

Guidelines for Recovering Lost Profit Damages in Ohio

J. Michael Nesser

Recent cases across the country have eroded the once generally accepted rule that lost profits for a new business are not recoverable. The Supreme Court of Ohio in its recent decision in *AGF, Inc. v. Great Lakes Heat Treating Company*¹ appropriately held (contrary to long-standing Ohio precedent) that in Ohio a new business may recover lost profits in a breach of contract action. In addition to providing precedent for lost profit claims of new businesses, the Court restated and clarified the general test for recovering lost profits in Ohio, and provided some guidance for establishing lost profit damages.

In *Charles R. Combs Trucking, Inc. v. International Harvester Co.*² the Supreme Court of Ohio set forth the following three-pronged test for recovery of lost profits in contract actions:

"Lost profits may be recovered by the plaintiff in a breach of contract action if: 1) profits were within the contemplation of the parties at the time the contract was made; 2) the loss of profits is the probable result of the breach of contract; and 3) the profits are not remote and speculative and may be shown with reasonable certainty."

Four years after *Combs*, the court clarified the third prong

of the test in *Gahanna v. Eastgate Properties Inc.*³ stating the "in order for a plaintiff to recover lost profits in a breach of contract action, the amounts of lost profits, as well as their existence, must be demonstrated with reasonable certainty." (Emphasis added.)

In holding that lost profits may be recoverable as consequential damages when the party seeking such damages is involved in a new business, the Court in *AGF* looked to the Uniform Commercial Code and the *Restatement of the Law of Contracts*, as well as the approach of other jurisdictions. Official comment 2 to UCC 2-708 (R.C. § 1302.82) provides support for the Court's position "...this section permits the recovery of lost profits in all appropriate cases...It is not necessary to a recovery of 'profit' to show a history of earnings, especially if a new venture is involved."

Restatement of the Law 2nd, *Contracts* (1981) 146, Section 352, comment b, states as follows:

"The difficulty of proving lost profits varies greatly with the nature of the transaction. If, for example, it is the seller who claims lost profit on the ground that the buyer's breach has caused him to lose a sale, proof of lost profit will ordinarily not

be difficult. If, however, it is the buyer who claims lost profit on the ground that the seller's breach has caused him loss in other transactions, the task of proof is harder. Furthermore, if the transaction is more complex and extends into the future, as where the seller agrees to furnish all of the buyer's requirements over a period of years, proof of the loss of profits caused by the seller's breach is more difficult. If the breach prevents the injured party from carrying on a well-established business, the resulting loss of profits can often be provided with sufficient certainty. Evidence of past performance will form the basis for a reasonable prediction as to the future. *However, if the business is a new one or if it is a speculative one that is subject to great fluctuations in volume, costs or prices, proof will be more difficult. Nevertheless, damages may be established with reasonable certainty with the aid of expert testimony, economic and financial data, market surveys and analyses, business records of similar enterprises, and the like.*" (Emphasis added.)

The Court adopted verbatim the language of the *Restatement* in setting forth evidentiary guidance for the proof of lost profits, holding that a business

(including a new business) "may establish lost profits with reasonable certainty through the use of such evidence as expert testimony, economic and financial data, market surveys and analyses, business records of similar enterprises, and any other relevant facts."

The Court's rejection of a *per se* rule against the award of such damages where they may be shown with the requisite degree of certainty is clearly the correct decision. As noted by the Court (citing the leading treatise on the topic - *Recovery of Damages for Lost Profits* 3d, Robert L. Dunn, Lawpress Corporation, 1987), there is no "....worthwhile end to be achieved by permitting one party to breach his contracts with impunity - giving him an option, as it were - because the other party has not yet commenced operation. The trend of the modern cases is plainly toward replacing the old rule of law with a rule of evidence - the unquestionable principle that damages for loss of profits must be proven with reasonable certainty and that the evidence must support that finding by trier of fact."

The question then remains - what is necessary to show that expected profits are not "remote and speculative," and how can they be shown with "rea-

How to Calculate Lost Profits

Sales Projections (Hypothetical Profits)

Under this method, a model of the business is created by making assumptions based on how the plaintiff would have performed absent ("but for") the alleged acts. For example, in an antitrust case, "but for" profits could be measured in a microeconomic model of the market that would suggest how volume and prices might change in the absence of the alleged anti-competitive behavior. The plaintiff company's cost structure would be modeled and applied to the alternative volume(s) and price(s).

