THE REASONABLE CERTAINTY REQUIREMENT IN LOST PROFITS LITIGATION: WHAT IT REALLY MEANS

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Hadley v. Baxendale[2] is the most famous case in contract law, perhaps in all of Anglo-American civil law.[3] It is a standard of law school curricula and the subject of a vast literature.[4] In truth, however, the rule in *Hadley v. Baxendale* is no longer much of an issue in real-world litigation.[5] The big issue in business litigation – the one the huge verdicts turn on – is whether the plaintiff's[6] lost profits have been proven with

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[2] Hadley v. Baxendale, 156 Eng. Rep. 145 (Ex. 1854).

[3] *See, e.g.,* GRANT GILMORE, THE DEATH OF CONTRACT 92 (Ronald K.L. Collins ed., 2d ed. 1995) ("Hadley v. Baxendale still is, and presumably always will be, a fixed star in the jurisprudential firmament.").

[4] *See, e.g.,* Symposium, *The Common Law of Contracts as a Force in Two Ages of Revolution: A Conference Celebrating the 150th Anniversary of* Hadley v. Baxendale, 11 TEX. WESLEYAN L. REV. 225-725 (2005) (21 articles concerning *Hadley*); JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 6-1(5th ed. 2000) ("Generations of law students have wrestled with . . . the baffling opinion in Hadley v. Baxendale.")

[5] *See* 1 ROBERT L. DUNN, RECOVERY OF DAMAGES FOR LOST PROFITS § 1.15 (6th ed. 2005) (noting that most cases have found the fact that the transaction was a commercial transaction was sufficient to put the breaching party on notice that a breach would lead to lost profits).

[6] For simplicity, this article will refer to the party seeking the lost profits as the plaintiff. In a small minority of cases, the party seeking the lost profits is a defendant and counter-plaintiff. *See, e.g.*, Ace Hardware Corp. v. Marn, Inc., No. 06-CV-5335, 2008 U.S. Dist. LEXIS 84709, at *72-73 (N.D. Ill. Sept. 16, 2008) (granting summary judgment on defendant's counterclaim for lost profits); Graham Hotel Co. v. Garrett, 33 S.W.2d 522, 523 (Tex. Civ. App. 1930) (landlord sued to recover unpaid rent and tenant counterclaimed for lost profits due to landlord's failure to perform lease obligations); Howe Mach. Co. v. Bryson, 44 Iowa 159 (Iowa 1876).

reasonable certainty.[7] This is an issue that is far more difficult and complex than the rule in *Hadley v. Baxendale*. Perhaps it is because of this difficulty and complexity that few academic writers have attempted to deal with the issue.[8]

Every United States jurisdiction has adopted the rule that lost profits must be proven with reasonable certainty.[9] Professor McCormick, in his classic treatise on damages, called the reasonable certainty requirement "probably the most distinctive contribution of the American courts to the common law of damages."[10] In spite of this universal adoption of the language, however, courts have never really explained what they mean by the term "reasonable certainty." One Justice of the Oregon

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[7] *See, e.g.,* Anchor Sav. Bank v. United States, Nos. 2008-5157 & 2008-5182, 2010 U.S. App. LEXIS 5009, at *40 (Fed. Cir., Mar. 10, 2010) (reviewing $356 million lost profits award by Court of Federal Claims under reasonable certainty standard); Celebrity Cruises, Inc. v. Essef Corp., 478 F. Supp. 2d 440, 447-55 (S.D. N.Y. 2007) (jury award of more than $190 million vacated because plaintiff's evidence did not show loss with reasonable certainty); Tractebel Energy Mktg, Inc. v. AEP Power Mktg, Inc., No. 03 Civ. 6731 (HB), 03 6770 (HB), 2005 U.S. Dist. LEXIS 15972, at *52 (S.D.N.Y. Aug. 8, 2005), *rev'd* 487 F.3d 89 (2d Cir. 2007) (denying claim for more than $500 million in lost profits on grounds it was not proven with reasonable certainty); Southern Pac. Commc'ns. Co. v. AT&T, 556 F. Supp. 825, 1073-95 (D.D.C. 1982) (rejecting damage claims seeking $1.5 billion (after trebling) on basis that evidence insufficient to prove them with reasonable certainty); Texaco, Inc. v. Pennzoil Corp., 729 S.W. 2d 768, 831, 866 (Tex. App. 1987) (upholding verdict for $8.5 billion, reduced from $11 billion, against arguments that jury instructions did not require proof with sufficient certainty).

[8] Except for student notes and comments, there appear to be no law review articles devoted to the reasonable certainty requirement.

[9] *See, e.g.,* TAS Distrib. Co. v. Cummins Engine Co., 491 F.3d 625, 632 (7th Cir. 2007) "all United States jurisdictions enforce the requirement of 'certainty' in damage award amount, but limit this requirement to 'reasonable certainty'"); Bernadette J. Bollas, *The New Business Rule and the Denial of Lost Profits: Men Keep Their Promises When Neither Side Can Get Anything by the Breaking of Them,* 48 OHIO ST. L.J. 855, 858 (1987).

In some jurisdictions, lost profits that are direct damages, rather than consequential damages are not required to be proven with reasonable certainty. *See* Tractebel Energy Mktg, Inc. v. AEP Power Mktg, Inc., 487 F.3d 89, 109 (2d Cir. 2007). In others, the reasonable certainty standard applies to all lost profits claims, regardless of whether they are direct or consequential damages. *See, e.g.*, United States v. Behan, 110 U.S. 338, 344 (1884); Mood v. Kronos Prods, Inc., 245 S.W.3d 8, 12 (Tex. 2007). Direct or general damages compensate the plaintiff for the value of the promised performance. *See* Rensselaer Polytechnic Inst. v. Varian, Inc., 340 F. App'x 747, 750 (2d Cir. 2009). Consequential damages seek to compensate the plaintiff for additional losses beyond the value of the promised performance. *See id.*

[10] CHARLES T. MCCORMICK, HANDBOOK ON THE LAW OF DAMAGES 124 (1935).

Supreme Court went so far as to say: "I must confess . . . that I have no more idea what reasonable certainty means than I have as to the meaning of certainty. I would assume that it is some lesser quantum of proof than . . . beyond a reasonable doubt, or to a moral certainty."[11]

At first glance, the case law is a jumble of inconsistent rules, some purporting to say what constitutes reasonable certainty, others purporting to say that reasonable certainty doesn't matter, and all of them at odds with at least some other pronouncements of the same court.[12] This article will show that the seemingly inconsistent case law actually makes considerable sense if one realizes that while there is no single measure of reasonable certainty, we can nevertheless identify a number of discrete factors which courts consider when determining whether a claimant has proven its lost profits with reasonable certainty.

The case law can best be understood if we think of the court as operating on two levels: the decision-making level and the opinion-writing level.[13] On the decision-making level, the judge decides whether the plaintiff presented sufficient proof and whether it is fair to award this much money on the basis of this much proof. If it is, she decides the lost profits have been proven with reasonable certainty; if it is not, she decides they have not been proven with reasonable certainty.

On the opinion-writing level, the judge does not explain the intuitive processes that led her to the decision. Instead, she seeks authority that makes it

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[11] Hardwick v. Dravo Equip. Co., 569 P.2d 588, 594 (Or. 1977) (Lent, J., specially concurring). The reference to the meaning of certain stems from the justice's earlier statement that he did not understand what the New York Court of Appeals meant when it used the term in its opinion in Griffin v. Colver, 16 N.Y. 489 (1858), considered the seminal case allowing the recovery of lost profits in the United States. *Id.*

[12] *See infra* text accompanying notes 66-139.

[13] *See* RICHARD A. POSNER, HOW JUDGES THINK 110 (2008). As Judge Posner explains it:

> The role of the unconscious in judicial decision making is obscured by the convention that requires a judge to explain his decision in an opinion. The judicial opinion can best be understood as an attempt to explain how the decision, even if, (as is most likely) arrived at on the basis of intuition, could have been arrived at on the basis of logical, step-by-step reasoning.

Id.

seem the decision was a foregone conclusion.[14] When lost profits are at issue, there is an abundance of authority to support whichever decision the judge makes. As explained below, there are many contradictory rules, and the opinion-writer can choose those that support her conclusion, making it seem the issue was never in doubt and often giving the impression that a single factor made the outcome inevitable.[15]

This article will attempt to explain the factors courts actually take into account when they decide whether the plaintiff has proven its lost profits with reasonable certainty. It will also argue that the courts should stop using outdated rules to rationalize their decisions and openly discuss all of the factors that lead to their decisions. Courts should treat the concept of reasonable certainty as it applies to lost profits in the same way that the Restatement (Second) of Contracts treats the concept of material breach. The Restatement does not attempt to define "material breach," but instead gives a non-exclusive list of factors which courts should take into account in determining whether there has been a material breach.[16] The same

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[14] *See id.*

[15] *See* Marin Roger Scordato, *Post-Realist Blues: Formalism, Instrumentalism, and the Hybrid Nature of Common Law Jurisprudence*, 7 NEV. L. J. 263, 275 (2007) (existence of established but contradictory rules makes common law adjudication indeterminate).

[16] RESTATEMENT (SECOND) OF CONTRACTS § 241 (1981).

The Restatement provides:

> In determining whether a failure to render or to offer performance is material, the following circumstances apply:
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> (a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
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> (b) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived;
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> (c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;
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> (d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;

should be done with the concept of reasonable certainty. This would not require the courts to change the way they decide cases; it would require only that they explain what they are actually doing, rather than trying to rationalize their actions within the existing framework of rigid, inconsistent, and outdated rules.

I. BALANCING THE COMPETING CONCERNS

The reason courts have found it so difficult to decide what the reasonable certainty requirement means is that the requirement itself is an attempt to balance two competing concerns. [17] It has long been recognized that the economy cannot flourish when businesses are afraid to enter into transactions because they fear an inadvertent breach will lead to a huge damage award.[18] Justice Story said as much two hundred years ago when he denied recovery to the owners of a ship detained by privateers in the War of 1812, reasoning that to allow the recovery of lost profits in these circumstances would be "in the highest degree unfavorable to the interests of the community."[19] These fears have only grown with decisions like the $11 billion verdict in *Pennzoil v. Texaco*.[20] Businesses rightly fear that parties they are dealing with in good faith today will turn on them tomorrow, claiming that but for the actions of the defendant, the plaintiff would have become the next Microsoft or the next Google. [21] To reduce this risk, businesses engage in a variety of defensive measures

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(e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.

Id.

[17] *See* Continental Ins. Co. v. Ursin Seafoods, Inc., No. 92-35023, 1992 U.S. App. LEXIS 25488, at *20 (9th Cir. Aug. 18, 1992) ("A lost profits award must balance two competing policy goals: prevent[ing] windfalls to wrongdoers simply because damages cannot be proved with [reasonable] certainty, but guard against requiring wrongdoers to become profit guarantors.").

[18] *See* Joseph M. Perillo, *Misreading Oliver Wendell Holmes on Efficient Breach and Tortious Interference*, 68 FORDHAM L. REV. 1085, 1096 (2000) ("the rule of certainty . . . encourages entrepreneurial risk taking"); MCCORMICK, *supra* note 10, at 105 ("the standard of 'certainty' was developed, and has been used, chiefly as a convenient means of keeping within the bounds of reasonable expectation the risk which litigation imposes upon commercial enterprise").

[19] The Lively, 15 F. Cas. 631, 634 (No. 8403) (C.C.D. Mass. 1812).

[20] *See* Texaco, Inc. v. Pennzoil Corp., 729 S.W. 2d 768, 831, 866 (Tex. App. 1987) (upholding verdict for $8.5 billion, reduced from $11 billion).

[21] *See* Robert M. Lloyd, Pennzoil v. Texaco, *Twenty Years After: Lessons for Business Lawyers*, 6 TENN. J. BUS. L. 321, 352-59 (2005)).

not unlike the defensive measures medical professionals take to avoid malpractice claims. [22] Like defensive medicine, the defensive measures businesses take waste resources. But even worse, they slow growth and innovation, and make foreigners reluctant to deal with American businesses.[23] One way to avoid these problems is to allow businesses to recover lost profits only when they can prove with a great deal of certainty that but for the actions of the defendant they actually would have earned those profits.

But setting the standard of proof too high may create even greater problems. If they believe their victims cannot prove their damages, unscrupulous businesses have an incentive to breach contracts, infringe intellectual property rights, or violate the antitrust laws to crush competitors.[24]

Trying to balance the competing concerns in a period of formalist jurisprudence led the courts to develop a series of rules that would be unworkable even if they were consistent with each other, which they are not. In addition to the rule that lost profits can be recovered only if the plaintiff can prove the amount of the loss with reasonable certainty, there is a "wrongdoer rule," which states that one who is liable for the loss of profits is a wrongdoer and therefore cannot insist that the profits be proven with reasonable certainty.[25] There is also a "fact and amount rule," which states that if it is certain there was some loss, the amount need not be

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[22] *See id.* (discussing steps businesses should take to protect themselves against such outcomes).

[23] The effect of such defensive measures on business is illustrated by an episode that has become a legend in Silicon Valley. *See* JAMES WALLACE & JIM ERICKSON, HARD DRIVE: BILL GATES AND THE MAKING OF THE MICROSOFT EMPIRE 179 (1992). When IBM Corporation, then the undisputed leader in computers, was looking for an operating system for its first personal computer (PC), it went first to Digital Research. *See id* Digital Research had developed an operating system called CP/M, which had become the standard in the PC industry. *See id.* at 154. To protect itself against lawsuits by small businesses with which it dealt on technical matters like these, IBM required potential vendors to sign a very one-sided nondisclosure agreement, which essentially said that the vendor waived its rights to sue IBM should IBM disclose the vendor's trade secrets. *See id.* at 179-80. The husband-and-wife team who ran Digital Research refused to sign the nondisclosure agreement, and IBM turned to the then-tiny Microsoft Corporation. *See id.* at 179-81. It was Microsoft's first big contract, and it was what eventually made Microsoft a corporate giant and Microsoft's founder, Bill Gates, the richest man in America. *See id.* at 188-206.

[24] *See, e.g.,* Guard v. P & R Enters., 631 P.2d 1068, 1072 (Alaska 1981) (precluding recovery would encourage breach of contract); Vickers v. Wichita State Univ., 518 P.2d 512, 517 (Kan. 1974)

[25] *See infra* text accompanying notes 109-31.

proven with reasonable certainty.[26] Then there is a rule that the plaintiff cannot recover unless it produces the best evidence available to show the amount of the loss,[27] and another, now abandoned by most jurisdictions, that a new business, one with no track record, cannot recover lost profits, no matter how compelling the evidence it produces.[28]

In truth, however, courts do not apply these as rules. As described, above, they apply a discretionary standard and then choose one or more of the rules to serve as a justification for a decision already reached on another basis.[29] The result is that it is hard for the average lawyer or litigant to predict the outcome in a lost profits case.

This article will attempt to explain how courts actually decide whether to award lost profits and recommend that they adopt a transparent standard that will enable lawyers and litigants to make informed decisions.

II. THE FACTORS THAT COURTS CONSIDER

There are thousands of judicial opinions applying the reasonable certainty standard to every imaginable kind of lost profits claim. As a result, a person could come up with an almost infinite number of factors that courts have taken into account in deciding these claims. The list below is my attempt to develop the most workable list of factors courts consider. It is based on several years of work on lost profits issues and on my reading of hundreds of lost profits cases. It is not a perfect list. Because of the nature of the inquiry there are necessarily some overlaps. And some factors courts have considered are excluded from the list because they are significant only in a minority of cases. Nevertheless, I am confident this list is far superior to any previous attempt to explain how courts determine whether a party has proven lost profits with reasonable certainty.

The factors courts consider are:

1. the court's confidence that the estimate is accurate;

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[26] *See infra* text accompanying notes 73-106.

[27] *See infra* text accompanying notes 132-49.

[28] *See infra* notes 46-47 and accompanying text.

[29] *See supra* note 13 and accompanying text.

2. whether the court is certain that the injured party suffered at least some damage;
3. the degree of blameworthiness or moral fault on the part of the defendant;
4. the extent to which the plaintiff produced the best available evidence of lost profits;
5. the amount at stake; and
6. whether there is an alternative method of compensating the injured party.

In most cases, courts consider all or almost all of these factors. Their written opinions, however, are misleading. The vast majority of opinions focus on only one or two factors. More often than not, the factors courts choose are those that serve best to justify the decision to the legal community, rather than those that were influential in making the decision itself. For this reason, the discussion that follows will at times focus on what could have been important (and should have been important) in the decisions instead of what the court said was important.

