DAMAGES—A NEW OR UNTRIED BUSINESS MAY RECOVER LOST FUTURE PROFITS AS DAMAGES FOR BREACH OF CONTRACT TO LEND MONEY, PROVIDED SUCH PROFITS CAN BE ESTABLISHED WITH REASONABLE CERTAINTY.—*Harsha v. State Savings Bank* (Iowa 1984).

David G. Harsha and Richard L. Perry sought to establish and operate a livestock feed retail business, to be named Baxter Feed Center, Inc. (Baxter Feed).[1] They enlisted the help of the State Savings Bank of Baxter (the bank) and its president, Jack E. Edge, in formulating a plan for the business's operation.[2] Harsha and Perry, with Edge's encouragement and assistance, applied for and received a guarantee for a sizeable loan from the Small Business Administration.[3]

Pursuant to the loan contract with the bank, Baxter Feed began to draw upon the loan amount to cover continuing expenses.[4] Before the company had exhausted its line of credit, however, the bank, apparently displeased with the management of the business, refused to lend the remaining amount of the available credit and informed the SBA of its action.[5]

The denial of the remaining funds began to adversely affect Baxter Feed's operating position. Although the company in its first year incurred losses of only half of those projected,[6] predictions of later-year profits turned into actualities of substantial losses following the bank's decision not to lend the remaining $10,000 of the original loan guarantee.[7] The business closed in October 1975, and at Edge's suggestion, declared bankruptcy eleven months later.[8]

Harsha filed a complaint in the Iowa District Court on his personal behalf and on behalf of Baxter Feed seeking damages, both compensatory and

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1. Harsha v. State Sav. Bank, 346 N.W.2d 791, 793 (Iowa 1984).

2. *Id.* at 794.

3. *Id.* The $25,000 loan was meant to cover projected losses during the business's first month of existence. *Id.* Once they secured the financing and contributed an additional $2,500 each to the business accounts, Harsha and Perry opened Baxter Feed in September 1971. *Id.*

4. *Id.* The company asked for, and received, $5,000 in disbursements from the bank for each of the following months: November and December, 1971 and June, 1972. *Id.* They also began to repay the loan in monthly installments at a rate computed on the original $25,000. *Id.*

5. *Id.* Baxter Feed's credit was not completely shut off, however. Harsha's mother, who had replaced Perry as a partner in the firm, lent the business $19,000, and the bank continued to make several short-term loans to the company. *Id.* Nevertheless, the absence of the remaining long-term capital was detrimental to Baxter Feed in that it reduced the company's ratio of assets to liabilities to 1:1, below the accepted minimum of 2:1. *Id.*

6. *Id.* Baxter Feed had projected a first-year loss of $4,560, but at the end of that period, it had incurred a loss of only $2,549. *Id.*

7. *Id.* at 795.

8. *Id.*

punitive, from Edge and the bank.[9] The jury found for the plaintiff on all three of the issues submitted to them,[10] namely, whether the bank made and then breached a contract with Baxter Feed to loan it $25,000, whether Edge and the bank tortiously interfered with Baxter Feed's business, and whether the defendants "intentionally inflicted severe emotional distress upon Harsha."[11] The Iowa Supreme Court *held*, affirmed in part, reversed in part, and remanded.[12] A new or untried business may recover lost future profits as damages for breach of contract to lend money, provided such profits can be established with reasonable certainty. *Harsha v. State Savings Bank*, 346 N.W.2d 791 (Iowa 1984).

Iowa has long adhered to the so-called "new business rule" which deemed the award of lost potential profits of new businesses as damages to be "too uncertain and conjectural for the practical administration of justice."[13] The Iowa Supreme Court originally adopted this rule, reasoning "that '[e]xpected profits from a new commercial enterprise [are] too remote and speculative to warrant judgment for their loss because there are no available data of past business from which the fact of anticipated profits could have been established.' "[14] In allowing Harsha to recover lost future profits from Edge and the bank, the court took a well-reasoned, though not overly drastic, step towards greater equitability.

Before addressing the "new business" issue, the court confronted Harsha's threshold problem of overcoming the general rule that damages in failure-to-lend claims be restricted to the difference in interest rates, if any, between the rate offered by the defendant and the prevailing market rate.[15] The *Harsha* court acknowledged the existence of the rule, but held that it is not to be invariably applied,[16] noting that the borrower, as here, may not be able to obtain funds elsewhere, thereby rendering the "difference in interest rates" test moot.[17] In deciding that Harsha was included in this exception,

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9. Appellees' Brief and Argument at 13, Harsha v. State Sav. Bank, 346 N.W.2d 791 (Iowa 1984).

