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Remedies -- Lost Profits As Contract Damages for an Unestablished Business: The New Business Rule becomes Outdated

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COMMENT

Remedies—Lost Profits as Contract Damages for an Unestablished Business: The New Business Rule Becomes Outdated

One of the more entrenched tenets of the law of remedies has been that lost profits for breach of contract cannot be recovered on behalf of an unestablished business for the reason that without a history of past profits the existence of any profits that would have been realized but for the breach cannot be proven with the requisite legal "certainty" necessary to allow a recovery.[1] This principle, sometimes known as the "new business rule,"[2] is the most frequently invoked corollary of the more general doctrine that damages must be proven with certainty.[3] Problems in this area have arisen in diverse cases involving distributorships and selling agencies,[4] franchises,[5]

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1. For formulations of the rule, see, *e.g.*, United States v. Dura-Lux Int'l Corp., 529 F.2d 659, 663 (8th Cir. 1976); McBrayer v. Teckla, Inc., 496 F.2d 122, 127 (5th Cir. 1974); Central Coal & Coke Co. v. Hartman, 111 F. 96, 99 (8th Cir. 1901); Koehler v. Cummings, 380 F. Supp. 1294, 1312 (M.D. Tenn. 1974); Gibson v. Hercules Mfg. & Sales Co., 80 Cal. App. 689, 702, 252 P. 780, 785 (1927); Head v. Crone, 76 Idaho 196, 200, 279 P.2d 1064, 1066 (1955); Consumers' Pure Ice Co. v. Jenkins, 58 Ill. App. 519, 525 (1895); Price v. Van Lint, 46 N.M. 58, 70, 120 P.2d 611, 618 (1941); Knier v. Azores Constr. Co., 78 Nev. 20, 24, 368 P.2d 673, 675 (1962); Southwest Battery Corp. v. Owen, 131 Tex. 423, 427, 115 S.W.2d 1097, 1099 (1938); D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES § 3.3, at 154-55 (1973); 1 T. SEDGWICK, A TREATISE ON THE MEASURE OF DAMAGES § 183 (9th ed. A. Sedgwick & J. Beale 1920); 1 J. SUTHERLAND, A TREATISE ON THE LAW OF DAMAGES § 67 (4th ed. 1916); 22 AM. JUR. 2D *Damages* § 173 (1965); Note, *The Requirement of Certainty in the Proof of Lost Profits*, 64 HARV. L. REV. 317, 319 (1950); Annot., 1 A.L.R. 156 (1919). *See generally* Note, *Speculative Profits as Damages for Breach of Contract*, 46 HARV. L. REV. 696 (1933); Note, *Damages—Loss of Profits Caused by Breach of Contract—Proof of Certainty*, 17 MINN. L. REV. 194 (1933).

2. Larsen v. Walton Plywood Co., 65 Wash. 2d 1, 16, 390 P.2d 677, 687 (1964). This name is somewhat misleading in that the rule applies to any business without a history of profits in the period immediately preceding the breach. *See* text accompanying notes 60-70 *infra*.

3. It is often said in new business cases that "profits are uncertain." This is properly understood as a characterization of the evidence rather than of profits themselves, because profits are—tautologically speaking—profits. *See* 5 CORBIN ON CONTRACTS § 1022, at 139 (1964). In addition, profits are frequently described not only as "uncertain," but also as "speculative, conjectural, and remote." This heaping on of pejorative adjectives adds nothing to the analysis—perhaps the surplusage is used to emphasize the presumptuousness of anyone who would dare come into court with such a claim.

4. *Compare, e.g.*, McBrayer v. Teckla, Inc., 496 F.2d 122 (5th Cir. 1974), *and* Goodman v. Dicker, 169 F.2d 684 (D.C. Cir. 1948), *and* Gruber v. S-M News Co., 126 F. Supp. 442 (S.D.N.Y. 1954), *and* Brigham & Co. v. Carlisle, 78 Ala. 243 (1884), *and* Carolene Sales Co. v. Canyon Milk Prods. Co., 122 Wash. 220, 210 P. 366 (1922) (lost profit recovery not allowed), *with, e.g.*, Lee v. Joseph Seagram & Sons, Inc., 522 F.2d 447 (2d Cir. 1977), *and* Autowest, Inc. v. Peugeot, Inc., 434 F.2d 556 (2d Cir. 1970), *and* Smith v. Onyx Oil & Chem. Co., 218 F.2d 104

contracts to loan money for the launching of a business,[6] leases,[7] motion picture distribution,[8] entertainment and sporting events,[9] crops,[10] fishing expeditions,[11] well drilling and mining,[12] book publishing,[13] construction

(3d Cir. 1955), *and* Aronowicz v. Nalley's, Inc., 30 Cal. App. 3d 27, 106 Cal. Rptr. 424 (1973), *and* Oliver v. Perkins, 92 Mich. 304, 52 N.W. 609 (1892), *and* Wakeman v. Wheeler & Wilson Mfg. Co., 101 N.Y. 205, 4 N.E. 264 (1886), *and* Furrer v. Int'l Health Assurance Co., 256 Or. 429, 474 P.2d 759 (1970) (lost profit recovery allowed). *See generally* Recent Cases, 14 MINN. L. REV. 820 (1930).

5. *Compare, e.g.*, Mullen v. Brantley, 213 Va. 765, 195 S.E.2d 696 (1973) (lost profit recovery not allowed), *with, e.g.*, Burks v. Sinclair Ref. Co., 183 F.2d 239 (3d Cir. 1950), *and* Gordon v. Indusco Mgmt. Corp., 164 Conn. 262, 320 A.2d 811 (1973), *and* Nash v. Thousand Islands Steamboat Co., 123 App. Div. 148, 108 N.Y.S. 336 (1908), *and* Smith Dev. Corp. v. Bilow Enterprises, Inc., 112 R.I. 203, 308 A.2d 477 (1973) (lost profit recovery allowed).

6. *See, e.g.*, Stanish v. Polish Roman Catholic Union of Am., 484 F.2d 713 (7th Cir. 1973); Towles v. Cincinatti Tobacco Warehouse Co., 146 Ky. 301, 142 S.W. 401 (1912); St. Paul at Chase Corp. v. Manufacturers Life Ins. Co., 262 Md. 192, 278 A.2d 12, *cert. denied*, 404 U.S. 857 (1971); Shurtleff v. Occidental Bldg. & Loan Ass'n, 105 Neb. 557, 181 N.W. 374 (1921); Price v. Van Lint, 46 N.M. 58, 120 P.2d 611 (1941); Davis v. Small Business Inv. Co., 535 S.W.2d 740 (Tex. Civ. App. 1976) (lost profit recovery not allowed).

7. *Compare, e.g.*, Narragansett Amusement Co. v. Riverside Park Amusement Co., 260 Mass. 265, 157 N.E. 532 (1927), *and* Jurcec v. Raznik, 104 Mont. 45, 64 P.2d 1076 (1937), *and* Weiss v. Revenue Bldg. & Loan Ass'n, 116 N.J.L. 208, 182 A. 891 (1936), *and* Sporleder v. Gonis, 68 Wis. 2d 554, 229 N.W.2d 602 (1975) (lost profit recovery not allowed), *with, e.g.*, Fera v. Village Plaza, Inc., 396 Mich. 639, 242 N.W.2d 372 (1976), *and* Ferrell v. Elrod, 63 Tenn. App. 129, 469 S.W.2d 678 (1971) (lost profit recovery allowed). *See generally* Annot., 104 A.L.R. 132 (1936).

8. *Compare, e.g.*, Broadway Photoplay Co. v. World Film Corp., 225 N.Y. 104, 121 N.E. 756 (1919) (lost profit recovery not allowed), *with, e.g.*, William Goldman Theatres, Inc. v. Loew's, Inc., 69 F. Supp. 103 (E.D. Pa. 1946), *aff'd*, 164 F.2d 1021 (3d Cir.), *cert. denied*, 334 U.S. 811 (1948), *and* Madison Pictures, Inc. v. Pictorial Films, Inc., 6 Misc. 2d 302, 151 N.Y.S.2d 95 (Sup. Ct. 1956), *and* Lester v. Fox Film Corp., 114 S.C. 533, 104 S.E. 178 (1920) (lost profit recovery allowed), *and, e.g.*, Eastern Fed. Corp. v. Avco-Embassy Pictures, Inc., 316 F. Supp. 1280 (N.D. Ga. 1970), *modified sub nom.* Eastern Fed. Corp. v. Avco-Embassy Pictures Corp., 331 F. Supp. 1253 (N.D. Ga. 1971) (lost profit recovery allowed for plaintiff's established theaters, but denied for newly-opened one).

9. *See, e.g.*, Chicago Coliseum Club v. Dempsey, 265 Ill. App. 542 (1932); Todd v. Keene, 167 Mass. 157, 45 N.E. 81 (1896); Carnera v. Schmeling, 236 App. Div. 460, 260 N.Y.S. 82 (1932); Bernstein v. Meech, 130 N.Y. 354, 29 N.E. 255 (1891) (lost profit recovery not allowed). *Compare* Rombola v. Cosindas, 351 Mass. 382, 220 N.E. 2d 919 (1966), *with* Alderson v. Miami Beach Kennel Club, Inc., 336 So. 2d 477 (Fla. Ct. App. 1976); *compare* Brady v. Erlanger, 188 App. Div. 728, 177 N.Y.S. 301 (1919), *aff'd*, 231 N.Y. 563, 132 N.E. 889 (1921), *with* Broadway Photoplay Co. v. World Film Corp., 225 N.Y. 104, 121 N.E. 756 (1919).

10. *Compare, e.g.*, Crowley, Inc. v. Soelberg, 8 Idaho 480, 346 P.2d 1063 (1959), *and* Rhodes v. Sigler, 44 Ill. App. 3d 375, 357 N.E.2d 846 (1976), *and* Gray v. Gray, 30 N.C. App. 205, 226 S.E.2d 417 (1976), *and* Harrison-Daniels Co. v. Aughtrey, 309 S.W.2d 879 (Tex. Civ. App. 1958) (lost profit recovery not allowed), *with, e.g.*, Malone v. Hastings, 193 F. 1 (5th Cir.), *cert. denied*, 229 U.S. 618 (1912), *and* Golden Gate Hop Ranch, Inc. v. Velsicol Chem. Corp., 66 Wash. 2d 469, 403 P.2d 351 (1965), *cert. denied*, 382 U.S. 1025 (1966) (lost profit recovery allowed). *See generally* 34 HARV. L. REV. 662 (1921).

11. *Compare, e.g.*, Putnam v. Lower, 236 F.2d 561 (9th Cir. 1956) (lost profit recovery not allowed), *with, e.g.*, Whitelaw v. United States, 9 F.2d 103 (N.D. Cal. 1925), *and* Blanchard v. Makinster, 137 Or. 58, 1 P.2d 583 (1931) (lost profit recovery allowed).

12. *Compare, e.g.*, Fisher v. Hampton, 44 Cal. App. 3d 741, 118 Cal. Rptr. 811 (1975) (lost profit recovery not allowed), *with, e.g.*, Sanford v. East Riverside Irrigation Dist., 101 Cal. 275, 35 P. 865 (1894), *and* Robinson v. Rispin, 33 Cal. App. 536, 165 P. 979 (1917), *and* Johnson v. Wright, 175 Minn. 236, 220 N.W. 946 (1928), *and* Osage Oil & Ref. Co. v. Lee Farm Oil Co., 230 S.W. 518 (Tex. Civ. App. 1921) (lost profit recovery allowed).

13. *Compare, e.g.*, Manney v. Burgess, 346 S.W.2d 937 (Tex. Civ. App. 1961) (lost profit

delays,[14] promotional ventures[15] and ventures to develop or market a new product.[16] Whether it is deemed a flexible guide to characterization of evidence, or a per se rule of exclusion, the new business rule has served to frustrate the overall remedial policy of seeking to put the nonbreaching party in as good a position as he would have been had the contract been fully performed.[17] This frustation is a result of an arbitrary disregard of possibly relevant evidence other than a history of past profits, which thwarts many meritorious claims. In recent years, however, a number of decisions have allowed lost profit awards for unestablished businesses,[18] and there is an increasing trend either to create exceptions and mitigating sub-doctrines to the new business rule or simply to recognize that its rationale is no longer persuasive. A number of factors have contributed to this development; among them, the influence of the liberal recovery policy of private plaintiff antitrust cases,[19] increasing acceptance of the "yardstick" measure of

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recovery not allowed), *with, e.g.*, For Children, Inc. v. Graphics Int'l, Inc., 352 F. Supp. 1280 (S.D.N.Y. 1972) (lost profit recovery allowed).

14. *Compare, e.g.*, Howard v. Stillwell & Bierce Mfg. Co., 139 U.S. 199 (1891), *and* Consumers' Pure Ice Co. v. Jenkins, 58 Ill. App. 519 (1895), *and* Evergreen Amusement Corp. v. Milstead, 112 A.2d 901 (Md. Ct. Spec. App. 1955), *and* Peabody Constr. Co. v. First Fed. Parking Corp., 330 N.E.2d 497 (Mass. App. 1975), *and* Sandusky Grain Co. v. Borden's Condensed Milk Co., 214 Mich. 306, 183 N.W. 218 (1921), *and* Christopher & Simpson Architectural Iron & Foundry Co. v. Steininger Constr. Co., 200 Mo. App. 33, 205 S.W. 278 (1918), *and* Exton Drive-In, Inc. v. Home Indem. Co., 436 Pa. 480, 261 A.2d 319 (1969), *and* Texas Power & Light Co. v. Roberts, 187 S.W. 225 (Tex. Civ. App. 1916) (lost profit recovery not allowed), *with, e.g.*, S. Jon Kreedman & Co. v. Meyers Bros. Parking-Western Corp., 58 Cal. App. 3d 173, 130 Cal. Rptr. 41 (1976) (lost profit recovery allowed).

15. *Compare, e.g.*, William B. Tanner Co. v. WIOO, Inc., 528 F.2d 262 (3d Cir. 1975), *and* Tri-State Sys., Inc. v. Village Outlet Stores, Inc., 135 Ga. App. 81, 217 S.E.2d 399 (1975), *and* Winston Cigarette Mach. Co. v. Wells-Whitehead Tobacco Co., 141 N.C. 284, 53 S.E. 885 (1906) (lost profit recovery not allowed), *with, e.g.*, Lakota Girl Scout Council, Inc. v. Havey Fund-Raising Mgmt., Inc. 519 F.2d 634 (8th Cir. 1975), *and* Riley v. General Mills, Inc., 226 F. Supp. 780 (E.D. Pa. 1964), *rev'd on other grounds*, 346 F.2d 68 (3d Cir. 1965) (lost profit recovery allowed).

16. *Compare, e.g.*, Gibson v. Hercules Mfg. & Sales Co., 80 Cal. App. 689, 252 P. 780 (1927), *and* Tonchen v. All-Steel Equip., Inc., 13 Ill. App. 3d 454, 300 N.E.2d 616 (1973), *and* Barbier v. Barry, 345 S.W.2d 557 (Tex. Civ. App. 1961) (lost profit recovery not allowed), *with, e.g.*, Standard Mach. Co. v. Duncan Shaw Corp., 208 F.2d 61 (1st Cir. 1953), *and* Perma Research & Dev. Co. v. Singer Co., 402 F. Supp. 881 (S.D.N.Y. 1975), *aff'd*, 542 F.2d 111 (2d Cir.), *cert. denied*, 429 U.S. 987 (1976) (lost profit recovery allowed).

17. The traditional goal in awarding damages for breach of contract is to award a sum that will put the non-breaching party in as good a position as he would have been in had the contract been performed. This gives him the benefit of his bargain, that is, the "profit" he would have made upon performance. This is said to give him his expectancy and to protect his "expectation interest."

D. DOBBS, *supra* note 1, § 12.1, at 786 (footnote omitted); *see* RESTATEMENT OF CONTRACTS § 329 (1932).

18. *E.g.*, Terrell v. Household Goods Carriers' Bureau, 494 F.2d 16 (5th Cir.), *cert. dismissed*, 419 U.S. 987 (1974); Mechanical Wholesale, Inc. v. Universal-Rundle Corp., 432 F.2d 228 (5th Cir. 1970); Vickers v. Wichita State Univ., 213 Kan. 614, 518 P.2d 512 (1974); Pace Corp. v. Jackson, 155 Tex. 179, 284 S.W.2d 340 (1955); cases allowing recovery cited in notes 4, 5, 7-16 *supra*.