A. The Court's Confidence That the Estimate is Accurate

If the term "reasonable certainty" were taken literally, the court's confidence that the estimate was accurate would be the only factor considered. But, as explained above, "reasonable certainty" is really code for "does the court think that, given all of the circumstances, this plaintiff has presented sufficient evidence to make it fair to award it the damages in question."[30] Still the court's confidence that the estimate is accurate is by far the most important factor, so much so that a court would seldom refuse to find that plaintiff had proven damages with reasonable certainty where that court was confident that the actual damages were within a few percent of the plaintiff's estimate. This is true no matter how badly the plaintiff fell short on the other factors. Conversely, if the court is convinced that the plaintiff's estimate is little better than an optimistic guess, the court will probably decide that the plaintiff failed to prove its damages with reasonable certainty, even though loose language in judicial opinions would lead the casual reader to believe otherwise.

Because this factor is so important, it may be useful to identify the subsidiary factors that courts look at to determine how confident they are that the plaintiff's estimate is accurate.

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[30] *See supra* note 13 and accompanying text.

1. The extent to which the claim is supported by verifiable data

The vast majority of courts have allowed the injured party to recover lost profits only when they supplied verifiable data, upon which the court can base its estimate of the loss.[31] As Professor McCormick put it many years ago, "the jury must be furnished with some yardstick, rough though it be, which they can use in making their award and by which their award can be tested."[32]

Because courts put so much weight on verifiable data, they look favorably on the before-and-after method for proving lost profits.[33] An analysis using the before-

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[31] *See, e.g.,* Kenford Co. v. County of Erie, 493 N.E.2d 234, 236 (N.Y. 1986) (lost profits could not be proven with 20-year projections for revenues and expenses of domed stadium where there was in existence only one other domed stadium); Willamette Quarries v. Wodtli, 781 P.2d 1196, 1200 (Or. 1985) (lost profits may be proven by past profits of an established business or by expert projections based upon tests performed under substantially similar conditions but not by testimony of unverifiable expectations); Continental Ins. Co. v. Ursin Seafoods, Inc., No. 92-35023, 1992 U.S. App. LEXIS 25488, at *20 (9th Cir. Aug. 18, 1992) (holding it proper for trial court to make award based on prior years' profits while rejecting "Seafoods' sophisticated market-based projections"); Geolar, Inc. v. Gilbert/Commonwealth of Mich., 874 P.2d 937, 945 (Alaska 1994) ("Because [the contractor] had had no prior experience with contacts of this size and complexity, its own estimates, offered without proof of how they were reached, [were] unreliable."); Buck v. Muller, 351 P.2d 61, 66-67 (Or. 1960) (reasonable certainty . . . requires that 'actual evidence' constituting 'substantial data' must be supplied in support of the claim.").

Cf. Pauline's Chicken Villa, Inc. v. KFC Corp., 701 S.W.2d 399 (Ky. 1985). The court held that the lost profits of an unestablished business could be proven with reasonable certainty because "this is a case containing factors and elements which eliminate virtually all the uncertain variables. This is a national franchisor, with uniformity of national advertising, uniform quality control, earnings and expense figure on nearby and comparable locations, and any available history concerning success and failure ratios." *Id.* at 401.

In Great Pines Water Co. v. Liqui-Box Corp., 203 F.3d 920 (5th Cir. 2000) the court vacated a two million dollar judgment on the ground that the plaintiff had not proven its lost profits with reasonable certainty. Members of the plaintiff's senior management testified as to large numbers of customers lost because of defective products supplied by the defendant. But because the plaintiff failed to introduce documentary evidence indicating the actual number of cancellations attributable to the defendant's products, the court held that the lost profits had not been proven with reasonable certainty. *See id.* at 923. The court said: "[O]pinions of estimated lost profits must, at a minimum, be based on objective facts, figures, or data from which the amount of lost profits can be ascertained." *Id.* at 922 (footnote omitted).

[32] MCCORMICK, *supra* note 10, at 101.

[33] *See* Charles J. Faruki, *The Defense of Terminated Dealer Litigation: A Survey of Legal and Strategic Considerations*, 46 OHIO ST. L.J. 925, 991-92 (1985) (noting that the leading case expressed preference

and-after method typically compares the plaintiff's profits during two periods, one during which those profits were affected by the damaging event and one during which they were not; for instance, first, the period before the defendant began its unfair competition, and then the period when the unfair competition was ongoing. The theory is that but for those damaging acts, the plaintiff's profits during the two periods would have been similar.[34]

The before-and-after method is preferred because it uses verifiable data from the plaintiff's business to make the estimate. As a result, there is no danger that the plaintiff's figures are based solely on wishful thinking. This does not mean that every time a plaintiff uses the before-and-after method, the court will find damages have been proven with reasonable certainty. If the plaintiff fails to apply the before-and-after method correctly, the court will reject before-and-after calculations just as they will reject other types of calculations. [35] One common error is failing to rule out other potential causes of the differential in profits between the two periods.[36] Another is selectively choosing the periods in question to produce the greatest differential in profits.[37]

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for this method); Molly L. Zohn, Casenote and Comment, *How Antitrust Damages Measure Up with Respect to* Daubert *Factors*, 13 GEO. MASON L. REV. 697, 700 (2005). (before-and-after and yardstick methods are most widely-used methods of calculating lost profits).

[34] *See* James O'Brien and Robert P. Gray, *Lost Profit Calculations—Methods and Procedures*, in THE COMPREHENSIVE GUIDE TO LOST PROFITS DAMAGES FOR EXPERTS AND ATTORNEYS 5-13 (Nancy J. Fannon, ed.) (2009).

[35] *See, e.g., infra* notes 36-37.

[36] *See, e.g.,* Isaksen v. Vt. Castings, Inc., 825 F.2d 1158, 1165 (7th Cir. 1987) (failure to account for possibility losses were result of market conditions rather than antitrust injury); Eastern Auto Distrib., Inc. v. Peugeot Motors of Am., Inc., 795 F.2d 329, 338 (4th Cir. 1986) (failure to rule out changes in dealer effectiveness, changes in demand for products, and introductions of new models); Saks Fifth Ave., Inc. v. James, 630 S.E.2d 304, 312 (Va. 2006) (failure to rule out other causes of loss of customers).

[37] *See, e.g.,* Sostichin v. Doll Enter., 847 So. 2d 1123, 1126 (Fla. Dist. Ct. App. 2003) (expert selectively chose periods so as to create trend of rising profits); Waggoner Mot., Inc. v. Waverly Church of Christ, 159 S.W.3d 42, 62 (Tenn. Ct. App. 2004) (expert witness chose period so as to exclude downward sales trend beginning 18 months before accident).

The other favored method of proving lost profits is the yardstick method.[38] In the yardstick method, the analyst uses comparable business or industry measures, usually comparisons to similar enterprises, to estimate what the plaintiff's business would have been like but for the conduct of the defendant.[39] Like the before-and-after method, the yardstick method depends on hard data that can be tied to the plaintiff's business. When a yardstick model is challenged, the issue is usually whether the yardstick is sufficiently similar to provide a gauge for the profits of the plaintiff's business. For example, courts have held that a similar business operated by the plaintiff at a different location is an adequate yardstick.[40] In the same way, the profit history of the business in question when it was run by someone other than the plaintiff may suffice.[41] But if the yardstick business does not have enough in common with the plaintiff's business, a yardstick calculation will not meet the reasonable certainty standard.[42] As the Seventh Circuit put it, "the business used as a [yardstick] must be as nearly identical to the plaintiff['s] as possible."[43]

Other methods of estimating lost profits use less reliable and less verifiable data or use data not as clearly related to the plaintiff's business.[44] Courts have often been willing to allow plaintiffs to use these methods, but when courts have found that lost profits were proven with reasonable certainty using these methods it has

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[38] In the quote above, Professor McCormick was not referring exclusively to what has since come to be known as the yardstick method but was using the term "yardstick" to refer to any verifiable data.

[39] *See* O'Brien & Gray, *supra* note 34, at p. 5-14.

[40] *See, e.g.*, Standard. Mach. Co. v. Duncan Shaw Corp., 208 F.2d 61, 64-65 (1st Cir. 1953); Leoni v. Bemis Co., 255 N.W.2d 824, 826 (Minn. 1977); El Fredo Pizza, Inc. v. Roto-Flex Oven Co., 261 N.W.2d 358, 364 (Neb. 1978).

[41] *See, e.g.,* Bigelow v. RKO Radio Pictures, Inc., 327 U.S. 251, 258, 266 (1946) (permitting comparison of receipts from period when the theater was owned by plaintiff's parents); General Elec. Supply Co. v. Mt. Wheeler Power, Inc., 587 P.2d 1312, 1313 (Nev. 1978).

[42] *See, e.g.,* Schonfeld v. Hilliard, 218 F.3d 164, 174 (2d Cir. 2000) (yardstick comparison rejected because plaintiff "failed to establish the high degree of correlation" necessary between plaintiff's business and proposed yardstick); China Doll Rest., Inc. v. Schweiger, 580 P.2d 776, 780-81 (Ariz. Ct. App. 1978) (Chinese restaurant not sufficiently similar to Mexican restaurant).

[43] Cates v. Morgan Portable Bldg. Corp., 591 F.2d 17, 21 n.7 (7th Cir. 1979) (quoting Lehrman v. Gulf Oil Co., 500 F.2d 659, 667 (5th Cir. 1974)).

[44] *See* O'Brien & Gray, *supra* note 34, at 5-15, 5-18 (discussing sales projection method and market model method); Zohn, *supra* note 33(other methods used less widely than before-and-after and yardstick methods).

usually been because the other factors discussed below weighed heavily in favor of the plaintiff.[45]

2. Whether the plaintiff has a track record

This is one area where the courts have already discarded a rule in favor of a standard. For many years, it was accepted doctrine that a business that did not have a track record could not recover lost profits.[46] This "new business rule" has been discarded by most jurisdictions, although it still prevails in a few.[47] Even though most courts no longer apply a *per se* rule, they still give lost profits claims heightened scrutiny when the plaintiff has no track record.[48] The reasons are obvious. The majority of new businesses never achieve significant success. They either fail completely or they limp along, never earning enough to compensate their owners for the time, effort, and money they put into the business.[49] Still, entrepreneurs are by nature optimistic, and they are by nature adept at transmitting their enthusiasm to others. As a result, they usually make great witnesses. All too often, they are able to convince a jury that what was really in fact a long shot would have become a huge

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[45] *See, e.g.,* Honeywell Int'l, Inc. v. Air Prods. & Chems., Inc., 858 A.2d 392, 424-31 (Del. Ch. 2004) (relying on estimates of plaintiff's expert after careful analysis of criticisms by defendant's expert).

[46] *See* Frank L. Williamson, Comment, *Remedies – Lost Profits as Contract Damages for an Unestablished Business: The New Business Rule Becomes Outdated*, 56 N.C. L. REV. 693, 696-99 (1978) (describing development of new business rule).

[47] *See id.* at 699-706 (describing decline of *per se* new business rule). *See also* AlphaMed Pharms. Corp. v. Arriva Pharms., Inc., 432 F. Supp. 2d 1319, 1339-40 (S.D. Fla. 2006) (majority of jurisdictions have abandoned strict application of new business rule).

[48] *See, e.g.,* Schonfeld v. Hilliard, 218 F.3d 164, 172 (2d Cir. 2000) (evidence of profits from new venture given greater scrutiny because of lack of track record); Roboserve, Ltd. v. Tom's Foods, Inc., 940 F.2d 1441, 1451 (11th Cir. 1991) ("Under Georgia law, future profits are ordinarily too speculative to be recovered , unless "the type of business and history of profits make the calculation of profits reasonably ascertainable.") (citation and internal quotation omitted): Kenford Co. v. County of Erie, 493 N.E.2d 234 (N.Y. 1986) (lack of track record caused court to give greater scrutiny to evidence of profits).

[49] Karen Klein, *What's Behind High Small-Biz Failure Rates?,* FRONTIER ADVICE & COLUMNS, http://www.businessweek.com/smallbiz/news/coladvice/ask/sa990930.htm (September 30, 1999) ("The NFIB [National Federation of Independent Business] estimates that over the lifetime of a business, 39% are profitable, 30% break even, and 30% lose money, with 1% falling in the "unable to determine" category.").

success but for the actions of the defendant.[50] Without the courts' skepticism of new ventures, considerations of potential liability would make established businesses (who have a lot to lose) reluctant to deal with new ventures.[51]

3. The number of difficult to quantify risks in the plaintiff's projections

It is a matter of elementary math that as the number of factors that must be estimated increases, the potential error in the projection increases exponentially. As an example, consider a case in which there are three variables, each of which can be estimated within a range of 25%. Suppose that because of the defendant's breach of contract, the plaintiff was unable to produce a product. The estimate is that the plaintiff lost 100,000 units of production a year, with a margin of error of plus or minus 25%. This would mean that the plaintiff lost between 75,000 and 125,000 units per year. If the duration of the loss was 4 years, with a margin of error of 25%, the duration would be between 3 and 5 years. If the plaintiff's potential profit on each unit was $10, with a margin of error of 25%, the potential profit per unit would be between $7.50 and $12.50. Then the low estimate of the plaintiff's lost profits would be $1,687,500 and the high estimate would be $7,812,500—more than four and a half times the low estimate. That is with only three variables. A fourth variable would mean that the high estimate could be more than seven and half times the low estimate. A fifth variable would make the potential high estimate almost thirteen times the low estimate.[52] This is all assuming that the estimates are accurate

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[50] *See, e.g.,* AlphaMed Pharms. Corp. v. Arriva Pharms., Inc., 432 F. Supp. 2d 1319, 1358 (S.D. Fla. 2006) (reversing $78 million verdict on grounds that it had not been proven with reasonable certainty, saying "[t]he jury obviously felt a great deal of sympathy for [the entrepreneurs] who presented a compelling narrative about a family and company wronged"); Cell, Inc. v. Ranson Investors, 427 S.E.2d 447, 448 (W. Va. 1992) (reversing half million dollar verdict on basis that "we have before us a typical real estate development dream where everyone thinks big thoughts *except* the institutions who are to do the financing").

[51] *See* AlphaMed Pharms. Corp. v. Arriva Pharms., Inc., 432 F. Supp. 2d 1319, 1340 (S.D. Fla. 2006) ("The rationale for applying heightened skepticism to new business's claim of lost profits is clear: the commercial success of a new venture should be determined in the marketplace, not in the courtroom. An endorsement of the alternative would permit start-up corporations to reap unearned profits without bearing the costs and risks that every other entrepreneur must shoulder.").

[52] Where the high estimate may exceed the actual number by 25% and the low estimate may fall short of it by 25% and the numbers are multiplicative, as is typical in lost profits calculations, the formula for the ratio of the high estimate to the low estimate is $(1.25/.75)^n$, where n is the number of variables. This may be generalized to say that the ratio is $[(1 + v)/(1 – v)]^n$, where v is the percentage (expressed

to 25%. Even with large, well-established businesses, estimates of sales, sales profit margins, and the like are often off the mark by much larger margins.[53]

The idea that too many variables mean too much uncertainty is not new. In an 1812 opinion, Justice Story explained his refusal to allow "damages upon the basis of a calculation of profits", saying:

> The subject would be involved in utter uncertainty. The calculation would proceed upon contingencies, and would require a knowledge of foreign markets, to an exactness in point of time and value, would sometimes present embarrassing obstacles. Much would depend upon the length of the voyage, and the season of arrival, much upon the activity of the master, and much upon the momentary demand. After all, it would be a calculation upon conjecture and not upon facts.[54]

Modern courts have been more willing to allow plaintiffs and their experts to estimate more of the crucial inputs.[55] Still, there are times when there are too many variables with too much potential for error. In these situations, courts have pointed to the number of hard to estimate variables as one of their reasons for deciding that the lost profits have not been proven with reasonable certainty.[56]

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as a decimal) by which the estimate may vary from the actual number and n is the number of variables.

[53] *See, e.g.*, *Notice on Revisions to the Performance Projections of Charle Co., Ltd.,* Business Wire, Oct. 21, 2008 (describing 45.3% upward revision in projected operating income of clothing wholesaler); *REG-Toyota Motor Corpn Business Performance-Amendmts*, LONDON STOCK EXCH. AGGREGATED REGULATORY NEWS SERVICE, Apr. 22, 2002 (describing 39.2% decrease in net income of Toyota Motor Corp).