10. Harsha v. State Sav. Bank, 346 N.W.2d at 793-94.

11. *Id.* at 793.

12. *Id.* at 801.

13. Creamery Package Mfg. Co. v. Benton County Creamery Co., 120 Iowa 584, 587, 95 N.W. 188, 189 (1903). This case concerned an unstarted business which sued to recover damages when the defendant breached the parties' contract and failed to deliver machinery essential to the operation of the business. *Id.* at 585-86, 95 N.W. at 188-89. Actually, the *Creamery Package* court excluded generally *all* prospective profits from the determination of damages because they were too speculative. *Id.* at 587, 95 N.W. at 189. The court allowed only those profits which would in "all reasonable probability have been acquired. . . ." *Id.*

14. Harsha v. State Sav. Bank, 346 N.W.2d at 797 (quoting City of Corning v. Iowa-Nebraska Light & Power Co., 225 Iowa 1380, 1389, 282 N.W. 791, 796 (1938)).

15. *Id.* at 796. The first Iowa articulation of the rule appears to be in Holt v. Doty, 193 Iowa 582, 588, 187 N.W. 550, 552 (1922).

16. Harsha v. State Sav. Bank, 346 N.W.2d at 796.

17. *Id.* at 797.

the court noted that he had pledged all of his available security to the loan with the bank, effectively reducing to nothing the possibility of obtaining credit elsewhere.[18]

The court, however, in not holding Harsha to the general interest damages rule, did not merely apply an exception, as it indicated it was doing,[19] but rather went a long way in undercutting the basis for the rule itself. *Hixson v. First National Bank*,[20] the case cited by the court as embodying the rule, involved facts similar to those in *Harsha* in that in *Hixson*, a business had also allegedly failed as the result of a bank's failure to lend it money.[21] The *Hixson* court, in restricting the plaintiff's damages to the difference in interest rates, noted that if the plaintiff's business

> was worth what he thinks it was, and if his debts were no greater than hereinbefore indicated, there was nothing in his way to obtain the necessary loan in a normal money market. If he had other indebtedness, and if the valuation of the farm was not such as to render marketable security for the proposed loan, then that was sufficient reason why the board of the defendant bank should reject the same.[22]

Needless to say, at the time of the *Hixson* decision, it must have been virtually impossible to prevail on a claim for damages measured by the difference in interest rates. If the business were healthy, it could get a loan anywhere, and if it were in poor shape, a defendant bank could rightly refuse to lend it money. Either way, the bank would escape liability. The *Harsha* court, however, rejected the black-and-white analysis of *Hixson* and indicated that an otherwise healthy business might not be able to find alternative credit sources.[23]

After the court held that Harsha did not have to comply with the difference in interest rate damages test, it then addressed the issue of whether a new business can, in fact, be awarded future lost profits as damages in a breach of contract case.[24] Perhaps surprisingly, however, this is not a case of first impression for the Iowa court. Neither the parties nor the court cited it, but nearly a quarter of a century ago, in *King Features Syndicate v. Courier*,[25] the court allowed lost future profits to a group of businessmen who

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18. *Id.* The court may have been too quick to discount Harsha's credit alternatives. First, no mention was made here of his mother who was a potential loan source in light of the fact that she had already lent the company substantial sums of money. *Id.* at 794. Second, the defendants indicated in their motion for rehearing that the balance of the SBA guarantee could conceivably have been obtained from another bank. Defendants' Petition for Rehearing at 3, Harsha v. State Sav. Bank, 346 N.W.2d 791 (Iowa 1984) (motion denied May 10, 1984).

19. Harsha v. State Sav. Bank, 346 N.W.2d at 796.

20. 198 Iowa 942, 200 N.W. 710 (1924).

21. *Id.* at 944, 200 N.W. at 711 (business involved was a farm).

