arising from, in connection with or in any way relating to" in an effort to deliberately avoid the *Hadley* damages limitation regime.

147. CertainTeed Corp. v. Celotex Corp., C.A. No. 471, 2005 WL 217032, at *3 (Del. Ch. Jan. 24, 2005); *see also* Chris Babcock & Robert B. Little, *When the Contractual Rubber Meets the Statutory Road:*

which requires the existence of a third-party claim.[148] As a result, this author subscribes to the view, which finds support in one English case,[149] that indemnification for breach of the contractual representations and warranties set forth in a private company acquisition agreement remains subject to the same common law damages limitation regime as the underlying breach of contract claim itself, unless such a breach results in an actual third-party claim.[150] But this is only a view, and drafting to avoid uncertain outcomes should always be the transactional lawyer's goal.

Because an indemnification provision typically provides an indemnity not only for direct claims arising from losses to the buyer as a result of one or more of the representations and warranties proving inaccurate, but also from third-party claims that are asserted against the buyer and arise as a result of one or more of the representations and warranties having been untrue, it is likely that this is the reason that the scope of indemnifiable losses became so expansive in the first instance. To cover every possible liability for which a buyer could become subject as a result of a third-party claim, the definition of "losses" outstripped the contract damages limitation regime's rule of reasonableness with respect to direct claims. Instead of addressing this issue head-on by bifurcating losses subject to indemnification for direct claims (which is really not indemnification at all but a contractual mechanism to pay damages for losses caused by a breach of contract) from losses subject to indemnification for third-party claims, draftspersons created the excluded losses provision, which typically only excludes the laundry list of damages from indemnification for direct claims, not third-party claims, anyway. If the original idea behind the excluded losses provision was to limit indemnifiable losses for direct claims to something closer to the contract-based damages regime that would have been available in the absence of an indemnification provision that is stated to be the sole remedy for a breach of the bargained-for representations and warranties in a private com-

Drafting Contractual Survival Provisions in Light of State Statutes of Limitations, Gibson Dunn (Mar. 20, 2014), http://goo.gl/UPn6eq.

148. *CertainTeed Corp.*, 2005 WL 217032, at *3.

149. *Total Transport Corporation*, [1996] 2 Lloyd's Rep. at 432; *but see* Patrick & Co Ltd v. Russo-British Grain Export Co Ltd, [1927] 2 K.B. 535, 539 ("Where a contract contains a term that the promisor, if he shall not perform some term of the contract, shall pay a sum ascertained by the contract or ascertainable under its terms, and the promisee claims payment accordingly, the promisor is not called on to make compensation for breaking the contract, he is called on to perform it."), *discussed in* West & Duran, *supra* note 2, at 787–88.

150. This author believes that an indemnification provision in the typical private company acquisition agreement (to the extent that it is triggered by a direct claim by the buyer against the seller, without a third party claim having been made) is not, in fact, an independent primary obligation at all; instead, it is simply a procedural mechanism that governs the secondary obligation to pay damages as a result of the breach of the primary obligation regarding the accuracy of the contractual representations and warranties. *See CertainTeed*, 2005 WL 217032, at *3. The distinction between primary and secondary obligations under common law contract doctrine was borrowed from Lord Diplock. *See* Photo Production Ltd v. Securicor Transport Ltd, [1980] A.C. 827, 848–50 (HL) (Eng.). But it is important to note that the language of an indemnity provision can be drafted in such a manner as to make clear that it is intended to be an independent primary obligation rather than a remedy for the primary obligation. *See, e.g.*, Lehman Brothers Holdings Inc. v. Hometrust Mortg. Co., No. 08-13555 (scc), 2015 WL 2194628, at *14 (Bankr. S.D.N.Y. May 7, 2015).

pany acquisition agreement, this is a goal with which this author wholeheartedly agrees. But trying to accomplish that goal with a laundry list of excluded losses has potentially made the cure worse than the disease. There has to be a better way.[151]

VII. Rejecting Market in Favor of a Rational Approach to Excluded Losses in the Actual Context of the Purchase of a Business