19. *See* text accompanying notes 100-17 *infra*. Antitrust cases that have influenced breach

looking at closely comparable businesses,[20] relaxation of restrictions on expert opinion evidence,[21] the growing sophistication of market analysis and business forecasting,[22] a dissatisfaction with the niggardly "all-or-nothing" approach inherent in the new business rule[23] and a recognition of the unfairness of allowing a class of defendants to breach their contracts with impunity.[24]

I. HISTORICAL DEVELOPMENT OF THE CERTAINTY DOCTRINE AND THE NEW BUSINESS RULE

Lost profits are usually considered to be "special damages," and therefore must be specifically pleaded and proven with certainty.[25] This certainty requirement was first announced and developed in lost profit cases, initially in *The Lively*,[26] in which a calculation of lost profits from the illegal capture of a merchant vessel and its cargo was declared to entail "utter uncertainty."[27] *Griffin v. Colver*[28] elaborated more fully on the certainty doctrine in response to a claim for lost profits occasioned by failure to deliver a steam engine to a sawmill, stating that "[p]rofits which would certainly have been realized but for the defendant's default are recoverable; those which are speculative or contingent are not,"[29] and that the certainty requirement was a "condition" upon the broad rule that plaintiff is entitled to recover all his damages.[30]

The most compelling reason for making an explicit requirement that the cause and amount of damages be proven with certainty was probably to obtain a device that would serve as a guide to or curb upon the discretion of juries.[31] Claims for damages, being at law, were triable before juries, and

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of contract analysis involving lost profits include Bigelow v. RKO Radio Pictures, Inc., 327 U.S. 251 (1946); Story Parchment Co. v. Paterson Parchment Paper Co., 282 U.S. 555 (1931); Eastman Kodak Co. v. Southern Photo Materials Co., 273 U.S. 359 (1927); Lehrman v. Gulf Oil Corp., 464 F.2d 26 (5th Cir. 1972), *on appeal from remand determination of damages*, 500 F.2d 659 (5th Cir.), *cert. denied*, 420 U.S. 929 (1974); Flintkote Co. v. Lysfjord, 246 F.2d 368 (9th Cir.), *cert. denied*, 355 U.S. 835 (1957); Kobe, Inc. v. Dempsey Pump Co., 198 F.2d 416 (10th Cir.), *cert. denied*, 344 U.S. 837 (1952); William Goldman Theatres, Inc. v. Loew's, Inc., 69 F. Supp. 103 (E.D. Pa. 1946), *aff'd*, 164 F.2d 1021 (3d Cir.), *cert. denied*, 334 U.S. 811 (1948).

20. The "yardstick measure" is discussed at text accompanying notes 123-49 *infra*.

21. *See* text accompanying notes 193-213 *infra*.

22. *See* text accompanying notes 176-91 *infra*.

23. *See* text accompanying notes 78-81 *infra*.

24. *See* note 243 *infra*.

25. C. MCCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 28, at 104 (1935). *See generally* D. DOBBS, *supra* note 1, §3.2, at 138-43 (discussion of the distinction between general and special damages).

26. 15 F. Cas. 631 (C.C.D. Mass. 1812) (No. 8,403).

27. *Id.* at 635.

28. 16 N.Y. 489 (1858).

29. *Id.* at 491.

30. *Id.* at 494-95.

31. *See* C. MCCORMICK, *supra* note 25, § 26, at 101.

there was legitimate concern that juries would make awards based upon inadequate evidence. The certainty requirement could thus be thought of as the basis for defining a prima facie case and also for giving cautionary instructions. As the case law developed, it was generally stated that the requisite certainty was most difficult to achieve in actions for lost profits in the commercial context because the contingencies of the marketplace made the realization of profits inherently uncertain.[32] Such claims were for the most part denied as a matter of course without being submitted to the jury.

An early exception reflected the recognition that profits directly attributable to the contract itself, as opposed to further transactions with third parties, were susceptible of definite proof.[33] *Masterton v. Mayor of Brooklyn*,[34] the seminal case making this distinction, termed the former "direct" and the latter "collateral."[35] This distinction, helpful in determining when a plaintiff had shown his loss with certainty, was later convoluted into a notion that responsibility for collateral profits was somehow not a "part" of the contract, and thus would allow a defaulting party to absolve himself for the damages flowing from his actions simply beacuse the lost benefits would have come from others rather than from his performance alone.[36] As an exception allowing recovery of lost profits, the direct profits doctrine was not applied to cases involving the destruction or prevention of the starting of a new business, since such claims almost by definition are for profits that would have been made from transactions with potential third party customers of the business, a class that may be as large as the general public.

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32. *See, e.g.*, Howard v. Stillwell & Bierce Mfg. Co., 139 U.S. 199 (1891).

33. An example would be when buyer refuses to accept delivery of a machine he has contracted to buy. Seller can easily show what profit he has lost by showing the expense of production and selling costs and subtracting these from the contract price. Stricter proof would be required from the buyer who seeks profits he would have made on the resale of the machine had the seller not breached. *See* M & R Contractors & Builders, Inc. v. Michael, 215 Md. 340, 346, 138 A.2d 350, 353-54 (1958); *cf.* McCormick, *The Recovery of Damages for Loss of Expected Profits*, 7 N.C.L. REV. 231, 240 (1929) (greater uncertainty adheres to claims arising out of frustrations of dealings with third parties).

34. 7 Hill 61 (N.Y. Sup. Ct. 1845).

35. *Id.* at 68-69.

36. *See* Howard v. Stillwell & Bierce Mfg. Co., 139 U.S. 199, 205-06 (1891). Some later cases stated that profits *must* be direct in order to be recoverable. *E.g.*, Merchants' Life Ins. Co. v. Griswold, 212 S.W. 807 (Tex. Civ. App. 1919), *rev'd on other grounds*, 237 S.W. 232 (Tex. Comm'n App. 1922). The distinction survives today for the most part only as a difference in proof requirements, not as a limitation on the right of recovery. *See* M & R Contractors & Builders, Inc. v. Michael, 215 Md. 340, 345-54, 138 A.2d 350, 353-58. It may be crucial, however, to courts that are still concerned with the Hadley v. Baxendale, 156 Eng. Rep. 145 (Ex. 1854), requirement that special damages must have been foreseeable or within the contemplation of the parties to be recoverable. *See* text accompanying notes 47-51 *infra*; *cf.* Rivenbark v. Finis P. Ernest, Inc., 37 Ill. App. 3d 536, 539, 346 N.E.2d 494, 497 (1976) (notice of possible collateral profits after execution of a contract will not satisfy the contemplation condition). *Masterton* stated that profits on resale can not be "presumed to have entered into their consideration at the time of contracting." 7 Hill at 68.

Although the early cases seemed to establish a proof requirement that was impossible for most claimants to satisfy, there was at no time a generally accepted rule stating that lost profits as such could never be proven with enough certainty to justify a recovery.[37] *Bagley v. Smith*,[38] an action for wrongful dissolution of a partnership, recognized that evidence of past profits was relevant to a determination of future profits. This acceptance of the common sense principle of induction—that if all relevant conditions are unchanged then one can know that the future will probably be like the past[39]—served as the foundation for the formulation of the rule, still prevalent, that is succinctly stated in *Central Coal & Coke Co. v. Hartman*:[40]

> [T]he anticipated profits of a business are generally so dependent upon numerous and uncertain contingencies that their amount is not susceptible of proof with any reasonable degree of certainty; hence the general rule that the expected profits of a commercial business are too remote, speculative, and uncertain to warrant a judgment for their loss. . . . There is a notable exception to this general rule. It is that the loss of profits from the destruction or interruption of an established business may be recovered where the plaintiff makes it reasonably certain by competent proof what the amount of his loss actually was. . . . The interest upon his capital and the expenses of his business deducted from its income for a few months or years prior to the interruption produce the customary monthly or yearly net profits of the business during that time, and form a rational basis from which the jury may lawfully infer what these profits would have been during the interruption if it had not been inflicted. . . . He who is prevented from embarking a new business can recover no profits, because there are no provable data of past business from which the fact that anticipated profits would have been realized can be legally deduced.[41]

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37. CORBIN ON CONTRACTS, *supra* note 3, § 1022, at 138; *see* Howard v. Stillwell & Bierce Mfg. Co., 139 U.S. 199 (1891) (limiting recovery on substantive grounds rather than remedial considerations); Griffin v. Colver, 16 N.Y. at 491 (nothing in the nature of profits per se prevents their allowance).

38. 10 N.Y. 489 (1853).

39. *See* J. KEYNES, THE GENERAL THEORY OF EMPLOYMENT INTEREST AND MONEY 147-64 (1936). *Contra*, D. HUME, AN INQUIRY CONCERNING HUMAN UNDERSTANDING (1748).

40. 111 F. 96 (8th Cir. 1901). While this is a case under the Sherman Act rather than for breach of contract, antitrust policy of recovery at the time had not yet diverged from that of contract. *See* text accompanying notes 113-17 *supra*. The rule as stated here applied with equal force to the latter.

41. 111 F.2d at 98-99 (citations omitted). *Compare* Central Coal & Coke, 111 F. 96 (8th Cir. 1901), *with* Fireside Marshmallow Co. v. Frank Quinlan Constr. Co., 213 F.2d 16, 19 (8th Cir. 1954), *and* Florida Outdoor, Inc. v. Steward, 318 So. 2d 414, 415 (Fla. Dist. Ct. App. 1975), *and* Southwest Battery Corp. v. Owen, 131 Tex. 423, 426, 115 S.W. 2d 1097, 1099 (1938). Some jurisdictions did not even recognize the history of past profits exception, *see, e.g.*, Harper Furniture Co. v. Southern Express Co., 148 N.C. 87, 89-90, 62 S.E. 145, 145-46 (1908), but this seems to have been aberrational.

Thus the new business rule became crystallized as a rule of law. The history of past profits exception, like the direct profits exception, was by definition of no avail to claimants with an unestablished business. Only much later would chinks begin to appear in the judicially erected barrier of the certainty doctrine.[42]

II. THE NEW BUSINESS RULE IN PRACTICE

The rule as stated in *Central Coal & Coke* is one of per se exclusion. It is also characterizable, however, as a flexible rule bearing on the weight of the evidence. Under the latter view past profits may be considered to be the most persuasive evidence of what future profits would have been, but their absence would not be fatal if the plaintiff could produce other evidence tending to establish lost profits with certainty. As a doctine regulating the sufficiency of evidence, the new business rule is helpful when instructing the jury, but indefensible when used automatically to take the case away from the jury—obviously it is fair to require a more extensive demonstration of the factors bearing upon whether profits would have been made from a plaintiff whose business never had any than from one whose business had.[43] It is in this sense, as an evidentiary consideration, that courts who have acknowledged the authority of the new business rule, but nevertheless have

42. The application of the standard of certainty to deny recoveries of lost profits was a peculiarly American development. Scottish law always allowed lost profits to be considered in the estimate of damages. J. MAYNE & L. SMITH, MAYNE ON DAMAGES § 59 (1st Am. ed. H. Wood 1880); *see* Oliver v. Perkins, 92 Mich. 304, 52 N.W. 609 (1892); Wakeman v. Wheeler & Wilson Mfg. Co., 101 N.Y. 205, 4 N.E. 264 (1886) (early applications of the history of profits exception in the selling agency context). *Contra*, Stern v. Rosenheim, 67 Md. 503, 10 A. 221 (1888). *Cf.* Johnson v. Railroad Co., 140 N.C. 574, 53 S.E. 362 (1906) (plaintiffs could recover in tort for the negligent burning of their crate-making factory the value of contracts already entered into, but not for possible future contracts). *Wakeman* also indicated that evidence of the business of the agencies that defendant later established would be admissible to prove the amount of business plaintiff would have done had not his agency been wrongfully terminated, 101 N.Y. at 217, 4 N.E. at 271, an idea that was not generally accepted until much later. *Compare* Wakeman, 101 N.Y. 205, 4 N.E. 264 (1886), *with* Smith v. Eubanks & Hill, 72 Ga. 280 (1884). The narrow circumscription of the history of profits exception was also departed from in Nash v. Thousand Islands Steamboat Co., 123 App. Div. 148, 108 N.Y.S. 336 (1908), a very liberal case for its time. Plaintiff held concessions for souvenirs and parcel checking, on defendant's six steamers for a term of three years. Plaintiff sought profits lost as a result of the failure of one of the steamers to operate for more than one month of the term. Evidence was properly taken concerning, among other things, profits earned during the same term on the other boats (now known as the "yardstick" measure), the nature of the business, and plaintiff's business ability. The court stated that "the fact that the jury would have difficulty in correctly reaching a proper amount would not prevent their passing upon the question and exercising their best judgment," *id.* at 158, 108 N.Y.S. at 343, indicating a greater faith in the discretion of juries than was customary at the time. For general discussions of the certainty requirement, see C. MCCORMICK, *supra* note 25, §§25-30; Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV 1145, 1210-15 (1970).

43. *Cf.* D. DOBBS, *supra* note 1, § 3.3, at 154-55 (established-unestablished distinction makes a good deal of sense as a matter of evidence, but not as a matter of substantive law).

been willing to entertain claims within its purview, have spoken of the effect of the lack of past profits.[44]

The requirement that the amount of lost profits be proved with certainty, of which the new business rule is a corollary, is the third condition in a tripartite proof sequence that has been developed to limit the recovery of lost profits.[45] The first condition is that the breach must be the proximate cause of the loss.[46] The second is the *Hadley v. Baxendale*[47] rule that special damages must have been "foreseeable," that is, that they either are the natural and inevitable result of the breach, or were within the "contemplation of the parties" in that the defendant at the time of contracting had notice of special circumstances making it likely that such damages would result from nonperformance.[48] Foreseeability, although stated as a condition to recovery, now is seldom a concern to most courts.[49] While *Hadley* may have had some coherent meaning in the undeveloped commercial context in which it arose, it now serves primarily as a source of confusion. Whatever "foreseeable" may mean,[50] it is a consideration that can be subsumed under

44. *See* Eastern Fed. Corp. v. Avco-Embassy Pictures, Inc., 326 F. Supp. 1280, 1284 (N.D. Ga. 1970), *modified sub nom.* Eastern Fed. Corp. v. Avco-Embassy Pictures Corp., 331 F. Supp. 1253 (N.D. Ga. 1971); William Goldman Theatres, Inc. v. Loew's, Inc., 69 F. Supp. 103-05 (E.D. Pa. 1946), *aff'd*, 164 F.2d 1021 (3d Cir.), *cert. denied*, 334 U.S. 811 (1948) ("The allowance of profits as damages is entirely a question of sufficiency of evidence."); Systems Corp. v. American Tel. & Tel. Co., 60 F.R.D. 692, 695 (S.D.N.Y. 1973). A court could not logically recognize the new business rule as a rule of law and then proceed to hear evidence when there was no history of past profits forthcoming, because as a matter of law—if not of reality—nothing that the plaintiff could offer would be relevant.

45. D. DOBBS, *supra* note 1, § 12.3, at 798.

46. *Id.*

47. 156 Eng. Rep. 145 (Ex. 1854).

48. *Id.* at 151; *accord*, Chain Belt Co. v. United States, 115 F. Supp. 701, 714 (Ct. Cl. 1953); M & R Contractors & Builders, Inc. v. Michael, 215 Md. 340, 348-49, 138 A.2d 350, 355 (1958); D. DOBBS, *supra* note 1, § 12.3, at 798 (recognizing the existence of the rule but describing it as an "oversimplification"); Comment, *Lost Profits as Contract Damages: Problems of Proof and Limitations on Recovery*, 65 YALE L.J. 992, 997-98 (1956). *See generally* D. DOBBS, *supra*, § 12.3. Howard v. Stillwell & Bierce Mfg. Co., 139 U.S. 199, 206 (1891), seems to indicate that lost profits need only be shown to be foreseeable *or* certain, but this is probably only a manifestation of the confused analysis in the opinion. The "contemplation of the parties" strain of *Hadley* was the first "condition" imposed by the court in Griffin v. Colver, 16 N.Y. at 494-95; *see* text accompanying note 30 *supra*. *See also* note 36 *supra*.

49. Lakota Girl Scout Council, Inc. v. Havey Fund-Raising Mgmt., Inc., 519 F.2d 634, 640 (8th Cir. 1975), and For Children, Inc. v. Graphics Int'l, Inc., 352 F. Supp. 1280, 1284 n.16 (S.D.N.Y. 1972), note it in passing. Grupe v. Glick, 26 Cal. 2d 680, 694, 160 P.2d 832, 841 (1945), is a rare case regarding contemplation of the parties as a dispositive issue.

