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Minn. _____, 255 N.W.2d 824 (1977)

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dards for each case, have indicated a willingness to involve both levels of courts in the development of substantive environmental quality standards. In assuming an active role in the area, the supreme court would be wise to consider further development of the trial court's role in cases under MERA, particularly in resolving the issue of when the *White Bear* balancing test should be applied.

Remedies—DAMAGES FOR LOST PROFITS OF AN UNESTABLISHED BUSINESS—*Leoni v. Bemis Co.*, ___ Minn. ___, 255 N.W.2d 824 (1977).

A growing acceptance of present day business methods of predicting future profitability¹ has resulted in a substantial liberalization of the former general rule that damages could not be recovered for the lost profits of an unestablished business.² This denial of recovery is based on the doctrine of certainty; damages for breach of contract cannot be speculative, remote, or conjectural.³ Originally, even the lost profits of an established business were considered inherently too uncertain to be awarded in either a tort or contract action.⁴ Courts began to modify this absolute exclusion by stating that lost profits could be recovered if three prerequisites were satisfied: the loss was caused by the breach,⁵

1. See generally C. ALMON, *AMERICAN ECONOMY TO 1975* (1966); Denning, *New Look at Business Forecasts*, 64 *NATION'S BUS.* 48 (1976); Wheelwright & Clarke, *Corporate forecasting: promise and reality*, 54 *HARV. BUS. REV.* 40 (1976).

The *RESTATEMENT OF CONTRACTS* § 331, Comment b (1932) defines profits as "the net pecuniary gain from a transaction, the gross pecuniary gains diminished by the cost of obtaining them." See *King Features Syndicate v. Courier*, 241 Iowa 870, 882, 43 N.W.2d 718, 726 (1950). See also *Swaney v. Derragon*, 281 Mich. 142, 143-44, 274 N.W. 741, 741 (1937).

2. Formerly, damages could not be recovered for any loss of profits, even though the business was established. *W. HALE & R. COOLEY, HANDBOOK ON THE LAW OF DAMAGES* § 32 (2d ed. 1912). Exceptions to the complete denial rule began to appear in the mid-nineteenth century. See, e.g., *Masterton v. Mayor of Brooklyn*, 7 Hill 61, 72 (N.Y. Sup. Ct. 1845) (profits directly attributable to contract, but not profits from further transactions with third parties, held recoverable); cf. *Village of Elbow Lake v. Otter Tail Power Co.*, 281 Minn. 43, 46, 160 N.W.2d 571, 574 (1968) (recognizing unestablished business rule). See also D. DOBBS, *HANDBOOK ON THE LAW OF REMEDIES* § 3.3 (1973).

3. See, e.g., *Hornblower & Weeks-Hemphill Noyes v. Lazere*, 301 Minn. 462, 467, 222 N.W.2d 799, 803 (1974); *Olson v. Naymark*, 177 Minn. 383, 384, 225 N.W. 275, 275 (1929); Note, *Damages—Loss of Profits Caused by Breach of Contract—Proof of Certainty*, 17 *MINN. L. REV.* 194 (1933).

4. See R. BAUER, *ESSENTIALS OF THE LAW OF DAMAGES* § 75, at 160 n.1 (1919). See also *Allison v. Chandler*, 11 Mich. 542, 551 (1863) (allowance of profits as damages less limited in tort action than in breach of contract action).

5. The requirement of causation is outside the scope of this comment. The Minnesota Supreme Court has recognized, however, the causation requirement. See *Faust v. Parrott*, 270 N.W.2d 117 (Minn. 1978) (in breach of noncompete clause action, plaintiff's lost profits must be caused by breach; possibility of poor management, market changes, and change of business name to be considered as possible alternative causes); *Northern Petro-*

the loss was foreseeable,⁶ and the amount of the loss could be proved with sufficient certainty.⁷ This modification of a formerly per se exclusion has helped those claimants with an established business and a history of past profits.⁸ Even today, however, an established business frequently has difficulty recovering profits lost as the result of a breach of contract. With no past profits to serve as a basis for calculating the award with reasonable certainty,⁹ an unestablished business is faced with often insurmountable proof problems. In *Leoni v. Bemis Co.*,¹⁰ the requisite quantum of proof was met: the Minnesota Supreme Court held that the plaintiff had proved a loss of prospective profits¹¹ with sufficient certainty to be entitled to recovery.¹²

