American Bar Association
www.supremecourtpreview.org

No. 09-1273

IN THE
Supreme Court of the United States

ASTRA USA, INC., et al.,

Petitioners,

v.

COUNTY OF SANTA CLARA, ON BEHALF OF ITSELF AND ALL OTHERS SIMILARLY SITUATED,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF CONTRACT LAW PROFESSORS AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

SHAWN J. BAYERN
Assistant Professor,
FLORIDA STATE UNIVERSITY
COLLEGE OF LAW
425 West Jefferson Street
Tallahassee, FL 32306
(850) 644-8308

STEPHEN M. TILLERY
Counsel of Record
KOREIN TILLERY
One U.S. Bank Plaza
505 N. 7th St., Suite 3600
St. Louis, MO 63101
(314) 241-4844
stillery@koreintillery.com

December 20, 2010

233966

COUNSEL PRESS
(800) 274-3321 • (800) 359-6859

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES iii

INTEREST OF AMICI CURIAE 1

INTRODUCTION AND SUMMARY OF ARGUMENT 1

ARGUMENT 3

I. THE COMMON LAW PERMITS "INTENDED" THIRD-PARTY BENEFICIARIES TO ENFORCE CONTRACTS 3

A. The Common Law Has Long Permitted Third-Party Beneficiaries to Enforce Contracts 4

B. Similar Substantive Principles Apply to Private Contracts and Government Contracts, Particularly Where Third-Party Beneficiaries Seek General Damages, Not Consequential Damages 14

II. PRINCIPLES OF AMERICAN CONTRACT LAW PERMIT THE COVERED ENTITIES TO ENFORCE THE PHARMACEUTICAL PRICING AGREEMENT 19

CONCLUSION 27

TABLE OF CITED AUTHORITIES

Page

Cases:

Astoria Fed. Sav. & Loan Ass'n v. Solimino,
501 U.S. 104 (1991) 22, 23

County of Santa Clara v. Astra USA Inc.,
588 F.3d 1237 (9th Cir. 2009) 2

Dutton v. Poole,
83 Eng. Rep. 523 (K.B. 1677) 4-5, 6

Empire HealthChoice Assur., Inc. v. McVeigh,
547 U.S. 677 (2006) 2

German Alliance Ins. Co. v. Home Water Supply Co., 226 U.S. 220 (1912) 25

H.R. Moch Co. v. Rensselaer Water Co.,
159 N.E. 896 (N.Y. 1928) 17, 18, 19

Jackson Transit Auth. v. Local Div. 1285, Amalgamated Transit Union, AFL-CIO-CLC, 457 U.S. 15 (1982) 23

Lawrence v. Fox,
20 N.Y. 268 (1859) 5, 6

Martinez v. Socoma Cos.,
11 Cal. 3d 394 (Cal. 1974) 21

Cited Authorities

Page

Martyn v. Hind,
98 Eng. Rep 1174 (K.B. 1776) 5

Robins Dry Dock & Repair Co. v. Flint,
275 U.S. 303 (1927) 25

S*amantar v. Yousuf*,
130 S. Ct. 2278 (2010) 23

Schemerhorn v. Vanderheyden,
1 Johns. 139 (N.Y. Sup. Ct. 1806) 5

Sec. Mut. Casualty Co. v. Pacura,
402 So. 2d 1266 (Fla. Dist. Ct. App. 1981) ... 12

Starkey v. Mill,
82. Eng. Rep. 723 (K.B. 1651) 4

United States v. Seckinger,
397 U.S. 203 (1970) 2, 22

Page

Statutes & Other Authorities:

42 U.S.C. § 256b(a)(1) 1, 20, 23

42 U.S.C. § 256b 20

42 U.S.C. § 256b 4

42 U.S.C. § 256b(a)(5)(D) 25

58 Fed. Reg. 27289 25

3 E. Allan Farnsworth, *Farnsworth on Contracts* (3d ed. 2004) 3, 19

Melvin A. Eisenberg, *The Nature of the Common Law* 50 (1988) 14

Melvin Aron Eisenberg, Third-Party Beneficiaries, 92 Colum. L. Rev. 1358 (1992) *passim* Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 .. 21

Peter Karsten, *"Discovery" of Law by English and American Jurists of the Seventeenth, Eighteenth, and Nineteenth Centuries: Third-Party Beneficiary Contracts as a Test Case*, 9 Law & Hist. Rev. 327 (1991) 4, 5

