

## RECOVERY OF DAMAGES FOR LOST PROFITS: THE HISTORICAL DEVELOPMENT

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A popular myth holds that *Hadley v. Baxendale*<sup>1</sup> was part of a judicial trend toward limiting the power of juries to award damages for lost profits. According to this myth, pre-*Hadley* juries exercised unlimited power to award plaintiffs the damages they had suffered on account of contract breaches and other wrongs. One of the leading contracts textbooks goes so far as to say: “Prior to 1854 [the date of the *Hadley* opinion] there were almost no rules of contract damages. The assessment of damages was for the most part left to the unfettered discretion of the jury.”<sup>2</sup>

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1. 156 Eng. Rep. 145 (1854).

2. JOHN D. CALAMARI & JOSEPH M. PERILLO, *THE LAW OF CONTRACTS* § 14.5 (4th ed. 1998). See generally CHARLES T. MCCORMICK, *HANDBOOK ON THE LAW OF DAMAGES* 563-64 (1935) [hereinafter McCormick Treatise] (“In short, apart from a few special rules for

The myth goes on to hold that the *Hadley* rule was necessary so that the industrial enterprises that were developing at the time would not be exposed to excessive damage awards if a plaintiff convinced a jury that the defendant's breach had cost the plaintiff immense profits. Even the eminent damages scholar Professor Charles T. McCormick said that the *Hadley* rule "harmonized well with the free-trade economic philosophy of the Victorian era during which our law of contracts became systematized."<sup>3</sup>

These myths fit nicely with the legal realist jurisprudence that was dominant in American legal scholarship for most of the twentieth century<sup>4</sup> (and even better with the critical legal studies jurisprudence that took the position that legal rules had developed as tools for maintaining the dominance of the entrenched elites).<sup>5</sup> Because these myths appeared to confirm what most American scholars already believed,<sup>6</sup> those scholars accepted the myths without question.<sup>7</sup>

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particular types of agreements and some expressions to the effect that damages must be the 'natural' or 'necessary' result of the breach, one who failed to carry out his contract was, so far as legal theory went, liable for any and all resulting loss sustained by the other party, however unforeseeable such loss might have been." *Accord* 11 JOSEPH M. PERILLO, CORBIN ON CONTRACTS § 56.2 (rev. ed. 2005)(providing identical language in his edition on contracts); Charles T. McCormick, *The Contemplation Rule As A Limitation Upon Damages For Breach of Contract*, 19 MINN. L. REV. 497, 500 (1935) (containing similar language). *See also* Ralph S. Bauer, *Consequential Damages in Contract*, 80 U. PA. L. REV. 687, 687-88 (1932) ("In all the cases prior to 1854, there seems to have been, on the whole, a fair and just determination of the issue of damages in each case, without the use of any even fairly distinct rule. Each court merely applied its own notions of justice to the particular case before it, usually doing justice with only a vague statement of supposed law as to damages."); HOWARD O. HUNTER, MODERN LAW OF CONTRACTS § 14:10, Westlaw (database updated Mar. 2015) ("[T]he [*Hadley*] decision was a reaction to the virtually unbridled discretion of juries that had been the rule before the case. The English judges wanted control over the award of damages by jurors who might be swayed more by emotion than by reason.").

3. MCCORMICK TREATISE, *supra* note 2, at 567.

4. Legal realists romanticized the jurisprudence of the late eighteenth and early nineteenth century courts as wise jurists dispensing justice as determined by the facts of the cases before them, unbound by legal dogma. *See, e.g.*, GRANT GILMORE, AGES OF AMERICAN LAW 36 (1977) (describing a "golden age" of American jurisprudence); *see also* KARL N. LLEWELLYN, THE COMMON LAW TRADITION: DECIDING APPEALS 36 (1960) (describing a "Grand Style" of judging during this period).

5. *See, e.g.*, Robert W. Gordon, *Critical Legal Histories*, 36 STAN. L. REV. 57, 71-76 (1984) (discussing competing interpretations of how the law developed as a tool for furthering the interests of the elite).

6. *See, e.g.*, Raymond S. Nickerson, *Confirmation Bias: A Ubiquitous Phenomenon in Many Guises*, 2 REV. GEN. PSYCHOL. 175, 175 (1998) (describing the tendency to give undue weight to facts that confirm preexisting beliefs and discount those that challenge such beliefs).

7. There was in fact a counter-myth. The counter-myth held that *Hadley* was important not because it limited the recovery of lost profits, but for the opposite reason—that the prior law did not allow the recovery of lost profits and the *Hadley* decision changed

In fact, however, the law developed in quite a different way. Roman law made the first steps toward allowing plaintiffs to recover lost profits in the third century B.C.<sup>8</sup> As the Roman economy developed, these rules on lost profits became more sophisticated and went on to become the core of the damages rules for the modern European civil law.<sup>9</sup> Anglo-American law took a different course. Contrary to the myths, the common law had rigid rules limiting awards of damages, and common law judges held juries to these rules.<sup>10</sup> But unlike the civil law rules, the common law rules made little allowance for the recovery of lost profits until a series of New York cases incorporated the civil law rules (as articulated by the French scholar Pothier) into American law years before the *Hadley* court famously relied on Pothier to postulate a rule already well known in America.<sup>11</sup>

What is far more important than the fact that the *Hadley* rule actually migrated from the United States to Great Britain, rather than crossing the Atlantic in the other direction, is that the rule *Hadley* announced has become relatively unimportant as a limitation on damages. Far more important in modern law is a rule that developed alongside the *Hadley* rule—the rule that damages in general and lost profits in particular can be recovered only if they can be proven with reasonable certainty. This article will trace that rule, showing how it developed alongside the *Hadley* rule and ultimately overshadowed it.

## I. THE DEVELOPMENT UNDER THE CIVIL LAW

### A. *Recovery of Lost Profits Under Roman Law*

The reasonable certainty requirement, like *Hadley*'s foreseeability

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the law to allow the recovery of these damages. See, e.g., GRANT GILMORE, THE DEATH OF CONTRACT 52 (1978) (“[T]he essential novelty of the *Hadley* formula . . . was its affirmative statement that . . . lost profits and other consequential damages caused by a breach of a contractual duty were recoverable.”). The counter-myth is closer to the truth, but it is still wrong. Contrary to what Gilmore and others said, as explained in Parts III-VI of this article, the law governing the recovery of lost profits developed independently of the *Hadley* rule for many years and by the time the *Hadley* rule became prominent, it was just a minor modification of a well-established body of rules.

8. See *infra* notes 24-32 and accompanying text (discussing the movement toward a new legal institution).

9. See *infra* notes 33-46 and accompanying text (describing the development of Roman law and the impact of legal scholars known as *jurisconsults*).

10. See *infra* notes 72-82 and accompanying text (discussing that the law of damages was separate from contracts and was already an extensively developed concept and discussing how they should be calculated).

11. See *infra*, Parts III-V (describing the additional cases that had a significant impact on damage recovery).

requirement, originated in Roman law. Both became important when the law began to allow recovery for lost profits. We do not know exactly when this began. We do know, however, that the concept of recovery for *lucrum cessans*, or profits lost, was part of the Lex Aquilia,<sup>12</sup> a plebiscite enacted in approximately 287 B.C.<sup>13</sup> The Lex Aquilia was a compilation of private law dealing almost exclusively with tort recovery for damage done to “movable property.”<sup>14</sup>

To understand why a 2,300 year-old law was such a legal landmark, we need to go back even further. The Roman legal system, like most primitive legal systems, arose as a substitute for blood feuds. The early Romans were organized on a clan basis and dealt with murder or injury to a member of the clan by taking revenge on the wrongdoer’s kin. Early on, the Romans developed (or more likely borrowed from other peoples with whom they were in contact) a device to replace the blood feud—the composition. Following a solemn ceremony, the wrongdoer made a payment of money or goods to the injured person or their kin.<sup>15</sup> Originally, the essence of the payment remained retribution, but the composition was an advance because it was retribution in a form that involved fewer social costs. More important than compensating the victim and their kin was making them see that the wrongdoer had also suffered and thus reducing the incentive for private vengeance.<sup>16</sup> Gradually, the emphasis of this still crude but evolving legal system shifted from retribution to compensation. At first the compensation was a payment in the form of cattle, but later the payment was in money, but the system remained crude. There was no attempt to measure the damage the injured party had incurred. The payment was a fixed sum based on a schedule of wrongs.<sup>17</sup>

As the Roman legal system became more sophisticated, the catalogue of rights and obligations became more complex, as did the rules of

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12. See José Alonso & Jakub Urbanik, *Liability for Damage in Others’ Property in Classical Law: Lex Aquilia, Pauperies, Corruption of Slave*, at 23, [http://en.wpia.uw.edu.pl/files/Urbanik/romanlaw/10obligations\\_damnum2.pdf?short=\[perma.cc/3KJH-ADPX\]](http://en.wpia.uw.edu.pl/files/Urbanik/romanlaw/10obligations_damnum2.pdf?short=[perma.cc/3KJH-ADPX]) (last visited, Feb. 28, 2015) (providing a list of the different types of damages available for plaintiffs who suffer different types of injuries).

13. See *infra* notes 25-33 and accompanying text (discussing Lex Aquilia which provided the first damages system).

14. Jeremy Ross, *An Economic Analysis of Aquilian Liability*, 14 TUL. J. INT’L & COMP. L. 521, 528 (2006).

15. MICHAEL E. TIGAR, *LAW & THE RISE OF CAPITALISM* 25-26 (2000); H.F. JOLOWICZ, *HISTORICAL INTRODUCTION TO THE STUDY OF ROMAN LAW* 162 (1952).

16. Ross, *supra* note 14, at 527-28.

17. See JOLOWICZ, *supra* note 15, at 174 (discussing that even as late as 450 B.C., approximately the time of the Twelve Tables, the law allowed punishment for the breaking of a limb by allowing the victim to inflict or have inflicted a similar injury on the perpetrator “‘if no agreement for compensation be made’”).

government. These rules, however, had not been reduced to writing. The plebeians believed (probably correctly) that the patricians were manipulating these unwritten rules to their own advantage, so the plebeians demanded that the laws be reduced to written form. The patricians resisted, but in approximately 450 B.C., the laws of the Roman Republic were set out on twelve bronze tablets.<sup>18</sup> These have become known as the Twelve Tables. While the laws they contained were crude and relied on magic and ritual, not only in the creation of obligations, but also as an integral part of legal procedure, they nevertheless form the foundation for our modern legal ideas. Our modern concepts of debt, contract, and civil wrongs can be traced to the Twelve Tables.<sup>19</sup>

Their provisions for remedies show how crude the Twelve Tables were. The penalty for the fracture of a bone was 300 *asses*<sup>20</sup> if the victim was a free man, and 150 *asses* if he was a slave.<sup>21</sup> For blows that did not result in serious injury, the penalty was 25 *asses*.<sup>22</sup> Twenty-five *asses* was also the penalty for unlawfully cutting down a tree belonging to someone else.<sup>23</sup> The size or the value of the tree did not matter; likewise the severity of the injury did not matter as long as it did not move the injury into a

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18. *See id.* at 11-12 (revealing that scholars do not agree as to how much of the story of the XII Tables is history and how much is myth, but the basic story is that the plebeians believed that the magistrates were manipulating the unwritten customary law of Rome to favor the patricians. A tribune of the plebeians proposed that five men be elected to draw up a code of law so that plebeians could have concrete provisions they could point to when they thought their rights were being violated. The patricians successfully opposed the project for eight years, and when they were finally forced to accede to the drafting of a code, they delayed it further by sending an embassy to Greece to study the laws of Solon). Most scholars doubt the embassy actually went to Greece. Some think it went to the Greek colonies of Sicily or the southern Italian mainland. *See, e.g.,* OLGA TELLEGEN-COUPEROUS, A SHORT HISTORY OF ROMAN LAW 20 (1993) (discussing how the original text of Twelve Tables was not preserved).

Finally, in 451 B.C., ten elected magistrates drafted a code. After the assembly ratified it, the code was inscribed on ten tablets that were then placed in the marketplace. The following year the people decided the work was not complete. They elected ten new magistrates, who in turn drafted more laws, had them ratified by the people and inscribed on two additional tablets. JOLOWICZ, *supra* note 17, at 11-12.

Accounts differ as to the material on which the laws were inscribed. Livy says it was bronze.

19. TIGAR, *supra* note 15, at 25.

20. *See Guide to Ancient Roman Coinage*, LITTLETON COIN CO., <http://www.littletoncoin.com/webapp/wcs/stores/servlet/Display%7C10001%7C10001%7C-1%7C%7CLearnNav%7CGuide-to-Ancient-Roman-Coinage.html> [perma.cc/354C-TQHA] (last visited Feb. 28, 2015) (discussing the *as*, the basic unit of coinage during the Roman Republic. In the early republic, a loaf of bread could be purchased for ½ *as* and a liter of wine for 2 *asses*).

21. JOLOWICZ, *supra* note 15, at 174.

22. *Id.* at 174-75.

23. *Id.* at 174.

different category. The system gave the judge no discretion.

As Rome evolved from a village-based agricultural economy to a commercial empire where traders and bankers played an important role, it outgrew the old legal system and new institutions developed.<sup>24</sup> The first step toward the modern law of remedies came when the Romans began to award damages on the basis of the victim's loss rather than a fixed schedule. This began with the Lex Aquilia, the previously-mentioned plebiscite of approximately 287 B.C.<sup>25</sup> Among other things,<sup>26</sup> the Lex Aquilia provided what may have been the world's first system of damages to base the victim's recovery on the value of their loss, rather than on a rigid schedule.

The first chapter of the Lex Aquilia provided: "[I]f anyone wrongfully . . . slays a male or female slave belonging to another person, or a four-footed . . . animal, let him be condemned to pay the owner as much money as the maximum the property was worth in the year (previous to the slaying)."<sup>27</sup> The third chapter contained similar remedies in the case where any person damaged other types of chattels "by wrongfully . . . burning, breaking or rending."<sup>28</sup> In the case of burning, breaking, or rending, however, the victim's recovery was limited to the highest value within the 30 days immediately preceding the damage.<sup>29</sup> In any of these cases, if the defendant denied liability, the payment to the plaintiff was doubled.<sup>30</sup>

The literal language of the Lex Aquilia allowed only the recovery of

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24. See TIGAR, *supra* note 15, at 27-28 (describing the growth in trade and the corresponding institutions that developed).

25. One commentator gives its date as 286 B.C. Ross, *supra* note 16, at 528. Another says the Lex Aquilia is "of uncertain date, but certainly later than the XII Tables." JOLOWICZ, *supra* note 14, at 173. And still another says: "The date of the *lex Aquilia* is not certain but what evidence there is points to 287 B.C. and there is no positive reason for assigning the statute to any other time." ALAN WATSON, THE LAW OF OBLIGATIONS IN THE LATER ROMAN REPUBLIC 234 (1965) (footnote omitted). He also expresses the belief that it was at least in part a codification of existing legislation. *Id.*

26. The Lex Aquilia is also notable because it did away with the need to fit the loss into one of the strict categories prescribed in the Twelve Tables. It allowed a plaintiff to bring "an action in *damnum injuria datum*, literally 'damage given without right.'" Ross, *supra* note 14, at 528.

27. As quoted at Ross, *supra* note 14, at 529.

28. Ross, *supra* note 14, at 529 (quoting DIG. 9.2.27.5 (Ulpian, Edict 18), *reprinted in* BRUCE W. FRIER, CASEBOOK ON THE ROMAN LAW OF DELICT 6 (Bruce W. Frier trans., 1989)).

29. See W.W. BUCKLAND, A TEXTBOOK OF ROMAN LAW FROM AUGUSTUS TO JUSTINIAN 585 (Peter Stein ed., 3d ed. 1963) ("[A]nyone who unlawfully damaged another's property in respects not coming under the first chapter, by burning, breaking or destroying, was liable to pay him the value the thing had had within 30 days before.").

