Future Lost Profit Damages in Business Litigation

"Show Me The Money"
Client to sports agent, Jerry Maguire.
Jerry Maguire (TriStar Pictures 1996)

Money isn't everything — not even in commercial litigation. Other forms of judicial relief — for example, injunctive relief in a trade secret case, declaratory relief in a contract dispute, or specific performance in a battle over real estate — may be equally or more important to the parties.

But the quest for a substantial monetary award is what drives most commercial cases. Many would never be brought, or as vigorously defended, were it not for the prospect of recovering lost profit damages, including lost future profits. Indeed, in many commercial disputes, a plaintiff's claim for lost profit damages will dwarf all other damage components taken together. And if recoverable on a claim that sounds in tort, the measure of lost profits can impact the magnitude of a defendant's punitive damage exposure.

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As business litigators, we may be called upon to defend a lost profit damages claim in one case, and pursue recovery of lost profits in the next. An understanding of the controlling standards for, and limitations on, recovery of lost profits will improve one's ability to value such claims and litigate them effectively.

Predicates to Recovery of Future Lost Profit Damages

In California as elsewhere, recovery for future loss of profits is permitted on both tort and contract theories. The predicates to recovery include, of course, those applicable whenever monetary damages are sought. For example, recovery for lost profits is subject to the general requirement that damages must have been legally caused by the defendant's wrongful conduct. And where recovery is pursued on a contract theory, the plaintiff must also show that the loss of profits was foreseeable.

The controlling principles of law relating to causation and foreseeability are relatively straightforward; and their application in lost profit damage cases is often without substantial controversy. The principal battleground over future lost profits is frequently on the issue of certainty.

How Certain Is Certain?

In 1872 the California Legislature enacted California Civil Code section 3283 which provides that "[d]amages

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may be awarded in a judicial proceeding for detriment *...certain to result in the future.*" Benjamin Franklin observed nearly a century earlier that "in this world nothing can be said to be certain, except death and taxes." (Letter of November 13, 1789 from Benjamin Franklin to Jean Baptiste Le Roy, in *10 The Writings of Benjamin Franklin 69* (A. Smyth ed. 1907)). If only future damages that are certain are recoverable, and if nothing is certain, where does that leave us?

Section 3283 is no more an accurate statement of California law than Franklin's aphorism is an accurate observation on the facts of life. Surely we can be certain of a good deal more than just death and taxes — for example, the setting of the sun in the west, and the appearance of rain clouds as soon as the car is washed. And many a dollar has changed hands in apparent defiance of the stricture of section 3283 — a statute that remains precisely as it was drawn in the Nineteenth Century.

Every commercial enterprise — or at least every commercial enterprise in the real world — is necessarily subject to some uncertainty. For most, the uncertainties are considerable. That, of course, is why no responsible executive (and no irresponsible executive advised by competent counsel or mindful of securities law) would lay claim to "certainty" when predicting profits. Yet substantial awards for future lost profit damages are not at all uncommon.

If the standard expressed in Section 3283 — a requirement of "certainty" without apparent qualification — does not accurately reflect the law, what then *are* the controlling standards? How much certainty is required to sustain a claim for future lost profit damages?

The easy — and partly accurate — answer is "reasonable certainty." It is perhaps worth noting that the word "reasonable" is nowhere to be found in any of the key statutory provisions delineating the scope of recoverable damage, not even in Civil Code section 3301 which speaks directly to the issue of certainty in the proof of damage. ("No damages can be recovered for a breach of contract which are not clearly ascertainable in both their nature and origin.") *See also* Civil Code sections 3283, 3300, 3333. Still, here as elsewhere, the law looks to the word "reasonable" to do much of the heavy lifting.

But *what* is it that must be reasonably certain before lost profit damages may be recovered? And what constitutes reasonable certainty for purposes of proving lost profits?

Ambiguity in the Case Law

The language and holdings of California cases are not entirely consistent. This is in part because each case necessarily turns so heavily on the particular facts and evidence before the court; but it is also because divergent formulations of the rule have been adopted in different cases.

