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The New-Business Rule and Compensation for Lost Profits

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In the late 1960s, the movers and shakers of Buffalo determined that their football team, the Buffalo Bills, needed a new domed stadium. The County entered into a contract with Kenford—a firm owned by local landowner Ed Cottrell, who teamed up with Judge Roy Hofheinz (the creator and operator of the Houston Astrodome, the first domed stadium). Under that contract, Kenford would provide land for the stadium in exchange for a management contract. The County's expected cost of building the stadium was $50 million. However, Kenford's lowest construction bid was $72 million. Unable to afford such costs, the County cancelled its plan to build the stadium, and Kenford sued the County for breach of contract. Kenford won on the basis of liability and entered a nine-month trial to address its damages.[1] In addition to the land that had been allocated to the stadium, the adjacent land belonged to Kenford. Kenford claimed that, had the stadium been built, it would have developed the peripheral land with a theme park, three hotels, four office buildings, a golf course, and a specialty retail center. Kenford's team of economic experts, which spent months testifying about their twenty-year projection of future costs and revenues on a year-by-year basis, concluded that Kenford's lost profits due to its inability to develop the adjacent land alone were over $380 million. Total damages claims exceeded $500 million.[2] When the dust had cleared, Kenford received only $10 million, none of which addressed its lost profits.[3]

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1 The litigation dragged on for eighteen years. For details, see VICTOR P. GOLDBERG, RETHINKING CONTRACT LAW AND CONTRACT DESIGN 96–114 (Edward Elgar 2016).

2 They also argued that, had the stadium been built, they would have been able to entice a major league baseball team (possibly the New York Yankees) to come. The expert opined that the lost profits arising from the failure to buy the Yankees was $146 million.

3 Kenford Co. v. County of Erie, 537 N.E.2d 176 (N.Y. 1989).

As a matter of sound policy the denial was correct, although the trial judge got there with a dubious argument, which I need not reproduce here.[4] Kenford's lost profit claim faced a doctrinal hurdle—the so-called "new-business rule."[5] If a business were *new*—that is, if it did not have a history of profitable operations—it would be denied recovery for lost profits. Until recently, most American jurisdictions followed the rule. That has changed. Robert Dunn summarized that change in his treatise: "The first edition of this book described the new-business rule as a 'majority rule' and the rejection of the new-business rule as a 'minority rule.' The trend in the cases since 1978 is unmistakable. The modern decisions . . . demonstrate an increased rejection of the traditional new-business rule. The majority and minority rules are now the other way around."[6] Likewise, Allan Farnsworth stated that the rule "has been largely abandoned."[7] The new-business rule still exists in some jurisdictions, notably in New York (although, for reasons that will become clear, the New York courts have tied themselves in knots in their efforts to apply the rule).

Today, the prevailing notion accepts Dunn's view that a new business is no different from an existing one. "What the earlier cases perceived as a rule of law has been replaced in the cases cited by a rule of evidence. The rule of evidence is far preferable. . . . The trend in the modern cases is plainly toward replacing the old rule of law with a rule of evidence—the unquestionable principle that damages for loss of profits must be proven with reasonable certainty."[8]

I argue that this so-called "modern" view is wrong. The damages for a new business ought not be viewed as merely a matter of whether the evidence is sufficient to surmount the "reasonable certainty" hurdle. By ignoring the underlying economics, the courts have lumped together a disparate set of problems under the new-business rubric and have attempted to treat all of those problems alike. For some cases—such as the Kenford litigation—a zero-compensation result would be appropriate. For others, zero-compensation would not suffice. Unpacking the "modern" view results in a more nuanced approach to measuring damages. In particular, it calls into question a common refrain in contracts discourse, namely, that the damage rules result in systematic undercompensation.[9] I will argue that the increased

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[4] For details, see Goldberg, *supra* note 1, at 102–03.

[5] *See* Bernadette J. Bollas, *The New Business Rule and the Denial of Lost Profits*, 48 Ohio St. L.J. 855 (1987).

[6] Robert C. Dunn, Recovery of Damages for Lost Profits § 4.3, at 391 (Lawpress Corp. 2005).

[7] E. Allan Farnsworth, Contracts § 12.15, at 272 (Wolters Kluwer 4th ed. 2004).

[8] Dunn, *supra* note 6, § 4.3, at 392; Dan B. Dobbs, Handbook on the Law of Remedies § 3.3, at 155 (West 1973) ("[T]he distinction between established businesses and new ones . . . goes to the weight of the evidence.").

[9] *See* Alan Schwartz, *The Case for Specific Performance*, 89 Yale L.J. 271, 275–76 (1979); Steven Shavell, *Is Breach of Contract Immoral?*, 56 Emory L.J. 439, 451 (2006); Douglas G. Baird, *The Young Astronomers*, 74 U. Chi. L. Rev. 1641, 1650 (2007); Melvin Aron Eisenberg, *The Principle of* Hadley v. Baxendale, 80 Calif. L.

liberality in awarding lost profits to new businesses has, in many instances, resulted in overcompensation. All the errors are not, however, in one direction; in other contexts, application of the rule has (or would have) resulted in undercompensation.

I break down the case law into four stylized categories; actual cases might not fit entirely under a single category. There is a class of cases in which the appropriate new business award is zero, but the courts have drawn the line in the wrong place. The crucial issue is not the lack of a track record or whether damages can be proved with "reasonable certainty." Rather, they should focus on a firm's expected return on a new investment, regardless of whether that investment is for a new business. Terry Malloy characterizes those cases with the plaintive cry, "I could've been a contender."[10] Following a breach of contract, the plaintiff—who has *not* executed its business plans that rely on the contract—claims that, absent the breach, it *would have* created certain businesses and earned profits by doing so. As one court said, "[m]ost contracts are motivated by the expectation of future profits. If such profits are within the contemplation of the parties at the time the contract is made, they may form the measure of damage."[11] Why, then, should the plaintiff be subject to zero compensation? The simple answer is that the damage remedy must account for the opportunity cost of capital. Since there is no reason to believe that this particular investment would have been more profitable than any alternative use of the funds that the plaintiff saved because the deal cratered, there would be no loss. Thus, returning to the domed stadium that wasn't, Kenford still had the funds it would have invested in the hotels, golf course, and other projects. It could have invested the funds in other projects, and there was no reason for it to believe that one set of projects was better or worse than the other.[12] I develop and qualify this argument in Part I.

In the second category of cases, an owner of intellectual property licenses the property to a party that fails to exploit it. Suppose that part of the licensor's compensation was contingent, perhaps, on a royalty on the licensee's sales, and that the licensor proved that the licensee breached the contract by failing to exploit the property. In that case, damages would be

Rev. 563, 610–11 (1992); Tess Wilkinson-Ryan & David A. Hoffman, *Breach Is for Suckers*, 63 Vand. L. Rev. 1003, 1006 (2010); David W. Carroll, *A Little Essay in Partial Defense of the Contract-Market Differential as a Remedy for Buyers*, 57 S. Calif. L. Rev. 667, 680–81 (1984).

[10] On the Waterfront (Columbia Pictures 1954) (Marlon Brando playing Terry Malloy).

[11] Larsen v. Walton Plywood Co., 390 P.2d 677, 686 (Wash.), *adhered to en banc by* 396 P.2d 879 (Wash. 1964) (mem.).

[12] The two principals were highly leveraged, so their future spending would most likely have been funded by debt. The principals either owned or had options on the adjacent land. As I note in Part I, owning a complementary asset can make the investment more valuable than its alternatives. However, the value of the new structures would have been reflected in the value of the land. The experts also claimed the potential appreciation in the value of that land as a separate source of damages. Including both measures in the damages calculation would have resulted in double counting. In the end, the Court of Appeals denied recovery for the lost appreciation in land value as well. *See* Kenford Co. v. County of Erie, 537 N.E.2d 176 (N.Y. 1989).

the royalties on the licensee's projected sales. Contrary to the first category of cases, the licensor *has already made its investment*. Unless the contract has a liquidated-damages clause or some other restriction on recovery, the damages should be recoverable. As I explain in Part II, the New York *per se* rule against awarding lost profits for new businesses has conflated such cases and the first category of cases, resulting in some very convoluted reasoning. I analyze the second category of cases and its interplay with the other categories in Part II.

The third category consists of cases in which the promisor delays performance or supplies a defective product. For example, there might be a delay in initiating a construction project or delivering products, or there might be a breach in warranty. In those cases, performance eventually does take place. I analyze such cases following the rule of *Hadley v. Baxendale*.[13] Depending on the facts, one could make a strong case for outcomes ranging from no compensation to expectation damages.[14] I analyze the third class of cases in Part III.

The final category consists of cases that involve a buyer's anticipatory repudiation of a long-term contract under which a seller has partially performed. I argue that the seller's ability to recover lost profits should depend on neither the newness of the business nor the reasonable certainty of the damage calculations, but rather on whether the market conditions have changed. If market conditions have not changed, there should be no recovery for lost profits. If market conditions have changed, lost profits should be recoverable. However, the recovery should be for direct, not consequential, damages. In Part IV, I explain why that specification makes a difference.

The new-business rule should not be thought of as a single rule. By stuffing inherently different types of problems into a single box, courts and commentators have undermined the rationale for the rule, even for cases in which application of the rule was appropriate. The courts have deployed on an *ad hoc* basis various devices—notably "reasonable certainty" or by labeling the claimant's business as new (or not)—to justify awarding damages to some plaintiffs but not others. With a proper understanding, neither these nor other ploys would be necessary.

[13] 9 Ex. 341, 156 Eng. Rep. 145 (1854).

