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Contractor Beware—Increased Damages Ahead: The Tenth Circuit Predicts That Oklahoma Would Allow New Businesses to Recover Lost Profits in *Specialty Beverages, L.L.C. v. Pabst Brewing Co.*

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Contractor Beware—Increased Damages Ahead: The Tenth Circuit Predicts That Oklahoma Would Allow New Businesses to Recover Lost Profits in *Specialty Beverages, L.L.C. v. Pabst Brewing Co.*[*]

I. Introduction

In 1854, the Court of the Exchequer in *Hadley v. Baxendale* formally developed the concept of consequential damages arising from a breach of contract.[1] Cautious of the potential effect on commercial transactions, the court expressly limited the award of consequential damages to only those damages which were "in the contemplation of both parties, at the time they made the contract."[2] Since the Court of the Exchequer's landmark decision, the array of remedies allowed as consequential damages has greatly expanded. In 1997, the Oklahoma Supreme Court in *Florafax International, Inc. v. GTE Market Resources, Inc.* provided a modern interpretation of *Hadley* specifically relating to the recovery of lost profits as consequential damages for businesses in Oklahoma.[3] There, the court applied a multipart test to aid lower courts in the determination of when lost profits could appropriately be recovered by businesses in Oklahoma.[4]

The idea that consequential damages include lost profits for established businesses has gained general acceptance.[5] However, the applicability of this concept to new businesses has resulted in a split of opinion among the courts, with some favoring the "new business rule," prohibiting new businesses from recovering damages for lost profits.[6] Courts originally denied the recovery of lost profits for new businesses on the theory of certainty, holding that these businesses have "no provable data of past business from which the fact that

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1. *See* (1854) 156 Eng. Rep. 145, 151 (Exch. Div.).
2. *Id.*
3. *See* 1997 OK 7, ¶¶ 25-32, 933 P.2d 282, 292-93.
4. *See id.*
5. *See, e.g.*, *id.*
6. *Compare* TAS Distrib. Co. v. Cummins Engine Co., 491 F.3d 625, 634 (7th Cir. 2007) (holding that the new business rule was still in effect in Illinois), *with* O'Tool v. Genmar Holdings, Inc., 387 F.3d 1188, 1204-05 (10th Cir. 2004) (concluding that Delaware would move away from the traditional new business rule), *and* MindGames, Inc. v. W. Publ'g Co., 218 F.3d 652, 656-57 (7th Cir. 2000) (concluding that Arkansas would overrule the only state-court case supporting the new business rule).

anticipated profits would have been realized can be legally deduced."[7] Therefore, the amount of lost profits would "remain speculative, remote, uncertain, and incapable of recovery."[8] Some circuits have now adopted a less stringent approach and allow new businesses to recover lost profits in certain circumstances.[9] Recently, the Tenth Circuit joined the modern trend, and its ruling greatly expanded the amount recoverable as consequential damages by new businesses in Oklahoma. In *Specialty Beverages, L.L.C. v. Pabst Brewing Co.*, the Tenth Circuit interpreted Oklahoma law as allowing new businesses to recover lost profits, just like more established businesses.[10]

This note argues that the Tenth Circuit's recent opinion goes too far in predicting that Oklahoma courts would abolish the new business rule.[11] Part II of this note discusses the evolution of Oklahoma's case law governing the recovery of consequential damages, and specifically lost profits for businesses. Part III presents the facts and procedural history of *Specialty Beverages, L.L.C. v. Pabst Brewing Co.* Part IV discusses the analysis used by the Tenth Circuit in developing its holding. Part V analyzes the strengths and weaknesses in the court's reasoning, addresses the possible effects of the court's opinion on future commercial transactions, and provides an alternative to the Tenth Circuit's abandonment of the new business rule. This note concludes in Part VI.

II. The Recovery of Lost Profits in Oklahoma Before Specialty Beverages

One of the earliest Oklahoma cases addressing the availability of lost profits damages dates back to 1912. In *Ft. Smith & Western Railroad Co. v. Williams*, the plaintiff contracted with a railroad company to transport a merry-go-round to a local park area where the plaintiff planned to charge for rides during a picnic.[12] The plaintiff expressly communicated to the railroad company that the merry-go-round was to be used for the picnic and that it needed to be set up for operation by August 14, 1908, the first day of the picnic.[13] The parties agreed that the merry-go-round would be delivered "not

7. *E.g.*, Cent. Coal & Coke Co. v. Hartman, 111 F. 96, 99 (C.C.W.D. Mo. 1901), *abrogated by* Cent. Telecomm, Inc. v. TCI Cablevision, Inc., 800 F.2d 711, 727-28 (8th Cir. 1986).

8. *Id.*

9. *See, e.g.*, *MindGames*, 218 F.3d at 658-59.

10. *See* 537 F.3d 1165, 1179 (10th Cir. 2008).

11. Oklahoma courts have not specifically used the term "new business rule" in reference to this limitation, though the Tenth Circuit employed that label in *Specialty Beverages*. *See id.* at 1178.

12. *See* 1912 OK 1, ¶ 0, 121 P. 275, 275.

13. *Id.*

later than the morning of the 14th of August."[14] Nevertheless, the defendant failed to deliver the merry-go-round until five o'clock in the evening on August 14.[15] In response, the plaintiff sued the railroad company for the profits he lost during the first day of the picnic.[16] At trial, the court entered judgment in favor of the plaintiff in accordance with the jury's verdict.[17] After having its motion for a new trial overruled, the defendant appealed the trial court's decision to the Oklahoma Supreme Court.[18]

The Oklahoma Supreme Court upheld the award of damages for lost profits to the plaintiff.[19] The court explained that if a carrier is given proper notice of the potential of lost earnings as a result of a failure to deliver goods as specified, lost profits may be the "most just and adequate measure of damages" if they can be proven with a "reasonable degree of accuracy."[20] The court also stated that "[t]he amount [of lost profits] may be estimated with only reasonable accuracy; but the fact that profits were lost should require stricter proof."[21]