An excluded losses provision that contains a laundry list of problematic terms, which has the potential of depriving the buyer of the benefit of the bargain or providing the seller a false sense of security, appears to continue to enjoy market dominance.[152] But there are signs of a change since 2008. While the majority of agreements continue to contain some form of the broad excluded losses provision previously noted,[153] a significant percentage of agreements contain no excluded losses provision at all,[154] and many that do contain an excluded losses provision evidence a real effort to address the laundry list of excluded losses with an approach that seeks to ensure that indemnification for direct claims is limited so that indemnifiable losses would be consistent with the common law damages limitation rules that would otherwise apply for breach of contract in the absence of indemnification. The most common formulation is as follows:

> Notwithstanding anything to the contrary in this agreement, neither the Buyer nor any Seller nor their respective Affiliates shall be liable hereunder to any Indemnified Party for any (i) punitive or exemplary damages or (ii) lost profits or consequential, special or indirect damages *except, in the case of this clause (ii), to the extent such lost profits or damages are (x) not based on any special circumstances of the party entitled to indemnification and (y) the natural, probable and reasonably foreseeable result of the event that gave rise thereto or the matter for which indemnification is sought hereunder, regardless of the form of action through which such damages are sought,* except in each case of the foregoing clauses (i) and (ii), to the extent any such lost profits or damages are included in any action by a third party against such Indemnified Party for which it is entitled to indemnification under this agreement.[155]

151. In an English style private company acquisition agreement, in contrast to a U.S. style acquisition agreement, the seller would typically resist granting any indemnities with respect to warranty claims, and only grant indemnification for specific identified risks that could give rise to third-party claims. *See* Practice Note, *Warranties and Indemnities: Acquisition*, Prac. L. Co., http://UK.practicallaw.com/2-107-3754 (last visited June 16, 2015) ("In the United States, it is also customary practice for a buyer to require the seller to give warranties on 'an indemnity basis.' This is usually resisted in M&A deals in the UK where the seller is likely to give indemnities in respect of specific identified risks only (in addition to tax and sometimes environment).").

152. Determining current market practice, however, means reviewing only those private company acquisition agreements that are publicly available, and that is not really a full survey of the market. *See* Lisa J. Hedrick, *Finding the Market in Private-Company M&A*, Law360 (Mar. 3, 2014, 2:38 PM), http://www.law360.com/mergersacquisitions/articles/513619.

153. *See supra* note 14.

154. Avery & Lin, *supra* note 10, at 3.

155. Purchase Agreement, by and among GIP II Eagle Holdings Partnership, L.P., GIP II Hawk Holdings Partnership, L.P., GIP Eagle 2 Holding, L.P., and GIP II Hawk 2 Holding, L.P., as Sellers,

Note that this provision avoids the use of "diminution in value," "multiples of earnings," or any similar terms that could potentially affect the basic market measure of damages for direct claims. Note further that recovery of lost profits or consequential, special, or indirect damages for direct claims are limited to those damages that are the natural, probable, and reasonably foreseeable result of the breach but are unlimited to the extent that they arise from third-party claims. This author is certainly not endorsing this language as a cure-all for the problems addressed by this article, but it is an appropriate starting place for real negotiations about understood concepts—losses incurred in connection with claims made by third parties should not be subject to any exclusions, but losses incurred in connection with direct claims should not permit recoveries by virtue of the fact of indemnification that would not be permitted for breach of contract in the absence of indemnification.[156]

Of course, this provision also appears to exclude damages based on special circumstances giving rise to those losses, even if those losses were otherwise the natural, probable, and reasonably foreseeable result of the breach. Consequential damages require the existence of special circumstances, to be sure, but if the special circumstances are not communicated, then the damages are not consequential but remote.[157] A waiver of any damages that depend on special circumstances means that only losses that come within the first prong of the *Hadley* rule would be recoverable, even though the losses that depend on special circumstances may have otherwise been foreseeable under the enhanced foreseeability standard required under the second prong of the *Hadley* rule. This may or may not be appropriate or what was intended (depending on the deal dynamics and facts).

An example of a provision that avoids this problem (even while employing all of the traditional offensive language from a broad excluded losses provision) is the following:

> [E]xcept with respect to those actually awarded and paid on account of a Third Party Claim, no Party shall be liable for (i) punitive or exemplary damages or (ii) inciden-

and The Williams Companies, Inc., as Buyer, PRAC. L. CO. § 8.04(e), at 28 (July 14, 2014), http://us.practicallaw.com/9-573-1927 (emphasis added).