30. See Ross, *supra* note 14, at 529 ("[T]he amount of payment to the plaintiff doubled if the defendant denied liability. . . .").

direct damages, but later interpretations allowed the plaintiff to recover his “interest” (*interesse* in Latin) in the wrongful act not having occurred.<sup>31</sup> From this developed the idea that the plaintiff could recover consequential damages.<sup>32</sup> One 19th century publication gave examples of the earliest consequential damages allowed under Roman law: “If one of a pair of mules, or of a team of four horses, or one of twins, or of a band of comedians, is killed, account must be taken not only of the value of the person killed, but also of the depreciation of the rest . . . .”<sup>33</sup>

As Roman commerce developed, the law of Rome developed along with it, becoming very solicitous to the interests of merchants.<sup>34</sup> Eventually, the recoverable consequential damages came to include future profits the plaintiff lost because of the injury.<sup>35</sup> Roman law then began dividing the damages into two categories: *damnum emergens* (damage emerging), which were the direct damages suffered by the plaintiff, and *lucrum cessans* (profit ceasing), which were the profits that the breach caused the plaintiff to lose.<sup>36</sup>

Like most of Roman law, these concepts did not come through judicial decisions or through legislation. Instead they resulted from the work of legal scholars known as *jurisconsults*. The *jurisconsults* (sometimes referred to simply as “jurists”) were scholars recognized as experts in their respective fields of law but without any direct legislative or judicial authority. Their writings carried great weight, so much so that for a time during the second century A.D., “[T]he opinions of certain *jurisconsults* were binding on judges.”<sup>37</sup> Much of the Roman law that eventually became

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31. See *id.* at 530 (describing how the plaintiff was restored to his rightful position in the defendant’s act not having occurred). For more information, see *infra*, text and accompanying notes 37-39 (discussing the importance of the interpretations of Roman law by the *jurisconsults*).

32. See Ross, *supra* note 14, at 530 (describing the increasing flexibility of damages available); see also JOLOWICZ, *supra* note 17, at 290 (noting that interpretations “going back at least as far as Labeo [who died c. 10 A.D.] allowed the plaintiff to include consequential damages as well . . . .”)

33. W.F. HARVEY, A BRIEF DIGEST OF THE ROMAN LAW OF CONTRACTS 92 (1878). Anticipating the modern law of lost profits, the Romans allowed recovery under the *Lex Aquilia* only if the amount of the damages could be estimated in money. See *id.* at 95 (“The damages must be capable of being estimated in money . . . .”); cf. RESTATEMENT (SECOND) OF CONTRACTS § 352 (1989) (explaining that damages are not recoverable beyond an amount proved with reasonable certainty).

34. See TIGAR, *supra* note 15, at 27 (describing the laws that developed as Roman trade expanded).

35. See BUCKLAND, *supra* note 29, at 588 (translating *lucrum cessans* to include profits the owner was prevented from gaining due to the injury).

36. See *id.* (describing what jurists considered to be a part of the highest value of damages available).

37. See JOHN HENRY MERRYMAN & ROGERLIO PÉREZ-PERDOMO, THE CIVIL LAW

the basis for the legal systems of modern continental Europe derives from the writings of the jurists.<sup>38</sup> This scholarly tradition continues to play an important part in the jurisprudence of civil law countries,<sup>39</sup> and it is through the work of an 18th century successor to the jurists, the previously-mentioned Robert Joseph Pothier,<sup>40</sup> that much of our law on commercial damages came into the common law system.<sup>41</sup>

### B. *European Civil Law and Pothier*

The Roman law-based legal system of modern Europe has its roots in Bologna, Italy in the late 11th century. The first modern university developed at Bologna and its scholars made law, specifically Roman law as set out in Justinian's Institutes, a major subject of study.<sup>42</sup> Scholars from throughout Europe came to Bologna, learned Roman law, and returned home to establish universities where they themselves taught the Roman law. In this way, they made Roman law a common law of continental Europe.<sup>43</sup> In some parts of the continent (*e.g.*, Germany), the principalities officially adopted Roman law, as taught at Bologna, as their governing law.<sup>44</sup> In others there was no official recognition of the Roman law, but tribunals accepted Roman law as authoritative even though it was not binding.<sup>45</sup> Thus, in one way or another, the law of Rome became the law of Western Europe.<sup>46</sup>

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TRADITION: AN INTRODUCTION TO THE LEGAL SYSTEMS OF EUROPE AND LATIN AMERICA 57 (3d ed. 2007) [hereinafter CIVIL LAW TRADITION]. Professor Dawson notes that there is some doubt as to the correctness of the reports that the opinions of the jurists were binding. JOHN P. DAWSON, THE ORACLES OF THE LAW 109-10 (1968).

38. See CIVIL LAW TRADITION, *supra* note 37, at 57 (crediting the Roman jurists as the founders of "the preeminence of the scholar in the civil law tradition." One writer says that the jurists "could function rather like an informal but very real standing commission for law reform." J.A.C. Thomas, *Roman Law*, in AN INTRODUCTION TO LEGAL SYSTEMS 8 (J.D.M. Derrett ed., 1968).

39. See CIVIL LAW TRADITION, *supra* note 37, ch. IX (discussing the scholarly tradition in civil law).

40. See *infra* Parts III-V (discussing Pothier's writings and their influence extensively).

41. See *infra* Parts III and IV (discussing various cases regarding damages).

42. CIVIL LAW TRADITION, *supra* note 37, at 9.

43. See *id.* at 9-10 (describing how scholars who studied in Bologna spread the Roman civil law to their native countries and effectively made Roman civil law a basis of a common law of Europe).

44. *Id.* at 10.

45. *Id.*

46. *Id.* Although some English scholars studied at Bologna, Roman law had initially had little influence on English law. By the time the Roman law began to have a significant influence on the continent, England had already developed its own intricate and quite different system of law. For more information about English and Roman law, see DAWSON, *supra* note 37, at 34-35.



In France, Robert Joseph Pothier, a professor at Orleans, published a series of studies on Roman law.<sup>47</sup> The most important of these was his *Traité des obligations*, a study of the Roman law of obligations (*i.e.*, contracts and torts).<sup>48</sup> The drafters of the Code Napoleon adopted Pothier's work as one of their technical guides,<sup>49</sup> and William Evans, a London barrister, translated it into English under the title *A Treatise on the Law of Obligations, Or Contracts*.<sup>50</sup> Evans's translation was first published in 1806, and it quickly became a standard reference work for lawyers in the United States as well as for those in England.<sup>51</sup>

With Roman law had come *lucrum cessans*. Although *lucrum cessans* had been important in allowing merchants to recover lost profits in the commercial economy of the late Roman Empire, the agrarian economy of the Middle Ages provided little opportunity for medieval lawyers to use the doctrine this way. They did use it however. It served them as a vehicle for avoiding the usury laws. This was not something new. The Roman lawyers had come up with a clever legal fiction. Prohibited from suing the borrower for interest on a defaulted loan, they sued under *lucrum cessans* to recover the "loss of profit . . . that could have been made with the money lent that is foregone[.]" and they combined this with a claim under *damnum emergens* for "the incurrence of costs in making the loan itself."<sup>52</sup>

Medieval lawyers built on this idea, and the device became so common that in 1176 Pope Alexander III wrote to the Archbishop of Genoa

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47. Compare TIGAR, *supra* note 15, at 218 (identifying the professor as Joseph-Robert Pothier), with Joseph M. Perillo, *Robert J. Pothier's Influence on the Common Law of Contract*, 11 TEX. WESLEYAN L. REV. 267 (2005) (calling him Robert Joseph Pothier).

48. The Roman law of obligations was essentially the law of *in personam* rights. For every right there was a correlative duty. According to Professor Barry Nicholas, "The [Latin] term *obligatio* denotes sometimes the right, sometimes (like the English 'obligation') the duty, but more properly, it denotes the whole relationship." BARRY NICHOLAS, AN INTRODUCTION TO ROMAN LAW 158 (1962). The great Roman juriscult Gaius divided obligations into two categories: *ex contractu* (those arising from contract) and *ex delicto* (those arising from delict). See *id.* (describing the two types of obligations that Gaius classifies).

49. See TIGAR, *supra* note 15, at 218 (stating how Pothier's work survived due to its adoption as a technical guide).

50. See Perillo, *supra* note 47, 11 TEX. WESLEYAN L. REV. at 270 n.22 (noting that this is a truncation of the French title). An earlier English translation, first published in the United States, was not widely distributed. See *id.* at 270 (describing a little-known edition in 1802).

51. See *id.* (describing how the 1806 edition was widely disseminated). Not everyone is impressed with Pothier's work. Professor Dawson describes it as "a shallow but readable statement that for some persons, strangely, still has charms." Dawson, *supra* note 29, at 350.

52. Brian M. McCall, *Unprofitable Lending: Modern Credit Regulation and The Lost Theory of Usury*, 30 CARDOZO L. REV. 549, 590 (2008) (footnotes omitted).

denouncing the practice:

You tell us that it often happens in your city that people buy pepper and cinnamon and other wares worth at the time not more than five pounds, promising those from whom they received them six pounds at an appointed time. Though contracts of this kind and under such a form cannot strictly be called usurious, yet, nevertheless, the vendors incur guilt unless they are really doubtful whether the wares might be worth more or less at the time of payment. Your citizens will do well for their own salvation to cease from such contracts.<sup>53</sup>

As a scholar of medieval economics points out, the justification for enforcement of the promise to pay six pounds is that “the trader is . . . entitled to recompense for the probable loss of profit,” and therefore the pope’s letter “consequently constitutes a recognition of the title *lucrum cessans*.”<sup>54</sup>

What is more important is that recent scholarship has shown that our modern rule allowing lost profits to be recovered only if they can be proven with reasonable certainty also has its origin in the jurisprudence of *lucrum cessans*:

[Beginning in the 13<sup>th</sup> Century,] [*lucrum cessans* as foregone profits was sometimes claimed by lenders of monetary capital who wished to collect interest on their loans and thus needed to avoid the charge of usury. They had to prove that in lending funds they forewent a real and certain opportunity of profiting by having invested their capital in a given project. Two corollaries follow from that:

- 1) The lender (businessman or entrepreneur) in question must . . . claim, with *certainty*, a *given amount* of foregone profits as a result of a lost economic opportunity and/or
- 2) The businessman or entrepreneur exercising the claim must operate in the framework of a stationary/traditional society. This has to be the case in order to:
  - a) calculate with certainty the value of lost profits. This would only be possible, assuming the absence of monopoly (itself a very improbable and unlawful market structure), were there to obtain a stationary or steady state economics system.
  - b) postulate the nonexistence of a competitive environment.

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53. Quoted in O’Brien, *An Essay on Medieval Economic Teaching*, FREEFICTIONBOOKS, <http://www.freefictionbooks.org/books/e/8417-an-essay-on-mediaeval-economic-teaching-by-obrien?start=83> [perma.cc/UQ9J-W3CP] (last visited Feb. 28, 2015) (footnotes omitted).

54. *Id.*

Obviously, were that not the case, competition would make it impossible to calculate with *certainty* a *given* foregone volume of profits.<sup>55</sup>

In other words, recovery of *lucrum cessans* required a level of proof that could be obtained only where the lender held near-monopoly power. If he did not, a 13<sup>th</sup> century court would not permit recovery because it was not certain that profits had been lost. But, if the lender was able to meet the burden of proof, he could recover interest on the money he lent by claiming that the interest was merely profit that the money could have made if it had been invested elsewhere.<sup>56</sup>

The *damnum emergens/lucrum cessans* dichotomy was carried forward into the civil law and into international commercial arbitration, in both of which areas it continues to play an important part.<sup>57</sup>

## II. THE COMMON LAW DEVELOPMENT

### A. *The Role of the Jury*

The common law principles of damages developed in quite a different way.<sup>58</sup> The earliest development was similar to that of the Roman law, with a rigid system of compensation emerging to replace the blood feud. Before the Norman Conquest, the Anglo-Saxon peoples developed a schedule that set the price at which a wrongdoer was required to make *bot*, or compensate his victim. Professor McCormick's treatise on damages contains an extensive list from the Law of Ethelbert, who reigned at 600

55. Antonio Jorge and Jorge Salazar-Carrillo, *Lucrum Cessans, Damnum Emergens and the Market Place*, JOURNAL OF FORENSIC ECONOMICS 4(1) 117, 117 (1990) (emphasis in original).

56. See *id.* (explaining the concept of foregone profits).

57. See, e.g., *Sapphire Int'l Petroleum, Ltd. v. National Iranian Oil Co.*, 35 I.L.R. 136 (1967), 13 Int'l & Comp. L.Q. 1011 (1964) (explaining that compensation for breach of contract included the loss in the form of *damnum emergens*, and the lost profit in the form of *lucrum cessans*.); SERGEY RIPINSKY & KEVIN WILLIAMS, DAMAGES IN INTERNATIONAL INVESTMENT LAW 106 (2008) (stating that the *lucrum cessans/damnum emergens* dichotomy has been "followed in countless international arbitration awards"), quoting *Himpurna v. PLN*, Final Award of 4 May 1999, (2000) XXV Yearbook of Commercial Arbitration 13, 70 para. 235 (available at <http://books.google.com/books?id=lqG5uXGmwEQC&pg=PA107&lpg=PA107&dq=dammun+emergens&source=bl&ots=wvpioJCTTW&sig=cZQV8dqTlYr1leeekS0IsEi0KQs&hl=en&sa=X&ei=o3JPUflVqaWJAvrLgbAG&ved=0CDcQ6AEwAzgK#v=onepage&q=dammun%20emergens&f=false>) [perma.cc/9PVZ-CEXM] (last visited Feb. 28, 2015).

58. Curiously, even though the Romans ruled Britain for 350 years, the Roman law had no discernible effect on the early English law. For an interesting discussion of the possible reasons, see generally David A. Thomas, *The Disappearance of Roman Law from Dark Age Britain*, 1984 BYU L. REV. 563 (1984).

A.D. If the wrongdoer struck out an eye, the *bot* was 50 shillings; for striking off an ear, it was only 12. Knocking out a front tooth cost 6 shillings, but a molar was worth only a single shilling.<sup>59</sup>

The royal courts established after the Norman Conquest generally did not have such specific rules, nor were what rules they had so uniformly followed, due to the fact that most rules were common law rules rather than statutes. This has led scholars to conclude that tribunals had considerable discretion in the award of damages. The most extensive study of the history of contract damages says: “Until the close of the eighteenth century, the Courts almost never discuss the principles by which the *quantum* of recovery is to be estimated. The inquiry is not ‘How much shall be given?’ but rather, ‘Who shall make the assessment, and who correct a finding alleged to be erroneous?’”<sup>60</sup> As discussed below, this is likely an overstatement.<sup>61</sup> The lawyers of the day were so focused on procedure that the contemporary case reports probably neglected to mention the substantive issues of damages that were actually argued.

The first provisions for correcting erroneous damages assessments were crude in the extreme. Beginning in the late thirteenth century, a defendant who felt the damages assessed against him were excessive could apply for the writ of attain,<sup>62</sup> which would result in the convening of a grand jury of 24 knights, who would re-try the case. If they issued a finding of *faux serement*, not only would the original verdict be annulled, but, more importantly from the point of controlling the jury, the petty jury that returned the verdict would suffer a punishment that strikes modern readers as entirely out of proportion to the offense:<sup>63</sup> They could be imprisoned for an indefinite time, suffer forfeiture of all their chattels, have their houses razed, their meadows plowed up, and their trees extirpated. If this was not enough, they could be condemned to perpetual infamy.<sup>64</sup>

Attain appears to have been seldom if ever granted for insufficient damages,<sup>65</sup> so there must have been considerable pressure on jurors to keep

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59. MCCORMICK TREATISE, *supra* note 2, at 22.

60. George T. Washington, *Damages in Contract at Common Law*, 47 L. Q. REV. 345, 346 (1931).

61. See *infra* notes 64-65 and accompanying text (discussing how jurors exposed themselves to potentially devastating punishment for flawed damage awards).

62. See Washington, *supra* note 60, at 346-47 (explaining the procedures and potential results when a defendant sought a writ of attain).

63. *Id.* at 346-47.

64. Harold J. Berman & Charles T. Reid, Jr., *The Transformation of English Legal Science: From Hale to Blackstone*, 45 EMORY L. J. 437, 468 n.59 (1996).

65. Washington, *supra* note 60, at 349. One article describes attain as “an extraordinarily complicated and rarely used procedure.” Berman & Reid, *supra* note 66, at 468. Still, the possibility of this extreme punishment must have weighed heavily on the jurors.

the award as small as possible. The plaintiff awarded insufficient damages may not have been without a remedy, however, because it appears to have been the practice to allow such a plaintiff to obtain a non-suit and then sue again.<sup>66</sup>

By the seventeenth century, attaint seems to have died out.<sup>67</sup> In its place, courts began to control the award of damages by the grant of a new trial in cases where the damage award offended the judge's sense of justice. Until 1670, however, it appears to have been the practice to fine the original jury whenever a new trial was awarded.<sup>68</sup>

During this time, the courts seem to have employed narrow rules for estimating the damages in the limited types of cases for which such rules were feasible. McCormick says:

By the end of the [eighteenth] century it was clear that in England the courts would grant a new trial if the award violated some rule of damages—such rules were few and still chiefly confined to contracts—or if even in tort cases the court, in its discretion, considered the amount unreasonable.