R. Fallon *et al.*, *Hart and Wechsler's The Federal Courts and the Federal System* 700 (5th ed. 2003) 2

Page

Restatement of the Law, Contracts, § 133 ..... 7, 8

Restatement of the Law, Contracts, § 133(1)(a) 8, 11

Restatement of the Law, Contracts, § 133(1)(c) .. 8

Restatement of the Law, Contracts, § 145 18

Restatement of the Law, Contracts, § 145(b) ... 18

Restatement of the Law, Contracts, ch. 6 3

Restatement of the Law, Second, Contracts § 1 .. 22

Restatement of the Law, Second, Contracts § 211 .. 13, 22

Restatement of the Law, Second, Contracts § 302 .... 3, 10

Restatement of the Law, Second, Contracts § 304 3

Restatement of the Law, Second, Contracts § 313 cmt. a 14, 16

Restatement of the Law, Second, Contracts § 313(1) .. 15

Restatement of the Law, Second, Contracts § 313(2) . 15, 16

Restatement of the Law, Second, Contracts § 351 cmt. b 16

Restatement of the Law, Second, Contracts § 351 cmt. d. 26

Cited Authorities

Page

Restatement of the Law, Second, Contracts, § 302(1)(a) 10

Restatement of the Law, Second, Contracts, § 302(1)(b) 10

Restatement of the Law, Second, Contracts, § 313 . . . . 15, 16

Samuel Williston & George J. Thompson, *A Treatise on the Law of Contracts* § 356A (rev. ed. 1938) 8

INTEREST OF *AMICI CURIAE*[1]

Amici are professors who teach and research American contract law. This case raises a question about the federal common law of contracts, and our scholarly aim is to advise the Court on principles of American contract law.

We file this brief as individuals and do not speak for our institutions.

INTRODUCTION AND SUMMARY OF ARGUMENT

This case implicates a question of contract law: when may those who are not parties to a contract enforce it?

The contract in this case (the "Pharmaceutical Pricing Agreement," or "Agreement") is a agreement between Petitioners and the Secretary of Health and Human Services. Under the agreement, Petitioners must offer certain drugs to parties like the Respondent ("Covered Entities") under a particular pricing scheme. Section 340B of the Public Heath Service Act, 42 U.S.C 256b(a)(1), required the Secretary to enter into the Agreement.

---

1. No counsel for a party authored this brief in whole or in part, and none of the parties or their counsel, nor any other person or entity other than *amici*, made a monetary contribution intended to fund the preparation or submission of this brief. Counsel for *amici* represents that all parties have consented to the filing of this brief, and letters reflecting their blanket consent to the filing of *amicus* briefs have been filed with the Clerk.

The Agreement, under its terms and this Court's jurisprudence, is enforceable in federal courts under federal contract law. *See* Agreement ¶ VII(g); *United States v. Seckinger*, 397 U.S. 203, 209–210 (1970) ("[F]ederal law controls the interpretation of the contract. This conclusion results from the fact that the contract was entered into pursuant to authority conferred by federal statute and, ultimately, by the Constitution.") (citations omitted).[2] Federal courts appropriately look to American common-law principles for guidance in fashioning federal common law. *Seckinger*, 397 U.S. at 210 ("In fashioning a federal rule we are, of course, guided by the general principles that have evolved concerning the interpretation of contractual provisions . . . .").

Accordingly, this brief explains how American contract law distinguishes beneficiaries that can enforce a contract from those that cannot. Courts use a variety of principles, and sometimes it is often surprisingly difficult to determine the precise conditions under which third parties should be able to enforce contracts. This case, however, is not a difficult one as a matter of contract law; contract principles permit the Covered Entities to enforce the Agreement at issue in this case.

---

2. This brief does not address what the opinion below called the "famously obscure" question of "whether federal or state law creates the cause of action underlying [Respondent's] claim." *County of Santa Clara v. Astra USA Inc.*, 588 F.3d 1237, 1244 n. 5 (9th Cir. 2009). Nor does it address this Court's holding that "'uniform federal law need not be applied to all questions in federal government litigation, even in cases involving government contracts.'" *Empire HealthChoice Assur., Inc. v. McVeigh*, 547 U.S. 677, 691 (2006) (quoting R. Fallon et al., *Hart and Wechsler's The Federal Courts and the Federal System* 700 (5th ed. 2003)).

ARGUMENT

I. THE COMMON LAW PERMITS "INTENDED" THIRD-PARTY BENEFICIARIES TO ENFORCE CONTRACTS

Under American contract law, it is an uncontroversial proposition that those who are not parties to a contract may sometimes enforce its terms, even when the contract does not explicitly address the question of whether they should be permitted to do so. *See* Restatement of the Law, Second, Contracts § 304 ("A promise in a contract creates a duty in the promisor to any intended beneficiary to perform the promise, and the intended beneficiary may enforce the duty.") (1981) [hereinafter "*Second Restatement*"]; Restatement of the Law, Contracts, ch. 6 (entitled "Contractual Rights Of Persons Not Parties To The Contract") (1932) [hereinafter "*First Restatement*"]; 3 E. Allan Farnsworth, *Farnsworth on Contracts* §§ 10.2, 10.3 (3d ed. 2004).

Of course, not everyone who seeks to enforce a contract may do so. It is often said that only "intended beneficiaries" of a contract, as opposed to its "incidental beneficiaries," may enforce it. *See Second Restatement* §§ 302, 304. The phrases "intended beneficiary" and "incidental beneficiary," however, often merely state conclusions; parties that are permitted to enforce a contract are said to be intended beneficiaries, and those that are not are said to be incidental beneficiaries. This Part develops the history and doctrinal analysis behind those conclusions.