50. Professor Dobbs suggests that foreseeability and contemplation of the parties are merely code words for other policies concerning contract liability. D. DOBBS, *supra* note 1, § 12.3, at 804. He also states that courts have frequently treated contemplation of the parties and certainty as the same problem. *Id.* § 12.3, at 814. Towles v. Cincinatti Tobacco Warehouse Co., 146 Ky. 301, 142 S.W. 401 (1912), is instructive in this regard. In *Towles*, the court said that the profits plaintiff lost by defendant's failure to loan money so that he could buy and sell warehouse tobacco were not contemplated and were therefore speculative. *Id.* at 302, 142 S.W. at 401. "Contemplated" is a foreseeability code word; "speculative" is a certainty code word.

certainty analysis. It is enough to state the requirement that the defendant's breach occasion the loss and that the loss be shown with a reasonable degree of certainty.[51]

If profits are to be recovered then the term must of course be defined. The *Restatement of Contracts* defines profits simply as "the net pecuniary gain from a transaction, the gross pecuniary gains diminished by the cost of obtaining them."[52] This definition is equivalent to the accountant's definition of net income as "the excess of revenues over the expenses incurred, plus or minus any gains or losses that are recognized during the period."[53] It is axiomatic that proof of gross income is insufficient.[54] In addition to operating expenses such as the cost of goods sold and wages and salaries, depreciation expense must usually be deducted from gross income as well.[55] Older cases indicated that an allowance for interest on capital should be made,[56] but this item is rarely mentioned in more recent cases.[57] One problem that only arises in the case of a new business when an established business enters a new geographic market or product line is the allocation of overhead, that is, those fixed costs that are not easily assignable as costs per unit. Consideration of overhead has been confused.[58] The preferable view is not to require a deduction of a percentage of overhead costs when the increased business would not actually have increased such costs (notwithstanding that as an accounting convention overhead cost is allocated proportionately to each unit or job in order to determine profit for accounting purposes) because such costs are not "saved" when performance is not forthcoming, but rather are allocated at a higher rate to business actually done.[59]

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51. *Cf.* Comment, *supra* note 48, at 1020 (the requirement of foreseeability should be abandoned).

52. RESTATEMENT OF CONTRACTS § 331, Comment b (1932).

53. M. GORDON & G. SHILLINGLAW, ACCOUNTING: A MANAGEMENT APPROACH 12 (5th ed. 1974). For economists' views of profits, see P. SAMUELSON, ECONOMICS 618-25 (9th ed. 1973).

54. *E.g.*, Lovely v. Burroughs Corp., 165 Mont. 209, 217, 527 P.2d 557, 562 (1974).

55. *E.g.*, Lee v. Durango Music, 144 Colo. 270, 279, 355 P.2d 1083, 1088 (1960).

56. *E.g.*, Central Coal & Coke Co. v. Hartman, 111 F. at 98-99, *quoted in* text accompanying note 41 *supra*; Morrow v. Missouri Pac. Ry., 140 Mo. App. 200, 213, 123 S.W. 1034, 1039 (1909).

57. *But cf.* Lee v. Joseph E. Seagram & Sons, Inc., 552 F.2d 447, 454-55 (2d Cir. 1977) (subtracting percentage of return from investment bonds from percentage of return on yardstick measure business to arrive at a net percentage of return lost by reason of the breach).

58. Comment, *supra* note 48, at 1009.

59. *See* Edwin K. Williams & Co. v. Edwin K. Williams & Co. -E., 542 F.2d 1053, 1062 (9th Cir. 1976), *cert. denied*, 97 S. Ct. 2973 (1977) ("Damages may be awarded on the basis of gross profits when the breach does not significantly reduce overhead."); Eastman Kodak Co. v. Southern Photo Materials Co., 273 U.S. 359, 376 (1927); Kobe, Inc. v. Dempsey Pump Co., 198 F.2d 416, 427 (10th Cir.), *cert. denied*, 344 U.S. 837 (1952). As an illustration, suppose Slumb Contracting Company has office and salary expenses of X dollars per period whether it completes N contracts or N-10 contracts. Slumb is prevented from performing a contracting job

The determination whether a business is "new" or not is crucial when to call it new would trigger the new business rule in its guise as a per se rule of exclusion. Although this determination will necessarily vary with the type of business involved, the decisions are essentially inconsistent. A vaudeville theater in operation for fifteen weeks has been held to be an established business,[60] while a distributorship for a milk product failed to qualify, notwithstanding successful operation for several months.[61] A general definition that has been advanced is that "[a]n established business should be one that is in actual operation long enough to give it permanency and recognition."[62]

It is often held that when an established retail or motel business moves to a new location, it then becomes a new business at the new location; profits formerly earned at the old location cannot be used as evidence of future profits at the new location.[63] While in the majority of cases this distinction may make some sense in that a retail store's or motel's location is an important factor in the composition of its goodwill and helps determine the type and number of customers it can attract, a change of location by itself has no significant effect on a manufacturing or wholesale enterprise. It has thus been held that moving a manufacturing operation to another plant does not make it unestablished.[64]

Even the expansion of capacity or capital improvement of a business may invoke the "unestablished" epithet.[65] This seems entirely unjustified if

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by a breach of contract. During the time this contract would have been performed, Slumb was actually working on N-3 contracts with equal costs of performance. If it had been working under the contract that had been breached, it would have been working on N-2 contracts of equal cost. Overhead would be assigned per contract as —

$$\frac{X}{N-3} \text{ rather than } \frac{X}{N-2}$$

by Slumb's accountant, but the actual amount of overhead—X—remained constant despite the breach.

60. Brady v. Erlanger, 188 App. Div. 728, 177 N.Y.S. 301 (1919), *aff'd*, 231 N.Y. 563, 132 N.E. 889 (1921).

61. Carolene Sales Co. v. Canyon Milk Prods. Co., 122 Wash. 220, 210 P. 366 (1922).

62. Atomic Fuel Extraction Corp. v. Estate of Slick, 386 S.W.2d 180, 189 (Tex. Civ. App. 1964).

63. *E.g.*, Knier v. Azores Constr. Co., 78 Nev. 20, 368 P.2d 673 (1962) (motel); Dieffenbach v. McIntyre, 208 Okla. 146, 254 P.2d 346 (1953) (beauty parlor); Sporleder v. Gonis, 68 Wis. 2d 554, 229 N.W. 2d 602 (1975) (jewelry store); *cf.* Jurcec v. Raznik, 104 Mont. 45, 64 P.2d 1076 (1937) (rooming house at old location continued operation so new location can be seen as an expansion rather than a "new location").

64. Chain Belt Co. v. United States, 115 F. Supp. 701, 717-18 (Ct. Cl. 1953); *cf.* Gardner v. The Calvert, 253 F.2d 395, 400 (3d Cir.), *cert. denied*, 356 U.S. 960 (1958) (replacement of a vessel used for ferry and charter service did not involve undertaking a new venture).

65. *See* Bixby-Theirson Lumber Co. v. Evans, 167 Ala. 431, 437-38, 52 So. 843, 845 (1910) (profits of mill did not relate to what profits would have been after construction of dam to improve the mill).

the plaintiff can demonstrate that demand for his product or service was such that the expanded capacity would be utilized to the same extent as his existing capacity.[66] The expansion of an established manufacturing or wholesale operation into a new geographic market presents an analogous issue. Courts have usually found a sufficient nexus between performance in the established territory and anticipated performance in the new territory to justify considering the business as continuing to be an established one.[67] An established business that enters a new product line, however, may be deemed unestablished in that new product market.[68] Some businesses, such as farming, may be considered inherently "speculative," regardless of how long the plaintiff has been in business.[69]

At least one case has held that the sale of an established business transforms it into an unestablished business in the hands of the new owners.[70] This result may be defensible when the business in question is small and dependent upon the skill, diligence and established goodwill of its proprietors, but would be unjustified when the business involved is a large firm and no changeover of management or firm strategy is contemplated.

There can be no comprehensive test for divining in all possible cases whether a business is established. Because this is a question of law for the court,[71] a judgment that a business is new may be no more than a reflection of a judge's view that the plaintiff's claim is not substantiated by the evidence, thus allowing him to keep the issue from going to the jury and to award the defendant a victory by definition. When the new business rule is not recognized, or is recognized only as a rule concerning the weight of the

66. *Compare* Hoag v. Jenan, 86 Cal. App. 2d 556, 195 P.2d 451 (1948), *with* Weiss v. Revenue Bldg. & Loan Ass'n, 116 N.J.L. 208, 182 A. 891 (1936).

67. *See* Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100 (1969); Aronowicz v. Nalley's, Inc., 30 Cal. App. 3d 27, 106 Cal. Rptr. 424 (1973); Madison Pictures, Inc. v. Pictorial Films, Inc., 6 Misc. 2d 302, 151 N.Y.S.2d 95 (Sup. Ct. 1956). In Richfield Oil Corp. v. Karseal Corp., 271 F.2d 709 (9th Cir. 1959), *cert. denied*, 361 U.S. 961 (1960), plaintiff was foreclosed from marketing his "Wax Seal" polish in 3,000 gas stations. These stations sold a total of 4,707 cases of "Mac's" polish during the period. The products were comparable, but Wax Seal outsold Mac's on the open market by a 3 to 1 margin. The Ninth Circuit in this antitrust action accepted the reasoning that without the restriction the stations would have sold 14,121 cases of Wax Seal. *Id.* at 714-15. A more realistic figure would have been that 3,272 cases of Wax Seal and 1,636 cases of Mac's would have been sold during the period, because demand for car polish could not be expected to vary with the number of brands available.

68. Atomic Fuel Extraction Corp. v. Estate of Slick, 386 S.W.2d 180 (Tex. Civ. App. 1964); *see* Thrift Wholesale, Inc. v. Malkinillion Corp., 50 F. Supp. 998 (E.D. Pa. 1943). Of course, what is a new product may also be problematic, bringing into play such considerations as different physical characteristics, and the availability of substitutes. *Thrift* drew a distinction between cigarette vending machines and cigar vending machines. *Id.* at 1000.

69. *See* Rhodes v. Sigler, 44 Ill. App. 3d 375, 357 N.E.2d 846 (1976). Curiously, drilling for oil is not usually put into this category, perhaps because geological evidence is more scientific than measures of the vagaries of the marketplace. *See* cases cited at note 12 *supra*.

70. Kurtz v. Oremland, 33 N.J. Super. 443, 111 A.2d 100 (1954).

71. *See* text accompanying notes 31 & 32 *supra*.

evidence, then this somewhat scholastic, definitional word game is of little importance. The question is restricted to whether the past history of the business bears a close enough relation to a hypothetical future of the business (which would have occurred had not the defendant breached his contract) to justify looking at the past history as a guide; any change in the character of the business would be a reason for adjustment—not preclusion altogether.

The application of the new business rule as a per se rule has the virtue of avoiding the problems presented when a court is willing to entertain evidence of lost profits. For instance, evidence of lost profits when not based on records of past profits is likely to be exceedingly complex, entailing, among other things, expert testimony by accountants and business economists, introduction of business records and such documents as market surveys, testimony by competitors, complicated statistical analysis and mathematical calculations of profit projections and present value. The possibility of confusing the jury is quite apparent.[72] In addition, because the rule is used to exclude evidence, it has the effect of avoiding expensive and protracted litigation.[73]

The most salutary effect of the new business rule, but one which is never explicitly stated as a justification, is that it avoids holding the defendant responsible for risks that are so great that they could not be fairly allocated between the parties under any circumstances.[74] A promisor to a contract only engages to part with his consideration. The expectation interest of the promisee, however, which the law seeks to protect, will be greater than the consideration which the promisor has promised to give when the expectation is that a business will be formed that will bring to the promisee profits from further transactions with third parties.[75] If the defendant is held accountable for these profits then he is in effect paying for benefits that would have flowed from the marketplace. Lost profit recoveries thus can be punitive in the sense that they require one who has breached a contract to do more than he would have had to do had he performed. The new business rule may reflect an implicit policy judgment that this situation places an unfair burden on the defendant and that the plaintiff is usually in the better position

72. *Cf.* T. MILNE, BUSINESS FORECASTING: A MANAGERIAL APPROACH 23 (1975) (statistical analysis is so powerful a forecasting tool that the method may blind the user to deficiencies in his data or his judgment).

73. Such litigation can indeed be protracted. *See* Fera v. Village Plaza, Inc., 396 Mich. 639, 242 N.W.2d 372 (1976). " '[T]here were days and days of testimony.' " *Id.* at 645, 242 N.W.2d at 374 (quoting the trial court).

74. *See* C. MCCORMICK, *supra* note 25, § 28, at 104.

75. That is, "collateral" profits. See notes 33-36 and accompanying text *supra* on the distinction between direct and collateral profits.

to anticipate and absorb this loss.[76] The obvious method of dealing with such problems at the stage of forming the contract is always to include a liquidated damages clause.[77]

If there is indeed a tacit policy that the law should not place the danger of excessive commercial risk upon promisors, then this purpose should be made explicit and given some underpinning of reasoned analysis. Even if this aim is desirable, however, the new business rule and the certainty doctrine in general are both overbroad and underbroad as tools for its realization. The certainty doctrine is underbroad in that if a plaintiff's business has a history of past profits, then there is no curb on his recovering his entire expectation interest—no matter how large—because he is deemed to be able to prove his loss with certainty. Conversely, the new business rule is overbroad in that without a history of past profits no profits can be recovered, even if the ad damnum is minimal.[78] A doctrine that purports to deal with problems of proof cannot also satisfactorily deal with problems of excessive verdicts; the two problems are not coextensive.

This point leads to consideration of the most severe shortcoming of the certainty doctrine as traditionally applied: it supports a view that either the full amount of damages must be proved with certainty and hence be recoverable, or else nothing may be recovered.[79] Either the entire burden of risk is shifted to the promisor or it is left entirely with the promisee. The certainty doctrine and the new business rule in their harshest form permit neither apportionment of the risk nor compromise whereby a plaintiff may recover some amount even though his proof as a whole falls short of demonstrating with certainty the entire loss he claims.[80] While a plaintiff will in most cases

76. This concern may underlie such cases as Chicago Coliseum Club v. Dempsey, 265 Ill. App. 542 (1932). Plaintiff sued Jack Dempsey for repudiation of an agreement to fight Harry Wills for the heavyweight championship and offered testimony to show a loss of $1,600,000. The court stated that "[t]he character of the undertaking was such that it would be impossible to produce evidence of a probative character sufficient to establish any amount which could be reasonably ascertainable by reason of the character of the undertaking." *Id.* at 549. This is preposterous. Obviously plaintiff could have made a substantial amount of money from staging a bout featuring the Manassa Mauler. This is probably an instance of a court invoking the certainty doctrine as a subterfuge to avoid placing an intolerable onus on a defendant.

77. A related policy consideration is that if lessors and lenders are to be held liable for profits lost due to breaches of leases and loan contracts, then they will pass along this increased risk to the public in the form of higher rental and credit charges. Fera v. Village Plaza, Inc., 396 Mich. 639, 242 N.W.2d 372 (1976), is instructive in this regard. There defendant shopping center developer was held liable in the amount of $200,000 for failure to put plaintiff into possession of space in a shopping center so that plaintiff could open a "book and bottle" shop. Such a risk of doing business could well chill further development of shopping centers. One might well consider this result desirable, however. This concern does not extend to lenders. Recovery of lost profits for failure to loan money is almost never allowed. *See* cases cited note 6 *supra*.

78. *Cf.* Comment, *supra* note 48, at 1016 ("the foreseeability test has been invoked to preclude recovery when no large verdict problem was present").

79. *See id.* at 1020.

80. *See* Farnsworth, *supra* note 42, at 1213-14.

be able to recover under an alternative measure of damages, this recovery will rarely serve to fully protect his expectation interest.[81]

III. ALTERNATIVE REMEDIES

As loss of profits is a measure of special damages, some measure of general damages will always be theoretically available as an alternative when lost profits are not proved with certainty.[82] In the case of destruction of capital, this measure is the cost of the capital plus interest;[83] for failure to convey land or fixtures it is the difference between the contract price and the fair market value of the property;[84] for delay in completion of construction, conveyance, placement into possession under a lease or interruption of an established business, it is the rental value of the property for the time it is idle[85] plus, occasionally, interest on the capital invested.[86] When the breach does not interfere with the use of any capital, only nominal damages may be recovered.[87]

Assuming that there is an ongoing profitable business or that one would have been established, none of the general damages measures is adequate to make an aggrieved party "whole." The difference between the fair market value of property and its contract price will be zero in a perfectly competitive market. Rental value, at most, only reflects operating expenses plus a premium that a willing lessee would pay for the right to receive the profits derived from the use of the property. Even when interest on capital is added to rental value, the sum is still a lesser amount than the return from a profitable business, because a "profitable" business almost by definition makes a greater return on investment than the rate on a relatively risk-free investment which is equivalent to the percentage of interest usually allowed.[88] Some courts, recognizing that an established business is worth more than its capital (that is, that its real value is equal to capital plus goodwill) have allowed evidence of profits to be considered for the limited

81. *See* text accompanying notes 82-97 *infra*.

