

What Constitutes Best Evidence?

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Attaining Reasonable Certainty in Economic Damages Calculations (Part III of III)

The purpose of this article—the third of three ([Part I](#) and [Part II](#)) on this topic—is to provide the reader with an understanding of Chapter 3 (What Constitutes Best Evidence) of the 2018 Practice Aid as well as certain other publications containing a body of knowledge on the best evidence to support economic damages in a court of law. Prior articles dealt with Chapter 1 (Revenue and Growth Rates) and Chapter 2 (Costs) of the 2018 Practice Aid and related topics.



In 2015, the American Institute of CPAs (AICPA) Forensic and Valuation Services (FVS) issued a practice aid entitled, “Attaining Reasonable Certainty in Economic Damages Calculations”. That publication added to the body of knowledge available to experts calculating lost profits and other forms of economic damages.

In November 2018, the AICPA FVS updated the practice aid, also entitled, “Attaining Reasonable Certainty in Economic Damages Calculations” (hereafter, the 2018 Practice Aid) further adding to the body of knowledge. The 2018 Practice Aid was updated after the AICPA decided that case law research may yield additional topics worth presenting.

The purpose of this article—the third of three on this topic—is to provide the reader with an understanding of Chapter 3 (What Constitutes Best Evidence) of the 2018 Practice Aid as well as certain other publications containing a body of knowledge on the best evidence to support economic damages in a court of law.[1] Prior articles dealt with Chapter 1 (Revenue and Growth Rates) and Chapter 2 (Costs) of the 2018 Practice Aid and related topics.

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The concepts of reasonable certainty and best evidence are inextricably interconnected.[2] Evidence is a critical factor to consider when Courts determine whether an expert’s opinion is reasonably certain.[3] There are no universally accepted criteria or requirements about what constitutes best evidence.[4] Like reasonable certainty, best evidence is predicated entirely on the specific facts and circumstances of each case.[5]

Best evidence, as it concerns reasonable certainty and economic damages, was discussed in the *Sunward* case[6] as follows:

A reasonable basis for computation and the best evidence which is obtainable under the circumstances of the case, and which will enable the jury to arrive at an approximate estimate of the loss, is sufficient.

While the damages may not be determined by mere speculation or guess, it is enough if the evidence shows the extent of the damages as a matter of just and reasonable inference, although the result be only approximate.

However, the plaintiff must establish his damage by the most accurate basis possible under the circumstances. He must produce the best evidence reasonably obtainable.

Chapter 2 of the 2018 Practice Aid analyzed more than twenty instances where Courts addressed the issue of reasonable certainty and/or best evidence in economic damages cases. These cases study plaintiffs’ claims that used the best evidence to support their economic damages claims and the Court’s decisions whether they have or have not done that. The balance of this article attempts to extract the most salient “takeaways” from a few of these cases.[7]

In *Eastern Fireproofing*,[8] the Court stated:

“[A] plaintiff may not conjure up favorable estimations and hold back more solid but less favorable evidence otherwise available. And the admissibility of a particular class of evidence will depend, to a degree, upon the availability of less speculative evidence. On the other hand, there is no rule of law that only the best available evidence may be used. This would necessarily imply a determination of what class of evidence is best and it seems that such a determination cannot be made without infringing on the proper function of the jury as the finder of fact.”

In *Bigelow*,^[9] the Court concluded there was evidence to support a verdict for damages on at least one theory on which the case was submitted to the jury and, in so doing, did not imply the verdict could not be supported on some other theory. The question for the Court was not whether one class of evidence was better than another but whether each is adequate itself to support a finding based upon it.