22. *Id.*

23. Harsha v. State Sav. Bank, 346 N.W.2d at 799.

24. *Id.*

25. 241 Iowa 870, 43 N.W.2d 718 (1950).

desired to start a corporation which was never formed, partly because of the defendant's breach of an essential contract.[26] In that case, the court held that "if performance of a contract for service is prevented by one party the other is entitled to all of the benefits he would have obtained had it been performed. . . . And in such a case [as here,] loss of profits that are not speculative or conjectural is basis for damages."[27]

As discussed earlier, the *Harsha* court found the rationale for the new business rule in the principle that lost future profits for an untried enterprise were too speculative to equitably award as damages.[28] The court then went the next logical step and held that if a new business could, with a reasonable element of certainty, establish its lost profits, such a recovery should not be barred.[29] Citing a long line of cases from several jurisdictions, the court noted the wisdom that the determination of damages should not rest with the relative newness of an enterprise, but rather with the more significant and equitable criterion of the certainty with which net loss of profits can be ascertained.[30]

The *Harsha* court relied heavily on the plaintiff's expert, who testified at length and in detail about his methods of determining what Baxter Feed's balance sheet would have looked like had Edge and the bank lent the company the remaining $10,000.[31] The court articulated no hesitation in affirming the lower court's admission of such testimony, noting that Iowa's rule providing for the admission of expert opinion testimony is a liberal one

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26. *Id.* at 872-73, 43 N.W.2d at 720-21. The plaintiff's prospective business was a radio station which had contracted with the defendants to receive daily news reports. *Id.*

27. *Id.* at 882, 43 N.W.2d at 726.

28. *See supra* text accompanying note 14.

29. Harsha v. State Sav. Bank, 346 N.W.2d at 798.

30. *Id.* The court cited Standard Mach. Co. v. Duncan Shaw Corp., 208 F.2d 61, 64 (1st Cir. 1953) (no sharp "line of distinction should. . .be drawn between old and new businesses" for the purpose of assessing damages), Burks v. Sinclair Ref. Co., 183 F.2d 239, 242 (3d Cir. 1950) (court disagreed with the contention that since plaintiff's enterprise, a gasoline station, "was a new business, prospective profits would be necessarily speculative"), and El Fredo Pizza, Inc. v. Roto-Flex Oven Co., 199 Neb. 697, ____, 261 N.W.2d 358, 364 (1978) (court refused to apply new business rule in all cases, holding instead that "lost profits must not be speculative, remote or imaginary, but must be established with reasonable certainty by the evidence").

The supreme court also cited Riddle v. Dean Mach. Co., 564 S.W.2d 238 (Mo. App. 1978), but support on that case appears to be misplaced. The *Riddle* court cited a legal encyclopedia, which stated "that prospective profits from an *established business*. . .are recoverable. . . ." *Id.* at 257 (quoting 22 AM. JUR. 2d *Damages* § 177 (1965)) (emphasis added). Additionally, the court did not even address the issue of the business's age, holding instead that the problem of the lower court's award of damages was "the failure of evidence, free of speculation and conjecture, showing probable profits in any sum." Riddle v. Dean Mach. Co., 564 S.W.2d at 257.

31. Harsha v. State Sav. Bank, 346 N.W.2d at 798-99. The expert, an accountant and lawyer, Appendix Vol. I at 845, Harsha v. State Sav. Bank, 346 N.W.2d 791 (Iowa 1984), looked at a variety of financial documents in making his determination. *Id.* at 894-98. Additionally, he considered various other elements such as Baxter Feed's newness and the effects of good management upon the profitability of the business. Harsha v. State Sav. Bank, 346 N.W.2d at 798.

and that "receipt of such evidence rests largely in the discretion of the trial court and its ruling will not be disturbed absent manifest abuse of that discretion."[32] Although it recognized the question as being a close one, the court held that the issue of damages was properly presented to the jury, whose award, "while generous," was not excessive.[33]

The *Harsha* court distinguished two cases which defendants cited for the proposition that expert testimony in lost profits cases does not raise the evidence above the speculation level.[34] The court distinguished *Wolf v. Murrane*[35] on the grounds that the expert there, unlike the expert in *Harsha*, was not able to evaluate all the documents that he desired, and, therefore, the evidence was inadmissible.[36] The second case cited by the defendants, *Dougherty v. Boyken*,[37] was also distinguished by the *Harsha* court in that the expert's testimony and opinions in *Dougherty* were based on inadmissible hearsay.[38] After distinguishing the two cases, the court then reasserted its position that the lower court did not abuse its discretion in allowing Harsha's expert testimony.[39]

The court then summarily disallowed Harsha's tort claims.[40] At the time of Harsha's loan problems with the bank and Edge, the owner of Baxter's other feed business, the Country Feed Store, put her enterprise up for sale.[41] David Harsha offered to buy the other business from its owner, Charlotte McCormick, and through the bank obtained another SBA guarantee, this time for $63,000.[42] Edge did not inform Harsha of the SBA's approval, however, and eventually cancelled the guarantee.[43]

Edge's cancellation of Harsha's loan voided the deal between Harsha and McCormick, and she eventually sold the business to a third party, Dean

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32. Harsha v. State Sav. Bank, 346 N.W.2d at 797 (citing Haumersen v. Ford Motor Co., 257 N.W.2d 7, 11 (Iowa 1977)).

