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ARTICLES

Enjoining a Fund Distribution Pending the Outcome of Litigation

By Meaghan E. Ryan – October 22, 2012

It's one of the essential elements that any party seeking an injunction must prove: A "remedy at law" (i.e., money damages) won't make the party whole. In such cases, an injunction barring the disbursement of money, or requiring a party to pay money into the court's registry, would resemble a pre-judgment attachment. *Grower Service Corp. vs. Brown*, 204 Ill. App. 3d 532, 561 N.E. 2d 1294 (3rd Dist. 1990). But some courts recognize an exception to this rule: Where the money at issue is a specific and identifiable fund, some courts may consider freezing or otherwise enjoining that fund.

A Specific and Identifiable Fund of Money

In *Martin v. First Federal Savings & Loan Association*, 559 So. 2d 1075 (Ala. 1990), First Federal, a mortgage lender, entered into an agreement with C&C Land Corp., a servicing company, to purchase mortgage loans from C&C. Under that agreement, C&C agreed to collect the borrowers' payments, hold the funds in trust, take a small commission, and then send the balance of the funds to First Federal each month.

First Federal learned that C&C was having financial difficulties. It also discovered discrepancies in First Federal's legal position as the first mortgage holder and of C&C's failure to hold the mortgage payments in trust for First Federal. First Federal terminated the servicing agreement and notified its mortgagors to make all future mortgage payments directly to First Federal. When the mortgagors contacted C&C to determine whether to make payments to C&C or to First Federal, C&C instructed the borrowers to disregard First Federal's letter and to continue remitting their payments directly to C&C.

First Federal filed suit and sought the entry of a temporary restraining order and preliminary injunction. After a hearing on First Federal's request for a preliminary injunction, the court found that C&C had deliberately converted to its own use monies that were due to be paid to First Federal and had actively engaged in conduct that frustrated First Federal's rights under the servicing agreement. The trial court frankly stated that its reason for entering the preliminary injunction was "to accomplish what in street terms is called 'stopping the bleeding.'" *Id.* at 1077. The trial court enjoined C&C from interfering with First Federal's attempts to collect mortgage payments directly, and, notably, from "failing to deliver to [First Federal] any monies in possession of any of the Defendants which have been collected by the Defendants on mortgages sold by the Defendants, or any of them to [First Federal]."

On appeal, the Alabama Supreme Court upheld the trial court's injunction. The court noted that First Federal presented evidence that it would be irreparably harmed by (1) C&C's continued conversion of funds due to First Federal; (2) C&C's interference with First Federal's efforts to

collect the mortgage payments directly; and (3) C&C's poor financial condition. Given the combination of these facts, the court found that the trial court was not plainly erroneous, and it declined to dissolve the injunction.

Florida courts have considered a very similar case. In *Georgia Banking Co. v. GMC Lending & Mortgage Services, Corp.*, 923 So. 2d 1224 (Fla. 3d Dist. 2006), Georgia Banking purchased from GMC residential mortgage loans that GMC originated. GMC continued to act as the servicer on behalf of Georgia Banking, and under its agreement with Georgia Banking, GMC was to collect the mortgage payments and other monies due from the borrowers and hold the funds in trust for Georgia Banking. The bank sued GMC for approximately \$426,000 that it alleged GMC held in trust for Georgia Banking at Wachovia Bank, and it obtained a preliminary injunction that prevented GMC from transferring any of the funds from the Wachovia accounts. GMC objected, arguing that Georgia Banking essentially stated a claim for breach of contract, which could be satisfied by a money judgment. The trial court dissolved the injunction.

On appeal, the court rejected GMC's argument that the potential recovery of a money judgment rendered injunctive relief inappropriate, and it reinstated the injunction. The court noted that Georgia Banking claimed that there existed specific, identifiable trust funds that GMC refused to turn over to Georgia Banking. Under those circumstances, the court found that injunctive relief was appropriate to prevent the dissipation of the specific fund.

Thus, where your client can identify a particular *fund* of money (as opposed to a particular *sum* of money, such as in cases for breach of a promise to pay), you may have a basis for asking the court to enjoin distribution of that fund—to preserve the status quo—pending the outcome of the litigation.

Constructive Trust or Other Equitable Relief

In *Castillo v. Castillo*, 701 So. 2d 1198 (Fla. 3d Dist. 1997), the court affirmed the trial court's entry of an injunction that prevented the disbursement of a \$200,000 fund. In *Castillo*, the plaintiff alleged that she had written a \$200,000 check to her son based on their understanding that he would purchase a certificate of deposit in the names of the plaintiff and all her surviving children. Instead, the son established a \$200,000 account in his name alone. The plaintiff sought, among other things, the imposition of a constructive trust. The court found that this fact distinguished the injunction from one that merely sought to preserve a defendant's funds for later execution. In so holding, the court reaffirmed the availability of injunctive relief to protect the *res* of a trust implied by operation of law.

Likewise, in *Blecher v. Dreyfus Brokerage Services, Inc.*, 770 So. 2d 1276 (Fla. 3d Dist. 2000), the court affirmed the trial court's entry of an injunction freezing certain assets of the defendant. In *Blecher*, defendant E.K.U. opened a brokerage account with plaintiff Dreyfus Brokerage Services with \$3,000 received from a foreign client. Two months later, 35,000 shares of American Financial Holdings stock, valued at approximately \$400,000, were mistakenly transferred into E.K.U.'s account. E.K.U. assumed that these shares represented an additional

investment by its foreign client, and it proceeded to sell the shares and then withdrew the proceeds from its account with Dreyfus. Dreyfus did not discover its mistake for another two months. Once it discovered its mistake, it demanded that E.K.U. refund the monies. E.K.U. refused, and Dreyfus filed suit, including a claim for the imposition of a constructive trust. The trial court entered an injunction freezing what remained of the proceeds withdrawn by E.K.U. On appeal, the court affirmed the injunction, again reasoning that injunctive relief is appropriate to protect the *res* in a claim for constructive trust.

In contrast, the Eleventh Circuit has vacated a trial court's entry of a preliminary injunction freezing a defendant's assets where the plaintiff ultimately seeks only money damages. See *Noventa Ocho LLC v. PBD Properties LLC*, 284 Fed. Appx. 726 (11th Cir. 2008). In *Noventa*, Noventa sought to recover a portion of a contractual purchase price still held by the defendants. Noventa requested, and the trial court granted, a preliminary injunction that required the defendants to pay approximately \$1.2 million into the court's registry, and alternatively froze certain assets of the defendants. Noventa sought only damages for fraudulent misrepresentation and breach of contract, and it did not seek injunctive or other equitable relief as a component of its main claim against the defendants. The Eleventh Circuit found this issue dispositive, holding that a district court lacks authority to freeze the assets of a defendant in a case where the plaintiff seeks only money damages. The court also noted that Noventa had an adequate remedy: to file suit for money damages, which Noventa had done. The court also found the injunction improper because there was not a specific, identifiable fund at issue. Even though Noventa identified a specific amount of money to which it claimed entitlement, that did not relieve it of the obligation to show the existence of a specific fund that could be the subject of an injunction.

In both *Castillo* and *Blecher*, the funds at issue were specific, identifiable sums of money to which the plaintiff claimed the defendant had no right. But the Florida courts appear particularly persuaded by the *type* of relief requested, rather than the source of the funds at issue. The *Noventa* court also focused on the type of relief requested by Noventa: Noventa's failure to request some form of equitable relief acted almost as an admission that money damages would compensate it. Thus, from a practical standpoint, counsel should examine the type of relief requested in these cases. Assuming that a specific fund of money can be demonstrated, parties who seek to freeze assets of a defendant pending the final outcome of a case should strongly consider including a request for a constructive trust or other equitable relief. In fact, counsel may have a difficult time justifying an injunction (a requirement of which is the absence of an adequate remedy at law) where it seeks only money damages.