The plaintiff in *Leoni* had produced and sold peat moss in approximately three-fourths of the United States for thirteen years. For his initial venture into the California market in 1971, the plaintiff purchased plastic bags from the defendant. Because the plastic bags lacked an ultraviolet ray inhibitor, the bags containing the peat moss disintegrated when stored outdoors in the California sun. The defect in the bags made the peat moss unsalable, preventing the plaintiff from profiting in California as he had nationally. In the resulting breach of contract action, the jury awarded damages for the loss of profits incurred on the initial California contracts because of the defective bags. This award was not disputed by the defendant.¹³ When the jury also awarded dam-

chem. Co. v. Thorsen & Thorshov, Inc., 297 Minn. 118, 124, 211 N.W.2d 159, 166 (1973) (recovery of lost profits for period in which occupancy of new building delayed because of defective design; loss direct and proximate result of injury); Note, *Lost Profits as Contract Damages: Problems of Proof and Limitations on Recovery*, 65 YALE L.J. 992, 997 (1956).

6. "The damages must be such as may fairly be supposed to have entered into the contemplation of the parties when they made the contract, that is, must be such as might naturally be expected to follow its violation." Griffin v. Colver, 16 N.Y. 489, 494-95 (1858). This is an application of the rule of Hadley v. Baxendale, 156 Eng. Rep. 145 (Ex. 1854). See Paine v. Sherwood, 19 Minn. 315 (1873); McCormick, *The Contemplation Rule as a Limitation Upon Damages for Breach of Contract*, 19 MINN. L. REV. 497, 499-504 (1935).

7. Absolute certainty is not required. See Vogue v. Shopping Centers, Inc., 58 Mich. App. 421, 228 N.W.2d 403 (1975) (business failed to meet burden of proof that lost profits must be shown with reasonable certainty); Northern Petrochem. Co. v. Thorsen & Thorshov, Inc., 297 Minn. 118, 125, 211 N.W.2d 159, 166 (1973); McCormick, *The Recovery of Damages for Loss of Expected Profits*, 7 N.C. L. REV. 235, 238-39 (1929). See generally RESTATEMENT OF CONTRACTS § 311 (1932).

8. See, e.g., Hendrickson v. Grengs, 237 Minn. 196, 54 N.W.2d 105 (1952); Force Bros. v. Gottwald, 149 Minn. 268, 183 N.W. 356 (1921); Pappas v. Stark, 123 Minn. 81, 142 N.W. 1046 (1913); Johnson v. Wild Rice Boom Co., 118 Minn. 24, 136 N.W. 262 (1912); cf. Ellis v. Lindmark, 177 Minn. 390, 396-97, 225 N.W. 395, 397 (1929) (recovery justified because plaintiff's business "had been established for several years").

9. See note 7 *supra* and accompanying text.

10. ___ Minn. ___, 255 N.W.2d 824 (1977).

11. The court alternately referred to the profits as prospective profits, future profits, and profits. See *id.* at ___, 255 N.W.2d at 826.

12. See *id.* at ___, 255 N.W.2d at 826-27.

13. The defendant did not dispute the propriety of the following awards: \$7,499.30 for

ages for loss of anticipated profits, the trial court granted the defendant's motion for a new trial,¹⁴ ruling that it had erred in permitting the award of lost profits because the plaintiff's California business was unestablished. Holding that the plaintiff had proved his loss of future profits with the requisite certainty, the Minnesota Supreme Court reversed the order for a new trial and remanded the case with instructions to reinstate the jury's verdict.¹⁵

In denying the existence of a per se unestablished business rule¹⁶ in Minnesota, the Minnesota Supreme Court recognized a more flexible form of the rule.¹⁷ Although the per se unestablished business rule automatically denies recovery of profits by a new or unestablished business,¹⁸ Minnesota's more flexible version of the rule is concerned with the evidentiary basis for the award.¹⁹ The court stated that an unestablished business possibly could recover future profits, although, admittedly, an unestablished business does not have the benefit of a history of profits.²⁰ The denial of future profits to new businesses will frequently occur because "lacking a history of profits, new businesses rarely have evidence upon which an award of damages may be based with the requisite

loss of profits on the initial California contracts the plaintiff breached, \$4500 for market promotion, \$2400 for defective bags, \$3000 to salvage the market, \$4500 for the failure to return plaintiff's name plates in good condition. *Id.* at ____, 255 N.W.2d at 825-26 n.2.