Parallel with the widening of the court's power to set aside the award was the growth of the practice by the judges of guiding the jury in advance toward a finding of damages in accordance with consistent standards. This is a chapter in legal history which has not as yet been written, but we know the charge or instruction of the judge was a feature of jury trials from the first. The amount of damages was a "fact," as to which the judge would have at first offered suggestions merely; but, as standards of damages are gradually worked out for the different forms of action, particularly the contract actions, the advice takes on the tone of instruction. We may be sure that this practice of advising the jury upon the measure of their award, even more than exercise of the power to change or set it aside, provided the main vehicle for the formulation of the rules and standards of damages.<sup>69</sup>

Most writers, however, have claimed that until *Hadley* was decided in 1854, juries had unfettered discretion in awarding damages in contracts cases.<sup>70</sup> The Calamari & Perillo textbook that was quoted at the beginning

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66. Washington, *supra* note 60, at 353.

67. *Id.* at 350.

68. *Id.* at 359.

69. MCCORMICK TREATISE, *supra* note 2, at 27-28.

70. See *supra* note 2 and accompanying text (providing examples of the common view among legal scholars that juries enjoyed largely unlimited discretion in awarding damages in pre-Hadley England).

of this article is one such source.<sup>71</sup> Richard Danzig, in his famous article on *Hadley v. Baxendale*, takes a similar position. He notes that Chitty's treatise on contracts, then the leading English authority on the subject, hardly discussed the question of damages at all. He says that Chitty's only comment on damages in the ordinary run of cases was: "When the parties have not furnished the criterion of damages by stipulating for a liquidated sum to be paid as such, it is, in general entirely the province of the jury to assess the amount, with reference to all the circumstances of the case."<sup>72</sup>

What Danzig and other scholars who have commented on the dearth of discussion of damages in contracts treatises overlook is that eighteenth century lawyers did not consider the rules of damages for breach of contract to be part of the law of contracts. Damages was considered a separate subject. Even as late as the early twentieth century, Langdell's contracts casebook did not contain *Hadley v. Baxendale* (or any other damages case).<sup>73</sup>

The truth is that by 1847 the law of damages was so extensive that Theodore Sedgwick, a Massachusetts lawyer, could write an extensive treatise on the subject.<sup>74</sup> In his Introduction, Sedgwick quoted Lord Kaims's 1767 English treatise *Principles of Equity* as saying: "Damages are taxed by the jury, who give such damages, as in conscience they think sufficient to make up the loss, without regarding any precise rule."<sup>75</sup> Sedgwick then went on to say: "It is superfluous to say, that no such arbitrary discretion is now tolerated, except in a very limited class of cases, if indeed, in can be properly said to exist at all."<sup>76</sup>

Later in his treatise, Sedgwick said:

[I]t is now well settled that in all actions of contract, subject to the exception [for breach of promises of marriage], and in all cases of tort where no evil motive is charged, that the amount of compensation is regulated by the direction of the court, and that the jury cannot substitute their vague and arbitrary discretion for the rules which the law lays down.

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71. *Id.*

72. Richard Danzig, *Hadley v. Baxendale: A Study in the Industrialization of the Law*, 4 J. LEGAL STUD. 249, 255 (1975) (quoting J. CHITTY, A PRACTICAL TREATISE ON THE LAW OF CONTRACTS 768 (4th ed. 1850)).

73. See E. Allen Farnsworth, *Contracts Scholarship in the Age of Anthology*, 85 MICH. L. REV. 1406, 1443 (1987) (providing examples of early casebooks on contract law that did not include some of the most influential damages cases). Although *Hadley* was often included in damages casebooks, it did not appear in any contracts casebook until 1931. *Id.*

74. THEODORE SEDGWICK, A TREATISE ON THE MEASURE OF DAMAGES (1847).

75. *Id.* at 2 (quoting HENRY HOME (LORD KAIMS), PRINCIPLES OF EQUITY 78 (2d ed. 1767)).

76. SEDGWICK, *supra* note 74, at 2.

It is, in fact, indispensable that it should be so: the measure of damages is the gist of the remedy; the remedy is no part of the facts of the cause, while, on the other hand, it so completely controls the rights of the parties, that if any absolute discretion be given the jury over the amount of compensation, the power of the court over questions of law, would be most emphatically a barren sceptre.<sup>77</sup>

A review of the cases shows that Sedgwick was right. Virtually every important American contract damages opinion from the decades immediately preceding *Hadley* indicates that the court gave the jury explicit instructions as to the way damages were to be calculated.<sup>78</sup>

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77. SEDGWICK, *supra* note 74, at 214-15.

78. See, e.g., *Bush v. Canfield*, 2 Conn. 485, 488 (1818) (upholding jury instructions on measure of damages); *Bridges v. Stickney*, 38 Me. 361, 371 (1854) (granting a new trial where jury instructed damage calculations could be included with losses on collateral contract); *Miller v. Mariner's Church*, 7 Me. 51, 56 (1830) (upholding jury instructions denying recovery of losses which claimant could have avoided); *Willey v. Fredericks*, 76 Mass. 357, 360 (1858) (upholding instruction that jury could take into account loss of use of land in determining damages for breach of agreement to build sea wall); *Fox v. Harding*, 61 Mass. (1 Cush.) 516, 522-23 (1851) (upholding jury instructions denying profits on collateral contracts); *Lord v. Strong*, 6 Mich. 61, 68-69 (1858) (upholding jury instructions that damages for breach of contract to carry lumber by ship were difference between contract price and price of freight on day cause of action accrued); *Morrison v. Lovejoy*, 6 Minn. 319, 354 (1861) (granting new trial because jury instructions failed to instruct jury rent of mills should have been taken into account in calculating lost profits); *Davis v. Talcott*, 14 Barb. 611 (N.Y. Sup. Ct. 1853) (relating detailed instructions given to the jury, explaining what items could be included in the damage calculation and how lost profits were to be calculated); *Driggs v. Dwight*, 17 Wend. 71, 74-75 (N.Y. 1837) (upholding jury instructions allowing tenant to recover cost of moving); *Deyo v. Waggoner*, 19 Johns. 241, 243 (N.Y. Sup. Ct. 1821) (reversing jury verdict because it improperly included consequential damages).

In *Thompson v. Shattuck*, 43 Mass. 615 (1841), the defendant breached a contract to contribute to the maintenance of a mill dam. The trial judge instructed the jury to calculate separately the two claimed items of damages: the defendant's share of the cost of the repairs and the profits lost while the repair was delayed. The jury did as instructed, but the appellate panel held that only the cost of the repairs was allowable as damages.

A Maine case, *White v. Oliver*, 36 Me. 92 (1853), involved a suit for failure to pay for the construction of a house. The defendant claimed the house had not been finished and that the construction that was completed had not been completed according the specifications. The court instructed the jury that the plaintiff "was entitled to receive for the house only the balance that would remain, after deducting from the contract price as much as it would cost to make the house what it should have been by the contract." *Id.*

In another Maine case, *Furlong v. Polleys*, 30 Me. 491, 494 (1849), a jury verdict was set aside and a new trial granted because the jury instruction, which specified the damages for the nondelivery of hay were the difference between the contract price and the market price, did not specify the place at which the market price was to be determined.

*Cf. Walrth v. Redfield*, 11 Barb. 368, 371 (N.Y. 1851) (awarding new trial because trial judge had given improper jury instructions as to damages where defendant's dam caused

*Blanchard v. Ely*, discussed *infra* in Section III, and *Masterton v. Brooklyn*, discussed *infra* in Section IV, are just two examples. In a case that reached the United States Supreme Court in 1852, two years before the *Hadley* decision, the plaintiff had requested eleven separate jury instructions, each pertaining to a separate item of damages.<sup>79</sup> It is not clear how long American judges had been instructing juries on the damages they were allowed to award, but there is evidence of such instruction from the first reports of the newly independent American states.<sup>80</sup>

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injury to plaintiff's mill, and indicating that in the absence of fraud, gross negligence, or wantonness, the same damages rules apply for tort as for contract).

79. See *Philadelphia, Baltimore & Wilmington R.R. v. Howard*, 54 U.S. 307, 319-20 (1852) (reviewing a prior case in which the plaintiff requested eleven separate jury instructions).

80. *Groves v. Graves*, 1 Va. (1 Wash.) 1 (1790) was the first officially-reported case of the Supreme Court of Virginia. The court reversed a jury verdict that awarded damages for the failure to deliver settlement certificates, the value of which had declined drastically. The Supreme Court ordered a new trial because the jury had valued the certificates as of the date of trial, rather than as of the date they should have been delivered. *Id.* at 3.

In some cases, it appears that the courts were actually looking to the jury to develop a rule of law that would be a binding precedent in future cases. For example, in 1804 Supreme Court Justice Washington, while riding circuit, tried a case in which an agent for a seller of goods delivered the goods to the buyer without receiving payment, apparently in violation of express orders. Justice Washington charged the jury:

The next question is, as to the damages? I admit the principle, that in cases sounding in damages, the amount of damages depends upon the sound discretion of the jury. In cases, where merely vindictive damages are sued for, the jury act without controls on this subject; because there is no legal rule by which they can be measured; and unless they are so extravagant as to induce a suspicion of improper conduct, the court will not interfere. *But in these cases, where a rule can be discovered; the jury are bound to adopt it.* That rule is, that the plaintiff shall recover so much, as will repair the injury sustained by the misconduct of the defendant; and applying this rule in the present case, what other measure of damages can be thought of, but the sum lost to the plaintiff by the violation of his orders? The sum demanded, is of no great consequence, perhaps, to either of the parties, on the score of its amount. But the question itself is important to the commercial interests of this country; in its intercourse with foreign nations. *A precedent is to be set to determine in a case like this, whether an agent is liable for a breach of orders and to what amount.*

*Walker v. Smith*, 29 Fed. Cas. 56 (Cir. Ct., D.Pa. 1804) (emphasis supplied). When the jury awarded the plaintiff what the reporter of decisions said was "a sum much inferior to the loss he had sustained," Justice Washington overruled the plaintiff's motion for a new trial. *Id.* The reporter paraphrases him as saying "that although he was not satisfied with the verdict, nor should he have assented to it as a juror, yet the question of damages, or of interest in the nature of damages, belonged so peculiarly to the jury, that he could not allow himself to invade their province . . ." *Id.* It is worth noting that while Justice Washington alluded to the broad general principle of awarding the amount that would make the plaintiff whole, the use of these broad principles did not come into vogue until a half century later (see *infra* note 176 and accompanying text), so he was looking to the jury to make a narrow



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rule for determining the damages to be awarded when an agent delivered goods without authority.

When the South Carolina Supreme Court upheld a compromise verdict in a case involving the value of a debt denominated in continental currency, the New Jersey Supreme Court read the opinion as creating a precedent requiring similar compromises in all such cases. In *Pledger v. Wade*, 1 Bay 35 (1786), Pledger had executed a promissory note to Ely Kershaw & Co. in the amount of 818l. 19s. 9d. In February, 1780, Wade contracted to acquire this note and return it to Pledger, but the note was held in Charleston and before Wade could get possession of the note, the British invested Charleston, and it became impossible for Wade to perform. *Id.* The courts did not then recognize the doctrine of impossibility (*See Berman & Reid, supra note 66, at 462-63* (noting that “the risk of impossibility due to unforeseen contingencies is placed on the lessee, in the absence of express terms to the contrary”)) so Wade was liable on his contract. The issue was the amount of damages.

The opinion does not say so explicitly, but from the context of the case, it seems clear that the note in question was payable, not in pounds sterling, but in bills of credit issued by the state of South Carolina and also denominated in pounds, shillings, and pence. For most of their existence, these bills (which were not backed by specie) traded at approximately seven South Carolina pounds to one pound sterling. *See JOHN J. MCCUSKER, MONEY & EXCHANGE IN EUROPE & AMERICA (1600-1775) 220-26* (1978) (reporting the rate of exchange of South Carolina pounds to sterling). To finance its participation in the Revolutionary War, however, South Carolina, like most states (and the Continental Congress), began issuing huge quantities of this fiat money. The combination of the increase in the amount of state currency in circulation and the prospect that it might become valueless if the revolution failed caused the currency to depreciate precipitously. *See id.* (describing the depreciation of South Carolina currency during the Revolutionary War). In 1783, South Carolina enacted a Depreciation Act setting the value in specie that would have to be paid to discharge a debt incurred during the inflationary period April 1777 through May 1780. It contained a month-by-month table setting the ratios of specie to paper currency.

Pledger’s counsel argued that because the note in question had been issued before the period covered by the Depreciation Act, Wade was liable for the principal amount of the note plus the interest that had accrued on it through the date of the Pledger-Wade contract (287l. 11s. 8d.). 1 Bay 35, at 35. Wade’s counsel argued that the debt on which the suit was based was the obligation to procure the note, and that had been incurred when the contract was executed, making the obligation subject to discounting under the act. 1 Bay 35, at 36. While today we would probably consider the issue a question of law for the court, this court treated it as a question of fact to be decided by the jury. 1 Bay 35, at 36.

On that issue, the jury returned a compromise verdict. They awarded the principal sum of “38l. 18s. 5d., the amount of money as depreciated in February, 1780 [the time the contract to acquire the note was made].” But it awarded interest in the amount of 71l. 2s. 9d. This, the reporter described as “interest on the nominal sum contended for [i.e., on the 287l. 11s. 8d. face amount of the note.]”

The South Carolina Supreme Court refused to order a new trial, issuing a per curiam opinion that read in full:

As this is a case sounding in damages, and as the jury have thought proper to give a kind of equitable verdict between the parties; and as this also appears to be a hard case, we are against granting a new trial.

1 Bay 35, at 37.

But unlike later scholars, (*see, e.g., Horwitz, infra note 89, 87 HARV. L. REV. at 926* (citing *Pledger v. Wade* as an example to demonstrate judges’ tendency to leave damage questions to the jury)) contemporary courts did not read this opinion as giving free rein to juries to

It is probably true that English judges were less likely to instruct the jury on the measure of damages than were American judges, but the few cases cited for the proposition that English juries had unfettered discretion<sup>81</sup> do not really support this. For example, in *Waters v. Towers*,<sup>82</sup> the defendants breached a contract by failing to set up the gearing for a bobbin mill in a timely and workmanlike manner.<sup>83</sup> The owners of the mill were awarded damages of 14l. for their apprentices being unemployed and 133l. for the lost profits on an oral contract to supply bobbins to a firm consisting of two of the three plaintiffs.<sup>84</sup> While this opinion does show the court upholding an award of lost profits on a collateral contract, something that American courts were still a few years from doing, and while it also shows the court upholding an award that might not have passed the *Hadley v. Baxendale* test, the report does not show that the jury's award exceeded the amount supported by the evidence, nor is there any indication the jury was not instructed on the rules of expectation damages. The case report consists almost entirely of the statement of the facts, the procedural history, and the argument of the defendants' barrister. The only opinion is a per curiam "The rule [nisi of the lower court] must be absolute."<sup>85</sup> The only other statement of the judges quoted in the opinion is Baron Alderson's statement that the plaintiff's testimony as to the oral contract to sell bobbins would have been sufficient evidence of the amount of the loss. Even this seems to have not been made in response to an argument concerning the amount of the damages, but in response to an argument that the contract to supply bobbins could not be the basis for a damages award because it was not in writing.<sup>86</sup>

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assess whatever damages they thought appropriate. The New Jersey Supreme Court cited *Pledger v. Wade* for the proposition that "when a bond was not wholly paid off, all payments of continental money, so far as they affect the principal, are to be liquidated according to the tables of depreciation; but in the payment of interest, it is to be taken as to its nominal value." *Executors of Todd v. Parker*, 1 N.J.L. 54, 55 (1791). So in refusing to overturn a jury verdict, the South Carolina court in effect created a rule for calculating damages that would be binding on later juries.