Keywords: business torts litigation, injunction, disbursement, fund of money, constructive trust, equitable relief

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Early Mitigation of Defamation Damages

By Amy B. Ginensky and Brian A. Berkley – October 22, 2012

While it may not be true that the pen is mightier than the sword, in the defamation world, it is unquestionably the case that the pen (or more appropriately in this digital age, the keystroke) can lead to the award of significant monetary damages. In recent years, defamation claims have resulted in multi-million-dollar verdicts. The cases are not limited to media defendants. Non-media businesses face serious risk. For instance, in 2008, in what was at the time the largest jury verdict in a defamation matter in U.S. history, a Mexican contractor obtained a \$188 million verdict against a businessman who was found to have made libelous statements in a U.S./Mexican publication. *See* Rebello, Justin, “Where Are They Now? A Look Back at the Top Verdicts of 2008,” *Lawyers Weekly USA* (2010) (referring to *Cantu v. Flanigan*, Case No. 05-3580 (E.D.N.Y.), which was appealed and affirmed in part and remanded in part, but the full verdict was eventually affirmed at 705 F. Supp. 2d 220 (E.D.N.Y. 2010)).

Defamation damages are notoriously difficult to quantify, which increases the risk and uncertainty in defending defamation claims. “Risk” and “uncertainty” are two words no business wants to hear from its general counsel’s office. Adding to the pressure is the fact that there are some very important tactical decisions that the potential defendant needs to make before the plaintiff files the complaint. Do you retract the allegedly offending statement? Do you stay silent? Do you respond with a clarification? Do you remind the plaintiff of the duty to mitigate damages? There is no easy answer to any of these questions, but all require the same thing: an early comprehensive assessment of the strengths and weaknesses of the pending defamation claim, including the potential exposure.

Defamation and Non-Media Defendants

Under the Restatement, a plaintiff asserting a claim for defamation must establish “(a) a false and defamatory statement concerning another; (b) an unprivileged publication to a third party; (c) fault amounting at least to negligence on the part of the publisher; and (d) either actionability of the statement irrespective of special harm or the existence of special harm caused by the publication.” *See* Restatement (Second) of Torts § 558. A public-figure plaintiff has the additional burden of proving actual malice—that is, that the defendant published the statement with knowledge of its falsity or with reckless disregard as to its truth. The Restatement states that the same standard of fault—whether it be negligence or actual malice (depending on the plaintiff)—should apply to media and non-media defendants alike. *See id.* at § 580A, cmt. h, 580B, cmt. The degree to which the Restatement standards have been applied varies to some degree from state to state.

Typically, there are three main categories of available damages: (1) general damages for harm to reputation; (2) special damages; and (3) punitive damages (only a handful of states do not allow punitive damages). Generally, the plaintiff must show actual damage to receive general and special damages, and must show willful and malicious injury to the plaintiff’s reputation to

obtain punitive damages. *See id.* at § 620–23; *see also* 1-6 Business Torts 6.02, Commercial Defamation (2012).

There are no defined rules as to the damages the jury may award. One reason for this ill-defined contour is the fact that it is difficult to quantify damage to one’s reputation. The amorphous nature of defamation damages can lead to wildly unpredictable results—sometimes benefiting the plaintiff and sometimes the defendant.

Further, non-media defendants can face significant liability. Here are a few examples of typical defamation claims brought against non-media defendants:

- A company (or its employee) allegedly makes false and disparaging comments about the quality of its competitor’s products or the competitor’s behavior.
- A former-employee sues because his or her former employer tells a potential employer of misconduct or poor performance.
- A company or its employee makes comments about its own product, which raises negative implications about a competitor’s product.
- An employee makes derogatory comments about another employee to someone inside or outside the company.

An Early Defense—To Retract or Not?

A smart plaintiff will ask for a retraction. It puts the defendant in a bind. In litigation, a plaintiff will argue that the retraction is an admission of falsity, and, depending on the facts and circumstances, may be successful. On the other hand, in some states, choosing not to retract can be considered evidence of actual malice if the statement is then known to be false, may open the door for a possible punitive-damages award, and certainly could be used by the plaintiff to paint the defendant in a worse light. Indeed, how you handle the retraction issue could be a multi-million-dollar decision for the defendant.

That is why it is so important to learn as much as possible, as early as possible, about the truth of the alleged offending statement. Conduct a thorough investigation—interview key people and review the underlying documents. If you determine that the statement is absolutely false, then a retraction would likely make sense. If the statement is absolutely true, then, business considerations aside, a retraction is inappropriate.

In those circumstances where the statement is (1) ambiguously false or (2) you are just not sure if it is false, the decision is much more difficult. Here, it is important to know what law will apply and what the law provides. States generally reward the defendant who retracts, but they do so in various degrees. Some hold that a proper retraction will completely protect the defendant from punitive damages (but may limit such protection to newspaper defendants), while others treat it as simply a mitigating factor. *See, e.g.,* W. E. Shipley, “Validity, Construction, and Application of Statute Limiting Damages Recoverable for Defamation,” 13 A.L.R. 2d 277 (2008) (noting retraction statutes that bar completely or partially punitive damages); *see also* *Rogers v. Florence*

Printing Co., 106 S.E.2d 258, 263 (S.C. 1958) (“[r]etraction of a libel is matter to be considered in mitigation, but does not bar punitive damages in the absence of a statute so providing.”). If you are in one of those states that does not allow a retraction to act as a complete bar to punitive damages, and your investigation shows you can put forward a plausible theory as to the truth of a particular statement, then a retraction may not be the proper strategy. Knowing your state law will help you decide between preserving your truth defense (by not retracting) and possibly eliminating the risk of punitive damages (by retracting).

Preserving a truth defense and also protecting against punitive damages do not have to be mutually exclusive options. There are two approaches that can keep both on the table. First, when sending the retraction request, most plaintiffs provide no more evidence of falsity other than to say “I did not do what you say I did” or some variation on this theme. If you don’t know whether the plaintiff is right, ask. Send a letter to the plaintiff, asking for support of the statement. Such a response preserves your truth defense (because you have not admitted to any falsity), while making it harder for the plaintiff to argue that you are acting in bad faith. Further, it puts the pressure back on the plaintiff to provide evidence (and to mitigate damages—we’ll get to that shortly). If the plaintiff does provide evidence, particularly evidence that you otherwise could not have obtained, then that will make your decision much easier. If the plaintiff does not provide evidence, then your decision not to retract will look more reasonable should the statement ultimately be proven false in litigation.

Second, a plaintiff sometimes latches onto an interpretation of a statement that was not what the writer intended but could make the statement false. Although the writer intended a different meaning that in fact is true, consider a clarification. Clarify the meaning of the statement and put forth your theory of the truth of the statement. A proper clarification will preserve a truth defense while also demonstrating good faith, thereby reducing the case for punitive damages.

If you decide to publish a retraction or clarification, there will be other considerations, including where and to whom to publish, and whether to include an apology. Media organizations (because they every day correct the record) for policy reasons often have a routinized approach to deal with these issues, from which they generally will not deviate. *See generally* editions of the *New York Times*, the *Washington Post*, and the *Philadelphia Inquirer*. Businesses have greater flexibility. For example, if there is an error, can you offer a more full-throated retraction (and apology) with broader distribution as part of a settlement package? Even if you can’t use it for settlement, if you find substantial error, consider whether you should correct not just in the medium where you made the error, such as a letter to editor or website correction, but more. A relatively obscure retraction on your website might be of little use in defending a case if you believe there has been a lot of chatter about the offending statement. And, if the misstatement has gone viral on the web, you need to think about whether there are others you want to contact to urge them to correct.

As for an apology, if you have clear error and there is no truth defense, an apology makes sense. We all understand making a mistake. We all make them every day; we also generally apologize and expect that of others.