The 2018 Practice Aid explains^[10] the relevant historical financial data preceding defendant’s alleged bad act may often be the starting point for analysis—for example, the use of a before-and-after approach to calculate lost profits requires the expert to compare plaintiff’s revenues, costs, and profits in the period leading up to the alleged breach to the damage period. “The before-and-after method is probably the most reliable method for proving lost profits as damages. Courts in nearly every jurisdiction have endorsed its use.”^[11]

Generally, lost profits experts should consider whether factors other than the defendant’s alleged bad act caused changes between the pre-damage and post-damage period. Such an analysis could not typically be done without some consideration of the underlying historical financial data.^[12]

In *Travellers*,^[13] plaintiff entered into a joint venture agreement for the mass marketing of tours. The Court concluded^[14] the statistical evidence presented at trial to establish damages was of the same type used and relied upon by the parties in conducting their own businesses, the ratio analysis relied on figures derived from the litigant’s historical relationship, the ratio analysis was a technique recognized and used in the industry, and was of the same type of data relied on by the litigants in their businesses. The Court found *Travellers* use of the same type of data used historically by management to make operating decisions to be persuasive.

The 2018 Practice Aid discusses how^[15] the availability of relevant third-party market data may assist the expert establish elements of a lost profits claim with reasonable certainty while contradictory market data may be effectively used to demonstrate flaws in opposing party’s analyses. In *Alaska Rent-A-Car*, plaintiff’s expert compared defendant’s operating results to a non-party with similar characteristics and assumed defendant would have performed much like the non-party.

The Court^[16] explained while it must assure expert testimony is relevant and rests on a reliable foundation, it is not required to exclude expert opinions merely because they are impeachable. Defendant had not challenged plaintiff's expert's general methodology, instead challenging the expert's testimony in using the non-party as the comparator; using a general rather than a specific geographic market; and extrapolating from a smaller market to a larger market. The Court ruled the claims challenged the weight of the testimony, not its admissibility, and found plaintiff's expert used contemporaneous market data as a benchmark.

The 2018 Practice Aid noted^[17] while, ideally, when attempting to establish lost profits with reasonable certainty, the expert would identify each specific sale lost as a result of defendant's actions, in most cases, this information was not available. The expert may have to develop damage calculations and rely on multiple sources of information and alternative damages methodologies. In *Great Lakes Bus*,^[18] plaintiff's expert concluded plaintiff earned revenues in every year, market demand existed and there was no need to reference lost contracts or specific lost customer sales data to estimate revenues plaintiff would have earned while its equipment was inoperable. The Court believed the historic revenue trend and that the market was experiencing increased demand and reduced supply and, but for defendant's conduct, the equipment would have earned revenue while its equipment was inoperable.

The 2018 Practice Aid explained the calculation of lost profits may require the expert to project what profits would have been earned by the plaintiff but for the defendant's alleged bad acts.^[19] Courts have found contemporaneous projections prepared by the parties prior to litigation may be more persuasive than projections prepared solely for the purposes of litigation. In *Lambert*,^[20] a damages expert calculated lost sales by taking the difference between actual net sales in specific years and the base case projections for those years prepared by the CFO. The Court found these projections were reasonable estimates but for the disruptions.

Compare that to *Mosaid Techs. Inc. v. LSI Corp.*, 2014 WL 807877 (D. Del. Feb. 28, 2014)^[21] where the support for the expert's opinion also came from pre-litigation projections prepared without contemplating litigation. However, in this case, while the document was the basis for the expert's analysis and testimony, the expert did not independently verify the assumptions contained in the pre-litigation projections. The Court concluded these pre-litigation projections were not the best evidence due (in large part) to the expert's lack of knowledge and due diligence regarding the projections.^[22]

The 2018 Practice Aid clarified^[23] while experts typically consider available information relevant to the reasonableness of the assumptions used in damages calculations, evidence of contradictory statements made by plaintiff prior to the litigation can be a fruitful basis for expert cross-examination. Experts who only consider facts that support their opinions,

ignoring those to the contrary, may cause the Court to view the expert's analysis and opinions unfavorably. In *Alaska Pulp*,^[24] the Court found statements made by the plaintiff outside of the litigation to be in conflict with claims made in litigation, and the many statements made by plaintiff's management more persuasive than the testimony offered by the expert.

