Threading the Needle

A Guide to Reasonable Certainty in a Lost Profits Case

By Linda M. Watson and Mariah S. Mumford

"Threading the needle" is an idiom frequently used in sports to describe passing the ball or puck to a teammate through a very small available space or window. Establishing lost profits in a commercial dispute can sometimes feel like threading the needle as trial attorneys aim for the goal of a "reasonable degree of certainty." It does not help that trial attorneys can be so focused on liability that they fail to give proper attention to developing admissible evidence related to the issue of damages. However, when it comes to seeking lost profits as damages at trial, success often depends on attention to detail.

This deep dive in a commercial dispute can be critical because the more sizable damages may not be in the cost to repair or out-of-pocket costs, but in lost profits as a remedy. And questions must be answered along the way, such as "Do I need an expert?" or "What methodology should I use?" and "Just how specific does my calculation need to be?" This article is designed to provide business litigators with the fundamentals of a lost profits claim and best practices on increasing your likelihood of success in both surviving a dispositive motion and obtaining a favorable verdict at trial.

At a Glance

The type of uncertainty that will more often bar recovery of damages is uncertainty as to fact of the damage and not as to the amount.

There are different approaches a plaintiff can use to calculate lost profits, such as the "yard stick" approach, the "before and after" approach, and the "market share" approach.

Early on in your case, determine whether you need an expert to satisfy the reasonable certainty standard.

A quick primer on the law of lost profits in Michigan

Under Michigan contract law, an award of damages should put the injured party in the position it would have been in had the promised performance been rendered.[1] And when it comes to lost profits, a litigator must essentially prove something that never happened. With this challenge at hand, the law requires that lost profits must be proven to a reasonable degree of certainty and cannot be based on conjecture or speculation.[2] Mathematical certainty, however, is not required.[3] Notably, under Michigan law, "[d]amages for lost profits must be based on the loss of net, rather than gross, profits."[4] An attorney will need to establish both the fact of damage and the amount of damage in a lost profits case. The type of uncertainty that will more often bar recovery of damages is uncertainty as to the fact of the damage and not as to its amount.[5] Therefore, "where it is certain that damage has resulted, mere uncertainty as to the amount will not preclude the right of recovery."[6]

So what does this all mean? What does it really take to prove lost profits in Michigan? What is just enough evidence and what may be too much, if that is even possible?

Determining which thread to use: Different approaches to lost profits

There are different approaches a plaintiff can use to calculate lost profits. For example, the "yardstick" or "control group" approach to calculate lost profits is widely accepted by courts.[7] This involves "a study of the profits of business operations that are closely comparable to the plaintiff's" business operations.[8] Stated differently, this approach "entails comparing the plaintiff's performance to a financial benchmark based on an alternative geographic area, product line, distribution channel, industry, or firm."[9]

On the other hand, the "before and after" approach involves "a comparison of the plaintiff's financial performance during the time period in which it was presumably impacted by the harmful act or acts of the defendant with another time period in which the plaintiff was presumably not impacted."[10] This approach assumes all trends present at the time of the breach would have continued or adjusts for any expected differences but for the breach and harm, and is extended over the damage period to establish the projected revenue.[11]

The "market share" approach has also been used on occasion to estimate lost profits.[12] For example, in *Innovation Ventures v Custom Nutrition Laboratories*, the plaintiff, the manufacturer and distributor of a popular "energy shot," sued a competitor for breaching restrictive covenants in a noncompete agreement.[13] Using the market-share approach, the plaintiff argued that "it should be allowed to present to the jury an estimate of lost profits calculated by multiplying the number of units" the defendant sold by the plaintiff's market share.[14] Specifically, the plaintiff contended that had the defendant not made the impermissible sales, the plaintiff, which sold 85 percent of the energy shots in the market, would have made 85 percent of those sales. The Sixth Circuit determined that the plaintiff could "introduce testimony that uses market share to qualify its lost profits" on remand.[15]

In addition to the three approaches discussed above, there are other methods for calculating damages. In fact, a simple method to calculate lost profits is to compare the average revenues or profits of a plaintiff before the perceived harm with the plaintiff's revenue and profits following the harmful act.[16] In contrast, more sophisticated methods to calculate lost profits include multiple regression techniques, which are becoming more common.[17]

Determining what needle to use: Do you need an expert?

During the initial phases of litigation, it is imperative that attorneys determine whether they will engage an expert to help establish and prove lost profits. As in sports, the goal posts of reasonable certainty are fairly narrow, there is only so much time on the clock, and you want your best players on the field to increase your odds of success.

