

FOCUS: BUSINESS LITIGATION & TRIAL SKILLS

# Demonstrating Lost Profit Damages With Reasonable Certainty

by Jonathan Childers

Lost profits are damages representing what a business would have earned had a defendant's allegedly injurious conduct not occurred. A claimant must demonstrate lost profit damages by competent evidence with reasonable certainty. This article examines the reasonable certainty standard, and offers practical suggestions for demonstrating lost profits with reasonable certainty.

The reasonable certainty requirement is a fact-intensive determination intended to be flexible enough to accommodate the myriad of circumstances in which claims for lost profits arise. See *Texas Instruments, Inc. v. Teletron Energy Mgmt.*, 877 S.W.2d 276, 279 (Tex. 1994).

Lost profits need not be susceptible to exact calculation. However, lost profits estimates, as well as expert opinions concerning such estimates, must be based upon objective evidence from which the lost profits amount may be ascertained.

*Helena Chem. Co. v. Wilkins*, 47 S.W.3d 486, 504 (Tex. 2001).

New businesses may recover lost profits, and a lack of prior profit history does not necessarily preclude recovery so long as some other objective data, such as future contracts, are used. See *id.* at 505.

That said, a plaintiff cannot recover profits that are largely speculative, such as profits from activities dependent upon uncertain market conditions, risky business opportunities, untested products, entry into unknown or unviable markets, or the future success of an unproven enterprise. See *Teletron*, 877 S.W.2d at 279; *Ramco Oil & Gas Ltd. v. Anglo-Dutch (Tenge) LLC*, 207 S.W.3d 801, 808 (Tex. App. — Houston [14th Dist.] 2006, pet. denied).

Courts appear more willing to permit recovery of lost profits for a new business when the business is not engaged in a novel or speculative enterprise. Compare *S.W. Battery Corp. v. Owen*, 131 Tex.

423, 115 S.W.2d 1097, 1099 (1936), with *Teletron*, 877 S.W.2d at 280.

Presenting a reasonably certain lost profits calculation takes forethought and preparation. Counsel should begin by examining the injured business' financial records, as well as records that relate to market conditions and business risks. They should also search for contracts that the business executed, or was on the verge of executing, with third parties. These contracts are useful in determining a loss period for the damages calculation. Counsel should also identify any customers the business lost as a result of the defendant's conduct, and obtain their affidavit or deposition. Moreover, they should investigate whether other businesses have successfully engaged in similar business activity.

Counsel should prepare a damages model and hire an expert early in litigation. This way, counsel and the expert can discuss ways to identify and isolate lost profits resulting from the defen-

dant's conduct versus lost profits attributable to other causes. Also, experts can assist counsel in drafting discovery that will help replace speculation with factual data.

Courts frequently hear expert testimony in determining whether lost profits are capable of proof by reasonable certainty. Generally speaking, the expert providing the lost profits calculation should possess sufficient industry expertise necessary to review the underlying data independently. If the expert lacks industry expertise, the party should limit the expert's designation solely to providing the financial projection (i.e. merely doing the arithmetic), and should hire another expert with industry experience to verify the accuracy of the underlying data. It is also important for an expert to choose an appropriate methodology, and to justify why he or she chose that methodology to the exclusion of alternative methodologies.

Most importantly, the expert's application of the methodology must result in a reasonable conclusion that is connected to record evidence. Recently, several courts of appeals have reversed judgments awarding lost profits damages, holding the claimant failed to establish reasonable certainty because expert testimony was based upon unfounded assumptions. Compare *Capital Metro. Transp. Auth. v. Cent. of Tenn. Ry. & Nav. Co., Inc.*, 114 S.W.3d 573, 582 (Tex. App. — Austin, 2003, pet. denied), with *Bright v. Addison*, 171 S.W.3d 588, 602-03 (Tex. App. — Dallas 2005, pet. dismissed).

If an assumption is unavoidable, the expert should explain why the assumption is reasonable and bridge any analytical gap between the available data and his or her conclusion. Cf. *Fraud-Tech, Inc. v. Choicepoint, Inc.*, 102 S.W.3d 366, 384-85 (Tex. App. — Fort Worth 2003, pet. denied). Similarly, experts should account for all data - including unfavorable data - in formulating a damages calculation. If certain data is not used, the expert should explain why the data was excluded.

Attorneys are best positioned to demonstrate lost profits with reasonable certainty by knowing the applicable legal standard, preparing a damages model early in litigation, and coordinating with a damages expert throughout the process. HN

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