Cf. Schonfeld v. Hilliard, 218 F.3d 164, 174 (2d Cir. 2000) (25% variance in estimated cash flows may have been too small because expert failed to account for potential inaccuracies in assumptions).

[54] The Lively, 15 F. Cas. 631, 634-35 (No. 8403) (C.C.D. Mass. 1812).

[55] *See, e.g.,* Honeywell Int'l, Inc. v. Air Prods. & Chems., Inc., 858 A.2d 392, 424-31 (Del. Ch. 2004) (relying on estimates of plaintiff's expert after careful analysis of criticisms by defendant's expert).

[56] *See, e.g.,* Royal Typewriter Co. v. Xerographic Supplies Corp., 719 F.2d 1092, 1105 (11th Cir. 1983) ("a satisfactory analysis of lost profits cannot use figures which result in too many variables"); Pot Luck, LLC v. Freeman, No. 06 Civ. 10195 (DAB), 2010 U.S. Dist. LEXIS 23473, at *8 (S.D.N.Y. Mar. 8, 2010); Kids' Universe v. In2Labs, 116 Cal. Rptr. 2d 158, 171-72 (Cal. Ct. App. 2002) (listing four "undisputed contingencies," the existence of which barred the computation of potential lost

4. The extent to which the lost profits fall within a defined range

In an ideal world, a court would be able to hear the evidence, estimate the plaintiff's damages, and quantify its own confidence that the estimate was accurate. A court might say something like "there is a 70% chance that the amount of profits the plaintiff lost was between $2.2 million and $2.8 million, with $2.5 million being the most likely amount." While some expert witnesses will make estimates similar to this, courts usually will not. But courts do seem to go through a similar process, albeit less precise and more intuitive, when they decide whether the plaintiff has proven its damages with reasonable certainty. There are few cases where courts have held that the plaintiff failed to prove its damages with reasonable certainty when it was clear from the evidence that the amount was within some reasonable range.[57]

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profits); Beverage Canners, Inc. v. Cott Corp., 372 So. 2d 954, 956 (Fla. Dist. Ct. App. 1979) (plaintiff "cannot justify using figures in its calculations which encompass too many variables and unforeseeable expenditures"); Kenford Co. v. County of Erie, 493 N.E.2d 234, 236 (N.Y. 1986) (multitude of assumptions necessary to project profits precluded proof of lost profits with reasonable certainty).

See also Mid-America Tableware, Inc. v. Mogi Trading Co., 100 F.3d 1353, 1367 (7th Cir. 1996) (combining series of estimates most favorable to plaintiff resulted in "monstrously excessive" estimate of lost profits).

One of the classic cases is Chicago Coliseum Club v. Dempsey, 265 Ill. App. 542 (Ill. App. Ct. 1932), where the court held that where boxer Jack Dempsey breached a contract to defend his heavyweight title, the promoter could not prove his damages with reasonable certainty because:

> The profits from a boxing contest of this character; open to the public, is dependent upon so many different circumstances that they are not susceptible of definite legal determination. The success or failure of such an undertaking depends largely upon the ability of the promoters, the reputation of the contestants and the conditions of the weather at and prior to the holding of the contest, the accessibility of the place, the extent of the publicity, the possibility of other and counter attractions and many other questions which would enter into consideration.

Chicago Coliseum, 265 Ill. App. at 549.

Cf. S. Jon Kreedman & Co. v. Meyers Bros. Parking-Western Corp., 130 Cal. Rptr. 41 (Cal. Ct. App. 1976) (allowing recovery of lost profits because "the operation of a parking garage is a relatively simple operation with sufficiently few decision points to make prediction of profits reasonably possible").

[57] *See, e.g.,* Thorp Sales Corp. v. Gyuro Grading Co., 331 N.W.2d 342 (Wis. 1983) (finding damages proven with reasonable certainty where high and low estimates were available).

Judge Posner implied a similar rationale in *Mindgames, Inc. v. Western Publishing Co.*,[58] when he spoke of proving lost royalties within "some broad but bounded range of alternative estimates."[59]

On the other hand, when the plaintiff asks for a large amount in damages and the court believes the actual damages might be much less, the court will scrutinize the plaintiff's damages evidence very strictly and will be quick to hold that the damages have not been proven with reasonable certainty.[60]

Courts should give great weight to whether there is a bounded range within which the lost profits can fall. This means that as long as the trier of fact stays within the range of numbers supported by the evidence, it cannot go far wrong. Therefore, there is no danger that a defendant who did little or no damage will be subjected to a crushing verdict. The plaintiff may get an award that is more than it deserves or less than it deserves, but not outrageously so.

Courts can go overboard using the range of lost profits as a reason for saying the reasonable certainty requirement has not been met. This appears to have been the case in *Tractebel Energy Marketing, Inc. v. AEP Power Marketing, Inc.*[61] The case arose out of a contract for the construction of an electric co-generation plant and the sale of the electricity from the plant for a period of 20 years.[62] When expectations for future electricity prices fell precipitously, the buyer of the electricity repudiated the contract.[63] In the resulting trial, both parties used highly-credentialed experts to present their damage calculations.[64] The seller's expert totaled the payments the seller was to receive under the contract ($646 million), and then subtracted the revenues he estimated the seller would earn from the facility if it could not sell the

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[58] 218 F.3d 652 (7th Cir. 2000).

[59] *Id.* at 657.

[60] *See generally* Atlas Copco Tools, Inc. v. Air Power Tool & Hoist, Inc., 131 S.W.3d 203 (Tex. App. 2004) (rejecting plaintiff's expert and holding that damages were not proven with reasonable certainty thereby altering the amount of damages awarded).

[61] No. 03 Civ. 6731 (HB), 2005 U.S. Dist. LEXIS 15972 (S.D.N.Y., Aug. 8, 2005) *rev'd on other grounds,* 487 F.3d 89 (2d Cir. 2007).

[62] *Tractebel*, 2005 U.S. Dist. LEXIS 15972, at *5.

[63] *See id.* at *39-*40.

[64] *Id.* at *43-44.

electricity to the buyer.[65] He calculated the potential revenues under a variety of alternative scenarios that allowed for the testing of extreme assumptions.[66] In this way, he calculated the seller's damages to be between $417 million and $604 million, with the most likely case being $520 million.[67] The buyer's expert estimated that the buyer's breach had actually saved the seller money, but the court rejected the buyer's expert's model out of hand, saying it "appears not grounded in reality" and "defies common sense."[68]

With the court having rejected the buyer's model, the seller should have been home free, but it was not. The court in fact denied the seller its lost profits, holding that it had not proven them with reasonable certainty.[69] The court's principal objection to the seller's proof was that the expert did not give a precise figure for the damages but instead gave a range of damages from $417 million to $604 million, with the most likely case being $520 million.[70] This, the court said, was fatal to its chances of recovering damages:

> [W]e are left with a gap of $187 million dollars between the low- and high-end estimates of [the buyer's] possible lost profits. Although the term 'reasonable certainty' brings with it a measure of flexibility, it does not include a margin of error of hundreds of millions of dollars, and thus AEP has failed to prove its calculations with the requisite reasonable certainty.[71]

On appeal, the Second Circuit vacated the district court's decision to the extent it denied the lost profits damages.[72] The Second Circuit said the lost profits

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[65] *Id.* at *44.

[66] *Id.*

[67] *See id.* at *44-*45.

[68] *Id.* at *47-*48. This model relied on an assumption that approximately 4.5% of all coal-fired electric generating plants would be retired each year for the next 20 years. The court found this to be unrealistic, given the fact that coal-fired plants remain extremely profitable. *See id.* at *48-*49.

[69] *See id.* at *52-*53.

[70] *See id.* at *45.

[71] *Id.* at *51.

[72] *See* Tractebel Energy Mktg., Inc. v. AEP Power Mktg., Inc., 487 F.3d 89, 113 (2d Cir. 2007).

were not consequential damages, as the district court had characterized them, but general damages, which, according to the Second Circuit, did not need to be proven with reasonable certainty.[73]

What is important for our purposes, however, is that the district court believed the gap between the expert's high and low estimates justified the conclusion that the damages had not been proven with reasonable certainty. While the court's language focused on the fact that the gap between the high and low figures was $187 million dollars, a more sophisticated way of looking at the estimates would be to say that the difference between the expert's high and low figures was 45% of the high figure.[74] This is not a wide range for an ordinary lost profits calculation, let alone a 20-year projection. Only the most stable businesses can project their profits with this accuracy.[75] If the sort of accuracy the court seems to expect were the standard for reasonable certainty, only the most stable businesses could recover lost profits and the rest would be fair game for all manner of contract breachers, antitrust violators, and the like.[76]

Nevertheless, courts should, and generally do, look much more favorably on an estimate of lost profits where the court is confident that the claimant's actual lost profits falls within a defined range, and the claimant's estimate is also within that range, even though it may be at the high end.

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[73] *See id.* at 109.

[74] It was only 31% of the high number and 36% of the most likely case.

[75] *See Financial Statements for General Electric Company*, GOOGLE FINANCE (Mar. 9, 2010), http://www.google.com/finance?q=NYSE:GE&fstype=ii (website defaults to "Quarterly Data"; press "Annual Data" hyperlink to reach this page. For information regarding Exxon Mobile Corporation, Toyota Motor Corporation, and Ford Motor Company input "XOM", "TM", and "F" into the Google Finance search bar, respectively, and click the "Financials" hyperlink); Press Release, Ford Motor Co., Ford Posts Full Year Profit for 2009 (Jan. 28, 2010), http://media.ford.com/images/10031/4Qfinancial_release09.pdf (for data regarding Ford's 2009 profits).

[76] An alternative, of course, is that plaintiff's experts could claim to have more confidence in their estimates than they actually have. This is undoubtedly going on already, but we certainly do not want to create a Gresham's law, that encourages dishonest experts and drives out the honest ones. *See* Joseph Sanders, *The Merits of the Paternalistic Justification for Restrictions on the Admissibility of Expert Evidence*, 33 SETON HALL L. REV. 881, 921 (2003) ("a number of commentators have observed that because the experts are chosen by the parties, the system favors the selection of experts with extreme views.").

B. Whether the Court is Certain the Plaintiff Has Suffered at Least Some Damage

In reversing a lower court's decision to deny an antitrust plaintiff the recovery of lost profits, the United States Supreme Court said: "The rule which precludes the recovery of uncertain damages applies to such as are not the certain result of the wrong, not to those damages which are definitely attributable to the wrong and only uncertain in respect of their amount."[77] Courts across the nation have now quoted or cited the Supreme Court in a wide variety of lost profits contexts.[78] The leading legal encyclopedias of the time then paraphrased the statement,[79] and later courts relied on the encyclopedias.[80] The result has become known as the "fact and amount rule" and it has, in one form or another, become a part of the case law of more than half of the United States jurisdictions.[81]

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[77] Story Parchment Co. v. Paterson Parchment Paper Co., 282 U.S. 555, 562 (1931).

[78] *See, e.g.,* Perma Research & Dev. v. Singer Co, 542 F.2d 111, 116 (2d Cir. 1976) ("the reasonable basis for damages that the law requires is a precise one, barring only those damages which are not the certain result of the wrong, not those . . . those damages which are definitely attributable to the wrong and only uncertain in respect of their amount"); Reefer Queen Co. v. Marine Constr. & Design Co., 440 P.2d 448, 452 (Wash. 1968) ("where the fact of damage is firmly established, the wrongdoer is not free of liability because of difficulty in establishing the dollar amount of damages").

[79] *See* 15 AM. JUR. *Damages* § 23(1958) ("the uncertainty which prevent a recovery is uncertainty as to the fact of damage and not as to its amount and . . . where it is certain that damage has resulted, mere uncertainty as to the amount will not preclude the right of recovery") (quoted at Wolverine Upholstery Co. v. Ammerman, 135 N.W.2d 572, 576 (Mich. Ct. App. 1965)); 25 C.J.S. *Damages* § 28 (1966) ("the rule against uncertain or contingent damages applies only to such damages as are not the certain results of the wrong, and not as to such as are the certain results but uncertain in amount").

[80] *See, e.g.,* Degnan v. Young Bros. Cattle Co., 103 P.2d 918,922 (Kan. 1940) (citing 17 C.J.S. § 756); Moore v. St. Louis Sw. Ry. Co., 301 S.W.2d 395, 403 (Mo. 1955) (citing 25 C.J.S. *Damages* § 28); Wenzler & Ward Plumbing & Heating Co. v. Sellen, 330 P.2d 1068, 1070 (Wash. 1959) (citing 25 C.J.S. *Damages* § 28).

[81] *See* 1 ROBERT L. DUNN, RECOVERY OF DAMAGES FOR LOST PROFITS § 1.8 (6th ed. 2005) (citing cases from 28 states as well as numerous federal cases).

One of the most often quoted statements of the fact and amount rule comes from an 1886 opinion of the New York Court of Appeals:

> When it is certain that damages have been caused by breach of contract and the only uncertainty is as to their amount, there can rarely be good reason for refusing, on account of such uncertainty any damages whatever for their breach. A person violating his contract should not be permitted entirely to escape liability because the amount of damage which he caused is uncertain.

In truth, however, the fact and amount rule is one of the more misleading statements in American jurisprudence, not because it is totally untrue, which it is not, but because it grossly overstates the importance of the plaintiff being able to prove it suffered some amount of damage. In doing so, it elevates certainty that some profits have been lost from being one of a number of factors courts consider to being a sine qua non for recovering the entire lost profits claim.

Even though many courts state the fact and amount rule as an absolute rule, saying such things as "where it is certain that damage has resulted, mere uncertainty as to the amount will not preclude recovery,"[82] they do not actually apply it as a rule. Instead, they make the certainty that there has been some loss one factor to be considered when determining whether the plaintiff has proven its damages with reasonable certainty. [83] It is an important factor to be sure, but it is still just one of a number of factors they consider.

Even Professor Williston, who has been criticized for his preference for rules over standards,[84] pointed out many years ago that the fact/amount distinction does not work as a rigid rule:

> An attempt is sometimes made to distinguish between certainty that some damage has been caused, and certainty as to the amount of damage; but no broad statement can be made that where it is uncertain that any damage has been caused by the breach no recovery is allowable. In almost every case where prospective profits are allowed it will be true that the profit was a chance – dependent upon the ability to make a large number of contracts with other persons on

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Wakeman v. Wheeler & Wilson Mfg. Co., 4 N.E. 264, 266 (N.Y. 1886).

Some courts have gone even further, not requiring certainty as to the fact of damage, but only reasonable probability that there has been damage. *E.g.,* Ace-Federal Reporters v. Barram, 226 F.3d 1329, 1333 (Fed. Cir. 2000) ("[i]f a reasonable probability of damage can be clearly established, uncertainty as to the amount will not preclude recovery"); Locke v. United States, 283 F.2d 521, 524 (Ct. Cl. 1960) (same).

[82] Kellerman v. Dedman, 411 S.W.2d 315, 317 (Ky. Ct. App. 1967) (quoting Essock v. Mawhinney, 88 N.W.2d 659, 664 (Wis. 1958)).

[83] *See infra* notes 87-111 and accompanying text.

[84] *See, e.g.,* Richard E. Speidel, *Restatement Second: Omitted Terms and Contract Method,* 67 CORNELL L. REV. 785, 786-90 (1982) (describing criticisms of Williston's method).

> advantageous terms. All reasonable expectations might have been disappointed by the happening of divers contingencies.[85]

A student note of the same era is even stronger in its criticism of the rule:

> It appears that "the fact of loss" and "the amount of loss" are in effect different terms for the same thing, since proof of the amount of loss with a reasonable degree of certainty conclusively establishes the fact of loss, and, conversely, the only way to prove the fact of loss would seem to be by proving with reasonable certainty at least a minimum amount of loss.[86]

Moreover, courts do not apply the fact and amount rule the way they purport to. A court is put to the test when the facts clearly show the plaintiff suffered some loss of profits, but the plaintiff failed to provide a reasonable basis for computing those lost profits. In those situations, courts have awarded only nominal damages or no damages at all.[87] For example, a business will often sue for lost profits when its listing or advertisement is omitted from a telephone directory or business directory. In these cases, courts usually deny recovery on the ground that the plaintiff cannot prove the amount of additional business it would have gained had it been correctly listed in the directory.[88] Yet it would be difficult to deny that the plaintiff suffered at

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[85] 3 SAMUEL WILLISTON, THE LAW OF CONTRACTS § 1346 (1924).

[86] Note, *Proof of Certainty*, 17 MINN. L. REV. 194, 196 (1933).