A. The Common Law Has Long Permitted Third-Party Beneficiaries to Enforce Contracts

1. Third-party enforcement of contracts is not a new phenomenon. Indeed, the principle that many third parties could enforce contracts without explicit authorization to do so was relatively uncontroversial in the early law of the United States and in the English law from which U.S. law was derived. The early cases did not articulate clear principles about which third-party beneficiaries could enforce contracts and which could not, but even at early common law there was no conceptualistic assumption that only parties to contracts could enforce them. To put it differently, for hundreds of years the existence of an "agreement" or a "contract," as called for by Section 340B, 42 U.S.C. § 256b, has connoted the possibility of third-party enforcement.[3]

English *assumpsit* cases as early as the mid-1600s held that nonparties could enforce promises.[4] *Dutton v.*

---

3. For a history of the early English and American cases governing third-party beneficiaries, see Peter Karsten, *"Discovery" of Law by English and American Jurists of the Seventeenth, Eighteenth, and Nineteenth Centuries: Third-Party Beneficiary Contracts as a Test Case*, 9 Law & Hist. Rev. 327 (1991); *see also* Melvin Aron Eisenberg, Third-Party Beneficiaries, 92 Colum. L. Rev. 1358 (1992). This brief's examples of historical cases come from Professor Karsten's and Professor Eisenberg's articles.

4. *See Starkey v. Mill*, 82. Eng. Rep. 723 (K.B. 1651) ("[T]he goods were given for the benefit of the plaintif, though the contract be not between him and the defendant, and he may well have an action . . ., for here is a promise in law made to the plaintif, though there be not a promise in fact, & there is a debt here; and the assumpsit is good.").

Poole, 83 Eng. Rep. 523 (K.B. 1677), is representative of the early case law. In *Dutton*, a son and heir promised his father that he would pay his sister £1000; in exchange, the father agreed not to sell a piece of property he owned in order to raise money for his younger children. The court held that the sister could enforce the contract.

Dutton was not unique, and its doctrinal soundness was well established in English law by 1776, at which time Lord Mansfield, addressing a potential issue concerning the law of third-party beneficiaries, mused that "it is a matter of surprise, how a doubt could have arisen" in *Dutton*. *Martyn v. Hind*, 98 Eng. Rep 1174 (K.B. 1776).

Following the English cases, early American law similarly allowed third parties to enforce contracts without significant controversy. *See* Karsten, *supra* note 3, at 340; Eisenberg, *supra* note 3, at 1362–1365. In 1806, a New York court articulated its view of the doctrinal principle behind the cases as follows: "[W]here one person makes a promise to another for the benefit of a third person, that third person may maintain an action on such promise." *Schemerhorn v. Vanderheyden*, 1 Johns. 139, 140 (N.Y. Sup. Ct. 1806). *Schemerhorn* added that "The same principle has, since [*Dutton*], been repeatedly sanctioned by the decisions of the English courts." *Id.* According to Professor Karsten, "between 1801 and 1820 the high courts of the first four American jurisdictions to address the problem spoke as one." Karsten, *supra*, at 340.

Representative of the early American rule is the well-known case of *Lawrence v. Fox*, 20 N.Y. 268 (1859),

although it is incorrect to think that *Lawrence* was either novel or particularly influential in its time. *See* Eisenberg, *supra* note 3, at 1363. In *Lawrence*, Fox had borrowed $300 from Holly, promising Holly that he would pay it to Lawrence (to discharge a debt from Holly to Lawrence). The court held that Lawrence could enforce the contract between Holly and Fox even though Lawrence was not a party. *Lawrence*, 20 N.Y. at 269.

2. *Lawrence*, far from heralding the start of third-party enforcement of contracts in the United States, as is sometimes supposed, did signal a temporary retrenchment. The *Lawrence* court was deeply divided, and as Professor Melvin Eisenberg, a leading contracts scholar, has observed, "what is striking about *Lawrence v. Fox* is not how far it advanced the law, which was very little, but how this now-celebrated case was almost drowned by the rising tide of classical contract law only ten or fifteen years after it was decided." Eisenberg, *supra* note 3, at 1363.

What Professor Eisenberg calls "classical contract law" was the conceptualistic, axiomatic approach to deciding contract cases that was prominent in the late 1800s and early 1900s. *See id.* at 1365. During that period, in both England and the United States, concerns about the lack of privity (or occasionally lack of consideration) between contracting parties and third parties led courts to question or even overturn the result in *Dutton*. *See id.* at 1365–71. These concerns were essentially circular: nonparties could not enforce contracts, courts began to hold, because only a party to a contract could have rights under it. *Cf. id.* at 1370. No justification for a rule based on that principle, or for a change in the doctrine, was offered.

The attempt to reason purely axiomatically about contract law did not last far into the 1900s. *See generally* Eisenberg, *supra* note 3, at 1371–74. It was well eclipsed by the time Section 340B of the Public Health Service Act was passed in 1992.

3. Indeed, even the *First Restatement*, conceptualistic in other areas, did not adopt a restrictive view of third-party beneficiaries. The *First Restatement* specified that two categories of third-party beneficiaries could enforce contracts: "donee beneficiaries," like the plaintiff in *Dutton* on whom one or both of the parties meant to confer a gift, and "creditor beneficiaries," like the plaintiff in *Lawrence* to whom one of the parties owed a debt. *First Restatement* § 133.