Four years after the *Ft. Smith* decision, the Oklahoma Supreme Court again considered lost-profits damages as an available remedy for a breach of contract.[22] In *Bokoshe Smokeless Coal Co. v. Bray*, the plaintiffs were in possession of a coal mine held under a lease assigned to them by a third party.[23] The plaintiffs alleged that on December 15, 1912, the defendant entered, "without right or authority," onto the lands covering the coal lease and took possession of the land and all of the personal property the plaintiffs kept on the premises, violating the lease agreement and the assignment.[24] As a result of this unlawful possession, the plaintiffs sought to recover for the loss of anticipated profits they would have made in the operation of the coal mine if not for the defendant's intrusion.[25] The jury returned a verdict against the defendant for wrongful eviction and awarded the plaintiffs $660 in lost profits.[26] The trial court entered judgment accordingly and overruled the

14. *Id.*
15. *Id.*
16. *Id.*
17. *Id.*
18. *Id.*
19. *Id.* ¶ 11, 121 P. at 278.
20. *Id.* ¶ 9, 121 P. at 277.
21. *Id.* ¶ 8, 121 P. at 277.
22. *See* Bokoshe Smokeless Coal Co. v. Bray, 1916 OK 111, 155 P. 226.
23. *Id.* ¶¶ 1-2, 155 P. at 227.
24. *See id.*
25. *Id.* ¶ 8, 155 P. at 229.
26. *Id.* ¶¶ 3-4, 155 P. at 228. The only questions submitted to the jury were whether the defendant had subjected the plaintiffs to wrongful eviction, and if so, how much of a loss in

defendant's motion for new trial, and the defendant appealed to the Oklahoma Supreme Court.[27]

The court stated that "[t]he general rule is that the anticipated profits of a commercial business are too remote, speculative, and dependent upon changing circumstances to warrant a judgment for their loss."[28] But, the court continued, "There is an exception to this rule that the loss of profits from the interruption of an established business may be recovered where the plaintiff makes it reasonably certain by competent proof what the amount of his actual loss was."[29] Applying this exception, the court rejected the plaintiffs' request for damages because the plaintiffs failed to procure an approximation of the number of tons of coal that would have been produced absent the defendant's interruptions.[30] The court held that the failure to approximate the volume of lost coal meant that the plaintiffs had not met their evidentiary burden for recovery of lost profits, making it impossible to properly estimate any damages in a case premised solely on lost profits.[31]

In 1936, the Oklahoma Supreme Court reaffirmed the *Ft. Smith* holding and further defined the burden on plaintiffs seeking to recover lost profits.[32] In *Firestone Tire & Rubber Co. v. Sheets*, the defendant, who was being sued for failure to pay a balance due on a bill for merchandise, filed a cross-petition seeking to recover lost profits resulting from damage to his business caused by Firestone.[33] Sheets operated a service station that sold Firestone tires.[34] After customers purchased Firestone tires from Sheets, many found workmanship defects in the tires.[35] The customers and Sheets complained about the quality of the tires to Firestone, but the company refused to compensate the customers or adjust the price for the defective tires.[36]

In his cross-petition, Sheets alleged that this refusal amounted to a violation of his dealer's contract with Firestone and that "he had completely lost his business" as a result of this violation.[37] Sheets produced various customers who testified that they quit doing business with him as a result of the

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profits the plaintiffs suffered as a result. *Id.* ¶ 3, 155 P. at 228.

27. *Id.*

28. *Id.* ¶ 9, 155 P. at 231 (quoting Cent. Coal & Coke Co. v. Hartman, 111 F. 96, 96 (C.C.W.D. Mo. 1901) (court syllabus)).

29. *Id.* (quoting *Central Coal*, 111 F. at 96-97 (court syllabus)).

30. *See id.* ¶¶ 17-18, 155 P. at 232-33.

31. *Id.* ¶ 18, 155 P. at 233.

32. *See* Firestone Tire & Rubber Co. v. Sheets, 1936 OK 523, 62 P.2d 91.

33. *Id.* ¶¶ 1-2, 62 P.2d at 92.

34. *Id.* ¶ 2, 62 P.2d at 92.

35. *Id.* ¶ 3, 62 P.2d at 92.

36. *See id.*

37. *See id.* ¶¶ 1-2, 62 P.2d at 92.

defective-tire sales.[38] Sheets also produced the service station's books showing the decrease in sales from the time he started the business until the time his customer base vanished entirely.[39] The trial court rendered judgment according to the jury's finding in favor of Sheets for $2,144.09, accounting for Sheets's lost business due to the breach.[40] Firestone appealed the trial court's judgment.[41]

In its opinion, the Oklahoma Supreme Court stated that because Sheets had operated an *established* business, the amount of lost profits was not entirely speculative and could be recovered as damages.[42] In determining the appropriateness of the lost-profits measure of damages, the court seemed to lessen the evidentiary burden on plaintiffs, reiterating the holdings of other recent opinions concluding that "uncertainty as to the amount of damages [for lost profits] does not prevent recovery."[43] The court also held that because the plaintiff had satisfied his burden to show *some* loss, "it [was] proper to let the jury determine what the loss probably was from the best evidence the nature of the case admitted."[44] Through its holdings in *Bokoshe*, *Ft. Smith*, and *Sheets*, the Oklahoma Supreme Court began to take a more liberal approach to the recovery of lost profits for established businesses, but recovery was still treated as an exception to the general rule.