[87] *See, e.g.,* S.C. Johnson & Son, Inc. v. Louisville & N.R. Co., 695 F.2d 253, 261(7th Cir. 1982); Hoefferle Truck Sales, Inc. v. Divco-Wayne Corp., 523 F.2d 543, 553 (7th Cir. 1975) ("[T]he admitted fact of damage is insufficient to prove the amount of damage."); Alover Distributors, Inc. v. Kroger Co., 513 F.2d 1137, 1140 (7th Cir. 1975) (same); Dowling Equip. & Supply Co. v. City of Anchorage, 490 P.2d 907, 909 (Alaska 1971) (party proving fact of damages must still introduce "some competent evidence as to the amount of damages"); Schoeneweis v. Herrin, 443 N.E.2d 36, 42 (Ill. App. Ct. 1982) ("If the party having the burden of proof establishes entitlement to damages yet fails to establish a proper basis from which those damages can be computed, the party is entitled only to nominal damages."); Mood v. Kronos Prods., Inc., 245 S.W.3d 8,12 (Tex. Ct. App. 2007),*review denied* (2008) *and reh'g of petition for review denied* (2008) ("The injured party must do more than show they suffered some lost profits.").

[88] *See, e.g.,* Shealy's, Inc. v. So. Bell Tel. & Tel. Co., 126 F. Supp. 382, 386-89 (E.D.S.C. 1954) (denying lost profits on account of omitted directory listing and discussing numerous similar cases) ; Midland Hotel Corp. v. Reuben H. Donnelly Corp., 515 N.E. 2d 61, 66-67 (Ill. 1987) (reversing $500,000 jury verdict for hotel lost because of failure to list in visitor's guide); Workers Comp. Legal Clinic of La. v. BellSouth Telecomms, Inc., 374 F. Supp. 2d 1215, 1218 (N.D. Ga. 2005) (upholding summary judgment on basis that plaintiff could not prove amount of loss); Tannock v. N.J. Bell Tel.Co., 537

least some damages. Some revenue-producing customers must have been lost, either because they couldn't find the plaintiff's business when looking for it and decided to deal with a competitor instead, or because they were looking for a particular type of business and would have chosen the plaintiff's had it been listed.

Similarly, when defendants have breached contracts to publish a book or to distribute a new product and pay the plaintiff a royalty, the plaintiff has certainly suffered some damage because somebody somewhere (if only the plaintiff's mother) would have made a purchase. Yet courts have generally awarded only nominal damages in such cases, on the ground that the damages have not been proven with reasonable certainty.[89]

Some jurisdictions purport to apply a less categorical version of the fact and amount rule, saying that where it is certain the plaintiff has suffered some lost profits, it must still prove the amount of loss. However, the proof is subject to some other specified standard, which presumably is less exacting than the reasonable certainty standard. Washington, for example, has case law saying that "once the fact of damage is established, [the jury] is permitted to make reasonable inferences based upon reasonably convincing evidence indicating the amount of damage."[90] The Florida Supreme Court has developed a second standard, seemingly less demanding than reasonable certainty, which it applies when the fact of damage has been proven.

A.2d 1307, 1310 (N.J. Super. Ct. App. Div. 1988) (upholding refusal to allow plaintiff's damages evidence to go to jury); Joy Floral Co v. S. Cent. Bell Tel. Co, 563 S.W.2d 190, 191-92 (Tenn. Ct. App. 1977) (upholding refusal to submit damages case to jury where plaintiff did most of its business over telephone and gross sales declined by $30,000 in year when listing inadvertently excluded from telephone directory white pages).

[89] *See, e.g.,* MindGames, Inc. v. Western Publ'g Co., 218 F.3d 652 (7th Cir. 2000) (no damages awarded for failure to promote board game because plaintiff did not seek nominal damages); Booker v. Ralston Purina Co., 699 F.2d 334, 336-37 (6th Cir. 1983) (where defendant breached contract by discontinuing marketing of licensed food product, plaintiff's damages were limited to royalties for product sold before breach); Freund v. Wash. Square Press, 314 N.E.2d 419, 421 (N.Y. 1974) (nominal damages awarded for breach of contract to publish book where anticipated royalties not proven with reasonable certainty).

In *MindGames*, *supra*, the court noted that by not seeking nominal damages, the plaintiff lost what could have been a substantial award of attorney fees. 218 F.3d at 654. There was a dissenting opinion which relied on the fact and amount rule and would have reversed the district court's grant of summary judgment. *See id.* at 660.

[90] Alpine Indus., Inc. v. Gohl, 637 P.2d 998, 1001 (Wash. Ct. App. 1981) (quoting Gaasland Co. v. Hyak Lumber & Millwork, Inc., 257 P.2d 784, 788-89 (Wash. 1953)).

This standard requires the amount of the lost profits be proven "with such certainty as satisfies the mind of a prudent and reasonable person."[91] The Alaska Supreme

[91] Twyman v. Roell, 166 So. 215, 217 (Fla. 1936). *Twyman* involved a suit for future profits from a farming partnership. The Florida Supreme Court said that such profits could be recovered if "the amount can be established with reasonable certainty, such certainty as satisfied the mind of a prudent and impartial person." *Id.* at 217. Later in the opinion, however, the court states very strongly the fact and amount rule, but then qualifies it by repeating the requirement that proof of the amount of damage satisfy a prudent and impartial person:

> Uncertainty of the amount or difficulty of proving the amount of damage with certainty will not be permitted to prevent recovery on such contracts. If it is clear that substantial damages have been suffered, the impossibility of proving its precise limits is no reason for denying substantial damages altogether.
>
> The uncertainty which defeats recovery in such cases has reference to the cause of the damage rather than to the amount of it. If from proximate estimates of witnesses a satisfactory conclusion can be reached, it is sufficient if there is such certainty as satisfies the mind of a prudent and reasonable person.

Id. at 218 (citations omitted).

More than seventy years later, *Twyman* is still the case that courts rely upon when awarding or denying lost profits under Florida law. *See, e.g.,* Nebula Glass Int'l v. Reichhold, Inc.*,* 454 F.3d 1203, 1217 (11th Cir. 2006). Where a court wants to justify a questionable award of lost profits, it is easy to quote the fact vs. amount rule without qualification. Conversely to justify requiring strict proof, the court can rely on the "prudent and impartial person" standard. But Florida courts, state and federal, have generally been quite honest about dealing with both aspects of *Twyman*.

Another Florida Supreme Court opinion issued within a few weeks of the *Tyman* opinion said that anticipated profits can be recovered only where "the plaintiff makes it reasonably certain by competent proof what the amount of his actual loss was." New Amsterdam Cas. Co. v. Utility Battery Mfg. Co., 166 So. 856, 860 (Fla. 1936). A number of later opinions relied on this to say that in Florida lost profits must be proven with reasonable certainty. *See, e.g.,* Nat'l Indus., Inc. v. Sharon Steel Corp.*,* 781 F.2d 1545, 1547 (5th Cir. 1986) (lost profits may be recovered "where the plaintiff makes it reasonably certain by competent proof what the amount of his actual loss was"); Royster Co. v. Union Carbide Corp.*,* 737 F.2d 941, 948 (11th Cir. 1984); Ctr. Chem. Co. v. Avril, Inc., 392 F.2d 289, 290-91 (5th Cir. 1968) (citing both *Twyman* and *New Amsterdam Casualty* for the proposition that "[t]here can be no recovery under Florida law where the evidence is not sufficient to enable the jury to assess damages with a reasonable degree of certainty and without leaving the amount awarded to speculation and conjecture."). *See also* Litman v. Mass. Mut. Life Ins. Co., 739 F.2d 1549, 1559 (11th Cir. 1984) (quoting *Twyman* for the proposition that lost profits may be recovered in Florida if "the amount can be established with reasonable certainty.") *New Amsterdam Casualty*, however, appeared to state a new business rule, indicating that lost profits could be recovered only for an established business. *See* 166 So. at 860. In W.W. Gay Mech. Contractor, Inc. v. Wharfside Two, Ltd., 545 So. 2d 1348, 1350 (Fla. 1989), the Florida Supreme Court determined that this aspect of *New Amsterdam*

Court has described the standard of proof necessary when the plaintiff has proven the fact of damages in a variety of ways. Most often it has said: "Once the fact of damages has been proven to a reasonable probability, the *amount* of such damages, on the other hand, need only be proven to such a degree as to allow the finder of fact to reasonably estimate the amount to be allowed for the item of damages."[92] At other times the Alaska court has said: "the evidence must provide a reasonable basis for the jury's determination,"[93] or "the jury [must have] a reasonable basis on which to compute its award."[94] Delaware courts have also said that when the fact of damage has been proven, the evidence must be such as will "lay a foundation which will enable the trier of facts to make a fair and reasonable estimate of the amount of damage."[95] Courts in Iowa have said the standard is "a reasonable basis in the evidence from which the amount can be inferred or approximated."[96] The Montana Supreme Court has said that "[o]nce liability is shown," the plaintiff need only supply

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Casualty was inconsistent with *Twyman*, which, although it involved an established business, did not limit its rule of recovery to established businesses. It chose to follow *Twyman* (*see* 545 So. 2d at 1351) and as a result subsequent opinions have generally stopped citing *New Amsterdam Casualty* and stopped using the "reasonable certainty" language in favor of "satisfies the mind of a reasonable and prudent person," even though *Twyman* treated the two as equivalent. *But see* Nebula Glass Int'l, Inc. v. Reichhold, Inc., 454 F.3d 1203, 1212 (11th Cir. 2006) ("Under the certainty rule, which applies in both contract and tort actions, recovery is denied where the fact of damages and the extent of damages cannot be established within a reasonable degree of certainty.") (quoting Miller v. Allstate Ins. Co., 573 So. 2d 24, 27-28 (Fla. Dist. Ct. App. 1990)).

92 Alaska Tae Woong Venture, Inc. v. Westward Seafoods, Inc., 963 P.2d 1055, 1061 (Alaska 1998) (quoting Pluid v. B.K., 948 P.2d 981, 984 (Alaska 1997)) (emphasis in original; internal quotations omitted). Similar language appears in other Alaska Supreme Court opinions: "[I]t is not necessary to prove lost profits with exactness so long as actual loss of profits is shown and the jury has a reasonable basis on which to compute its award." Municipality of Anchorage v. Locker, 723 P.2d 1261, 1267 (Alaska 1986) (quoting City of Whittier v. Whittier Fuel & Marine Corp., 577 P.2d 216, 222 (Alaska 1978)).

93 Ben Lomond, Inc. v. Schwartz, 915 P.2d 632, 636 (Alaska 1996); City of Palmer v. Anderson, 603 P.2d 495, 500 (Alaska 1979); City of Whittier v. Whittier Fuel & Marine Corp., 577 P.2d 216, 222 (Alaska 1978).

94Municipality of Anchorage v. Locker, 723 P.2d 1261, 1267 (Alaska 1986).

95 Total Care Physicians, P.A. v. O'Hara, No. Civ. A. 99C-11-201JRS, 2003 Del. Super. LEXIS 261, at *11 n. 19 (Del. Super. Ct. July 10, 2003) (quoting 22 AM. JUR. 2D *Damages* § 488 (1988)).

96 Larsen v. United Fed. Sav. & Loan Ass'n of Des Moines, 300 N.W.2d 281, 288 (Iowa 1981): Pringle Tax Serv., Inc. v. Knoblauch, 282 N.W.2d 151, 153 (Iowa 1979).

"a reasonable basis for computation and the best evidence available under the circumstances."[97]

On the other hand, it appears that many jurisdictions have not expressly adopted the fact and amount rule, and have opinions stating categorically that both the fact and the amount of lost profits must be proven with reasonable certainty.[98] Some expressly reject the fact and amount rule.[99]

In still other jurisdictions, courts state a fact and amount rule, yet in the same opinion state categorically that the *amount* of lost profits must be proven with reasonable certainty. For example, at least half a dozen Georgia Court of Appeals opinions have said (using the same words in every opinion):

> The rule against the recovery of vague, speculative, or uncertain damages relates more especially to the uncertainty as to cause, rather than uncertainty as to the measure or extent of the damages. Mere difficulty in fixing their *exact* amount, where proximately flowing from the alleged injury, does not constitute a legal obstacle in the way of their allowance, when the amount of the recovery comes within that authorized with *reasonable certainty* by the legal evidence

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[97] Sebena v. Am. Auto. Ass'n, 930 P.2d 51, 54 (Mont. 1996) (quoting Stensvad v. Miners & Merchants Bank, of Roundup, 640 P.2d 1303, 1310 (Mont. 1982)).

[98] *See, e.g.,* Beverly Hills Concepts, Inc. v. Schatz and Schatz, Ribicoff and Kotkin, 717 A.2d 724, 736 (Conn. 1998) ("Although we recognize that damages for lost profits may be difficult to prove with exactitude . . . such damages are recoverable only to the extent that the evidence affords a sufficient basis for estimating their amount with reasonable certainty.") (quoting Gargano v. Heyman, 525 A.2d 1343, 1346 (Conn. 1987)) (emphasis omitted); Nora v. Safeco Ins. Co., 577 P.2d 347, 351 (Idaho 1978) ("The damages would only be proper when the person whose property has been converted shows that the conversion has resulted in lost business profits and shows with reasonable certainty the amount of these lost profits."); Midland Hotel Corp. v. Reuben H. Donnelly Corp., 515 N.E.2d 61, 66 (Ill. 1987) ("recovery may be had for prospective profits when there are any criteria by which the probable profits can be estimated with reasonable certainty.") (citations and internal quotations omitted); Ameristar Jet Charter, Inc. v. Dodson Int'l Parts, Inc., 155 S.W.3d 50, 54 (Mo. 2005) ("For an award of lost profits damages, a party must produce evidence that provides an adequate basis for estimating the lost profits with reasonable certainty."); Olivetti Corp. v. Ames Bus. Sys., Inc., 356 S.E.2d 578, 586 (N.C. 1987) ("As part of its burden, the party seeking damages must show that the amount of damages is based upon a standard that will allow the finder of fact to calculate the amount of damage with reasonable certainty.") (citations omitted).

[99] *See* Merion Spring Co. v. Muelles Hnos. Garcia Torres, 462 A.2d 686, 696 (Pa. Super. Ct. 1983) (rejecting argument that lower standard of proof needed for amount of damages).

submitted.[100]

There are similar juxtapositions in the opinions of the courts of California,[101] Hawaii,[102] and Iowa.[103] These opinions make sense only if the word "certainty," as

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[100] Signsation, Inc. v. Harper, 460 S.E.2d 854, 856 (Ga. Ct. App. 1995); Ga. Ports Auth. v. Servac Int'l, 415 S.E.2d 516, 519 (Ga. Ct. App. 1992); B & D Carpet Finishing Co., Inc. v. Gunny Corp., 281 S.E.2d 354, 355 (Ga. Ct. App. 1981); Farmers Mut. Exch. of Baxley v. Dixon, 247 S.E.2d 124, 125-26 (Ga. Ct. App. 1978); Summerfield v. DeCinque, 213 S.E.2d 712, 714 (Ga. Ct. App. 1977); Booker v. J.T. Bickers Realty Co., 194 S.E.2d 490, 492 (Ga. Ct. App. 1972); Ayers v. John B. Daniel Co., 133 S.E. 878, 878 (Ga. Ct. App. 1926) (emphasis supplied).

[101] In California, the conflicting precedents seem to have so confused one Court of Appeal panel that its opinion seems to change the standard twice in the same paragraph. In Brandon & Tibbs v. George Kevorkian Accountancy Corp., 277 Cal. Rptr. 40 (Cal. Ct. App. 1990) the court interprets the basic wrongdoer rule from an opinion of the state's supreme court: "It is well settled that '[o]ne whose wrongful conduct has rendered difficult the ascertainment of the damages cannot escape liability because the damages could not be measured with exactness.'" *Id.* at 49 (quoting Zinn v. Ex-Cell-O Corp., 149 P.2d 177, 181 (Cal. 1944)).

The Court of Appeal opinion then proceeds to imply that both the occurrence and extent of the lost profits must be shown with reasonable certainty, quoting a prior California Court of Appeal opinions: "[L]oss of prospective profits may nevertheless be recovered if the evidence shows with reasonable certainty *both* their *occurrence* and the *extent* thereof." Brandon & Tibbs, 277 Cal. Rptr. at 49-50 (quoting Gerwin v. Southeastern Cal. Assn. of Seventh Day Adventists, 92 Cal. Rptr. 111, 119 (Cal. Ct. App. 1971)) (emphasis in original).