The *First Restatement* defined the terms as follows:

> [A beneficiary is] a donee beneficiary if it appears from the terms of the promise in view of the accompanying circumstances that the purpose of the promisee in obtaining the promise of all or part of the performance thereof is to make a gift to the beneficiary or to confer up on him a right against the promisor to some performance neither due nor supposed or asserted to be due from the promisee to the beneficiary
>
> [A beneficiary is] a creditor beneficiary if no purpose to make a gift appears from the terms of the promise in view of the accompanying circumstances and performance of the promise will satisfy an

> actual or supposed or asserted duty of the promisee to the beneficiary, or a right of the beneficiary against the promisee which has been barred the statute of Limitations or by a discharge in bankruptcy, or which is unenforceable because of the Statute of Frauds.

Id. Those who benefit from a contract but are neither donee beneficiaries nor creditor beneficiaries—and thus without a right to enforce it—are called "incidental beneficiaries." *Id.* § 133(1)(c).

Two features of the *First Restatement* rule are worth highlighting. First, the tests depend on the purposes that are inferred from the "terms of the promise in view of the accompanying circumstances." The inquiry is necessarily purposive and contextual, and even though the *First Restatement* is not known for open-ended inquiries generally, it does not restrict the purposive inquiry to limited sets of evidence such as the text of the contract. *See* Eisenberg, *supra* note 3, at 1376; Samuel Williston & George J. Thompson, *A Treatise on the Law of Contracts* § 356A, at 331 (rev. ed. 1938).

Second, under the *First Restatement*, "donee" beneficiaries are not necessarily those to whom the promisor or promisee intended to confer a *gift*. *See* Eisenberg, *supra* note 3 at 1376. The category also includes those who, even though they are not receiving a gift or donation, are inferred to have "a right against the promisor" in view of the "purpose of the promisee." *First Restatement* § 133(1)(a). Precisely what this means is unclear because the *First Restatement*, as Professor

Eisenberg has put it, "provided no guidance concerning the critical question of how a court was to determine whether the relevant purpose was present." Eisenberg, *supra* note 3, at 1377.

To interpret the *First Restatement*'s test generously, it is possible that it makes some easy cases easy, but that is probably the best it can do. Contracts clearly intended to confer a gift or discharge a debt lead, fairly simply under the *First Restatement*'s test, to third-party enforcement rights. Unfortunately, other cases are more difficult, and the *First Restatement* provides little guidance as to those cases.

4. The *Second Restatement* is probably the most widely used summary of modern black-letter contract law. It abandons the *First Restatement*'s "donee beneficiary" and "creditor beneficiary" categories, at least in name:

> (1) Unless otherwise agreed between promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and either
>
> > (a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or
> >
> > (b) the circumstances indicate that the promisee intends to give the

> beneficiary the benefit of the promised performance.
>
> (2) An incidental beneficiary is a beneficiary who is not an intended beneficiary.

Second Restatement § 302.

Note, as with the *First Restatement*, that the inquiry is purposive and contextual, and third-party enforcement does not depend on explicit authorization in the contract's text.

Despite their terminological differences, it is not clear that the tests of the *First Restatement* and the *Second Restatement* are, in practice, very different from each other. Paragraph 302(1)(a) of the *Second Restatement* might be taken to apply to the *First Restatement*'s creditor beneficiaries, and paragraph 302(1)(b) might be taken to apply to the *First Restatement*'s donee beneficiaries. *Cf.* Eisenberg, *supra* note 3, at 1382.

What the *Second Restatement* adds, at least overtly and as a matter of doctrinal emphasis, is a dependence on the "intention" of the parties. As the introductory clause to *Second Restatement* § 302 suggests, modern courts often focus on whether a third party is an "intended" beneficiary of a contract in deciding whether to permit that party to enforce the contract. This is often true even of courts that use the test of the *First Restatement* rather than that of the *Second Restatement*. For a list and discussion of cases applying

intent-to-benefit tests, see Eisenberg, *supra* note 3, at 1378–81.[5]

What "intent" means in this context, however, is often not clear. As Professor Eisenberg points out, the word "intent" is often ambiguous between subjective intent and objectively manifested intent, on one hand, and between narrow intents and broader purposes, on the other. *Id.* at 1378. As a result, it is often unclear how to apply the test. *Id.* at 1379–81.

For example, if the test refers to objectively manifested intent, it provides very little guidance in resolving questions about which third-party beneficiaries should be able to enforce contracts: "How is it to be determined, as an objective matter, why in some contracts whose performance will benefit a third party, the benefit is objectively 'intended' within the meaning of the test, while in other contracts whose performance will benefit a third party, the benefit is not so 'intended'?" *Id.* at 1379.

