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# BUSINESS LAW

# An Update on the New Business Rule in N.J.

## Reports of its repeal, so far, have been greatly exaggerated

**By Andrew T. Fede**

New Jersey remains among the minority of states enforcing a rule barring the recovery by a new business of damages for lost profits caused by a tort or a breach of contract. *See, MindGames v. Western Publishing*, 218 F.3d 652, 655-659 (7th Cir. 2000). The rule differs, however, in New Jersey's federal courts. The Court of Appeals for the Third Circuit, in 1990, predicted that the New Jersey Supreme Court would no longer apply this new business rule. Twenty-two years later, that prediction remains unproven, bringing to mind Mark Twain's response to his prematurely published obituary: "The reports of my death are greatly exaggerated."

The New Jersey courts generally permit litigants to recover lost-profits damages in breach-of-contract and tort actions if the damages are capable of being estimated with a reasonable degree of certainty. "Past experience of an ongoing, successful business provides a reasonable basis for computation of lost profits with a satisfactory degree of definiteness." *V.A.L. Floors v. Westminster Communities*, 355 N.J. Super. 416, 426 (App. Div. 2002) (internal quotation and citation omitted).

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But what about a new business, which, by definition, does not have a history of past experience — either successful or unsuccessful? Indeed, according to government statistics, 30 percent of new small businesses fail after the first two years and the failure rate rises to 50 percent after five years.

The New Jersey Errors and Appeals Court enforced the new business rule in *Weiss v. Revenue Bldg. & Loan Ass'n*, 116 N.J.L. 208 (E. & A. 1936). The plaintiff in that case, on Jan. 30, 1934, leased from the defendant a 56-room rooming house in Newark. He also signed an option to lease an adjoining identical 56-room building. Both leases were to be for three-year terms. The period in which the plaintiff could exercise the option was between April 1, 1934, and April 3, 1934. The plaintiff exercised the option, but the defendant breached the option agreement.

The trial judge allowed the plaintiff to testify that he operated other rooming houses in the Newark area, and that the "reasonable return on the same business conducted" at the building in question "would be … $2,500 a year." The plaintiff stated that these were gross profits. He referred to his experience with another rooming house that he operated.

The Errors and Appeals Court reversed the judgment for the plaintiff, finding that "the anticipated profits were so remote, speculative and problematical as to preclude their consideration in the appraisement of the loss." Justice Harry Heher's opinion based the new business rule on the principle that future-profits damages must "meet the legal standard of reasonable certainty[.]" He held that the new rooming house was a new business venture. Accordingly, the plaintiff's "prospective profits are too remote, contingent and speculative to meet the legal standard of reasonable certainty." The court contrasted a new business, which has no history of profits, with "one in actual operation," which has "provable data furnished by actual experience [that] provides the basis for an estimation of the quantum of such profits with a satisfactory degree of definiteness."

The court also recognized that "the success of a business usually depends upon a variety of circumstances," and the outcome of a new business "is too uncertain to provide a tangible basis for computation[.]" In contrast, an existing business with "past experience has demonstrated the success of the enterprise and provides a reasonably certain basis for the calculation of plaintiff's probable loss consequent upon the breach of the contract to lease." The courts later applied this rule in *Seaman v. United*

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*States Steel Corp.,* 166 N.J. Super. 467 (App. Div.) (plaintiff was a new business because it rented cranes of the size not previously purchased), *certif. denied*, 81 N.J. 282 (1979), and *Adrian v. Rabinowitz*, 116 N.J.L. 586 (Sup. Ct. 1936) (opinion by Justice Heher applying *Weiss* rule to damage claim for breach of lease for a shoe store).

