

Surveying the Damage

By Mack J. Morgan III

Introduction

Many damages claims in business related litigation include a claim for lost profits or lost goodwill. The uncertainty involved in calculating lost profits or lost goodwill often makes those cases difficult to settle, and results in a substantial expenditure of time and attorneys' fees in contesting the damages issues. Indeed, an entire two volume treatise is devoted to the law of lost profits,¹ and the Texas Supreme Court has stated that "[i]t is impossible to announce with exact certainty any rule measuring the profits and the loss for which recovery may be had."²

Traditionally, calculation of lost profits and lost goodwill has involved the use of experts, usually accountants and/or economists. Surveys have rarely, if ever, been directly used to quantify damages. This article suggests that a properly sponsored and conducted survey can directly be used to quantify lost profits or lost goodwill, or can be used to support a calculation of lost profits or lost goodwill by an accountant and/or economist. Moreover, a survey may be the most persuasive damage evidence that can be presented to the finder of fact.

General Proof of Lost Profits and Lost Goodwill

In Oklahoma, goodwill is defined as the custom or patronage of an established trade or business, and the benefit or advantage of having established a business and secured its patronage by the public.³ The value of goodwill results from the probability that prior or existing customers will continue to trade with an established concern.⁴ By definition, the valuation of goodwill requires an estimate of the probability (not certainty) that customers will continue to trade with an established concern.

Likewise, the calculation of lost profits is, by definition, speculative. The calculation of lost profits requires an estimate of future revenues

in excess of future expenses over a period of time. Lost profits may relate to a specific contract, a specific act or acts affecting sales of a particular product, a specific act or acts preventing expansion of a business, a specific act or acts resulting in the downsizing of a business, or a specific act or acts causing a business to be closed. Generally, lost profits may not be recovered for a prospective business, but can be recovered for a newly formed business if it has been in existence long enough to allow a reasonable calculation of lost profits by extrapolation of revenues and expenses.⁵

Accordingly, claims for lost profits and lost goodwill cannot be proven precisely. While courts require that the fact of damage be proven with certainty, uncertainty in proving the amount of the damage is allowed if the plaintiff presents the best evidence possible under the circumstances of the case in order to permit a reasonably accurate estimate.⁶ In other words, a plaintiff must prove with certainty that he has been damaged, but he only need present a credible estimate of the amount of such damage. This is particularly true when the difficulty in ascertaining the amount of damages is a result of the action or fault of the defendant.⁷

Traditionally, plaintiffs have attempted to quantify lost profits and lost goodwill by using the testimony of expert accountants and/or economists, often in conjunction with testimony from the owner of the damaged business. Theoretically, the owner's knowledge of the business and its customers, when combined with the expertise of accountants and/or economists (using the history of the business and the economic factors affecting the industry generally) allows for an extrapolation of the performance of the business if it had not been damaged by the act or acts of the defendant. The owner or president of a company may offer an opinion regarding the amount of the



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lost goodwill suffered by the company without the aid of expert testimony.⁸

Thus, while the law allows plaintiffs a great deal of leeway in attempting to establish the amount of lost profits or lost goodwill, the finder of fact is free to draw conclusions regarding the reliability and persuasiveness of that evidence. For example, in an action in which the president of a company testified that his company had suffered injury to its goodwill in the amount of \$250,000.00, but the plaintiff offered no expert evidence to support the president's opinion regarding the amount of lost goodwill, the jury only awarded the plaintiff \$37,500.00.⁹

On the other hand, when credible expert testimony is presented, usually proposing a range of damages based upon the margin of error, juries often award damages within that range. The more credible the expert and the evidence, the greater the chance of persuasion of the jury.

Using Surveys to Quantify Damages

Both lost goodwill and lost profits are based upon an assumption that customers would continue to patronize the plaintiff's business had it not been damaged by the act or acts of the defendant. Thus, the calculation of lost goodwill and/or lost profits attempts to, at least in some degree, quantify what customers would have done in the absence of the defendant's bad acts. Yet, the traditional damage witnesses (the owner, president, accountant, or economist) do not usually seek to determine the customers' future actions by actually interviewing those customers. The customers, however, can be asked.