33. *Id.* at 799. Judge Carter, in his dissenting opinion, was not impressed with the expert's testimony, or with the trial court's submission of the issue to the jury:

> I find nothing in the record, however, to suggest that [the expert's] views that the lack of $10,000 in long-term financing made the difference in the success or failure of the business are other than pure speculation. The jury was offered no credible theory based on evidence in the case as to why it was more likely than not that the lack of those funds caused the business to fail.

Id. at 802 (Carter, J., dissenting). Judge Carter concurred with the remainder of the court's holding. *Id.*

34. *Id.* at 797.

35. 199 N.W.2d 90 (Iowa 1972).

36. Harsha v. State Sav. Bank, 346 N.W.2d at 798.

37. 261 Iowa 602, 155 N.W.2d 488 (1968).

38. Harsha v. State Sav. Bank, 346 N.W.2d at 798.

39. *Id.*

40. *Id.* at 800.

41. *Id.* at 795.

42. *Id.*

43. *Id.*

Flora, though the property transfer was somewhat unorthodox.[44] Flora, being a competitor of McCormick's, was concerned that McCormick would not sell to him, so he had Jack Edge conduct the sale as though Edge were the principal.[45] Before the buyer signed the real estate contract, however, the name of Jack Edge was struck out and replaced with that of Baxter Grain and Coal Company, Dean Flora's business.[46]

Harsha asserted three claims: that the bank made and then breached the contract to lend $25,000 to Baxter Feed; that Edge tortiously interfered with Baxter Feed's operation; and that he intentionally inflicted emotional distress upon Harsha.[47] In dealing with the tortious interference claim, the supreme court, noting that the tort is an intentional one "which requires a showing that the actor had a purpose to 'injure or destroy' the plaintiff's business,"[48] determined that the defendant's actions did not rise to that level.[49] "Deliberate breach of a contract is generally not considered to be improper means," the court stated, "as the law remedies such breaches with damages calculated to give the injured party the benefit of the bargain; generally no need thus exists for additional tort remedies."[50] The court held that Harsha failed to meet his burden of proving a substantial link between the Flora-Edge-McCormick business purchase deal and the failure of Baxter Feed, noting that the "relationship is simply too attenuated[; t]his tort basis of liability should not have been submitted for jury consideration."[51] The court also reversed the severe emotional distress award, holding that while Edge's conduct was not to be condoned, it nevertheless failed to "approach the requisite standard of outrageousness which is necessary to create liability."[52]

The Iowa Supreme Court took an important and equitable step in removing the arbitrary prohibition against untried businesses recovering lost future profits when they have been harmed by another's wrongful conduct. While the firm enunciation of this principle, however, was a necessary clarification, the court did not so much strike out on a bold new legal path as it merely expanded a sound rule one more degree towards fairness.

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44. *Id.*

45. *Id.* Neither the court nor the parties can explain the apparent inconsistency in Flora's fear that McCormick would not sell to a competitor when she had earlier agreed, in her deal with Harsha, to do just that.

46. *Id.* It is intriguing to note that Edge went through the extra efforts of this name-switching, ostensibly to shield from McCormick the knowledge that a competitor desired to purchase her business, when he helped engineer Harsha's open offer to buy the company only months earlier. *Id.*

47. *Id.* at 793.

48. *Id.* at 799 (citing Farmers Coop. Elevator, Inc. v. State Bank, 236 N.W.2d 674, 679 (Iowa 1972)).

49. *Id.* at 800.

50. *Id.* at 799.

51. *Id.* at 800.

52. *Id.* at 801.

The court's determination is well-founded—a business's age should not be the threshold consideration of whether a wronged enterprise can recover for damages. That determination is best left to the principle articulated in so many other areas of the law: he who can adequately prove that his damages were a result of another's wrongful acts can prevail. The court may well have increased its own workload in adopting this case-by-case method of adjudication, but the increased fairness to plaintiff-businesses justifies the added attention.

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