

New Guidelines for Businesses Seeking to Recover Damages for Lost Profits

In many breach of contract lawsuits between businesses, the largest element of damages is lost profits. Lost profits are an example of consequential damages—those losses that are claimed as a result of the alleged breach of contract. California law allows such damages to be recovered so long as the amount of damages can be established with some degree of specificity. Often expert testimony is needed to establish the amount of lost profits.

The California Supreme Court recently raised the bar on the nature and quality of expert testimony that is required to support recovery of lost profits in breach of contract cases. In *Sargon Enterprises, Inc. v. University of Southern California et al.* (decided on November 26, 2012), the California Supreme Court affirmed the decision of a trial court to exclude expert testimony that valued the amount of lost profits to a dental implant company. Sargon contracted with the University of Southern California to conduct clinical trials and sued for breach of contract to recover the lost profits it would have earned from sales of a dental implant it had patented. Sargon retained an expert who used a market-share approach; lost profits were calculated based on what Sargon's projected market share would have been had USC not breached its contract. The expert opined that Sargon lost profits of between \$200 million and over \$1 billion from USC's failure to properly present reports from clinical tests it had been contracted to conduct.

The Court found this approach to be too speculative because it required too many assumptions and guesswork. The Court noted that Sargon's expert did not rely on historical data such as the market share that Sargon actually achieved but only speculated on what Sargon's market share may have become in the future if sales of its new product were successful. In addition, the Court found that Sargon's expert testimony was also too speculative because it compared Sargon with market leaders in the dental implant industry which had annual revenues and profits that were many times greater than Sargon's.

What does this mean for companies on either side of a breach of contract action where lost profits may be an issue? I foresee three implications from the Sargon decision. First, profits calculated using a market-share approach must be supported by actual historical financial data or comparisons to similar sized companies. Second, plaintiffs should also be prepared to defend more summary judgment motions. Defendants may be more inclined to try and move to get cases dismissed at the summary judgment stage because of the higher standards that experts must now meet. Third, plaintiffs' counsel should also be prepared to find better experts. Together these changes are likely to increase the costs of litigating breach of contract cases where damages from lost profits comprise the bulk of a potential recovery.

As 2012 comes to an end, I would like to wish everyone Happy Holidays and hope that 2013 is filled with success and blessings. I look upon the coming year with optimism about the new

exciting possibilities that are yet to materialize. As always, I look forward to continuing to deepen existing friendships.

If you have any questions or comments, I would be delighted to hear from you.

Law Office of Michael Chung

213.700.0198

mchung@lo-mc.com