The 2018 Practice Aid explained^[25] surveys used to establish consumer preferences may be relevant to establishing lost profits and the results may be useful to the damages expert (even though a survey expert may plan or conduct the survey) provided the survey is designed and conducted in accordance with accepted standards. The expert needs to carefully consider how the information will be used to ensure that the data sample is large enough. In *Apple v. Motorola*,^[26] plaintiff's damages expert expressed an opinion based, in part, on a contemporaneous consumer survey conducted by defendant prior to the litigation. The Court found^[27] the methodology to be problematic, concluding that, outside of the litigation context, plaintiff's expert would have conducted a different survey than the survey used.^[28]

The 2018 Practice Aid^[29] described how Courts often find contemporaneous transactions probative in establishing damages, and the *Schonfeld*^[30] case has been cited in a number of opinions. In that case, the Court found contemporaneous transactions provide more reliable evidence of damages than projected lost profits. In other cases, the availability of contemporaneous data was found to add to the credibility of the expert's analysis, provided they reflected legitimate arm's-length transactions.

The 2018 Practice Aid^[31] noted experts sometimes face a problem with a large magnitude of transactions to be examined, and some experts use statistical sampling procedures applying the results to the broader population of data. In *Commonwealth*,^[32] the Court held that plaintiff's expert based his analysis on an inadequate sample size. The Court found the expert's analysis of other factors not supported by hard numerical data and attributed little weight to plaintiff's expert's damages model.

The 2018 Practice Aid explained that^[33] multiple regression analysis may be useful to establish various elements of a damage calculation with reasonable certainty and its omission (without an appropriate alternative) may leave the Court with a lack of credible evidence.^[34] Like any analytical approach used by an expert, the expert should understand how to correctly perform a regression analysis and to be careful to avoid common errors that could invalidate its results.^[35] In *Zenith*,^[36] the Court criticized the expert for not using regression analysis (or some other scientific methodology).

The 2018 Practice Aid provided^[37] that damages experts may be retained because of the knowledge, information, and expertise they have developed, including experience related to the subject industry. This information may include proprietary data, financial models, and methodologies that the expert considers to be trade secrets. In *Emerald Casino*,^[38] the

Court rejected the expert's analysis as unreliable. Among other things, the expert relied upon proprietary data and methodologies that could not be tested or replicated by the Court. Reliance by the expert on proprietary data that cannot be examined by opposing party and/or not subject to peer review may present admissibility challenges even if the underlying analysis is sound.^[39]

The 2018 Practice Aid explained^[40] the expert is frequently provided information by the parties that may serve as the foundation for the damages calculation and its underlying assumptions. The expert must determine the extent to which the information can be relied on and the need to test its reasonableness. Courts have been divided on the expert's reliance of information supplied by the parties. Some Courts hold an expert to a higher standard, demanding independent corroboration of material facts and assumptions, whereas others have concluded that such reliance will be subject to cross-examination and it is simply a matter of the weight accorded by the trier of fact.^[41] Because the use of such information may form the basis of a *Daubert* challenge and/or rigorous cross-examination, experts should consider the nature and extent of the evidence available and assess its reliability based on the facts and circumstances of each case.

In *TK-7 Corp.*,^[42] plaintiff expert testimony almost exclusively relied upon a market study authored by an individual who failed to testify. The Court found plaintiff failed to present evidence establishing the sales assumed by expert and "the fact that [Expert] relied upon the report in performing his calculation of lost profits did not relieve the plaintiffs from their burden of proving the underlying assumptions contained in the report."^[43] The expert should understand how counsel intends to introduce facts or data that the expert will rely upon.