Before-and-After Approach

Under this approach, the periods before and/or after the alleged acts are analyzed and compared to calculate what the plaintiff's anticipated performance would have been during the period absent the alleged wrongful acts. For example, in a bid-rigging case, if no illegal behavior had occurred, the market price for "widgets" during the damages period might be expected to exhibit the same relationship to the market prices of other products as it did both before and after the damage period.

Yardstick Approach

Under this method, a study is made of a similar company, industry, or market that was unaffected by the alleged acts, to calculate what the plaintiff's performance would have been during the period of the alleged acts. For example, sales in the damaged company, industry, or market might be expected to have grown at the same rate relative to GNP (or other recognized indicia) as did a similar, but unaffected company, industry, or market during the same period. Another variation measures the losses suffered by plaintiff based on the gains realized by defendant. The underlying theory is that the defendant's action transferred customers (or sales or market share, etc.) from plaintiff to defendant.

sonable certainty?"

AGF provides some indication as how *not* to show damages with "reasonable certainty." In AGF the Appellant (Defendant Great Lakes Heat Treating Company) had purchased from AGF a furnace capable of producing a certain number of parts per hour. The furnace never functioned properly and when the plaintiff brought suit for the purchase price, Great Lakes counterclaimed, demanding, among other things, lost profits.

At trial, Great Lakes offered the following evidence: 1) testimony of a customer; 2) testimony from a certified public accountant; and 3) testimony of the president of Great Lakes. The customer testified that "we agreed to give...(appellant) everything...(appellant) could

handle." Additionally, he stated that he could "very easily" provide appellant with enough work to run the furnace 24 hours a day, seven days a week. However, the witness did not provide any further specificity as to the price or quantity of parts.

The certified public accountant testified that he had reviewed financial statements and other documents from a company in a similar type of business, as well as industry statistics from a recognized textbook in the area. The CPA's opinion testimony was then proffered as to what he believed appellant's lost profits would have been.

Lastly, the president of Great Lakes testified, on proffer, that the average price appellant received per part was 20 cents. He then stated that the loss of

profit suffered by appellant was \$39,000 per month, using the simple calculation of subtracting expenses from expected revenues based on the average price of a single part.

The Court concluded that Great Lakes had not demonstrated lost profits with the required "reasonable certainty." The Court held that the CPA could not be considered an expert witness on the business in question, and moreover, his opinion testimony was without proper foundation since none of the records, documents or sources he used were ever offered as evidence. Additionally, while the CPA testified that he examined business records of similar companies involved in the same line of work as Great Lakes, none of that information was introduced into evidence.

Likewise the customer who testified provided no specific quantities of either work already performed or work to be performed in the future. He also did not indicate any type of price for the work.

Finally, Great Lakes did not submit any of its own business records to substantiate its claims for lost profits.

The deficiency in Great Lakes' effort to prove lost profit damages does not appear to have been a problem with "bad facts," but rather the failure to properly calculate and document the lost profits claims, and to lay the proper foundation and present the evidence in Court. The Court had in fact found that AGF breached the agreement between the parties, and acknowledged that Great Lakes had satisfied the first and second prongs of the *Combs* test. Furthermore, since the lost profit claims related to lost sales of Great Lakes itself, the deficiency was apparently not due to problems with discovery from AGF.

The failure of Great Lakes to provide a proper foundation for the testimony of the CPA in AGF points out the importance

of recognizing the significant difference between Federal and Ohio Evidence Rule 703.

Ohio Evidence Rule 703 states: "The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived by him or admitted into evidence at the hearing."

Federal Evidence Rule 703 states: "The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived by or made known to the expert at or before the hearing. If of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject, the facts or data need not be admissible in evidence."

Accordingly, although in federal court an expert may often rely on otherwise inadmissible evidence as the basis for his or her opinion, in Ohio Courts, as demonstrated in *AGF*, care should be taken to admit into evidence all relevant documents relied upon by the expert.

Elements of Lost Profits

If the business is a continuing one, or if only a portion of a business is affected, the revenues and costs generally would be the incremental revenues and costs of the affected portion of the business. However, if the business is terminated, or unestablished, the revenues and costs generally would be total revenues and total costs. An accounting or economic expert would first calculate the probable revenues that would have been achieved and the additional costs that would have been incurred to generate those revenues. Lost profit damages may also include a claim for incidental costs.

Lost Revenues- Volume

To calculate lost revenue, there must be an analysis of the relevant market for the product or service and the volume that

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