14. *Id.* at ____, 255 N.W.2d at 825. The court conditioned the new trial on the plaintiff's nonacceptance of a remittitur of the jury award for loss of future profits. *Id.*

15. *Id.*

16. Although the rule is often called a "new business rule" by the courts and commentators, the term "unestablished business rule" is more inclusive and thus more accurate.

17. The court stated, "although the law recognizes that it is more difficult to prove loss of prospective profits to a new business than to an established one, the law does not hold that it may not be done." ____, Minn. at ____, 255 N.W.2d at 826.

18. The unestablished business rule simply states that an unestablished business cannot recover lost profits for breach of contract because the loss cannot be proved with the requisite certainty. See Comment, *Remedies—Lost Profits for Contract Damages for an Unestablished Business: The New Business Rule Becomes Outdated*, 56 N.C. L. Rev. 693, 693 (1978).

The Eighth Circuit explained:

[A]nticipated profits of a business are generally so dependent upon numerous and uncertain contingencies that their amount is not susceptible of proof with any reasonable degree of certainty; hence the general rule that the expected profits of a commercial business are too remote, speculative and uncertain to warrant a judgment He who is prevented from embarking in a new business can recover no profits, because there are no provable data of past business from which the fact that anticipated profits would have been realized can be legally deduced.

Central Coal & Coke Co. v. Hartman, 111 F. 96, 98-99 (8th Cir. 1901).

19. See ____, Minn. at ____, 255 N.W.2d at 826. This version recognizes that past profits are highly persuasive evidence but does not consider their absence fatal. See, e.g., Smith Dev. Corp. v. Bilow Enterprises, Inc., 112 R.I. 203, 213, 308 A.2d 477, 482 (1973); Dunn, *Recovery of Damages for Lost Profits in California*, 9 U.S.F. L. Rev. 415, 434 (1975).

20. See ____, Minn. at ____, 255 N.W.2d at 826.

degree of reasonable certainty."²¹ The court emphasized that mathematical precision in proof of loss is not required;²² proof to a reasonable certainty is sufficient.²³ While the established business generally can offer proof of past events to substantiate the fact of the loss and to serve as a reasonable basis for the computation of the award, a new business does not have records of past experiences from which future profits could be projected. In *Leoni*, reasonable certainty was achieved because the plaintiff had already established a profitable business enterprise in three-fourths of the states and was able to prove his national profit margin. The plaintiff also proved that his profits outside California had doubled or tripled during the three years between the defendant's breach and the trial. If the plaintiff's initial marketing in California had not been the extension of an existing operation, it is doubtful that the court would have strayed from "the general rule that proof of loss of profits in a new business is too speculative to be the basis for recovery."²⁴

In reaching its decision in *Leoni*, the court ignored its earlier recognition of a per se unestablished business rule in *Village of Elbow Lake v. Otter Tail Power Co.*,²⁵ a case involving a proposed power plant. The court did not expressly adopt the per se version of the rule in *Elbow Lake*, but it did base its denial of recovery for lost profits on the impossibility of an accurate determination of lost profits for "a new plant, newly

21. *Id.*

22. *See id.*; cf. *Northern States Power Co. v. Lyon Food Prods., Inc.*, 304 Minn. 196, 229 N.W.2d 521 (1975) (allowing approximation of damages where defective meter measured electricity flowing over only one of three lines). *But cf.* *Faust v. Parrott*, 270 N.W.2d 117, 120 (Minn. 1978) ("While the law most certainly does not require that damages be calculable with absolute precision, damages must nevertheless be ascertainable with reasonable exactness and may not be the product of benevolent speculation.").

