Final award in case no. 8362 of 1995

Parties:                       
Claimant: Distributor (UK)  
Defendant: Manufacturer (US)  

Place of arbitration:  
London, United Kingdom  

Published in:  
Unpublished  

Subject matters:  
- breach of exclusive distributorship agreement by termination  
- offer and acceptance of modification of contract  
- effective date of termination of exclusive distributorship damages  
- expectation damages  
- lost profits not waived by contractual exclusion of liability  
- meaning of "net profits"  

[...]
III. DAMAGES

[...]

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B. Meaning of "Lost Profits"

43 "Claimant's original claim for expectation damages was for its estimated lost gross profit. It has since amended its original claim and now requests lost 'net profits'..., which it defines as lost gross profits ... less variable costs that would have been incurred in connection with its performance under the Distributor Agreement. Claimant and defendant agree that under New York law the proper measure of recoverable damages is lost net profits, but disagree as to the meaning of 'net profits'.” (...)

1. Opinion of the Sole Arbitrator

44 "Under New York law, the proper measure of expectation damages is net losses as measured essentially, in a case such as this, by lost net profits. The case authorities cited by the parties, however, do not provide a specific general rule for calculating net profits to be consistently applied in all cases, in particular as regards the question of deduction of operating expenses. In ascertaining the essential principle of New York law, it is necessary to look at the facts of the cases cited and the purpose underlying the decisions, which is to grant a party no more nor less than its reasonable expectation interest.

45 "That essential principle appears to be that a party must deduct from gross profits the costs associated with the performance that have been avoided. These costs may in some, but not all, cases include a portion or even the entire amount of the operating costs or other costs incurred in the running of the business as a whole. This would be the case where such operating or other costs are indeed avoided by the absence of performance. There appears to be no rule of general application that expectation damages are equal to the net accounting profit (or loss) of the business entity as a whole. Likewise, there would appear to be no general rule that only variable costs, in an accounting sense, are deducted from gross revenues in determining lost profit.

46 "The intent of the court is that the aggrieved party be placed in the same economic position that it would otherwise have enjoyed, but for the breach. This requires no more than that the benefit of avoiding performance — the cost avoided — be deducted from the value to be received through performance. This is fundamentally what the courts mean by 'lost net profits', regardless of what specific deductions the courts have required, or not required, in given cases.

47 "If one considers the fact alone that claimant's net loss for the fiscal year ending 30 April of year 4 increased substantially over the prior period, it is evident that the value of the performance not received by it is greater than the cost avoided by it. It is accordingly not in the same economic position.

48 "It is therefore proper to deduct from gross revenues only the cost avoided by claimant, which may be called 'variable costs' in this limited sense. The amount of these costs are considered in the following section concerning the certainty of claimant's alleged damages."

C. Certainty of Damages

49 "Both parties acknowledge that some standard of certainty must be met with respect to (i) the causal link between the breach and the alleged damages, and (ii) the amount of damages claimed to have been suffered. The parties disagree as to what the applicable standard of certainty is and whether that standard has been met." (....)

1. Opinion of the Sole Arbitrator
"Under New York law, claimant must show: (i) that it has suffered harm, (ii) that such harm was caused with certainty by the breach, and (iii) that the amount of its damages is established with reasonable certainty. The decline, and in some cases the complete disappearance, in sales volume suffered by claimant in the UK and in Continental European markets were clearly the direct result of its loss, through breach of the Distributor Agreement, of the exclusive distribution rights and favourable price terms that it enjoyed thereunder. As the right to resell at a profit was what was contemplated by the parties upon concluding the Distributor Agreement, so the loss of profit suffered from the withdrawal of that right was clearly within the contemplation of the parties. The damages incurred by claimant directly flowed from the breach, which was the immediate and proximate cause thereof. Claimant has therefore established with certainty that is has suffered a loss and that such loss resulted from the breach of the Distributor Agreement.

With respect to calculation of the amount of alleged damages, counterbalancing factors are taken into account under the law: on the one hand, there must be a sound basis upon which alleged damages are to be calculated. They cannot be the product of sheer speculation unsupported by tangible evidence. On the other hand, the law will not reward a party in breach by depriving the other party of compensation merely because no precise basis for determining the amount of damages exists."

After calculating the avoided cost, the Sole Arbitrator calculated the lost net profit as a percentage of the estimated lost sales equal to gross margin less avoided cost. With respect to the time period to which lost profits relate, it was held that: "[C]laimant assumes in its damage estimates various scenarios under which its rights under the Distributor Agreement would have terminated on 31 December of year 5, on 30 April of year 6 (end of fiscal year), on 31 July of year 6 (end of selling year), and on the same dates two years thereafter on the assumption that the Distributor Agreement would have run for five years.

As termination under the extension agreement was allowed as of 18 November of year 5, termination as of that date must be assumed (See [35] above.) Based on the industry practise of submitting orders in the fall for delivery late in the year or in the early part of the subsequent year, claimant probably would have been unable to order and receive products for sale during the selling season of year 6 prior to termination. Moreover, the Distributor Agreement provides that the manufacturer has the right to repurchase products upon termination. Claimant's claim for lost profits will therefore be accepted only to the extent of lost profits through 18 November of year 5. As a practical matter, as few if any sales are made between mid-November and the end of the year, the relevant period extends through the end of the calendar year 5."

[...]

Referring Principles:

VII.3.2 - Calculation of damages