If you don't believe that an error was made (unless business relations demand otherwise), still reply to a retraction demand and do it respectfully. Remember, if this goes to trial, the response will be looked at closely by six to twelve jurors, and you don't want to be embarrassed by what you said two years earlier. If the first draft you write in response to a demand for retraction is full of spitfire, you might want to wait a day or give it to someone else to read first before sending.

In sum, a defendant should consider the following steps in response to a retraction demand:

- Investigate the truth of the statement immediately.
- Determine the applicable retraction law, particularly to what degree a retraction will protect you from punitive damages or be used as evidence of actual malice with respect to the original publication.
- Inform the plaintiff that you are investigating the matter, and ask the plaintiff to provide information.
- If a retraction or clarification is appropriate, carefully draft, think about how to distribute, whether to apologize, where and how to distribute, and whether it should be part of a settlement discussion.
- If you decide not to retract or clarify, respond, thinking about it being read by jurors years later.

Urging a Plaintiff to Mitigate

A defamation plaintiff must mitigate its damages, like any other victim of a tort. Indeed, the Supreme Court in *Gertz v. Robert Welch* stated that “[t]he first remedy of any victim of defamation is self-help—using available opportunities to contradict the lie or correct the error and thereby to minimize its adverse impact on reputation.” While mitigation can come in many forms, the bottom line is this: A plaintiff must do whatever it reasonably can to protect its own reputation from the alleged damage caused by the offending statement.

Defendants facing other claims, particularly breach-of-contract claims, often aggressively push plaintiffs to identify their mitigation efforts. Surprisingly, it appears the same cannot be said of defamation defendants. There exists a noticeable dearth of case law showing a defendant making a big stink about a plaintiff's lack of mitigation efforts. *See, e.g., Desnick v. American Broadcasting Companies, Inc.*, 1999 US Dist. LEXIS 972 (N.D. Ill. 1999) (noting both parties “short on legal authority pertaining to mitigation of damages in a defamation action”). A possible explanation is that the topic of plaintiff mitigation gives the plaintiff yet one more category of damages to claim. *See, e.g., Comdyne I, Inc. v. Corbin*, 908 F.2d 1142, 1149 (3d Cir. 1990) (finding a plaintiff entitled to “expenditures made in a reasonable effort” to mitigate damages).

Nevertheless, there are several reasons why you should still consider urging the plaintiff to mitigate. First, there is a reason the law requires mitigation: It leads to a more efficient use of resources. The law provides incentives so that resorting to litigation to obtain monetary damages is a last resort. A defamation defendant obviously benefits from this situation. For instance, if a former employee is able to find comparable work at comparable pay notwithstanding an offending statement, then the defamation defendant will not be on the hook for lost wages. If a corporate plaintiff is able to convince its customers to still purchase products notwithstanding the defamation defendant's accusations of poor quality, then the plaintiff will struggle to establish lost profits as a result of the offending statement. Indeed, there are services on the Internet that will assist individuals to protect their reputations online. By reminding the defamation plaintiff of its duties early, and if the plaintiff is successful in limiting its damages, then you can control the exposure your client faces.

Second, you can gauge early how seriously the plaintiff takes its own case. If the plaintiff takes significant steps—such as hiring a public-relations firm, sending its high-ranking employees to meet with top customers, or publishing its own statement attacking the offending statement—then this information will tell you that the plaintiff takes the issue seriously. Any insight on how your opponent views its own case is valuable when it comes time to determine settlement options and overall case strategy.

Third, if you decide a retraction is appropriate, you may decide to enlist the plaintiff in the crafting of the retraction. This can be an important consideration. After a retraction is released, a plaintiff may well argue that because of the way it was written, the retraction made the situation worse. Convincing the plaintiff to participate in the drafting of the retraction will bypass that potential risk.

Fourth, a plaintiff's failure to mitigate even after receiving a letter from a defendant reminding the plaintiff of that duty can help inform a jury of how the plaintiff viewed the seriousness of the statement. A defendant can tell the jury a compelling story that the plaintiff does not take its own claim seriously enough to do anything about it other than sue and seek money. That can be an important fact at trial.

And even if you believe the statement is true, you should consider, when responding to the retraction-demand letter, reminding the plaintiff of the duty to mitigate. In other words, inform the plaintiff that while you do not believe there is anything to mitigate, if the plaintiff believes it has been damaged, then it has a duty to do so.

Conclusion

In a defamation case, perhaps more so than in other matters, there are important issues that a potential defendant should consider and address before the suit is filed. The decision whether to retract can be a critical and nuanced decision. Further, in the right case, aggressively pushing a plaintiff to mitigate may be important. These pre-litigation decisions can put you in the best position possible to reduce the risk and uncertainty inherent in defamation actions.

Keywords: business torts litigation, defamation, damages, mitigation, retraction, Restatement, non-media business

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***Koehler v. Bank of Bermuda* Three Years Later: Fewer Places to Hide**

By George F. Hritz and Amy A. Lehman – October 22, 2012

It has now been three years since New York’s highest court ruled in *Koehler v. Bank of Bermuda*, 12 N.Y. 3d 533, 911 N.E.2d 825 (2009), that under New York law, courts may access judgment debtors’ assets anywhere in the world as long as those assets are held by a bank that also has a branch in New York, as do many large international banks. Although there have been a few significant reported decisions discussing *Koehler* since 2009, there has also not been the disastrous increase in post-judgment litigation predicted by some.

To appreciate the impact of *Koehler*, imagine a counseling session between a client (“Mr. Bermuda”) and his Bermudian solicitor before *Koehler*:

Solicitor: I have reviewed the court papers you have given me. They say a Mr. Koehler has sued you in a Maryland federal court in the United States. Do you have any assets in Maryland?

Mr. Bermuda: No.

Solicitor: Do you have any assets in the United States?

Mr. Bermuda: No.

Solicitor: What connection does this lawsuit have to Maryland or even to the United States?

Mr. Bermuda: None that I can see. Mr. Koehler and I had a business venture in Nevis that went bad.

Solicitor: Unless you have any assets in the United States, I don’t see any reason to respond to these papers. It sounds like the Maryland court does not have jurisdiction over you. Let’s make him come to Bermuda and sue you here. Our courts are plenty fair. In fact, we may even be able to home-cook him here.

Mr. Bermuda: Sounds good to me.

Before *Koehler*, the solicitor’s advice would have been sound. The case started routinely in 1993. Lee Koehler obtained his default judgment in Maryland and had it domesticated in a New York federal court under Article 52 of the New York Civil Practice Law and Rules (CPLR). Mr. Koehler then brought collection proceedings in New York against the Bank of Bermuda as a stakeholder of stock certificates belonging to Mr. Koehler that were in the possession of a branch of the same bank in Bermuda. After 10 years of litigation, the court ordered the bank to turn over the certificates, but the bank then revealed that it no longer had them in its possession.

In 2005, the Southern District of New York dismissed Mr. Koehler’s action against the bank, ruling that the stock certificates at issue were outside of the court’s jurisdiction and could not be reached in the New York action. The U.S. Court of Appeals for the Second Circuit “certified” Mr. Koehler’s case to the New York State Court of Appeals, which ruled (4–3) in June 2009 that the state’s courts may order New York branches of international banks to turn over a judgment debtor’s funds located in other states (*or other countries*) to satisfy judgments registered in New York, even default judgments and even if the creditor, debtor, underlying dispute, or the asset all

had nothing to do with New York. A New York court may order the garnishee over whom there is jurisdiction to turn over the assets wherever they may be located, even when the judgment debtor has no assets in New York. *Koehler*, 12 N.Y.3d at 541.

Following that ruling, the Second Circuit remanded *Koehler* to the Southern District of New York for further proceedings. There the district court records go silent. Presumably, the case then settled, at long last.