Generally, in Michigan, expert testimony is used to introduce evidence that requires "scientific, technical or other specialized knowledge."[18] In a commercial dispute involving a claim for lost profits, an attorney may want to consider retaining an accounting expert, an economist, or even an industry expert regardless of whether the expert testifies at trial. The circumstances of your case will dictate whether you need one or more experts to establish causation and lost profits or if

you can rely solely on a lay witness such as a business owner, officer, or employee with the appropriate experience and skill sets to establish causation and lost profits.

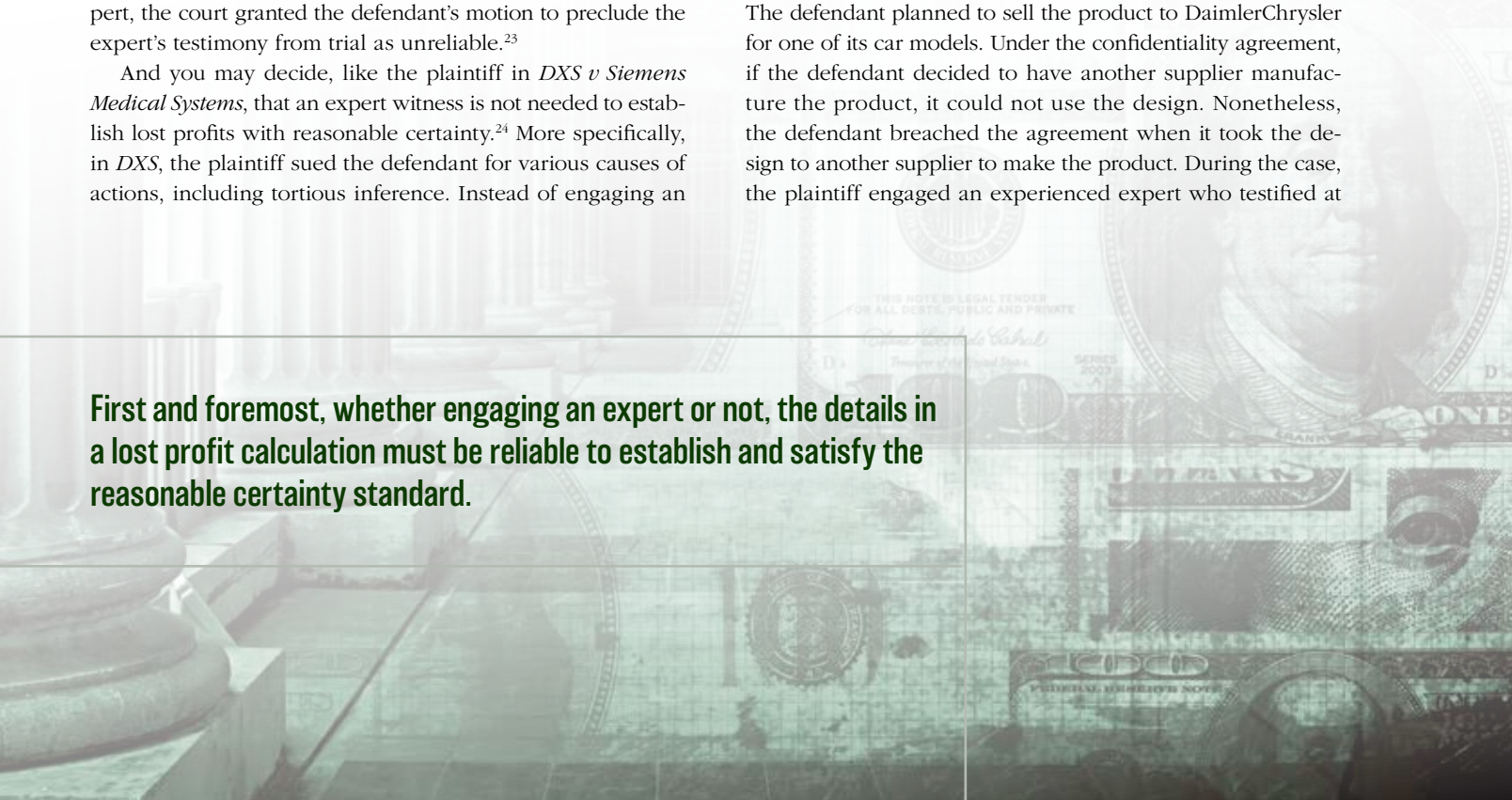
What supports a reasonable certainty of lost profits?