156. Another approach, which appears to follow a suggestion made in the 2008 *The Business Lawyer* article, is to define losses excluded from the covered losses for the purposes of indemnification for direct claims in such a way that the only excluded losses are those losses that would not be recoverable under the contract damages regime in any event:

> . . . for all purposes of this Agreement, Covered Losses excludes any punitive, exemplary or Consequential Damages (as defined below) except to the extent they (i) are Retained Liabilities, (ii) were incurred as a result of any Third Party Claim, [or] (iii) were probable or reasonably foreseeable and are a direct result of the related or alleged breach. . . . As used herein, "Consequential Damages" are damages that are remote, speculative, indirect or arise solely from the special circumstances of Purchaser that have not been communicated to Seller.

Asset Purchase Agreement, dated May 26, 2014, by and among Motherson Sumi Systems Limited, MSSL (GB) Limited and Stoneridge, Inc., PRAC. L. CO. § 1.01 ("Covered Loss"), at 6 (May 26, 2014), http://us.practicallaw.com/5-583-9265 (emphasis added); *see also* West & Duran, *supra* note 2, at 805–06.

157. *See supra* notes 81–88 and accompanying text.

> tal, consequential, special or indirect damages, lost profits or lost business, loss of enterprise value, diminution in value of any business, damage to reputation or loss to goodwill, whether based on contract, tort, strict liability, other Law or otherwise and whether or not arising from any other Party's sole, joint or concurrent negligence, strict liability or other fault except, in the case of clause (ii), to the extent such Damages are reasonably foreseeable in connection with the event that gave rise thereto or the matter for which indemnification is sought hereunder.[158]

And the following definition of "Excluded Losses" is offered, not as a one-size-fits-all form but as a potential starting place for the development of a private company, context-specific provision that recognizes some of the concerns that created the proliferation of the broad laundry-list approach to excluded losses provisions, without throwing the baby out with the bathwater:

> "Excluded Damages" means (i) punitive or exemplary damages, (ii) any loss of profits arising out of or resulting from an anticipated, expected, projected or actual increase in profits after the Closing as compared to the Company's historical profits prior to the Closing, and (iii) Losses that are not, as of the date of this Agreement, the probable and reasonably foreseeable result of (A) an inaccuracy or breach by the Company or a Seller of any of its or their representations or warranties under this Agreement or (B) the other matters giving rise to a claim for indemnification, except in each case to the extent any such Losses or damages are required to be paid to a third party pursuant to a Third-Party Claim.

An even better approach, which is found in an increasing number of agreements, is to reject the traditional excluded losses provision in favor of a provision that recognizes the distinction between direct claims and third-party claims for indemnification, and treats a direct claim as subject to well-established rules governing recoverable damages for breach of contract so that indemnification for direct claims is limited to only those losses "that are otherwise recoverable in a claim for breach of contract under applicable law."[159] Doing so could potentially prevent an overly expansive indemnification provision from being declared void

158. Asset and Stock Purchase Agreement, dated as of May 15, 2014, by and between Darden Restaurants, Inc. and RL Acquisition, LLC, PRAC. L. CO. § 9.04(g), at 100 (May 15, 2014), http://us.practicallaw.com/3-570-4366. But again this provision uses the term "reasonably foreseeable" without the added limitation of "probable." *See* the discussion at *supra* note 24.

159. *See, e.g.*, Purchase Agreement, dated as of May 9, 2015, by and among On Assignment, Inc., MSCP V CC Parent, LLC, Lawrence Sert, as Founders' Representative and MSCP V CC Holdco, LLC, as Seller's Representative, PRAC. L. CO. § 8.4(c)(ii), at 58 (May 9, 2015), http://us.practicallaw.com/7-613-5706 ("[I]n no event shall an Indemnifying Party have liability to the Indemnified Party for any consequential, special, incidental, punitive or exemplary damages, *except if and to the extent any such damages would otherwise be recoverable under applicable Law in an action for breach of contract* or any such damages are recovered against an Indemnified Party pursuant to a Third Party Claim." (emphasis added)); Agreement and Plan of Merger, dated as of December 5, 2012, by and among Korn/Ferry International, Unity Sub, Inc., Personnel Decisions International Corporation, Its Stockholders and The Stockholder Representative, PRAC. L. CO. § 8.02(a), at 65 (Dec. 5, 2012), http://us.practicallaw.com/3-523-3385 (excluding in clause (ii) of the excluded losses provision "any indirect, special, remote or consequential damages, lost profits, diminution in value, damages to reputation or loss to goodwill *to the extent that any of the foregoing damages or other amounts described in this clause (ii) are not otherwise recoverable under principles of Delaware contract law applicable to a breach of the underlying contractual provisions*" (emphasis added)).