In *Dieffenbach v. McIntyre*, the Oklahoma Supreme Court further clarified when businesses could recover lost profits for breaches of contract.[45] There, the plaintiff sought to rent an office space in the defendant's building, located outside of the business district of Tulsa.[46] The plaintiff intended to move her beauty parlor from its previous location in downtown Tulsa and to take possession of all four of the defendant's rental units.[47] The plaintiff alleged that she was granted assurance by the defendant that the current occupants would vacate the units before June 1, 1946.[48] The plaintiff claimed that only two of the units had been vacated by June 1, 1946, and when she questioned the defendant regarding the use of the other two units, the defendant reassured

38. *Id.* ¶ 4, 62 P.2d at 92.
39. *Id.* ¶ 4, 62 P.2d at 92-93.
40. *Id.* ¶ 5, 62 P.2d at 93.
41. *Id.*
42. *Id.* ¶¶ 8-9, 62 P.2d at 93.
43. *Id.* ¶ 8, 62 P.2d at 93.
44. *Id.*
45. *See* 1952 OK 453, 254 P.2d 346.
46. *Id.* ¶ 2, 254 P.2d at 347.
47. *Id.*
48. *Id.* ¶ 3, 254 P.2d at 347.

her that the current occupants would leave no later than June 7, 1946.[49] Relying on this assurance, the plaintiff began to occupy one of the units.[50]

On August 1, 1946, the plaintiff vacated the premises, claiming that she never obtained sole possession of all of the units, as promised by the defendant.[51] The plaintiff filed a claim to recover the rent paid, compensation for repairs she made to the building, and "anticipated profits" her business had lost as a result of her "removal from the building."[52] At trial, the court refused to allow evidence relating to the plaintiff's loss of anticipated profits, but still entered judgment in favor of the plaintiff for other damages.[53] The defendant appealed the judgement, and the plaintiff cross-appealed based on the refusal of the court to allow the evidence relating to the plaintiff's lost profits.[54]

The Oklahoma Supreme Court held that "where the loss of anticipated profits is claimed as an element of damages, the business claimed to have been interrupted must be an established one."[55] In defining an "established business," the court stated that "it must be shown that it has been successfully conducted for such a length of time and has such a trade established that the profits therefrom are reasonably ascertainable."[56] The court denied the plaintiff's recovery of lost profits by holding that the plaintiff's former, downtown location could not be used to estimate lost profits for the new location.[57] Additionally, because the plaintiff had only attempted to occupy the defendant's building for two months, there was "not a sufficient length of time to constitute her business there as an established business."[58]

Once again, the Oklahoma Supreme Court's allowance for the recovery of lost profits for a breach of contract appeared limited to only established businesses. As stated in *Bokoshe*, when courts in Oklahoma initially developed the rationale for the recoverability of lost profits for breach of contract claims, the remedy was an exception to the general rule that only

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49. *Id.*

50. *Id.*

51. *Id.* ¶¶ 2-3, 254 P.2d at 347.

52. *Id.* ¶ 1, 254 P.2d at 346.

53. *Id.* ¶¶ 6, 11, 254 P.2d at 346, 347.

54. *Id.* ¶ 11, 254 P.2d at 347.

55. *Id.* ¶ 13, 254 P.2d at 349. The Oklahoma Supreme Court reiterated this holding several years later in *Plummer v. Fogley*, 1961 OK 107, ¶¶ 7-8, 363 P.2d 238, 241. *See infra* text accompanying notes 117-18.

56. *Dieffenbach*, ¶ 13, 254 P.2d at 349.

57. *Id.*

58. *Id.*

damages directly flowing from the breach of the contract were recoverable.[59] The Oklahoma Supreme Court changed this view in 1997.

In *Florafax International, Inc. v. GTE Market Resources*, the Oklahoma Supreme Court held that lost profits for breach of contract are no longer the exception to the rule, but are instead a "common measure of damages for breach of contract."[60] The defendant in *Florafax* had contracted to supply telemarketing services to Florafax, an established business that coordinated flower delivery between florists and customers.[61] Florafax lost customers as a result of GTE's alleged failure to properly staff its telemarketing services around major holidays, such as Mother's Day, when floral sales are known to escalate.[62]

In Florafax's action to recover lost profits, the Oklahoma Supreme Court recited the specific set of elements that must be shown in order to recover lost profits for a breach of contract.[63] The court required that the losses (1) must have been in "the contemplation of the parties at the time the contract was made," (2) "flow[] directly or proximately from the breach," and (3) be "capable of reasonably accurate measurement or estimate."[64] The proponent must prove these elements by a preponderance of the evidence in order to recover.[65]

While the Oklahoma Supreme Court has not directly dealt with the issue of recoverability of lost profits for new businesses, federal circuit courts have recognized a growing trend among states to allow new businesses to recover damages for lost profits.[66] Although courts originally deemed lost profits unrecoverable by new businesses because they considered such profits not "capable of reasonably accurate measurement or estimate,"[67] some circuits now allow these damages on the grounds that "courts have become sufficiently

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59. *See* Bokoshe Smokeless Coal Co. v. Bray, 1916 OK 111, ¶ 8, 155 P. 226, 229; *see also* Carpenters' Local 1686 v. Wallis, 1951 OK 293, ¶ 13, 237 P.2d 905, 908 (citing Firestone Tire & Rubber Co. v. Sheets, 1936 OK 523, ¶ 8, 62 P.2d 91, 93; City of Collinsville v. Brickey, 1925 OK 885, ¶ 17, 242 P. 249, 253).

60. 1997 OK 7, ¶ 26, 933 P.2d 282, 292.

61. *Id.* ¶¶ 4, 9-10, 933 P.2d at 287, 288.

62. *See id.* ¶ 14, 933 P.2d at 289.

63. *Id.* ¶ 26, 933 P.2d at 292.

64. *Id.* (citing Groendyke Transp., Inc. v. Merchant, 1962 OK 32, ¶ 0, 380 P.2d 682, 682).

65. *Id.* ¶ 42, 933 P.2d at 296.

66. *See* O'Tool v. Genmar Holdings, Inc., 387 F.3d 1188, 1204 (10th Cir. 2004) (citing, inter alia, MindGames, Inc. v. W. Publ'g. Co., 218 F.3d 652, 656-57 (7th Cir. 2000); Bernadette J. Bollas, Note, *The New Business Rule and the Denial of Lost Profits*, 48 OHIO ST. L.J. 855, 859 (1987)).