The 2018 Practice Aid discussed^[44] the existence of records prepared by third parties (cost estimates, bids, or proposals) with no interest in the outcome of litigation may provide useful information for the damages calculation. Generally, the burden of proof lies on the party introducing the documents, especially if the author will not be available to testify. If a party fails to appropriately lay a foundation at trial, such documents may be found inadmissible at trial, potentially compromising the expert's ability to establish damages to a reasonable certainty. In *BP Amoco*,^[45] defendant relied on written repair cost estimates provided by third parties. Plaintiff challenged these estimates, arguing that such records failed to qualify for the business records exception to the hearsay rule.

The Weil Text quotes^[46] noted that Section 352 of the *Restatement (Second) of Contracts* (1981) states: "Damages are not recoverable for loss beyond an amount that the evidence permits to be established with reasonable certainty." The Weil Text continues to note that while all Courts require reasonable certainty for the award of damages, no single measure of reasonable certainty exists, and individual Courts have all issued their own opinions as to the nature of reasonable certainty.

The Fannon Text^[47] provides another view of how the expert may look at the question of reasonable certainty in economic damages calculations. The Fannon Text suggests thinking of the Court as operating on two levels: the decision-making level and the opinion-writing level^[48] as follows:

On the decision-making level, the court decides whether the claimant has presented sufficient proof. On this level, the judge decides whether it is fair to award this much money on the basis of this much proof. If it is, he or she decides that the lost profits have been proven with reasonable certainty; if it is not, she decides that they have not been proven with reasonable certainty. On the opinion-writing level, the judge does not explain the intuitive processes that led him or her to the decision. Instead, the judge seeks authority that makes it seem as if the decision was a foregone conclusion. When lost profits are at issue, there is an abundance of authority to support whichever decision the court makes. â€, there are many contradictory rules, and the opinion writer can choose those that support his or her conclusion, making it seem as if the issue was never in doubt and often giving the impression that a single factor made the outcome inevitable.

Michael D. Pakter has more than 40 years of experience in accounting and forensic accounting, business economics and investigations in numerous industries and diverse engagements, including more than 20 years of experience in economic damages and business valuations. He has submitted expert reports in several jurisdictions and testified in arbitrations, regulatory proceedings and litigated disputes. State, Federal and Bankruptcy Courts, as well as arbitral bodies, have recognized him as an expert in accounting, financial analysis, forensic accounting, economic damages, business valuation and business economics.

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^[1]AICPA FVS Practice Aid: Attaining Reasonable Certainty in Economic Damages Calculations: pg 59.

^[2] *Ibid*, pg 59.

[3] *Ibid.*

[4] *Ibid.*

[5] *Ibid.*

[6] *Ibid*, pg 59–60, referring to *Sunward Corp. v. Dun and Bradstreet, Inc.*, 811 F.2d 511 (10th Cir. 1987).

[7] The reader should recognize that the brief summaries in this article are not a substitute for reading the entirety of Chapter 3 of the 2018 Practice Aid as well as the Court rulings themselves. The author believes the reader will benefit from reading the entirety of the 2018 Practice Aid and the underlying cases cited therein.

[8] *Ibid*, pg 62, referring to *Eastern Fireproofing Co., Inc. v. United States Gypsum Co.*, No. S7-938-G (D. Mass. 1970).

[9] *Ibid*, pg 62, referring to *Bigelow v. RKO Radio Pictures, Inc.*, Supreme Court, 327 U.S. 251, at 266.

[10] *Ibid*, pg 63.

[11] *Ibid*, pg 63, referring to Lloyd, Robert M., "Proving Damages for Lost Profits: The Before-and-After Method" (2014). College of Law Faculty Scholarship.
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[12] *Ibid*, pg 63.

[13] *Ibid*, pg 63, referring to *Travellers Int'l, A.G. v. Trans World Airlines*, 41 F.3d 1570 (2d Cir. 1994).

[14] *Ibid*, pg 63.

[15] *Ibid*, pg 66.

[16] *Ibid*, pg 66, referring to *Alaska Rent-A-Car, Inc. v. Avis Budget Group, Inc.*, 738 F.3d 960 (9th Cir. 2013).