81. See, e.g., Larry T. Garvin, *Disproportionality and the Law of Consequential Damages*, 59 OHIO ST. L.J. 339, 347 n.31 (1998) (citing several cases in support of the proposition that courts gave juries substantial discretion).

82. 155 Eng. Rep. 1404 (Ex. 1853).

83. *Id.* at 1404.

84. *Id.* at 1405. Remaining consistent with the cited sources, the authors have deliberately chosen to refer to the Pound (unit of damages) as "."

85. *Id.*

86. See *id.* at 1405. ("If a person undertakes to make a certain article for another, and to deliver it to him on a particular day, but fails to do so until a year afterwards, it would be most unreasonable that the latter could not recover any damage because the contract was not in writing. The existence of a contract is evidence of the probable amount of loss sustained. Suppose the plaintiffs had said, 'We should have made such and such a contract if the

### B. *The Reluctance of American Courts to Award Lost Profits*

To understand the way the law of lost profits developed in the United States, we need to understand the jurisprudence of the early nineteenth century. American lawyers of that time were not concerned with broad general principles from which the rule for a specific case could be derived. Instead, they adhered to narrow precedents that articulated specific rules for specific situations. Oliver Wendell Holmes, Jr. described American law as late as 1864 as “a ragbag of details.”<sup>87</sup>

We can put the blame on Blackstone. American legal thinking of that time derived primarily from Blackstone.<sup>88</sup> In Blackstone’s time, and for many centuries leading up to that time, the English social structure was based on ownership of real property.<sup>89</sup> So to Blackstone, law was all about property rights.<sup>90</sup> And because the stability of the society depended on property rights, Blackstone was very focused on black-letter rules.<sup>91</sup> These

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defendants had performed theirs,’ and the jury believed the plaintiffs would have done so, that would surely have been evidence of the amount of loss occasioned by the defendant’s breach of contract.”)

87. Michael L. Rustad & Thomas H. Koenig, *Taming the Tort Monster: the American Civil Justice System as a Battleground of Social Theory*, 68 BROOK. L. REV. 1, 12 (2002) (quoting OLIVER WENDELL HOLMES, *Introduction to the General Survey*, in COLLECTED LEGAL PAPERS 298, 301 (1881)).

88. See, e.g., William D. Bader, *Some Thoughts on Blackstone, Precedent, and Originalism*, 19 VT. L. REV. 5, 5-9 (1994) (discussing Blackstone’s tremendous influence on early American legal thought); Robert C. Berring, *Legal Research and the World of Thinkable Thoughts*, 2 J. APP. PRAC. & PROCESS 305, 308 (2000) (“[Blackstone’s] *Commentaries* became the cornerstone of American law”); Rustad & Koenig, *supra* note 89, 68 BROOKLYN L. REV. at 13 (“Colonial America imported Blackstone’s vision of the common law.”).

89. See David A. Thomas, *Anglo-American Land Law: Diverging Developments from a Shared History, Part I: The Shared History*, 34 REAL PROP. PROB. & TR. J. 143 (1999) (detailing the development of English real estate law).

90. See 2 WILLIAM BLACKSTONE, *COMMENTARIES ON THE LAWS OF ENGLAND* 2 (1766) (“There is nothing which so generally strikes the imagination, and engages the affections of mankind, as the right of property . . .”).

Professor Horwitz has written: “To modern eyes, the most distinctive feature of eighteenth century contract law is the subordination of contract to the law of property. In Blackstone’s *Commentaries* contract appears for the first time in Book II, which is devoted entirely to the law of property. Contract is classified among such subjects as descent, purchase, and occupancy as one of the many modes of transferring title to a specific thing. Contract appears for the second and last time in a chapter entitled, “Of Injuries to Personal Property.” In all, Blackstone’s extraordinarily confused treatment of contract ideas occupies only forty pages of his four volume work.” Morton J. Horwitz, *The Historical Foundations of Modern Contract Law*, 87 HARV. L. REV. 917, 920 (1974).

91. See Stewart E. Sterk, *Intellectualizing Property: The Tenuous Connections Between Land and Copyright*, 83 WASH. U. L. Q. 417, 419 n.4 (2005) (“Blackstone, in both his judicial opinions and his commentaries, contributed significantly to the conception of

were not the broad general rules that guide our jurisprudence today. They were narrow rules designed to cover specific situations. As one writer put it, “the common law he was talking about was a hodge-podge of local practice and custom.”<sup>92</sup> In 1847, Sedgwick apologized for the disjointed organization of his treatise on damages, explaining that convention dictated following Blackstone’s scheme of organization:

In preparing the work, my chief embarrassment has arisen from the difficulty of making a proper and scientific division of the subject. The whole arrangement of our Anglo-American jurisprudence . . . [is] so purely arbitrary and technical, that it is almost impossible to prepare a treatise on a subject as extensive, as that of the measure of damages, which shall be at once useful and logically arranged. To be useful, it must, to a very considerable extent, (at all events,) conform to those arbitrary divisions which are altogether independent of any scientific analysis, and very frequently are directly in conflict with logical order. Conscious of the difficulty, yet seeing no mode to avoid it altogether, I have endeavoured as far as possible, to make my treatment of the subject correspond with that which Blackstone adopted, and which subsequent writers on our law have generally followed.<sup>93</sup>

Foremost among these “subsequent writers on our law” was Chancellor James Kent, whose *Commentaries on American Law*, first published in four volumes in 1825-30, came to overshadow Blackstone in shaping American law.<sup>94</sup> Like Blackstone, Kent set out specific rules that applied only in specific situations. For example, Kent did not have a chapter on the rules of contract law. Instead, he had one chapter for the law of contracts of sale of personal property, one for the law of contracts of bailment, among other types of contracts.<sup>95</sup>

None of these rules contemplated the award of lost profits, except to the extent that the damages formula gave some sort of recovery that would approximate the profits. For example, where a seller failed to deliver the goods contracted for and the buyer had paid no part of the purchase price, the damages were the difference between the contract price and the market

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property as rigid and rule-laden.”).

92. Berring, *supra* note 90, at 308.

93. SEDGWICK, *supra* note 74, at 2-3.

94. See McGrane Coxe, *Chancellor Kent at Yale (Part II)*, 17 YALE L.J. 553, 562 (1908) (quoting Story’s dedication of his treatise on conflict of law to Kent: “You have done for America what Mr. Justice Blackstone in his invaluable commentaries has done for England.”).

95. 2 JAMES KENT, COMMENTARIES ON AMERICAN LAW vi-ix (6th ed. 1848).

price at the time and place the goods were to be delivered.<sup>96</sup> This is basically the rule under the UCC, except that the UCC contemplates additional incidental and consequential damages.<sup>97</sup> But if the buyer had paid the purchase price in advance, some of the case law held that the damages were the difference between the contract price and the highest market price of the article between the time of the contract and the time of trial.<sup>98</sup>

Kent's narrow rules so frustrated Oliver Wendell Holmes, Jr., who edited the twelfth edition of the *Commentaries*, that he grouched that Kent "has no general ideas except wrong ones . . . ."<sup>99</sup>

Justice Joseph Story's opinion in *The Lively*<sup>100</sup> was the second major cause of American courts' failure to award damages for lost profits. The case arose during the War of 1812 when the owners of a merchant ship sought to recover the profits they lost when a privateer improperly delayed their vessel.<sup>101</sup> Story, who, in addition to being an Associate Justice of the United States Supreme Court, was the most respected legal scholar of the time,<sup>102</sup> heard the case when he was riding circuit. The opinion he wrote was, like many of his opinions, eloquent and full of common sense.<sup>103</sup> After reviewing the applicable case law and finding no authority awarding lost profits in similar situations, he went on to say:

Independent however of all authority, I am satisfied upon principle, that an allowance of damages upon the basis of a calculation of profits is inadmissible. The rule would be in the highest degree unfavorable to the interests of the community.

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96. See *Shepherd v. Hampton*, 16 U.S. 200, 204 (1818) (holding that the measure of damages in a breach of a contract of sale is the price of the article at the time it was to be delivered).

97. U.C.C. § 2-713 (AM. LAW INST. & UNIF. LAW COMM'N 2012).

98. See *id.* at 480 n.a. (noting that Sedgwick had criticized Kent's earlier edition for having overlooked this distinction. Kent replies that: "These commentaries are not calculated to embody all of the nice, or arbitrary, or fanciful distinctions that are to be met in the reports. I do not regard the distinction alluded to as well founded or supported." *Id.* In this, Kent seems not to be guilty of the ultra-narrow rules and slavish adherence to precedent of which he has been accused).

99. GILMORE, *supra* note 6, at 160-161 n.14 (quoting M. HOWE, JUSTICE OLIVER WENDELL HOLMES—THE PROVING YEARS (1870-1882), at 16 (1963)).

100. 15 Fed. Cas. 631 (C.C. D. Mass. 1812).

101. *Id.* at 632.

102. Lord Campbell, later to become Lord Chancellor of England, said that Story was "greater than any law writer of which England could boast . . . since the days of Blackstone." Quoted at Gerald T. Dunne, *The American Blackstone*, 41 WASH. U.L.Q. 321, 322 (1963).

103. For a contrary view, see Karl Llewellyn's criticism of Story's opinion in *Swift v. Tyson*, 16 U.S. 1 (1842). KARL N. LLEWELLYN, *THE COMMON LAW TRADITION: DECIDING APPEALS* 414-21, 428 (1960).

The subject would be 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 and would sometimes present embarrassing obstacles. Much would depend upon the length of the voyage, and the season of arrival, much upon the vigilance and activity of the master, and much upon momentary demand. After all, it would be a calculation upon conjecture, and not upon facts.<sup>104</sup>

Other courts shared their reluctance to award damages.<sup>105</sup> They based their refusal to award lost profits on two forms of analysis, sometimes using one, sometimes using the other, and sometimes using both. One form of analysis simply carried on Justice Story's argument made in *The Lively* and looked at the facts of the particular case to hold that the uncertainties inherent in the venture meant that any profits that would be made were purely speculative.<sup>106</sup> The other analysis stemmed from the previously described jurisprudence of the time that attempted to find a mechanical formula to govern every case so that the element of human judgment would be removed completely from the calculation of damages. Courts applying the latter form of analysis (if that term may be applied to this mechanical jurisprudence) combed the precedents, looking for a rule that would govern the damages calculation.<sup>107</sup> None of these rules allowed the court to do what a modern court would do and simply look at how much better off the plaintiff would have been if the defendant had fulfilled its legal obligations.<sup>108</sup>

Justice Story himself combined the two bases for denying lost profits in another opinion regarding privateering matters, *The Amiable Nancy*:<sup>109</sup>

The probable or possible benefits of a voyage, as yet *in fieri*, can never afford a safe rule by which to estimate damages in cases of marine trespass. There is so much uncertainty in the rule itself, so many contingencies which may vary or extinguish its application, and so many difficulties in sustaining its legal

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104. 15 Fed. Cas. at 634-635.

105. See, e.g., *Larabee Flour Mills Co. v. Mo. Pac. Rwy. Co.*, 116 P. 901, 902 (Kan. 1911) (relying on an old principle that profits are not recoverable); *Jones v. Van Patten*, 3 Ind. 109, 112 (Ind. 1851) (affirming award profits lost on flatboat trip down Mississippi River on procedural grounds, but expressing doubt that the trial court had correctly applied the damages rule, stating that reliance damages should have been awarded instead).

106. See *supra* notes 82-86 and accompanying text (allowing, in the case of an oral contract, plaintiff's testimony as sufficient evidence of the amount of the loss).

107. See, e.g., *Blanchard v. Ely*, 21 Wend. 342, 345-346 (N.Y. 1839) (demonstrating a court's combing of precedents).

108. Cf. RESTATEMENT (SECOND) CONTRACTS, *supra* note 35, at § 347 (providing that damages are measured by the injured party's expectation interest).

109. 16 U.S. 546 (1818).

correctness, that the court cannot believe it proper to entertain it. In several cases in this court, the claim for profits has been expressly overruled; and in *Del Col v. Arnold*, (3 Dall 333.) and the *Anna Maria*, (2 Wheat. Rep. 327.) it was, after strict consideration, held, that the prime cost or value of the property lost, at the time of loss, and in the case of injury, the diminution in value, by reason of the injury, with interest upon such valuation, afforded the true measure for assessing damages. The rule may not secure complete indemnity for all possible injuries; but it has certainty and general applicability to recommend it, and in almost all cases, will give a fair and just recompense.<sup>110</sup>

Sedgwick discussed the tendency toward narrow rules with mechanical formulas in his 1847 treatise on damages,<sup>111</sup> a treatise that became a classic and went through nine editions over the next seventy-three years.<sup>112</sup> Sedgwick complained about the narrow precise damage rules of American law<sup>113</sup> and quoted a passage in which Justice Story compared treatises on the common law with their civil law counterparts, saying that the former “contain little more than a collection of the principles laid down in the adjudged cases, with scarcely an attempt to illustrate them by any general reasoning” while the civilians “discuss every subject with an elaborate theoretical fullness and accuracy, and ascend to the elementary principles of each particular branch of the science.”<sup>114</sup>

In fact, one can get an idea of the way the law of damages evolved simply by studying the table of contents of Sedgwick’s treatise as it went through its many editions. For example, in the 1847 edition, there are entire chapters devoted to rules for particular types of transactions, including chapters titled “Rule of Damages in Actions Brought for Breach of Real Covenants,” “The Measure of Damages in Actions Growing Out of the Contract of Principal and Surety,” “Rule of Damages as Between Principal and Agent,” and “The Rule of Damages in the Action of Trover.”<sup>115</sup> There is a chapter containing general rules for tort damages, but it takes up only nine pages of this 600-page work.<sup>116</sup> The general rules for contract damages get slightly better treatment, being given thirty pages.<sup>117</sup>

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110. *Id.* at 560-561.

111. SEDGWICK, *supra* note 74, at 2-3.

112. See THEODORE SEDGWICK, A TREATISE ON THE MEASURE OF DAMAGES (rev. ed. Arthur G. Sedgwick & Joseph H. Beale, Jr. 1920).

113. SEDGWICK, *supra* note 74, at 2-3.

114. *Id.* at 5 (quoting Joseph Story, *Pref to Com. on Bailments*).

115. See SEDGWICK, *supra* note 74, at ix-xiii (listing these chapters of the treatise).

116. *Id.*

117. *Id.*

In contrast, the eighth edition of the same work, published in 1891, looks more like a modern work on the subject, organizing its discussion not on rules in particular types of cases but on broad general principles.<sup>118</sup> It begins with a “General View of the Subject,” which contains, among other things, a history of Anglo-American damages law and a summary of the damages rules of other legal systems.<sup>119</sup> It then devotes an 88-page chapter to a discussion of general principles of compensation in damages jurisprudence.<sup>120</sup> An eighty-nine-page chapter on Consequential Damages<sup>121</sup> is followed by a chapter on Certain and Uncertain Damages (*i.e.*, the rule that damages must be proven with reasonable certainty).<sup>122</sup> There are also chapters on Avoidable Consequences,<sup>123</sup> The Measure and Elements of Value,<sup>124</sup> Exemplary Damages,<sup>125</sup> Liquidated Damages<sup>126</sup> and other topics, most of which would be of interest to modern readers.<sup>127</sup>

But in the jurisprudence of the early nineteenth century, there was no room for general rules about lost profits. In fact, there was little room for the general rule that damages should be whatever makes the plaintiff whole. Instead, there were myriad, narrow rules. If profits were lost because the defendant breached its contract to sell goods, the plaintiff’s recovery was via the rule for the sale of goods. If the plaintiff lost profits because the defendant breached a lease, the recovery was determined by the rules for breach of leases.

### III. *BLANCHARD V. ELY* – THE CASE THAT ANTICIPATED *HADLEY V. BAXENDALE*

In 1839, New York’s Supreme Court of Judicature, then the state’s highest court, used a new theory to deny recovery of lost profits. *Blanchard v. Ely*<sup>128</sup> was a suit to recover the unpaid balance of the \$12,500 price to be paid for the building of a steamboat to ply the Susquehanna River between Oswego and Wilkes-Barre.<sup>129</sup> The defendants claimed

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118. THEODORE SEDGWICK, A TREATISE ON THE MEASURE OF DAMAGES (8th. ed. Arthur G. Sedgwick & Joseph H. Beale, Jr. 1891).

119. *See id.* ch. I. (listing the sections under the first chapter of the treatise).

120. *See id.* ch. II. (Compensation).

121. *See id.* ch. IV. (Chapter III is devoted to situations when only nominal damages are awarded).