Some courts have attempted to address the ambiguities in intent-based tests by imposing additional requirements before allowing third parties to enforce

5. It should not be a surprise that even courts that purport to apply the test of the *First Restatement* use an intent-based test. Recall that *First Restatement* allows a class of donee beneficiaries to enforce contracts when "the purpose of the promisee in obtaining the promise . . . is to . . . confer upon [the beneficiary] a right against the promisor." *First Restatement* § 133(1)(a). Accordingly, even that test relied largely on the "purpose" of the contracting parties, which in this context appears to mean roughly the same thing as "intent."

contracts. For example, some courts purport to apply a test that requires the intent to benefit third parties to be "clear" or "definite." *E.g.*, *Sec. Mut. Casualty Co. v. Pacura*, 402 So. 2d 1266, 1267 (Fla. Dist. Ct. App. 1981) (holding that third parties may enforce contracts "where the provisions of the contract clearly show an intention primarily and directly to benefit the individual bringing suit or to a class of persons to which he claims to belong as a third party beneficiary"). Others require that contracts expressly confer a right to enforce the agreement on third parties. Professor Eisenberg responds nicely to these additional requirements, however:

> Both types of requirement are inconsistent with modern principles of contract interpretation, which do not place a thumb on the interpretative scale and do allow courts to look to surrounding circumstances. And both types of requirement are difficult or impossible to apply meaningfully and consistently, and are not so applied in fact. The better-reasoned cases reject these formal requirements, and so does [the *Second Restatement*].

Eisenberg, *supra* note 3, at 1379–80.

5. *A synthesis*. Professor Eisenberg's comprehensive article concludes that the most justifiable legal rule permits third-party beneficiaries to enforce contracts where either:

> (I) allowing the beneficiary to enforce the contract is a necessary or important means of effectuating the contracting parties' performance objectives, as manifested in the contract read in the light of surrounding circumstances; or
>
> (II) allowing the beneficiary to enforce the contract is supported by reasons of policy or morality independent of contract law and would not conflict with the contracting parties' performance objectives.

Eisenberg, *supra* note 3, at 1385.

Professor Eisenberg's synthesis ordinarily suggests an inquiry into the circumstances of the parties' bargaining. Of course, not all contracts cases reflect true bargains; the Agreement at issue in this case was not the product of a bargain, for example. But the lack of a bargain does not generally render contracts unenforceable; it merely changes the inquiry from one about actual bargains to one about whether a form's terms are reasonable and about whether parties would have nonetheless assented to a contract knowing that it contained particular terms. *See* Second Restatement § 211.

Incidentally, it is important to note that the second part of Professor Eisenberg's test explicitly incorporates the kinds of moral and policy propositions that justify the common law of contracts. *See id.* at 1358–1359. Modern American contract law explicitly incorporates such propositions as justifications, and it

is difficult to understand or apply modern contract law without recognizing and evaluating those propositions. *See generally* Melvin A. Eisenberg, *The Nature of the Common Law* 50–76 (1988).

B. Similar Substantive Principles Apply to Private Contracts and Government Contracts, Particularly Where Third-Party Beneficiaries Seek General Damages, Not Consequential Damages

1. Under the law governing third-party beneficiaries, government contracts tend to present at least some factual differences from private contracts.

One difference is that when a governmental entity is a party to a contract, parties outside the government will almost necessarily benefit from it, at least indirectly. *See Second Restatement* § 313 cmt. a. ("Government contracts often benefit the public . . . ."). Many individuals have no recognizable dependents and enter into contracts only or largely for themselves, but organizations like governments typically act, at least in principle, for the benefit of others.

Moreover, government contracts potentially have large numbers of beneficiaries; it is easier for the government to affect many parties than for most individuals to do so. *See* Eisenberg, *supra* note 3, at 1407.

Perhaps for these reasons, courts have been careful when identifying intended beneficiaries of government contracts, and they have often constructed nominally different principles to guide that identification.

For example, the *Second Restatement* includes a special rule for government contracts, laid out in section 313. On the surface, the section has two separate roles. First, it makes clear that the interpretation of government contracts is subordinate to, and must be consistent with, the "policy of the law authorizing the contract or prescribing remedies for its breach." *Second Restatement* § 313(1). Second, it purports to restrict the circumstances under which third-party beneficiaries may recover "consequential damages" under a government contract. *Id.* § 313(2).

For several reasons, however, it is unclear whether section 313 of the *Second Restatement* presents a rule that differs substantively from the Restatement's more general principles. Section 313(1), to the extent it simply subordinates contract interpretation to statutory policy, is probably uncontroversial, but a similar principle applies to the relationship between public laws and *private* contracts: a constitutionally valid statute may expand or restrict remedies for private contracts just as it could for governmental contracts, and indeed it might do so on matters far broader than questions of third-party enforcement. Section 313(1), therefore, essentially states the truism that properly enacted statutes can change parties' legal rights.

Nor is it clear that section 313(2) departs significantly from more general principles of third-party enforcement.[6] For one thing, it applies only to

6. Professor Eisenberg believes it may. See Eisenberg, *supra*, at 1407 n. 170. But as he observes, "Section 313 is not a model of clarity." In any event, his argument is that there is no *reason* to treat government contracts in a manner categorically (Cont'd)

consequential damages, and third-party enforcement for consequential damages is likely comparatively rare; for example, consequential damages do not figure at all in the remedies Respondent seeks in this case. Even where third parties seek to receive consequential damages under a contract, however, section 313(2) may be consistent with the Restatement's more general rule: it appears simply to allow consequential damages when either (1) the contract explicitly permits them or (2) the contract impliedly permits them.