67. *Florafax*, ¶ 26, 933 P.2d at 292; *see also supra* note 64 and accompanying text.

sophisticated in analyzing lost-earnings claims."[68] In 2004, the Tenth Circuit joined the growing trend when it interpreted Delaware law and determined that "the Delaware Supreme Court would, if directly faced with the issue, follow the majority trend and reject strict application of the 'new business' rule."[69] In 2008, the Tenth Circuit revisited the recoverability of lost profits for new businesses and predicted that Oklahoma would also move away from a rigid application of the new business rule.[70]

III. Specialty Beverages, L.L.C. v. Pabst Brewing Co.*: Statement of the Case*

In 2004, Specialty Beverages entered into a contract with Pabst Brewing Company to become a distributor of Pabst's beer.[71] The relationship between the two companies was premised on the Oklahoma Legislature's intense regulatory control over alcohol distribution in the form of the Alcoholic Beverage Control Act (ABCA).[72] This Act creates a "four-tiered system for selling beer" in Oklahoma that prevents brewers of beer from selling "directly to a wholesaler or retailer."[73] Instead, brewers must sell to a "non-resident" seller, who holds a state-issued license to transact with wholesalers.[74] This non-resident seller "sells the beer to a licensed 'wholesaler,' who in turn sells the beer to a licensed retail establishment."[75]

At the time of its contract with Pabst Brewing, Specialty Beverages was a non-resident seller of beer, founded in 2002 and licensed in February 2003.[76] Pabst ranked as the largest supplier of "strong beer" to Oklahoma consumers.[77] Pabst had previously contracted with Marrs Distributing Company, another non-resident seller of beer, granting that company the exclusive right to distribute Pabst products in Oklahoma.[78] During the course of the contract

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

69. *O'Tool*, 387 F.3d at 1205.

70. *See* Specialty Beverages, L.L.C. v. Pabst Brewing Co., 537 F.3d 1165, 1178 (10th Cir. 2008).

71. *Id.* at 1171.

72. *Id.* at 1169 (citing 37 OKLA. STAT. §§ 501-599 (2001)).

73. *Id.*

74. *Id.*

75. *Id.* at 1170.

76. *Id.*

77. *Id.* Oklahoma law differentiates between two types of beer in its regulations. "Strong" beer contains "more than three and two-tenths percent (3.2%) alcohol by weight," whereas "low point" beer contains "more than one-half of one percent (½ of 1%) alcohol by volume, and not more than three and two-tenths percent (3.2%) alcohol by weight." *Id.* at 1169 (quoting 37 OKLA. STAT. §§ 163.1-163.2(1) (2001)).

78. *Id.*

with Marrs, however, "Pabst had become increasingly dissatisfied," chiefly on account of Marrs's failure to maintain inventory of Pabst's beer on hand.[79] This policy inconvenienced wholesalers and retailers who wished to purchase Pabst's beer by requiring them to place orders for Pabst's beer "several months in advance" of their desired delivery.[80] Additionally, Marrs "did not make any effort to market Pabst's brands to retail establishments," but only relied on wholesalers to purchase the beer.[81]

Oklahoma marketing manager for Pabst, Chuck Lefholz, contacted Specialty Beverages to discuss the possibility for Specialty Beverages to replace Marrs as Pabst's strong beer distributor.[82] Lefholz voiced some of Pabst's frustrations with Marrs and told Specialty Beverages that the Pabst contract with Marrs was only a "one-year terminable-at-will 'appointment letter,'" that the term had already expired, and that Pabst had no intentions to renew.[83] After negotiations with Specialty Beverages, Pabst sent Specialty Beverages the same kind of letter to appoint Specialty Beverages as a distributor of Pabst's beer in place of Marrs.[84]

After receiving this letter, Specialty Beverages took on considerable expenses to ensure that it could fully meet Pabst's distribution needs. In anticipation of these needs, "Specialty Beverages tripled its warehouse space and added temperature controls in the warehouse in order to store" Pabst's beer in the appropriate conditions.[85] Specialty Beverages also "added office space and administrative staff[,] bought a refrigerated trailer to store Pabst's keg products," increased its sales force, increased its marketing, borrowed money, and "increased its line of credit" to buy the beer.[86] Not surprisingly, it also "bought thousands of cases of Pabst beer."[87]

On April 29, 2004, when Marrs learned of the agreement that Pabst had entered into with Specialty Beverages, Marrs sued Pabst for breach of the parties' exclusivity agreement, which contained no termination date.[88] The trial court issued a temporary restraining order prohibiting "Pabst from breaching its distribution agreement with Marrs and order[ing] Pabst and Marrs to retain the status quo" of their previously existing contractual

79. *Id.* at 1171.
80. *See id.* at 1170.
81. *Id.*
82. *Id.*
83. *Id.* at 1170-71.
84. *Id.* at 1171.
85. *Id.* at 1172.
86. *Id.*
87. *Id.*
88. *Id.* at 1171-72.

relationship.[89] As a result, "Pabst directed Specialty Beverages not to sell any of [the beer it purchased] to . . . retailers."[90]

In the weeks following the issuance of the restraining order, Pabst continued to encourage Specialty Beverages to keep placing orders, which it did.[91] Over the next couple of months, representatives from Specialty Beverages attempted to communicate with Pabst on numerous occasions, seeking direction on how to proceed with customers and the beer in its warehouses.[92] After many failed attempts at communication, Specialty Beverages stopped paying for its orders, and the beer in Specialty Beverages' possession grew stale and ruined.[93]

"By February 2005, Specialty Beverages went out of business," having injured its reputation with the many retailers to whom it promised to supply Pabst beer.[94] Specialty Beverages then sued Pabst alleging breach of contract and fraud.[95] At trial, the jury "entered a verdict in Specialty Beverages' favor on the breach-of-contract claim, awarding $274,022 in damages for economic loss and $400,000 in damages for the diminished value of Specialty Beverages' business."[96] Both parties appealed to the Tenth Circuit.[97]

IV. The Tenth Circuit's Decision

On appeal, Pabst argued that the district court erred in denying Pabst's "motion for a judgment as a matter of law on [Specialty Beverages'] lost profits damages claim."[98] Specifically, Pabst contended "that the court erred because Oklahoma's 'new business' rule prohibits companies without an established track record from recovering lost profits damages."[99] Reviewing this issue, the Tenth Circuit concluded that the Oklahoma Supreme Court would allow the recovery of lost profits by a new business.[100] The court directed most of its analysis to the third element of the *Florafax* test, which requires profits to be "capable of *reasonably accurate measurement or estimate*."[101]

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89. *Id.* at 1172.
90. *Id.*
91. *Id.* at 1173.
92. *See id.* at 1172-73.
93. *See id.* at 1173.
94. *Id.*
95. *Id.*
96. *Id.*
97. *Id.*
98. *Id.* at 1177.
99. *Id.*
100. *Id.* at 1178.
101. Florafax Int'l, Inc. v. GTE Mkt. Res., 1997 OK 7, ¶ 26, 933 P.2d 282, 292 (emphasis added); *see also supra* note 64 and accompanying text.