122. *See id.* ch. V. (Certain and Uncertain Damages).

123. *See id.* ch. VI. (Avoidable Consequences).

124. *See id.* ch. VIII. (The Measure and Elements of Value).

125. *See id.* ch. XI. (Exemplary Damages).

126. *See id.* ch. XII. (Liquidated Damages).

127. *See, e.g., id.* ch. VII (expenses of litigation).

128. *Blanchard v. Ely*, 21 Wend. 342, 342 (N.Y. 1839).

129. *Id.* at 342-43.



offsets because the boat the defendants delivered had defects that not only required repairs, but also required that the defendants cancel planned trips, causing them in turn to lose profits of \$100 per trip.<sup>130</sup> The trial judge instructed the jury that they should deduct from the unpaid price the cost of repairing the defects, but not the lost profits.<sup>131</sup> Addressing the propriety of this instruction, Justice Cowen,<sup>132</sup> writing for the Supreme Court, said:

No common law authority was cited at the bar, one way or the other, having any direct application to the measure of damages in such a case as this; nor am I aware that any exists. If there be none, it is somewhat singular, considering the many contracts for building boats and other vessels which must have been made in England and this country.<sup>133</sup>

While it strikes the modern reader as strange that the court would not ask whether lost profits were generally recoverable, but would instead look for a case of lost profits in a boat-building contract, this search for a narrow rule based on the type of transaction involved was still the norm in 1839.

Finding no boat-building cases, the court did go further afield and looked at cases involving breach of warranty in the sale of real estate. There, the court cited one of its earlier opinions that in turn echoed the reasoning of Justice Story in *The Lively*: “it would be ruinous and oppressive to make the seller respond in damages, for any accidental rise in value of the land or the increased value in consequence of the improvements made by the purchaser.”<sup>134</sup> The court then went on to quote still another of its own opinions, saying that “[t]he safest rule is, to limit the recovery as much as possible, to an indemnity for the actual injury sustained, without regard to the profits the plaintiff has failed to make.”<sup>135</sup> After discussing similar analogous rules with respect to sales of chattels, the opinion proceeded to break with tradition and consider a rule of general application:

In short, it will be seen by the cases cited and many more, that on the subject in question, our courts are more and more falling into the track of the civil law, the rule of which is thus laid down by a learned writer: “In general, the parties are deemed to have contemplated only the damages and interest which the creditor might suffer from the non-performance of the obligation, in

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130. *Id.* at 343.

131. *Id.* at 344.

132. See LLEWELLYN, *supra* note 105, at 64-68, 423-26 (praising Cowen as one of the masters of what Llewellyn called the “Grand Style” of opinion writing).

133. Blanchard, 21 Wend. at 345.

134. *Id.* at 346 (quoting *Dimmick v. Lockwood*, 10 Wend. 150 (N.Y. 1833)).

135. *Id.* (quoting *Baldwin v. Munn*, 2 Wend. 399, 406 (N.Y. 1829)).

respect to the particular thing which is the object of it; and not such as may have been accidentally occasioned thereby in respect to his own affairs,” 1 Evans, Poth. 91, Lond. ed. 1806. He illustrates the rule by the rise of value in goods which the promisor fails to deliver. He adds, if the lessor’s title to a house fails, he is bound to pay to his lessee the expense of removal, and indemnify him against the advance of rents, but not against the loss of custom in a business he may have established while residing in the house. He also adverts to the distinction that the vendor may, notwithstanding, incur liability for extrinsic damages of the creditor, if it appears they were stipulated for or tacitly submitted to in the contract. One instance is that of stipulating to deliver a horse in such time that a certain advantage may be gained reaching such a place. There the debtor shall, on default, pay for the loss of the advantage.<sup>136</sup>

This is not only the reasoning of *Hadley v. Baxendale*,<sup>137</sup> articulated fifteen years before the Court of the Exchequer’s opinion in *Hadley*,<sup>138</sup> but it is the same authority (William Evans’s translation of Pothier’s *Traité des obligations*) that Baron Parke so forcefully put forward early in the oral arguments in *Hadley*.<sup>139</sup> If things had gone differently, *Blanchard v. Ely*

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136. *Id.* at 348.

137. *Hadley v. Baxendale*, 156 Eng. Rep. 145 (Ex. 1854).

138. The Supreme Judicial court of Maine articulated the same rule even earlier, saying:

In general [in cases of breach of contract] the delinquent party is holden to make good the loss occasioned by his delinquency. But his liability is limited to direct damages, which, according to the nature of the subject may be contemplated or presumed to result from his failure. Remote or speculative damages although susceptible of proof, and deducible from the nonperformance, are not allowed.

*Miller v. Mariners Church*, 7 Me. 51, 55 (1830). The case has rather picturesque facts. The plaintiff was the warden of the state prison. He brought the action against the trustees of a church for the price of hammered stone (presumably rocks broken by the convicts) delivered for use in a new church building. The trustees counterclaimed for damages for late delivery and defects in workmanship. *Id.* at 51.

Later courts (including the United States Supreme Court) frequently cited the opinion, not for the *Hadley* rule, but for the rule that a plaintiff may not recover damages that could have been avoided without undue burden. *See, e.g., Pullman’s Palace Car Co. v. Metropolitan Street Rwy. Co.*, 157 U.S. 94, 111 (1895)(citing *Miller* for the proposition a plaintiff may not recover damages that could have been avoided without undue burden).

139. *Hadley*, 156 Eng. Rep. at 147-48.

It’s not the same passage that Parke said stated the “sensible rule”. *Id.* at 147. The passage quoted by the *Blanchard* court is actually a more restrictive form of the rule, requiring not only that the potential loss be foreseeable, but that the circumstances be such that the defendant can be thought to have consciously assumed the risk. This rule, now referred to

might be the opinion that everyone reads in their first-year contracts course, but, as we shall see, later events conspired to make *Blanchard* a little-known footnote in the law of damages.

#### IV. *MASTERTON V. BROOKLYN* ALLOWS LOST PROFITS IN LIMITED CIRCUMSTANCES

In 1845, everything changed. In an opinion that is little remembered today, the New York high court unequivocally announced that lost profits could be awarded in a breach of contract case. *Masterton v. Brooklyn*<sup>140</sup> was a suit by a firm that had contracted to supply the marble to be used in the new city hall in Brooklyn. The city had run out of funds and ceased construction when it had taken delivery of only a small fraction of the marble.<sup>141</sup> When the sellers sued, the trial judge, who was the son of Chancellor James Kent, the author of *Kent's Commentaries*, charged the jury that they should award as damages the difference between the contract price and what it would have cost the plaintiffs to acquire, process, and deliver the marble.<sup>142</sup> The defendants objected to the charge and requested a charge that no profits could be awarded. When Judge Kent refused their request, the defendants appealed.<sup>143</sup> The Supreme Court of Judicature reversed the trial judge and granted a new trial, but not because he instructed the jury to award lost profits. His error, they said, was instructing the jury to take into account in their damage calculations the subcontract the plaintiffs had made in order to acquire the marble.<sup>144</sup>

In his opinion, Chief Justice Nelson<sup>145</sup> acknowledged that:

[i]t is not to be denied that there are profits or gains derivable from a contract which are uniformly rejected as too contingent and speculative in their nature, and too dependent upon fluctuation of markets and the chances of business, to enter into a safe or reasonable estimate of damages.<sup>146</sup>

He also noted that the civil law generally denied recovery of lost profits, but for a different reason. Again quoting from Evan's translation of

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as the tacit agreement test, is still applied in New York (*see infra*, Part VI. C.) (discussing the tacit agreement test) even though most other Anglo-American jurisdictions only require the loss be foreseeable.

140. *Masterton v. Brooklyn*, 7 Hill 61 (N.Y. 1845).

141. *Id.* at 64-65.

142. *Id.* at 66.

143. *Id.*

144. *Id.* at 72-74.

145. The Supreme Court of Judicature issued three opinions in the case. That of Chief Justice Nelson appears first in the report and is the longest.

146. *Id.* at 67.

Pothier, the chief justice explained that the civil law denied lost profits because of what would become known in the common law world as “the rule of *Hadley v. Baxendale*”:

“In general,” says Pothier, “the parties are deemed to have contemplated only the damages and interest which the creditor might suffer from the non-performance of the obligation, in respect to the particular thing which is the object of it, and not such as may have been incidentally occasioned thereby in respect to his other affairs.”<sup>147</sup>

In other words, lost profits are disallowed not because of a general rule prohibiting their recovery, but because they are not contemplated at the time of contract formation.<sup>148</sup> The chief justice noted that this objection to the recovery of lost profits did not apply in the case where the damages sought were “the direct and immediate fruits of the contract entered into between the parties.”<sup>149</sup>

With respect to the argument that the profits were too uncertain to be awarded as damages, the chief justice said the concern that it was impossible to predict the way that costs would change over the life of the contract, the sort of concern that had troubled Justice Story,<sup>150</sup> could be dealt with by estimating the plaintiff’s cost of fulfilling the contract on the market prices prevailing at the time of breach.<sup>151</sup> The costs not incurred by the plaintiff due to the breach would be subtracted from the unpaid contract price. Rather than trying to estimate how the costs of labor and materials would rise or fall over the three and a half years remaining in the contract, the jury should estimate the damages on the basis of the prices prevailing at the time of the breach.<sup>152</sup> The chief justice used the reasoning that would later form the basis for the *Hadley v. Baxendale* opinion to hold that the jury should not take into account the subcontracts the plaintiffs had entered into to acquire the unfinished marble. He said that the defendants had no control over the making of the subcontracts and therefore were neither required to assume the burden of unfavorable subcontracts nor to gains the

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147. *Id.* at 68.

148. We use the word “contemplated” rather than foreseeable, because that was the term more commonly used prior to the mid-twentieth century. The meaning of that term has changed over the years and for many years it meant that the damages had to be not only foreseeable, but actually foreseen and in some jurisdictions the defendant had to accept liability, at least tacitly. See *infra* text accompanying notes Part VI. C.

149. Masterton, 7 Hill at 69.

150. See *supra* notes 100-04 and accompanying text (discussing Justice Story’s opinion, “The Lively”).

151. Masterton, 7 Hill at 70.

152. *Id.* at 71.

benefits from favorable ones.<sup>153</sup> In other words, it was not contemplated at the time the prime contract was made that the plaintiff would enter into subcontracts that deviated from the norm for that kind of contract.

The chief justice did not give the jury free rein to award damages as they thought fit. In fact, he gave what could be a good summary of the modern rule that lost profits can be recovered only when their amount is proven with reasonable certainty:

[T]he parties will be obliged to go into an enquiry as to the actual cost of furnishing the article at the place of delivery; and the court and jury should see that in estimating this amount, it be made upon a substantial basis, and not left to rest upon the loose and speculative opinions of witnesses. The constituent elements of the cost should be ascertained from sound and reliable sources; from practical men, having experience in the particular department of labor to which the contract relates. It is a very easy matter to figure out large profits upon paper; but it will be found that these, in a great majority of the cases, become seriously reduced when subjected to the contingencies and hazards incident to actual performance . . . . [A jury] should not overlook the risks and contingencies which are almost inseparable from the execution of contracts like the one in question, and which increase the expense independently of the outlays in labor and capital.<sup>154</sup>

In a separate opinion, Justice Beardsley concurred with the proposition that lost profits could be recovered when they were direct damages, but made it clear that they could not be recovered in contract when they were consequential damages:

Remote and contingent damages, depending on the result of successive schemes or investments, are never allowed for the violation of any contract. But profits to be earned and made by the faithful execution of a fair contract are not of this description. A right to damages equivalent to such profits results directly and immediately from the act of the party who prevents the contract from being performed.<sup>155</sup>

Other courts soon followed *Masterton* and allowed plaintiffs to recover lost profits in contract cases as long as they were direct damages.<sup>156</sup>

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153. *Id.* at 72.

154. *Id.* at 72-73.

155. *Id.* at 74.

156. *See, e.g.*, *Chi. & Rock Island R.R. Co. v. Ward*, 16 Ill. 522, 530-31 (1855) (finding that farmer could recover lost profits where railroad breached covenant to maintain fence); *Bridges v. Stickney*, 38 Me. 361, 368 (1854) (allowing recovery of direct damages but not consequential damages); *Hoy v. Grenoble*, 34 Pa. 9, 10-11 (1859) (enabling sharecropper to

In *Fox v. Harding*,<sup>157</sup> itself a widely cited opinion, the Supreme Court of Massachusetts said that lost profits could be recovered if they were “the direct and immediate results” of the contract, but not if they were the result of “independent and collateral undertakings.”<sup>158</sup>

As noted above, the first edition of Sedgwick’s treatise on damages was published in 1847, shortly after the *Masterton* opinion appeared. Further, in addition to all of the chapters dealing with the narrow rules in individual types of actions, Sedgwick did have a chapter titled “Of Remote and Consequential Damages.” In this chapter, he stated the general rule as to consequential damages—they are not awarded except in the case of deliberate wrongdoing:

[T]he law refuses to take into consideration any damages remotely or consequentially resulting from the act complained of. This general principle pervades the civil law as well as the common law, and applies equally to cases of breach of contract, and of violation of duty; to all cases, in short, where no complaint is made of any deliberate intention to injure. In these latter cases we have seen that our law does not pause at the line of mere compensation, but proceeds to punish the offender.<sup>159</sup>

However, he went on to say that this rule and the reasons given for it are not consistent. He took the position that in actuality the rule against the award of consequential damages was simply a generalization from what we today refer to as the rule of *Hadley v. Baxendale*. In a passage that Hadley’s barristers were to quote in their argument before the Court of the Exchequer, Sedgwick said:

It is sometimes said in regard to contracts, that the defendant shall be held liable for those damages only which both parties may fairly be supposed to have at the time contemplated as likely to result from the nature of the agreement, and this appears to be the rule adopted by the writers upon the civil law.<sup>160</sup>

Sedgwick then went on to give a picturesque example from the ubiquitous Pothier. If a seller breaches a contract to sell a horse, the

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recover profits lost when landowner breached oral contract); *Hinckley v. Beckwith*, 13 Wis. 31, 35 (1860) (holding that the lost profits of sawmill were recoverable).

See also *Water Lot Co. v. Leonard*, 30 Ga. 560, 577 (Ga. 1860) (denying recovery of consequential damages but relying on *Masterton* to support dictum that direct damages could be recovered); *Simmons v. Brown*, 5 R.I. 299, 302-03 (1858) (relying on *Masterton* to allow mill owner to recover lost profits where defendant’s dam reduced water flow at mill).

157. 61 Mass. 516, 516 (1851).

158. *Id.* at 522.

159. SEDGWICK, *supra* note 74, at 63-64.

160. *Id.* at 64 (quoted at *Hadley v. Baxendale*, 156 Eng. Rep. 145, 147 (1854) (argument of Keating and Dowdeswell)).

damages are the difference between the contract price and the price the buyer has to pay to obtain a substitute animal.<sup>161</sup>

But on the other hand, if the purchaser were a canon, and by reason of the non-delivery of the horse, could not arrive at his residence in season to receive his *gros fruits*, the seller is not liable for the loss of those *gros fruits*, because this was not foreseen at the time of the contract.<sup>162</sup>

After another example, Sedgwick noted that Pothier had further qualified his initial qualification, saying:

But if on the other hand, the horse above referred to had been sold for the express object of enabling the canon to arrive in time for his *gros fruits*, . . . then the injuries which otherwise would be remote and consequential, become direct and immediate, and constitute a valid claim, as forming part of the contract between the parties.<sup>163</sup>

This statement goes beyond the rule of *Masterton* because it deals with damages that are not the failure to receive the other party's performance as in *Masterton*, but are what we today would likely call a consequential loss. This can be confusing to the modern reader because it makes a distinction between direct damages and consequential damages that is different from the one we make. We generally think of direct damages as those that compensate the injured party for the loss of the promised performance, whereas consequential damages compensate for additional losses, such as the loss of profits on contracts with third parties.<sup>164</sup> We say that these consequential losses are recoverable in contract only if they were foreseeable to the breaching party at the time they entered into the contract.<sup>165</sup> Under the Pothier/Sedgwick terminology, consequential damages are those damages that were not foreseeable and thus were never recoverable, absent deliberate wrongdoing. Losses that were within the contemplation of the parties at the time they entered into the contract were called direct damages, even if they were the result of some collateral undertaking, such as a contract to resell the purchased

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161. *Id.* This is of course the modern rule. See U.C.C. § 2-713 (laying out the modern rule). Actually, the example seems to assume that the contract was made at the market price because it speaks in terms of a rise in prices necessitating the payment of a higher price.