The dissent in *Koehler* expressed policy concerns that New York would become a collection venue for anyone who wanted to collect a judgment against a debtor—regardless of whether or not there are any jurisdictional ties to New York for either party—arguing that this could result in an increase in the volume of foreign judgments domesticated in New York and a consequent increase in executions on assets held by banks with New York offices, regardless of the location of the debtor’s assets.

Koehler, however, is not the only example of New York encouraging the use of its courts for dispute resolution unrelated to New York. For example, New York’s General Obligations Law §5-1401 permits parties to choose a New York forum for disputes involving over \$250,000, regardless of the parties’ connections to New York. Should international commercial (and maybe other) creditors with large debts owed to them by solvent debtors, after due process and final judgment, be required to jump through hoops to collect final judgments? Should it take 16 years of additional litigation (and countless litigation dollars) *after judgment*, to collect on a debt? Do Rule 104 of the CPLR (providing that the CPLR “shall be liberally construed to secure the just, speedy and inexpensive determination of every judicial proceeding”) and Rule 1 of the Federal Rules of Civil Procedure (providing that the FRCP “should be construed and administered to secure the just, speedy, and inexpensive determination of every action and proceeding”) mean anything? Isn’t international commerce facilitated by more efficient judicial mechanisms for judgment collections? If a state permits and even encourages international financial institutions to do business within its borders, what would be wrong with the state deciding, as a policy matter, that it would enhance the state’s position in international commerce to facilitate collections, as New York seems to have done? One need not go as far as one commentator to think something was wrong with the system before *Koehler*. See Gluck, “National (and Perhaps Global) Judgment Enforcement through New York’s Banks?,” Judgment Marketplace, March 6, 2012 (encouraging international collections could create an appropriate and desirable “cottage industry” in New York, resulting “in well-paying jobs and new revenue for the under-funded court system”).

Since *Koehler*, there have been numerous cases and several legislative efforts both to narrow and to broaden its holding. There are, however, relatively few court decisions.

Domestication of Foreign Country Judgments

Koehler can be seen as the latest step in the increasing availability of New York courts to provide remedies for international disputes. New York has a long-standing tradition of

recognizing and enforcing non-U.S. money judgments (*see* CPLR Art. 53). The New York Court of Appeals held that personal jurisdiction over a judgment debtor is not needed for domestication of a non-U.S. judgment and execution on the resulting New York judgment, as long as there is jurisdiction over the garnishee. *Koehler*, 12 N.Y.3d at 541; *see also McCarthy v. Wachovia*, 759 F. Supp. 2d 265, 275 (E.D.N.Y. 2011).

Aside from international comity and foreign-relations considerations that are addressed in those lines of cases, there should be no serious due-process concerns arising out of *Koehler*, inasmuch as domestication of a foreign judgment (at least in non-default situations) does not involve the merits of a claim, but merely the recognition of an existing debt after a judicial or an arbitral determination. Once a foreign-country judgment is domesticated, remedies are available as they would be for any other New York judgment, with the limited exception of certain claims against sovereigns.

Post-Judgment Discovery

Koehler involved recognition of a sister-state judgment under the CPLR, but post-judgment discovery and collections are the same for recognition of either Article 52 sister-state judgments or Article 53 foreign-country judgments. Once a judgment is domesticated in New York, post-judgment discovery, execution, and other enforcement may begin. *Koehler* involved post-judgment restraining notices under Article 52, rather than pre-judgment attachments under Article 62.

Koehler makes a clear distinction between the jurisdictional requirements for pre-judgment attachment and post-judgment collection. In an Article 62 proceeding, there must be *in rem* jurisdiction over the assets themselves or personal jurisdiction over a debtor to attach the assets.

Before *Koehler*, only judgment creditors with serious prospects of finding judgment debtors' assets in New York in the near term wanted to go to the expense of domesticating foreign judgments in New York. This changed dramatically after *Koehler*. Since then, a number of non-U.S. judgment-enforcement proceedings have been filed in New York by judgment creditors, especially against international bank stakeholders with offices in New York. The paucity of reported decisions, however, suggests that once judgments are domesticated in New York, debtors and creditors find ways to resolve their cases, perhaps encouraged by innocent stakeholders who do not wish to become embroiled in expensive and intrusive discovery and motion practice.

For post-judgment restraint or turnover of property belonging to the debtor, the *Koehler* court held that all that is necessary is personal jurisdiction over the garnishee that is in possession of the property. The court found that a garnishee may be ordered to turn over out-of-state assets even if there is no jurisdiction over the original debtor. *Koehler*, 12 N.Y.3d at 540–41. That being the case, there are only limited grounds for resisting discovery of such out-of-state assets.

In a recent case, *EM, Ltd v. Republic of Argentina*, decided on August 23, 2012, the U.S. Court of Appeals for the Second Circuit has now decided that the New York branches of Bank of America and Banco de la Nacion Argentina must comply with subpoenas served on them for information about any assets owned by Argentina that they might hold. The Second Circuit also refused to limit discovery of the banks based on claims of sovereign immunity by the debtor. The appellate court (1) pointed out that discovery is distinguished from attachment, and “does not implicate Argentina’s immunity from attachment” and (2) held that the banks themselves had no immunity claims. This ruling opens up the door for creditors to discover through non-party banks information that might otherwise be unavailable about sovereign debtors and their assets, at least in the Second Circuit.

Because *Koehler* is based on an interpretation of a state statute, and because the New York State Court of Appeals has the last word on interpretation of New York state statutes, federal courts are theoretically without power to overrule *Koehler*. Thus, there should be few grounds to resist *Koehler* turnover orders, with two possible exceptions. First, a federal court may still take the position that it was only a New York state statutory interpretation question that was “certified” from the federal to the state appellate court in *Koehler*. That would leave it open to defendant-judgment debtors and stakeholder institutions to argue that there are constitutional due-process arguments still available to them, such as those raised in the “minimum contacts” line of cases following *International Shoe Co. v. Washington*, 326 U.S. 310 (1945). Second, the federal courts can, and some have tried to, distinguish *Koehler* by using New York’s “separate entity” doctrine.

The Separate-Entity Doctrine

One line of post-*Koehler* cases has limited the perceived negative effects of *Koehler* on stakeholding international financial institutions by raising the “separate entity rule.” *Koehler* does not purport to directly abrogate this rule, a judge-made doctrine based on banking and accounting procedures that existed in the pre-computer era. This rule characterizes each branch of a bank as a separate, independent entity and holds, as a matter of law, that each branch should be considered an individual entity, without access to assets of other branches of the same bank to avoid an “intolerable burden” on the banking industry due to the difficulty of transmitting information between branches at the time. *Cronan v. Schilling*, 100 N.Y.S.2d 474, 476 (N.Y. Sup. 1950), *aff’d*, 282 A.D. 940 (1st Dep’t 1953). As a factual matter, of course, this has probably not been true since the advent of modern computer systems.

Even before *Koehler*, the separate-entity rule has been found to be a basis for refusal to allow a judgment creditor to access funds from a non-New York bank through attachment or execution on a New York branch. See *Lok Prakashan Ltd. v. India Abroad Publ’ns, Inc.*, 2002 WL 1585830, at *2 (S.D.N.Y. 2002).

In *Koehler*, after many years of litigation, the bank branch that was purported to hold the assets in Bermuda did submit to the jurisdiction of the New York courts, mooting the question of whether or not there was jurisdiction over the separate branch of the bank. Thus, *Koehler* did not address the separate-entity issue.