The very next sentence of the opinion quotes from another opinion a statement that seems to say that if the existence of damages is proven, it is *not* necessary that the extent of the damages be proven with reasonable certainty:

> [I]t appears to be the general rule that while a plaintiff must show with reasonable certainty that he has suffered damages by reason of the wrongful act of defendant, once the cause and existence of damages have been so established, recovery will not be denied because the damages are difficult of ascertainment.

Brandon & Tibbs, 277 Cal. Rptr. at 50 (quoting Stott v. Johnston, 229 P.2d 348, 355 (Cal. Ct. App. 1951)).

[102] *See* Chung v. Kaonohi Ctr. Co., 618 P.2d 283, 291 (Haw. 1980). The court quoted the following from Ferreira v. Honolulu Star-Bulletin, Ltd., 356 P.2d 651, 656 (Haw. 1960):

> A distinction is made in the law between the amount of proof required to establish the fact that the injured party has sustained some damage and the measure of proof necessary to enable the jury to determine the amount of damage. It is now generally held that the uncertainty which prevents a recovery is uncertainty as to the fact of damage and not as to its amount. However, the rule that uncertainty as to the amount does not necessarily prevent recovery is not to be interpreted as

used in the "fact and amount" rule, means some standard of certainty greater than the reasonable certainty necessary to prove the amount of the lost profits. Opinions in some states seem to have recognized this. For example, two opinions of the Nebraska Supreme Court have said:

> While it is true that such damages need not be proved with mathematical certainty, neither can they be established by evidence which is speculative and conjectural . . . [l]oss of prospective profits may be recovered if the evidence shows with reasonable certainty both its occurrence and the extent thereof. Uncertainty as to the fact of whether damages were sustained at all is fatal to recovery, but uncertainty as to amount is not if the evidence furnishes a reasonably certain factual basis for computation of the probable loss.[104]

So, in Nebraska at least, it's clear that the fact and amount rule means "mathematical certainty" when it speaks of "certainty" without qualifying the term, and that it means the lack of that same degree of certainty when it speaks of "uncertainty." That is probably the case, to the extent the courts have actually thought about it, in the other jurisdictions that use the fact and amount rule in the same opinions in which they state that the amount of lost profits must be proven with reasonable certainty.[105] It is tempting to assume this is also the case in those

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> requiring no proof of the amount of damage. The extent of plaintiff's loss must be shown with reasonable certainty and that excludes any showing or conclusion founded upon mere speculation or guess.

[103] City of Corning v. Iowa-Neb. Light & Power Co., 282 N.W. 791, 796 (Iowa 1938) ("The damages claimed must be the certain result of the alleged breach on which the injured party relied. If the damages are the result of the breach, the fact that the amount of damages is uncertain or difficult to determine does not prevent recovery if the amount of the damages can be established with reasonable certainty."). More recent Iowa opinions have stated a different standard of proof when the fact of damages has been proven. *See supra*, text accompanying note 91.

[104] Katskee v. Nev. Bob's Golf of Neb., Inc., 472 N.W.2d 372, 379 (Neb. 1991); Buell, Winter, Mousel & Assocs. v. Olmsted & Perry Consulting Eng'rs, Inc., 420 N.W.2d 280, 283-84 (Neb. 1988).

[105] *See, e.g.,* Addison Miller, Inc. v. United States, 70 F. Supp. 893, 900 (Ct. Cl. 1947). In *Addison Miller,* the Court of Claims interpreted the fact and amount rule as holding that the plaintiffs did not have to prove lost profits with mathematical certainty:

> It is undoubtedly the rule, of course, as plaintiffs, the uncertainty as to the amount of damage does not preclude recovery where the fact of damage is clearly established. However, it is equally well settled that we cannot indulge in pure

jurisdictions that state the fact and amount rule in some opinions and state in others that the amount of the lost profits, as well as the fact that they occurred, must be proven with reasonable certainty. But there are at least some judges in these jurisdictions who seem to believe the fact and amount rule means that the amount of lost profits does not have to be proven with reasonable certainty.

A case in point is Texas, where for many years there were two lines of lost profits cases emanating from the Texas Supreme Court. When in a close case the court decided in favor of the plaintiff, it supported its decision with the fact and amount rule.[106] When it decided in favor of the defendant, it supported the decision with a statement that the plaintiff had failed to prove the amount of its loss with reasonable certainty.[107] Finally, in a 1992 decision, *Holt Atherton Industries, Inc. v. Heine*,[108] the court split on the issue of whether a plaintiff, who had clearly suffered some lost profits, had furnished sufficient proof of its loss. The majority, citing previous decisions of the court, said, "the injured party must do more than show they suffered some lost profits. The amount of loss must be shown by competent evidence with reasonable certainty."[109] Two judges dissented, saying: "The majority . . . erod[es] the distinction we have long recognized between uncertainty as to the occurrence of lost profits and uncertainty merely as to their exact amount. The

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> speculation. There must be some foundation for the judgment rendered. All of the cases holding that the amount of damage need not be capable of mathematical computation nevertheless recognize that there must be some reasonable basis for ascertaining the amount of the damage.

Id.

[106] *See, e.g.,* Pace Corp. v. Jackson 284 S.W.2d 340, 348 (Tex. 1955):

> The courts draw a distinction between uncertainty merely as to the amount and uncertainty as to the fact of legal damages. Cases may be cited which hold that uncertainty as to the fact of legal damages is fatal to recovery, but uncertainty as to the amount will not defeat recovery. A party who breaks his contract cannot escape liability because it is impossible to state or prove a perfect measure of damages.

Id.

[107] *See, e.g.*, City of Austin v. Teague, 570 S.W.2d 389, 395 (Tex. 1978) ("In *Southwest Battery* . . ., the rule was stated that losses must be shown by competent evidence and with reasonable certainty.").

[108] Holt v. Atherton Indus., Inc v. Heine, 835 S.W.2d 80 (Tex. 1992).

[109] *See id.* at 84.

former, but not the latter, is fatal to recovery."[110] In doing so, they made it clear that they thought the fact and amount rule as applied in Texas was inconsistent with the majority's statement that the amount of lost profits must be proven with reasonable certainty. Later courts seem to have agreed and taken the majority opinion as a renunciation of the fact and amount rule, because that rule no longer appears in Texas opinions.[111]

It would be interesting to see if, as a result of the *Holt Atherton* opinion, Texas law has become more hostile to the recovery of lost profits. It does not seem possible to rigorously test my hypothesis, but I feel quite certain that it has not. I don't think the *Holt Atherton* opinion has affected the way judges actually decide lost profits cases. I am confident they still decide them on the basis of whether it is fair to allow the plaintiff to recover the amount in question on the basis of the proof it has presented. But *Holt Atherton* certainly does affect the way Texas courts explain their decisions.

C. The Degree of Blameworthiness or Moral Fault on the Part of the Defendant

Another factor exerts an important influence on courts' decisions, but not in the way the courts say it does. The extent to which the defendant has done something morally wrong, rather than merely causing damage through inadvertence or bad luck, plays a major part in the courts' determinations of whether the lost profits have been proven with reasonable certainty, but it does so in a way that is much more subtle than the language of the opinions would suggest.[112]

Many judicial opinions purport to rely on the so-called "wrongdoer rule," which says that because the defendant's conduct has made it hard to measure the lost profits, it cannot escape liability merely because the plaintiff cannot prove its loss

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[110] *Id.* at 88 (Doggett, J., dissenting).

[111] *See, e.g.,* Texas Instruments, Inc. v. Teletron Energy Mgmt., Inc., 877 S.W.2d 276, 279 (Tex. 1994) (stating "[i]n order that a recovery may be had on account of loss of profits, the amount of the loss must be shown by competent evidence with reasonable certainty").

[112] *See* Gregory v. Slaughter, 99 S.W. 247, 249 (Ky.1907) ("a more liberal rule in regard to damages for profits lost should prevail in actions purely of tort") (quoting Allison v. Chandler, 11 Mich. 542, 559 (1863). Perillo, *supra* note 18, at 1096 (certainty requirement applied more strictly in contract than in tort); Ralph S. Bauer, *The Degree of Moral Fault as Affecting Defendant's Liability*, 81 U. PA. L. REV. 586, 592 (1933); 5 ARTHUR L. CORBIN, CORBIN ON CONTRACTS 1026-27 (1964) (less certainty required when breach willful).

with reasonable certainty.[113] Courts have expressed the rule in many different ways, including "a defendant whose wrongful conduct has rendered difficult the ascertainment of the precise damages suffered by the plaintiff, is not entitled to complain that they cannot be measured with the same exactness and precision as would otherwise be possible"[114] and "fundamental principles of justice require us to throw the risk of any uncertainty upon the wrongdoer instead of upon the injured party."[115] This rule would take moral fault into account, but it would do so in a way so inflexible as to make the rule totally useless. If taken literally, the rule would require juries to award lost profits on the basis of no more evidence than the projections of the disappointed entrepreneur. Moreover, while one who reads the rule in the abstract might think that it is limited to situations where the defendant has done something affirmative to prevent the plaintiff from proving its lost profits with more certainty, like destroying evidence, perhaps, that is not what the rule means. Courts have consistently interpreted the rule to mean that the acts that gave rise to the defendant's liability were the acts that made it hard to determine how much the plaintiff lost. The theory is that if it were not for those acts, the plaintiff would have earned a certain amount of profits. Now the plaintiff is in the position of having to prove what it would have earned but for the defendant's acts. So the plaintiff should

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[113] *See* Eastman Kodak Co. of N.Y. v. S. Photo Materials Co., 273 U.S. 359, 379 (1927).

[114] Eastman Kodak Co. of N.Y. v. S. Photo Materials Co., 273 U.S. 359, 379 (1927).

[115] Yarway Corp. v. Eur-Control U.S.A., Inc., 775 F.2d 268, 276 (Fed. Cir. 1985); Kori Corp. v. Wilco Marsh Buggies & Draglines, Inc., 761 F.2d 649, 655 (Fed. Cir. 1985); Paper Converting Mach. Co. v. Magna-Graphics Corp., 745 F.2d 11, 22 (Fed. Cir. 1984); BIC Leisure Prods., Inc. v. Windsurfing Int'l, Inc., 761 F. Supp. 1032, 1038 (S.D.N.Y. 1991)

Other courts have stated the rule in similar terms. *See, e.g.,* Contemporary Mission, Inc. v. Famous Music Corp., 557 F.2d 918, 926 (2d Cir. 1977) ("the burden of uncertainty as to the amount of damage is on the wrongdoer").

The Michigan Court of Appeals has said:

> On the principle that where a litigant can show he has been damaged, but his damages cannot be measured with certainty, that it is better that he recover more than he is entitled to than less, the rule in Michigan is that the risk of the uncertainty is cast upon the wrongdoer, not the inured party.

Lorenz Supply, Inc. v. Am. Standard., Inc., 300 N.W.2d 335, 340 (Mich. Ct. App. 1980).

not be denied its damages merely because it cannot present this proof.[116] Whatever one thinks of the merits of this reasoning, it means that the rule applies in every lost profits case, not just those where the defendant has done something to render the calculation more difficult.

The requirement that the defendant be a "wrongdoer" is similar. Courts never seem to explain who fits that description under the rule. While the rule seems to be most often applied where the defendant violated the antitrust laws, the rule is also applied to ordinary contract breaches, frequently without the court ever indicating that there was anything malicious about the breach.[117]

These interpretations mean we have a rule that is directly contradictory to the rule that lost profits must be proven with reasonable certainty. Taken literally, the wrongdoer rule says that uncertainty as to the amount of profits is not grounds for denying recovery. Furthermore, in almost every jurisdiction in which the courts have relied on the wrongdoer rule in some cases, they have also stated categorically in others that lost profits must be proven with reasonable certainty.[118] As a result, many jurisdictions have a situation similar to what Texas had with the fact and amount rule. Courts have two inconsistent rules: the wrongdoer rule and the reasonable certainty requirement. In any given case, they can (and do) apply whichever rule fits the court's view of the equities.

To make things more complex, there are many different versions of the wrongdoer rule, just as there are with the fact and amount rule. The wrongdoer rules

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[116] *See, e.g.,* Haverhill Gazette Co. v. Union Leader Corp., 333 F.2d 798, 806 (1st Cir. 1964) (error to limit application of wrongdoer rule to situation where difficulties of proof were result of defendant's unlawful acts).

[117] *See, e.g.*, Lee v. Joseph D. Seagram & Sons, Inc., 552 F.2d 447, 455 (2d Cir. 1977) (applying wrongdoer rule in breach of contract for liquor distributorship); A to Z Rental, Inc. v. Wilson, 413 F.2d 899, 908 (10th Cir. 1969) (applying wrongdoer rule against franchisor unable to fulfill obligations); Locke v. United States, 283 F.2d 521, 524 (Ct. Cl. 1960) (applying wrongdoer rule against United States government in breach of contract action); First-Citizens Bank & Trust Co. v. United States, 76 F. Supp. 250, 274 (Ct. Cl. 1948); Gilmore v. Cohen, 386 P.2d 81, 83 (Ariz. 1963) (stating wrongdoer rule in opinion involving disputed breach of contract to sell real estate to developer); Murphy v. Lifschitz, 49 N.Y.S.2d 439, 441 (N.Y. Sup. Ct. 1944) (applying wrongdoer rule in connection with contract to sell liquor). *But see* Erickson v. Playgirl, Inc., 140 Cal. Rptr. 921, 923 (Cal. Ct. App. 1977) (describing wrongdoer rule as "the tort rule" and stating it "is of limited application" in contract case).

[118] *See* Lloyd, *supra* note 21.

quoted above are among the stronger versions, because they state the rule without qualifications. When it suits their purposes, the courts state the rule with qualifications. The United States Supreme Court did this in *Story Parchment Co. v. Paterson Parchment Paper Co.,*[119] the opinion most often cited for the wrongdoer rule:

> Where the tort itself is of such a nature as to preclude the ascertainment of the amount of damages with certainty, it would be a perversion of fundamental principles of justice to deny all relief to the injured person, and thereby relieve the wrongdoer from making any amend for his acts. In such case, while the damages may not be determined by mere speculation or guess, it will be enough if the evidence show the extent of the damages as a matter of just and reasonable inference, although the result be only approximate. The wrongdoer is not entitled to complain that they cannot be measured with the exactness and precision that would be possible if the case, which he alone is responsible for making, were otherwise.[120]

While this version contains all of the righteous indignation of the stronger versions of the rule, it adds an important qualification: the plaintiff is not relieved entirely of its burden of proving the amount of the lost profits.[121] It must now "show the damages as a matter of just and reasonable inference."[122] This means that we have a new rule saying that if the defendant is a wrongdoer, the plaintiff need only meet this (presumably) lower standard of proof. Unfortunately, however, the cases do not explain how this new standard of proof differs from the traditional reasonable certainty standard.

At times, courts have subjected the wrongdoer rule to other limitations. Some opinions have stated that the wrongdoer rule applies only when the plaintiff has shown it has suffered some amount of damage, thus transforming it into a fact

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119 282 U.S. 555, 563 (1931).

120 *Id.*.

121 *Id.*

122 Other opinions have stated the rule in terms of other vague standards. *See, e.g.,* Contemporary Mission, Inc. v. Famous Music Corp., 557 F.2d 918, 926 (2d Cir. 1976) (articulating the standard as "a stable foundation for a reasonable estimate"); Freund v. Wash. Square Press, Inc., 314 N.E.2d 419, 421 (N.Y. 1974).

and amount rule with pejorative language.[123] Others have said that the wrongdoer rule does not apply where the damages are "speculative."[124] Unfortunately, however, most courts do not say what "speculative" means, so they give themselves carte blanche to apply the wrongdoer rule or not as they see the equities of the case.

There is yet another version of the rule which simply says that doubts should be resolved against the wrongdoer.[125] This version comes closer to explaining what the courts are really doing, but it still doesn't say to whom it should apply nor does it distinguish among degrees of blameworthiness.

All of these versions of the wrongdoer rule are merely post hoc justifications of decisions reached on other grounds. What courts are actually doing, and what they should do, is take into account the defendant's blameworthiness as one of a number of factors in determining whether the lost profits have been proven with sufficient certainty.[126]

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[123] *See, e.g.,* Point Prods., A.G. v. Sony Music Entm't, Inc., 215 F. Supp. 2d 336, 346 n.5 (S.D.N.Y. 2002) ("the [wrongdoer] rule only applies when the only uncertainty is as to the amount of damages, rather than the existence of damages.").