162. *Id.*

163. *Id.* at 65.

164. See, e.g., *Schonfeld v. Hilliard*, 218 F.3d 164, 175-76 (2d Cir. 2000) (explaining the distinction between direct or "general" damages and consequential or "special" damages).

165. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 33, at § 351 (1979) (commenting that a contracting party is accountable for those risks that are foreseeable at the time of contract formation).

goods.

V. GRIFFIN V. COLVER COMPLETES THE TRANSFORMATION

In 1854, the Court of the Exchequer issued its famous opinion in *Hadley v. Baxendale*. The opinion quickly became known in the United States, but it didn't have much immediate effect on the recovery of lost profits. There were two reasons for this. First, the rule was already known in the United States, so much so that Kent had years before set out a version of it in his *Commentaries*.<sup>166</sup> More importantly, American courts had not yet begun awarding lost profits as damages, except where they were direct benefit of the bargain damages.

Four years later, however, American courts did begin awarding lost profits as consequential damages. In 1858, the newly-established New York Court of Appeals issued its opinion in *Griffin v. Colver*.<sup>167</sup> Substantively, the facts of *Griffin* were identical to those of *Blanchard v. Ely*, and arguably *Griffin* should not even have been appealed. The case involved the building, not of a steamboat, but of a steam engine for a lumber mill. Once again, the builder sued for the contract price, and once again the defendant attempted to offset the profits lost because the product was not delivered on time.<sup>168</sup> The referee before whom the case was tried held that the lost profits were not a proper measure of damages. Instead, he awarded the defendants \$66.12 as compensation for the loss of use of their property.<sup>169</sup> This was in keeping with a rule of the time that the proper measure of damages in such cases was the use value of the property or capital involved.<sup>170</sup> After the supreme court affirmed the judgment entered

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166. See KENT, *supra* note 95, at 480 ("Damages for breach of contract are only those which are incidental to, and directly caused by the breach, and may reasonably be supposed to have entered into the contemplation of the parties, and not speculative profits, or accidental or consequential losses or the loss of a fancied good bargain.").

Later commentators may have failed to understand the significance of Kent's statement because they did not realize that when Kent wrote, the term "consequential damages" was understood to exclude any damages that were contemplated by the parties at the time they entered into the contract.

167. 16 N.Y. 489 (N.Y. 1858).

168. See *Griffin v. Colver*, 22 Barb. 587, 587 (N.Y. Sup. Ct. 1855) (providing a hearing of complaint that sought to recover lost profits for the time of performance over what was stipulated in the contract).

169. See *id.* at 588 (summarizing referee's finding that the delay in performance of the contract caused defendant's to sustain \$66.12 in damages).

170. See *infra* Part VI.B (noting that most courts followed the rule that where a party is deprived of the use of property, the measure of damages is not lost profits, but rather the rental value of the property involved).



on the referee's report,<sup>171</sup> the plaintiff appealed to the new Court of Appeals.

The Court of Appeals' opinion gets directly to the point. It begins by acknowledging that there is a "rule which precludes the allowance of profits, by way of damages, for the breach of an executory contract."<sup>172</sup> But it then immediately states that the rule is not to be taken literally:

To determine whether this rule was correctly applied by the referee, it is necessary to recur to the reason upon which it is founded. It is not a primary rule, but is a mere deduction from that more general and fundamental rule which requires that the damages claimed should in all cases be shown, by clear and satisfactory evidence, to have been actually sustained. It is a well established rule of the common law that the damages to be recovered for a breach of contract must be shown with certainty, and not left to speculation or conjecture; and it is under this rule that profits are excluded from the estimate of damages in such cases, and not because there is anything in their nature which should *per se* prevent their allowance. Profits which would certainly have been realized but for the defendant's default are recoverable; those which are speculative or contingent are not.<sup>173</sup>

This one paragraph has become the basis for the modern law of lost profits: lost profits may be recovered in contract, but only if they are proven with certainty. (We now say "reasonable certainty." This will be discussed later.<sup>174</sup>)

This was a huge change from the prior law. Even after *Masterton*, courts had uniformly refused to award lost profits as consequential damages in contract cases. While some courts had used the difficulty of proof as a justification for the rule that lost profits could not be recovered as consequential damages, they nevertheless adhered to it as a *per se* rule, rather than considering the possibility that in some cases the lost profits could easily be determined.<sup>175</sup>

To support the novel proposition it was advancing as settled law, the

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171. See *Griffin*, 22 Barb. at 593 (affirming the judgment and report of the referee, thereby disallowing a recovery of lost profits).

172. *Griffin*, 16 N.Y. at 491.

173. *Id.*

174. See *infra* notes 266-75 and accompanying text (tracing the development of the reasonable certainty rule as distinguished from the absolute certainty rule).

175. See, e.g., *Taylor v. Maguire*, 12 Mo. 313, 319-20 (Mo. 1848) (refusing to award defendant lost profit damages). Interestingly, another justification the court gave for denying the recovery of lost profits was that "[t]he loss . . . which forms the criterion of damages . . . must be a loss within the probable contemplation of the parties at the time of the execution of the contract." *Id.* at 318. This is just one more instance of American courts anticipating the *Hadley* rule.

court used a technique that would later be perfected by Judges such as Benjamin Cardozo on this same New York Court of Appeals and Roger Traynor on the California Supreme Court. It analyzed the leading cases that seemed to support the contrary point of view and argued that if you looked at the facts and what the court actually decided on the basis of those facts, rather than looking at the language these courts used in support of their reasoning, the cases really did support the judge's rule, not the opposing rule for which they were cited.<sup>176</sup> More importantly, it embraced the emerging trend toward replacing narrow, situation-specific rules with broad principles of general application.<sup>177</sup>

To work this transformation, the court began by discussing a group of rules that depended on the market price of goods and attempted to show that these are in reality specific applications of the general rule that lost profits can be recovered when they can be proven with certainty and cannot be recovered when they cannot.<sup>178</sup> It cited the rule that in an action for breach of a contract to transport goods, the damages are the difference between the price of the goods at the point of origin and the price at the destination and the rule that where a seller breaches a contract to sell goods, the damages are the difference between the contract price and the market price at the time and place for delivery. "[T]his," the court said, "amounts to an allowance of profits."<sup>179</sup> It is recoverable because "those profits do not depend upon any contingency."<sup>180</sup> The court then goes on to distinguish the cases that do not allow the recovery of profits in the case of the illegal capture of goods at sea or in the case of insurance for goods lost at sea. In those cases, "the fluctuation of the markets and the contingencies affecting the length of the voyage render every calculation of profits speculative and unsafe,"<sup>181</sup> whereas in cases involving the transportation of goods by land, the market price at the destination "can be ascertained with reasonable certainty."<sup>182</sup>

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176. See Arthur L. Corbin, *Mr. Justice Cardozo and the Law of Contracts*, 39 COLUM. L. REV. 56 (1939) (discussing Cardozo's method); *Pac. Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.*, 442 P.2d 641 (Cal. 1968) (exemplifying Traynor's method). Cf. Grant Gilmore, *Legal Realism: Its Cause and Cure*, 70 YALE L.J. 1037, 1045 (1961) (describing Cardozo's method in an alternative way).

177. See GILMORE, *supra* note 4, at 41-67 (1977) (describing how courts in the period from the post-Civil War to World War I viewed themselves as discovering immutable rules of law rather than adapting the law to changing conditions).

178. See *Griffin v. Colver*, 16 N.Y. 489, 491-92 (N.Y. 1858) (using existence of predictable market price to reach conclusion that damages for lost profits may not be speculative).

179. *Griffin*, 16 N.Y. at 491.

180. *Id.*

181. *Id.* at 492.

182. *Id.*

One can certainly question this reasoning. The rules cited are not rules allowing the injured party to recover its lost profits. They are rules that give a fixed measure of damages that will in many cases approximate the party's actual lost profits. But if they were really intended to give the injured party its lost profits, they would, like their modern equivalents, allow the injured party to prove that its damages were greater than the amount allowed by the rule (or to allow the defendant to prove that the damages were less). For instance, there might be cases where the buyer or the shipper had a contract to sell the goods to a third party at a price above (or below) the prevailing market price (perhaps because the contract had been made at a time when the price was higher or lower) or there might be cases where the buyer or the shipper needed the goods for a special purpose (think of Hadley's mill shaft). The pre-*Griffin* rules made no provision for that.<sup>183</sup>

As further support for the idea that it was the difficulty of determining the profits to be made from a sea voyage that was the reason for the *per se* rule against allowing such profits, the court quoted part of the passage from Justice Story's opinion in *The Lively* quoted earlier in this article.<sup>184</sup>

Next, the court jumped to a truly amazing conclusion: "Indeed, it is clear that whenever profits are rejected as an item of damages, it is because they are subject to too many contingencies, and are too dependent upon the fluctuations of markets and the chances of business, to constitute a safe criterion for an estimate of damages."<sup>185</sup> We have added the emphasis to make clear how incredibly broad a statement the court was making. It is particularly significant, because cases in New York and other American jurisdictions had almost never allowed the recovery of lost profits as consequential damages and had given many reasons for not doing so, most

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183. See *supra* notes 103-32 and accompanying text (showing lack of flexibility to prove higher or lower damages).

184. *Griffin*, 16 N.Y. at 492. The opinion said:

[T]hat these are the true reasons is shown by the language of Mr. Justice Story, in the case of the *Schooner Lively* (1 *Gallis.*, 315), which was a case of illegal capture. He says: "Independent, however, of all authority, I am satisfied upon principle, that an allowance of damages, upon the basis of a calculation of profits, is inadmissible. The rule would be in the highest degree unfavorable to the interests of the community. 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 which would sometimes present embarrassing obstacles. Much would depend upon the length of the voyage, and the season of arrival; much upon the vigilance and activity of the master, and much upon the momentary demand. After all, it would be a calculation upon conjecture, and not upon facts.

185. *Id.* (emphasis supplied).

commonly that there was a rule that mandated a specific damages formula that did not include lost profits.<sup>186</sup> But the court goes on to say: “The decision in the case of *Blanchard v. Ely* (21 Wend., 342) must have proceeded upon this ground, and can, as I apprehend, be supported upon no other.”<sup>187</sup> The court explains that the “Rule of Pothier” (i.e., the rule now known as the Rule of *Hadley v. Baxendale*) as it was discussed in *Blanchard v. Ely* and says that it cannot have applied in that case:

In *Blanchard v. Ely* the damages claimed consisted in the loss of the use of the very article which the plaintiff had agreed to construct; and were, therefore, in the plainest sense, the direct and proximate result of the breach alleged. Moreover, that use was contemplated by the parties in entering into the contract, and constituted the object for which the steamboat was built. It is clear, therefore, that the rule of Pothier had nothing to do with the case. Those damages must then have been disallowed, because they consisted of profits depending, not, as in the case of a contract to transport goods, upon a mere question of market value, but upon the fluctuations of travel and of trade, and many other contingencies.<sup>188</sup>

This reasoning is interesting for a couple of reasons. First, contrary to the court’s assertion, it is not at all clear that the civil law consequential damages rule (the “rule of Pothier”) had nothing to do with the case. It might well have precluded recovery in *Blanchard v. Ely*. It is true that the rule of *Hadley v. Baxendale*, as it is now applied in most American jurisdictions, would hold that the builder’s knowledge that the boat was to be used to carry passengers for hire would be enough to make the builder liable for the normal profits lost on account of delays in making it serviceable.<sup>189</sup> But the civil law rule, at least as understood by the *Blanchard v. Ely* court, required more than mere foreseeability. In a portion of the opinion previously quoted, the *Blanchard* court had said:

[Pothier] also adverts to the distinction that the vendor may, notwithstanding, incur liability for extrinsic damages of the creditor, *if it appear they were stipulated for or tacitly submitted to in the contract*. One instance of this is that of stipulating to deliver a horse in such time that a certain advantage may be gained reaching such a place. There the debtor shall, on default,

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186. See *supra* notes 106-35 and accompanying text (showing reluctance to award lost profits as consequential damages).

187. *Griffin*, 16 N.Y. at 492.

188. *Id.* at 493-94.

189. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 33, at § 351, ill. 5 (1989) (illustrating reasonable foreseeability of lost profits when the breaching party has knowledge that delay will lead to inability to run operation at full capacity).

pay for the loss of the advantage.<sup>190</sup>

This seems to say that in order to recover consequential damages, the plaintiff must do more than simply show the defendant had reason to know the damages would be incurred; it must show the defendant had agreed, at least tacitly, that it would be liable for those damages. This rule, sometimes called the “tacit agreement test,” was adopted by most American jurisdictions in the years following *Hadley v. Baxendale*.<sup>191</sup> Most American jurisdictions dropped it in favor of a more liberal reading of *Hadley* early in the twentieth century, but, interestingly, the courts of New York still retain it.<sup>192</sup>

With *Griffin*’s rejection of the foreseeability requirement as the rule of decision in *Blanchard v. Ely*, that opinion became just another forgotten nineteenth century opinion. It was not cited in scholarly writing until 2005 when scholars writing about *Hadley v. Baxendale* in honor of the 150<sup>th</sup> anniversary of the issuance of that opinion noted that an American court had adopted the same rule a decade and a half before the Court of the Exchequer.<sup>193</sup>

## VI. LATER DEVELOPMENT

### A. *The Griffin Rule Spreads*

If *Blanchard* was quickly forgotten, *Griffin* quickly gained notoriety. It soon became known as the “leading American case” on the recovery of lost profits.<sup>194</sup> Courts in other jurisdictions began almost immediately to cite it for the proposition that lost profits were now a recoverable item of damages.

The first of these was the Wisconsin Supreme Court in *Hinkley v.*

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190. *Blanchard v. Ely*, 21 Wend. 342, 348 (N.Y. 1839) (emphasis supplied).

191. See *infra*, Part VI. C (tracing the development of the tacit agreement test in English and American law).

192. See, e.g., *Kenford Co. v. County of Erie*, 537 N.E.2d 176, 178-89 (N.Y. 1989) (finding that a County that failed to build a stadium was not liable to pay damages for the loss of anticipated appreciation value of the land where the stadium would have been located because the County never contemplated that it would be liable for such a loss).

193. See Wayne Barnes, *Hadley v. Baxendale and Other Common Law Borrowings from the Civil Law*, 11 TEX. WESLEYAN L. REV. 627, 635-36 (2005); Perillo, *supra* note 47, at 273-74 (describing the influence of Pothier’s contemplation of the parties test on the *Blanchard* court).

194. See, e.g., *Jones v. Nathop*, 1 P. 435, 437 (Colo. 1883) (describing *Griffin* as “the leading American case”); *accord* *Western Gravel Road Co. v. Cox*, 39 Ind. 260, 261 (Ind. 1872) (citing *Griffin* as the leading American case on lost profits); see also *Manville v. Western Union Tel. Co.*, 37 Iowa 214, 219 (1873) (calling *Griffin* “a leading American authority on the subject”).

*Beckwith*,<sup>195</sup> decided just two years after *Griffin*. A sawmill lease provided that the lessors would make any repairs that cost more than five dollars and were necessary to keep the sawmill running.<sup>196</sup> When the engine failed in the last sixty days of the lease term, the lessors refused to repair it.<sup>197</sup> In the resulting lawsuit, the trial court awarded the lessees the profits they had lost in during the time the mill was out of service<sup>198</sup> and the defendant appealed. Interestingly, both parties cited *Griffin* in their briefs to the Wisconsin Supreme Court. The lessees cited it for the proposition that lost profits were recoverable and the lessors cited it for the proposition that they were not.<sup>199</sup> The Supreme Court sided with the lessees, discussing *Griffin* at length and saying that it “fully sustains” the rule allowing lost profits to be recovered.<sup>200</sup>

After *Hinckley*, the *Griffin* rule spread by stealth. Courts in many jurisdictions issued opinions upholding denials of lost profits (or reversing awards of lost profits), but in doing so they cited *Griffin*. These courts reasoned that under proper circumstances lost profits were recoverable, and that the instant cases were not the proper circumstances.<sup>201</sup> The most important of these opinions was that of the United States Supreme Court in *United States v. Behan*.<sup>202</sup> Behan had been working under a contract with the Army to make improvements in the harbor of New Orleans when the Army decided that it was not worthwhile to continue the work and terminated the contract.<sup>203</sup> Behan thereupon petitioned the War Department for his expenses to date and the profit he would have made had he been allowed to complete the contract.<sup>204</sup> When he was not paid, he sued in the Court of Claims, which only awarded him his expenditures to date, finding that he had not sufficiently proven his lost profits.<sup>205</sup> The Supreme Court

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195. 13 Wis. 31 (1860).