In short, it is unclear that section 313 substantively departs from the Restatement's general principles that govern private contracts. Indeed, the Restatement itself purports not to, observing in a comment that section 313(2) "applies to a particular class of contracts the classification of beneficiaries in § 302." *Id.* § 313 cmt. a.

2. Further discussion of the difference between general damages and consequential damages may be helpful. The terms do not have rigid meanings, but general damages are those that a promisee can recover for "loss that results in the ordinary course of events," whereas consequential damages are those "recoverable for loss that results other than in the ordinary course of events." *Second Restatement* § 351 cmt. b. As perhaps a more useful distinction, general damages reflect damages that essentially any promisee would receive, such as the difference between a promised price for a

---

(Cont'd)

different from private contracts. *Id.* at 1407. That is, he believes that even if section 313(2) does vary from contract law's general principles, that variation would be a mistake.

commodity and a price that a promisee must pay when the contract is breached; consequential damages, by contrast, result from harms that are more particular to the individual promisee.

For instance, because Respondent seeks to recover from Petitioners the difference between the prices for covered drugs to which the Agreement entitled them and the prices they were in fact charged for covered drugs, they are seeking a paradigmatic example of general damages. If, hypothetically, they sought damages for a problem in medical treatment that arose because drugs were not available at the Agreement's guaranteed price, those damages would be consequential.

Where expanding the range of parties that can recover consequential damages may vastly increase the promisor's total liability under a contract, courts have been reluctant to permit third parties to enforce contracts—particularly government contracts. The famous case of *H.R. Moch Co. v. Rensselaer Water Co.*, 159 N.E. 896 (N.Y. 1928) (Cardozo, J.) is illustrative. In *Moch*, a water supplier breached its contract to supply water to a city, but it was not liable to a third party for fire damage that resulted from its breach.

Ordinarily, promisors, like Petitioners in this case, can more easily predict general damages than consequential damages; allowing third parties to receive general damages does not ordinarily threaten limitless or unmanageable liability. Accordingly, there is less reason to scrutinize the third-party beneficiaries of government contracts when those beneficiaries seek

only general damages. The danger of limitless liability, or even merely increased liability, is minimal when third parties seek general damages. Those damages are easy to predict, could have been due to the promisee anyway, and are not significantly expanded by permitting third parties to enforce contracts.[7]

---

7. Compare the *First Restatement*'s approach to government contracts. The *First Restatement* does not treat government contracts differently in general, as if they were a separate class of contracts, but it does attempt to limit what appear to be consequential damages to members of the public. Specifically, the *First Restatement* aims to prevent some parties who promise governments "to do an act or render a service" from liability for "compensation for the injurious consequences of performing or attempting to perform" the service. *First Restatement* § 145. The focus is on "compensation for the injurious *consequences*" (emphasis added), not for market damages from breach of contract.

Perhaps oddly, the *First Restatement* indicates that even this limitation on consequential damages should not apply to cases where the promisor has contracted with a municipality (and apparently only a municipality) "to render services the non-performance of which would subject the municipality to a duty to pay damages." *Id.* § 145(b). The *First Restatement* does not make the motivation for this exception clear, but the illustrations suggest that section 145 means to prevent liability for consequential damages, as in *Moch*, but to allow damages for more direct harms, such as when a contractor promises to keep a municipality's streets safe and fails to do so, injuring a member of the public. *See id.* cmt. a. illus. 2, 5. An easier way to reach the same result is to say that in the latter case, the contractor could easily have foreseen that its breach of contract could lead to the kinds of damages it caused.

In short, general damages like those at issue in this case do not significantly change the legal duties or the total amount of liability that promisors like Petitioners face. As a result, there is little fear here of the dangers with which Cardozo was concerned in *Moch*. *Accord* Farnsworth, *supra*, § 10.6 ("[I]f consequential damages are not involved, so that the promisor's risk is more limited, as when the contract merely fixes a maximum rate for a utility company, courts have permitted enforcement by third persons."); *cf.* Eisenberg, *supra* note 3, at 1409 n. 176 (suggesting that "if not for the problem of extended liability," the decision to permit "a well-defined and specifically favored class" of third parties to enforce a government contract would be straightforward).

II. PRINCIPLES OF AMERICAN CONTRACT LAW PERMIT THE COVERED ENTITIES TO ENFORCE THE PHARMACEUTICAL PRICING AGREEMENT

As Part I demonstrated, American contract law permits third-party enforcement for many contracts, but it does not offer singular or reductive rules by which courts can easily address questions concerning third-party enforcement. Although inconsistencies among cases might be problematic in many third-party-beneficiary cases, however, Respondent's case is relatively straightforward as a matter of contract law; under essentially every contract-law test that courts have applied, the Covered Entities may enforce the Agreement. This section lays out further details of various doctrinal approaches and applies them to the Covered Entities' case.