First and foremost, whether engaging an expert or not, the details in a lost profit calculation must be reliable to establish and satisfy the reasonable certainty standard. For instance, in *Rondigo, LLC v Casco Township*, a waste disposal company sued a township for various causes of actions related to the loss of a bid.[19] During the litigation, the defendant moved to preclude the plaintiff's expert testimony that used the yardstick approach, claiming it was unreliable because the plaintiff's economic loss report relied on "the fact that 12,690 trucks per year (60 per day) [would] deposit raw material at the proposed composting site."[20] However, this number of truckloads was directly contradicted by the plaintiff's own operations manual which estimated that the "number of trucks depositing raw material at the site…[would be] 230 truckloads per year."[21] While the plaintiff's expert attempted to provide an explanation for this inconsistency, the court did not find it persuasive. The defendant also challenged the number of acres for composting that the plaintiff's expert relied on in his report. The court, however, was more concerned that the plaintiff did "not actually articulate how many acres the report did consider available for composting as a basis for calculations."[22] Among other things, the court was also critical of the start date used by the plaintiff's expert for his lost profits calculations. Because of collective issues with the plaintiff's expert, the court granted the defendant's motion to preclude the expert's testimony from trial as unreliable.[23]

And you may decide, like the plaintiff in *DXS v Siemens Medical Systems*, that an expert witness is not needed to establish lost profits with reasonable certainty.[24] More specifically, in *DXS*, the plaintiff sued the defendant for various causes of actions, including tortious inference. Instead of engaging an expert, the president of DXS presented the evidence of lost profits. The plaintiff's president introduced invoices for service performed by the defendant, which the plaintiff would have performed but for the defendant's improper conduct. Specifically, the plaintiff's president analyzed each of the "invoices, identifying the number of regular and overtime hours expended by" defendant's employees.[25] In turn, the president "then multiplied the number of hours on each invoice by the appropriate DXS service rate to arrive at the amount of revenue lost by DXS as a result of" the defendant's performance of the service work.[26] Notably, the plaintiff's president further testified that the company "was entitled to the full amount of the revenue because DXS had no incremental costs attributable to the performance of the repair work" as "all costs of establishing and maintaining DXS's technical service staff were fixed and thus affected by the quantity of the work performed by its staff."[27]

At the close of the plaintiff's case, the defendant moved for judgment as a matter of law. The district court granted the defendant's motion, reasoning that the plaintiff "failed to submit evidence of net losses or net profits."[28] On appeal, however, the Sixth Circuit reversed this portion of the district court's decision and remanded the case, holding that "DXS presented sufficient evidence of its lost profits, if by a narrow margin."[29]

In other cases, particularly complex commercial disputes with significant damages, engaging an expert and focusing on the details to prove a reasonable certainty may be advisable. In *Multimatic, Inc v Faurecia Interior Systems USA*, the plaintiff sued the defendant for breach of contract and sought lost net profits.[30] In particular, the plaintiff designed a product for the defendant that was subject to a confidentiality agreement.[31] The defendant planned to sell the product to DaimlerChrysler for one of its car models. Under the confidentiality agreement, if the defendant decided to have another supplier manufacture the product, it could not use the design. Nonetheless, the defendant breached the agreement when it took the design to another supplier to make the product. During the case, the plaintiff engaged an experienced expert who testified at



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trial and was awarded $10 million in lost profit damages by the jury. The expert calculated lost profits by multiplying the number of cars DaimlerChrysler would produce under the specific model program (using publicly available automotive forecasting information) by the plaintiff's estimated profits per product.

On appeal, the defendant challenged the lost profits award as "unduly speculative."[32] The Sixth Circuit disagreed and held that the damages calculations by the plaintiff's expert had a reasonable basis of computation and essentially cleared the hurdle of conjecture and speculation—even if they were only approximate.[33] Indeed, the appellate court found that the expert's opinions were reasoned and his forecasts were based on data that was proven reliable.[34]

Summary

Establishing a reasonable degree of certainty is like threading the needle. It is something that should be considered and analyzed at the beginning of any case that seeks lost profits as a remedy. Trial attorneys should first consider whether to engage an expert, even if only in a consulting role. The next step should be to collect business records, including historical financial information, forecasts, business plans, tax returns, and market and industry information. The more data you have, the better you will be able to select a method of calculation that best suits your case and will support your lost profits. In addition, discovery requests should be designed to include information you may need to establish a reasonable degree of certainty. Finally, consider the admissibility of evidence and your best witnesses at trial to ensure success. ■