196. *Id.* at 33.

197. *Id.*

198. *Id.* at 32.

199. *Id.* at 31, 34.

200. *Id.* at 34-35.

201. See, e.g., *Jones v. Nathop*, 1 P. 435, 437 (Colo. 1883) (describing *Griffin* as “the leading American case,” but rejecting lost profits claim because profits were “speculative”); *Western Gravel Road Co. v. Cox*, 39 Ind. 260, 261-263 (Ind. 1872) (quoting *Griffin* at length but holding that lost profits not proven with sufficient certainty); *U.S. Tel. Co. v. Gildersleve*, 29 Md. 232, 250-51 (1868) (discussing *Griffin* but reversing lost profit award because loss not foreseeable); *Cushing v. Seymour*, 15 N.W. 249, 250 (Minn. 1883) (citing *Griffin* for the proposition that lost profits can be recovered if reasonably certain, but holding plaintiff’s lost profits were not proven with reasonable certainty).

202. 110 U.S. 338 (1884).

203. *Id.* at 339-40.

204. *Id.* at 340-41.

205. *Id.* at 342-43.

affirmed the Court of Claims, but in doing so stated unequivocally that lost profits may be recovered in proper circumstances and that this principle was so well established that “[i]t is unnecessary to review the authorities on this subject.”<sup>206</sup> *Behan* added weight to the growing *Griffin* consensus and by the end of the 1880s courts throughout the nation had acknowledged the principle that lost profits were a proper item of damages.<sup>207</sup>

Some of the cases giving rise to these acknowledgments were the routine eighteenth century commercial cases (mills and shipping contracts continued to play leading roles)<sup>208</sup> and some involved interesting situations. In 1889, the New Mexico Supreme Court relied on *Griffin* to allow a doctor to recover the fee he would have earned by travelling to a town one-hundred miles away to treat a gunshot victim.<sup>209</sup> A telegram asking him to

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206. *Id.* at 346.

207. *See, e.g.*, *Bell v. Reynold & Lee*, 78 Ala. 511, 514 (1885) (finding that lost profits from an anticipated resale are recoverable); *Jones v. Nathop*, 1 P. 435, 437 (Colo. 1883) (stipulating that the lost profits claim is a valid principle); *Cohn v. Norton*, 18 A. 595, 597 (Conn. 1889) (holding that definite and certain profits lost through the breach of a contract are recoverable); *Chicago R.R. Co. v. Hale*, 83 Ill. 360, 363-64 (1876) (allowing recovery for lost profits where an outstanding contract is present or the future purpose of goods is known); *City of Terre Haute v. Hudnut*, 13 N.E. 686 (Ind. 1887) (directing award of damages for lost profits resulting from a hiatus of business activity caused by a breach of contract); *Alexander v. Bishop*, 13 N.W. 714, 717 (Iowa 1882) (recognizing that recovery would be allowed definite and certain lost profits resulting from a breach); *Stewart v. Power*, 12 Kan. 596, 599-600 (1874) (ordering recovery of damages for lost profits where this loss was contemplated during the formation of the breached contract); *Cushing v. Seymour*, 15 N.W. 249, 250 (Minn. 1883) (holding that reasonably certain lost profits resulting from a breach of contract may be recovered); *Deming v. Grand Trunk R.R. Co.* 48 N.H. 455, 471 (1869) (noting that recovery for lost profits would be allowed for breach of contracts made in reference to a resale); *Wisner v. Barber*, 10 Or. 342, 344 (1882) (affirming that “the allowance of profits [is] now well established”); *McHose v. Fulmer*, 73 Pa. 365, 367 (1873) (holding that actual loss of profits is the appropriate measure of damages in a contract breach where the goods cannot be readily replaced); *Simmons v. Brown*, 5 R.I. 299, 305-06 (1858) (finding that a loss of profits that is the direct and necessary result is recoverable); *Hinckley v. Beckwith*, 13 Wis. 31 (Wis. 1860) (establishing lost profits or earnings as a proper item for consideration in the calculation of damages). *See also* *Ye Seng Co. v. Corbitt & Macleay*, 9 F. 423 (D. Or. 1881) (relying on *Griffin* to allow recovery of lost profits in admiralty for breach of charter-party); *Shouse v. Neiswaanger*, 18 Mo. App. 236, 250-51 (1885) (allowing recovery of lost profits on remand if foreseeable).

By 1890, the Pennsylvania Supreme Court seems to have thought the recovery of lost profits in contract to be so uncontroversial that it found it unnecessary to cite a single authority in an opinion upholding a verdict for lost profits. *Imperial Coal Co. v. Port Royal Coal Co.*, 20 A. 937, 937 (Pa. 1890).

208. *See, e.g.*, *Pac. Sheet Metal Works v. Californian Canneries, Co.*, 164 F. 980, 985 (9th Cir. 1908) (awarding lost profits where storms delayed shipment); *Morrow v. Mo. Pac. Ry. Co.*, 123 S.W. 1034, 1039 (Mo. Ct. App. 1909) (involving delay in shipment of mill rolls).

209. *Western Union Tel. Co. v. Longwill*, 21 P. 339 (N.M. 1889).

come was not delivered in a timely manner, and as a result, the victim died before the doctor could treat him and earn his fee.<sup>210</sup> The court said that under *Griffin*, the injured party is entitled to recover all damages, including gains prevented as well as losses sustained.<sup>211</sup>

### B. *A New Rule Limiting Lost Profits*

There were, however, still some bumps on the road to the present law of lost profits. One of these bumps was created by the *Griffin* opinion itself. Like Ophelia (“the lady doth protest too much, methinks”<sup>212</sup>), Judge Selden knew he was on shaky ground when he tried to explain away *Blanchard v. Ely*, and he went on explaining for too long. In doing so, he inadvertently created a new rule that slowed the development of the law of lost profits:

Had the defendants in the case of *Blanchard v. Ely* . . . taken the ground that they were entitled to recoup, not the uncertain and contingent profits of the trips lost, but such sum as they could have realized by chartering the boat for those trips, I think their claim must have been sustained . . . .

The rent of a mill or other similar property, the price which should be paid for the charter of a steamboat, or the use of machinery, &c., &c., are not only susceptible of more exact and definite proof, but in a majority of cases would, I think, be found to be a more accurate measure of the damages actually sustained in the class of cases referred to . . . .<sup>213</sup>

What the court is saying here is that if the lost profits are uncertain, the plaintiff can be awarded the lost profits of some other hypothetical enterprise that it could have entered into but for the defendant’s default. This led courts to adopt a number of narrow rules for application in similar situations. Most courts adopted some version of the rule that where a party is deprived of the use of property by the defendant’s action or omission, the measure of damages is not the profits lost, but rather the rental value of the property of which they were deprived. The reasoning by which they reached this conclusion varied. The Supreme Court of Iowa put it in terms of a *Hadley v. Baxendale* issue:

[O]n the principle that speculative profits are not deemed to have been within the contemplation of the parties, where there is some

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210. *Id.* at 340.

211. *Id.* at 342.

212. WILLIAM SHAKESPEARE, *HAMLET* act 3, sc. 2.

213. *Griffin*, 16 N.Y. 489, 496-497 (N.Y. 1858).



other more substantial basis on which to reckon the damages for breach of contract, it has been generally held that where the contract was as to the completion of a building or boat, or for the use of land or machinery, or the like, the rental value of the use of which the party was deprived should be taken as the measure of his damage, and that he could not substitute therefor or include therein profits which he should have made in such use.<sup>214</sup>

The court went on to say: “It is well established by the decided preponderance of authority that where future profits are in the contemplation of the parties, *and there is no other basis on which damages for breach of contract can be estimated*, such profits may be made the basis for the recovery of damages.”<sup>215</sup>

The Michigan Supreme Court, in a tort case where the defendant wrongfully took possession of the plaintiff’s boat, phrased the rule as a *per se* rule disallowing profits and instead allowing the recovery of the rental value of the boat:

The measure of damages is not to be made to depend upon the use, or non-use, of the property by the defendant; neither can the use to which the plaintiff could have put the property during its detention, and the prospective estimates of profits therefrom, contingent upon his chance of business, determine the value of its use. Such rule would be too uncertain and speculative.<sup>216</sup>

The Illinois Supreme Court applied similar reasoning to reverse an award of lost profits and give a farmer the rental value of his land when the City of Chicago flooded the land and prevented him from growing a year’s crop.<sup>217</sup> In doing so, it overruled a previous case allowing the farmer to recover his lost profits under similar circumstances.<sup>218</sup>

Most courts, however, did not bother elaborating their reasoning, let alone qualifying the rule. They simply stated that the established rule was that the injured party was entitled to the rental value, not the lost profits.<sup>219</sup>

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214. *Hirschhorn v. Bradley*, 90 N.W. 592, 594-95 (Iowa 1902).

215. *Id.* at 595. (emphasis added). *See also* *Connerville Wagon Co. v. McFarlan Carriage Co.*, 76 N.E. 294, 299 (Ind. 1905) (deciding that “the value of the use should be regarded as the basis for a recovery, where a case is made for an allowance of special damages growing out of a deprivation of the use of property”).

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

217. *See* *City of Chicago v. Huenerbein*, 85 Ill. 594, 595-96 (Ill. 1877) (overruling *Chicago & Rock Island R.R. Co v. Ward*, 16 Ill. 522, 530-31 (1855)).

218. *Id.* at 596.

219. *See, e.g.*, *Sinker et al. v. Kidder*, 24 N.E. 341, 341 (Ind. 1890) (relying on *Griffin*); *Benton v. Fay*, 64 Ill. 417, 420-21 (1872) (finding damages were rental value of entire plant where operation of plant delayed because of late delivery of planning machine); *Strobel Steel Constr. Co. v. Sanitary Dist. of Chicago*, 160 Ill. App. 554, 564 (Ill. App. Ct. 1911) (relying on *Griffin* to award rental value of plaintiff’s plant where construction was delayed

Ironically, *Griffin* was often cited as the leading case for this rule.<sup>220</sup>

Similarly, where sales agents for a sewing machine company sought the profits they lost because the company failed to supply the agents with machines as promised, the Iowa Supreme court, after an extensive discussion of *Griffin*, which it characterized as a leading case, held that the agents were entitled to the value of their time and that the trial court had erred in instructing the jury that they could “take into consideration the market demand for such machines in the country.”<sup>221</sup>

Some courts gave *Griffin* a slightly different interpretation. The *Griffin* opinion said:

Cases not unfrequently occur in which . . . it is certain that some loss has been sustained or damage incurred, and that such loss or damage is the direct, immediate, and natural consequence of the breach of the contract, but where the amount of the damages may be estimated in a variety of ways. In all such cases the law . . . uniformly adopts that mode of estimating damages which is most definite and certain.<sup>222</sup>

This could be read to mean that if there is one method (such as the awarding of lost profits) that is most likely to put the plaintiff in the position they would have been in but for the breach of the contract or duty and a second method where the calculation is subject to less inaccuracy or uncertainty, the court should always adopt the latter. This may have been the reason some cases quoted and relied on this language from *Griffin*.<sup>223</sup>

But most of these cases seem to have thrown in a citation from *Griffin* as additional authority where the lost profits were too uncertain to be recovered.<sup>224</sup> One example is a case that eerily parallels the facts of *Hadley*

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because of fault of defendant). *See also* Brownell et al. v. Chapman, 51 N.W. 249, 250 (Iowa 1892) (noting that while some cases had adopted the interest that could have been earned on the capital invested in the property as the measure of damages, the rental value rule far outweighed it in “the number of cases and the reasoning supporting the rule.” The opinion also quoted *Griffin*).

220. *See, e.g.*, Vilter Mfg. Co. v. Abeel, 191 F. 272, 281 (5th Cir. 1911) (calling *Griffin* “a leading case on the subject”); Washington & Georgetown R.R. Co. v. American Car Co., 5 App. D.C. 524, 544-46 (1895) (calling *Griffin* “a leading case on the subject”); Sanitary Dist. of Chicago v. McMahon & Montgomery Co., 110 Ill. App. 510, 526 (Ill. App. Ct. 1903) (calling *Griffin* “the leading American case” on the subject).

221. *Howe Mach. Co. v. Bryson*, 44 Iowa 159, 162 (Iowa 1876).

222. *Griffin v. Colver*, 16 N.Y. 489, 495 (N.Y. 1858).

223. *E.g.*, *St. Louis & S. F. R. Co. v. Lilly*, 55 So. 937 (Ala. Ct. App. 1911) (finding that a salesman could not recover lost profits caused by a carrier’s delay because the profits were too uncertain).

224. *E.g.*, *Sanitary Dist. of Chicago v. McMahon & Montgomery Co.*, 110 Ill. App. 510, 526 (Ill. App. Ct. 1903) (finding that the true measure of damages did not include market rental value of dredging equipment during the time appellees were deprived of its use).

*v. Baxendale*. In *S. Ry. Co. v. Coleman*,<sup>225</sup> a cotton gin was shut down because of a broken press pin. The owner of the gin delivered the pin to the Southern Railway, which was to carry it to an iron works at Selma, Alabama, 56 miles away, where it was immediately to be repaired and returned to the ginner.<sup>226</sup> Unlike the famous ambiguity in the *Hadley* opinion,<sup>227</sup> 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.”<sup>228</sup> Nevertheless, through the negligence of the railroad employees the pin was not delivered to the iron works for seven days and then only because the plaintiff himself went to Selma and located the pin in a railroad car. The pin was then repaired within three hours and returned to the gin the next day. The plaintiff sued to recover the profits lost during the time the gin was shut down on account of the railroad’s negligence.<sup>229</sup> The plaintiff said that his profit was 75 cents for each bale of cotton ginned, but he could not give a good estimate of the number of bales lost.<sup>230</sup> In spite of this, the trial judge charged the jury that he was entitled to recover his lost profits. The Alabama Supreme Court, however, reversed the award of lost profits. Its opinion quoted *Griffin*’s statement that the law adopts “the mode of estimating damages which is most definite and certain.”<sup>231</sup> It concluded that if the period of the delay was long enough for the gin to have had an ascertainable rental value for that period, then that rental value would be the appropriate measure of damages. If there was no ascertainable rental value for such a short period, then the damages would be the interest on the value of the gin.<sup>232</sup>

### C. *The Tacit Agreement Test*

Another roadblock on the highway to a rule allowing the recovery of lost profits was the rule of *Hadley v. Baxendale*. Although the modern reading of *Hadley* is that lost profits need only to have been foreseeable at

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225. 44 So. 837 (Ala. 1907).

226. *Id.* at 838.

227. The facts of the case as related by the reporter say that the plaintiffs’ servant told the defendant’s clerk that the shaft must be sent immediately because the mill was stopped. 156 Eng. Rep. at 147. Baron Alderson’s opinion, however, says that the clerk had no way of knowing whether the mill was stopped. *Id.* at 151.

Numerous commentators have theorized about this discrepancy. The best analysis is at Danzig, *supra* note 74, at 262-63.

228. *S. Ry. Co.*, 44 So. at 838.

229. *Id.*

230. *Id.*

231. *Id.*

232. *Id.* at 839.

the time the contract was made,<sup>233</sup> courts in many American jurisdictions adopted the so-called *tacit agreement test*. Under this test, a party seeking to recover lost profits (or any other consequential damages) had to do more than simply show that the defendant had notice of the special circumstances giving rise to the damages. They had to show that the defendant had manifested (expressly or impliedly) an intent to assume the risk of those damages.<sup>234</sup> This rule apparently originated in England shortly after *Hadley*. Most accounts trace it back to *B.C. Saw-Mill Co. v. Nettleship*,<sup>235</sup> an English opinion of 1868.<sup>236</sup> The defendant had contracted to transport machinery for a sawmill from Glasgow to Vancouver. One of the boxes, which contained many small and important items, failed to arrive at Vancouver.<sup>237</sup> It took nearly a year for replacement parts to arrive from Britain, during which time the sawmill was idle.<sup>238</sup> The jury awarded damages of 3,000 pounds, the bulk of which (264*l. 2s. 3d.*) was the rental value of the whole of the machinery (not even the rental value of the *sawmill*, let alone the lost profits from the sawmill).<sup>239</sup> The court of common pleas, however, reduced the damages to 353*l. 17s. 9d.*, the cost of replacing the missing parts, including freight to British Columbia.<sup>240</sup> In his opinion, Bovill, C.J. said:

The extent of the carrier's liability is to be governed by the contract he has entered into, and the obligations which the law imposes upon him. He is not to be made liable for damages beyond what may fairly be presumed to have been contemplated by the parties at the time of entering into the contract. It must be something which could have been foreseen and reasonably expected, *and to which he has assented expressly or impliedly by entering into the contract.*<sup>241</sup>

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233. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 33, at § 351 (“Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made”).