Post-Koehler Cases

Cases following *Koehler* are split on whether or not *Koehler* is in conflict with the separate-entity rule. *J.W. Oilfield v. Equipment, LLC. V. Commerzbank AG*, 764 F. Supp. 2d 587, 595 (S.D.N.Y. 2011) states that although the separate-entity rule may still apply to pre-judgment attachment, “New York courts will not apply the separate entity rule in post-judgment execution proceedings,” holding that the court had the authority to order the bank to turn over the assets to the New York branch. The presence of a branch of the bank in New York was found sufficient to grant “general jurisdiction over the entire entity.” *Eitzen Bulk A/S v. State Bank of India*, 2011 WL 4639823 at *4 (S.D.N.Y. 2011) also cites *Koehler* for the same proposition.

Not all post-*Koehler* cases agree with this analysis. *Samsun Logix Corp. v. Bank of China*, 2011 WL 1935954 (N.Y. Sup. 2011) and *Parbulk II AS v. Heritage Maritime, SA*, 935 N.Y.S.2d 829 (N.Y. Sup. 2011), both addressing post-judgment execution after *Koehler*, found that *Koehler* had not overturned the separate-entity rule. Following *Samsun* and *Parbulk*, *Shaheen Sports, Inc. v. Asia Ins. Co.*, 2012 WL 919664 (S.D.N.Y. 2012), one federal district court recently denied a turnover order under CPLR 5225(b), acknowledging *Koehler*, but invoking the separate-entity rule. Based on the complicated nature of the issues and the “lack of clarity permeating this area of the law,” the court encouraged the plaintiff to appeal the decision, *Shaheen*, at *9, although it appears that the plaintiff did not do so.

International financial-institution advocates and others have also attempted, unsuccessfully, to deal with *Koehler* by devising legislative solutions to problems it presents them. Those efforts have thus far failed in the New York state legislature. *See* H.B. A11109 and S.B. S7972 (N.Y. May, 2010).

Conclusion

As evidenced by the “separate entity” cases, New York courts have shown considerable sympathy toward stakeholding international financial institutions that may need to bear the additional work and expense imposed on them after *Koehler*. Indeed, many stakeholders apparently have customer agreements that provide for appropriate cost-shifting so that financial institution should not need to bear the cost of defending defaulting debtors against creditors’ legitimate efforts to enforce their rights, including discovery costs. It also seems unlikely that the problems some courts are addressing by invoking the separate-entity rule remain as actual problems given centralized record keeping in use in modern financial-services institutions. Other problems remain, however, such as foreign banking laws that are inconsistent with New York law, which could place multi-jurisdictional institutions in double jeopardy. Those are issues that courts and legislatures should resolve, keeping in mind the actual business and technical realities of global commerce and finance as they exist today.

Keywords: business torts litigation, judgment, domesticate, discovery, Koehler, debtor, creditor, collection, bank

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Proving a Reasonable Royalty for Trade-Secret Misappropriation

By Chip Brooker – October 22, 2012

As the proverbial catchall of intellectual property, trade secrets are nebulous by their very nature, protecting hazier forms of intellectual property, such as business methods; manufacturing processes and formulas; customer, supplier, and vendor information and lists; marketing information and strategies; and “know-how,” among other things. By contrast, patents, copyrights, and trademarks each protect a discrete form of intellectual property, enjoy the consistent application of federal statutory and common law, and unlike trade secrets, do not lose value when they are publicly disclosed. As a result, any attempt to calculate damages for trade-secret misappropriation comes with inherent difficulties and inconsistencies in the law from one jurisdiction to the next, despite the extensive adoption of the Uniform Trade Secrets Act.

With this background, each trade-secret-misappropriation case requires a flexible and imaginative approach to the problem of damages. Each case should be controlled by its own facts and circumstances. As a result, plaintiffs should adjust their damages theories to fit with the commercial setting of the injury, the future consequences of any misappropriation, and the nature and extent of the defendant’s use of the trade secret after misappropriation. In some cases, damages will be subject to exact measurement, either because the parties had previously agreed on a licensing rate or because an industry standard provides a clear measure. In other cases, damages will be easily calculable based on traditional damages theories, such as a plaintiff’s lost profits or a defendant’s unjust enrichment.

However, where the damages are uncertain, the plaintiff should be afforded every opportunity to prove damages once misappropriation is proven. In these cases, a plaintiff may consider pursuing a reasonable royalty for a defendant’s misappropriation, or at the very least, the plaintiff should employ a reasonable royalty measure to backstop more traditional damages theories, such as lost profits and unjust enrichment.

Reasonable Royalties for Trade Secrets Generally

In the context of damages for a reasonable royalty, trade secrets benefit greatly from the thorough development of a comparable analysis for patent infringement. Consequently, the reasonable-royalty analysis is well established in common law. Originally, courts employed the reasonable-royalty measure of damages to deal with the situation where the misappropriated trade secrets were used either to improve the defendant’s manufacturing process or as part of a larger manufactured product. This approach is consistent with comment (f) to section 45 of the Restatement of the Law of Unfair Competition, in which the American Law Institute noted that:

If the trade secret accounts for only a portion of the profits earned on the defendant’s sales, such as when the trade secret relates to a single component of a product marketable without the secret, an award to the plaintiff of defendant’s entire profit may be unjust. The royalty that the plaintiff and defendant would

have agreed to for the use of the trade secret made by the defendant may be one measure of the approximate portion of the defendant's profits attributable to the use.

In *Egry Register Co. v. Standard Register Co.*, 23 F.2d 438 (6th Cir. 1928)—a seminal patent-infringement case utilizing a reasonable royalty—the defendant manufactured and sold cash registers that used, only in part, a device developed by the plaintiff to roll paper through the machine. However, the trial court awarded the plaintiff the total profits the defendant made on all sales of all machines using this component. On appeal, the U.S. Court of Appeals for the Sixth Circuit reversed and remanded, holding that this measure of damages was inequitable because the device was only a part of the larger product sold by the defendant.

Because it was impossible to determine what percentage of profits was attributable to the plaintiff's component, the Sixth Circuit held that the proper measure of damages would be a reasonable royalty on the defendant's sales, thereby creating a percentage of profits based on an approximation of the actual value of the infringed device to the defendant. The Sixth Circuit stated that “to adopt a reasonable royalty as the measure of damages is to adopt and interpret, as well as may be, the fiction that a license was to be granted at the time of beginning the infringement, and then to determine what the license price should have been.” Ultimately, in adopting a willing licensor-willing licensee standard, the court further clarified that, “in effect, the court assumes the existence *ab initio* of, and declares the equitable terms of, a supposititious license, and does this *nunc pro tunc*; it creates and applies retrospectively a compulsory license.”

Uniform Trade Secrets Act

Unlike patents, trademarks, and copyrights, whose protection is codified by federal statute and subject to the exclusive jurisdiction of federal courts, the laws of each state continue to govern trade-secret misappropriation. The Uniform Trade Secrets Act (UTSA) was initially drafted and published in 1979—and subsequently amended in 1985—in an attempt to codify and harmonize common-law principles that had developed from state to state concerning trade-secret misappropriation. Now, 47 states, the District of Columbia, and the U.S. Virgin Islands have formally enacted and adopted the UTSA in some form. Massachusetts, New York, and Texas remain the only states that have not adopted the UTSA. New York and Texas rely on their established common law alone and are guided by the Restatement (First) of Torts. Massachusetts, however, has adopted its own trade-secret statute, which represents a codification of its own common law.

Section 3(a) of the UTSA governs damages. When originally drafted in 1979, section 3(a) did not provide for the recovery of a reasonable royalty as a measure of damages for trade-secret misappropriation. Instead, initially, section 3(a) limited damages to “the actual loss caused by misappropriation” and the “unjust enrichment caused by misappropriation that is not taken into account in computing damages for actual loss.” Subsequently, in 1985, section 3(a) was amended to allow for damages as follows:

Damages can include both the actual loss caused by misappropriation and the unjust enrichment caused by misappropriation that is not taken into account in computing actual loss. In lieu of damages measured by any other methods, the damages caused by misappropriation may be measured by imposition of liability for a reasonable royalty for a misappropriator's unauthorized disclosure or use of a trade secret.