[124] *See, e.g.,* Contemporary Mission, Inc. v. Famous Music Corp., 557 F.2d 918, 927 (2d Cir. 1977) (invoking wrongdoer rule to allow plaintiff to prove profits lost on account of defendant's failure to promote record, but not allowing proof of profits lost from concert tours because these were speculative).

[125] *E.g.*, MindGames, Inc. v. W. Publ'g Co., 218 F.3d 652, 658 (7th Cir. 2000) ("reasonable doubts as to remedy ought to be resolved against the wrongdoer"); Sir Speedy, Inc. v. L&P Graphics, Inc. 957 F.2d 1033, 1038 (2d Cir. 1992) ("doubts are generally resolved against the party in breach") (quoting RESTATEMENT (SECOND) OF CONTRACTS § 352 cmt. a. (1981)); Olympia Equip. Leasing Co. v. W. Union Tel. Co., 797 F.2d 370, 383 (7th Cir. 1986) ("doubts should be resolved against the wrongdoer"); *See also* Jones Motor Co. v. Holtkamp, Liese, Beckemeier & Childress, P.C., 197 F.3d 1190, 1194 (7th Cir. 1999) (legal malpractice opinion stating "reasonable doubts as to remedy ought to be resolved against the wrongdoer; but there are limits").

[126] There is a small minority of the wrongdoer rule cases that justify the application of the rule on the ground that the defendant has done something morally wrong, as opposed to merely having merely through inadvertence given rise to liability. *See, e.g.*, Tri-County Grain Terminal Co. v. Swift & Co., 254 N.E.2d 311, 316 (Ill. App. Ct. 1969) ("The more certain is the [wrongdoer] rule where a wrongdoer's acts appear to be deliberate or wilful."). In Native Alaskan Reclamation & Pest Control, Inc. v. United Bank Alaska, 685 P.2d 1211, 1222-23 (Alaska 1984), the Alaska Supreme court relied on a comment to the Restatement (Second) of Contracts, which states: "A court may take into account all the circumstances of the breach, including willfulness, in deciding whether to require a lesser degree of certainty, giving greater discretion to the trier of facts." RESTATEMENT (SECOND) CONTRACTS, § 352, cmt. a (1981).

Virginia presents a particularly interesting study in this regard, because Virginia has two distinct lines of cases. The opinions in the first line state very clearly that lost profits can be recovered only when the claimant can prove with reasonable certainty the amount of profits it lost. The opinions in the second line state weak versions of the wrongdoer rule and the fact and amount rule.

The majority of Virginia opinions on lost profits are in the first line, which dates from 1897 and extends through the present day.[127] These opinions state categorically that the amount of lost profits must be proven with reasonable certainty.[128]

The second line of Virginia opinions consists of opinions stating a wrongdoer rule, a fact and amount rule, or both.[129] This line of opinions contains far fewer opinions involving lost profits.[130] These opinions often say very clearly that it

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Another Alaska Supreme Court opinion noted that "[t]he policies of antitrust law favor a less stringent certainty requirement for lost profits than the contract law policy." Guard v. P & R Enters., Inc., 631 P.2d 1068, 1072 (Alaska 1981).

127 Banks v. Mario Indus. of Va., Inc., 650 S.E.2d 687, 696 (Va. 2007) (claimant "had the burden of proving with reasonable certainty the amount of damages"); Whitehead v. Cape Henry Syndicate, 68 S.E. 263, 264 (Va. 1910) (lost profits can be recovered only where amount can be ascertained with reasonable certainty); Burruss v. Hines, 26 S.E. 875, 877 (Va. 1897).

128 *See, e.g.,* Saks Fifth Ave., Inc. v. James, Ltd., 630 S.E.2d 304, 311 (Va. 2006) (claimant "had the burden of proving with reasonable certainty the amount of damages"); TechDyn Sys. Corp. v. Whittaker Corp., 427 S.E.2d 334, 339 (Va. 1993); ADC Fairways Corp. v. Johnmark Const., Inc., 343 S.E.2d 90, 93 (Va. 1986) (damages recoverable for loss of profits "only to the extent that the evidence affords a sufficient basis for estimating their amount in money with reasonable certainty"); Boggs v. Duncan 121 S.E.2d 359, 363 (Va. 1961); Atl. Coast Realty Co. v. Townsend, 98 S.E. 684, 690 (Va. 1919) (plaintiff is allowed to recover as lost profits "such amount as he can prove, with reasonable certainty").

129 *See, e.g.,* Worrie v. Boze, 95 S.E.2d 192, 200 (Va. 1956) (stating fact and amount rule in lost profits context); Jefferson Standard Life Ins. Co. v. Hedrick, 27 S.E.2d 198, 202-03 (Va. 1943) (invoking wrongdoer rule and fact and amount rule in suit for recovery of increased construction costs incurred because of fraud by defendant's agent); Kiser v. Amalgamated Clothing Workers of Am., 194 S.E. 727, 732-33 (Va. 1938) (invoking wrongdoer rule and fact vs. amount rule in suit for lost wages); Cauley v. Cauley, No. 1335-04-3, 2005 Va. App. LEXIS 150, at *5-6 (Va. Ct. App. Apr. 12, 2005) (stating both wrongdoer rule and fact vs. amount rule in action for damages against defendant who wrongfully removed ex-wife as pension beneficiary).

130 *See supra,* note 121, differentiating lost profits cases from cases involving other forms of damage. Virginia applies the same standards of proof to lost profits that it applies to other types of damages. Therefore lost profits opinions frequently rely on opinions involving other types of damages and vice

is proof with "absolute certainty" that the wrongdoer rule or the fact and amount rule make unnecessary, implying that reasonable certainty may still be required. [131] This allows them to be reconciled with the other line. Many of these opinions, as well as many opinions that state neither a wrongdoer nor a fact and amount rule, say that damages may be recovered when the evidence will permit "an intelligent and probable estimate" of the loss.[132] This means that the two lines of cases are entirely consistent if one is willing to accept "presenting evidence that will permit an intelligent and probable estimate of the lost profits" as the functional equivalent of "proving the amount of lost profits with reasonable certainty."

A few Virginia opinions, none involving lost profits, seem to treat the two standards as equivalent. In the seminal case, which is quoted or paraphrased in the later opinions, the Virginia Supreme Court said: "The burden was on the plaintiff to prove the elements of her damage with reasonable certainty. She was not required to prove with mathematical precision the exact sum she had lost, but having shown herself entitled to have damages from the defendant it was her duty to furnish evidence of sufficient facts or circumstances to permit at least an intelligent and

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versa. *See, e.g.,* In re Landbank Equity Corp., 83 B.R. 362, 374 (E.D. Va. 1987) (applying Virginia law and citing both lost profits case and non-lost profits case as authority for fact vs. amount rule in lost profits case).

131 *See, e.g.,* Worrie v. Boze, 95 S.E.2d 192, 200 (Va. 1956) (in lost profits cases, "absolute certainty" not required and plaintiff who has shown substantial injury not precluded from recovery because "exact amount" of damages not shown); *see also* Cauley v. Cauley, No 1335-04-3, 2005 Va. App. LEXIS 150, at *5-6 (Va. Ct. App. Apr. 12, 2005) (applying both wrongdoer rule and fact vs. amount rule and stating that "[d]amages must be proved with reasonable, but not absolute, certainty"); Simbeck, Inc. v. Dodd-Sisk Whitlock Corp., 44 Va. Cir. 54, 64 (Va. Cir. 1997)(lost profits case applying fact vs. amount rule and stating that "absolute certainty in proving [the] quantum [of lost profits] is not required").

132 *See, e.g.,* In re Landbank Equity Corp., 83 B.R. 362, 374 (E.D. Va. 1987) (stating fact and amount rule and quoted standard of proof): Estate of Taylor v. Flair Prop. Assoc., 448 S.E.2d 413, 414 (Va. 1994) Worrie v. Boze, 95 S.E.2d 192, 200 (Va. 1956); Jefferson Standard Life Ins. Co. v. Hedrick, 27 S.E.2d 198, 202-03 (Va. 1943) (stating fact vs. amount rule and quoted standard of proof); Cauley v. Cauley, No 1335-04-3, 2005 Va. App. LEXIS 150, at *5-6 (Va. Ct. App. Apr. 12, 2005) (stating wrongdoer rule and fact vs. amount rule as well as quoted standard of proof); Sterbutzel v. Trumbower, Chancery No. 149686, 2000 Va. Cir. LEXIS 149, at *5 (Va. Cir., June. 30, 2000) (stating fact vs. amount rule and quoted standard of proof); Simbeck, Inc. v. Dodd-Sisk Whitlock Corp., 44 Va. Cir. 54, 63-64 (Va. Cir. 1997) (stating fact vs. amount rule and quoted standard of proof).

probable estimate thereof."[133] As authority, the court cited two of its prior opinions, one that applied the reasonable certainty standard and one that applied the intelligent and probable estimate standard along with a fact vs. amount rule.[134]

One could argue that the standard of proof the Virginia courts require under the wrongdoer rule and under the fact and amount rule is equivalent to the reasonable certainty standard. These courts, however, still appear to choose which standard to articulate in their opinions based on the outcome of the case. In a comparison of ten randomly selected cases articulating the reasonable certainty standard with ten randomly selected cases articulating the fact and amount rule, the party claiming the damages prevailed in all ten of the cases in which the court articulated the fact and amount rule.[135] But in the ten cases in which the court

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[133] Gwaltney v. Reed, 84 S.E.2d 501, 502 (Va. 1954) (personal injury action involving lost earnings of injured nurse). *See also*, *e.g.*, Bulala v. Boyd, 389 s.E.2d 670, 677 (Va. 1999) (quoting *Gwaltney* in medical malpractice opinion); Barnes v. Graham Va. Quarries, Inc., 132 S.E.2d 395, 398-99 (Va. 1963 (quoting *Gwaltney* in property damage action); Gertler v. Bowling, 116 S.E.2d 268, 270 (Va. 1960) (paraphrasing *Gwaltney* in action to recover for damage to vehicle).

[134] *Gwaltney*, 84 S.E. 2d at 502 (citing Southern Ry. Co. v. Burton, 141 S.E. 113, 114 (Va. 1928)) (in action to recover for loss of apples during shipment plaintiff required to prove amount of damages with reasonable certainty). *See also* Jefferson Standard Ins. Co. v. Hedrick, 27 S.E.2d 198, 202 (Va. 1943).

[135] *See* In re Landbank Equity Corp., 83 B.R. 362, 374 (E.D. Va. 1987); MacDonald v. Winfield Corp., 93 F. Supp. 153, 161-62 (E.D. Pa. 1950) (construing Virginia law); Worrie v. Boze, 95 S.E.2d 192, 200 (Va. 1956) (stating fact and amount rule in lost profits context – damages proven with sufficient certainty); Jefferson Std. Life Ins. Co. v. Hedrick, 27 S.E.2d 198, 202-03 (Va. 1943) (invoking wrongdoer rule and fact vs. amount rule in suit for recovery of increased construction costs incurred because of fraud by defendant's agent); Wycoff Pipe & Creosoting Co. v. Saunders, 9 S.E.2d 318, 321 (Va. 1940) (invoking fact and amount rule – damages proven with sufficient certainty); Kiser v. Amalgamated Clothing Workers of Am., 194 S.E. 727, 732-33 (Va. 1938) (invoking wrongdoer rule and fact vs. amount rule in suit for lost wages—damages could be proven with sufficient certainty); Agostini v. Consolvo, 153 S.E. 676 , 680 (Va. 1920) (invoking fact and amount rule – damages proven with sufficient certainty); Manss-Owens Co. v. Owens & Son, 105 S.E. 543, 550 (Va. 1921) (invoking wrongdoer rule and fact and amount rule – damages proven with sufficient certainty); Cauley v. Cauley, No 1335-04-3, 2005 Va. App. LEXIS 150, at *5-7 (Va. Ct. App. Apr. 12, 2005) (stating both wrongdoer rule and fact vs. amount rule in action for damages against defendant who wrongfully removed ex-wife as pension beneficiary – damages proven with sufficient certainty); Sterbutzel v. Trumbower, Ch. No. 149686, 2000 Va. Cir. LEXIS 149, at *5 (Cir. Ct., June 30, 2000) (invoking fact and amount rule and holding damages proven with sufficient certainty); In re Landbank Equity Corp., 83 B.R. 362, 374 (E.D. Va. 1987) (applying Virginia law as authority for fact vs. amount rule – damages proven with sufficient certainty); MacDonald v. Winfield Corp., 93 F. Supp. 153, 161-62

articulated the reasonable certainty standard it prevailed in only three.[136] It seems clear that when courts were satisfied that the plaintiff's proof was sufficient, they justified their decisions with the fact and amount rule, and when they thought the proof was insufficient, they conveniently ignored the rule.

This does not mean that courts are reaching the wrong outcomes. They may well be using the indeterminacy of the existing rules to justify what are very reasonable outcomes. Professor McCormick approved this approach more than eighty years ago:

> [A]n examination of a large number of the cases, in which claims for lost profits are asserted, leaves one with a feeling that the vagueness and generality of the principles which are used as standards of judgment in this field, are by no means wholly to be regretted. It results in a flexibility in the working of the judicial process in these cases—a free play in the joints of the machine—which enables the judges to give due effect to certain "imponderables" not reducible to exact rule. This is apparent when one compares the different result

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(E.D. Pa. 1950) (applying Va. law as authority for fact and amount rule – damages proven with reasonable certainty).

136 Banks v. Mario Indus. of Va., Inc., 650 Va. 687, 696 (Va. 2007) (claimant "had the burden of proving with reasonable certainty the amount of damages"); Saks Fifth Ave., Inc. v. James Ltd., 630 S.E.2d 304, 311 (Va. 2006); Techdyn Sys. Corp. v. Whittaker Corp., 427 S.E.2d 334, 339 (Va. 1993) (damages recoverable for loss of profits "only to the extent that the evidence affords a sufficient basis for estimating their amount in money with reasonable certainty"--damages not proven with reasonable certainty); ADC Fairways Corp. v. Johnmark Constr., Inc., 343 S.E.2d 90, 93 (Va. 1986) (damages recoverable for loss of profits "only to the extent that the evidence affords a sufficient basis for estimating their amount in money with reasonable certainty"—damages not proven with reasonable certainty); Boggs v. Duncan 121 S.E.2d 359, 363 (Va. 1961) (damages recoverable for loss of profits "only to the extent that the evidence affords a sufficient basis for estimating their amount in money with reasonable certainty"—damages not proven with reasonable certainty); Atlantic Coast Realty Co. v. Townsend, 98 S.E. 684, 690 (Va. 1919) (plaintiff is allowed to recover as lost profits "such amount as he can prove with reasonable certainty"—damages proven with reasonable certainty); Whitehead v. Cape Henry Syndicate, 68 S.E. 263, 264 (Va. 1910) (lost profits can be recovered only where amount can be ascertained with reasonable certainty – damages not proven with reasonable certainty); Burruss v. Hines, 26 S.E. 875, 877 (Va. 1897) (lost profits can be recovered only where amount can be ascertained with reasonable certainty – damages proven with reasonable certainty).

> of the application of the same general formula of damages to cases where the defendant is a malicious or deliberate wrongdoer, from those cases where he is merely negligent or improvident.[137]

I agree with Professor McCormick. What I am advocating is not that courts change the way they are deciding cases, but rather that they stop hiding behind outdated rules and explain what they are really doing. Courts should continue to take moral fault into account, perhaps to an even greater extent than they are doing now, but they should explain how and why they are doing it. Rather than claiming to be bound by a rigid rule, courts should explain that the defendant's blameworthiness is a factor, among several, that is being considered in the determination that the damages have or have not been proven with reasonable certainty. The purpose of requiring that the plaintiff prove its damages with reasonable certainty is to protect honest businesses from inflated claims.[138] The tradeoff is that some honest plaintiffs will not be compensated for their losses. If the defendant has intentionally violated the antitrust laws or intentionally infringed the plaintiff's intellectual property, it should not get the benefit of a rule intended to protect honest businesses, particularly when that benefit comes with a cost to the injured plaintiff.

The test, however, should not be a formalistic yes/no test. The court should not say: "if the defendant did something morally wrong, the plaintiff can recover on minimal proof; if the defendant did not, the plaintiff's proof is subjected to stringent requirements." Rather, the court should consider the degree of the defendant's fault. A business whose vice president of sales intentionally violated her non-compete and went to work for its main competitor because she thought her old employer could not prove its damages should get more leeway in proving those damages than should a business suing a lower-level employee who legitimately thought his new work did not violate the non-compete. Where the defendant's wrong consisted of unknowingly passing on a defective product received from a supplier, the plaintiff should be given even less leeway.