Attempting to predict how the Oklahoma Supreme Court would apply the new business rule, the Tenth Circuit's opinion traced the development of the theory for recoverability of lost profits through the Oklahoma Supreme Court's prior decisions.[102] The Tenth Circuit plotted the evolution of Oklahoma case law from the general rule prohibiting any recovery of future profits to the rule in *Florafax* requiring only a showing of reasonable certainty for recovery.[103] Given this "current legal landscape," the court determined that "the Oklahoma Supreme Court would allow for the recovery of reasonably estimated lost future profits, regardless of whether the business was well established."[104]

Following this analysis of the lost profits rules in Oklahoma, the court stated that "because the business venture at issue was generally established," Specialty Beverages should be considered an established business.[105] The court explained that because Specialty Beverages had been in business for two years, it would not even qualify as a new enterprise.[106] Additionally, in reference to the contract with Pabst, the court stated that "the agreement dictated that Specialty [Beverages] would essentially step into the shoes of Marrs, an established business," in the contract.[107] Because Speciality Beverages was just substituting for Marrs, the court held that any damages suffered by Specialty Beverages could easily be proven with the requisite degree of certainty.[108] Having found that Specialty Beverages proved the other elements of the *Florafax* test, the court held that "Oklahoma law would allow for Specialty [Beverages] to recover damages for anticipated lost profits."[109]

V. Analysis

The Tenth Circuit's opinion failed to properly predict the Oklahoma Supreme Court's interpretation of the new business rule and the rule's application to Specialty Beverages and Pabst. First, the Tenth Circuit failed to provide any case law to substantiate its view that the Oklahoma Supreme Court would go so far as to abolish the new business rule. Second, the court

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102. *See Specialty Beverages*, 537 F.3d at 1178. Because of a lack of federal legislation dealing with the application of the new business rule, the Tenth Circuit observed the mandate of the *Erie* doctrine to apply state law. *See* Erie R.R. Co. V. Tompkins, 304 U.S. 64, 78 (1938) ("Except in matters governed by the Federal Constitution or by acts of Congress, the law to be applied in any case is the law of the state.").

103. *See Specialty Beverages*, 537 F.3d at 1178.

104. *Id.*

105. *Id.*

106. *Id.*

107. *Id.*

108. *See id.* at 1178-79.

109. *Id.* at 1179.

incorrectly concluded that Specialty Beverages was an established business for purposes of recovering lost profits. Finally, the court failed to properly consider the implications of its ruling on future contracts between new businesses and customers.

A. The Case Law Suggests That the Oklahoma Supreme Court Would Not Abolish the New Business Rule

While the Tenth Circuit appropriately traced the evolution of the recovery of lost profits as an available remedy in Oklahoma, it failed to substantiate its ultimate conclusion with any Oklahoma case law. In its opinion, the court correctly observed that Oklahoma case law reveals a movement from a general disallowance of lost profits to a rule allowing recovery of lost profits for businesses "so long as they can demonstrate that those losses are 'capable of reasonably accurate measurement or estimate.'"[110] However, the court failed to explain how this sequence of case law led to the conclusion that the Oklahoma Supreme Court would go so far as to abolish the new business rule and allow new businesses to recover lost profits. Indeed, much of the case law in Oklahoma has directly pointed to the contrary, holding that while the requirements for recovering lost profits may be loosened, the rule still applies *only* to established businesses.[111]

From the Oklahoma Supreme Court's early adoption of the rule allowing recovery of lost profits in *Bokoshe*, the court clearly established that recovery was to be allowed only in one specific circumstance—where the business injured was an established one.[112] There was no exception carved out for those businesses that were not established. Instead, new businesses would fall under the general rule barring the recovery of lost profits because the damages were deemed "too remote, speculative, and dependent upon changing circumstances to warrant a judgment for their loss."[113]

Even as the rule allowing recovery of lost profits as a standard remedy for a breach of contract has gained acceptance, the Oklahoma Supreme Court has been consistent in limiting its application to only those businesses that were

110. *Id.* at 1178 (quoting Digital Design Group, Inc. v. Info. Builders, Inc., 2001 OK 21, ¶ 34, 24 P.3d 834, 844); *see also supra* note 64 and accompanying text.

111. *See* Plummer v. Fogley, 1961 OK 107, ¶ 8, 363 P.2d 238, 241; Dieffenbach v. McIntyre, 1952 OK 453, ¶ 13, 254 P.2d 346, 349 (both holding that before lost profits may be recovered, a business must show proven success for a sufficient length of time to demonstrate that it had become "established"); *see also supra* note 55 and accompanying text.

112. *See* Bokoshe Smokeless Coal Co. v. Bray, 1916 OK 111, ¶¶ 9-10, 155 P. 226, 231 (quoting Cent. Coal & Coke Co. v. Hartman, 111 F. 96, 96-98 (C.C.W.D. Mo. 1901) (court syllabus and main opinion)).

113. *Id.* ¶ 9, 155 P. at 231 (quoting *Central Coal*, 111 F. at 96 (court syllabus)); *see also supra* text accompanying note 28.

established. In *Dieffenbach*, the Oklahoma Supreme Court specifically refused to award lost profits to the plaintiff because there was no finding that the plaintiff operated an established business.[114] The court expressly held that for a plaintiff to recover lost profits, "the business claimed to have been interrupted *must be an established one*."[115] The Oklahoma Supreme Court also explicitly defined an "established business" as one that could show "that it has been successfully conducted for such a length of time and has such a trade established that the profits therefrom are reasonably ascertainable."[116] Instead of offering any evidence of moving toward dissolving the new business rule, the *Dieffenbach* court *reaffirmed* the applicability of the rule and defined the scope of an "established business," further limiting those who could recover lost profits.