82. *See* D. DOBBS, *supra* note 1, § 12.3, at 803; C. MCCORMICK, *supra* note 25, § 28, at 104; RESTATEMENT OF CONTRACTS § 331(2) (1932).

83. *See* The Lively, 15 F. Cas. at 635.

84. *See* Koch v. Godshaw, 75 Ky. (12 Bush) 318 (1876).

85. *See* Consumers' Pure Ice Co. v. Jenkins, 58 Ill. App. 519 (1895); Evergreen Amusement Corp. v. Milstead, 206 Md. 610, 112 A.2d 901 (1955) (construction delays); Griffin v. Colver, 16 N.Y. 489 (1858) (lumber mill had to be shut down for a period when steam engine not delivered); Harrison-Daniels Co. v. Aughtrey, 309 S.W.2d 879 (Tex. Civ. App. 1958) (delay in conveyance of land).

86. *See* Paola Gas Co. v. Paola Glass Co., 56 Kan. 614, 44 P. 621 (1896).

87. *See* Todd v. Keene, 167 Mass. 157, 45 N.E. 81 (1896) (breach of contract for single theatrical performance).

88. If the interest rate happens to equal the return on capital of the business, then this recovery would be equivalent to a recovery of lost profits.

purpose of determining the fair value to the plaintiff of property or its use in awarding general damages even though lost profits per se are not awarded.[89] There is in reality very little difference between this approach to a general damages measure and recovery of lost profits; to the user, the incremental value of the property over its "market" value is simply a function of profitability. These cases may also reflect a recognition that a general damages measure may be no more susceptible to "certain" determination than lost profits.[90] For instance, there is no more "certain" measure of the value of an idle factory than the profits it generates during an equivalent period of normal operation. The term "fair rental" in such a case is meaningless in any other sense. Perhaps the reason why courts often continue to adhere to the general damages measures of damages even when they are inadequate or no more susceptible to certain proof than lost profits is that, as Professor Dobbs suggests, courts "traditionally preferred to protect capital rather than income. . . . Thus the rules opposed to lost profits recoveries are very often not rules about certainty of proof at all; instead they are merely rules reinforcing the general damages-value approach taken in other cases . . . ."[91]

Even when a lost profit recovery is denied, out of pocket expenditures incurred in preparation for performance of the contract may nevertheless be recovered.[92] One of the most confused issues in remedial law is whether expenditures may be recovered in addition to lost profits. Some cases state that the two remedies are exclusive and that to give both would be to award a double recovery;[93] others state precisely the opposite.[94] As a general proposition, the former view is patently absurd: "expenses" are by definition distinct from profits as "net income." Expenses are deducted from revenues to arrive at the profit figure.[95] The plaintiff would first necessarily have

89. *See* Palmer v. Connecticut Ry. & Lighting Co., 311 U.S. 544 (1941); Lee Shops, Inc. v. Schatten-Cypress Co., 350 F.2d 12 (6th Cir. 1965); Chapman v. Kirby, 49 Ill. 211 (1868); *cf.* Twentieth Century-Fox Film Corp. v. Brookside Theatre Corp., 194 F.2d 846 (8th Cir. 1952) (in determining damages, jury in antitrust case may consider evidence of profits earned before and after sale of plaintiff's business forced as a result of defendant's illegal conspiracy).

90. *Cf.* Comment, *supra* note 48, at 1015 (it is often unclear whether a court is awarding the value of a lease or lost profits); Note, *The Requirement of Certainty in the Proof of Lost Profits*, *supra* note 1, at 325 (recovery of fair rental value of a business is very close to recovery of profits).

91. D. DOBBS, *supra* note 1, § 3.3, at 154 (footnote omitted).

92. *See, e.g.*, Brenneman v. Auto-Teria, Inc., 200 Or. 513, 491 P.2d 992 (1971); Annot., 17 A.L.R.2d 1300 (1951).

93. *See* Smith v. Onyx Oil & Chem. Co., 218 F.2d 104, 112 (3d Cir. 1955); William Goldman Theatres, Inc. v. Loew's, Inc., 69 F. Supp. 103-05 (E.D. Pa. 1946), *aff'd*, 164 F.2d 1021 (3d Cir.), *cert. denied*, 334 U.S. 811 (1948); Johnson v. Wright, 175 Minn. 236, 220 N.W. 946 (1928); McCormick, *supra* note 33, at 246.

94. United States v. Behan, 110 U.S. 338, 344 (1884); Flintkote Co. v. Lysfjord, 246 F.2d 368 (9th Cir.), *cert. denied*, 355 U.S. 835 (1957).

95. See the discussion of the meaning of "profits" at text accompanying notes 52-59 *supra*.

retrieved his expenses before any profits would have been realized. If he recovers his "profits" but not his expenses, then he is in effect recovering only some of the expenses and none of the profits (assuming that expenses are greater than profits) that he has lost, something far less than his expectation interest. Therefore, expenditures actually incurred should always be recoverable in conjunction with lost profits, subject only to a possible exception when the expenditure is more accurately classified as a capital outlay. Expenditures ordinarily are capitalized when they produce an asset; they are expensed when they are consumed in the production of income.[96] A recovery of capital costs would not be proper if the plaintiff has in his possession an asset "bought" with those expenditures.[97] Otherwise, expenses should be recovered because the income they would have helped to produce was never realized.

IV. MITIGATING DOCTRINES FOR LOST PROFIT RECOVERIES IN GENERAL

If the doctrine of certainty were carried to its logical extreme then lost profits could never be recovered. Of necessity, certain qualifying doctrines have been developed to soften its impact. Some are applicable to lost profit cases in general; others apply only in the new business context. The most important of the general doctrines is that it is enough to merit recovery if the existence of lost profits is shown with "reasonable" certainty.[98] Just what

96. *See generally* M. GORDON & G. SHILLINGLAW, *supra* note 53, at 339-55.

97. If the market value of the asset is less than its cost, however, the difference should be recoverable. As an illustration, suppose *B* obtains a promise from Hamburger, Incorporated, that they will grant him a franchise on the condition that *B* provide a site with a building built to Hamburger's specifications. *B* has the building constructed on a lot that he already owns. Hamburger reneges. *B* still has a building—a capital asset. But since the building has trademarked trappings suitable only for a "Hamburger Stand," *B* cannot sell the building and the lot without the franchise for even as much as it cost him to build it. Since he cannot retrieve this loss from the marketplace, he should be allowed to recover it from Hamburger in the courts. *Cf. id.* at 274 (generally accepted accounting principle that inventory should be valued at cost or market, whichever is lower). In promissory estoppel cases, expenses may be recovered in protection of the reliance interest, but not lost profits. *See* Goodman v. Dicker, 169 F.2d 684 (D.C. Cir. 1948).

98. *See* Eastman Kodak Co. v. Southern Photo Materials Co., 273 U.S. 359, 379 (1927) (antitrust) ("It is sufficient if a reasonable basis of computation is afforded . . . ."); Standard Machinery Co. v. Duncan Shaw Corp., 208 F.2d 61, 64 (1st Cir. 1953) ("the basic question [is] whether a prospective loss of net profits has been shown with reasonable certainty"); William Goldman Theatres, Inc. v. Loew's, Inc., 69 F. Supp. 103, 105 (E.D. Pa. 1946), *aff'd*, 164 F.2d 1021 (3d Cir.), *cert. denied*, 334 U.S. 811 (1948) (antitrust) ("In every case the question is whether the data of which the evidence consists is such that a just and reasonable estimate can be drawn from it, so that a verdict will not be based on mere speculation or guesswork, it being fully recognized that it is not necessary to show with absolute accuracy how much profit would have been earned."); Brenneman v. Auto-Teria, Inc., 260 Or. 513, 517 n.1, 491 P.2d 992, 994 n.1 (1971) ("Although the courts have sometimes refused to permit recovery of lost profits on the ground that the profits of a new business are necessarily too speculative . . ., others have recognized that the question in each case is simply whether or not prospective profits can be proved with reasonable certainty."); RESTATEMENT OF CONTRACTS § 331(1) (1932) ("Damages

"reasonable" means in a particular situation is difficult to pinpoint, but it is helpful to conceive of all the other general qualifying doctrines as corollaries of the fundamental axiom of reasonable certainty. Professor McCormick catalogues these doctrines as follows:

(a) If the fact of damage is proved with certainty, the extent or amount may be left to reasonable inference.
(b) Where the defendant's wrong has caused the difficulty of proof of damage, he cannot complain of the resulting uncertainty.
(c) Mere difficulty in ascertaining the amount of damage is not fatal.
(d) Mathematical precision in fixing the exact amount is not required.
(e) If the best evidence of the damage of which the situation admits is furnished, this is sufficient.
(f) The plaintiff may recover the value of his contract, and this may be measured by the value of the expected profits.
(g) Profits may sometimes be proved as evidence of the damages, when they would not be directly recoverable.[99]

In considering these doctrines and the extent to which the rule of certainty has been relaxed in breach of contract cases, it is important to bear in mind the influence of antitrust decisions upon contract analysis and to ask whether the differing substantive policies of antitrust and tort law on the one hand, and contract law on the other, should mandate different remedial treatment.

Eastman Kodak Co. v. Southern Photo Materials Co.,[100] *Story Parchment Co. v. Paterson Parchment Paper Co.*[101] and *Bigelow v. RKO Radio Pictures, Inc.*[102] are the three most important Supreme Court antitrust decisions that have been most often adopted (usually without an attempt to distinguish between antitrust and contract[103]) as authority for awarding lost profits in breach of contract cases. *Kodak*, in addition to phrasing the rule of "reasonable" certainty in a liberal manner,[104] also institutionalized the notion that "a defendant whose wrongful conduct has rendered difficult the

are recoverable for losses caused or for profits and other gains prevented by the breach only to the extent that the evidence affords a sufficient basis for estimating this amount in money with reasonable certainty.").

99. C. MCCORMICK, *supra* note 25, § 27 (footnotes omitted). Items (c) and (d) make essentially the same point, and are no more than tautologous rephrasings of reasonable certainty. Item (f) is of course true, but "may" means "might" here rather than "will." On item (g) see text accompanying notes 89-91 *supra*.

100. 273 U.S. 359 (1927).

101. 282 U.S. 555 (1931).

102. 327 U.S. 251 (1946).

103. For example, Professor McCormick cites *Story Parchment* for several of the propositions listed in the textual quotation at note 99 *supra*.

104. 273 U.S. at 379; *see* note 98 and accompanying text *supra*.

ascertainment of the precise damages suffered by the plaintiff, is not entitled to complain that they cannot be measured with the same exactness and precision as would otherwise be possible."[105] *Story Parchment* conjured up the idea that "[t]he rule which precludes the recovery of uncertain damages applies to such as are not the certain result of the wrong, not to those damages which are definitely attributable to the wrong and only uncertain in respect of their amount."[106]

These rules, which have the effect either of relaxing the plaintiff's burden under the certainty doctrine or of shifting the burden to the defendant after a minimal prima facie showing are clearly derived from tort analysis rather than contract.[107] A tort victim, like the victim of an antitrust violation, is not in a position to anticipate the consequences of the tortfeasor's wrong and to allocate the risk of damages that may flow therefrom. A party to a contract, however, ordinarily has such an opportunity to allocate anticipated risks. Therefore the standard of certainty in tort cases has traditionally been more relaxed than that of contract.[108] In addition, antitrust policy has as its primary goal the protection of the public rather than the protection of private rights as in contract. Finally, antitrust treble damages are punitive and are intended to have a deterrent effect; contract damages are merely compensatory.[109] Thus it may be that the degree of uncertainty that is acceptable is a function of the relative strength of the underlying substantive legal policy rather than a reflection of any inherent problems of proof. The more reprehensible a defendant's behavior, the more the law will feel justified in resolving doubts against him concerning the consequences of the behavior.[110]

Another problem with absorbing the antitrust rules of damages measurement into contract cases is the open ended manner in which the rules are phrased. The *Kodak* rule, with its emphasis on the wrongdoer, would, if carried to its extreme, shift the burden of uncertainty entirely to the defendant. The *Story Parchment* rule, if likewise extended, would eradicate the requirement that the amount of damages be proved with certainty and would leave only the requirement that the defendant's breach be the proximate cause of the loss suffered.[111] The antitrust cases themselves, however, did

105. 273 U.S. at 379; *accord*, Bigelow, 327 U.S. at 265.

106. 282 U.S. at 562; *accord*, Bigelow, 327 U.S. at 267-68 (Frankfurter, J., dissenting).

107. *Cf.* Bigelow, 327 U.S. at 265 (rule that the wrongdoer should bear the risk of uncertainty is an ancient principle not limited to antitrust actions); Story Parchment, 202 U.S. at 563-64 (discussion of rule in tort cases).

108. *See, e.g.*, Shreveport Laundries, Inc. v. Red Iron Drilling Co., 192 So. 895 (La. Ct. App. 1939).

109. However, lost profit recoveries in contract can be said to have a punitive aspect. *See* text following note 75 *supra*.

110. *See* D. DOBBS, *supra* note 1, § 3.3, at 152-53.

111. *See* text accompanying notes 47-51 *supra*.

not carry these rules to their limits. *Kodak* involved an established retailer who was unable to carry defendant's line of goods due to the latter's refusal to sell at a retailer's discount. The only uncertainty in the measurement of damages was as to the estimate of the additional cost of handling the goods.[112] Plaintiff in *Bigelow* owned an established motion picture theater. His claim was for loss of earnings for a five year period due to a refusal by defendants to supply him with first-run pictures. The only uncertainty was whether lost profits could be estimated on the basis of a comparison of receipts for a period preceding the unlawful action with receipts during the period of unlawful action, when the theater showed only later-run pictures.[113] Plaintiffs in both *Kodak* and *Bigelow* had established businesses and both could estimate the elements of damages on the basis of past experience. Therefore, the relief accorded in these early antitrust decisions, in contrast to the Courts' language, did not actually represent a radical departure from the common law rule of reasonable certainty.[114] Although later antitrust cases have moved toward a more liberal view of recovery,[115] and in at least two instances have awarded lost profits for destruction of a business that never was profitable,[116] it has been the contract cases in which the courts have seized upon the dicta from the early Supreme Court antitrust decisions to justify profit recoveries for businesses that are never established.[117] Thus it may be that courts may have been predisposed to make

112. 273 U.S. at 376.

113. 327 U.S. at 262-64, 266. The Court also considered evidence of the "yardstick" measure, comparing plaintiff's receipts with those of comparable competitors during the same period, but seemed to consider the "before and after" demonstration sufficient. *Id.* at 257-58, 266.

114. The roots of the antitrust damages doctrines can actually be traced to older contract cases. *Compare* Story Parchment, 282 U.S. at 562, *with* Wakeman v. Wheeler & Wilson Mfg. Co., 101 N.Y. 205, 215-17, 4 N.E. 264, 270-71 (1886); *compare* Kodak, 273 U.S. 359 (1927), *with* Brady v. Erlanger, 188 App. Div. 728, 177 N.Y.S. 301 (1919), *aff'd*, 231 N.Y. 563, 132 N.E. 889 (1921), *and* Osage Oil & Ref. Co. v. Lee Farm Oil Co., 230 S.W. 518, 521 (Tex. Civ. App. 1921).

115. *See* Locklin v. Day-Glo Color Corp., 429 F.2d 873 (7th Cir. 1970), *cert. denied*, 400 U.S. 1020 (1971); Flintkote Co. v. Lysfjord, 246 F.2d 368, 391 (9th Cir.), *cert. denied*, 355 U.S. 835 (1957); Donovan & Irvine, *Proof of Damages Under the Anti-Trust Law*, 88 PA. L. REV. 511, 517 (1940).

116. Terrell v. Household Goods Carriers' Bureau, 494 F.2d 16 (5th Cir.), *cert. dismissed*, 419 U.S. 987 (1974); William Goldman Theatres v. Loew's, Inc., 69 F. Supp. 103 (E.D. Pa. 1946), *aff'd*, 164 F.2d 1021 (3d Cir.), *cert. denied*, 334 U.S. 811 (1948).

117. *See, e.g.*, Lee v. Joseph E. Seagram & Sons, Inc., 552 F.2d 447, 455 (2d Cir. 1977); Autowest, Inc. v. Peugeot, Inc., 434 F.2d 556, 565 (2d Cir. 1970); Perma Research & Dev. Co. v. Singer Co., 402 F. Supp. 881 (S.D.N.Y. 1975), *aff'd*, 542 F.2d 111, 116 (2d Cir.), *cert. denied*, 429 U.S. 987 (1976); For Children, Inc. v. Graphics Int'l, Inc., 352 F. Supp. 1280, 1284 (S.D.N.Y. 1972); Blanchard v. Makinster, 137 Or. 58, 60, 1 P.2d 583, 584-85 (1931); Ferrell v. Elrod, 63 Tenn. App. 129, 146-47, 469 S.W.2d 678, 689 (1971). *But see* Evergreen Amusement Corp. v. Milstead, 206 Md. 610, 112 A.2d 901 (1955); *cf.* Davis v. Small Business Inv. Co., 535 S.W.2d 740, 743 (Tex. Civ. App. 1976) (evidence held speculative even as to the fact of damage).

inroads upon the new business rule for other reasons and have cited the antitrust opinions simply for their supporting language.

