

## Finding a Road Map to ‘Reasonable Certainty’ in Economic Damages Calculations

*By Larry Kanter – (Aug. 28, 2015) – Dockets across the country are littered with jury verdicts and bench rulings in commercial litigation that have been undermined by weak or flawed economic damages projections and a failure to understand and appreciate the concept of “reasonable certainty” as it relates to calculating lost profits.*



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A sound, “bulletproof” economic damages model that can withstand an aggressive Daubert expert challenge is critically important in a wide variety of commercial litigation and represents one of the most important jobs for forensic accountant experts in litigation. It’s quite a task

to prove something that has not yet occurred, and the “reasonable certainty” threshold is particularly vexing considering the range of interpretations and contradictory rulings that have been made in recent years.

With that in mind, a special task force of the American Institute of Certified Public Accountants (AICPA) took a deep dive into more than 50 recent cases heard by trial and appellate courts as well as scholarly works. A 107-page Practice Aid released earlier this month (Aug. 5) offers indispensable guidance for practitioners preparing damages calculations and to help understand the expectations that courts impose upon experts, but also serves as a valuable resource for lawyers on both sides of a Daubert challenge.

While the AICPA’s Practice Aid is not considered an accounting standard or authoritative pronouncement, it examines four basic damage calculation controversies and provides guidance

to CPAs serving as expert witnesses. Litigators who try commercial damages cases will be well served by familiarizing themselves with the Practice Aid.

### **Reasonable Certainty**

Although the concept of “reasonable certainty” sounds straightforward at first glance, it’s not that simple. The Task Force concluded, based on its analysis of numerous judicial opinions, that damage calculations *do not* need to be certain in order to adduce a calculation of damages. Rather, reasonable certainty is attained when the calculation itself has a reasonable basis through sound methodology. Citing case law, the Task Force says that once there is a high degree of certainty that a plaintiff was damaged, damage calculations based on sound methodologies *do not* fail the test of reasonable certainty – even if the chance of achieving the calculated amount is less than 50 percent.

### **Expert’s Reliance on Client-Supplied Data**

The issue of an expert providing testimony based on, for example, projections from his or her client has been the source of countless hours of debate. CPAs have always been ethically obligated to obtain sufficient and relevant data to provide a reasonable basis for any conclusions. Faced with the challenge of winning the confidence of judges in commercial litigation while using data supplied by a client, the Task Force examined 11 cases in depth and determined that courts appear to prefer experts who:

- Use management-supplied projections that rest on assumptions that are testable and connected to operating conditions of the market and the company’s business. >

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- Rely on management representations from client personnel who are qualified to make such assessments based upon their day-to-day responsibilities or background.
- Consider the underlying data and assumptions that go into management-provided information along with further corroborating evidence.
- Use management-supplied projections that are prepared in the normal course of business, as opposed to projections that are prepared solely for litigation purposes.

### **Expert's Role in Proving Causation**

The Task Force's examination of numerous rulings resulted in valuable takeaways. Among them, courts were less likely to exclude an expert when multiple experts were retained and included one who provided reliable opinions regarding causation. The implication here was that a damages expert's credibility can be enhanced when other experts bolster the causation argument. In addition, courts are less likely to exclude a damages expert when:

- Alleged damages occur in less technical circumstances, such as personal injury, wrongful death, or business interruption actions.
- The court has found that the expert has applied accepted methodologies to calculate the amount of damages.
- The calculation of damages does not rely on seemingly speculative assumptions. For example, the more complications that exist in other aspects of the damages expert's testimony, the more likely causation may be identified by the court as a factor for exclusion.
- No other obvious unaccounted for causes of damages are evident.

### **Calculating Damages in Newly Established Businesses**

Judges are often understandably concerned with awarding damages to newly established businesses with little or no operational history or untested or experimental products. Some states have specific rules for the recovery of damages by "new businesses," but the Task Force found cases in which courts made exceptions to such rules. The Task Force found that plaintiffs with limited operational history were more likely to be awarded damages if their claim had sufficient analysis or evidence to back it up. Not surprisingly, experts who had several bases for their opinions or who relied on other experts were far more likely to succeed in proving damages than those who simply relied on representations from their clients. One of the key components of a successful damage claim was reported to be the use of the "yardstick approach."

The yardstick approach is a common method for calculating damages in a range of cases but appears to be especially well-suited for those involving a newly established business. Rather than relying solely on a plaintiff's internal projections, the yardstick approach bases a damages calculation on the actual performance of another business that is similar based on product, service, industry or location. The Practice Aid provides a useful table of cases for such comparisons.

If the facts of a case do not permit the use of the yardstick approach, courts have embraced experts who use projections prepared by their client, with some caveats. As noted previously, the CPA expert may rely on client-supplied data, but the burden is far greater for an expert representing a business without a historical track record.

The Task Force reported that courts are more likely to rely on pre-litigation (normal course of business) projections tested by a well-qualified >



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expert who made appropriate adjustments consistent with the facts of the case and relevant data such as market conditions. Proving up lost profit calculations with reasonable certainty will remain a challenging area of commercial litigation, but familiarization with these known challenges will help litigators on both sides of a Daubert challenge.

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