[17] *Ibid*, pg 70.

[18] *Ibid*, pg 72, referring to *Great Lakes Bus. Trust v. M/T Orange Sun*, 855 F. Supp. 2d 131 (S.D.N.Y. (2012)).

[19] *Ibid*, pg 74.

[20] *Ibid*, pg 75, referring to *Lambert v. Weyerhaeuser Co. (In re Paragon Trade Brands, Inc.)*, 324 B.R. 829 (Bankr. N.D. Ga. 2005).

[21] *Ibid*, pg 76, referring to *Mosaid Techs. Inc. v. LSI Corp.*, 2014 WL 807877 (D. Del. Feb. 28, 2014).

[22] The author testified in a litigated dispute with a remarkably similar fact pattern where plaintiff relied on defendant's pre-litigation internal projections. The author's methodology for computing plaintiff's lost profits included obtaining a detailed understanding of the pre-litigation projections and independently testing material assumptions included within those projections. The author's all-day deposition focused on the nature, timing, and extent of the testing of the material assumptions. The case, however, did not proceed past a motion for summary judgement, so the Court's final decisions on the author's methodology was not tested at trial.

[23] *Ibid*, pg 77.

[24] *Ibid*, pg 78, referring to *Alaska Pulp Corp., Inc. v. United States*, 59 Fed. Cl. 400 (Ct. Fed. Cl. 2004).

[25] *Ibid*, pg 79.

[26] *Ibid*, pg 80, referring to *Apple, Inc. v. Motorola, Inc.*, 2012 WL 1959560 (N.D. Ill. May 22, 2012).

[27] *Ibid*, pg 80.

[28] In the one time that the author has used a survey to determine lost profits, the Court ruled on the exact form of the question before the survey commenced after detailed motion practice and a hearing on the form of the question. In the author's opinion, the final wording of the survey question created a bias in favor of defendant that resulted in the survey results favoring defendant. The author's engagement team faithfully asked the Court-ordered question to a valid sample of the population (defendant's customers) and applied the result to the lost profits calculations ultimately settled upon by the litigants prior to trial in the matter.

[29] *Ibid*, pg 81.

[30] *Ibid*, pg 81, referring to *Schonfeld v. Hilliard*, 218 F.3d 164 (2d Cir. 2000).

[31] *Ibid*, pg 85-86.

[32] *Ibid*, pg 86, referring to *Commonwealth Sci. and Indus. Research Org. v. Cisco Sys.*, 2014 WL 3805817 (E.D. Tex. July 23, 2014).

[33] *Ibid*, pg 87.

[34] *Ibid*.

[35] *Ibid*, pg 88.

[36] *Ibid*, pg 88, referring to *Zenith Elecs. Corp. v. WH-TV Broad., Corp.*, 395 F.3d 416 (7th Cir. 2005).

[37] *Ibid*, pg 90.

[38] *Ibid*, pg 90, referring to *In re Emerald Casino, Inc.*, 530 B.R. 44 (Bankr. N.D. Ill. 2014).

[39] *Ibid*, pg 92.

[40] *Ibid*.

[41] The author has testified in cases where the underlying accounting books and records were accepted as business records and generally reliable, and in one case where the sole topic of the author's cross-examination was an attack on the reliability of the underlying accounting books and records used to develop the lost profits model.

[42] *Ibid*, pg 92, referring to *TK-7 Corp. v. Estate of Barbouti*, 993 F.2d 722 (10th Cir. 1993).

[43] *Ibid*.

[44] *Ibid*, pg 94.

[45] *Ibid*, pg 94, referring to *BP Amoco Chem. Co. v. Flint Hills Res., LLC*, 697 F. Supp. 2d 1001 (N.D. Ill. 2010).

[46] The Weil Text Chapter 4 section 4.3(a).

[47] *Ibid*, pg 92.

[48] The Fannon Text at pg 92, citing Richard A. Posner, *How Judges Think* 110 (2008).