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ENDNOTES

1. *Demirjian v Kurtis*, 353 Mich 619, 622; 91 NW2d 841 (1958) and *Body Rustproofing, Inc v Michigan Bell Telephone Co*, 149 Mich App 385, 390; 385 NW2d 797 (1986) (citing *Ambassador Steel Co v Ewald Steel Co*, 33 Mich App 495; 190 NW2d 275 (1971); *Dierickx v Vulcan Industries*, 10 Mich App 67, 73; 158 NW2d 778 (1968); and *Allen v Michigan Bell Telephone Co*, 61 Mich App 62, 67–68; 232 NW2d 302 (1975)).
2. *Body Rustproofing, Inc*, 149 Mich App at 390–391. See also *Lorenz Supply Co v American Standard, Inc*, 100 Mich App 600, 613; 300 NW2d 335 (1980).
3. *Stimac v Wissman*, 342 Mich 20, 28; 69 NW2d 151 (1955).
4. *Getman v Mathews*, 125 Mich App 245, 250; 335 NW2d 671 (1983) (citing *Lawton v Gorman Furniture Corp*, 90 Mich App 258; 282 NW2d 797 (1979)).
5. *Wolverine Upholstery Co v Ammerman*, 1 Mich App 235, 244; 135 NW2d 572 (1965).
6. *Id.* See also *Bonelli v Volkswagon of America, Inc*, 166 Mich App 483, 512; 421 NW2d 213 (1988).
7. *Rondigo, LLC v Casco Township*, 537 F Supp 2d 891, 894 (ED Mich 2008) ("The 'yardstick' or 'control group' approach to calculating lost profits employed by Plaintiffs' expert is widely accepted by courts to measure damages.") (citing *Conwood Co, LP v US Tobacco Co*, 290 F3d 768, 793 (CA 6, 2002)). See also *T&S Distributors, LLC v Michigan Bell Telephone Co*, unpublished per curiam opinion of the Court of Appeals, issued March 20, 2012 (Docket Nos. 296257 and 296428).
8. *Conwood Co, LP*, 290 F3d at 793 n 8 (quoting *Eleven Line, Inc v North Texas State Soccer Ass'n*, 213 F3d 198, 207 n 17 (CA 5, 2000)).
9. Tomlin & Merrell, *The Accuracy and Manipulability of Lost Profits Damages Calculations: Should the Trier of Fact Be "Reasonably Certain?,"* 7 Tenn J Bus L 295, 297 (2006), available at <http://trace.tennessee.edu/cgi/viewcontent.cgi?article=1091&context=transactions> [https://perma.cc/M283-QF8V] (accessed November 20, 2019).
10. *Id.*
11. *Id.*
12. *Innovation Ventures, LLC v Custom Nutrition Laboratories, LLC*, 912 F3d 316, 345 (CA 6, 2018). See also *Fabbrini Family Foods, Inc v United Canning Corp*, 90 Mich App 80; 280 NW2d 877 (1979).
13. *Innovation Ventures, LLC*, 912 F3d at 323–324.
14. *Id.* at 344.
15. *Id.*
16. *The Accuracy and Manipulability of Lost Profits Damages*, 7 Tenn J Bus L at 297.
17. *Id.* at 297–298.
18. MRE 702 governs the use of expert witnesses at trial and allows the court to operate as a gatekeeper in excluding unreliable expert testimony and opinions. While this article does not address steps to having a witness recognized as an expert by the court or challenges to experts or expert opinions, MRE 702 instructs on what is required for expert testimony to be admitted into evidence. See also *Daubert v Merrell Dow Pharmaceuticals, Inc*, 509 US 579; 113 S Ct 2786; 125 L Ed 2d 469 (1993) and *Kumho Tire Co, Ltd v Carmichael*, 526 US 137; 119 S Ct 1167; 143 L Ed 2d 238 (1999).
19. *Rondigo, LLC*, 537 F Supp 2d at 892.
20. *Id.* at 895.
21. *Id.* (Emphasis omitted.)
22. *Id.* at 896.
23. *Id.* at 899.
24. *DXS, Inc v Siemens Med Sys, Inc*, 100 F3d 462 (CA 6, 1996).
25. *Id.* at 473.
26. *Id.*
27. *Id.*
28. *Id.*
29. *Id.* at 474.
30. *Multimatic, Inc v Faurecia Interior Systems USA, Inc*, 358 F App'x 643, 645 (CA 6, 2009).
31. *Id.* at 645–646.
32. *Id.* at 650.
33. *Id.* at 650–651.
34. *Id.*