[14] Judge Posner recognized this range of outcomes in his decision in MindGames, Inc. v. W. Publ'g Co., 218 F.3d 652, 655 (7th Cir. 2000) ("The rule of *Hadley v. Baxendale* often prevents the victim of a breach of contract from obtaining lost profits, but that rule is not invoked here. Neither the 'new business' rule nor the rule of *Hadley v. Baxendale* stands for the *general* proposition that lost profits are never a recoverable item of damages in a tort or breach of contract case." (emphasis added) (citation omitted)).

I. Opportunity Cost

Suppose that, when a promisor breached a contract, the promisee had not taken any action in reliance on that contract. The promisee then claims that, absent the breach, it *would have* invested in a business that would have been profitable and that it has lost the profits from that forgone activity. Suppose further that the promisee has no complementary assets that would have made that forgone activity uniquely valuable. The promisee would then bring in expert economic witnesses who would testify to its "lost profits," the forgone earnings of the "stillborn enterprise."[15]

In such a case, the relevant question is not whether the project would be profitable but rather whether it would be more profitable than its next-best alternative. The investment might have turned out to be a wild success or a dismal failure, but there is no reason *a priori* to believe that the expected rate of return would exceed the going market rate. After the breach of contract, the promisee still has the money that it would otherwise have invested in the project, as well as the freedom to use those funds for any purpose. In that case, the expected value of the specific project would be the same as the market value, so the promisee's loss would be zero. I need not qualify this by comparing the riskiness of the particular project with the market rate because the opportunity cost of the funds accounts for relative riskiness. Thus, for cases in which the promisee has not made any investments that depend on the breached contract, the *per se* rule—no compensation—makes sense.

By not recognizing that economic rationale, courts have allowed plaintiffs like Kenford to claim losses that would overcompensate them substantially. Because damage claims are usually treated as a matter of fact, courts, with no coherent theory behind their approach in dealing with the claims, allow many of those claims to succeed or at least to reach the jury. Even if the claims are denied ultimately, allowing plaintiffs to make such legal claims alone can have significant effects. They raise litigation costs if expert testimony is given to prove the alleged loss.[16] For example, in the Kenford litigation, expert economic testimony wasted hundreds of thousands of dollars—an amount that, adjusting for inflation, would cost millions today—and months

[15] Roger I. Abrams, Donald Welsch & Bruce Jonas, *Stillborn Enterprises: Calculating Expectation Damages Using Forensic Economics*, 57 Ohio St. L.J. 809 (1996).

[16] In an antitrust case, Judge Posner disparaged the damages testimony of the expert witnesses:

> The projection of lost profits that Olympia's expert witness made to the jury bore no relation to Olympia's internal business planning or to economic reality. It is thus one more illustration of the old problem of expert witnesses who are "often the mere paid advocates or partisans of those who employ and pay them, as much so as the attorneys who conduct the suit. There is hardly anything, not palpably absurd on its face, that cannot now be proved by some so-called 'experts.'" The expert in this case dazzled the jury with "an array

of jurors' time. In addition, uncertainty over whether a court would accept the evidence would affect the settlement value.[17] In the remainder of this part, I provide some examples from case law of plaintiffs' attempts to assert lost profit claims for stillborn projects.

A. Fera v. Village Plaza, Inc.

Fera v. Village Plaza, Inc.[18] appears in a number of casebooks and is often cited as an illustration of a modern court decision recognizing the lost profits of a business that had not yet begun to operate.[19] Fera intended to open a "book and bottle" shop and executed a ten-year lease with Village Plaza.[20] For reasons unimportant to my discussion, Village Plaza leased the property to someone else. However, there was no indication that the lease terms had become any different—that is, the court gave no indication that there might have been a change in the market value of the leasehold. Fera sued Village Plaza, arguing that had he been able to lease the property, he would have made profits over the next ten years. Fera, testifying as an expert on his own behalf, claimed $270,000 in lost profits. Village Plaza's expert testified that Fera would probably have made losses instead. The jury awarded Fera $200,000 in lost profits.

The Michigan Supreme Court upheld the jury verdict, asserting that the claim for lost profits by a new business is no different from the general rules regarding claims for lost profits generally:

> These cases and others since should not be read as stating a rule of law which prevents *every* new business from recovering anticipated lost profits for breach of contract. The rule is *merely an application of the doctrine* that

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> of figures conveying a delusive impression of exactness"—delusive because the figures had no relation to reality.

Olympia Equip. Leasing Co. v. W. Union Tel. Co., 797 F.2d 370, 382 (7th Cir. 1986) (citations omitted) (first quoting Keegan v. Minneapolis & St. Louis R.R., 78 N.W. 965, 966 (Minn. 1899); then quoting Herman Schwabe, Inc. v. United Shoe Mach. Corp., 297 F.2d 906, 912 (2d Cir. 1962) (Friendly, J.)); *see also* J. Gregory Sidak, *Court-Appointed Neutral Economic Experts*, 9 J. Competition L. & Econ. 359 (2013). Of course, not all expert witnesses behave this way. I am occasionally retained in that role, and I hope that I am objective. Nonetheless, as we shall see in some of the cases discussed below, the experts do often stretch the truth.

17 There is some behavioral evidence that introducing a high number, even a ridiculously high one, could bias the fact finder's decision upward. For a nontechnical introduction to the "anchoring" effect, see Daniel Kahneman, Thinking Fast and Slow 119–28 (Farrar, Straus & Giroux 2011).

18 242 N.W.2d 372 (Mich. 1976).

19 *See* E. Allan Farnsworth, Carol Sanger, Neil B. Cohen, Richard R.W. Brooks & Larry T. Garvin, Contracts: Cases and Materials (West 8th ed. 2013); John P. Dawson, William Burnett Harvey, Stanley D. Henderson & Douglas G. Baird, Contracts: Cases and Comment (Foundation Press 10th ed. 2013); Daniel Markovits, Contract Law and Legal Methods (Foundation Press 2012); Gerald E. Berendt, Rebecca A. Cochran, Doris Estelle Long, Robert J. Nye & John H. Scheid, Contract Law and Practice (LexisNexis 2d ed. 2009); George W. Kuney & Robert M. Lloyd, Contracts: Transactions and Litigation (West 3d ed. 2011).

20 Fera intended to open a bookstore with a liquor license. Probably not a great business idea.

> "[i]n order to be entitled to a verdict, or a judgment, for damages for breach of contract, the plaintiff must lay a basis for a reasonable estimate of the extent of his harm, measured in money." The issue becomes one of sufficiency of proof. "The jury should not [be] allowed to speculate or guess upon this question of the amount of loss of profits."[21]

Thus framed, Fera's recovery hinged on the sufficiency of proof. The court used the fact that both parties spent a considerable amount of effort on proving damages as evidence that the damage measure would not be speculative. It quoted the trial judge:

> The loss of profits are often speculative and conjectural on the part of witnesses. When this is true, the Court should deny loss of profits because of the speculative nature of the testimony and the proofs. However, the law is also clear that where lost profits are shown, and there is ample proof on this point, they should not be denied merely because they are hard to prove. In this case, both parties presented testimony on this issue for days. This testimony took the lost profits issue out of the category of speculation and conjecture. The jury was given an instruction on loss of profits and what the proofs must show, and the nature of the proofs, and if they found them to be speculative they could not award damages therefor. The jury, having found damages to exist, and awarded the same in this case in accord with the proper instructions, the Court cannot, now, overrule the jury's finding.[22]

This is a funny argument. Because the parties tried to prove lost profits, the results were not speculative, and, therefore, the jury should be allowed to find lost profit damages. I believe no other court has embraced such reasoning, although many cite *Fera* when justifying their conclusion that lost profits should be awarded.[23]

Jurors in *Fera* only had to sit through days of nonsense as opposed to the jurors of *Kenford*, who had to endure months. Still, the only purpose of the "factual" inquiry was to mislead the jury. The estimates were not speculative; they were silly. Fera had taken a ten-year lease on a space in a shopping center for a "book and bottle" shop; and he claimed that, because the shopping center leased that space to someone else, he had lost profits from that shop for the ten-year period. After the breach of contract, Fera still possessed his

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21 *Fera*, 242 N.W.2d at 373–74 (first and third alterations in original) (second emphasis added) (citation omitted) (first quoting 5 Arthur L. Corbin, Corbin on Contracts § 1020, at 124 (West 1964); then quoting Kezeli v. River Rouge Lodge IOOF, 161 N.W. 838, 840 (Mich. 1917)).

22 *Id.* at 375 (internal quotation marks omitted).

23 *See, e.g.*, Drews Co. v. Ledwith-Wolfe Assocs., Inc., 371 S.E.2d 532, 533 (S.C. 1988); Super Valu Stores, Inc. v. Peterson, 506 So. 2d 317 (Ala. 1987); Mid-Am. Tablewares, Inc. v. Mogi Trading Co., 100 F.3d 1353 (7th Cir. 1996); Fredonia Farms, LLC v. Enbridge Energy Partners, L.P., No. 1:12-CV-1005, 2014 WL 3573723, at *10 (W.D. Mich. July 18, 2014); Hunters Int'l Mfg. Corp. v. Christiana Metals Corp., 561 F. Supp. 614, 617 (E.D. Mich. 1982), *aff'd*, 725 F.2d 683 (6th Cir. 1983); Beverly Hills Concepts, Inc. v. Schatz & Schatz, Ribicoff & Kotkin, 717 A.2d 724 (Conn. 1998).

business idea, his cash, and his ability to lease other spaces. Awarding Fera any lost profit damages assumes that spending money on this shop in this location was better than any alternative use, which makes no sense.[24]

My colleague Robert Scott suggested that I was just cherry picking "lousy lawyering" cases in which the defendant's lawyer should have been guilty of malpractice. Unfortunately, it was the law, not the lawyer, that was the problem. As I note later in this article, *Fera* is cited with approval in a number of cases, and none questions its outcome. I found 33 scholarly articles in the *Westlaw* database that cite *Fera;* none question its reasoning. The Farnsworth treatise includes the case in a string citation, without comment, for the proposition that the "rule of law which prevents *every* new business from recovering anticipated lost profits" is rejected.[25] The curators of the Corbin treatise trumpeted the fact that *Fera* had cited the treatise's previous edition,[26] but the treatise was silent on the merits of *Fera*. Without a framework for analysis, the *Fera* decision has passed without criticism into the body of law.