Similarly, over eight years later, in *Plummer v. Fogley*, the Oklahoma Supreme Court again expressly refused to allow new businesses to recover lost profits.[117] Again, the court adopted the view that

> [w]here the loss of anticipated profits is claimed as an element of damages, the business claimed to have been interrupted *must be an established one*, and it must be shown that it has been successfully conducted for such a length of time and has such a trade established that the profits therefrom are reasonably ascertainable.[118]

The pronouncement by the Oklahoma Supreme Court in *Dieffenbach*, and again in *Plummer*, is precisely the clarification the Tenth Circuit was searching for in *Specialty Beverages*. Instead of attempting to guess the "legal landscape" in Oklahoma,[119] the Tenth Circuit needed to look no further than *Dieffenbach* and *Plummer*. In both of these cases, the Tenth Circuit would have found unambiguous statements by the highest court of the state, directly on point.

Given the absence of more recent holdings by the Oklahoma Supreme Court to the contrary, the court's holding in *Dieffenbach* stands as a clear view of the application of the new business rule in Oklahoma. Nevertheless, the Tenth Circuit failed to discuss this case's holding in its opinion. The case was cited

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114. *Dieffenbach*, ¶ 13, 254 P.2d at 349.

115. *Id.* (emphasis added).

116. *Id.*

117. 1961 OK 107, ¶¶ 7-8, 363 P.2d 238, 241 (citing, inter alia, *Dieffenbach*, 1952 OK 453, 254 P.2d 346).

118. *Id.* ¶ 8, 363 P.2d at 241 (emphasis added); *see also supra* text accompanying notes 55-56.

119. *See* Specialty Beverages, L.L.C. v. Pabst Brewing Co., 537 F.3d 1165, 1178 (10th Cir. 2008); *see also supra* text accompanying note 104.

by both Specialty Beverages and Pabst in their respective briefs,[120] and yet the court chose to ignore this precedent. The holding in *Dieffenbach* hardly allows for any interpretation that the Oklahoma Supreme Court's "legal landscape" would allow new businesses to recover lost profits.

Nor does there appear to be any other case law by the Oklahoma Supreme Court ever hinting at a liberalization of the new business rule to the extent argued for by Specialty Beverages. Instead, there is only reaffirmation from *Ft. Smith* through *Bokoshe*, *Firestone*, *Dieffenbach*, *Plummer*, and *Florafax* that the new business rule remains valid in Oklahoma.[121] While the history of the Oklahoma Supreme Court's holdings shows a movement toward the acceptance of lost profits as a normal remedy for breaches of contract involving *established* businesses, the court has shown no inclination to allow the recovery of these damages for businesses that do not have a track record of proven profits.[122]

B. The Court Incorrectly Deemed Specialty Beverages an Established Business

After its lengthy discussion of the new business rule in Oklahoma, the Tenth Circuit concluded that the rule would not apply because Specialty Beverages was not in fact a new business.[123] The court observed that "the [Specialty Beverages–Pabst] agreement dictated that Specialty would essentially step into the shoes of Marrs, an established business."[124] Therefore, the court concluded that Specialty Beverages could "rely on Marrs's experiences as a baseline" to demonstrate its lost profits by a preponderance of the evidence.[125] Furthermore, the court stated that because Specialty Beverages "had been in existence for two years prior to reaching the agreement with Pabst[,]. . . . it was not a new enterprise."[126]

When it was approached by Pabst regarding the distribution of Pabst's beer, Specialty Beverages had been licensed for only a few *months*.[127] Even when

120. *See, e.g.*, Cross-Appellant Pabst Brewing Co., Inc.'s Reply Brief at 4, *Specialty Beverages*, 537 F.3d 1165 (Nos. 06-6243, 06-6250); Appellant & Cross-Appellee Specialty Beverages' Combined Response & Reply Brief at 11, *Specialty Beverages*, 537 F.3d 1165 (Nos. 06-6243, 06-6250).

121. *See* discussion *supra* Part II.

122. *See* Florafax Int'l, Inc. v. GTE Mkt. Res., 1997 OK 7, ¶ 48, 933 P.2d 282, 297 (allowing recovery of lost profits because the facts were "sufficiently close to be analogized to the established business situation").

123. *Specialty Beverages*, 537 F.3d at 1178.

124. *Id.*

125. *Id.* at 1178-79.

126. *Id.* at 1178.

127. *See id.* at 1170-71.

the appointment letter was sent to Specialty Beverages, it had been in business for less than two years.[128] Additionally, Specialty Beverages had never distributed such a high volume of beer or such a well known brand as Pabst, having only distributed "lesser known, smaller beverage brands" since its formation.[129] In its opinion, the court acknowledged that "those brands did not have the volume of business that would make and keep Specialty Beverages profitable."[130] But the court seemed to later ignore this fact in its conclusion that Specialty Beverages was an "established" business.[131] It would be nearly impossible for a business to be "established" without customers who could "make and keep" it profitable. Considering that Specialty Beverages' customer base before the Pabst contract could not achieve profitability, it would have been an insurmountable hurdle for Specialty Beverages to pass the *Dieffenbach* test, requiring that a business be "successfully conducted for such a length of time and [have] such a trade established that profits therefrom are reasonably ascertainable."[132]

In reaching its conclusion, the court also failed to consider the past dealings between Specialty Beverages and Pabst. Specifically, the court's opinion references trial testimony of Pabst's general counsel regarding the formation of the distribution agreement to be entered into with Specialty Beverages.[133] The general counsel stated that in drafting the agreement, Pabst made modifications to the standard distribution agreement, because "Specialty Beverages was a new company without a track record," requiring unique contract provisions.[134] This testimony suggests that in the minds of the parties at the time of formation of the contract, Specialty Beverages was a new business.