The doctrine that it is sufficient if a plaintiff offers the best evidence possible under the circumstances has likewise proven in practice not to be as radical as it would seem. Obviously in some factual circumstances the best evidence available will not be enough to cross the threshold of certainty. Rather, the doctrine has been utilized to legitimate awards based upon evidence other than past profits when the defendant's conduct has prevented entry into a market,[118] if the data is probative, convincing and as detailed and complete as can be expected. This evidence may often include evidence of the plaintiff's experience and capacity to handle additional business, records of closely comparable businesses and expert testimony.[119] The converse of this doctrine—that an offer of less than the best evidence available will not satisfy the burden of certainy—has been of more importance. The converse is applied when a plaintiff offers a general estimate of lost profits without introducing business records upon which an estimate could be founded[120] or when his estimates are based upon assumptions not supported by the evidence.[121]

V. MITIGATING DOCTRINES FOR NEW BUSINESS CASES

The doctrines that mitigate the effects of the strict certainty rule in relation to recovery of lost profits in general apply to recovery of lost profits for unestablished businesses as well. Courts allowing such recoveries have stated in effect that if the proof of damages issue is framed in terms of "reasonable" certainty, then there can be no rigid adherence to the new business rule.[122] Because a court must examine some sort of evidence other

118. *See* note 113 and accompanying text *supra*.

119. *See* Kobe, Inc. v. Dempsey Pump Co., 198 F.2d 416 (10th Cir.), *cert. denied*, 344 U.S. 837 (1952); William Goldman Theatres v. Loew's, Inc., 69 F. Supp. 103 (E.D. Pa. 1946), *aff'd*, 169 F.2d 1021 (3d Cir.), *cert. denied*, 334 U.S. 811 (1948); *cf.* Stott v. Johnston, 36 Cal. 2d 864, 229 P.2d 348 (1951) (proof of damages for loss of goodwill due to defective paint).

120. *See* Central Coal & Coke Co. v. Hartman, 111 F. 96 (8th Cir. 1901); Cook Indus., Inc. v. Carlson, 334 F. Supp. 809 (N.D. Miss. 1971); Myrick v. Miller, 256 So. 2d 255 (Fla. Dist. Ct. App. 1971); Peoples Moss Gin Co. v. Jenkins, 270 So. 2d 285 (La. Ct. App. 1972); Rambo v. Galley, 188 Neb. 692, 199 N.W.2d 14 (1972); Douglas Constr. Corp. v. Mazama Timber Prods., Inc., 256 Or. 107, 471 P.2d 768 (1970); Gilmartin v. Stevens Inv. Co., 43 Wash. 2d 289, 261 P.2d 73 (1953); *cf.* DeLong Corp. v. Lucas, 278 F.2d 804 (2d Cir. 1960) (defendants in action for breach of covenant not to compete could not complain that plaintiff's estimate of the profit margin on a contract he lost to defendent was too speculative, when defendant did not show what profit was actually realized).

121. *See* Cecil Corley Motor Co. v. General Motors Corp., 380 F. Supp. 819 (M.D. Tenn. 1974).

122. *See, e.g.*, Flintkote Co. v. Lysfjord, 246 F.2d 368, 392 (9th Cir.), *cert. denied*, 355 U.S. 835 (1957); Standard Mach. Co. v. Duncan Shaw Corp., 208 F.2d 61, 64 (1st Cir. 1953) ("[a]s we see it a sharp line of distinction should not be drawn between old and new businesses, but

than that of past profits in the case of an unestablished business, there have of necessity developed some generally accepted principles concerning the types of evidence that can be introduced to demonstrate the probability that profits would have been earned. While these types of evidence have been most prominent in the new business cases, they have also been used as additional supporting data for businesses with a history of past profits.

The method of proving lost profits (other than by a history of past profits) that has achieved the most recognition is the "yardstick" measure:[123] a comparison with the performance of businesses as similar to the plaintiff's as possible in size, location and nature during the time period in question. *Bigelow v. RKO Radio Pictures, Inc.*[124] was one of the first important decisions to recognize the yardstick measure. As evidence of earnings lost during a five year period when his theater was wrongfully prevented from booking motion pictures on a first-run basis, plaintiff offered a comparison between his actual earnings and the earnings of his competitor during the same period.[125] The Supreme Court did not rest its decision on this comparison; rather, it relied upon the comparison between plaintiff's receipts during the period in which he could book first-run pictures with the diminished receipts during the period in which he could get only later runs, perhaps because the Court viewed plaintiff's theater as superior to its competitor in location, equipment and patron attractiveness.[126] The Court nevertheless stated that the two approaches to proving damages were not mutually exclusive.[127]

The yardstick measure was used in *William Goldman Theatres, Inc. v. Loew's, Inc.*,[128] a case similar to *Bigelow* on its facts with the important difference that plaintiff's theater was new, thus making a before and after comparison impossible. Plaintiff offered an estimate of damages calculated by taking the average volume of five competing theaters during the damage period in downtown Philadelphia and deducting an estimated operating

recourse should be had in both situations to the basic question whether a prospective loss of net profits has been shown with reasonable certainty."); S. Jon Kreedman & Co. v. Meyers Bros. Parking-W. Corp., 58 Cal. App. 3d 173, 184-85, 130 Cal. Rptr. 41, 49 (1976); Fera v. Village Plaza, Inc., 396 Mich. 639, 645, 242 N.W.2d 372, 374 (1976); Ferrell v. Elrod, 63 Tenn. App., 129, 145-46, 469 S.W.2d 678, 686 (1971).

123. *See generally* Lehrman v. Gulf Oil Corp., 500 F.2d 659, 667 (5th Cir.), *cert. denied*, 420 U.S. 929 (1974); 11 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1346 A, at 249 (3d ed. 1966); Note, *The Requirement of Certainty in the Proof of Lost Profits*, *supra* note 1, at 318-19.

124. 327 U.S. 251 (1946).

125. *Id.* at 257-58.

126. *Id.* at 258-59.

127. *Id.* at 260.

128. 69 F. Supp. 103 (E. D. Pa. 1946), *aff'd*, 164 F.2d 1021 (3d Cir.), *cert. denied*, 334 U.S. 811 (1948).

cost.[129] The calculation was rejected for the reason that plaintiff's theater was in an inferior location and had no established goodwill. The court, however, was willing to use one of the five theaters that also had a poor location as a yardstick, and then make adjustments downward in consideration of the location, lack of goodwill, lack of air conditioning, a contingent increase in rental provided for in the lease and the fact that the yardstick's earning figures were only for the last three months of the damage period, when the war boom had created a rise in movie attendance.[130]

The yardstick comparison has also been used for the narrower purpose of proof of expenses. Plaintiff in *Lehrman v. Gulf Oil Corp.*[131] forced out of his service station business, correlated his average monthly expense data with three other service stations.[132] The yardstick measure probably becomes more reliable as the industry of which the business is a part approaches the perfectly competitive (such as commercial fishing[133] and the cultivation of crops[134]). The plaintiff can be assured of finding a market for all he can produce at the same price as his competitors.

Two elements are common to these yardstick cases: (1) the presence of an undifferentiated product (one brand of gasoline, onions, a species of fish and first-run motion pictures considered as a group) that, if sold at retail, commonly may be purchased from a large number of outlets of a fairly standard size having fixed costs that do not vary substantially among competitors; and (2) the problems of determining whether the plaintiff's business could capture a market share equal to its closest competitors are not of great concern. When these factors are present, the operations of competitors can be considered roughly equivalent to what the plaintiff's would have been, and adjustment for any apparent differences can be accurately made. Any uncertainty is further lessened when the comparison is, as in *Lehrman*, of expenses only,[135] since expenses are but one constituent variable in the calculation of profits.[136]

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129. *Id.* at 107.

130. Id. at 107-08. *But see* Broadway Photoplay Co. v. World Film Corp., 225 N.Y. 104, 121 N.E. 756 (1919). In *Photoplay*, Justice Cardozo emphasized the different tastes in pictures on behalf of the public and the fact that quality counts. *Id.* at 108-09, 121 N.E. at 757-58. While it is true that every individual film is unique, and that there is wide fluctuation among them in profitability, it is also true that over a long period with screenings of numerous films these differences should even out at the box office.

131. 500 F.2d 659 (5th Cir.), *cert. denied*, 420 U.S. 929 (1974).

132. *Id.* at 668.

133. *See* Blanchard v. Makinster, 137 Or. 58, 1 P.2d 583 (1931).

134. Malone v. Hastings, 193 F. 1 (5th Cir.), *cert. denied*, 229 U.S. 618 (1912); *cf.* Gardner v. The Calvert, 253 F.2d 395 (3d Cir.), *cert. denied*, 356 U.S. 960 (1958); Fera v. Village Plaza, Inc., 396 Mich. 639, 242 N.W.2d 372 (1976) (testimony of competitors allowed). *Contra*, Evergreen Amusement Corp. v. Milstead, 206 Md. 610, 112 A.2d 901 (1955).

135. *See* text accompanying notes 131 & 132 *supra*.

136. *See generally* text accompanying notes 52-59 *supra* (definition of profits).

Autowest, Inc. v. Peugeot, Inc.,[137] is a case using the yardstick measure in a context where these equalizing factors were not present. In an action for wrongful termination of a franchise to distribute Peugeot automobiles in the far western states, the court permitted the introduction of plaintiff's comparison with Volvo sales in the same states during the same period. The comparison was made between businesses selling differentiated products on a large scale with varying costs and no competitors in the same product line and geographic market.[138] This comparison, however, was not the main evidence upon which lost profits were calculated.[139]

The *Autowest* court also utilized a related standard: looking at the performance of plaintiff's *successor*.[140] The chief difference between this and the yardstick measure is that the time periods compared are consecutive rather than concurrent, although the successor's period of performance may overlap with the damage period, as distinguished from the period of actual performance by the plaintiff. This measure is most useful in cases of breach of an exclusive distributorship[141] or concession[142] situation, in which the plaintiff would have had a closed territory in the line of goods. This method is also applicable in the case of breach of a construction contract or subcontract in which the job to have been done is finite, the work is indivisible and costs would not be expected to vary significantly in relation to the identity of the performing party.[143] If the interest is such that the breaching party could have established more than one other agency, as in the case of a nonexclusive distributorship, then it would be impossible to equate the plaintiff's projected market share—and hence the volume of business done—with that of the plaintiff's successor.[144] If the claim is for profits lost by reason of delay in the opening or reopening of the plaintiff's business, then looking at the plaintiff's performance following the delay for a time

137. 434 F.2d 556 (2d Cir. 1970).

138. *Id.* at 563-67.

139. Ten year income and sales projections received the most weight. There were also comparisons with the performance of plaintiff's successor and Peugeot's New England operations. *Id.* at 567.

140. *Id.*

141. *See id.*; Wakeman v. Wheeler & Wilson Mfg. Co., 101 N.Y. 205, 217, 4 N.E. 264, 271 (1886).

142. Macke Co. v. Pizza, Inc., 259 Md. 479, 270 A.2d 645 (1970).

143. *Cf.* Verret v. Leagjeld, 263 Or. 112, 501 P.2d 780 (1972) (defendant in suit for breach of a subcontract for excavation, site preparation and fill work called the subcontractor who did the work to testify that he had lost money on the job; this evidence was held not to be dispositive, because plaintiff could have commenced work earlier and consequently have had better weather conditions). *But cf.* Smith v. Eubanks & Hill, 72 Ga. 280 (1884) (error to take into account profits made by successors in possession of a lease of a grocery store and bar, in part because the successors may have been better businessmen).

144. *See* Friedman v. McKay Leather Co., 179 Cal. 566, 178 P. 139 (1919).

equal to the time lost has the obvious, additional advantage of restricting the comparison to the same business that is the subject of the suit.[145]

Another variation upon the yardstick measure is looking at other businesses operated by the plaintiff when those businesses are essentially of the same type as the one in question. This has been done chiefly in the area of franchised fast food outlets where each franchise is essentially fungible, all benefit from a program of national advertising and each is uniformly profitable.[146] A possible problem with the validity of such a comparison arises when the contemplated outlet would be located close enough to an existing outlet for there to be intrabrand competition and consequent uncertainty as to what the contemplated outlet's share of the market for the franchised product in the competitive territory would be.[147]

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145. *See* United Elec. Coal Cos. v. Rice, 22 F. Supp. 221 (E.D. Ill. 1938); CORBIN ON CONTRACTS, *supra* note 3, § 1023, at 151-52. *Contra*, Evergreen Amusement Corp. v. Milstead, 206 Md. 610, 112 A.2d 901 (1955); Cramer v. Grand Rapids Show Case Co., 223 N.Y. 63, 119 N.E. 227 (1918). Even though a subsequent profit record is simply the mirror image of a past profit history (and indeed may be more probative than a profit history preceding the breach), *see* United Elec. Coal Cos. v. Rice, 22 F. Supp. 221 (E.D. Ill. 1938), remarkably few courts have been willing to award lost profits on such a basis.

146. Smith Dev. Corp. v. Bilow Enterprises Inc., 112 R.I. 203, 308 A.2d 477 (1973), presented what was probably the best conceivable circumstances for recourse to this method. McDonald's had it their way in a suit for malicious interference with contract rights asking damages for prevention of the erection of a franchise establishment on a particular site. Evidence was presented through the testimony of McDonald's marketing research manager and the record keeper for the McDonald's Eastern Regional Office of the uniformity of procedures at all of plaintiff's restaurants, uniformity of national advertising, uniform quality control, earnings and expense figures from all franchises within a twenty-five mile radius, and the fact that not one of hundreds of such restaurants had failed. Thus, almost all uncertain variables were eliminated from the damages equation. *Id.* at 213, 308 A.2d at 483; *see* Gordon v. Indusco Mgmt. Corp., 164 Conn. 262, 320 A.2d 811 (1973) (contemplated "Heap Big Beef" operation is comparable to an outlet in another town); *cf.* S. Jon Kreedman & Co. v. Meyers Bros. Parking-W. Corp., 58 Cal. App. 3d 173, 130 Cal. Rptr. 41 (1976) (plaintiff operated several other profitable parking garages). *But see* Eastern Fed. Corp. v. Avco-Embassy Pictures, Inc., 326 F. Supp. 1280 (N.D. Ga. 1970), *modified sub nom.* Eastern Fed. Corp. v. Avco-Embassy Pictures Corp., 331 F. Supp. 1253 (N.D. Ga. 1971) (holding damages allowable for failure to distribute film "The Graduate" to plaintiff's two established theaters, but disallowing damages for a newly-opened theater); Narragansett Amusement Co. v. Riverside Park Amusement Co., 260 Mass. 265, 157 N.E. 532 (1927) (holding a recovery based upon showings of wax figures in two other cities too speculative). *Avco-Embassy Pictures* is distinguishable in that "The Graduate" would have run only during the initial startup period when the new theater in fact suffered losses, while the established theaters continued to operate at a profit. 326. F. Supp. at 1285. Also, no theater of plaintiff's did show the film, so there was no measure to compare that was free of the interference complained of. An interesting question is, if plaintiff could have proven that "The Graduate" would have attracted a greater volume of patronage in a constant ratio for any theater, then whether plaintiff should have been allowed to recover such of his losses as he would have certainly recouped, even though he would not have earned profits from the showing.

147. *See* Mullen v. Brantley, 213 Va. 765, 768-70, 195 S.E.2d 696, 699-700 (1973) (noting that while Shakey's Pizza Parlors had in general been highly successful, there had been failures where—as here—outlets were located too close to each other); *cf.* Richfield Oil Corp. v. Karseal Corp., 271 F.2d 709 (9th Cir. 1959), *cert. denied*, 361 U.S. 961 (1960) (interbrand competition).

Lee v. Joseph E. Seagram & Sons, Inc.,[148] one of the most liberal of the new business cases, used an analogous but somewhat more arbitrary measure of comparison. Plaintiffs, one-half owners of an existing liquor distributorship, sued a distiller for failure to supply them with a new distributorship in another location which was to have equaled in value plaintiffs' investment in the existing distributorship. The Court of Appeals for the Second Circuit accepted, virtually without discussion, an estimate of damages calculated as the same percentage of return on the old distributorship in the preceding year multiplied by the dollar value of the plaintiffs' interest in the old distributorship (which by the terms of the agreement would roughly equal their investment in the contemplated distributorship), computed for the ten year estimated "life" of the new distributorship.[149] This result is defensible in the sense that plaintiffs would not rationally have consented to give up their interest in the old distributorship unless in their business judgment the new distributorship would be at least as profitable. Nevertheless, the factors that weighed in their decision should have been considered in the opinion. A crucial question would be whether there were any economies of scale involved so that a distributorship with only half the capitalization of the yardstick would be expected to earn a lower return.