B. Super Valu Stores, Inc. v. Peterson

Super Valu Stores, Inc. v. Peterson[27] also concerned the breach of a promise to award a lease, but with one twist—the disappointed promisee gave up a well-paying job in anticipation of obtaining a fifteen-year lease. Peterson had been an employee for 24 years, had been president of a division of Super Valu, and earned $100,000 per year (in Alabama in 1984). Because Super Valu would not allow an employee to own a retail outlet, he had no choice but to retire. The deal fell through and Peterson succeeded in his claim that Super Valu had breached the contract.

The trial court awarded damages for lost profits, and the award was upheld on appeal. Rejecting Super Valu's argument that Alabama had a *per se* rule against awarding lost profits for an unestablished business, the court adopted the "reasonable certainty" standard and concluded that Peterson's

[24] For another example in which the court wrongly allowed recovery of lost profits for a lease, see S. Jon Kreedman & Co. v. Meyers Bros. Parking-Western Corp., 130 Cal. Rptr. 41 (Ct. App. 1976).

[25] Farnsworth, *supra* note 7, § 12.15 n.28, at 276 (emphasis in original) (quoting *Fera*, 242 N.W.2d at 373).

[26] 11 Joseph M. Perillo, Corbin on Contracts § 56.16 n.19 (Matthew Bender & Co. rev. ed. 2013) ("The court cited the prior edition of this section to show that a plaintiff must lay a basis for a reasonable estimate of the extent of his harm, but held that lost profits could be recovered in a new business if they could be proven with reasonable certainty, just as for any other business. The court cited the prior edition of § 1023 (now § 15.20) to show that it is just easier to establish a reasonable certainty of lost profits in the case of an established business. The court cited the prior edition of § 1022 (now § 15.19) to show that mathematical precision is not required[] where[,] by the nature of the circumstances, precision cannot be attained, and particularly this is true where the defendant's breach caused the imprecision.").

[27] 506 So. 2d 317 (Ala. 1987).

evidence was sufficient to meet that standard.[28] What was that evidence? The court began with a seemingly promising statement:

> The fundamental basis for Peterson's evidence as to damages was *Super Valu's own projections of profits,* produced in its normal course of business long before this dispute arose. These projections were the product of an intense, exhaustive process involving many different Super Valu personnel. Super Valu's projections resulted from the application of a scientific methodology that for many years had accurately predicted the future performance of stores associated with Super Valu.[29]

The court emphasized the fact that the lost profits estimate was "based on pre-dispute projections prepared by the *defendant*."[30] The expert then took Super Valu's projected profit-and-loss statements for the first three years—\$124,684, \$619,267, and \$750,198—as the basis for projections for the remaining twelve years of the lease. Unfortunately, there is a gap in the court's exposition, so I do not know how the expert derived his conclusion from those numbers. He concluded that, over the fifteen years, the lost profits would be over \$19 million.[31] There must have been an assumption that the growth in profits substantially exceeded the discount rate, assuming that the expert even applied a discount rate. Having certified the \$19 million estimate as credible, the court then approved the jury verdict of \$5 million. There is no information available as to why \$19 million had shrunk to \$5 million.

Of course, the \$5 million award had no basis either. There is no reason to believe that a lease for operating a small supermarket would be a better investment opportunity than any other. The expert's estimate did not presume that Peterson brought something exceptional to the project. The estimate was made on the basis of Super Valu's projections with a generic supermarket operator. Peterson's "lost profits" should have been zero. That conclusion does not mean that he should not have been compensated at all. His compensation should have been based on his reliance on the contract. He gave up a job that paid \$100,000 per year and, according to the court, "[he] expended time, energy, and money in undertaking the necessary actions to properly equip, staff, and outfit the County Market."[32] Thus, compensation for at least some of Peterson's reliance would be plausible.[33] How much is

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28 The court cited *Fera*, 242 N.W.2d 372, among other decisions.

29 *Super Valu*, 506 So. 2d at 330 (emphasis in original).

30 *Id.* at 331 (emphasis in original).

31 *Id.* at 332 ("The sophistication of these projections of lost profits, we believe, equals or exceeds that of the projection methodology approved by this Court [in another case].").

32 *Id.* at 335.

33 The decision does not indicate whether he was employed in the interim or whether he should have been employed. If he had been employed, any recovery should have been reduced to account for that fact.

unclear, but it certainly would have been far less than the $5 million awarded by the jury.[34]

C. Beverly Hills Concepts, Inc. v. Schatz & Schatz, Ribicoff & Kotkin

The *Beverly Hills Concepts (BHC)* case[35] is particularly interesting because it contains a dissent by a very knowledgeable contracts scholar, Justice Ellen Peters of the Connecticut Supreme Court, a former Yale Law School professor. That she was fundamentally wrong adds to its significance. Technically, the case concerned lawyers' malpractice, not breach of contract, but that can be ignored. The court found that the malpractice resulted in the failure of a new firm, Beverly Hills Concepts (BHC). BHC's primary business would have involved the sale of franchises for fitness clubs. The majority held that lost profits for a new business were recoverable, subject to the reasonable certainty standard:

> The plaintiff argues that the present value of a stream of expected future profits is an appropriate way to value a business and that it is therefore an appropriate measure of damages. We conclude that it is proper to award damages for the destruction of an unestablished enterprise and that lost profits may constitute an appropriate measure of damages for the destruction of such an enterprise.[36]

The majority concluded, however, that the plaintiff failed to prove the damages with reasonable certainty. The majority, I should note, cited both *Super Valu* and *Fera* as examples of successful application of the reasonable-certainty standard.

The plaintiff's expert witness projected sales of franchises and the resulting fees over a twelve-year period and concluded that the plaintiff had suffered a loss of $15.9 million. The majority concluded that the plaintiff had not produced sufficient evidence that it would become profitable. It also

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[34] For another case in which a potential lessee had made some expenditures in reliance and was improperly awarded lost profits, see Chung v. Kaonohi Center Co., 618 P.2d 283, 286 (Haw. 1980) ("In anticipation of operating the Chinese kitchen, plaintiffs arranged for financing, ordered equipment and furnishings, hired chefs and workers, advertised in the yellow pages of the telephone book for the to-be-built kitchen, and incurred other expenses."), *abrogated by* Francis v. Lee Enters., Inc., 971 P.2d 707 (Haw. 1999). In Energy Capital Corp. v. United States, 302 F.3d 1314 (Fed. Cir. 2002), the Department of Housing and Urban Development (HUD) breached a contract with a firm that was supposed to make up to $200 million worth of loans to owners of HUD properties to install energy-efficient heating systems. Rejecting the *per se* rule, the court found damages exceeding $10 million. The Federal Circuit remanded because the trial court had used a risk-free discount rate, holding that it should have used a risk-adjusted discount rate instead. The opportunity cost of this hypothetical loan portfolio would be an alternative loan portfolio with an equivalent risk profile. Lost profits should, therefore, have been zero. Energy Capital did incur costs in reliance and could have been compensated for those outlays.

[35] Beverly Hills Concepts, Inc. v. Schatz & Schatz, Ribicoff & Kotkin, 717 A.2d 724 (Conn. 1998).

[36] *Id.* at 733.

concluded that "the trial court abused its discretion in failing to limit the recovery of lost profits to a reasonable time period."[37]

The majority opinion included sufficient information to buttress the conclusion that BHC had suffered no loss except the costs incurred in reliance on the contract. BHC first contacted the law firm in late October 1987.[38] But BHC's financial condition was already poor:

> The plaintiff's financial statement, prepared by Coopers, revealed that it was insolvent as of November 30, 1987, and its situation had deteriorated even further by January, 1988. It is particularly telling that the plaintiff had attempted to obtain financing from a number of banks as well as from the Small Business Administration and that it had been rejected by all of these institutions. According to Charles Remington, one of the plaintiff's officers, this financing was necessary to the proposed franchising operation. Additionally, the model franchise opened by the plaintiff in East Hartford quickly failed. Finally, despite several months of trying, the plaintiff never sold a single franchise. Moreover, its own damages expert, Ferreira, characterized the plaintiff as a poor credit risk. These facts serve to indicate that the plaintiff was not financially stable and that its prospects for earning profits in the future were, at best, questionable.[39]

Why would a firm be a poor credit risk unable to find a lender if it had available to it a project worth $15.9 million? Because no one in their right mind believed it. There was no basis for claiming that the value of BHC's project would exceed BHC's opportunity cost. Given the market evidence, it was more likely that the project's expected present value was, in fact, negative.

Of course, even projects with negative expected present values can succeed. In her dissent, Justice Peters invoked Apple to illustrate how startups with questionable finances sometimes succeed:

> [T]he majority opinion starts out with an accurate description of the rocky state of the plaintiff's finances when it came to the defendants for legal representation. To my mind, it is not surprising that start-up companies, in the first years of their operation, would have a difficult time making ends meet. It is not far-fetched to assume that Steve Jobs, when he started Apple Computers, might have had difficulty in obtaining financing for so untested

[37] *Id.* at 739. The majority made the following odd argument: "We agree with the plaintiff that there is nothing inherently improper about allowing damages for lost profits over a twelve year period. What is improper, however, is to award damages over such a long time span when there is no evidence that the plaintiff would have survived for twelve years, let alone that it would have remained profitable for that length of time." *Id.* The court did not indicate how one could possibly demonstrate that a new firm could survive for a particular length of time.