23. *See* ____ Minn. at ____, 255 N.W.2d at 826; cf. *Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U.S. 555, 562 (1931) ("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.").

One noted commentator has stated that the plaintiff must show with certainty that the profits were lost and must also show the amount of the profits. This latter requirement is less strict, however, not requiring mathematical precision. *See* C. McCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 27 (1935); McCormick, *supra* note 7, at 238. A number of decisions follow this method of calculating damages. *See* *Northrup v. Miles Homes, Inc.*, 204 N.W.2d 850, 857 (Iowa 1973) (quoting with approval *Patterson v. Patterson*, 189 N.W.2d 601, 605 (Iowa 1971)); *Northern States Power Co. v. Lyon Food Prods., Inc.*, 304 Minn. 196, 202, 229 N.W.2d 521, 525-26 (1975); *Willmar Gas Co. v. Duinck*, 236 Minn. 499, 506, 53 N.W.2d 225, 229 (1952). *But cf.* *Faust v. Parrott*, 270 N.W.2d 117, 121 (Minn. 1978) (in action for breach of noncompete clause, defendant's actual profit resulting from breach must be shown; demonstration that plaintiff would have obtained these profits required; financial records of business plaintiff purchased showing profits before and after sale must be introduced).

24. *Village of Elbow Lake v. Otter Tail Power Co.*, 281 Minn. 43, 46, 160 N.W.2d 571, 574 (1968).

25. 281 Minn. 43, 160 N.W.2d 571 (1968).

constructed, with no experience.²⁶ The village had offered expert testimony on predicted costs of operating from which profits could be projected; however, the court found that the efficiency of management and the costs of operation were too variable to be assessed accurately.²⁷ Therefore, even though the new power plant would be taking over an established operation, the court reasoned that the newly constructed plant had no experience on which to base projected profits.²⁸

No similar concern with variable expenses was expressed by the Rhode Island Supreme Court in *Smith Development Corp. v. Bilow Enterprises, Inc.*,²⁹ the case cited by the *Leoni* court in support of its holding.³⁰ In *Smith*, McDonald's sought the profits it lost during the period of time it was unable to operate its restaurant.³¹ The trial court had excluded the testimony of a college professor who was to estimate the loss sustained by McDonald's through sales projections and evaluations.³² Testimony by McDonald's marketing research manager, describing the uniformity of the procedures, the quality, and the success of McDonald's restaurants, also was stricken from the record. The court held that the testimony of the professor and the marketing research manager, in conjunction with earnings and expense figures for McDonald's for a twenty-five mile radius of the site, could have satisfied the requirement of an adequate evidentiary basis for the jury's determination of the profit lost and that the court, therefore, committed error in excluding the testimony.³³ No concern was expressed by the court in *Smith*, as had been expressed by the Minnesota court in *Elbow Lake*, that the efficiency of management was a variable that made predictions of profits hopelessly inaccurate. Perhaps the availability of figures for other McDonald's in the area made the difference.

Minnesota appears to be following the trend away from the strict requirement that a business be established before future profits can be awarded.³⁴ This is not a drastic departure from prior Minnesota decisions, but simply another small erosion of the general rule that the proof of lost profits for an unestablished business is inherently too speculative to justify an award of damages. How much erosion of the per se rule actually has been accomplished by *Leoni*, however, is still uncertain.

26. *Id.* at 46, 160 N.W.2d at 574.

27. *See id.*

28. *See id.*

29. 112 R.I. 203, 308 A.2d 477 (1973) (cited in *Leoni v. Bemis Co.*, ___ Minn. at ___, 255 N.W.2d at 826-27).

30. ___ Minn. at ___, 255 N.W.2d at 826-27.

31. 112 R.I. at 212, 308 A.2d at 482.

32. *See id.* at 214, 308 A.2d at 483.

33. *See id.* at 213-14, 308 A.2d at 483 (remanded for new trial).