A properly conducted survey can determine whether the customers of the business were aware of the defendant's acts in issue (such as the fact that the defendant's business was pricing its products lower than the plaintiff's business), and whether that knowledge is translated into a diminution of future buying intentions.¹⁰

Surveys have been used extensively to establish consumer behavior for use in marketing strategies and advertising campaigns, and to determine the likelihood of confusion between two products in trademark infringement cases,¹¹ but not to determine damages. There is, however, no legal impediment to using a survey to quantify damages in an appropriate case. In fact, the use of a survey to quantify damages, or to support another expert's quantification of damages, can be extremely persuasive with the finder of fact.

Survey evidence is not hearsay, in that it is not offered to prove the truth of what the respondents said, but merely to prove their state of mind.¹² Moreover, Federal Rule of Evidence 703 permits an expert to form an opinion based upon information which is not admissible in evidence if the facts or information are of a type reasonably relied upon by experts in the field in forming opinions upon the subject.

A survey is also admissible as an exception to the hearsay rule if it is material and more probative on the issue than other evidence, and if it has guarantees of trustworthiness.¹³ If a survey has been conducted according to generally accepted survey principles, it is deemed to be trustworthy.¹⁴ The testimony of the survey director alone is sufficient to establish the foun-

dation that the survey was conducted according to generally accepted survey principles.¹⁵

The proper foundation for a survey can be proven by evidence that:

1. The proper universe was selected and examined;
2. A representative sample was drawn from that universe;
3. A correct method of questioning the interviewees was used;
4. The persons conducting the survey were recognized experts;
5. The data gathered were accurately reported; and
6. The sample, the questionnaire and the interviewing were in accordance with generally accepted standards of objective procedure and statistics in the field of such surveys.¹⁶

The foregoing foundation can be established solely by the person responsible for directing the survey, and it is not necessary to call any of the participants in the survey. Moreover, under Federal Rule of Evidence 702, the director of the survey may not only testify regarding his opinion, but may testify in detail regarding the scientific principles of statistical sampling in opinion polls which provide the basis for his opinion.

Most importantly, "[t]echnical and methodological deficiencies in the survey, including the sufficiency of the universe sampled, bear on the weight of the evidence, not the survey's admissibility."¹⁷ Thus, as long as the survey is conducted according to generally accepted survey principles, all attacks on the survey (including attacks on the phrasing of the questions, choice of respondents, number of questions, number of respondents, and conclusions drawn) are simply relegated to closing argument. Significantly, the admission of a survey by the trial court is reviewed under an abuse of discretion standard.¹⁸

Examples of Survey Usage

In *Harold's Stores, Inc. v. Dillard Department Stores*,¹⁹ the plaintiff Harold's employed a marketing professor to survey its customers to determine whether its goodwill had been damaged by Dillard's actions in violating Harold's copyrights by offering infringing skirts for sale

at a lower price. Harold's had sold all of its copyrighted skirts and, therefore, did not directly lose sales of its copyrighted skirts by Dillard's sale of infringing skirts a year later. Harold's, however, believed that Dillard's sale of infringing skirts had damaged Harold's goodwill because Harold's had advertised those skirts as being exclusive to Harold's. The only practical way to test and quantify that theory was to ask Harold's customers.²⁰

Dr. Daniel Howard, chairman of the marketing department at Southern Methodist University, offered opinion testimony quantifying Harold's damage claim based upon a survey of undergraduate women at Southern Methodist University who had visited a Dillard's store in 1993 (when Dillard's offered infringing skirts for sale) and visited a Harold's store or looked at a Harold's catalog in 1991 or 1992 (when Harold's offered the skirts that were copied). Dr. Howard determined that the women who saw the infringing skirts at Dillard's were less likely to purchase clothes from Harold's in the future.