The court also supported its conclusion that Specialty Beverages was an "established" business by stating that in using Marrs's success as a "baseline," Specialty Beverages could demonstrate that its lost profits could be proved with sufficient certainty.[135] However, Marrs and Specialty Beverages were distinct entities. There was no evidence of any relationship between them that would suggest that the profits of Specialty Beverages would mirror those of

128. *See id.*

129. *Id.* at 1172.

130. *Id.*

131. *See id.* at 1178-79.

132. Plummer v. Fogley, 1961 OK 107, ¶ 8, 363 P.2d 238, 241 (citing, inter alia, Dieffenbach v. McIntyre, 1952 OK 453, ¶ 13, 254 P.2d 346, 249); *see also supra* note 118 and accompanying text.

133. *Specialty Beverages*, 537 F.3d at 1171.

134. *Id.*

135. *Id.* at 1178-79; *see also supra* text accompanying note 125.

Marrs under the distribution agreement. Nevertheless, the Tenth Circuit stated that Marrs's experiences with Pabst could be used by Specialty Beverages to estimate its own success.[136] Using this reasoning, the court improperly classified Specialty Beverages as an "established" business "because the business *venture* at issue was generally established";[137] however, Oklahoma case law requires that the determination of established-business status be based on the business *entity*, not the venture.[138]

Each company's formation of its own balance sheets can yield largely different results with respect to profitability. The Tenth Circuit ignored this basic understanding that each corporation or entity will have its own needs and obligations, and that the success of one corporation does not equate to the success of a competitor, even one acting under the same contract. Specialty Beverages had to confront distinct issues in order to fulfill its contract with Pabst that Marrs did not need to address. Specifically, in anticipation of receiving Pabst's beer, Specialty Beverages increased its debt, its operating expenses, its overhead, and its employee base.[139] Also, Specialty Beverages' corporate structure at the commencement of the contract was not identical to that of Marrs. In assuming that Marrs's profitability under the contract could be used to estimate Specialty Beverages' success, the Tenth Circuit went too far.

Evaluating the Tenth Circuit's reasoning, it appears that the court may have had in mind the end goal of designating Specialty Beverages as an "established" business. In reaching its ultimate conclusion, the court struggled to place Specialty Beverages into this category. The court ignored the many characteristics that made Specialty Beverages a new business at the time the contract was entered into between the parties. To fill that void, the court focused on the success of an established competitor to prove that Specialty Beverages' damages were not too speculative.[140] With so much evidence suggesting that Specialty Beverages was a new business, the court's finding to the contrary seems problematic.

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136. *Specialty Beverages*, 537 F.3d at 1178-79.

137. *Id.* at 1178 (emphasis added); *see also supra* text accompanying notes 124-25.

138. *See* Plummer v. Fogley, 1961 OK 107, ¶ 7, 363 P.2d 238, 241 (examining whether the *business* itself was established by looking at the length of time the business was in existence as well as the consistency of the business's profits).

139. *See Specialty Beverages*, 537 F.3d at 1172; *see also supra* text accompanying notes 85-87.

140. *See Specialty Beverages*, 537 F.3d at 1178-79.

C. The Court Failed to Properly Consider the Implications of Its Ruling on Future Contracts Between New Businesses and Customers

In establishing that new businesses should also be able to recover lost profits, the Tenth Circuit failed to address the implications of its findings on future commercial transactions. Specifically, the court failed to consider that abolishing the new business rule would provide disincentives to those considering entering into contracts with new businesses. First, increased damages in the form of lost profits present an increase in liability in the event of a breach by those who enter into contracts with new businesses. Second, the court's holding requires more due diligence by those businesses wishing to enter into contracts with new businesses. Lastly, the holding increases the cost of contract drafting for those wishing to enter into contracts with new businesses.

1. Increased Liability

When an individual or a business entity enters into an agreement with a new business, there are additional risks that would not be present when dealing with experienced businesses. Obviously, businesses that have shown a pattern of success in dealing with similar contracts provide greater certainty to those with whom they contract that their success will continue in the current transaction. For new businesses, much of this goodwill has yet to be established. Thus, concerns about stability and efficiency may already produce disincentives for participating in a transaction with a newer business.

The Tenth Circuit's conclusion in *Specialty Beverages* produces another significant disincentive. Without the new business rule, if the contract falls apart, the individual who has contracted with the new business may now be liable for extensive damages resulting from lost profits that have yet to be realized by the new business. Effectively, this could produce extensive damages that are beyond those contemplated by those contracting with new businesses at the time of the contract formation. This potential liability, in addition to the risks already present with new businesses, may deter other businesses from entering into contracts with new businesses and thereby lead to less business and profitability for these new businesses.

2. Increased Due Diligence

The new finding articulated by the Tenth Circuit will also require attorneys to perform additional diligence when clients wish to contract with new businesses. When the court looked to Marrs's profits as a "baseline" from which to measure Specialty Beverages' profitability,[141] it created an additional risk for those wishing to enter into contracts with new businesses. An analysis based on a competitor's profits may require attorneys to conduct additional diligence regarding the new business's competitors before the client enters into a contract. Considering that new businesses, by definition, have no consistent showing of profitability, a transactional attorney may need to examine the profitability of other competitors in similar ventures in order to predict damages or the cost of breach if a party needs to change its position in the contract after its formation.

This additional cost may not be required in smaller transactions; however, if the contract requires the new business to invest substantial resources in order to effectively perform its duties under the contract, a breach could result in an award of significant damages. Therefore, a proper estimation of the cost of breach would need to include research into other competitors' profitability. The additional cost associated with this extra due diligence provides yet another disincentive for companies to contract with new businesses.

3. Increased Contract Drafting Costs

After incurring significant costs in additional diligence, if an individual wishes to pursue an agreement with a new business, it would be prudent to construct additional contract language limiting the recoverability of lost-profits damages for the new business. In reality, these costs may not be significant, but they still produce an additional disincentive to those wishing to contract with a new business.