Unfortunately, the UTSA has not necessarily accomplished its goal of uniformity, as the adopting states have codified various versions influenced by their own common law. Further, subsequent court opinions in each state have continued to modify and interpret the UTSA. Plus, the six-year delay in recognizing the legitimacy of a reasonable royalty as a measure of damages for trade-secret misappropriation has resulted in disparities between early adopters and later adopters of the UTSA. For example, as an early adopter of the UTSA, until recently, California would not allow a litigant to recover a reasonable royalty for trade-secret misappropriation. *But see Ajaxo, Inc. v. E*Trade Financial Corp.*, 187 Cal. App. 4th 1295, 115 Cal. Rptr. 3d 168 (Cal. Ct. App. 2010) (allowing the recovery of a reasonable royalty where the plaintiff could not prove lost profits or unjust enrichment).

Calculating a Reasonable Royalty

As the reasonable-royalty measure of damages developed, courts often cited and quoted the *Egry Register* decision. Now, in practice, a reasonable royalty is usually reserved for situations when a plaintiff can prove neither lost profits nor unjust enrichment, which generally offer easier, more cost-efficient analyses. As the term is presently understood, a reasonable royalty is taken to mean more than simply a percentage of actual profits. Instead, the measure now attempts to approximate the actual value of what has been misappropriated. Because this is rarely subject to exact measurement, multiple methods have developed to determine a reasonable royalty, including (i) an established royalty, (ii) a fair-market-value approach, (iii) the *Georgia-Pacific* factors, (iv) an analytical approach, and (v) the 25 percent rule.

First, with regard to an established royalty, courts will refer to any other products that the plaintiff and the defendant have actually licensed in the past. With that historical context, the court will analyze the product at issue, its associated licensing agreements, and the parties' prior licensing history to determine a range of reasonably acceptable royalty rates. Similarly, under the fair-market-value approach, where there is no prior licensing history between the parties, the court will consider the rates with which third parties in the industry have recently licensed other comparable technologies or products. Plaintiffs utilizing a fair-market-value approach must be careful to obtain credible, reliable, and relevant data and to consider only truly comparable transactions.

One of the most influential cases concerning the reasonable-royalty measure of damages is *Georgia-Pacific Corp. v. United States Plywood Corp.*, 318 F.Supp. 1116, 1120 (S.D.N.Y. 1970). In *Georgia-Pacific*, a patent case whose analysis has been expanded to trade secrets, the Southern District of New York significantly expanded the willing-licensor-willing-licensee

analysis. The *Georgia-Pacific* court noted that “[w]here a willing licensor and a willing licensee are negotiating for a royalty, the hypothetical negotiations would not occur in a vacuum of pure logic.” Instead, those negotiations would involve a “a market place confrontation of the parties”—the outcome of which would depend upon numerous factors, which include, among others, similar license agreements between the parties or in the industry, anticipated profits, the trade secret’s contribution to the product, the nature of the market, the parties’ competitive positions, and the development costs of the same or a similar trade secret.

Under *Georgia-Pacific*, this “hypothetical negotiation” is by its very nature speculative. Essentially, an expert is opining on what two unwilling parties would have agreed to be a fair price if they were willing to negotiate a deal. While each factor may not apply in each case, courts have indicated that an expert must at least consider every factor and make a decision to include or exclude each factor from his or her analysis. Obviously, proving as many factors as possible reduces the speculation inherent in this “hypothetical negotiation.”

Another method to calculate a reasonable royalty for trade-secret misappropriation includes an analytical approach that uses one of the following two formulas: (i) the defendant’s expected profit margin minus the industry’s profit margin or (ii) the defendant’s expected profit margin minus its normal profit margin. In these cases, courts generally base the reasonable-royalty award on the defendant’s own internal profit projections at the time misappropriation began for any product employing the trade secret. Essentially, this approach attempts to use the information upon which the defendant may have made its decision to misappropriate the trade secret. Consequently, courts have found pre-misappropriation memoranda and projections particularly relevant, which often forces the defendant into the uncomfortable position of having to undermine the reliability of its own internal and proprietary documents.

Finally, another approach commonly referred to as the 25 percent rule simply sets the royalty rate at 25– 33 percent of operating profit depending on a number of factors. Although this approach has proven useful to courts, it is regularly criticized for being overly simplistic. However, at the very least, the 25 percent rule may provide a useful starting point to any reasonable-royalty analysis.

Conclusion and Practical Application

A plaintiff’s lost profits or a defendant’s unjust enrichment should still be the first options considered when attempting to calculate damages for trade-secret misappropriation. These measures of damages are generally easier and more cost-efficient to calculate. However, with that being said, a plaintiff should not forget about or ignore its ability to recover a reasonable royalty. There are certainly factual scenarios where a reasonable royalty may maximize damages, such as where the plaintiff does not actively market its trade secret and the defendant has only recently begun profiting from its misappropriation. Further, where evidence of lost profits and unjust enrichment is weak, a plaintiff can effectively backstop its damages by pleading and proving a reasonable royalty as an alternative measure of damages. That way, should the plaintiff

be unable to prove lost profits or unjust enrichment, it will not have sacrificed its ability to recover in the alternative.

Keywords: business torts litigation, remedies, trade secret, reasonable royalty

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A Primer on Recovering Lost-Profit Damages

By Zachary G. Newman and Anthony Ellis – October 22, 2012

Lost-profits-damage claims can arise in any manner of cases, including contract disputes, business torts, antitrust, and even insurance cases. As lost-profits claims often have the potential to significantly exceed conventional damage claims, litigants are well served to understand the unique evidentiary and theoretical challenges that are associated therewith. Although establishing lost profits may be as simple as calculating the anticipated profit on goods sold, other scenarios may present far more difficult calculations, even involving complex and potentially costly expert testimony and analysis.

Burden of Proof

The requirements and standards of proof for claiming lost-profits damages vary depending on the context in which such damages arise. While an exact calculation of lost profits is not necessary for the recovery of damages (*see Rusty's Weigh Scales & Serv., Inc. v. N. Tex. Scales, Inc.*, 314 S.W.3d 105, 110 (Tex. Ct. App. 2010) (*citing Texas Instruments, Inc. v. Teletron Energy Mgmt., Inc.*, 877 S.W.2d 276, 279 (Tex. 1994))), plaintiffs should provide enough definite proof of the amount to “afford a sufficient basis for estimating” the amount of lost profits being claimed. *See Muir v. Navy Fed. Credit Union*, 744 F. Supp. 2d 145, 148 (D.C. Cir. 2010) (*citing Boggs v. Duncan*, 202 Va. 877, 882, 121 S.E.2d 359, 363 (1961)). Many courts require that the proof be sufficient to allow fact finders to reach a “reasonably certain determination of the amount of gains prevented.” *See Glynn v. Impact Sci. & Tech., Inc.*, 807 F. Supp. 2d 391 (D. Md. 2011) (applying New Hampshire law). If such claims are contingent or uncertain, some jurisdictions will preclude recovery of lost-profits damages. *See, e.g., Muir*, 744 F. Supp. 2d at 149.