[38] *Id.* at 728.

[39] *Id.* at 732.

> an idea as a personal computer. At that time, how could he have projected future profits with analytic precision?[40]

Justice Peters' statement simply reinforces the notion that, *ex post*, some investments are great successes and some are not. For projects that were aborted, we have only the *ex ante* information and, unless there is a credible reason to believe otherwise, the expected value of the loss would be zero.

Justice Peters had a legitimate concern. A wrongdoer should not be allowed to get away with its bad behavior without any liability. "We condone professional misconduct if we discharge these defendants of all liability to a plaintiff that has tried, as best it could, to quantify the loss that the defendants' misconduct has caused it to suffer."[41] The difficulty was that the doctrine had limited the court to choose between two options: either (1) to let experts dispute "lost profits" or to (2) to hold that the measures were not reasonably certain and therefore that damages were zero. There was a third option. By recognizing the spurious nature of lost-profit estimates, the court could have focused instead on what the plaintiff had actually lost—namely, its expenditures in reliance upon the defendant law firm's nonengagement in malpractice.

Justice Peters quoted an earlier opinion that would have limited the reviewing court's discretion in reviewing a damage award: "The amount of a damage award is a matter peculiarly within the province of the trier of fact . . . . The size of the verdict alone does not determine whether it is excessive. The only practical test to apply to this verdict is whether the size of the verdict so shocks the sense of justice as to compel the conclusion that the [trier of fact] was influenced by partiality, prejudice, mistake or corruption."[42] If reviewing courts were to so constrain themselves, the likelihood is high that juries would overcompensate plaintiffs.

D. Franchise Cases

In his treatise *Recovery of Damages for Lost Profits*, Robert Dunn argued in favor of awarding lost-profit damages to the aspiring franchisee:

> The supposed rule that lost profits damages of an unestablished business are not recoverable would seem to be least justifiable when the business to be established is a location for a national franchise. Each store is cast

[40] *Id.* at 744.

[41] *Id.* at 747 (Peters, J., dissenting). She criticized the majority: "As a matter of principle, the majority opinion subscribes to the position advanced by the defendants that, no matter how egregious and protracted their professional misconduct, it is more appropriate for this court to take an unnecessarily rigorous view of proof of damages than to provide relief for the plaintiff." *Id.* at 741.

[42] *Id.* at 744 (alterations in original) (quoting Grayson v. Wofsey, Rosen, Kweskin & Kuriansky, 646 A.2d 195, 203–04 (Conn. 1994)).

> from the same mold. The locations are rigidly controlled by the national franchisor. Projections are available based on extensive experience in other stores from which sales and profits can be derived with a high degree of certainty. These projections are the basis for the franchisor's selection of the new location and the franchisee's investment in it. If the figures are good enough for the parties to invest their money, it would seem that they should be good enough for a court. . . . If plaintiff can demonstrate that its operations at the new location would be comparable to those at its existing location, then adequate probative evidence may be introduced to demonstrate damages with the requisite reasonable certainty.[43]

Dunn's argument seems plausible, and many courts have accepted it. But the relevant question is not whether the franchisee's operations would be as successful in that location as they would be anywhere else. Rather, it should be whether there is a reason to believe that it would do better, and the answer to that should be negative Indeed, the very notion of using the earnings of comparable franchises as a basis for compensation presumes that the plaintiff's operations would not outperform others. Nor should the plaintiff expect to earn more than the opportunity cost of his capital and time. That does not mean that the plaintiff should not be compensated. The basis for the compensation would not, however, be the lost profits as defined by Dunn.

As his illustration, Dunn chose a case that did not pit a franchisor against a disappointed franchisee. In *Smith Development Corp. v. Bilow Enterprises, Inc.*,[44] McDonald's was the plaintiff. It alleged that the defendant had tortiously interfered with its contractual relations. McDonald's had entered into a conditional lease to open an additional franchised outlet, but a competitor attempted to prevent the restaurant's entry. The court held that there had been interference in McDonald's contract with the landowner. Although the court granted the landowner compensation, it denied McDonald's any compensation. The Rhode Island Supreme Court remanded the matter to the jury for errors in the charge and also examined whether McDonald's had a valid claim for damages. It first noted McDonald's history of success:

> McDonald's marketing research manager had testified. He described the uniformity of procedures utilized at all McDonald's restaurants, its training and national advertising programs, and the efforts made to maintain standards and quality. This witness informed the judge and jury that while in 1962 there were 800 units in operation, this number had increased at trial time to 1,200. He also reported an amazing record of successes—not one restaurant has failed. The trial justice ordered this testimony be stricken.[45]

[43] Dunn, *supra* note 6, §§ 4.7–4.8, at 398–400.
[44] 308 A.2d 477 (R.I. 1973).
[45] *Id.* at 483.

The court then concluded that compensation would be appropriate:

> Having in mind America's acceptance of McDonald's method of merchandising, we believe the requisite evidentiary basis had been established so that the jury could with "reasonable certainty" make a determination of the profit loss sustained as the result of McDonald's lengthy preoccupation with litigation, rather than the distribution of hamburgers, at its Middletown location.[46]

The court did not indicate whether McDonald's ever opened the outlet. That would not matter for lost profits damages calculated a la Dunn. But it would make a difference if one recognizes that Dunn's standard (and implicitly the court's) is the wrong one. If the outlet had opened, then a plausible measure of the harm caused by the delay would be based on the actual earnings; damages for delay are discussed in more detail in Part III. If the outlet did not open, then damages should be based on McDonald's reliance—for example, legal costs incurred because of the defendant's wrongful behavior. Neither of those remedies bears any relationship to the "lost profits."

E. Brundige v. Sherwin-Williams Co.

I do not argue that courts should never use the lost-profit remedy. ***Brundige v. Sherwin-Williams Co.***[47] presents a situation in which the lost-profit remedy would probably have been appropriate. Brundige, who had a noncompete agreement, had been an employee of Sherwin-Williams for ten years at a particular location. When Sherwin-Williams relocated, Brundige quit the company and opened a similar business at the old location. Sherwin-Williams obtained a temporary restraining order (TRO) to prevent Brundige's operating the store. Ultimately, the TRO was dissolved and Brundige sued the company for the losses incurred from its inability to operate while the TRO was in force. As the court noted, Brundige brought many specific assets to his project:

> In the case before us . . . the appellant had substantial experience in the retail paint sales business; he undoubtedly had a reputation in the community as a man of experience; his place of business was the same building where a business like his had been located for some time; he did open his business almost immediately after the injunction was dissolved; and he made a profit his first month and every month thereafter for the first six months he was in business.[48]

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[46] *Id.*
[47] 551 S.W.2d 268 (Ky. Ct. App. 1977).
[48] *Id.* at 271.

One could argue that it is precisely these characteristics that would have motivated Sherwin-Williams to enforce the noncompete covenant in the first place. The court does not say whether there would have been competition between the businesses in the old and new locations. Having concluded that such competition did not justify enforcement of the covenant, the court had to determine Brundige's damages. Brundige possessed multiple assets that were valuable only at that location and were specific to the purpose of operating his business. The loss should be the return on those specific assets during the period the TRO was in effect, and the best evidence of that would be the actual earnings after the TRO was lifted. If Brundige had managed to earn anything during the interim period, there could be an offset, but the basic point is that the expected returns would be positive, when taking into account the specific assets Brundige brought to the table.

Brundige illustrates an important qualification to the argument. If the plaintiff brings specific assets to the project, its expected returns would be positive. Such assets include those that have been acquired in reliance on that particular transaction or those that the plaintiff happened to have, which are useful for the particular project but cannot be deployed easily to another.

II. Cases Involving Nonpayment of Royalties

The recent treatment of the new-business rule in New York revolves around the *Kenford* litigation. In the Appellate Court's first shot, it was confronted with two precedents. In 1918, the New York Court of Appeals took what had then been the majority position, holding in *Cramer v. Grand Rapids Show Case Co.*[49] that a new business could not claim recovery for lost profits. Over half a century later, in *Perma Research & Development Co. v. Singer Co.*,[50] the Second Circuit refined the test when interpreting a contract under New York law: "Although lost profits in a new venture are not ordinarily recoverable, they may be awarded where: the loss of prospective profits are the direct and proximate result of the breach; profits were contemplated by the parties when they entered the contract; and there is a rational basis on which to calculate the lost profits."[51] The Appellate Division in *Kenford* interpreted *Perma* as qualifying *Cramer*: "What the court did in *Perma Research,* in essence, was to add a third requirement for new businesses by requiring them to establish some rational basis on which to calculate the lost profits. By so holding, the court converted the *Cramer* rule of nonrecoverability into a rule of evidence."[52]

[49] 119 N.E. 227 (N.Y. 1918).
[50] 402 F. Supp. 881, 898 (S.D.N.Y. 1975), *aff'd sub nom.* Perma Research & Dev. v. Singer Co., 542 F.2d 111 (2d Cir. 1976)
[51] *Id.* (citing *Cramer*, 119 N.E. 227).
[52] Kenford Co. v. County of Erie, 489 N.Y.S.2d 939, 946 (App. Div. 1985), *rev'd*, 537 N.E.2d 176 (N.Y. 1989).

The Court of Appeals soundly rejected the "rational basis" test: "It is our view that the record in this case demonstrates the efficacy of the principles set forth by this court in [*Cramer*], principles to which we continue to adhere. In so doing, we specifically reject the 'rational basis' test enunciated in [*Perma*] and adopted by the Appellate Division."[53] Thus, it appears that New York continues to honor the *per se* new-business rule. The Court of Appeals' opinion was unanimous (indeed *per curiam*).