When discussing the certainty of future damage, it is important to distinguish the *fact* of damage from the *amount* of damage. In the context of a claim for loss of profits, the fact of damage is addressed by showing that plaintiff was deprived of *some* profit as a result of the defendant's conduct. Even if the *fact* of damage can be shown with great certainty, it will generally be impossible to state with anywhere near the same degree of confidence what the precise *amount* of the future damage will be. How do the courts address and accommodate this fact of commercial life?

There is language in some cases that, if read in isolation, can be argued to require that a claimant demonstrate the *fact* of damage with the same degree of certainty as the *amount* of damage. Specifically, in some lost profit damage cases, it is stated that *both* the "*occurrence*" and the "*extent*" of the injury must be shown with "reasonable certainty." *See, e.g., Shade Foods, Inc. v. Innovative Products Sales & Mktg., Inc.*, 78 Cal.App.4th 847, 849 (2000) ("Lost profits...may be recovered if their *extent and occurrence* can be ascertained with reasonable certainty.")

Notwithstanding these statements in the caselaw suggesting a common legal standard for assessing proof of the fact and the amount of damage, California courts have long applied different standards of proof to these inquiries. While uniformly insisting that the *fact* of *some* lost profit be shown to a reasonable certainty, the courts have articulated, and applied, a substantially less demanding standard of proof for assessing a claimant's evidence regarding the *extent* or *amount* of lost profit damage. This more relaxed standard has been expressed in a variety of ways. A common formulation is that set forth in *GHK Associates v. Mayer Group, Inc.*, 224 Cal.App.3d 856, 873-4 (1990). In *GHK Associates* the Court of Appeal stated that "the law requires only that *some reasonable basis of computation of damages be used*...even if the result is an approximation." A similar standard was adopted in *Noble v. Tweedy*, 90 Cal.App.2d 738, 746 (1949), the Court of Appeal concluding that "[a]s long as there is available a *satisfactory method for obtaining a reasonable proximate estimation* of the damages, the defendant whose wrongful act gave rise to the injury will not be heard to complain that the amount thereof cannot be determined with mathematical precision." In *Stott v. Johnston*, 36 Cal.2d 864, 876 (1951), a case involving a claim for loss of good will, the California Supreme Court stated that "the law only requires that the *best evidence* be adduced of which the nature of the case is capable."

Different formulations of the relaxed standard for proving the amount of lost profits frame the ultimate issue somewhat differently: for example, whether there is "some reasonable basis" for determining damage; or, whether the amount of damage has been shown with as much certainty as the circumstances of the case permit. Counsel should be mindful of, and prepared to address, the various formulations. But whatever might be said about these differences in formulation, there can be no doubt that proof of the amount of lost profits is subject to a distinctly different, and lesser, requirement of certainty than is the fact of damage. This uniform approach to lost profit damage claims would appear to be at odds with the statement appearing in some opinions (like *Shade Foods*,

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quoted above) to the effect that both the "occurrence" and "extent" of lost profit damage must be proved to the same "reasonable certainty" standard.

One might argue that the apparent conflict is illusory in light of the elastic nature of the term "reasonable." The degree of certainty that the law considers "reasonable" for purposes of proving the amount of damage is simply not the same — and not as great — as the degree of certainty that the law considers "reasonable" for purposes of proving that some damage has been suffered. The rationale which the courts have given for applying discrepant standards can be understood in the framework of a "reasonableness" inquiry. The evolution of the law in California and elsewhere reflects the commonsense notion that projecting future profits is necessarily subject to considerable uncertainty. The law takes the view that once the fact of damage has been shown, it is "reasonable" to require that the defendant shoulder much of the risk of uncertainty as to its amount, especially if the defendant's conduct gave rise to the difficulties of proof. As the California Supreme observed in *Sanchez-Corea v. Bank of America*, 38 Cal.3d 892, 908 (1985) "[t]he wrongdoer cannot complain if his own condition creates a situation in which the court must estimate rather than compute." (quoting *Guntert v. City of Stockton*, 55 Cal.App.3d 131, 143 (1976)).