1. *A review of the contract and its authorizing statute*. The Agreement, as noted at the outset, is a agreement between the Department of Health and Human Services and Petitioners, called for by section 340B of the Public Health Service Act, 42 U.S.C. § 256b. The statute requires the Secretary to enter "an agreement" with manufacturers "under which the amount required to be paid . . . to the manufacturer for covered outpatient drugs" is set so that it "does not exceed" a ceiling price computed under the statute. 42 U.S.C. § 256b(a)(1)

The most significant agreement of the Agreement is set out in paragraph II, under which Petitioners agreed as follows:

> for single source and innovator multiple source drugs, to charge covered entities a price for each unit of the drug that does not exceed an amount equal to the AMP for the covered outpatient drug reported (or which would have been reported had the Manufacturer participated in the Medicaid rebate program) to the Secretary in accordance with the Manufacturer's responsibilities under section 1927(b)(3) of the Social Security Act, reduced by the rebate percentage.

Agreement ¶ II(a). That Paragraph, in order to achieve the objectives of section 340B, imposes on Petitioners a separate *contractual* obligation to charge 340B entities based on AMPs and best prices reported in accordance with their responsibilities under the Medicaid rebate statute.

The Agreement also provides an "elective dispute resolution process," *id.* ¶ IV, that gives Petitioners and the Secretary various rights. It is not a comprehensive or binding dispute-resolution procedure, however, as the Agreement explicitly notes: "Nothing in this paragraph shall preclude [Petitioners] or the Secretary from exercising such other remedies as may be available by law."[8]

---

8. Of course, the paragraph does not explicitly retain rights for third parties, but it had no reason to do so because it did not grant extra rights to third parties. Indeed, paragraph IV as a whole strongly suggests that the Agreement conceived of flexible rather than narrow dispute-resolution procedures.

Had the Agreement provided a comprehensive and mandatory dispute-resolution procedure that referred only to the parties, contract principles would likely oppose third-party enforcement. *See Martinez v. Socoma Cos.*, 11 Cal. 3d 394 (Cal. 1974) (holding that third parties could not enforce a federal-government contract because "the contracts' provisions for retaining the Government's control over determination of contractual disputes and for limiting defendants' financial risks indicate a governmental purpose to exclude the direct rights against defendants claimed here"). But the Agreement's dispute-resolution procedures are explicitly not mandatory. *Contra* Brief for APA Watch as *Amicus Curiae* Supporting Petitioners 9 ("[*E*]*ven the United States* could not enforce the Agreement under contract law, without first invoking the Agreement's dispute-resolution provisions." (italics in original)).

It is beyond the scope of this brief to analyze the changes to relevant dispute-resolution procedures that will be made in the future under the Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119.

2. *Application of contract-law principles to the Agreement*. Contract principles permit Covered Entities like Respondent to enforce the Agreement. Indeed, as a matter solely of contract principles, this case is a straightforward one.

As a preliminary matter, we see no reason not to treat the Agreement as a contract. *See Second Restatement* § 1 (defining contracts). It is true, as the United States observes, that the Agreement does not arise from an individually negotiated transaction. *See* Brief for the United States as Amicus Curiae Supporting Petitioners 15–19. But the absence of individual negotiation does not make a contract unenforceable. *See Second Restatement* § 211. A statute's determination to achieve a result by means of contractual agreement implicates contract law; indeed, "where a common-law principle is well established . . . the courts may take it as given that Congress has legislated with an expectation that the principle will apply." *Astoria Fed. Sav. & Loan Ass'n v. Solimino*, 501 U.S. 104, 108 (1991).[9]

---

9. The principle that the federal common law of contracts applies to government contracts is well established. *See, e.g.*, *Seckinger*, 397 U.S. at 209–210.

The Washington Legal Foundation, as *amicus curiae* in support of Petitioners, would require even narrow legal propositions—like the availability of third-party enforcement for federal contracts called for by statutes—to be "well-established" even where they are simply instances of settled common-law principles. *See* Brief of Washington Legal Foundation as *Amicus Curiae* in Support of Petitioners 12 ("[T]here is no well-established federal common law rule permitting suits by intended beneficiaries under contracts of this sort (*i.e.*, contracts mandated by a federal statute and

(Cont'd)

Although, as Petitioners note, "an agency cannot by regulation create a cause of action to enforce a statute," Pet. Br. at 15, an agency must surely enter into an enforceable contract where a statute directs it to do so.[10]

Several features of the contract in this case are clear. A significant performance objective of the contract is clearly to limit the price that Covered Entities must pay Petitioners for particular drugs. Section 340B requires specifically that an agreement be made to prevent prices from exceeding a particular computed amount; the Agreement fulfills that requirement. The contracts and the statute behind them seek to provide Covered

(Cont'd)
intended to ensure compliance with a statutory requirement).").
But their position is mistaken. *See Samantar v. Yousuf*, 130 S. Ct. 2278, 2290 n.13 (2010) (quoting *Astoria*, 501 U.S. at 108, for the proposition that "Congress 'is understood to legislate against a background of common-law . . . principles'" (ellipsis in original)). In any event, it would be unusual for a narrow principle to be as thoroughly settled as the Washington Legal Foundation appears to demand.