Many courts have recognized that the standard of “reasonable certainty” is not subject to a uniform or concrete definition. Thus, in certain jurisdictions, such as Minnesota, the plaintiff is required to prove future damages to a “fair preponderance of evidence.” *Pietrzak v. Eggen*, 295 N.W. 2d 504, 507 (Minn. 1980). Other states, such as Ohio, consider evidence to be reasonably certain if “it is probable or more likely than not.” *Bobb Forest Prods. v. Morbark Indus.*, 151 Ohio App. 3d 63, 88, 783 N.E.2d 560, 579 (Ohio Ct. App. 2002). Truthfully, this may be a linguistic difference, and there may not be much substantive difference in what a plaintiff would need to demonstrate to satisfy either standard. Some courts apply the reasonable-certainty standard only to the question of causation but not to the amount of such damages. *See Joseph Wylie & Christopher Fahy, Proving and Defending Lost-Profits Claims*, *Business Torts Journal*, Fall 2007, at 7. In such cases, courts may not always require that the amount of damages be established with the “same degree of certainty” as the evidence used to calculate such an amount. As the Supreme Court of Missouri noted:

In some cases, the evidence weighed in common experience demonstrates that a substantial pecuniary loss has occurred, but at the same time it is apparent that the loss is of a character which defies exact proof. In that situation, it is reasonable to require a lesser degree of certainty as to the amount of loss, leaving a greater

degree of discretion to the court or jury. This principle is applicable in the case of proof of lost profits.

Ameristar Jet Charter, Inc. v. Dodson Int'l Parts, Inc., 155 S.W.3d 50, 55 (Mo. 2005) (quoting *Ranch Hand Foods, Inc. v. Polar Pak Foods, Inc.*, 690 S.W.2d 437, 444–45 (Mo. Ct. App. 1985)).

The “New Business” Exception to Recovery

Arguably the greatest variation of the “reasonable certainty” standard exists in the context of analyzing potential lost-profits damages of new businesses. Because new businesses lack past experience from which profits may be estimated, it is difficult to make a reasonably certain claim for the loss of expected profits. As such, a few states, such as Virginia, have adopted or applied a “new business rule” that bars recovery of lost-profits damages for newly established business enterprises. *See, e.g., Vienna Metro LLC v. Pulte Home Corp.*, 786 F. Supp. 2d 1076, 1086 (E.D. Va. 2011); *Sunrise Continuing Care, LLC v. Wright*, 277 Va. 148, 154, 671 S.E.2d 132, 135 (2009); *Clark v. Scott*, 258 Va. 296, 520 S.E.2d 366 (1999) (determining that a dental practice that operated for eight months was still considered a new business under the “new business rule”).

An illustration of the bias against these claims found in some jurisdictions can be found in Virginia, where courts have barred recovery of lost profits for new businesses despite the fact that the Virginia legislature enacted a statute that expressly permits new or unestablished businesses to sue and obtain damages for lost profits. *See* Va. Code Ann. § 8.01-221.1 (2012) (allowing the recovery of lost-profits damages for a new or unestablished business that presents proper proof). Courts in such jurisdictions have reasoned that a new commercial business that lacks a track record of actual profits generally cannot qualify for recovery because such profits are too uncertain to meet the legal standard of reasonable certainty. *See, e.g., Re/Max of Ga. v. Real Estate Group on Peachtree*, 201 Ga. App. 787, 789, 412 S.E.2d 543, 546 (Ga. Ct. App. 1991) (holding that lost profits of a new business are generally too speculative for recovery).

New York courts also have recognized that it is more difficult for new businesses to prove lost profits with reasonable certainty and to ultimately recover damages. *See Ashland Mgmt., Inc. v. Janien*, 82 N.Y.2d 395 (1990) (holding that calculations of anticipated profits based on advanced financial data and strategies met the burden of reasonable certainty, but recognizing the difficulty in establishing such damages). Nevertheless, it is not impossible to meet the burden. In *Ashland*, the court noted that the claim rested on “the parties’ carefully studied professional judgments of what they believed were realistic estimates of future assets.” *Id.* at 406. The court also noted that although the parties were launching a new investment strategy, “they were not entering a new or unfamiliar business.” *Id.* Key factors included the fact that the new strategy was an enhancement to an existing successful business, there was a “ready reservoir of customers,” and there was extensive testing to provide a predictable damage analysis. *Id.*

Because the “new business rule” can emasculate any “reasonable certainty” and result in harsh consequences, many jurisdictions have rejected it and opted, instead, for less rigid versions or alternative pleading hurdles. Illinois courts, for example, have created exceptions to the rule permitting lost-profits damages to be proven when the new business venture was selling products similar to other products with a known market (*see Milex Prods., Inc. v. Alra Lab.*, 237 Ill. App. 3d 177, 603 N.E.2d 1226 (Ill. App. Ct. 1992) (awarding lost profits that were determined by evidence based upon actual products in the marketplace and authoritative sources for data)), or when a new business was prevented from acquiring operations of an existing business, *see Malatesta v. Leichter*, 186 Ill. App. 3d 602, 542 N.E.2d 768 (Ill. App. Ct. 1989). Wisconsin and Texas have also recognized lost-profits claims for new businesses, but note that they impose a heightened standard for new businesses making a lost-profits claim. *See, e.g., Helena Co. v. Wilkins*, 47 S.W.3d 486, 505 (Tex. 2001) (noting that a new business that lacks a profit history is not precluded from recovering lost-profits damages); *Mrozek v. Intra Financial Corp.*, 281 Wis. 2d 448, 477, 699 N.W.2d 54, 68 (2005) (recognizing that a party seeking lost profits for a business with no previous profit history may obtain damages but must provide additional guidance and evidence to allow a “fact finder to reasonably ascertain future lost profits”).

Presenting Evidence of Lost Profits in Admissible Form

Because the uncertain nature of lost profits makes it difficult to calculate with mathematical precision, sufficient allegations need to be made and evidence presented to enable the fact finder to make a fair and reasonable finding that damages were actually suffered. *See Price-Orem Invest. Co. v. Rollins, Brown & Gunnell, Inc.*, 784 P.2d 475, 478 (Utah Ct. App. 1989). Practitioners should bear in mind that lost profits refers to lost *net* profits and have been defined as “what remains in the conduct of a business after deducting from its total receipts all of the expenses incurred in carrying on the business.” *See G & W Marine, Inc. v. Morris*, 471 S.W.2d 644, 647 (Tex. Civ. App. 1939). Thus, the defending party should take sufficient discovery to determine whether the claimant is seeking its own operating costs or its gross profits. Generally, the claimant will be unable to recoup direct costs it would have incurred in earning the profits. However, it is less certain whether fixed costs, such as overhead expenses and tax benefits, should also be deducted from the gross-profit calculations. *See* Andrea Renne St. Julian, “Lost Profits Resulting from Tortious Injury to Business,” *American Jurisprudence Proof of Facts* 3d (April 2012), at § 12; *see also Waggoner Motors, Inc. v. Waverly Church of Christ*, 159 S.W.3d 42, 59 (Tenn. Ct. App. 2004).

In some cases, establishing lost profits is fairly straightforward and involves merely showing the profit the non-breaching party would have made on the transaction after deducting the claimant’s costs if it had been consummated, which can be established based on the transaction documents already executed. Where the calculation is not so simple, courts have recognized a variety of ways that parties can establish their lost profits. The two predominant methods are the “before-and-after theory” and the “yardstick test.” Under the “before-and-after theory,” the claimant must demonstrate prior earnings as evidence of lost profits. The “yardstick test” involves external data comparing the profits of a business that is closely related to that of the claimant’s business.

Regardless of the applicable theory, counsel must take care in assembling and presenting the evidence for lost profits in admissible form. Given that many lost-profit claims are challenged at the pleading stage in a motion to dismiss, a claimant should assemble and verify the supporting information prior to pleading. The most persuasive types of evidence include verifiable data, corroborated profit history, and comparative profit performance.