as a penalty because it seeks to set forth an agreed amount of damages for breach of contract that is not a reasonable estimate of the damages that would otherwise be recoverable at common law.[160]

VIII. Conclusion

Mitu Gulati and Robert Scott have recently devoted an entire book to examining the persistent use of a specific contractual provision notwithstanding the fact that the lawyers drafting that provision apparently cannot articulate what the provision is intended to accomplish.[161] Despite the conventional wisdom that highly skilled transactional lawyers will adapt and change market terms when they cease to make sense or they have been interpreted by courts in a manner inconsistent with their intended meaning,[162] Gulati and Scott suggest that the force of "what is market" can contribute to the continued use of outdated and ambiguous provisions just because they are considered market and irrespective of whether they are understood by the draftspersons.

Good transactional lawyers should "study past disputes in order to draft contractual provisions that will avoid similar disputes in the future."[163] But Gulati and Scott believe that there is little "evidence of transactional lawyers engaged in the dynamic process of regularly reading cases and incorporating that learning into novel innovations in subsequent contracts."[164] While this author does not believe that this is a fair criticism of all transactional lawyers, there does appear to be a basic fear among many transactional lawyers of making any changes to a

160. *See* Carter & Courtney, *supra* note 143, at 5–6; *see also supra* note 66. And it is worth noting that the most reliable means of addressing concerns over excessive exposure to indemnifiable losses is not an excluded losses provision but a cap on liability (with a generous deductible). *See generally* Sonya Smith & Lawrence Maxwell, *The Sky Is Not the Limit: Limitation of Liability Clauses May Be the Solution to Cap Your Contractual Liability*, Lorman (Jan. 8, 2014), http://goo.gl/eDkilS; Rob Sumroy, Miles McCarthy & Duncan Blaikie, *Limitation of Liability: Taking an Inclusive Approach*, Prac. L. Co. 3–4 (Feb. 24, 2010), http://us.practicallaw.com/5-501-3943.

161. Mitu Gulati & Robert E. Scott, The Three and a Half Minute Transaction: Boilerplate and the Limits of Contract Design (2013).

162. Clifford W. Smith & Jerald B. Warner, *On Financial Contracting*, 7 J. Fin. Econ. 117, 123 (1979) ("[Boilerplate contract terms] take their current form and have survived because they represent a contractual solution which is efficient from the standpoint of the firm. . . . Harmful heuristics, like harmful mutations, will die out."), *as quoted in* Gulati & Scott, *supra* note 161, at 4.

163. Gulati & Scott, *supra* note 161, at 4 (quoting Robert E. Scott & Jody Kraus, Contract Law and Theory vii (4th ed. 2007)); *see also* Glenn D. West & W. Benton Lewis, Jr., *Contractually Avoiding Extra-Contractual Liability—Can Your Contractual Deal Ever Really Be the "Entire" Deal?*, 64 Bus. Law. 999, 1004 (2009) ("Good business lawyers understand the effect of case law developments on contract making and enforcement and adjust their negotiating and drafting strategies accordingly to maximize the likelihood that courts will interpret the written agreements they negotiate in a manner that advances their clients' best interests.").