Many new businesses are often not in the best position to undergo extensive negotiation regarding contracts with new customers. Often, the new business's eagerness to remain profitable and to acquire new customers will result in its acceptance of contracts that may not be as favorable as it had originally desired. For instance, in *Specialty Beverages*, the Pabst contract was Specialty Beverages' "big break" that was going to keep Specialty Beverages profitable.[142] Given Specialty Beverages' need to keep the contract alive,[143] it was not in the best position to negotiate, and like other new businesses, if it had been offered a contract that limited damages recoverable upon a breach, it may have been forced to accept these terms. While this practical reality will effectively mitigate some of the risk incurred in dealing with new businesses, these types of contract provisions injure new businesses and require additional

141. *Id.* at 1178; *see also supra* text accompanying note 125.

142. *Specialty Beverages*, 537 F.3d at 1172.

143. *See id.* (observing that sales of the brands Specialty Beverages had been distributing prior to receiving Pabst's appointment letter were insufficient to "make and keep Specialty Beverages profitable").

costs in contract drafting, which may actually produce an additional disincentive for entering into agreements with these businesses.

On its face, a rule allowing new businesses to recover lost profits appears to favor those businesses. The theory for allowing new businesses to recover lost profits has been grounded in the idea that those contracting with new businesses may take advantage of them, knowing that new businesses are limited in the damages they can recover.[144] But allowing these businesses to recover damages that may not be representative of their actual losses (by estimating damages based on other experienced businesses) provides an additional disincentive to those wishing to contract with these businesses, which may lead to less activity, profitability, and growth by new businesses.

Additionally, if parties were to continue to contract with new businesses, increased costs in conducting due diligence and redrafting contracts would create even more disincentives. The additional disincentives could result in a lack of new customers and growth for these businesses as others opted to do business with their more experienced competitors. In the end, a rule that was intended to aid new businesses may in fact hurt them and decrease their profitability. The Tenth Circuit failed to acknowledge these effects of its determination.

D. An Alternative to the Court's Abandonment of the New Business Rule

After *Specialty Beverages*, lower courts are left to determine on a case-by-case basis whether a new business's profits are "capable of reasonably accurate measurement" before allowing recovery. The per se rule presented in *Dieffenbach*—prohibiting the recovery of lost profits for new businesses—did not require such a determination.[145] Moving away from a per se rule compels courts to examine sophisticated issues of corporate capital structure, business profitability, and customer relations of a *new business* to determine if profits are "capable of reasonably accurate measurement."[146] Such a sophisticated and extensive analysis of a new business requires courts to go beyond their area of expertise, thereby wasting limited judicial resources.[147]

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144. *See* TK-7 Corp. v. Estate of Barbouti, 993 F.2d 722, 726 (10th Cir. 1993) (stating that "courts have recognized that a strict application of the rule could encourage tortious behavior or the breaking of contracts by those dealing with new businesses").

145. *See* Dieffenbach v. McIntyre, 1952 OK 453, ¶ 13, 254 P.2d 346, 349; *see also supra* text accompanying notes 55-58.

146. Florafax Int'l, Inc. v. GTE Mkt. Res., 1997 OK 7, ¶ 26, 933 P.2d 282, 292; *see also supra* note 64 and accompanying text.

147. The Restatement (Second) of Contracts states that if a "business is a new one or if it is a speculative one," such a determination is "more difficult," requiring courts to rely on the "aid of expert testimony, economic and financial data, market surveys and analyses, business records of similar enterprises, and the like." RESTATEMENT (SECOND) OF CONTRACTS § 352 cmt. b

Instead of replacing the per se rule established by *Dieffenbach* with a pure facts-and-circumstances determination, other courts and legislatures may prefer a hybrid approach. An appropriate alternative would be a rule prohibiting the recovery of lost profits for new businesses upon a breach of contract *except* when the breach was a result of willful or wanton conduct by the breaching party. Such a rule would absorb the benefits of both the per se and facts-and-circumstances alternatives without negatively impacting new businesses.

First, this rule would prevent courts from performing a pure facts-and-circumstances analysis, thereby preserving judicial resources. The rule would also decrease the disincentives present after *Specialty Beverages* for those wishing to contract with new businesses.[148] Additionally, if such a rule were adopted, it may be less likely that those contracting with new businesses would attempt to limit the recovery of lost profits by contract modification, because they would be secure in the knowledge that lost profits would only be recoverable upon a willful or wanton breach.

A hybrid approach would also properly address the major policy concern cited by opponents of the new business rule—that new businesses could easily become victims because of their inability to recover profits.[149] Instead, in cases where the business suffered as a result of a willful or wanton breach, the new business would be granted relief in the form of lost-profits damages. This would produce a deterrent to those contracting with new businesses who wish to damage these businesses. A hybrid approach would more effectively fulfill the Tenth Circuit's goals in joining the national trend toward the abolition of a strict new business rule, but would also produce a rule with significantly fewer negative implications than a complete abandonment of the new business rule.

VI. Conclusion

The Tenth Circuit's analysis in *Specialty Beverages* represented an improper interpretation of Oklahoma case law. The Oklahoma Supreme Court has followed a clear and unambiguous pattern of limiting the recovery of lost profits to only established businesses. There is no evidence that the Oklahoma Supreme Court would adopt the Tenth Circuit's liberal interpretation of the new business rule in Oklahoma. Instead, the Oklahoma Supreme Court has

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(1981).

148. The concerns of increased liability, increased due diligence, and increased cost of contract drafting would be reduced by allowing the recovery of lost profits only in isolated circumstances.

149. *See TK-7 Corp.*, 993 F.2d at 726; *see also supra* note 144 and accompanying text.

consistently rejected the idea that new businesses may recover lost profits, a fact which the Tenth Circuit refused to acknowledge. The court also failed to acknowledge and consider the many effects of its decision on new businesses in Oklahoma, leading to a rule that produces an overall disincentive for those wishing to contract with new businesses in the future. Allowing the recovery of lost profits for new businesses clearly goes beyond the boundaries for the recovery of consequential damages established in *Hadley v. Baxendale* by including damages that were not ascertainable and within the contemplation of both parties at the time of the forming of the contract.

Brandon M. Watson