234. CALIMARI & PERILLO, *supra* note 2, § 14.5(a).

235. 3 C.P. 499, 500 (1868).

236. See, e.g., John R. Hudson, *Case Note, Stiff's Jewelers v. Oliver: The Tacit Agreement Test—Arkansas Clings to a Dinosaur*, 40 ARK. L. REV. 403, 405 (1986).

237. 3 C.P. at 500.

238. *Id.*

239. *Id.* at 501.

240. *Id.* at 505.

241. *Id.* at 505-06 (emphasis added). In his concurring opinion, Judge Willes, said that the question of consequential damages was a difficult one and described a case from 250 years earlier in which a man who was travelling to be married to an heiress had a horseshoe replaced on the journey. The blacksmith who replaced the horseshoe did such a bad job of the repair that the horse became lame, the groom did not arrive on time and the woman married someone else. *Id.* at 508. If the judges considered the case even remotely similar to

The leading American authority for the tacit agreement test was Justice Holmes' 1903 opinion in *Globe Refining Co. v. Landa Cotton Oil Co.*<sup>242</sup>

Another impediment to recovering lost profits was that courts of the day seemed unwilling to assume that a party making a contract to supply goods or services would foresee that its buyer intended to earn a profit through the use or resale of those goods or services.<sup>243</sup> For example, in 1891, defendants who were being sued on a note for the purchase price of saw mill machinery attempted to set off the profits they lost because the machinery had been delivered two months late.<sup>244</sup> Their lawyers, undoubtedly having read *Hadley v. Baxendale* very carefully, included in their plea an allegation that the plaintiff's knew the mill was stopped on account of the non-delivery of the machinery.<sup>245</sup> The Alabama Supreme Court nevertheless held that the plea was "bad" because there was no allegation that the plaintiffs knew the defendants had contracts to sell the lumber from the mill at a profit.<sup>246</sup>

In a 1901 case, *Acme Cycle Co. v. Clark*,<sup>247</sup> the Indiana Supreme Court held that a trial court had been correct in refusing to award a bicycle manufacturer the profits due to the late delivery of machinery necessary to manufacture the hubs for its bicycles. The court said that even if the bicycle company notified the machinery supplier it could manufacture an additional 500 bicycles per month, had the hub machines, and sold those bicycles at a profit, the company still would not meet the requirements of *Hadley v. Baxendale* (and *Griffin v. Colver*, which the court cited along with *Hadley* for the foreseeability requirement).<sup>248</sup> According to the court:

The later English cases indicate that, where extraordinary

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the one preceding it, one can understand why they decided as they did. Interestingly, the first Restatement of Contracts, which rejected the tacit agreement test, used this fact situation as an example of a situation where the breaching party would clearly *not* be liable. RESTATEMENT OF CONTRACTS, *infra* note 257, at § 330, il. 8 (1932).

242. 190 U.S. 540 (1903).

243. *See, e.g.*, *Harvey v. Conn. & Passumpsic R.R. Co.*, 124 Mass. 421, 423-25 (Mass. 1878) (finding that shipper could not recover profits lost on contracts to make lumber into railroad ties even though it had informed railroad of the contracts at the time it made the contracts for shipment); *Thomas, Badgley & W. Mfg. Co. v. Wabash, St. L. & P. Ry. Co.*, 22 N.W. 827 (Wis. 1885) (finding that shipper could not recover for loss of use of machine damaged during shipping because railroad was not informed of the machine's use).

244. *Reed Lumber Co. v. Lewis*, 10 So. 333, 334 (Ala. 1891).

245. *Id.*

246. *Id.*

247. 61 N.E. 561.

248. *Id.* at 562-563. Although *Blanchard v. Ely* has been overlooked as an early case requiring that damages for breach of contract be foreseeable (see note 107), *Griffin v. Colver* was often cited in the late eighteenth and early nineteenth centuries for that rule. *See, e.g.*, *Hagen v. Rawle*, 143 Ill. App. 543, 545 (Ill. App. Ct. 1908).

liabilities are to be assumed by a party contracting to deliver goods, it should appear that he understood the nature of the responsibility he was taking upon himself, and that his compensation should include some consideration for the responsibility assumed. Furthermore, these cases intimate that the liability of the party for the extraordinary damages which might result from a breach of the contract to deliver should be so plainly understood as to render it one of the terms of the contract that, in case of a failure to deliver the goods, the person guilty of the breach would be responsible for such damages. And the very reasonable observation has been made that, if parties desire to avail themselves of a claim to such damages, they should expressly stipulate for them in the contract itself.<sup>249</sup>

This combines the rationale of the tacit agreement test with the assumption that the defendant would not expect that the plaintiff intended to use the goods in a profit-making endeavor.

In 1891, the United States Supreme Court said: “The authorities both in England and the United States are agreed that as a general rule, subject to certain well-established qualifications, the anticipated profits prevented by breach of a contract are not recoverable in the way of damages for such breach . . . .”<sup>250</sup> Citing the 1880 edition of *Sedgwick on Damages*, the court listed three reasons this was so:

(1) that in the greater number of cases such expected profits are too dependent upon numerous [sic], uncertain and changing contingencies to constitute a definite and trustworthy measure of actual damages; (2) because such loss of profits is ordinarily remote and not, as a matter of course, the direct and immediate result of the non-fulfilment of the contract; (3) and because most frequently the engagement to pay such loss of profits, in case of default in the performance, is not part of the contract itself, nor can it be implied from its nature and terms.<sup>251</sup>

The first of these reasons we would express today by saying that the plaintiff failed to prove his damages with reasonable certainty.<sup>252</sup> The second shows the courts’ unwillingness to assume that the breaching party should have expected that the other party had plans to use the goods and services in question to make a profit, and the third presages the Court’s adoption of the tacit agreement test.

This idea that the breaching party would not expect the plaintiff to

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249. *Id.* at 563.

250. *Howard v. Stillwell & Bierce Mfg. Co.*, 139 U.S. 199, 205-06 (1891).

251. *Id.* at 206.

252. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 33, § 352 (1979).

have plans to earn profits on what it had expected to buy continued well into the twentieth century. As late as 1934, Professor McCormick could write about “the rule which denies recovery for unusual consequences of a breach of contract, where knowledge of the risk is not brought home to the defendant” and go on to say that the among the most frequent of these “unusual consequences” was loss of profits on a contract to resell the goods contracted for.<sup>253</sup> Professor Bauer went even further, saying that even though Williston’s treatise on contracts (the leading work on contracts of that era) said that consequential damages could be awarded if the defendant was on notice of special circumstances, there were few cases it cited in which the plaintiff recovered without evidence that the defendant intended to assume liability for the consequences of those special circumstances.<sup>254</sup>

Even as McCormick wrote, however, things were beginning to change. Courts were beginning to allow plaintiffs to recover consequential damages without showing they had put the defendant on notice they intended to earn a profit with the goods (or occasionally, services) contracted for.<sup>255</sup> McCormick himself suggested that judges interpreted the contemplation requirement flexibly, finding the lost profits within the contemplation of the parties when they thought it fair to allow recovery of the lost profits and finding they were not contemplated when the court thought their recovery would be unfair.<sup>256</sup>

The drafters of the first Restatement of Contracts (Professor Williston was the Reporter) took a position seemingly opposite to that of most of the case law when they said in a comment to section on the *Hadley v. Baxendale* rule:

A seller or carrier of goods usually has reason to know that the buyer or shipper either has made or will probably make a contract for the sale of the goods at a reasonable profit. Such circumstances are in the usual course of things. He therefore has reason to foresee that his own failure to deliver the goods as agreed will prevent the plaintiff from making such a reasonable profit.<sup>257</sup>

The Restatement also rejected categorically the tacit agreement test.<sup>258</sup>

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253. McCormick, *supra* note 2, at 505.

254. Ralph S. Bauer, *Consequential Damages in Contract*, 80 U. PA. L. REV. 687, 696 (1932).

255. See, e.g., *Bonhard v. Gindin*, 142 A. 52, 55 (N.J. 1928) (allowing recovery of lost profits which plaintiff intended to make on resale of property without proof that defendant had actual knowledge of intent to resell) (citing *Hadley v. Baxendale*, 156 Eng. Rep. 345 (Ex. 1854)).

256. McCormick, *supra* note 4, at 508.

257. RESTATEMENT OF CONTRACTS § 330 cmt. c (1932).

258. See *id.* cmt. a (“One who has committed a breach of contract is bound to pay

Perhaps more importantly, the Restatement expressed the *Hadley* test in terms of the defendant's liability for those injuries that he "had reason to foresee" as a result of the breach.<sup>259</sup> Although this is a subtle change from the language generally used before, it is an important one. It implies that the plaintiff can recover if the defendant, at the time it made the contract, had reason to expect that the plaintiff would lose profits if the defendant breached. The defendant did not have to be thinking about, or "contemplating" the loss of profits; he just had to be in a position where, if he had thought about the issue, he should have realized there was a good chance that a breach would lead to a loss of profits. The Uniform Commercial Code took a similar position. A comment said that the standard was whether the seller "had reason to know" of the potential damages.<sup>260</sup>

These developments contributed to a general relaxation of the foreseeability requirement that began about 1930. The current attitude is reflected in cases such as *Burnett & Doty Development Co. v. Phillips*.<sup>261</sup> There, the California Court of Appeals held that the fact a builder personally added a completion date into a subcontract was enough to make it foreseeable that the builder would suffer lost profits when the subcontractor failed to complete its work on time.<sup>262</sup> In *Manouchehri v. Heim*,<sup>263</sup> the New Mexico Supreme Court allowed a physician to recover the profits he lost as a result of a defective x-ray machine. The seller argued that these lost profits were not foreseeable, but the court rejected this argument, saying: "[The defendant] knew his customer and knew how the x-ray machine was to be used. Any reasonable person in his position would assume that a doctor using such a machine would charge more for its use than the cost of operation and would earn income from it."<sup>264</sup> Similarly, when Virginia Polytechnic Institute (Virginia Tech) breached a contract to work with a private corporation to jointly develop new technology, it was foreseeable from the nature of the enterprise that the

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damages only for such injury as he had reason to foresee when he made the contract. This does not mean, however, that the defendant must have had the resulting injury actually in contemplation or that he promised either impliedly or expressly to pay therefore in case of breach.")

259. *Id.* at § 330.

260. U.C.C. § 2-715 (2015), cmt. 2 (internal quotations omitted).

261. 148 Cal. Rptr. 569 (Cal. Ct. App. 1978).

262. *See id.* at 572-573 (holding that plaintiff was entitled to lost profits where defendant personally wrote the completion date into the contract and failed to complete work by that date).

263. 941 P.2d 978 (N.M. 1997).

264. *Id.* at 983.



parties would receive profits from the licensing or sale of the technology.<sup>265</sup>

A few jurisdictions, most notably New York, still use the tacit agreement test,<sup>266</sup> and in those jurisdictions the *Hadley* principle is still an important limitation on a plaintiff's ability to recover lost profits, though even in those jurisdictions the certainty requirement is much more important.

This leaves open one question in the development of the reasonable certainty rule. How did the courts transform the requirement that the lost profits be proven with absolute certainty to one that they be proven with "reasonable certainty?" The language of *Griffin v. Colver* was ambiguous on this score. In the second paragraph of the opinion, Judge Selden says that "[i]t is a well established rule of common law that the damages to be recovered for a breach of contract must be shown with certainty[.]"<sup>267</sup> Later in the opinion, in language that has been incorporated into many opinions in many jurisdictions, he says that the damages "must be certain, both in their nature and in respect to the cause from which they proceed."<sup>268</sup> But here it is not clear that when he speaks of certainty he means absolute certainty rather than reasonable certainty because he contrasts "certain" with "speculative," indicating that a reasonable estimate may be all that is required.<sup>269</sup> More importantly, two paragraphs later, he says that "the law . . . uniformly adopts that mode of estimating the damages which is most definite and certain."<sup>270</sup> This clearly implies that some uncertainty is to be tolerated.

Some twentieth century courts have said that *Griffin* stated a requirement of absolute certainty that later was transformed into the less demanding requirement of reasonable certainty.<sup>271</sup> But the courts of *Griffin*'s time seem to have been stating the requirement as one of reasonable certainty as soon as they began relying on *Griffin* to allow the

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265. *Va. Polytechnic Inst. & State Univ. v. Interactive Return Serv.*, 595 S.E.2d 1, 7-8 (Va. 2004).

266. *See, e.g., Kenford Co. v. County of Erie*, 537 N.E.2d 176, 178-89 (N.Y. 1989) (noting that in determining whether damages had been within the contemplation of the parties, circumstances of the contract and to what extent the defendant consciously assumed liability may be considered); John R. Hudson, *Stiff's Jewelers v. Oliver: The Tacit Agreement Test—Arkansas Clings to a Dinosaur*, 40 ARK. L. REV. 403 (1986) (describing the various states that have shown an inclination for applying the tacit agreement test).

267. *Griffin v. Colver*, 16 N.Y. 489, 491 (N.Y. 1858).

268. *Id.* at 495.

269. *See id.*

270. *Id.*

271. *See, e.g., TAS Distrib. Co. v. Cummins Engine Co.*, 491 F.2d 625, 631-32 (7th Cir. 2007) (relying on the opinion's use of the word "certainty without qualification"); *Certain-Teed Prods. Corp. v. Goslee Roofing & Sheet Metal, Inc.*, 339 A.2d 302, 316 (Md. Ct. Spec. App. 1975).

recovery of lost profits.<sup>272</sup> An 1883 opinion of the Minnesota Supreme Court cited *Griffin* for the proposition: “To enable loss of profits to be shown on a question of damage, they should, for obvious consideration, be reasonably certain, otherwise any estimate of damages based upon them is conjecture.”<sup>273</sup> A year earlier, the Iowa Supreme Court, though not citing *Griffin*, talked of tracing the loss “with reasonable certainty to the breach of the contract.”<sup>274</sup> Similarly, Maryland’s highest court, after citing *Griffin*, said: “the plaintiff must establish the *quantum* of his loss by evidence from which the jury will be able to estimate the extent of his injury, excluding all elements of injury as are incapable of being ascertained to a reasonable degree of certainty by the usual rules of evidence.”<sup>275</sup>

## VII. CONCLUSION

It is impossible to overstate the importance of three now-forgotten New York opinions—*Blanchard*, *Masterton*, and *Griffin*. They brought into American law the foundation for damages in commercial disputes: Lost profits may be recovered, but only if they are proven with reasonable certainty. Law students may be tortured with the Court of the Exchequer’s opinion in *Hadley v. Baxendale*, and academics may write endless articles about whether the rule that case articulated is economically efficient,<sup>276</sup> but in significant commercial litigation, it is the rule of *Griffin v. Colver* that determines the outcome.

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272. See, e.g., *Cent. Coal & Coke Co. v. Hartman*, 111 F. 96, 98 (8th Cir. 1901) (citing *Griffin* for the proposition that profits of a commercial enterprise generally cannot be recovered because they cannot be proven with reasonable certainty); *Hunt v. Or. Pac. Ry. Co.*, 36 F. 481, 484 (D. Ore. 1888) (citing *Griffin* for requirement that damages be proven with reasonable certainty).

273. *Cushing v. Seymour*, 15 N.W. 249, 250 (Minn. 1883).

274. *Alexander v. Bishop*, 13 N.W. 714, 717 (Iowa 1882).

275. *Lanahan v. Weaver*, 29 A. 1036, 1038 (Md. 1894).

276. See, e.g., Melvin Aron Eisenberg, *The Principle of Hadley v. Baxendale*, 80 CAL. L. REV. 563 (1992) (arguing that economic theories do not justify the principle in *Hadley v. Baxendale*).