Less than a decade later, the Court of Appeals confronted another new-business claim in *Ashland Management Inc. v. Janien*[54] and again produced a unanimous opinion. The court invoked *Kenford* but, instead of applying its *per se* rule, said that *Kenford* held that for

> a new business seeking to recover loss of future profits, a *stricter standard* is imposed because there is no experience from which lost profits may be estimated with *reasonable certainty* and other methods of evaluation may be too speculative. Whether the claim involves an established business or a new business, however, the test remains the same, *i.e.*, whether future profits can be calculated with reasonable certainty.[55]

How can we reconcile the court's notion that, on the one hand, it applies *Kenford*'s *per se* rule—which awards no lost profits for an unestablished business—and, on the other hand, it finds that the plaintiff must satisfy only the reasonable-certainty standard? Logically, I don't think we can. If, however, we recognize that the new-business rule lumped together very different types of claims, the outcome (if not the rationale) makes more sense. In Part I, the claim was for consequential damages—because you breached, I did not make an investment on which I would have made a lot of money. In *Perma*, *Ashland*, and similar cases, the claim involves direct damages—I sold you an asset for a future stream of payments and you have not paid. Subject to the qualifications that I discuss earlier in this article, the expected value in the former case is zero; in the latter case, it is positive.[56]

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[53] Kenford Co. v. Erie County, 493 N.E.2d 234, 236 (N.Y. 1986) (first citing *Cramer*, 119 N.E. 227; then citing *Perma*, 542 F.2d 111).

[54] 624 N.E.2d 1007 (N.Y. 1993).

[55] *Id.* at 1011 (emphasis added) (citations omitted).

[56] However, the courts continue to pay lip service to *Kenford* while mischaracterizing it, even in a case in which the *per se* bar would have made sense. For example, in Shelton v. Sethna, No. 10 Civ. 4128(TPG), 2012 WL 1022895 (S.D.N.Y. Mar. 26, 2012), Shelton, a real estate developer, bought property with the intention of developing it. He executed a contract to get a letter of credit that would be necessary for him to obtain a construction loan. He paid over $50,000, but the letter of credit was not forthcoming. He sued in federal court for return of his money and for damages. To assert that the amount in controversy exceeded the jurisdictional threshold of $75,000, Shelton argued that, "had his venture gone forward, he would have reaped $20,000,000 in profit in 60 months." *Id.* at *4. The Southern District of New York cited *Kenford* for the proposition that "[l]ost profits . . . are difficult to prove and recover when they concern a new and untested business." *Id.* (citing *Kenford*, 493 N.E.2d 234). Having thus misread *Kenford*, the court concluded that Shelton's assertions "suffice to state a colorable claim for lost profits under New York law. Plaintiff's

A. Perma Research & Development Co. v. Singer Co.

Perma licensed its patents to Singer for an automotive anti-skid device and was to receive royalty payments on the device's sales. Since the devices had not yet been perfected, the agreement required continued collaboration. Eventually, Singer decided to discontinue its development of the device. The court held that, by failing to put forth its best efforts, Singer had breached its agreement with Perma. The trial judge found damages of approximately $7 million, including prejudgment interest. The Second Circuit affirmed the decision, but provided only generic language in support:

> In simple terms, the measure of the damage is the amount necessary to put the injured party in [the] exact position as he would have been if the contract had not been breached. If Singer had put its resources and ingenuity to the anti-skid device, it probably would have been successful in the marketing of the same. Nor are the damages too speculative to assess. At the outset, since Singer produced the damage, it must bear the uncertainty of proof.[57]

The court did not specify how it arrived at the damage estimate, although it appears that the court simply projected sales (assuming that Singer finished developing the product), multiplied those sales by the royalty rate, and found the present discounted value of the projected stream of royalty payments.

Accepting the court's conclusion on liability, it is clear that Perma suffered a loss. It had already incurred the costs of developing the product to the point of being nearly marketable. Although it had some financial obligations, they were minor. To calculate damages, one could start by examining either the expected return on the investment or the costs incurred. There is no reason to believe that a remedy calculated on the basis of either of those methods would yield the same result as the "lost profits"—that is, the projected stream of royalty payments. Absent any language in the contract that bars its ability to do so, Perma should have received compensation.

But the contract was not silent as the dissent observed:

> The contract provided that defendant "in its absolute discretion shall determine the method of manufacturing, exploiting and marketing the Product" but gave plaintiff the right to reacquire its device if defendant failed to spend at least one hundred thousand dollars for "marketing, promoting and advertising" in any year beginning with 1966.[58]

claim may fail on the merits, but a weak claim does not warrant dismissal for lack of subject matter jurisdiction." *Id.*

57 *Perma*, 542 F.2d at 116.

58 *Id.* at 120 (Van Graafeiland, J., dissenting).

Moreover, Singer was obligated to pay roughly $500,000 even if it produced no units.[59] My concern is not whether the contract language supplanted the default damage rule. The point I want to emphasize is that when the bulk of the plaintiff's costs have already been incurred as in this case, the expected value of the claim is positive, not zero as in Part I.

B. Ashland Management Inc. v. Janien

Janien was an employee of an investment advisory company. He developed Eta, a stock-selection strategy, for the firm. Although there had been some dispute over whether his contract with the firm was binding, the Court of Appeals concluded that it was. The contract provided that

> if "for any reason" Janien left Ashland's employment he was entitled to "a royalty of the higher of $50,000 or 15% of gross revenues per annum of any and all existing or future accounts" using the Eta model or "any derivative thereof". The gross revenue was the 1% fee charged customers by Ashland for the funds under management.[60]

After firing Janien, Ashland sought a permanent injunction to bar him from using Eta. Janien counterclaimed for damages in the amount his lost profits under the contract.

After reaffirming *Kenford*'s *per se* rule, the Court of Appeals misapplied it by finding that Janien could recover his lost profits, notwithstanding that Eta was a new business. The court concluded that "it is manifest from an examination of [the contract] that the parties contemplated that Janien could recover damages if the agreement was not completed and that those damages could include lost profits from accounts using Eta."[61] The court reasoned:

> [T]he issue of future earnings was not only contemplated but also fully debated and analyzed by sophisticated business professionals at the time of these extended contract negotiations, projections of the increments to be anticipated over the years were calculated and provisions made for Janien's share of the anticipated profits. Inasmuch as Janien was entitled to damages based upon the revenues derived from "any and all existing or future" accounts, plaintiff must have foreseen that if it breached the contract defendant would be entitled to lost profits.[62]

The court then concluded that Janien had met the burden of proving lost profits with reasonable certainty. But, as in *Perma*, the basis of the court's

59 *Id.*
60 Ashland Mgmt. Inc. v. Janien, 624 N.E.2d 1007, 1009 (N.Y. 1993).
61 *Id.* at 1011.
62 *Id.*

decision should not have been certainty. Janien had already developed Eta, and his investment was therefore sunk. His damage claim was only for the future stream of earnings from his investment. Had the court framed the question this way, it would have avoided the intellectual contortions that resulted from its attempt to conform to *Kenford*'s *per se* rule.

C. MindGames, Inc. v. Western Publishing Co.

MindGames, Inc. v. Western Publishing Co.,[63] a diversity case decided in the Seventh Circuit under Arkansas law, is another case involving royalty payments for an already-existing item. A developer of a game, Clever Endeavor, licensed it to Western, a major marketer of games. Western would pay a 15 percent royalty for around four years. In addition, Western had an annual option to renew for $300,000 per year. In the first year, the royalty payment was $600,000, but sales afterwards fell precipitously. Western, according to MindGames, breached the agreement by putting forth inadequate promotional effort.[64] The opinion is unclear as to the nature of the plaintiff's damage theory. It appears to be that but for the alleged inadequate performance of Western, a lot more games would have been sold and (I think but the opinion is really unclear about this) the agreement would have been renewed so that even more games could have been sold in the future.

The trial judge, invoking a 75-year-old Arkansas decision,[65] held that the new-business rule barred the recovery of lost profits and granted summary judgment to Western. On appeal, Judge Richard Posner wrote for the Seventh Circuit that, given the chance, the Arkansas Supreme Court in 2000 would overrule its 1924 precedent and would abandon the new-business rule.[66] Instead, he would use "the serviceable and familiar standard of excessive speculativeness."[67] He rejected the new-business *rule* and replaced it with a *standard* that would apply to new and existing businesses alike:

> Just as a start-up company should not be permitted to obtain pie-in-the-sky damages upon allegations that it was snuffed out before it could begin to operate (unlike the ice factory in *Marvell,* which did begin production, albeit a little later than planned), capitalizing fantasized earnings into

[63] 218 F.3d 652 (7th Cir. 2000).

[64] According to the dissent, "MindGames' complaint alleged that a substantial number of games produced by Western failed to meet quality standards; Western failed to promote and make reasonable efforts to sell; and its efforts did not meet standards under the agreement or those recognized in the industry. It is MindGames' position that these failures caused loss of sales." *Id.* at 660.

[65] Marvell Light & Ice Co. v. General Elec. Co., 259 S.W. 741 (Ark. 1924).

[66] In rejecting the new-business rule, Judge Posner claimed that it could lead to an absurd result: "Suppose a first-time author sued a publisher for an accounting, and the only issue was how many copies the publisher had sold. Under the 'new business' rule as construed by Western, the author could not recover his lost royalties even though there was no uncertainty about what he had lost." *MindGames*, 218 F.3d at 657. However, there is no reason to believe that the rule would prevent recovery of past due payments.

[67] *Id.* at 658.