10. This brief does not take a position on the general federal jurisprudence concerning implied statutory private rights of action, except to note that questions about the private rights implied by a statute are analytically distinct from questions about claims for breaches of contracts that have been authorized or required by a statute, and therefore would appear to be inapplicable here *See Jackson Transit Auth. v. Local Div. 1285, Amalgamated Transit Union, AFL-CIO-CLC*, 457 U.S. 15 ("[O]n several occasions the Court has determined that a plaintiff stated a federal claim when he sued to vindicate contractual rights set forth by federal statutes, despite the fact that the relevant statutes lacked express provisions creating federal causes of action.").

Entities with drugs under a particular pricing scheme, and neither the contract nor the statute channels or limits remedies in ways that suggest third-party enforcement is inconsistent with the performance objectives of the contract. Importantly, because the Covered Entities seek only general market damages, Petitioners' potential liability under the contract would not increase because of third-party enforcement.[11]

Under the *First Restatement* test, the Covered Entities are a well-defined group of true donee beneficiaries who are seeking nonconsequential damages. Under the *Second Restatement* test, Covered Entities clearly are intended to benefit from the contract, in view both of its text and its fulfillment of the obligations of a statute one of whose chief purposes was to ensure that they receive drugs under a particular pricing scheme.

3. *Application of narrower doctrinal tests.* Occasionally, courts allow beneficiaries to enforce contracts if (and only if) the contract has called for

---

11. That is, Petitioners would need to pay only those damages they might have owed had the Department of Health and Human Services enforced the Agreement.

Of course, Petitioners may face lawsuits from a greater number of parties if third-party enforcement is permitted, and they may need to disclose information in those lawsuits that they would not have needed to disclose otherwise, as the United States argues. *See* Brief for the United States as *Amicus Curiae* Supporting Petitioners 28–29. But there is no indication they would have refused to sign the Agreement if third-party enforcement had been explicit, nor is there any indication of a direct conflict between third-party enforcement and the Medicaid Act. *Contra id.* at 28.

performance to be provided *directly* to the beneficiaries.[12] Directness of performance is a questionable criterion in determining the appropriateness of third-party enforcement under modern contract law. *See* Eisenberg, *supra* note 3, at 1830 ("[Directness] has no rational connection with the intent-to-benefit test or, for that matter, with anything else."). Nonetheless, some courts have purported to determine third-party enforcement rights in part on that basis, and this Court has occasionally endorsed a similar test. *See German Alliance Ins. Co. v. Home Water Supply Co.*, 226 U.S. 220, 230 (1912) ("Before a stranger can avail himself of the exceptional privilege of suing for a breach of an agreement to which he is not a party, he must, at least show that it was intended for his direct benefit."); *see also Robins Dry Dock & Repair Co. v. Flint*, 275 U.S. 303, 307 (1927) (quoting *German Alliance*).

To the extent directness matters, the Covered Entities directly benefit from the contract and are to receive performance directly.[13]

---

12. *See* Eisenberg, *supra* note 3, at 1380 n. 85 (collecting cases).

13. This conclusion is clear from the contract's terms, and other direct interactions between Petitioners and the Covered Entities are established in guidance found in the May 7, 1993, *Federal Register*, to which the contract's preamble refers. *See* 58 Fed. Reg. 27289 (requiring that drug manufacturers "remit a rebate directly to the covered entity (or provide for a credit)" and, inversely, that covered entities shall be directly liable to manufacturers under a penalty provision related to resale restrictions). *Cf.* 42 U.S.C. § 256b(a)(5)(D) (referring to "the agreement between the entity and the manufacturer under this paragraph").

Similarly, the *Second Restatement*, perhaps confusingly, suggests that reasonable reliance of third-party beneficiaries can bear on their ability to enforce a contract:

> Either a promise to pay the promisee's debt to a beneficiary or a gift promise involves a manifestation of intention by the promisee and promisor sufficient, in a contractual setting, to make reliance by the beneficiary both reasonable and probable. Other cases may be quite similar in this respect. . . . Where there is doubt whether such reliance would be reasonable, considerations of procedural convenience and other factors not strictly dependent on the manifested intention of the parties may affect the question whether under Subsection (1) recognition of a right in the beneficiary is appropriate. In some cases an overriding policy, which may be embodied in a statute, requires recognition of such a right without regard to the intention of the parties.

Second Restatement § 302 cmt. d.

To the extent reliance matters, the Covered Entities, given even the text of the Agreement alone, reasonably could have relied on receiving the price promised for their benefit.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

Stephen M. Tillery
Counsel of Record
Korein Tillery
One U.S. Bank Plaza
505 N. 7th St., Suite 3600
St. Louis, MO 63101
(314) 241-4844
stillery@koreintillery.com

Shawn J. Bayern
Assistant Professor,
Florida State University
College of Law
425 West Jefferson Street
Tallahassee, FL 32306
(850) 644-8308

December 20, 2010

APPENDIX

APPENDIX OF *AMICI CURIAE*[1]

Michael Asimow
Visiting Professor
Stanford Law School

Shawn J. Bayern
Assistant Professor,
Florida State University College of Law

Christopher T. Hines
Assistant Professor
Northern Illinois University College of Law

Francis J. Mootz III
William S. Boyd Professor
University of Nevada, Las Vegas School of Law

---

1. School affiliation is given for identification purposes only. This affiliation should not be construed as institutional endorsement of this brief.