The 1990 Court of Appeals decision predicting that the New Jersey Supreme Court would no longer apply the new business rule relied on a case law trend elsewhere, and on the legal commentary that was critical of the rule. But the court cited no New Jersey cases suggesting that the rule's support was undermined, although it cited a District of New Jersey decision that did not even refer to *Weiss*. *See, In re Merritt Logan*, 901 F.2d 349, 356-358 (3d Cir. 1990), citing *Universal Computers (Systems) v. Datamedia Corp*., 653 F. Supp. 518, 525-527 (D. N.J. 1987), *aff'd without opinion*, 838 F.2d 1208 (3d Cir. 1988).

This new business rule discussion in *Merritt Logan* was to some extent dictum because the damages claimed were for a new supermarket that did in fact open and operate for one-and-one-half years. Three years later, the court again rejected the new business rule. The court relied on *In re Merritt Logan* and a New Jersey Supreme Court's three-judge plurality opinion. That opinion affirmed an arbitration award permitting a renovated casino to recover damages, including lost profits as a new business. *See Lightning Lube v. Witco Corp*., 4 F.3d 1153, 1176-1178 (3d Cir. 1993), citing *Perini Corp. v. Greate Bay Hotel & Casino*, 129 N.J. 479, 509-510 (1992), overruled on other grounds, *Tretina Printing v. Fitzpatrick & Assocs*., 135 N.J. 349, 358-359 (1994).

The New Jersey state courts cannot decline to follow an Errors and Appeals Court precedent based upon a mere prediction that the Supreme Court is likely to rule to the contrary. The lower courts must follow this precedent unless more recent Supreme Court decisions "plainly undermine" a decision's authority without squarely and explicitly overruling it. *Kass v. Brown Boveri Corp*., 199 N.J. Super. 42, 53 (App. Div. 1985).

The central issue in the New Jersey state courts, then, is when is a business a new business? The Appellate Division shed some light on this question in two cases decided after *Lightning Lube*. In an opinion by Judge Donald Coburn, the court held that *Weiss* still was binding on the Superior Court. The court thus affirmed the trial judge's order granting partial summary judgment based on the new business rule and on the finding that the lost profits damages were too speculative. The defendant in that case claiming lost profits clearly was a new business venture. *Bell Atlantic v. P.M. Video Corp*., 322 N.J. Super. 74, 97-101 (App. Div.), certif. denied, 162 N.J. 130 (1999).

The Appellate Division in *RSB Lab. Services v. BSI Corp*., 368 N.J. Super. 540 (App. Div. 2004), in contrast, also affirmed the new business rule, but held the plaintiff claiming lost profits was not a new business. The plaintiff in that case purchased equipment from the defendant. It claimed breach of warranty and consumer fraud, and it sought damages, including lost profits. The plaintiff had been operating a business as a "bleeding station," which obtained samples from patients and then sent the samples to laboratories for testing and analysis. The laboratories paid the plaintiff commissions on the referrals. The court found that the plaintiff proposed "to expand its business to include the laboratory work, using its same employees, facilities, and customer base. It needed only new equipment and a license to accomplish the expansion."

The opinion by Judge Jose Fuentes noted the cases and commentary critiquing the new business rule, but he held that the motion and trial judges erred to the extent that they suggested that the new business rule no longer applied in New Jersey. He also affirmed the lost-profits damage award based on the finding that the plaintiff was not opening a new business. He distinguished *Weiss* and *Seaman* because the plaintiff did not need to find new customers. Instead, the plaintiff would use "existing clients and referring physicians, thereby resulting in readily ascertainable profits." In conclusion, the new business rule still applies in New Jersey's state courts, but not in diversity cases filed in the Third Circuit based on New Jersey law, where the reasonable certainty rule applies to all lost profits claims. In the New Jersey courts, the key issue after *RSB Lab. Services* is whether the business is "new." The inquiry will most often focus on questions including: (1) is the business an existing business (even if an expansion) or is it an entirely new business; (2) will the business rely on existing clients and markets or entirely new ones; (3) will the business use existing employees or new ones; and (4) can the plaintiff establish "readily ascertainable profits" in the absence of a track record of success and profits? ■