34. *See, e.g.*, *Terrell v. Household Goods Carriers' Bureau*, 494 F.2d 16 (5th Cir.), cert. dismissed, 419 U.S. 987 (1974); *Mechanical Wholesale, Inc. v. Universal-Rundle Corp.*, 432 F.2d 228 (5th Cir. 1970); *Vickers v. Wichita State Univ.*, 213 Kan. 614, 518 P.2d 512 (1974); Comment, *supra* note 18.

Although the business records of a successful national business can provide a basis for the computation of lost profits for one of its territories, this same principle might not extend to the several retail outlets of a local merchandiser,³⁵ or to the owner of a franchise operation with less success than McDonald's.³⁶

The *Leoni* decision does not necessarily foreshadow the abandonment of the unestablished business rule in favor of relying on the kind of economic data a business person might use in making investment decisions.³⁷ Even the former requirement that a business have a past history of profit to serve as a basis for the award was not relaxed totally in *Leoni*; the court was able to use the plaintiff's national profit margin as a basis for recovery—a basis from which the court could comfortably extrapolate conclusions as to the amount of profit lost as a result of the defendant's breach. But perhaps even this small erosion of the unestablished business rule will increase a plaintiff's chance of establishing the requisite certainty through a combination of indirect evidence such as sales projections,³⁸ general industry conditions,³⁹ or the experiences of the plaintiff's predecessor,⁴⁰ successor,⁴¹ or competitors.⁴² Certainly the possibility of an increasing acceptance of the use of economic evidence that a business person would find relevant has not been foreclosed.

The court has achieved flexibility by modeling the unestablished business rule to permit the recovery of profits proved with reasonable certainty and by retaining a flexible standard of certainty. As the Minnesota court has stated, "[a]long the line from speculation to certainty there is a point not found by mathematical demonstration where it can

35. *But cf.* *Lucky Auto Supply v. Turner*, 244 Cal. App. 2d 872, 883, 53 Cal. Rptr. 628, 634 (1966) (evidence of profits at other stores in local chain admissible as basis for damages).

36. *See* *Gordon v. Indusco Mgmt. Corp.*, 164 Conn. 262, 320 A.2d 811 (1973) (reversal of award of damages to owners of a Heap Big Beef franchise).

37. *See* note 1 *supra*.

38. *See generally* Comment, *supra* note 18, at 719-29.

39. *See* Note, *The Requirement of Certainty in the Proof of Lost Profits*, 64 HARV. L. REV. 317, 320 (1950).

40. *Cf.* *Goebel v. Hough*, 26 Minn. 252, 256, 2 N.W. 847, 849 (1879) (lost profits for interruption of established business shown by proving monthly sales of business prior to interruption). *But cf.* *Village of Elbow Lake v. Otter Tail Power Co.*, 281 Minn. 43, 46, 160 N.W.2d 571, 574 (1968) (same owner but new facilities for operation).

41. *See, e.g.*, *Autowest, Inc. v. Peugeot, Inc.*, 434 F.2d 556 (2d Cir. 1970) (distributor of Peugeots introduced evidence of Volvo sales in same area at same time; however, the court also permitted a comparison of the performance of plaintiff's successor). *But see* *Smith v. Eubanks & Hill*, 72 Ga. 280, 288-89 (1884) (profits made by successor to a lease of a grocery store and bar not considered).

42. *See, e.g.*, *William Goldman Theatres, Inc. v. Leow's, Inc.*, 69 F. Supp. 103 (E.D. Pa. 1946), *aff'd*, 164 F.2d 1021 (3d Cir.) (*per curiam*), *cert. denied*, 334 U.S. 811 (1948); *cf.* *Bigelow v. RKO Radio Pictures, Inc.*, 327 U.S. 251 (1946) (comparison with competitor permitted but not relied on).

be said that a jury or other fact-finding tribunal can give a safe judgment of the amount of damages flowing from a breach.”⁴³ This retention of flexibility is to be applauded; “more definite and mechanical rules would lead to greater certainty, but it would be the ‘certainty of injustice.’”⁴⁴

43. *Olson v. Naymark*, 177 Minn. 383, 384, 225 N.W. 275, 275 (1929).

44. *McCormick*, *supra* note 7, at 248.