> a huge present value sought as damages, so a novice writer should not be permitted to obtain damages from his publisher on the premise that but for the latter's laxity he would have had a bestseller, when only a tiny fraction of new books achieve that success. Damages must be proved, and not just dreamed.[68]

The plaintiff had claimed future royalties of $40 million, which would have required future sales of about 10 million games.[69] In rejecting the claim, Judge Posner emphasized the plaintiff's lack of a track record. The plaintiff "could not point to other games that he had invented and that had sold well."[70] Because "[i]t pointed to no evidence from which lost royalties could be calculated to even a rough approximation . . . [he found] its silence eloquent and Western's argument compelling, and so the judgment in favor of Western is affirmed."[71] Indeed, Judge Posner asserted:

> [w]hen the breach occurred, MindGames should have terminated the contract and sought distribution by other means. The fact that it did not do so—that so far as appears it has made no effort to market "Clever Endeavor" since the market for the game collapsed in 1991—is telling evidence of a lack of commercial promise unrelated to Western's conduct.[72]

Because the contract gave Western a renewal option, which it did not execute, MindGames' damages would have been the basis for future sales by an unidentified third party. That MindGames found no such third party indicates that the future royalty stream would have not amounted to a substantial amount.

However, the value of that future royalty stream would probably have been greater than zero. MindGames might have been able to argue that Western had destroyed its brand image by producing a poor product; had it produced a quality product, the future sales would have been greater. Projecting those sales would have been speculative, but MindGames could have at least shown that the quality of the games was so substandard that industry experts would testify that the reputation could not be salvaged.[73] If MindGames surmounted that hurdle, then the parties could put forth competing estimates of future sales and royalties. To be sure, some of the estimates would be absurd. If the parties did not constrain the damages ex ante, then a judge could impose some logic on the process ex post. Both the

[68] *Id.*
[69] *Id.* at 654. The decision does not indicate the basis for this projection.
[70] *Id.* at 659.
[71] *Id.*
[72] *Id.* (citation omitted).
[73] I presume that the contract did not specify either any quality standards for Western or the consequences of failing to meet any quality standards.

"new business" and the "reasonable certainty" approach give the judge one blunt weapon to rein in the experts—the threat of zero.

MindGames is a classic case of a plaintiff's winning the battle but losing the war. The court rejected the *per se* new-business defense but then held that, because damages were too speculative, they would be zero. Compounding the plaintiff's pain, Judge Posner noted:

> Although the victim of a breach of contract is entitled to nominal damages, MindGames does not seek them . . . . By not seeking nominal damages, incidentally, MindGames may have lost a chance to obtain significant attorneys' fees, to which Arkansas law entitles a prevailing party in a breach of contract case.[74]

Had the case been remanded, as the dissent proposed, MindGames might at least have recovered its attorney fees.

D. Freund v. Washington Square Press, Inc.

In the well-known case of *Freund v. Washington Square Press, Inc.*[75] the court awarded only nominal damages of six cents to an author when a publisher chose not to publish his book. Although it did not explicitly invoke the new-business rule, the New York Court of Appeals held: "[The author's] expectancy interest in the royalties—the profit he stood to gain from sale of the published book—while theoretically compensable, was speculative. . . . In these circumstances, his claim for royalties falls for uncertainty."[76] There are two problems with this statement.

First, the author, Freund, neither attempted to prove lost royalties nor requested them. The court's denial was pure dictum.[77] Second, the contract gave Freund a sizable advance against royalties, such that he was compensated implicitly for the royalties on about 2,000 books.[78] Recovery could have been denied, not because the claimant had a new business, but because it could not show plausibly that the future royalties would have exceeded the advance. Again, as in *Perma*, I do not argue that the *ex ante* payment does, or should, supplant the default rule. The essential point is that when the claim is for lost royalties, the expected loss would be positive.

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[74] *MindGames*, 218 F.3d at 654 (citations omitted).
[75] 343 N.Y.S.2d 401 (App. Div. 1973), *modified and aff'd*, 314 N.E.2d 419 (N.Y. 1974).
[76] *Freund*, 314 N.E.2d at 421.
[77] This dictum has misled many commentators. *See, e.g.*, Melvin Eisenberg, *Probability and Chance in Contract Law*, 45 UCLA L. Rev. 1005, 1056–57 (1998).
[78] For an extensive discussion of *Freund*, see Goldberg, *supra* note 1, ch. 5.

III. Cases Involving Delay and Defect

Judge Posner noted in *MindGames*:

> The rule of *Hadley v. Baxendale,* often prevents the victim of a breach of contract from obtaining lost profits, but that rule is not invoked here. Neither the "new business" rule nor the rule of *Hadley v. Baxendale* stands for the *general* proposition that lost profits are never a recoverable item of damages in a tort or breach of contract case.[79]

In *Hadley*, of course, the breach of agreement caused a delay. Delay was also a problem in a number of new-business cases. Interestingly, one of the earliest new-business cases, *Abbott v. Gatch*,[80] involved a contract into which the parties had entered a year before the *Hadley* decision and concerned the delayed construction of a flour mill.

A. Delay

In *Abbott v. Gatch*, the Maryland Court of Appeal in 1859 found a contractor to have missed the contractual deadline for constructing a mill by about three months. The court rejected the owner's claim for lost profits:

> We cannot adopt any estimate of profits that Abbott might have realized from working the mill, because these were merely speculative, depending on the quantity of flour it might grind, the fluctuations of the market, as to prices of flour and grain, and the remote contingencies of his being able to procure wheat, labor and fuel, as well as the continuance of the mill in running order, free from accidents and loss of time from other causes.[81]

However, this conclusion did not mean that the owner would not receive any compensation. "Considering the uncertainties attending the milling business, and the difficulty of defining a safer guide for juries, we are of opinion, that a fair rent is the most reasonable standard of the defendant's loss by reason of the plaintiff's failure to complete the mill."[82] The court gave no indication as to how it would determine a "fair rent." There are a number of possible measures, none very good. Although unlikely, one possible measure would be the expected revenues less the sum of the projected operating costs and the cost of capital—that is, the projected lost operating profits minus the cost of capital. That would entail the same problems that the court recognized when it rejected "lost profits." A second possible measure would be discounted

79 *MindGames*, 218 F.3d at 655 (discussing Hadley v. Baxendale, 9 Ex. 341, 156 Eng. Rep. 145 (1854)).
80 13 Md. 314 (1859).
81 *Id.* at 333–34.
82 *Id.* at 334.

construction costs—that is, the construction costs plus land acquisition costs. A third measure would involve finding a comparable, although it is hard to imagine that there were any rented flour mills to compare with.

The rental value measure appeared again in *Evergreen Amusement Corp. v. Milstead*,[83] decided in 1955. In that case, a contractor was hired to clear a site for the construction of a drive-in theater. There was a delay, probably attributable to inaccuracies in the initial survey, which made the execution of the project much more difficult. There had been a dispute over who should pay for the additional 8,000 cubic yards of dirt required to complete the project. Evergreen withheld payment for that work, and the contractor sued Evergreen. Evergreen then counterclaimed for lost profits from the delay. The court denied Evergreen's counterclaim, invoking the new-business rule. Citing *Abbott v. Gatch*, the court concluded: "We think the [trial] court was right in basing the damages for delay in the completion of the site on fair rental value and the actual monetary losses incurred."[84] Again, the court was silent on how it might determine the fair market value of a drive-in theater rental.

The plaintiff could argue alternatively that, because the mill or theater had been completed and was operable, the court could calculate a reasonable estimate of the harm on the basis of actual operations over a given period. That approach was unsuccessful in 1918 in *Cramer v. Grand Rapids Show Case Co.*[85] When it reasserted the *per se* rule in *Kenford*, the New York Court of Appeals harkened back to *Cramer*,[86] which involved the delayed delivery of furniture worth $1,376.75 that was necessary for opening a retail store. The Court of Appeals in *Cramer* observed that the trial judge in *Cramer* had instructed the jury:

> If a man has arranged to start a business at a certain time, and is prevented from starting it by reason of wrong or breach of contract by somebody else, he is entitled to recover whatever profits he can show he would have made during that time for the breach of contract by the other party.[87]

The plaintiff had relied on data on sales and costs after it finally opened in determining its lost profits, arguably for a comparable period of time. It claimed lost profits of about $6,000 and additional losses of approximately $800. The jury award did not calculate damages by category, but awarded a lump sum of $3,310, which the trial judge reduced further to $1,500. The Court of Appeals found the jury instruction to be reversible error. Only data

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83 112 A.2d 901 (Md. 1955).
84 *Id.* at 906; *see id.* at 905 (citing *Abbott*, 13 Md. 314).
85 119 N.E. 227 (N.Y. 1918).
86 Kenford Co. v. Erie County, 493 N.E.2d 234, 236 (N.Y. 1986) (citing *Cramer*, 119 N.E. 227).
87 *Cramer*, 119 N.E. at 228.

from past performance would be allowed and it would be impossible for a new business to generate such data.[88]

If the only question was whether such data would be adequate for proving losses, then the court was surely wrong. Although the parties might quibble over the appropriate time period that should be subject to analysis, the data would be just as real as the data that an existing firm would have presented. The more relevant question is the *Hadley* question. Putting it in the "tacit assumption" framework, fashionable at that time (and still one that I prefer),[89] would a seller of furniture know that if it were late the buyer could not open its business, and would it agree that it would pay for all lost profits prior to the opening, even though it knows virtually nothing about the nature of the buyer's business? I would say No; others might disagree, but for the purposes of my article, the important point is that the fact that Cramer's was a new business was irrelevant for determining the damages.