Even though the plaintiff may not be in a position to offer evidence of records of similar businesses that he or others have operated, any experience that he may have had in a similar line of business is nevertheless usually given some weight.[150] This evidence is never sufficient by itself to allow recovery; it is relevant only to show managerial or other operational skill, one factor bearing on possible profitability of a business, and provides no basis for a wholistic estimate of damages in the way that a yardstick measure does. The converse, which has been applied as a rationale for denying recovery, is that lack of experience will weigh against a plaintiff.[151]

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148. 552 F.2d 447 (2d Cir. 1977).

149. *Id.* at 454-55. An allowance for percentage of return on income from investments in bonds was subtracted from the percentage of return figure. The gross amount was also reduced to present value. The court seemed to have put the burden on defendant to come forward with what it considered to be a more certain measure of damages—such as the profits of an existing distributorship—if it objected to the measure offered by plaintiff. This is a good example of the antitrust damages doctrines let loose in a contracts case. The Second Circuit cited all three antitrust decisions discussed in text accompanying notes 100-17 *supra*. *Id.* at 455.

150. *See* Smith v. Onyx Oil & Chem. Co., 218 F.2d 104 (3d Cir. 1955); Standard Mach. v. Duncan Shaw Corp., 208 F.2d 61 (1st Cir. 1953); William Goldman Theatres, Inc. v. Loew's Inc., 69 F. Supp. 103 (E.D. Pa. 1946), *aff'd*, 164 F.2d 1021 (3d Cir.), *cert. denied*, 334 U.S. 811 (1948); S. Jon Kreedman & Co. v. Meyers Bros. Parking-W. Corp., 58 Cal. App. 3d 173, 130 Cal. Rptr. 41 (1976); Aronowicz v. Nalley's, Inc., 30 Cal. App. 3d 27, 106 Cal. Rptr. 424 (1973); Johnson v. Wright, 175 Minn. 236, 220 N.W. 946 (1928).

151. *See* Putnam v. Lower, 236 F.2d 561 (9th Cir. 1956); Gruber v. S-M News Co., 126 F. Supp. 442 (S.D.N.Y. 1954); American Oil Co. v. Lovelace, 150 Va. 624, 143 S.E. 293 (1928); *cf.*

If past profits are considered to provide the only permissible foundation for calculating lost profits, the rate of past return might likely be considered to set the outside limit for recovery of future profits; that is, the plaintiff cannot be heard to claim that he would have earned more during the period represented by the breach than he had previously. The more charitable view is that an expected increase in the rate of return may be acknowledged in estimating damages when there are indications of such a trend, as for instance a steady growth in sales volume[152] or the fact that the market was underdeveloped at the time of breach and the plaintiff would have had the capacity to develop it further.[153] There is no reason why this principle should not also be applied to businesses that have never shown a profit if it is demonstrated that the business is reducing its losses at a rate that would indicate future profitability or, if the breach occurs during the startup period when the business would be expected to be operating at a loss, its prospects for success could be forecast as otherwise favorable based upon objective criteria.[154]

In determining future profitability courts have sometimes been willing to rely on defendant's representations that the ventures would be profitable.

Flintkote v. Lysfjord, 246 F.2d 368, 392-93 (9th Cir.), *cert. denied*, 355 U.S. 835 (1957) (plaintiffs' experience as salesmen for a tile company was of scant weight when they attempted to start their own tile company and sought damages based on what they had formerly made on sales commissions).

152. *See* Pacific Scientific Co. v. Glassey, 245 Cal. App. 2d 831, 54 Cal. Rptr. 235 (1966); *cf.* Kobe, Inc. v. Dempsey Pump Co., 198 F.2d 416, 427 (10th Cir.), *cert. denied*, 344 U.S. 837 (1952) (expert testimony for Sherman Act counterclaim in patent infringement suit that growth curve of product would have continued upward over the period in question).

153. *See* Pace Corp. v. Jackson, 155 Tex. 179, 191, 284 S.W.2d 340, 348-49 (1955).

154. *See* Vickers v. Wichita State Univ., 213 Kan. 614, 620-21, 518 P.2d 512, 517 (1974); *cf.* Autowest, Inc. v. Peugeot, Inc., 434 F.2d at 557 (significant that although plaintiff's successor to automobile distributorship did sustain losses, its sales rose at a rate virtually equalling plaintiff's ten year sales projection). In For Children, Inc. v. Graphics Int'l, Inc., 352 F. Supp. 1280 (S.D.N.Y. 1972), plaintiff corporation was formed to publish and market children's books. Its first project was to market "pop-up" books. Defendant printer's product proved defective. The court held that damages for loss of profits on the order were proven with sufficient certainty through evidence that the new company was in readiness to market the books, had already received substantial orders, and a sales promotion campaign indicated a probability of successful distribution of most of the order. Damages were calculated on the assumption that 75% of the order would have been sold. *Id.* at 1285. Thus, while there was not even a pattern of growth due to the newness of the venture, the court nevertheless was willing to extrapolate from preparations preceding actual sales to a conclusion as to what amount of sales would have been achieved. This situation differs from the problems presented by a typical new business case in that the claim for damages referred to a specific, finite amount of goods rather than the prevention of the establishment of the business as an entity, and was therefore inherently limited in amount. *Compare* For Children, Inc., 352 F. Supp. 1280 (S.D.N.Y. 1972), *with* Terrell v. Household Goods Carriers' Bureau, 494 F.2d 16 (5th Cir.), *cert. dismissed*, 419 U.S. 987 (1974). In addition, the premarketing activity made possible a detailed estimate of overhead expenses, thus eliminating one element of uncertainty often present in new business cases.

The expressions may be found in the contract itself[155] or in parol communications between the parties.[156] Such representations serve as an equitable estoppel rather than inherently certain measures of damages in that they are statements which the plaintiff has relied upon to his detriment.[157] In *Perma Research & Development Co. v. Singer Co.*,[158] however, a determination by defendant that the venture would be profitable was recognized as cogent evidence of lost profits even though plaintiff did not rely on this information, when the determination was the result of a study undertaken for the purpose of deciding whether to enter the venture.[159]

The district court's opinion in *Perma Research* is an express affirmation of the view that the information compiled and relied upon by businessmen in making a contractual commitment decision may be a reliable indication of the probable profitability of the venture that the resulting contract contemplates, especially when the study is undertaken without an eye toward litigation.[160] The Second Circuit in *Autowest*[161] adopted this

155. *See* Burks v. Sinclair Ref. Co., 183 F.2d 239 (3d Cir. 1950) (maximum and minimum amounts in an agreement to sell gasoline to a service station reflected what defendant's representative thought the plaintiff could sell in one year). *But see* Universal Commodities, Inc. v. Weed, 449 S.W.2d 106, 113-14 (Tex. Civ. App. 1969).

156. *See* Buxbaum v. G.H.P. Cigar Co., 188 Wis. 389, 206 N.W. 59 (1925) (cigar manufacturer terminated an exclusive distributorship after three years; plaintiff distributor had never made a profit, but defendant had represented to him that his startup work would bear fruit in the fourth year). *Contra*, Universal Commodities, Inc. v. Weed, 449 S.W.2d 106, 113-14 (Tex. Civ. App. 1969) (prospectus that defendant offered plaintiff purporting to estimate the future profit of a processing plant in an attempt to induce plaintiff to take over the plant held too speculative).

157. *Cf.* text accompanying note 105 *supra* (wrongdoer whose actions have rendered difficult the ascertainment of damages shall not be heard to claim that damage cannot be proven with certainty).

158. 402 F. Supp. 881 (S.D.N.Y. 1975), *aff'd*, 542 F.2d 111 (2d Cir.), *cert. denied*, 429 U.S. 987 (1976).

159. Plaintiff assigned a patented anti-skid device to defendant, who was to perfect, manufacture and market it in the automobile aftermarket. Defendant's own engineers found the device to be perfectible. Defendant's market expert compiled sales projections in making a report on whether to enter the contract with plaintiff. Defendant entered the contract in reliance on these figures projecting sales for five years of a ten year contract. "If Singer's experts judged [the sales projections] sufficiently reliable to justify entering a contract without further market analyses, then I have no reason to challenge their accuracy." *Id.* at 901. The trial judge adopted the figures in the sales projections for purposes of computing damages. Singer thus was the victim of its own careful business practices. One reason why Singer's market analysis would be entitled to so much weight is that meeting the sales projection depended entirely on its own initiative. Nevertheless, *Perma Research* is probably the most liberal new business case to date. The anti-skid device itself was never perfected and did not meet established standards of the auto industry. Thus there was inherent technological uncertainty raising doubts as to whether the device would ever reach the market. Compounding this uncertainty was the fact that the aftermarket would have had to be developed from scratch, there being no comparable devices available for the aftermarket at that time.

160. *See id.*

161. 434 F.2d 556 (2d Cir. 1970).

attitude of deference to products of the businessman's skill and judgment in considering the weight to accord records of sales and income projections made by plaintiffs prior to the breach.[162]

The iconoclastic development in the new business cases that promises to sound the death knell for the traditional new business rule is the increasing acceptance of business economists' expert testimony based upon studies produced through the techniques of business forecasting and expressly prepared for litigation. While such testimony may incorporate many of the more familiar types of information discussed above, the information will ordinarily be synthesized in a more rigorous and coherent manner when presented by an expert economist.[163] This synthesis may take the form of a hypothetical model constructed from a wide range of relevant data and assumptions that take into account the interrelation between factors that could not be considered without the application of the economist's analytical expertise. The elements that combine to determine the profitability of a business are many and diverse. While economic analysis can produce only measures of probabilities rather than mathematical certainty, it can at least lessen and delineate the extent of the uncertainty, and in addition provide new information through such techniques as the use of surveys.[164]

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162. "These projections were no mere 'interested guess' prepared with an eye on litigation. Instead, they were the product of deliberation by experienced businessmen charting their future course." *Id.* at 566. Comparative yardstick measures were also considered. *See* text accompanying notes 137-40 *supra*. In addition, the Second Circuit revealed a healthier attitude of skepticism than it did when affirming the *Perma Research* decision, emphasizing that the bases from which the projections were derived were set out at length and that there was vigorous cross-examination. Defendant was able to demonstrate that some facets of the projections were entitled to little weight (for instance, that the projected advertising and salary expense for the first several years was probably too low), but on the whole plaintiff could account for each of the figures on the basis of investigations, facts and defensible assumptions. 434 F.2d at 564-66. See the thoughtful cautionary instruction reproduced at *id.* at 564 n.2. In contrast, the *Perma Research* court seemed to abrogate its fact-finding function by accepting Singer's studies without question. *See* quotation in note 159 *supra*. While a businessman's analysis should be given careful consideration, it should not be accepted as presumptively correct, especially when subsequent facts contradict the analysis or cast doubt on its continuing validity. *Cf.* S. Jon Kreedman & Co. v. Meyers Bros. Parking-W. Corp., 58 Cal. App. 3d 173, 186-87, 130 Cal. Rptr. 41, 42 (1976) (The court ordered a new trial on the computation of damages issue for breach of a contract to construct and lease a parking garage, when the recent gasoline shortage descended one month after the judgment was rendered. The testimony of an expert land economist who had concluded from "feasibility studies" that the operation would have been very profitable was important evidence at the first trial.).

163. *See* Smith Dev. Corp. v. Bilow Enterprises, Inc., 112 R.I. 203, 308 A.2d 477 (1973), *discussed in* note 146 *supra*.

164. Surveys "are a source of estimates of the probability of outcomes in various unique situations in which there is no history to serve as a guide." T. MILNE, *supra* note 72, at 152. "What we are trying to do is not to define what will happen, but to reduce our uncertainties concerning the future, to assign measures to them and to use our defined uncertainties as a basis for building a speculative model of the future." *Id.* at 133; *accord*, C. ROBINSON, BUSINESS FORECASTING: AN ECONOMIC APPROACH 169 (1971).

An example of the use of such studies and expert testimony is found in *S. Jon Kreedman & Co. v. Meyers Bros. Parking-Western Corp.*,[165] an action for breach of a contract to construct a parking garage and lease it to an operator. An expert land economist concluded from "feasibility studies" that the operation would be very profitable, taking into account such variables as the occupancy factor in an adjoining office building and the projected transient usage. Rather than label his assumptions "speculative and conjectural" (as would be the usual judicial practice under the new business rule),[166] the California court instead deferred to the trial court's evaluation of the expert testimony.[167]

The antitrust decision of *Terrell v. Household Goods Carriers' Bureau*[168] is an even more striking example of reliance upon market studies and surveys. Unlike *Kreedman*, expert testimony was the predominant evidence of damages.[169] Plaintiff's business of computing and selling national mileage guides was destroyed before there was an opportunity for it to become profitable. A marketing and public opinion research expert compiled opinion surveys and "a wealth of other data."[170] He then compiled a market study determining the total national market for mileage guides and drew a number of conclusions on which to rely in estimating plaintiff's ability to penetrate that market. From this foundation he presented an opinion as to how many guides plaintiff would have sold over a thirteen year period. A certified public accountant adopted these projected sales figures, deducted actual known expense figures, and offered a net profit analysis on this basis. The Fifth Circuit approved the admissibility of evidence so constructed, stating that "[t]his indirect type of proof may include estimates based on assumptions, at least so long as the assumptions rest on adequate bases" and that the jury instructions in regard to the weight to be given the expert testimony was a sufficient safeguard against predicating an award of damages upon uncertain evidence.[171]

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165. 58 Cal. App. 3d 173, 130 Cal. Rptr. 41 (1976). This case is significant in several other respects. First, the court rejected the contention that the measure of damages for breach of a lease is always the general damages measure of the difference between agreed rent and rental value. *Id.* at 184, 130 Cal. Rptr. at 49. Second, it rejected the new business rule in favor of the reasonable certainty test. *Id.* at 184-85, 130 Cal. Rptr. at 49. Third, it entertained evidence of the profitability of other garage operations of plaintiff and plaintiff's experience as a garage operator. *Id.* at 185, 130 Cal. Rptr. at 49.

166. *See* note 3 *supra*.

167. 58 Cal. App. 3d at 185, 130 Cal. Rptr. at 49.

168. 494 F.2d 16 (5th Cir.), *cert. dismissed*, 419 U.S. 987 (1974).

169. *Compare id.* at 29, *with* text accompanying notes 165-67 *supra*.

170. 494 F.2d at 23.

171. *Id.* at 24; *cf.* Autowest, Inc. v. Peugeot, Inc., 434 F.2d at 564 n.2 (reproduction of trial judge's cautionary instruction).

VI. A PROPOSED NEW TEST AND THE ROLE OF EXPERTS

It should be apparent from the preceding discussion that many courts have sloughed off the traditional restrictions of the new business rule in favor of a more liberal, pragmatic approach to recovery for lost profits for an unestablished business that may, in its most far-reaching form, recognize the entire range of information that a businessman would consider in forming an investment decision. This development, however, has been rather sporadic and of varying intensity. Some jurisdictions have jettisoned the new business rule altogether, others recognize only certain circumscribed exceptions, and still others continue to adhere to the rule as classically stated. The law in this area is thus at a watershed stage of evolution.

While the new business rule lingers on as an emasculated force, no concise test of general applicability that can encompass the recent developments has arisen to replace it. How much certainty is enough certainty remains uncertain.[172] "Reasonable" certainty can mean anything from logical necessity to a strong hunch. The following test would give some content to the meaning of reasonable certainty in this context: within the rules of evidence regulating hearsay, opinion evidence and the qualification of experts, all information that a business person would find relevant in deciding whether to invest in the enterprise in question would ordinarily be admissible on the issue of profits lost by a business on account of a contract breach. A prima facie case would be established if the plaintiff's evidence, when considered in the light most favorable to him, could support a decision by a prudent business person that the enterprise would be an investment within an acceptable degree of risk.[173] The jury should be instructed that if, based upon an evaluation of all the evidence, a prudent business person would more likely than not consider the enterprise to be an investment within an acceptable degree of risk, then it must award some damages to the plaintiff.[174] Other cautionary instructions would probably be warranted by

172. *See* Farnsworth, *supra* note 42, at 1213-14; Comment, *supra* note 48, at 999; Note, *The Requirements of Certainty in the Proof of Lost Profits*, *supra* note 1, at 325.

173. Of course it must necessarily be demonstrated that the loss, if any, was the proximate result of a breach of a legal duty that would give rise to a substantive right of recovery. *See* text accompanying note 46 *supra*.