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[137] Charles T. McCormick, *The Recovery of Damages for Loss of Expected Profits*, 7 N.C. L. REV. 235, 248 (1929).

[138] *See supra* notes 13-18 and accompanying text.

D. The Extent to Which the Plaintiff Has Produced the Best Available Evidence of Lost Profits

Many judicial opinions say all that is required to prove lost profits is that the plaintiff produce the best evidence available.[139] Others state the converse, saying that if the plaintiff has failed to produce the best evidence available, it has necessarily failed to prove its lost profits with reasonable certainty.[140]

Neither of these is a correct statement of the law. One can find numerous cases in which the plaintiff has produced the best available evidence and the court has denied recovery. The cases involving omitted advertisements and directory listings discussed above are examples.[141] Typically, when a court holds that a plaintiff has failed to prove its lost profits with reasonable certainty, its opinion never mentions the fact that the plaintiff presented the best available evidence of its loss. This reinforces the misapprehension that producing the best evidence one can guarantees a recovery.

Conversely, where the proof is solid, courts have been willing to hold that a plaintiff has proven its lost profits with reasonable certainty, even though the plaintiff could have (and should have) produced proof even better than that it did actually produce.[142] For instance, while it is universally acknowledged that a plaintiff

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[139] *See, e.g.,* Mid-America Tableware, Inc. v. Mogi Trading Co., 100 F.3d 1353, 1365 (7th Cir. 1996) ("If the best evidence of damage of which the situation admits is furnished, this is sufficient."); Oral-X Corp. v. Farnam Companies, Inc., 931 F.2d 667, 671 (best evidence available is sufficient) (10th Cir. 1991); Koehring Co. v. Hyde Const. Co., 178 So. 2d 838, 853 (Miss. 1965) (though plaintiff's proof "not entirely without fault," it was sufficient because it was the best reasonably obtainable under the circumstances).

[140] *See, e.g.,* Ice Corp. v. Hamilton Sunstrand Corp., 615 F. Supp. 2d 1256, 1261 (D. Kan. 2007) (stating that the court should require the claimant to furnish the best available proof of lost profits); United States *ex rel.* D&P Corp. v. Transamerica Ins. Co., 881 F. Supp. 1505, 1509 (D. Kan. 1995)("the claimant must furnish the best available proof as to the amount of loss that the particular situation warrants"); Graphic Directions, Inc. v. Bush, 844 P.2d 1190, 1196 (Colo. App. 1992) ("the claimant is obligated to offer the best proof available").

[141] *See supra* note 83 and accompanying text.

[142] *See, e.g.,* PRS Benefits LP v. Cent. Leasing Mgmt., Inc., No. 3:03-CV-1183-B, 2004 U.S. Dist LEXIS 24135, at *5-*6 (N.D. Tex. Nov. 29, 2004) (CPA's failure to verify data provided by health plan administrator could be dealt with by presenting evidence as to its lack of reliability); *In re* Tasch, Inc., No. 97-15901 JAB, 1999 U.S. Dist. LEXIS 12368, at *10-*11 (E.D. La. Aug. 5, 1999) (admitting testimony of expert as to profits lost on breach of contract for sandblasting and painting of semi-

can only recover the net profits it lost,[143] some courts have been willing to allow recovery under a reasonable certainty standard where the plaintiff's evidence pertains only to gross profits. This has generally been done where the cost savings attributable to the lost business would be relatively small.[144]

Courts taking this approach have usually avoided mentioning the fact that the plaintiff has failed to produce the best available evidence, so we have the one-sided situation where courts awarding damages when the plaintiff has produced the best available evidence often highlight that fact, while those awarding damages where the plaintiff has failed to produce the best evidence usually fail to mention in their opinions the deficiencies in the proof. In the same way, where the plaintiff has failed to prove its damages with reasonable certainty, the opinions often emphasize the fact that the plaintiff failed to present the best evidence possible.[145] But where the plaintiff has produced the best possible evidence and still failed to reach the level of reasonable certainty, the opinions generally ignore the fact that the plaintiff's evidence was the best it could be expected to gather.[146]

There are, however, some notable exceptions where courts have candidly admitted that lost profits had been proven with reasonable certainty even though

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submersible oil rig, in spite of admission expert "made no effort to verify the financial information provided by his client").

143 *See, e.g.,* Kuffel v. Seaside Oil Co., 90 Cal. Rptr. 209, 216 (Cal. Ct. App. 1970) ("It is fundamental that in awarding damages for the loss of profits, net profits, not gross profits, are the proper measure of recovery."(citations omitted)).

144 *See, e.g.,* Trabert & Hoffer, Inc. v. Piaget Watch Corp, 633 F.2d 477, 484 (7th Cir. 1980) (incremental costs of additional watch sales would be "nominal); Buono Sales, Inc. v. Chrysler Motors Corp., 449 F.2d 715, 719-20 (3d Cir. 1971) (breach did not significantly reduce overhead); Edwin K. Williams & Co. v. Edwin K. Williams & Co.- East, 542 F.2d 1053, 1062 (9th Cir. 1976) (breach did not significantly reduce overhead); Distillers Distrib. Corp. v. J.C. Millet Co., 310 F.2d 162, 164 (9th Cir. 1962). (plaintiff's controller testified that operating costs would not be substantially reduced because of lost business).

145 *See, e.g.*, Puckett Mach. Co. v. Edwards, 641 So. 2d 29, 37 (Miss. 1994) (reversing award of lost profits because plaintiff did not present best evidence available).

146 *See, e.g.,* Alphamed Pharm. v. Arriva Pharm., 432 F. Supp. 2d 1319, 1345-46 (S.D. Fla. 2006) (denying recovery because nature of plaintiff's business precluded estimating lost profits with reasonable certainty).

plaintiff's evidence was not the best available,[147] or that the damages had not been proven with reasonable certainty even though the plaintiff had produced the best evidence available. The Second Circuit's opinion in *Contemporary Mission, Inc. v. Famous Music Corp.*[148] provides an excellent example of a court upholding a lost profits award even though the plaintiff's evidence was flawed. The plaintiff had argued (and the jury later found) that the defendant had breached its contract by failing to adequately promote the plaintiff's records.[149] As evidence of the damages it suffered, the plaintiff attempted to introduce a statistical analysis that purported to show the success that one of the plaintiff's records would have enjoyed had the defendant promoted it properly.[150] The record had reached number 61 on the record charts, and the analysis showed that of the records that had reached number 61 on the charts that year, 76% had reached the top 40 and ten percent had reached number one.[151] The district court excluded the evidence because it failed to account for several key factors. The records that rose to number 61 quickly tended to be much more successful than those that rose slowly, as the plaintiff's record had done, and number 61 records by artists that had previous hit records (which the plaintiff's

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147 For instance, in De Koven Drug Co. v. First Nat'l Bank of Evergreen Park, 327 N.E.2d 378 (Ill. App. Ct. 1975) the plaintiff sued for the profits it lost on account of the defendant's breach of an agreement giving the plaintiff the exclusive right to sell liquor in the defendant's shopping center. *Id.* at 379. The plaintiff calculated its lost profits by claiming that the need to reduce prices to meet competition reduced its gross margin by 2.67% and applying that percentage reduction to its actual sales. *Id.* at 381. The court noted a number of weaknesses in the plaintiff's proof, pointing out that the plaintiff had not attempted to introduce evidence of any actual price reductions, that the plaintiff's expert assumed that there was an uptrend in the plaintiff's liquor sale, when in fact there was a downtrend, and that it ignored evidence that when the competition ceased, the plaintiff's sales went up but its gross margin on liquor sales actually declined. *Id.* The court nevertheless affirmed a judgment in an amount less than the plaintiff sought. *Id.* at 382. The small amount of the judgment ($5,000) was probably a factor. *See also* Malloy v. Monahan, 73 F.3d 1012, 1017 (10th Cir. 1996) (upholding verdict awarding lost profits even though "we do not endorse [the expert's projection] as a model calculation of lost profits"); Koehring Co. v. Hyde Constr. Co., 178 So. 2d 838 (Miss. 1965) (awarding lost profits even though "the method used in obtaining the measure of damages is not entirely without fault.").

148 557 F.2d 918, 926 (2d Cir. 1977).

149 *Id.* at 923-24.

150 *Id.* at 927.

151 *See id.* at 927.

artists did not) also had much greater success.[152] The Second Circuit, however, concluded that this exclusion was in error and that the deficiencies in the statistical study went to the weight of the evidence, rather than to its admissibility.[153] In effect, the court held that this admittedly-flawed study was sufficient to prove the plaintiff's damages.[154]

Another notable exception to the pattern of ignoring inconvenient facts is the opinion of the New York Court of Appeals in *Kenford Co. v. County of Erie*.[155] There, the intermediate court reversed an award of lost profits while admitting that the plaintiff had produced the best evidence possible.[156] On appeal, the New York Court of Appeals stated:

> The quantity of proof is massive and, unquestionably, represents business and industry's most advanced and sophisticated method of predicting the probable results of contemplated projects. Indeed, it is difficult to conclude what additional relevant proof could have been submitted by [the plaintiff] in support of its attempt to establish, with reasonable certainty, loss of prospective profits. Nevertheless, [the claimant's] proof is insufficient to meet the required standard.[157]

Most courts are not so forthright. They are reluctant to admit that there are many cases in which the lost profits are simply so speculative that it would be unfair to allow the claimant to go to the jury. Courts should candidly say that whether the plaintiff has produced the best available proof is an important factor. It can be

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[152] *See id.*

[153] *See id.*

[154] If the study had been admitted, the plaintiff was prepared to offer evidence of the amount of revenue that was lost on account of the plaintiff's failure to promote the record. *See id.* at 927-28. The Second Circuit opinion noted that on remand the district court might still exclude the study under the Federal Rules of Evidence on the ground that it was more prejudicial than probative, but he could not exclude it on the ground that New York substantive law rendered it speculative. *See id.* at 928 n.17.

[155] 493 N.E.2d 234 (N.Y. 1986).

[156] *See* Kenford Co. v. County of Erie, 489 N.Y.S.2d 939, 942 (App. Div. 1985). This court reversed a $25 million damage award made after a trial, limited to the issue of damages, which lasted nine months and generated 25,000 pages of transcript.

[157] *Kenford*, 493 N.E.2d at 236.

decisive in close cases, but standing alone, it is insufficient to ruin a strong case or save a weak one.

E. The Amount at Stake

Only a few courts have said so explicitly,[158] but even a cursory reading of the published opinions makes it clear that the more the plaintiff is claiming in damages, the higher the standard of proof to which the court will hold it.[159] This is as it should be. Not only is it unfair to require a plaintiff seeking a relatively small amount to hire expensive experts to prove its lost profits, but factoring the size of the potential liability into the certainty equation also furthers the goal of preventing lost profits claims from being a drag on the economy. It is the cases where a weak claim results in a large verdict that make businesses think twice before entering into deals, not those where the recovery is small.

There is an easily discernible pattern among the cases. The more money at stake, the more proof the court will normally require before holding that the damages were proven with reasonable certainty. Where the amount at stake is very small, courts will sometimes accept unsupported estimates made by the owners of the plaintiff business.[160] When the damage claim becomes at all substantial, the courts not only refuse to accept such unsupported estimates, but they make statements that, if taken at face value, would be rules that unsupported estimates are

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158 *See* Sw. Stainless, LP v. Sappington, 582 F.3d 1176, 1185-86 (10th Cir. 2009) (what is sufficient certainty for proof of lost profits "can depend on the amount at stake."); Manouchehri v. Heim, 941 P.2d 978, 984 (N.M. Ct. App. 1997) (evidence necessary "in a suit for a million dollars may be an excessive burden for a small claim").

159 *See infra*, notes 152-65 and accompanying text.

But even in the smallest cases, some reasonable evidence of the lost profits must be introduced. *See, e.g.,* Dowling Supply & Equip., Inc. v. City of Anchorage, 490 P.2d 907, 909 (Alaska 1971) (conclusory oral testimony insufficient to support award of $2,416).

160 *See, e.g.,* Aywon Film Corp. v. Hatch, 126 A. 637, 638 (N.J. 1924) (affirming award of $956.68 in lost profits based solely on estimate of theater owner); Husky Spray Serv., Inc. v. Patzer, 471 N.W.2d 146, 150-51 (S.D. 1991) (affirming award of $4,300 for lost profits on owner's unsupported projections of crop-dusting job lost); Leoni v. Bemis Co., Inc, 255 N.W.2d 824, 826-27 (Minn. 1977) (damages of $75,500 based on owner's unsupported estimates).

per se insufficient to prove damages.[161] As the size of the claim continues to grow, the amount of support needed for the estimates increases along with it.

We can best see this pattern if we compare cases that use particular methods of proof and if we compare cases in particular jurisdictions. For example, where the claimant tries to prove its damages through the before-and-after method and the amount at stake is very small, a court may very well be willing to accept the business owner's unsupported testimony as to the amounts of profits before and after.[162] As the size of the claim grows, courts will quickly demand documentation of the profits.[163] When the claim becomes more substantial, courts will demand that this documentation be verified by CPAs or similar professionals,[164] and when the claims get very large, courts will typically demand that the plaintiff's proof go beyond merely showing that there was a difference in profits during the before and after periods. They will typically demand that expert witnesses with a background in economics account for or explain away any factors other than the defendant's actions which might have caused the differential.[165]

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161 *See, e.g.,* Cent. Coal & Coke Co. v. Hartman, 111 F. 96, 98-100 (8th Cir. 1901) (refusing to accept owner's estimate of $2,500 in lost profits); New Amsterdam Cas. Co. v. Util. Battery Mfg. Co., 166 So. 856, 859-60 (Fla. 1935) (owner's estimate inadmissible to prove lost profits).

162 *See, e.g.*, Uganski v. Little Giant Crane & Shovel, Inc., 192 N.W.2d 580, 590-91 (Mich. Ct. App. 1971) (owner could testify net profits were between $15,000 and $16,000 per year).

163 *See, e.g.,* Hillstrom v. McDonald's Corp., 746 P.2d 222, 225 (Ore. Ct. App. 1987) (expert witness testified as to decline in profits when franchisor in breach).

164 *See* Tyler J. Bowles & W. Cris Lewis, *A Note on the Credibility of Financial Data Used in Lost-Profit Appraisals*, Litigation Economics Digest, 51, (Spring 2006), *available at* http://www.nafe.net/assets/files/resources/ler_articles/l1_2_5.pdf

165 *See, e.g.,* Nat'l Papaya Co. v. Domain Indus., Inc., 592 F.2d 813 (5th Cir. 1979) (vacating $250,000 award because experts failed to rule out other causes of decline in profits); Children's Broadcasting Corp. v. Walt Disney Co., 245 F.3d 1008, 1018 (8th Cir. 2001) (trial court could grant new trial where damages expert failed to consider effect of competition); Blue Dane Simmental Corp. v. Am. Simmental Ass'n, 178 F.3d 1035,1040-41 (8th Cir.1999) (court did not abuse discretion by excluding testimony of damages expert who failed to exclude other causes of loss); Water Craft Mgmt. v. Mercury Marine, 638 F. Supp. 2d 619, 623-24 (M.D. La. 2009); (stating that proof of future lost profits "is difficult without expert testimony"); *cf. Hillstrom*746 P.2d at225 (Or. Ct. App. 1987) (upholding $47,000 verdict in spite of expert's failure to rule out other causes for decline in profits). *But see* R.A. Jones & Sons, Inc. v. Holman, 470 So. 2d 60, 71-72 (Fla. Dist. Ct. App. 1985) (upholding $250,000 lost profits award on ground that defendant had burden to show part of loss attributable to other causes).

Opinions from the courts of Louisiana show how courts will state seemingly clear and dispositive rules concerning the proof required and then deviate from them when a small amount in controversy requires it. In a case involving a lost profits award of approximately $9,000,000, the Louisiana Court of Appeals said: "A claim for lost profits based solely on the testimony of the injured party and unsubstantiated by other evidence does not constitute reasonable certainty."[166] The United States District Court for the Eastern District of Louisiana quoted this statement when rejecting a claim for lost profits in excess of $400,000.[167] But where a business that had obviously suffered some lost profits was awarded $2,800 in lost profits solely on the basis of the owner's testimony, a different panel of the Louisiana Court of Appeals created a contrary rule: "[T]he amount of lost profits need not be proved with mathematical certainty, but by such proof as reasonably establishes the claim, *and such proof may consist only of the plaintiff's own testimony.* Reasonable certainty is the standard."[168]

We can see a similar progression in cases in which the plaintiff attempts to prove lost profits by showing the defendant's actions caused customers to desert it. Where the amount is small, courts will accept anecdotal evidence of customer dissatisfaction as satisfying the reasonable certainty requirement, but as the amounts at stake get larger, courts require surveys conducted in accordance with recognized sampling techniques.[169]

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166 New Orleans Riverwalk Assocs. v. Robert P. Guastella Equities, Inc., 664 So. 2d 151, 157 (La. Ct. App. 1995).