Marvell Light & Ice Co. v. General Electric Co.[90] is a case similar to *Cramer. Marvell* was the 1924 Arkansas precedent cited in *MindGames* for the notion that there was a *per se* rule against awarding lost profits for a new business. Judge Posner noted quite properly that *Marvell* was a case of delay, and he questioned why the court found the computation of damages difficult:

> *Marvell* was a classic *Hadley v. Baxendale* type of case—in fact virtually a rerun of *Hadley,* except that the appellants alleged that they had notified the seller of the icemaking machinery of the damages that they would suffer if delivery was delayed, and the seller had agreed to be liable for those damages. The decision is puzzling in light of that allegation; it is doubly puzzling because, assuming that by the time of the trial the ice factory was up and running, it should not have been difficult to compute the damages that the appellants had lost by virtue of the five and a half month delay in placing the factory in operation. Presumably it would have had five and a half months of additional profits.[91]

Of course, Judge Posner is correct. Unlike the cases involving opportunity cost, *Marvell* involved losses that were real and easy to measure. The only question should have been whether the *Hadley* rule precluded recovery.

In *Cook Associates, Inc. v. Warnick*[92] the lost-profits claim succeeded, and the court addressed the *Hadley* issue specifically.[93] Cook constructed a manufacturing plant that opened eight months late because the supplier—Chief—

[88] *Id.* at 228–29.
[89] *See* GOLDBERG, *supra* note 1, ch. 8.
[90] 259 S.W. 741 (Ark. 1924).
[91] MindGames, Inc. v. W. Publ'g Co., 218 F.3d 652, 655 (7th Cir. 2000).
[92] 664 P.2d 1161 (1983).
[93] For another case involving delay in which the court rejected the *per se* rule, see Drews Co. v. Ledwith-Wolfe Assocs., Inc., 371 S.E.2d 532, 533 (S.C. 1988). However, in this case, the court concluded that the claimant's proof was inadequate and awarded nothing.

failed to deliver the plant's parts on time.[94] Cook sued Chief, and the jury awarded lost profits of $56,908 on the basis of the plant's actual operation in the first two months.[95] As in the previous two cases, there is no real question about the adequacy of proof—the actual profits after the plant had started operating were a good enough proxy for the forgone profits during the delay. Chief urged an "adoption of the 'tacit agreement test' of foreseeability."[96] However, the court noted that the Uniform Commercial Code had rejected the tacit-assumption test and concluded that the "evidence is sufficient to support a conclusion that Chief had reason to know that an inordinate delay on its part could prevent Cook's production and sale of slurry, thereby causing a loss of profits."[97] I am not concerned with whether or not the finding is correct; given the finding, the court framed the question in *Hadley* terms and held in effect that the seller bore the risk of the costs due to delay.

B. Defects

In the delay cases in which the plaintiff did ultimately operate the business, the actual earnings from operation could provide a reasonable estimate of the damages. The recoverability of those damages would be subject to two qualifications. The first is the possibility that the *Hadley* rule would bar recovery.[98] The second is the possibility that the parties had contracted over the issue with either a disclaimer or a damage limitation. Defect cases raise similar questions. I focus on two cases in which the courts held that lost profits were recoverable but then rejected the claim on the grounds of measurability.

1. Mid-America Tablewares, Inc. v. Mogi Trading Co.

In *Mid-America Tablewares, Inc. v. Mogi Trading Co.*,[99] the defendant stipulated that there had been breaches of express warranty, implied warranty of merchantability, and implied warranty of fitness for a particular purpose, so the only issue was damages. The buyer had been in the table-linen business and wanted to launch a dinnerware business to complement it. It contracted with Mogi, a Japanese firm, to provide ceramic dinnerware. Unfortunately, the dinnerware exceeded FDA regulatory-guidance levels for leachable lead.

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94 Cook sued both the manufacturer, Chief, and the dealer, Warnick. The latter was exonerated. *Warnick*, 664 P.2d at 1164.

95 *Id.* at 1163–64. Cook had asked for $100,000. According to the court, the average monthly profits for the first thirteen months of operation were $35,650, which indicates lost profits over eight months of $285,200. There is no discussion of the discrepancy.

96 *Id.* at 1167.

97 *Id.*

98 The *Hadley* rule is typically referred to as *foreseeability*. I find that label to be an unhelpful and misleading term. *See* Goldberg, *supra* note 1, chs. 8–10. For those who feel comfortable with it, feel free to substitute *foreseeability* for *Hadley* in the text.

99 100 F.3d 1353 (7th Cir. 1996).

Mid-America stopped shipping the dinnerware to its customers and recalled all shipments that had already been made. The jury found incidental damages of approximately $57,000.[100] At issue was the claim for lost profits, about $300,000 in the first year (1994) and $2.6 million over the next decade.[101]

The Seventh Circuit, asserting that to deny recovery for lost profits "'would be tantamount to holding that the defendant could breach this particular contract with impunity,'"[102] held that Wisconsin would permit the recovery of lost profits for a new business. Invoking both *Fera* and *Super Valu,* the court said:

> The determination as to whether future profits were within the contemplation of the parties when contracting necessarily turns on the specific facts established at trial. . . . There is no basis to conclude that evidence as to the foreseeability of Mid-America's lost future profits should be excluded as a matter of law.[103]

The evidence that Mid-America's expert witnesses presented was the best available evidence and therefore could not be excluded as a matter of law.[104]

After arguing at length that the lost-profits claim was not barred, the court rejected the expert's damage estimate for the post-1994 period, holding that it was "monstrously excessive."[105] The Seventh Circuit criticized the expert's sales projections as being wildly optimistic and remanded for further proceedings.[106] The court did not say whether that component of damages should be determined on retrial or whether the claim was too speculative and should therefore be zero. The defense expert had attacked various elements of the projections, but even he conceded that "there clearly were lost profits."[107] However, his claim is basically the same as Fera's and others' that I discuss in Part I. There is no reason to believe that the rewards to future expenditures on this project would be better than anything else Mid-America could have done with the same funds. Its lost profits would be zero—not because of a *per se* rule, but because the expected value of the

100 The court did not say what the "incidental damages" comprised. I presume that they included the costs of the recall and perhaps some of the costs of management time spent in dealing with the problem.

101 *Mogi Trading*, 100 F.3d at 1356. The defendant did not contest the 1994 damages.

102 *Id*. at 1366 (quoting Welch v. U.S. Bancorp Realty & Mortg. Tr., 596 P.2d 947, 963–64 (Or. 1979)). For an argument that this was an inaccurate statement of Wisconsin law, see L. Katie Mason, Mid-America Tablewares, Inc. v. Mogi Trading Co.*: The Seventh Circuit's Tasty Recipe for New Business Recovery of Future Lost Profits Under Wisconsin Law, Or a Suspicious Side Dish Wisconsin Won't Try?*, 2005 Wis. L. Rev. 1385.

103 *Mogi Trading*, 100 F.3d at 1362–63.

104 *Id.* at 1366–67.

105 *Id.* at 1367.

106 *Id.* at 1368–69.

107 *Id.* at 1376.

future expenditures on that project would be the opportunity cost of the funds.[108]

2. Olathe Manufacturing, Inc. v. Browning Manufacturing

In *Mid-America*, the buyer did not make further expenditures—hence the zero-profit outcome. In *Olathe Manufacturing, Inc. v. Browning Manufacturing*,[109] the buyer continued to make expenditures, which raised a different question. I must note first that, unlike *Mid-America*, the existence of a limitation on remedies was a significant issue. As is quite common, Browning sold its goods conditional on a repair-and-replace remedy limitation. Or at least it tried to do so. A considerable portion of the opinion—about 8,000 words—dealt with whether the limitation was part of the contract, and the court concluded that, as a matter of law, it was not.[110] Thus, it was up to Olathe to prove damages, including those from lost profits. However, the trial court and the Kansas Supreme Court ultimately rejected the expert witness's damage measurement, concluding that it was too speculative.

Browning manufactured bearings, components of the 866 Tub Grinder, which was a new product that Olathe designed and sold. Because the 866 Tub Grinder was a new product, it would be subject to the new-business rule. Browning's bearings failed, causing Olathe's tub grinders to malfunction. Olathe sued Browning for damages for the tub grinders that had been damaged and for the lost profits on its future sales. Unlike in *Mid-America*, Olathe continued its business. To understand the underlying damage theories of this case, it is necessary to note that the damage was on the 10-foot tub grinders and that the 10-foot model was replaced subsequently by a 12-foot model. Because the first trial ended as a mistrial, Olathe's expert presented two estimates. For the first trial, he argued that Olathe's damaged reputation resulted in a loss of future sales, and he claimed lost profits of $4.3 million.[111] However, at his deposition before the second trial, the economic expert "admitted that his planned testimony for the first trial—that Olathe lost $4.3 million in lost profits due to the lost sales of 10-foot tub grinders—was 100% wrong."[112] Olathe's market share for 10-foot grinders did not fall. In fact, its market share was greater than its expected share had the bearing malfunction not occurred. Undaunted, the expert proposed a different theory.[113] Because Olathe devoted a substantial amount of resources to redesigning the

108 Mid-America might have argued that because of its existing table-linen business, it had complementary assets that made the expected returns in the dinnerware market greater than the opportunity cost of capital.
109 915 P.2d 86 (Kan. 1996).
110 I confess that I found the court's reasoning unpersuasive.
111 *Olathe*, 915 P.2d at 100.
112 *Id.* at 102.
113 There was no explanation why Olathe decided to use the same expert the second time around.

10-foot grinders, its development of the 12-foot grinders had been delayed, resulting in a loss of Olathe's market share in the 12-foot grinder market.[114] The expert estimated lost profits of about $8 million.[115]

Olathe argued that, under the "certainty" rule, it needed to prove only that it had actually suffered damages and that certainty was not necessary to prove the actual amount of damages. In upholding the trial judge's decision to bar the expert's testimony, the court said: "Olathe's evidence regarding the new lost profit theory was based on rumors, guesses, and assumptions. Thus, the trial court did not abuse its discretion in holding that the lost profit evidence was speculative as a matter of law."[116] Note two things. First, it presumes implicitly that there is some boundary at which "rumors, guesses, and assumptions" become so egregious that there is a shift from a matter of *fact* to a matter of *law*. Second, the court's statement concerns the quality of the inputs, not the damage theory itself. If only the expert had been more rigorous in assembling the data, the damage report would have been admissible.