164. Gulati & Scott, *supra* note 161, at 4. Perhaps this merits some reconsideration of whether the criticism of the law school caselaw method for ill preparing law students for the actual practice of law should be redirected as a criticism of practicing lawyers who have too soon forgotten the benefits of that caselaw method they learned as law students in enhancing their practice. Indeed, it appears that there is a disturbing "tendency of many transactional lawyers to become document processors rather than contract draftspersons." *See* Glenn D. West, *That Pesky Little Thing Called Fraud: An Examination of Buyers' Insistence Upon (and Sellers' Too Ready Acceptance of) Undefined "Fraud Carve-Outs" in Acquisition Agreements*, 69 Bus. Law. 1049, 1069 n.112 (2014).

contractual provision that has become part of the marketplace, even where that provision's applicability or meaning in the context of a particular type of transaction cannot be explained.[165] Although Gulati and Scott were studying this phenomenon in the context of the *pari passu* clause of sovereign debt instruments, the excluded losses provision of most private company acquisition agreements could just as easily have been the subject of their study.[166] Is this "herd mentality"[167] really worthy of the sophisticated transactional bar? Shouldn't contractual provisions adapt to the changing circumstance of a particular deal and in response to court decisions interpreting those provisions?[168] Contract draftspersons' jobs are to protect their clients' best interests by "predicting" how a court will interpret the provisions that they draft and by shaping those provisions as best as possible so that they will be faithfully interpreted by a court consistent with that prediction.[169] To do that job effectively, contract drafting must be responsive to the reported decisions of the courts that could ultimately be required to interpret that contract.[170]

The continued use of a loss exclusion provision containing a laundry list of terms that have been inconsistently interpreted by the courts may be defensible on the basis that it has enjoyed market acceptance, but like the undefined fraud carve-out discussed in another recent *The Business Lawyer* article,[171] it is hoped that this market acceptance will be increasingly rejected in favor of more

165. GULATI & SCOTT, *supra* note 161, at 93. This fear can be traced to the belief that these provisions have become part of the marketplace because they were "the result of the experience and prophetic vision of a great many able lawyers" and, therefore, "who would say that any of [these] provisions . . . should be rejected simply because he cannot for the moment think when or how it will become useful." Paul D. Cravath, *Reorganizations of Corporations*, *in* 1 LECTURES DELIVERED BEFORE THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK 153, 178 (1917), *as quoted in* GULATI & SCOTT, *supra* note 161, at 10.

166. Commenting on the continued use in England of contractual provisions that exclude "consequential loss," and the caselaw that fails to define that term in a fashion that appears to achieve the actual commercial objectives of the parties contracting, Professor J.W. Carter noted that "it seems remarkable that English contracts continue to employ the terminology. If nothing else, this seems good evidence that commercial people (and many of their lawyers) do not read law reports!" Carter, *supra* note 12, at 133; *see also* Sumroy, McCarthy & Blaikie, *supra* note 160, at 2 (suggesting that lawyers that continue to use so-called "market-standard" forms that "focus on the negative (what is excluded) in their approach to limiting liability," and which rely on using terms such as "indirect or consequential loss," "are doing a disservice to their clients . . . [because] they are exposing their clients to the court's interpretation of the rules on remoteness and the risk of a judgment that may be totally at odds with their client's rationale for entering into the contract"). Of course, deal attorneys are not always in a position to resist the inclusion of certain provisions, even when they know they create ambiguity. *See* West, *supra* note 164, at 1069 n.112.

167. West, *supra* note 164, at 1069 n.112.

168. Gulati and Scott appear to both believe that Mr. Cravath's response to this question clearly would have been yes. *See* Gulati & Scott, *supra* note 161, at 10.

169. *See* West & Lewis, *supra* note 163, at 1004 (citing Oliver Wendell Holmes, Jr., *The Path of the Law*, 10 HARV. L. REV. 457, 457 (1897).

170. *See id.*

171. West, *supra* note 164. Another example is the continued use in bond indentures of a standard "non-recourse" provision even though Delaware courts have repeatedly construed that clause in a manner that does not appear to be consistent with the intention of the draftsperson. *See* Glenn D. West & Natalie A. Smeltzer, *Protecting the Integrity of the Entity Specific Contract: The "No Recourse Against Others" Clause—Missing or Ineffective Boilerplate?* 67 BUS. LAW. 39 (2011).

thoughtful and workable provisions. After all, following the example of how "road bugs learn about Mack trucks"[172] is a bad idea; we should instead all follow our mothers' time-honored advice not to follow the crowd into doing something we know is fraught with danger simply based on the fact that everyone else is doing it. This advice is equally applicable to the seller with the leverage to insist upon a broad excluded losses provision, thinking it may exclude more than it actually does, as it is to a buyer accepting such a provision and believing or hoping that it excludes less than it actually does.

172. Anderson, *supra* note 53, at 353.