167 Toga Soc'y, Inc. v. Lee, No. 03-2981, 2005 U.S. Dist. LEXIS 13408, at *10 (E.D. La. Jun. 29, 2005) (quoting *New Orleans Riverwalk Assocs.*, 664 So. 2d at 157); *see also* Towing & Recovery Prof'l of La. Trust v. Swift Transp. Co., No. 08:1685C/W08-3152 and 08-3691, 2009 U.S. Dist. LEXIS 48419, at *6-*7(E.D. La. June 8, 2009) (quoting same statement in dictum).

168 Kevin's Rest., LLC v. Fire Tech, Inc., No. 2006 CA 0299, 2006 WL 3813696, 38, at *4 (La. Ct. App. Dec. 28, 2006) (emphasis added). The Court of Appeals increased the damage award from $2,800 to $3,600. *See id.* at *5.

169 *See* Great Pines Water Co. v. Liqui-Box Corp., 203 F.3d 920, 924 (5th Cir. 2000) (surveys of lost customers excluded because not conducted in accordance with accepted techniques); Upjohn Co. v. Rachelle Labs., Inc., 661 F.2d 1105, 1114 (6th Cir. 1981) (allowing reliance on surveys made by experienced personnel); Lanphere Enters., Inc. v. Jiffy Lube Int'l, Inc., CV 01-1168-BR, 2003 U.S. Dist. LEXIS 16205, at *18-*47 (D. Ore., Jul. 9, 2003) (excluding improperly conducted customer survey); Albert v. Warner-Lambert Co., 234 F. Supp. 2d 101, 105-07 (2002) (rejecting survey of potential customers where sample size too small and inexperienced person conducted survey).

The whole issue was summed up very nicely in a case in which a physician was allowed to recover $2,500 for the profits he lost because a used x-ray machine he purchased failed to perform as warranted.[170] The plaintiff's proof of his damages consisted of his own testimony "that taking an x-ray would cost him from three to six dollars and [that] he would charge 'about $85 to $88' for taking and reading" each one. He claimed that the failure of the machine to perform as warranted resulted in his charging for at least 30 x-rays a month, but offered no documentation to support this estimate.[171] When the defendant claimed the plaintiff had not proven his damages with reasonable certainty, the court said:

> [The defendant] argues that the evidence of lost profits was not certain enough. We disagree. We recognize that when it is *possible* to present accurate evidence on the amount of damages, the party upon whom the burden rests to prove damages must present such evidence. This requirement must be understood, however, in the context of the amount at stake. What it is "possible" to present in a suit for a million dollars may be an excessive burden for a small claim. Although [the plaintiff's] evidence was minimal, it was adequate in the circumstances. The absences of detail and documentary corroboration detracted from the weight of the testimony, but the district court could still find it sufficiently credible to support the $2,500 award.[172]

F. Whether There is an Alternative Method of Compensating the Injured Party

Whether they say so or not, courts deciding the reasonable certainty question undoubtedly consider the availability of alternative measures of damages. If the court decides damages have not been proven with reasonable certainty, is there another measure of damages that give some measure of compensation for the loss? It is much easier for a court to decide that a plaintiff's optimistic (but not demonstrably unrealistic) projections, supported by questionable (but not demonstrably false) assumptions, fail to meet the reasonable certainty test when the plaintiff can still go home with something that approaches fair compensation.

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[170] Manouchehri v. Heim, 941 P.2d 978 (N.M. 1997).

[171] *See id.* at 982.

[172] *Id.* at 984 (internal quotations and citations omitted).

There are several alternative methods that courts can use to award damages when the plaintiff has not proven its lost profits with reasonable certainty. One common alternative, and certainly one that is favorable to plaintiffs, is to allow the plaintiff to recover the loss in the value of its business resulting from the defendant's breach.[173] The classic case taking this approach is *Schonfeld v. Hilliard*.[174] The defendants breached an agreement to provide funding for a cable television network that would broadcast British Broadcasting Corporation (BBC) news programming in the United States.[175] Noting that the plaintiff's projections were based on a "seemingly endless list of assumptions," the court held that he could not prove with reasonable certainty how much, if any, profits he had lost.[176] The court nevertheless remanded the case with instructions to allow the plaintiff to attempt to prove the market value the business would have had if the defendants had performed their contractual obligations.[177] Noting that there was considerable evidence of this value because of prior negotiations among the parties and with third parties, the court said that the plaintiff "ought to be able to establish with reasonable certainty" the value the business would have had if the defendants had performed.[178]

Because the market value of the asset lost or damaged can often, as in *Schonfeld*, be based on actual offers made by real people backing their offers with their own (or at least their shareholders') money,[179] lost asset value is often a superior method of determining the plaintiff's loss. Lost asset value is the equivalent of lost profits because, as many courts have noted, the value of an asset is simply the present value of the future profits to be earned by that asset.[180] Lost asset value takes

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173 *See, e.g.*, Bessemer Trust Co. v. Branin, 544 F. Supp. 2d 385, 390 (S.D.N.Y. 2008) (rejecting lost profits estimation in favor of lost asset value).

174 218 F.3d 164 (2d Cir. 2000).

175 *Id.* at 167-71.

176 *Id.* at 173.

177 *Id.* at 184-85.

178 *Id.* at 183.

179 *See id.* at 169 (potential buyer offered $1.7 million cash plus 5% equity interest in venture for the contract rights in dispute).

180 *See, e.g.,* First Fed. Lincoln Bank v. United States, 518 F.3d 1308, 1317 (Fed. Cir. 2008) ("The market value of income-generating property reflects the market's estimate of the present value of the chance to earn future income, discounted by the market's view of the lower future value of the income and the uncertainty of the occurrence and amount of any future property."); Eateries, Inc. v.

into account the uncertainty of future profits; something courts projecting future profits often do a poor job of.[181] The Court of Federal Claims recently noted:

> The market value of income-producing property at the time the property is lost properly reflects the uncertainty that the expected stream of future profits will actually materialize, and . . . an award of actual lost profits, stemming as it does from a stream of profits that actually did materialize, improperly ignores such uncertainty.[182]

Some courts have even gone so far as to say that where it is feasible, determining the lost asset value is preferable to determining the lost profits directly.[183] Even if a court does not believe that a lost asset approach is preferable as a general principle, the fact that there is evidence from which the lost asset value can be determined would be a reason for a court to hold, in a close case at least, that the proffered estimate of the stream of profits to be earned in the future fails to meet the reasonable certainty standard, thus forcing the claimant to use the lost asset value approach.

J.R. Simplot Co., 346 F.3d 1225, 1236 (10th Cir. 2003) ("Fair market value '*necessarily* incorporate[s] expected future profits.'") (emphasis in original, citations omitted); Holland v. United States, 83 Fed. Cl. 507, 514 (2008) (market value reflects market's estimate of future profits, discounted to present value).

[181] *See* Robert M. Lloyd, *Discounting Lost Profits in Business Litigation: What Every Lawyer and Judge Needs to Know,* 9 TENN. J. BUS. L. 9, 49 (2007); *see also* Schonfeld v. Hilliard, 218 F.3d 164, 177 ("The market value of an income-producing asset is inherently less speculative than lost profits because it is determined at a single point in time. It represents what a buyer is willing to pay for *the chance* to earn the speculative profits.").

[182] *Holland*, 83 Fed. Cl. at 514 (2008); *see also* Mann v. United States, 86 Fed. Cl. 649, 664 (2009) ("If the asset were already producing income, or had an ascertainable market value, the preferred approach to valuing the profits lost due to breach would be to determine the market value on the date of the breach. Under this approach, the evaluation of the potential risks is performed by the participants in the market, and the market value is set by their expectations of profits, capitalized and discounted accordingly" (citations and internal quotations omitted)).

[183] *See, e.g.*, *Schonfeld*, 218 F.3d at 176 (2d Cir. 2000) (lost asset value "is the most accurate and immediate measure of damages"); Bessemer Trust Co.v. Branin, 544 F. Supp. 2d 385, 390 (S.D.N.Y. 2008) (same). *But see* Anchor Sav. Bank v. United States, Nos. 2008-5157 & 2008-5182, 2010 U.S. App. LEXIS 5009, at * 38 (Fed. Cir., Mar. 10, 2010) (trial court did not abuse discretion where it determined lost profits was more accurate measure of damages than lost asset value).

Courts can also use the rental value or use value of the assets in question as a measure of compensation.[184] In the eighteenth century and early nineteenth century, American courts often awarded as damages the rental value or the use value of property instead of the profits that could have been earned from that property.[185] For example, in a case bearing an eerie similarity to *Hadley v. Baxendale*, a cotton gin was shut down because a railroad misplaced a pin that was being sent off for repairs.[186] Unlike the famous ambiguity in the *Hadley* opinion, there was no question that the ginner had told the railroad agent "that his ginnery 'would be at a standstill' until the pin should be repaired and returned."[187] In spite of this, the railroad lost the pin and the gin was shut down for seven days.[188] The ginner's evidence as to his lost profits was shaky, but the trial court nevertheless instructed the jury they could award lost profits.[189] The Alabama Supreme Court reversed, holding that the proper measure of damages was the rental value of the gin for the time it was out of operation.[190] In other cases, courts held that where the defendant wrongfully deprived the plaintiff of the use of a boat, the measure of damages was the rental value of the boat, not the profits the plaintiff would have earned from the use of the boat.[191]

Although the reasoning of these opinions was not uniform, some of the opinions awarded the use value because the use value could be proven with more certainty than could the profits that would have been earned. In other opinions it was clearly a secondary measure of recovery when lost profits could not be

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184 *See* JOHN EDWARD MURRAY, JR., MURRAY ON CONTRACTS § 121 at 796 (4th ed. 2001).

185 *See, e.g.,* City of Chicago v. Huenerbein, 85 Ill. 594, 595-96 (Ill. 1877) (awarding rental value of land flooded by city rather than profits that would have been earned farming the land)*; see also* Howe Mach. Co. v. Bryson, 44 Iowa 159, 162-64 (Iowa 1876) (awarding sales agent the value of his time, rather than profits he could have earned during that time).

186 S. Ry. Co. v. Coleman, 44 So. 837 (Ala. 1907).

187 *Id.* at 838.

188 *Id.*

189 *See id.* at 839.

190 *Id.*

191 Aber v. Bratton, 27 N.W. 564, 566 (Mich. 1886).

recovered, because they could not be proven with reasonable certainty, because they were not foreseeable, or for some other reason.[192]

Where the lost profits were caused by the breach of a contract the court may award the injured party the amount expended in reliance on the contract. While this often seems like chump change in relation to the profits the injured party hoped to get from the venture,[193] there are cases in which the reliance damages are significant indeed. In a suit against the federal government, one plaintiff recovered more than $200 million in reliance damages.[194] Moreover, even when the reliance damages are small, economic theory suggests that they will often be quite adequate as compensation. Unless the plaintiff has some idea that will allow it to command economic rent, the income from a business will be the value of the economic inputs to that business, including, of course, the value of the time and effort the principals invest in the business.[195] Thus, the future profits of a business (discounted, as they always must be to present value) will typically be equal to the value of the inputs already made into the business (with, of course, a reasonable rate of return), together with the inputs to be made in the future (discounted to present value).[196] There are, of course, businesses that earn much more than these reasonable rates of return, but they are few and far between.[197] Courts are, and should be, leery of holding that

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192 *See, e.g.,* Hunt v. Or. Pac. Ry. Co., 36 F. 481, 483 (D. Or. 1888) (plaintiff given opportunity to prove use value of railroad where lost profits not provable with reasonable certainty).

193 *See, e.g.,* Chi. Coliseum Club v. Dempsey, 265 Ill. App. 542, 549-54 (1932) (promoter of heavyweight championship boxing match limited to recovery of minor expenses).

194 Westfed Holdings, Inc. v. United States, 407 F.3d 1352 (Fed. Cir. 2005) (affirming award of more than $200 million in reliance damages).

195 *See, e.g.,* PAUL ANTHONY SAMUELSON, FOUNDATIONS OF ECONOMIC ANALYSIS 83 (1947); GEORGE J. STIGLER, THE THEORY OF PRICE 157-60 (4th ed. 1987) (describing variable returns to scale); Olympia Equip. Leasing Co. v. W. Union Tel. Co., 797 F.2d 370, 383 (7th Cir. 1986) (whenever there is a large profit, competition drives prices down to cost of inputs); Coleman Motor Co. v. Chrysler Corp., 525 F.2d 1338, 1351 n.22 (3d Cir. 1975) (discussing the need to consider owner salary).

196 *See* Magnus Henrekson, *Entrepreneurship and Institutions*, 28 COMP. LAB. L. & POL'Y, 717, 725-29 (2007) (discussing entrepreneurial rent seeking); RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 9 (7th ed. 2007) (revenues in excess of opportunity costs of inputs "are earned only by the owners of resources that cannot be augmented rapidly and at low cost to meet an increased demand for the goods they are used to produce").

197 *See, e.g.,* Am. Bearing Co. v. Litton Indus., 540 F. Supp. 1163, 1174 (E.D. Pa. 1982) (testimony of economist excluded because it failed to account for fact that high profits would attract competitors).

optimistic entrepreneurs have proven with reasonable certainty that they have one of those rare ideas that, but for the actions of the breaching party, would have allowed them to get one of these unusually high rates of return.[198] Thus, reliance damages will often be a reasonable approximation, and in many instances a more reasonable approximation than the plaintiff's rosy predictions, of the profits that would have been earned.

There are, of course, serious problems in limiting plaintiffs who have been injured by contract breaches to reliance damages. Reliance damages often fail to include inputs like entrepreneurial time, energy, expertise, and inspiration, things that would be well rewarded in the market. Nevertheless, damages measured by the amount the plaintiff has already spent on the venture will often give a measure of recovery that is superior to a questionable estimate of lost profits, and the possibility of such an alternative is something a court should take into consideration when deciding whether to award lost profits.

III. REPLACING RULES WITH A STANDARD

As we have seen, the courts have created a body of rules that can only be described as confusing and inconsistent. They are rationalizing their decisions with outdated rules when in actuality they are engaging in a much more sophisticated analysis, considering a number of factors, the relative importance of which varies according to the circumstances. They are applying a flexible standard.

Judge Posner explained the difference between rules and standards:

> A rule singles out one or a few facts and makes it or them conclusive of legal liability; a standard permits consideration of all or at least most facts that are relevant to the standard's rationale. A speed limit is a rule; negligence is a standard. Rules have the advantage of being definite and of limiting factual inquiry but the disadvantage of being inflexible, even arbitrary. . . . Standards are flexible, but vague and open-ended; they make business planning difficult, invite the sometimes unpredictable exercise of judicial discretion and are more costly to adjudicate—and yet when based on lay intuition they may

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198 *See* Olympia Equip. Leasing Co. v. W. Union Tel. Co., 797 F.2d 370, 383 (7th Cir. 1986) (whenever there is a large profit, competition drives prices down to cost of inputs); *see also* Schonfeld v. Hilliard, 218 F.3d 164, 173 (2d Cir. 2000) (noting that "the enterpreneur's cheerful prognostications are not enough" to prove lost profits with reasonable certainty) (citation and internal quotation omitted).

> actually be more intelligible, and thus in a sense clearer and more precise, to the persons whose behavior they seek to guide than rules would be. No sensible person supposes that rules are always superior to standards, or vice versa, though some judges are drawn to the definiteness of rules and others to the flexibility of standards.[199]

It is now time for courts to explain clearly what they are doing. If a court decides that a claimant has or has not proven its lost profits with reasonable certainty, the court should not cite a rigid rule that purports to leave the court no discretion. Instead, the court should list all the factors that went into its decision and explain why in this case these factors outweighed the factors that pointed to the opposite result.

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[199] MindGames, Inc. v. Western Publ'g Co., 218 F.3d 652, 657 (7th Cir. 2000) (Posner, J.).