The certainty of the damage estimate was the not relevant issue; the expert was measuring the wrong thing. Olathe's expected damages—beyond the costs associated with its damaged grinders and its possible redesign effort—were the delay costs, which should be subject to the *Hadley* rule. That is, the expected cost due to the delay in bringing a product to the market, which is mainly the time value of money.[117] The delay would entail a real loss, and the contract would determine which party would bear the risk of that loss. If recovery were to be denied, the reason should not be the newness of the business; rather, it should be that by creating a forcing default,[118] the parties would then be induced to deal with the problem *ex ante* with a disclaimer or a liquidated-damages clause. Ironically, in *Olathe* the court had gone out of its way to hold that these defenses were unavailable as a matter of law.

IV. Cases Involving Anticipatory Repudiation

Suppose that, under a long-term contract, a seller has begun performing but has not yet delivered any output. If the buyer were to breach the contract, would the seller have a viable claim to its lost profits? There are two different

[114] "[A]ccording to Olathe, . . . it was required to pour all of its resources into the redesign of the 10-foot tub grinder[,] and . . . Olathe would have used these resources to develop a 12-foot tub grinder had the bearings in the 10-foot grinder not been faulty." *Olathe*, 915 P.2d at 105.

[115] *Id.* at 102.

[116] *Id.* at 106.

[117] That is the equivalent of the rental value in Abbott v. Gatch, 13 Md. 314 (1859), and Evergreen Amusement Corp. v. Milstead, 112 A.2d 901 (Md. 1955).

[118] For a discussion of default rules, see Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale L.J. 87 (1989).

scenarios. One involves cases in which there is no change in the market at the time of the buyer's repudiation. The other involves cases in which market conditions had deteriorated at the time of repudiation.

In *Tractebel Energy Marketing, Inc. v. AEP Power Marketing, Inc.*,[119] the trial judge in the Southern District of New York misused the new-business rule in denying the plaintiff's recovery. To simplify the facts, the seller (AEP) agreed to build a power plant, and the buyer (TEMI) agreed to a twenty-year take-or-pay contract. After the AEP had spent about $500 million on the plant, but before it actually had produced any power, the market collapsed and the buyer, TEMI, repudiated. The trial judge denied AEP recovery for its lost profits on two grounds: (1) the project was a new business and (2) determination of lost profits was too speculative. I will come to the "speculative" question below, but first I want to consider the new-business issue, with a variation on the facts.

Suppose, contrary to fact, that market conditions had not changed at all. If that were the case, should the seller receive any compensation? In one sense, the problem is similar to that in *Fera*. There is no reason to believe that subsequent performance of the contract would be any more profitable for AEP than its alternatives. The difference is that in *Fera*, the plaintiff had not made any investments in reliance on the lease. In this case, AEP had spent $500 million. There should be no recovery for *future* lost profits. Because market conditions had not changed, the expected value of the future stream of profits had not changed. However, it would be relevant to compensate AEP for the costs that it incurred in reliance on the contract. That compensation would depend on the alternative use of the power plant. If AEP had no feasible alternatives, one could argue that the buyer should be liable for the entire $500 million. However, if AEP could switch seamlessly to selling to an alternative customer, then the reliance damages (net of mitigation) would be zero.

In the actual case, the market did collapse. The seller now had a valuable asset—the right to sell at the contract price, which was greater than the market price. The damages would be the change in the value of that asset. The existence of damages has nothing to do with the newness of the business. The seller's expert witness concluded that damages were $520 million, but the buyer's expert concluded that there had not been any losses at all. The trial judge was not impressed by either expert and "found both experts provided unreliable testimony and worse yet, [that their testimonies] appeared to be clouded by their obvious advocacy, to paraphrase a popular show tune, on behalf of the lady they came in with."[120] But even if the expert witnesses had

[119] *Tractebel II*, Nos. 03 Civ.6731 HB, 03 Civ.6770 HB, 2006 WL 147586 (S.D.N.Y. Jan. 20, 2006), *vacated in part*, *Tractebel III*, 487 F.3d 89 (2d Cir. 2007).
[120] *Tractebel II*, 2006 WL 147586, at *4.

done impeccable work, the judge would not have accepted their estimations on the grounds that they were too speculative:

> In order to know what AEP's revenues would be over the next twenty years, one would have to be able to presage a vast and varied body of facts. Any projection of lost profits would necessarily include assumptions regarding the price of electricity and the costs of operating over twenty years. One would also need to surmise what competing forms of energy such as coal and nuclear energy would cost over the same time period. Also factoring into this calculation are the political and regulatory developments over twenty years, population growth in the Entergy region, and technological advances affecting the production of power and related products. With so many unknown variables, these experts might have done as well had they consulted tealeaves or a crystal ball.[121]

So, the lost-profit damages were zero.[122]

The Second Circuit reversed and held that AEP's "lost profits" were indeed the appropriate damage remedy.[123] It concluded that, although the projection of lost profits would be difficult, it was not "speculative."[124] Projecting lost profits was essentially the same exercise in which the parties had engaged at the time of their negotiation of the twenty-year contract.[125] I want to make two points. First, neither "speculative" nor "certainty" is helpful in determining whether there should be compensation. Is it easier to assess damages in this contract, with a twenty-year horizon and with both quantity and price variable, than in any of the cases discussed earlier in which the court first said the new-business rule no longer precluded recovery, but then denied recovery because the measurement was too uncertain. Courts have been content to fall back on "certainty," using it as a wild card to reward some claimants but not others.

Second, in most of the cases discussed earlier, the lost-profits claim involved c*onsequential* damages. In *Tractebel*, the lost-profits claim was for *direct* damages. The contract was an asset for the seller; when the market collapsed, the value of that asset went up. How much? That is the measure of what the seller lost at the time of repudiation. It would be the difference between the expected net revenues had the market conditions not changed and the net revenues given that there had been a change. That difference is precisely what the experts attempted to quantify under the lost-profit

121 Tractebel Energy Mktg., Inc. v. AEP Power Mktg., Inc. (*Tractebel I*), Nos. 03 Civ. 6731(HB), 03 Civ. 6770(HB), 2005 WL 1863853, at *16 (S.D.N.Y. Aug. 8, 2005), *aff'd in part and vacated in part*, *Tractebel III*, 487 F.3d 89.
122 *Id.* at 17.
123 *Tractebel III*, 487 F.3d 89 (2d Cir. 2007).
124 *Id.* at 112 n.26.
125 *Id.*

rubric—the net present value of the difference between two projected-revenue streams.[126]

V. Conclusion

In *MindGames,* Judge Posner rejected the new-business rule:

> The rule doesn't work because it manages to be at once vague and arbitrary. One reason is that the facts that it makes determinative, "new," "business," and "profits," are not facts, but rather are the conclusions of a reasoning process that is based on the rationale for the rule and that as a result turns the rule into an implicit standard. What, for example, is a "new" business? What, for that matter, is a "business"? And are royalties what the rule means by "profits"?[127]

Courts have fiddled with all these questions to determine whether a particular claimant should be allowed to recover. Sometimes they upheld the *per se* rule but then decided that a business was not new.[128] In a number of instances, courts have found that there is no *per se* rule, but then declined to award lost profits for various reasons, often invoking a lack of certainty. In other cases, courts have claimed that certainty is only needed to show the existence of lost profits and that a lower standard exists for showing the magnitude of the loss. Some courts have judged the lost-profits measure by an even lower standard; recall Justice Peters' criterion in her dissent in *BHC*: does "the size of the verdict so shock[] the sense of justice as to compel the conclusion that the [trier of fact] was influenced by partiality, prejudice, mistake or corruption."[129]

Judge Posner elaborated on his dismissal of the new-business rule: "The rule could be made sensible by appropriate definition of its terms, but we find it hard to see what would be gained, given the existence of the serviceable and familiar standard of excessive speculativeness."[130] However, I have argued that courts focus wrongly on speculativeness, or reasonable certainty. The problem is not that measuring damages is difficult, but that courts have often been measuring the wrong thing.

In cases that involve a claim for the future stream of profits on a project that never launched, the presumption should be that there were no lost

126 I elaborate on this point in Victor P. Goldberg, *Reckoning Contract Damages: Valuation of the Contract as an Asset* (Columbia Law & Economics Working Paper No. 530, Mar. 24, 2016), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2754267.

127 MindGames, Inc. v. W. Publ'g Co., 218 F.3d 652, 657 (7th Cir. 2000).

128 RSB Lab. Servs., Inc. v. BSI, Corp., 847 A.2d 599 (N.J. Super. Ct. App. Div. 2004).

129 Beverly Hills Concepts, Inc. v. Schatz & Schatz, Ribicoff & Kotkin, 717 A.2d 724, 744 (Conn. 1998) (Peters, J., dissenting) (alteration in original) (quoting Grayson v. Wofsey, Rosen, Kweskin & Kuriansky, 646 A.2d 195, 203–04 (Conn. 1994)).

130 *MindGames*, 218 F.3d at 658.

profits. Any recovery should be based on whether the plaintiff had assets—either preexisting ones or those acquired in reliance on the contract—the value of which was contingent on the performance of the project.

For other cases, such as those involving nonpayment of a royalty stream, delivery delay, or a defective product, claimants have suffered a *real* loss. Whether those claimants should recover damages does not depend on the newness of the business or the certainty of proof. The *Hadley* rule provides one constraint. *Ex ante* contract language—that is, liquidated damages, warranty disclaimers, and remedy limitations—provide another.