174. *See* C. MCCORMICK, *supra* note 25, § 29, at 108 ("[T]he practice of investors indicates that a prudent evaluation of a new enterprise may disclose that the chances of successful profit making of a new undertaking . . . are much more favorable than the chances of failure. The courts should be willing to accept a similar showing, if the proof is strong and the wrong deliberate."); Comment, *supra* note 48, at 1018. ("Courts should not exclude information used by businessmen in reaching business decisions, nor require appreciably more information than businessmen commonly use.").

the special circumstances of each case. Because the amount of damages is always problematic, the jury should be given wide discretion in affixing the amount so long as the threshold right to recovery is satisfied, subject to the devices for controlling excessive verdicts.[175]

Paralleling the increasing acceptance of various types of market analyses and economic data as evidence in lost profit cases has been the growth of sophisticated business forecasting techniques as tools for management decisions and the consequent development of forecasting as a recognized subdiscipline within the field of business economics.[176] The relaxation of judicial restrictions upon economic evidence represents, to some extent, a conscious recognition of the increasing reliability of business forecasting. The lacuna in remedial law, which the new business rule left uncharted because exploratory techniques were deficient, can presently be filled in some cases by business forecasting expertise. Businessmen facing capital investment decisions desire to avoid mere speculation and guesswork at least as much as courts do in adjudicating lost profits cases. Courts should therefore rely on the same type of input as businessmen.[177]

Business forecasting, of course, offers no panacea for the difficult problems of proving the existence of lost profits for unestablished businesses. Economic analysis cannot transform an inherently unmeritorious claim into a winner. In other cases, sufficient information may not be available from which to extrapolate to any confident conclusion concerning probable profitability. Forecasting commentators readily admit that forecasting deals only in probabilities—not certainities.[178] The law does not require precise certainty, however, but only "reasonable" certainty.[179] One

175. *See* text accompanying notes 220-41 *infra*.

176. *See generally, e.g.*, N. ENRICK, MARKET AND SALES FORECASTING: A QUANTITATIVE APPROACH (1969); METHODS AND TECHNIQUES OF BUSINESS FORECASTING (W. Butler, R. Kavesh & R. Platt eds. 1974) [hereinafter cited as BKP]; T. MILNE, *supra* note 72; C. ROBINSON, *supra* note 164.

177. Business managers of course must continually forecast the future in charting the course of their firms. Business forecasting as used here means the more formalized process of predicting the probable future consequences of business decisions, generally with the aid of professional business economists. The emphasis here is upon capital investment decisions, because this bears most directly upon the typical lost profit new business case. Formal forecasting is often used to make these types of decisions. *See* T. MILNE, *supra* note 72, at 5; C. ROBINSON, *supra* note 164, at 178; *cf.* Schultz, *Sales Forecasting*, in BKP, *supra* note 176, at 393, 396 (one purpose of the long-term forecast of five to twenty years is for considering entry into new markets); SEC Securities Act Release No. 5699 (April 23, 1976) (SEC policy regarding disclosure of projections of future economic performance to investors). *See generally* Hartz, *Risk Analysis in Capital Investment*, 42 HARV. BUS. REV., Jan.-Feb. 1964, at 95.

178. *See* T. MILNE, *supra* note 72, at 157; C. ROBINSON, *supra* note 164, at 4, 169; Schultz, *supra* note 177, at 395; Zarnowitz, *How Accurate Have the Forecasts Been?*, in BKP, *supra* note 176, at 565, 568-70.

179. *See* note 98 *supra*.

commentator has characterized the forecaster's task in these terms: "What we are trying to do is not to define what will happen, but to reduce our uncertainties concerning the future, to assign measures to them and to use our defined uncertainities as a basis for building a speculative model of the future."[180] The law of damages should require no more than this, and except for the new business rule it has not.

A forecasting model for an individual business necessarily proceeds in a three stage process: from a forecast of the general economy (or macro-environment), to the market environment of the particular industry, and finally to the individual firm in the market environment.[181] Because each stage builds on the more general stage preceding it, it follows that the most uncertainty is at the individual firm level.[182] As a rule, when a business has a history of past profits, records of these profits will be sufficiently certain as evidence to support a recovery. The analysis therefore proceeds expressly on the third level, conditions at the first and second levels being implicitly reflected in the fact that the business has been profitable. On the other hand, a plaintiff without a history of profits must present evidence from the second level of the market environment as well, drawing inferences and conclusions concerning his own business from this data.[183] Comparisons with the performance of similar businesses are of this nature. Failure to offer some form of evidence of the state of the industry during the contract period is ordinarily fatal in the case of an unestablished business, because the available information concerning the individual business alone is not a sufficient premise from which to conclude that future profits would have been

180. T. MILNE, *supra* note 72, at 133; *cf.* C. ROBINSON, *supra* note 164, at 13 (factors such as profits which cannot be fully controlled are sometimes known as "target variables"). *See also* Schultz, *supra* note 177, at 395.

181. C. ROBINSON, *supra* note 164, at 14; Schultz, *supra* note 177, at 395.

182. BKP, *supra* note 176, at 391.

183. *Cf.* Note, *The Requirements of Certainty in the Proof of Lost Profits, supra* note 1, at 320 ("[W]here the plaintiff's own figures . . . do not possess sufficient strength it would seem they should be supportable by evidence that the industry as a whole has had a history of profitable operation."). One peculiar case has appeared to confuse the term "unestablished" in the new business rule, which means unestablished as a specific firm, with "unestablished" as meaning an unestablished industry. Paola Gas Co. v. Paola Glass Co., 56 Kan. 614, 44 P. 621 (1896). A stronger argument can be made for denying lost profits as a matter of course when the industry as well as the particular firm is unestablished or not profitable at the time than when only the latter is new. *See* Biothermal Process Corp. v. Cohu & Co., 119 N.Y.S.2d 158 (Sup. Ct.), *aff'd in part and rev'd in part*, 283 App. Div. 60, 126 N.Y.S.2d 1 (1953), *aff'd*, 308 N.Y. 689, 124 N.E.2d 323 (1954) (rejecting the classical new business rule, but denying recovery when it appeared that the type of disposal plant that would have been built had never been operated in the United States, but only in France). *But see* Perma Research & Dev. Co. v. Singer Co., 402 F. Supp. 881 (S.D.N.Y. 1975), *aff'd*, 542 F.2d 111 (2d Cir.), *cert. denied*, 429 U.S. 987 (1976) (allowing recovery even where there was no comparable product, and hence no established industry or market).

made.[184] Evidence of the state of the general economy, while always implicit in second and third level evidence, is almost never directly in issue.[185]

There are three generic types of input that forecasters use in constructing forecasting models: controlled experiments (what people do); past experience (what people have done); and surveys (what people say).[186] It is impractical to carry out experiments in preparation for litigation, because this method requires an ongoing business. The category of past experience is broad enough to include the entire panoply of evidence traditionally relied upon in lost profit cases. In addition, the business economist has access to vast sources of statistics and other data, such as trade journals and government publications, that can be incorporated into the model building process.[187] It is in the use of surveys, however, that business economists can make unique contributions in proving lost profits where past experience alone would be incomplete.[188] Consumer surveys can be marshalled as evidence of a business' ability to penetrate a market if in-court testimony of potential buyers would be prohibitively time-consuming and cumbersome.[189]

If complex economic evidence is utilized, it *must* be compiled by experts. The services of business economists for this purpose are becoming

184. *See* Flintkote Co. v. Lysfjord, 246 F.2d 368, 391-94 (9th Cir.), *cert. denied*, 355 U.S. 835 (1957). For an established business, the logic of recovery is as follows: the business has been profitable in the past; if and only if there is a breach of contract will the future of the business not be like its past; therefore, if there is no breach of contract, then the business will be profitable in the future. The first premise is true; the second is false but nevertheless accepted as true for purposes of the litigation if other conditions have remained constant. If the business in question is unestablished, then both premises are false and neither can be accepted as true for purposes of the litigation. Yet the same conclusion must be reached for there to be recovery. The logic, obviously, is much more complex and requires more and different premises. The more generalized the market environment that serves as the starting point of analysis, the more involved will be the logical steps—and hence the evidence—necessary for recovery.

185. *But see* S. Jon Kreedman & Co. v. Meyers Bros. Parking-W. Corp., 58 Cal. App. 3d 173, 130 Cal. Rptr. 41 (1976) (ordering new trial on effect of energy crisis on operation of proposed parking garage).

186. C. ROBINSON, *supra* note 164, at 11.

187. For listings of informational resources, see N. ENRICK, *supra* note 176, at 94-110; Rodriguez, *Sources of Data*, in BKP, *supra* note 176, at 124.

188. *See* T. MILNE, *supra* note 72, at 152. On the use of surveys generally, see *id.* at 133-52; *cf.* Cohen, *Surveys and Forecasting*, in BKP, *supra* note 176, 76-92 (concerned more with the application of surveys to sectoral analysis than with analysis of the position of the single firm).

189. Pace Corp. v. Jackson, 155 Tex. 179, 192, 284 S.W.2d 340, 349 (1955), is a rare example of the use of testimony by consumers. As evidence of the wholesale cigarette business that plaintiff lost by reason of defendant's failure to supply him with cigarettes at "cost," two witnesses testified that they would have given plaintiff all their business at the price he could have charged had not his supply been cut off. Such testimony is more feasible when the business has only a few potential customers. It would be impracticable for most retail stores because a statistically significant sampling would require a very large number of individuals.

increasingly available through the growth of professional consulting firms.[190] Not only are experts needed to compile the data, their expertise is also essential to forming opinions based upon interpretation of the data. Defendants also may find the assistance of experts crucial in rebutting a plaintiff's case. Since forecasting techniques have become fairly systematic and institutionalized, an expert can point out weaknesses in method or data and false assumptions in another expert's testimony much more readily than can a layman.[191] Business economists could also serve in the capacity of court-appointed experts or special masters.

The testimony of accountants has always played an important role in proving lost profits. With more widespread use of business economists, the role of accountants would also be expanded. While business forecasting can be used to form profit projections, it is more commonly used for projecting sales as the target variable. A desirable sequence of proof would be for a business economist to offer a sales projection, followed by the testimony of an accountant who would adopt the sales projection and then deduct estimated expenses in order to arrive at a net profit figure that could be reduced to present value. This approach was used in *Terrell v. Household Goods Carriers' Bureau*.[192]

As a matter of the law of evidence, much of the economic evidence would not be admissible without expert participation. A forecaster's projection, while based upon facts, is nevertheless an opinion, because the forecaster draws inferences from known facts to arrive at his conclusions.[193] This type of opinion is not admissible when offered by a lay witness,[194] but is admissible if offered by a qualified expert for whom proper foundation has been laid.[195] Who may qualify as an expert is problematic; it is possible that a managerial officer such as the company's president could not, while a

190. *See generally* Greenspan & Eickhoff, *Economic Consulting*, in BKP, *supra* note 176, at 629-35.

191. *See* Autowest, Inc. v. Peugeot, Inc., 434 F.2d at 563-67; Cecil Corely Motor Co. v. General Motors Corp., 380 F. Supp. 819, 855-58 (M.D. Tenn. 1974).

192. 494 F.2d 16 (5th Cir.), *cert. dismissed*, 419 U.S. 987 (1974); *cf.* Hoag v. Jenan, 86 Cal. App. 2d 556, 195 P.2d 451 (1948) (Plaintiff in action for failure to build an addition to the building that housed plaintiff's garage repair business testified that he had to reject more than half the business offered to him due to lack of space. A certified public accountant testified to a net profit figure based upon the assumption that the sales of parts and labor would have doubled during the period if the annex had been built.). *See also* Lee v. Joseph E. Seagram & Sons, Inc., 552 F.2d 447 (2d Cir. 1977).

193. T. MILNE, *supra* note 72, at 1.

194. FED. R. EVID. 701; *see* MCCORMICK'S HANDBOOK OF THE LAW OF EVIDENCE § 11 (2d ed. E. Cleary 1972) [hereinafter cited as MCCORMICK/EVIDENCE].

195. *See* FED. R. EVID. 702-705; C. MCCORMICK, *supra* note 25, § 29, at 107. *See generally* MCCORMICK/EVIDENCE, *supra* note 194, §§ 13-16.

financial officer such as its treasurer could.[196] The safest course is always to use outside experts. This practice also avoids the Boeotian trap of offering an estimate of lost profits, which, though admissible, could not support a judgment having been offered by an "interested" witness.[197]

Under rule 705 of the Federal Rules of Evidence[198] an expert may give opinion testimony without prior disclosure of underlying facts unless required to do so by the court. In courts in which the Federal Rules, or their equivalent, are in effect,[199] it is unlikely that an expert—once qualified as such—would have his testimony declared inadmissible for lack of a proper foundation.[200] He is, however, required to disclose underlying facts on cross examination.[201] In most states where a proper foundation is still required,[202] and generally, as a matter of strategy, it is advisable that the expert disclose his information and reasoning, utilizing exhibits whenever appropriate. At any rate, when proof of lost profits is based upon past experience, the relevant business records should be introduced into evidence at some point. Otherwise the plaintiff will be penalized for failure to produce the best evidence available.[203]

Hearsay problems may also be present. When evidence of past experience is the foundation used for expert testimony or otherwise, the supporting documents are ordinarily admissible under the business records hearsay exception.[204] Government publications and private market reports customarily relied upon by business economists are also expressly excepted under the

196. *Compare* Thrift Wholesale, Inc. v. Malkinillion Corp., 50 F. Supp. 998, 1000 (E.D. Pa. 1943), *with* Rankin v. Associated Bill Posters of United States & Can., 42 F.2d 152, 155-56 (2d Cir. 1930), *cert. denied*, 282 U.S. 864 (1931). Older cases indicated that opinion testimony should always be excluded in lost profits cases, *e.g.*, Wakeman v. Wheeler & Wilson Mfg. Co., 101 N.Y. 205, 217, 4 N.E. 264, 271 (1881), but restrictions on expert opinion testimony have subsequently been relaxed, especially with the advent of the Federal Rules of Evidence.

197. *See* Tonchen v. All-Steel Equip., Inc., 13 Ill. App. 3d 454, 461, 300 N.E.2d 616, 621 (1973). Only Illinois—thankfully—appears to follow this rule. When an estimate is unrebutted and supported by facts, a direct verdict for defendant on this basis would be senseless. Interested persons have been competent to testify since Lord Denman's Act, 6 & 7 Vict. c. 85 (1843).

198. FED. R. EVID. 705.

199. As of 1977, six states had adopted the Federal Rules and seven more were considering their adoption. Mueller, *Foreward: Should Wyoming Adopt These Rules?* to *Symposium on the Federal Rules of Evidence*, 12 LAND & WATER L. REV. 585, 585-86 & 586 nn.2 & 3 (1977).

200. *But see* Tri-State Sys. Inc. v. Village Outlet Stores, Inc., 135 Ga. App. 81, 217 S.E.2d 399 (1975); Peabody Constr. Co. v. First Fed. Parking Corp., 330 N.E.2d 497 (Mass. App. 1975). For a classic example of what would be an unsupported—even though divinely inspired—forecasting opinion, see *Genesis* 41:15-32 (Joseph's prediction to Pharoah that seven good years would be followed by seven bad years).

201. FED. R. EVID. 705.

202. *See* MCCORMICK/EVIDENCE, *supra* note 194, § 14, at 31.

203. *See* text accompanying notes 120 & 121 *supra*.

204. FED. R. EVID. 803(6); MCCORMICK/EVIDENCE, *supra* note 194, § 306; *see* Flintkote Co. v. Lysfjord, 246 F.2d 368, 392 (9th Cir.), *cert. denied*, 355 U.S. 835 (1957).

federal rules.[205] Surveys present more of a problem; if conducted for litigation purposes rather than in the regular course of business, they might not be admissible under the business records exception.[206] Surveys should, however, be admitted under the catch-all exception of rule 803(24), which provides for admission when the defendant has had an opportunity before trial to examine the survey and thereby formulate any objections if it appears that the survey was conducted without adequate safeguards to ensure objectivity and statistical accuracy.[207]

Introduction of all relevant records may be burdensome. While summaries are a great aid to judicial economy, at least one court has refused to allow recovery based upon an exhibit when the records used by the accountant in preparing the exhibit were not produced, seemingly on best evidence rule grounds.[208] Rule 1006 expressly allows summaries of voluminous writings as long as the originals are available for examination by the parties or production in court, thus eliminating this problem.[209]

Finally, market studies prepared by the defendant or authorized and adopted by him may be used against him as an admission by a party-opponent, thus avoiding the hearsay bar to admissibility.[210] In all other cases the accountant or business economist who carries out the study should be prepared to authenticate the factual records relied upon as exhibits, as well as his conclusions if they are in the form of an exhibit. Under the federal rules, however, the facts relied upon by the expert need not themselves be admissible,[211] a point that allows the business economist virtually unrestricted freedom to exercise the total range of his professional skill in formulating the opinion he will present in court.