In the case of new business models or evidence that requires some degree of speculation or opinion, litigants may want to use expert as well as lay-witness testimony, consistent with the requirements set forth in the Federal Rules of Evidence (FRE). *See* Wylie and Fahy, at 10. Under FRE 701, courts may consider the testimony of business owners with special knowledge of the business and its operations to testify as to the facts of the business that relate to the lost-profits calculations. Some courts have even admitted lay-witness testimony where the witness has direct knowledge regarding the profit calculation. *See, e.g., In re Merritt Logan, Inc.*, 901 F.2d 349, 359 (3d Cir. 1990) (allowing the plaintiff’s accountant bookkeeper and principal shareholder to testify concerning the company’s lost profits). To ensure the admissibility of expert and lay-witness testimony, claimants should make sure that experts strike a balance between a “reasonable estimation of damages and speculating about what could have been.” *See* Neil Steinkamp, Gavin J. Fleming, and Jacob Reed, [“Presenting Evidence when Businesses Have Limited Financial Information.”](#)

Breach-of-Contract Claims

In contract cases, in addition to the standard requirements of proving damages to a “reasonable certainty,” most jurisdictions require the claimant to prove that the lost profits were within the contemplation of the parties at the time of contract. *See, e.g., Mead v. Johnson Group, Inc.*, 615 S.W.2d 685, 687 (Tex. 1981). For example, Massachusetts courts apply the “contemplation of the parties” test by requiring that

the loss be the natural, primary and probable consequence of the breach, . . . the profits arising from the performance of the contract or the loss [resulting] from its nonperformance were within the contemplation of the parties, and . . . the profits are not so uncertain or contingent as to be incapable of reasonable proof.

Knightsbridge Marketing Services, Inc. v. Promociones Y Proyectos, S.A., 728 F.2d 572, 575 (1st Cir. 1984). Establishing that future profits were foreseeable and contemplated by the parties at the time of contract requires specific evidence, and the claimant must take care in developing this evidence through the contract itself or admissions by the breaching party. *See Mid-America Tablewares, Inc. v. Mogi Trading Co., Ltd.*, 100 F.3d 1353, 1362 (7th Cir. 1996) (stating that determining whether future profits were within the contemplation of the parties at the time of contracting “turns on the specific facts established at trial”); *see also Fid. Interior Constr., Inc. v. Southeastern Carpenters Reg’l Counsel*, 675 F.3d 1250 (11th Cir. 2012).

Lost Profits in Tortious Injury to Business Claims

The types of intentional torts claims that allow for the recovery of lost profits include, but are not

limited to: tortious interference with the performance of a contract or prospective economic advantage, fraud, breach of fiduciary duty, defamation, and even malicious prosecution. *See* Andrea Renee St. Julian, “Lost Profits Resulting from Tortious Injury to Business,” 26 Am. Jur. Proof of Facts 3d, 119–204 (2012). Within the context of these tortious causes of action, the claimant has the burden of proving the foreseeability of the harmful conduct, and the causality between the tortious conduct and the resulting loss of profits. *See, e.g., JAire Corp. v. Gregory*, 24 Cal. 3d 799 (1979). In proving lost profits, there is typically a good deal of focus on the comparison of profits before and after the occurrence of the tortious conduct. *See Roane-Barker v. Southeastern Hosp. Supply Corp.*, 99 N.C. App. 30, 40, 392 S.E.2d 663, 669 (Ct. App. 1990) (explaining that the plaintiff was entitled to show evidence of its lost profits by comparing its past history of profits with gross sales of his former salesmen). A before-and-after profits comparison is less effective in establishing lost profits for new businesses that lack a profit history or businesses whose profits after the tortious conduct are not significantly less than previous years. These businesses could instead establish the profits they were expected to make before the tortious occurrence, present evidence of the profits of similar competitors, or evaluate gains made by the tortfeasor. *See Sandare Chemical Co. v. WAKO Int’l, Inc.*, 820 S.W.2d 21 (Tex. Ct. App. 1991) (outlining methods and holding that a plaintiff who had no profit history could prove lost profits through the profits gained by the defendant).

To establish the foreseeability requirement, the claimant will need to demonstrate in many jurisdictions that it was foreseeable he would be harmed by the defendant’s conduct. The California Supreme Court awarded plaintiff restaurant owner lost profits damages when construction delays prevented the restaurant from operating. *See JAire Corp. v. Gregory*, 24 Cal. 3d 799, 598 P.2d 60 (1979).

To satisfy causation, the claimant cannot simply present proof that the business operated at a loss following the alleged tortious actions. *See Turner v. PV International Corp.*, 765 S.W.2d 455 (Tex. Ct. App. 1988). To meet the reasonable-certainty standard, the plaintiff must also have had the ability as a business to perform the work that would have produced the lost profits, and had the opportunity to acquire the work that would have produced the profits. *See Cal. E. Airways v. Alaska Airlines*, 229 P.2d 540 (Wash. 1951).

Lost Profits in Antitrust Claims

Under the Sherman Antitrust Act and the Clayton Act, which prohibit contracts, combinations, and conspiracies that reduce competition in the marketplace, lost profits can be alleged and awarded. *See* Sherman Antitrust Act, 15 U.S.C. § 1; Clayton Antitrust Act, 15 U.S.C. §§ 12–27, 29 U.S.C. §§ 52–53. In an antitrust claim, the plaintiff must have suffered an “injury of the type the antitrust laws were intended to prevent,” such as a business’s loss of profits as a result of supra-competitive pricing or a reduced ability to compete. *See Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977). As in breach-of-contract and tortious-injury cases, the amount of the lost profits claim should be “a just and reasonable estimate based on relevant data.” *See Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 123 (1969).

The appropriate types of damages in the antitrust context are dependent on the nature of the alleged restraint on the marketplace. *See* Patrick L. Anderson, Theodore R. Bolema and Ilhan K. Geckil, “Damages in Antitrust Cases,” Anderson Economic Group, Feb. 26, 2007, at 4. When antitrust violators cause prices to increase through monopolization, a price-fixing conspiracy, or exclusionary conduct, for example, the harm they cause may be alleged as (1) overcharges paid for goods actually purchased, and (2) lost profits resulting from the lost opportunity to buy and resell a greater volume of goods. *See* Jeffrey L. Harrison, “The Lost Profits Measure of Damages in Price Enhancement Cases,” 64 Minn. L. Rev. 751, 753, 770–72 (1980). Cases involving price-fixing and monopolization often result in an overcharge injury, which could entitle the claimants to compensation for the consequences of the wrongful action. *See Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 297–98 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980).

Conclusion

Lost-profit claims are sure to fall under rigorous factual review at trial and sustain challenges during a motion to dismiss and a motion for summary judgment. To present a persuasive case for recovery of lost profits, a claimant’s counsel should be attentive to the various tests and standards of proving lost-profits damages within the context of a breach of contract, tortious injury to a business, or antitrust claims. Careful attention to providing sufficient evidence and abiding by evidentiary rules could make the difference between recovering damages and having the claim barred.

Keywords: business torts litigation, burden of proof, new business exception, lost profits

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NEWS & DEVELOPMENTS

Court Finds for Defendant in Age Discrimination Case

In [Woodward v. Emulex Corp.](#) [PDF], No. 10-11382-RGS, ___ F. Supp.2d ___, 2012 WL 1245586 (D. Mass. April 13, 2012), the U.S. District Court for the District of Massachusetts (Stearns, J.) granted summary judgment against the plaintiff’s claims of age discrimination and breach of express and implied contract against his former employer, as well as a claim of tortious interference against a former supervisor.

In the first instance, the court assumed that the plaintiff had made a prima facie showing sufficient to raise a reasonable inference of age discrimination but then accepted the plausibility of the employer’s lawful explanation for the plaintiff’s termination in the second step of the analysis. In the third step of the analysis, the court found that the plaintiff was unable to provide sufficient evidence that discrimination was the basis of his termination, finding instead that the action had been an exercise of business judgment. Among other things, the court also found that the defendant’s “positive and encouraging remarks” regarding the plaintiff’s continued employment did not contain a specific promise sufficient to create an implied contract or create a reasonable expectation of permanent employment. The court also found that the plaintiff failed to present sufficient evidence to demonstrate malice, which is required to prove his claim of tortious interference against his former supervisor.

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