There is language in a number of California cases that can be read to say, by implication if not explicitly, that the reasonable certainty standard simply does not apply to proof of the amount of lost profits. By way of example, in *Stott v. Johnston*, 36 Cal.2d 864, 875-6 (1951) the California Supreme Court stated: "[i]t appears to be the general rule that while a plaintiff must show with reasonable certainty that he has suffered damages by reason of the wrongful act of defendant, once the cause and existence of damages have been so established, recovery will not be denied because the damages are difficult of ascertainment." The court went on to apply the "best evidence" approach described above. The same pattern occurs in many other California cases — that is, a reaffirmation by the court that the reasonable certainty standard applies to the fact of damage, coupled with a suggestion that uncertainty as to amount will not be fatal, followed by exposition and application of a different and more lenient standard for assessing proof of the amount.

Erosion of the New Business Rule

A claim for lost profits is often supported by evidence of the plaintiff's past performance and profitability. A comparison of profits before and after the event or conduct giving rise to a claim can often be used to assess the impact of the defendant's challenged conduct. In the past, courts in California routinely held that a new business could not recover lost profits because, in the absence of an operating history, any such damages were necessarily too speculative. *See e.g., Patton v. Royal Industries, Inc.*, 263 Cal.App.2d 760, 768 (1968) (plaintiffs libeled by defendant denied recovery because "there was no way in which the plaintiffs could prove the business they launched for themselves would have been a success if the defendants had not interfered with it.").

In *California Press Mfg. Co. v. Stafford Packing Co.*, 192 Cal. 479, 485 (1923), the California Supreme Court stated the so-called "new business rule" in absolute terms, and described its underlying rationale as follows:

> "Where...damages by way of profits are sought for... interruption or prevention [of a new business or enterprise], the rule is that they will be denied, for the reason that such business is an adventure as distinguished from an established business, and its profits are speculative and remote, existing only in anticipation. The rule is one of necessity. Damages must be certain of ascertainment. If one engages in a new industry, there are no provable data of past business from which the fact can be legally deduced that anticipated profits would have been realized." [Citations omitted]

In the past, the new business rule was often invoked to preclude recovery of lost profits even by an established entity if the profits were to have been earned in the context of a new venture or line of business. *See e.g., Handley v. Guasco*, 165 Cal.App.2d 703 (1958) (recovery of lost profits anticipated in connection with new location foreclosed by "new business rule").

California courts no longer slavishly adhere to the new business rule. If a claimant can demonstrate the requisite certainty, both as to the fact and amount of lost profit damage, recovery will be allowed notwithstanding that the business or venture was new. For example, in *Aronowicz v. Nalley's, Inc.*, 30 Cal.App.3d 27 (1972), the Court of Appeal affirmed a substantial award of lost profits in favor of the plaintiff, a new entity set up to package meat products, against the defendant distributor that prematurely terminated a distribution agreement. Without a distribution network, the plaintiff's business failed within a matter of months. Relying in part upon budgets prepared by the plaintiff, and profit projections generated by the defendant, the court found there to be sufficient evidence to sustain the award of lost profits to the new enterprise. *See also Shade Foods*, 78 Cal.App.4th at 889-90 (affirming substantial award of lost profits to an enterprise that was forced out of business after a very brief operating period as a result of the defendant insurer's improper denial of coverage).

Conclusion

How a jury will evaluate the testimony of dueling experts, or choose between competing explanations for the suffering fortunes of a plaintiff's business, can rarely be predicted with certainty — either reasonable or otherwise. But the odds of success here, as in virtually everything we do as lawyers, improve greatly with careful and creative lawyering. A mastery of the facts, a good understanding of the impacted business as well as of the industry in which it operates, and effective experts, can all make a critical difference.

Sage: My son, a man who is absolutely certain of anything is a fool!

Son: Are you sure?

Sage: Positive!

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