Because expert testimony is likely to be very complex when used to prove lost profits, there is an inherent danger of unfair surprise to the defendant. This danger is largely mitigated, however, by rules of evidence that require disclosure of the basis for expert opinion[212] and production of

205. FED. R. EVID. 803(8), (17). The common law is generally in accord. *Id.* 803(17), Advisory Comm. Note; MCCORMICK/EVIDENCE, *supra* note 194, § 315.

206. *See* MCCORMICK/EVIDENCE, *supra* note 194, § 308, at 723-24.

207. FED. R. EVID. 803(24). *See generally* Note, *Evidence—Hearsay—Admissibility of Public Opinion Polls*, 52 MICH. L. REV. 914 (1954).

208. Flame Coal Co. v. United Mine Workers, 303 F.2d 39, 43-44 (6th Cir. 1962).

209. FED. R. EVID. 1006. The common law is in accord. MCCORMICK/EVIDENCE, *supra* note 194, § 233, at 564.

210. FED. R. EVID. 801(d)(2); MCCORMICK/EVIDENCE, *supra* note 194, § 762; *see* text accompanying notes 155-59 *supra*.

211. FED. R. EVID. 703. *But cf.* MCCORMICK/EVIDENCE, *supra* note 194, § 15 (majority rule, albeit with a strong trend contra, is that expert opinion must be based on admissible evidence).

212. *E.g.*, FED. R. EVID. 705.

documents when summaries are used.[213] In addition, liberal discovery rules now enable the defendant to learn how the plaintiff will prove his damages claim,[214] thus affording him an adequate opportunity to prepare his own case in rebuttal.[215]

Focusing on the information that businessmen use in making decisions as the basis of the test for proving the existence of lost profits for an unestablished business does not necessarily mean that the plaintiff must always produce formal forecasting studies. Full scale forecasting—especially the use of surveys—is costly, and therefore may not be economically feasible for a small business or where the ad damnum is relatively small.[216] A plaintiff should not be penalized simply because he cannot afford the most rarefied expert assistance, but there should be an insistence that he produce the relevent information that he has within his possession.[217] Many of the methods of forecasting are simple and can be used by small businesses to great advantage.[218] A strong case can usually be constructed from accounting records on hand by anyone with common business sense, if it is prepared and presented in a complete and logical manner. One cannot read the opinions in this area and not be impressed by the number of cases that have been lost—not because the claim was inherently deficient—but rather because of inadequate preparation of counsel.

VII. POSSIBLE DEVICES FOR CONTROLLING UNDULY LARGE VERDICTS AND APPORTIONING RISK

The proposed test for allowing recovery of lost profits for an unestablished business addresses mainly the problem of certainty of proof. This test does not resolve the other major problem that the new business rule seeks to address: the unduly large verdict. The policy of the new business rule not to apportion risks through some form of compromise has resulted in an inadequate resolution of this problem.[219] Nevertheless, there are bases for compromise that can alleviate the danger of placing too great a burden on a

213. *Id.* 1006.

214. *See, e.g.*, FED. R. CIV. P. 26-37 (especially 34).

215. When both parties are well prepared, the possibility of confusing the jury is also lessened. Extensive pretrial discovery can be used to shorten the litigation by facilitating the delineation of issues and the obtaining of admissions of uncontested points and stipulations regarding the admissibility of evidence. When both parties make a good faith effort to simplify the issues, the expert testimony in a case for lost profits of business is likely to be little more confusing to the jury than proof of loss of earnings in a wrongful death action.

216. *See* T. MILNE, *supra* note 72, at 134; C. ROBINSON, *supra* note 164, at 180-87.

217. *See* text preceding note 120 *supra*.

218. *See* C. ROBINSON, *supra* note 164, at 185-86.

219. *See* text accompanying notes 74-81 *supra*.

breaching party and at the same time adequately protect the expectation interest of the promisee.

The reduction to present value of amounts that would have been earned in the future is not really a compromise at all, but rather a necessary calculation to avoid giving the plaintiff a recovery of more than he deserves.[220] It has been clearly established that when the plaintiff would have contributed his own labor in conducting the business, then he must deduct the value of his labor as an expense in arriving at a profit figure.[221] Alternatively, if the breach has freed the plaintiff to work elsewhere, he must deduct what he in fact earned as a credit against anticipated profits.[222]

The principle that the value of labor should be deducted from total revenues as an expense is—like the concept of present value—not properly understood as a compromise, but rather follows by definition from the meaning of profits.[223] Similarly, the value of the capital that would have been invested in the business may be freed by a contractual breach to be put to other uses. The defendant should be given credit for the income that this freed capital could earn elsewhere. Any investment entails some risk. A fair compromise apportionment of this risk would provide that the breaching party be given credit for the income on a relatively safe bond investment which the freed capital could be expected to yield. While early cases addressed this idea by excluding the value of interest on capital from the

220. Present value is defined as "the amount which, if invested at the specified rate of return, will grow to an amount equal to the anticipated cash amount at the specified future date." M. GORDON & G. SHILLINGLAW, *supra* note 53, at 247. This figure can be calculated with the use of tables. For example, suppose that by reason of a breach of a franchise agreement plaintiff has proven that he would have made a profit of $100 each year for the 10 year contract period, which runs from approximately the date of the judgment. He has thus lost $1000. If he were given the entire amount now, however, he could invest it at a rate of, for instance, 5%, and accumulate more at the end of 10 years than he would have lost, namely $1,629.00. Since he would have received $100 each year, however, rather than $1000 at the end of the period, the present value of $1000 for a 10 year period, $613.90, would not be adequate. Instead, his loss should be calculated as an annuity, which would award him $772.17, leaving him at the end of 10 years with $1,257.79 (figures calculated from tables in *id.* at 741 app. A.). For cases in which present value has been used, see, *e.g.*, Lee v. Joseph E. Seagram & Sons, Inc., 552 F.2d at 454; S. Jon Kreedman & Co. v. Meyers Bros. Parking-W. Corp., 58 Cal. App. 3d 173, 130 Cal. Rptr. 41 (1976). It was held not to be error to fail to include a jury instruction on present value in Lehrman v. Gulf Oil Corp., 500 F.2d at 664.

221. *See, e.g.*, Gordon v. Indusco Mgmt. Corp., 164 Conn. 262, 274-76, 320 A.2d 811, 819-20 (1973); Buck v. Mueller, 221 Or. 271, 284, 351 P.2d 61, 67 (1960).

222. *See* Lehrman v. Gulf Oil Corp., 464 F.2d 26, 47-48 (5th Cir. 1972); Furrer v. International Health Assurance Co., 256 Or. 429, 474 P.2d 759 (1970). *But cf.* Aronowicz v. Nalley's, Inc., 30 Cal. App. 3d 27, 106 Cal. Rptr. 424 (1973) (allowing a recovery of lost profits by manufacturer against defendant distributor of its products who terminated the agreement, notwithstanding that plaintiff secured another broker whose actual sales exceeded defendant's estimate). It would seem that the appropriate measure would be whichever of the two figures—value of labor or actual earnings—yields the higher earnings.

223. *See* text accompanying notes 52-59 *supra*.

definition of profits,[224] only one recent case has applied this principle.[225] Widespread adoption, whether based on the definition of profits or as part of the mitigation of damages doctrine, promises to mollify significantly the large verdict problem, because under its aegis there would only be a recovery of lost profits if the estimated return on capital were in excess of the prevailing rate of return on low-risk bonds. The recovery formula would be

> [(total estimated percentage of return on capital[226]— the prevailing percentage of return on bonds) × (capital investment)] × (number of years of recovery period) = total lost profits.

Total lost profits, when reduced to present value, would equal the allowable recovery.[227] If the value of the plaintiff's labor were capitalized, then the formula would account for this factor without the necessity of giving a separate credit.

The need for compromise is most apparent when the business in question is of a speculative nature, and therefore must yield an abnormally high profit return to offset the increased risk and thereby attract investment. One extreme alternative would be to deny recovery altogether on the ground that the speculative nature of the business makes proof of lost profits too uncertain. The other would be to allow total recovery based upon the high rate of return.[228] A compromise basis is arrived at by averaging in the number of known failures in the industry to arrive at an overall mean percentage of return for the type of business, and to use this figure as the basis of recovery.[229] Thus, the probability of the risk of failure would be divided between the parties.

The amount of recovery of course varies directly with the length of time for which lost profits are calculated. There is usually no problem when

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224. *E.g.*, Central Coal & Coke Co. v. Hartman, 111 F.2d 96 (8th Cir. 1901); Morrow v. Missouri Pac. Ry., 140 Mo. App. 200, 123 S.W. 1034 (1909).

225. Lee v. Joseph E. Seagram & Sons, Inc., 552 F.2d 447 (2d Cir. 1977); *see* text accompanying notes 56 & 57 *supra.*

226. Whether the percentage of return would be calculated as pre-tax earnings or post-tax earnings would depend upon whether the recovery was of a sort subject to taxation.

227. *See* Lee v. Joseph E. Seagram & Sons, Inc., 552 F.2d at 454-55.

228. *See* Locklin v. Day-Glo Color Corp., 429 F.2d 873, 884 (7th Cir. 1970), *cert. denied*, 400 U.S. 1020 (1971).

229. For example, suppose Omegamax Corporation was formed for the purpose of manufacturing atomic flatulators. There are four successful producers of atomic flatulators, all enjoying a return of approximately 18%. Two other companies, however, have failed. The average return for the industry is therefore only 12%. This figure should thus be used as Omegamax's legitimate expectation. Statistics concerning industry performance are available in trade journals and government publications. *Cf.* T. MILNE, *supra* note 72, at 10-11 (projections should show the probabilities of the risk of failure).

a specific period is included in the contract[230] or the breach merely delays the opening of the business for a determinate period. If no contract period is specified, however, or if lost profits cannot be proved with certainty over the contract period,[231] then some period must be chosen. Merely to instruct the jury to confine the recovery to a "reasonable period of time"[232] provides no guidance. If the contract is of indefinite duration, then the period of recovery should be no longer than the average life of a new business in the industry[233] or, if such statistics are not available for the type of business in question, then the average life of a new business in general. This limit should be observed even when a longer, definite period is called for in the contract. Often the nature of the evidence itself will place a practical limit on the recovery period. Even the most elaborate of economic studies can project with any degree of confidence for no more than several years.[234] The cutoff point should occur when the illumination of reasonable certainty fades into the shadow of speculation, which in practice would be where a forecaster would decline to issue an opinion, or else qualify his opinion to such an extent that it could not be given credence.[235]

The characteristic form of a forecaster's projection itself provides a basis for compromise. Forecasting speaks in terms of probability or measurable uncertainty.[236] Therefore, forecasts do not ordinarily give single number projections. Instead they present a range of probabilities, represented by figures of a most optimistic outcome, a most likely outcome, and a most pessimistic outcome.[237] The latter figure would be the most certain to be reached, even though a plaintiff might legitimately ask for damages based

230. *See* Autowest, Inc. v. Peugeot, Inc., 434 F.2d 556 (2d Cir. 1970) (ten year distributorship franchise agreement); Ferrell v. Elrod, 63 Tenn. App. 129, 469 S.W.2d 678 (1971) (five year lease, with an option to renew for five additional years).

231. *See* Automatic Canteen Co. of Wash. v. Automatic Canteen Co. of Am., 182 Wash. 133, 45 P.2d 41 (1935) (recovery for 23 year unexpired term of exclusive distributorship agreement too speculative).

232. *See* Shearon v. Boise Cascade Corp., 478 F.2d 1111 (8th Cir. 1973).

233. *See* Lee v. Joseph E. Seagram & Sons, Inc., 552 F.2d at 455 (calculating damages on assumed minimum 10 year "life" of new distributorship). When the object of the contract is a valuable right enabling the promisee to do business that would be treated as an asset by an accountant—such as a patent license or a franchise—and amortized over an assumed life, then this accounting convention could be adopted as fixing the applicable recovery period. This may have been done in *Lee*.

234. Forecasts for 5 to 20 year periods are considered to be long term and do not usually take into account business cycles. Schultz, *supra* note 177, at 396.

235. *Cf.* T. MILNE, *supra* note 72, at 7 ("The planning horizon is simply the period over the future to which decisions being made now will be relevant.") At least one case has looked at the relative fault of the parties in fixing the recovery period. Edwin K. Williams & Co. v. Edwin K. Williams & Co.-E., 377 F. Supp. 418, 429 (C.D. Cal. 1974), *aff'd*, 542 F.2d 1053 (9th Cir. 1976), *cert. denied*, 97 S. Ct. 2973 (1977).

236. T. MILNE, *supra* note 72, at 155.

237. *Id.* at 10-11; C. ROBINSON, *supra* note 164, at 169-71.

on the most likely outcome. Calculating damages on the most pessimistic projection would not only ease the burden of excessive risk on a promisor, but would also be more consonant with the policy of reasonable certainty.[238]

An obvious but under utilized solution to the problem of excessive verdicts is the use of the remittitur.[239] The application of this traditional procedural device can be used to restrict jury awards to that amount of damages which has been proven in satisfaction of the legal standard of reasonable certainty.[240]

Where the nature of the venture contemplated by the contract is so unique that it would be impossible to forecast its probable outcome short of conducting the venture as an experiment—but it is nevertheless quite certain that some profits would have resulted—then it is entirely defensible to arrive at some admittedly arbitrary damage figure as a compromise.[241]

VIII. CONCLUSION

While the new business rule has the virtue of any bright line test of serving judicial economy by excluding offers of evidence and helping courts avoid facing hard questions, such objectives are extrinsic to the original purpose of the rule and should not mandate a continuing adherence to it when its major premise—that past profits are necessarily the only reliable basis from which the existence of future profits may be inferred—is no

238. See Furrer v. International Health Assurance Co., 256 Or. 429, 474 P.2d 759 (1970) for an example of calculation of damages on this basis.

239. Remittitur has not often been applied in new business cases because the new business rule has been most often used as an excuse to keep the lost profit damages issue from going to the jury at all. Therefore, there has usually been no jury finding that could be the object of a remittitur.

240. *See* Larsen v. Walton Plywood Co., 65 Wash. 2d 1, 20-21, 390 P.2d 677, 689 (1969).

241. *See* Lakota Girl Scout Council, Inc. v. Havey Fund-Raising Mgmt., Inc., 519 F.2d 634 (8th Cir. 1975). Defendent was hired to manage a fund-raising drive for the local Girl Scouts. Only $89,000 was grossed—far short of the $345,000 goal. Defendant's director of sales testified that the goal probably could have been reached if the campaign had been directed properly, but there was no guarantee that any money would in fact be raised. The Eighth Circuit upheld a jury verdict for $35,000. *Id.* at 643-44. In Riley v. General Mills, Inc., 226 F. Supp. 780 (E.D. Pa. 1964), *rev'd on other grounds*, 346 F.2d 68 (3d Cir. 1965), defendant improperly discontinued a promotional venture whereby it would put schoolchild accident insurance policy applications in boxes of Betty Crocker Gingerbread Mix that would offer $1000 of coverage for $1. Schoolchild accident insurance was a relatively new field at the time and had never been sold through the agency of dehydrated gingerbread men. Plaintiff estimated that there would have been a 60% to 90% return of the applications; defendant estimated that there would have been a 1% return. The court concluded that there would have been a 25% return, and awarded damages for guaranteed commissions on net premiums on this basis, but denied a recovery of contingent commissions on net profits from premiums as being too speculative. *Id.* at 784-85; *cf.* Story Parchment Co. v. Paterson Parchment Paper Co., 282 U.S. at 562, *quoted at* text accompanying note 106 *supra* (if the fact of damage is proved with certainty, then the amount may be left to reasonable inference). *See generally* Comment, *supra* note 48 (advocating more widespread resort to compromise and approximation in lost profit cases).

longer acceptable. The mere tacking on of exceptions to the rule is unsatisfactory, because they do not serve as reliable guides to decisionmaking for particular cases and have led to inconsistent results. A less intractable test along the lines suggested above[242] that takes into account developing commercial and economic realities is needed. The recent cases allowing lost profit recoveries for unestablished businesses have already, in effect, tacitly adopted this test, while for the most part still framing the analysis in terms of the new business rule. The time has come to make explicit that which has heretofore been implicit, and for our judicial system to exhibit more faith in the capacity of participants in this economic regime to see their endeavors bear fruit.[243]

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242. *See* text accompanying notes 172-75 *supra*.

243. *Cf.* Farnsworth, *supra* note 42, at 1216 ("All in all, our system of legal remedies for breach of contract, heavily influenced by the economic philosophy of free enterprise, has shown a marked solicitude for men who do not keep their promises.").