Dr. Howard estimated that Harold's damages to its goodwill and sales to future and prospective customers fell in the range of \$226,367.00 to \$517,809.00. Based upon this evidence, the jury awarded Harold's damages of \$312,000.00. It is unlikely the jury would have awarded Harold's as much as \$312,000.00 in lost goodwill if, in the absence of a survey and testimony by Dr. Howard, the President of Harold's had simply testified that Harold's suffered damages in that amount.

Surveys can also be used to support a calculation of damages indirectly, rather than quantify the damages directly. In *Florifax International, Inc. v. GTE Market Resources, Inc.*,²¹ the plaintiff claimed lost profits for a specific period of time. The plaintiff's expert economist testified that the plaintiff lost \$1,921,028.00 for the period of time at issue. The defendant's expert certified public accountant estimated the plaintiff's lost profits over the same time frame at only \$505,731.00. The jury awarded lost profits of \$750,000.00, apparently being more persuaded by the defendant's expert's calculation than the plaintiff's expert's calculation.

The Oklahoma Supreme Court noted that "one major difference between the experts' projections" was that the plaintiff's expert increased sales volumes in his projections,

while the defendant's expert kept the sales volumes at a flat growth rate "because the general floral industry survey indicated declining volumes of the floral industry from the late 1980s through 1991."²² Thus, the defendant's expert relied upon an industry survey to support his calculations, while the plaintiff's expert had no such supporting survey.

Conclusion

Given that the finder of fact in cases involving lost goodwill and lost profits must, by definition, speculate regarding future events, it is natural for the finder of fact to desire as much information as possible to make that determination. Surveys can be extremely persuasive because they involve responses from neutral third parties. Judges and juries are acutely aware that expert economists and accountants are highly paid to advocate a damages calculation that is favorable to their client. However, customers who respond to a survey are usually not compensated, and unaware that their responses will be used in litigation. This type of objective evidence will often be more persuasive than any other evidence that is introduced in the case. The surveys may be even more persuasive when performed by an independent third party for an independent purpose. Then, the survey evidence is even more objective because the survey director was not employed by either of the parties, and was not conducting the survey for use in litigation.

Surveys can be used both as a sword to quantify damages for a plaintiff (as shown in *Harold's*) and as a shield to mitigate damages on behalf of a defendant (as shown in *Florifax*). Relying solely upon cross-examination to impeach the credibility and trustworthiness of a survey director and survey will usually prove ineffective. A counter survey should be

offered in opposition. If a counter survey is not offered, the finder of fact may assume that the opposing party has not countered with its own survey because it could not obtain one favorable to its position. Simply put, a lone survey, while not perfect evidence, may be the best evidence.

1. Robert L. Dunn, *Recovery of Damages for Lost Profits* (4th Ed. 1992).
2. *Southwest Battery Corp. v. Owen*, 115 S.W.2d 1097, 1099 (Tex. 1938).
3. *Freeling v. Wood*, 361 P.2d 1061 (Okla. 1961).
4. *Id.*
5. See e.g., *Dieffenbach v. McIntyre*, 254 P.2d 346, 349 (Okla. 1952).
6. See *Miami Int'l Realty Co. v. Paynter*, 841 F.2d 348, 350 (10th Cir. 1988); *Lee v. Kane*, 893 P.2d 854, 859 (Mont. 1995).
7. *Restatement (Second) of Contracts* § 352 comment a (1979) ("A court may take into account all the circumstances of the breach, including willfulness, in deciding whether to require a lesser degree of certainty, giving greater discretion to the trier of the facts. Damages need not be calculable with mathematical accuracy and are often at best approximate.")
8. *Rainbow Travel Services v. Hilton Hotels Corp.*, 896 F.2d 1233, 1239 (10th Cir. 1990).
9. *Id.*
10. See *Harold's Store Inc. v. Dillard's Department Stores*, 82 F.3d 1533 (10th Cir. 1996).
11. See *McCarthy on Trademarks and Unfair Competition* § 32:158.
12. See *Brunswick Corp. v. Spinit Reel Company*, 832 F.2d 513 (10th Cir. 1987); *The Manual for Complex Litigation*, Second, § 21.484, at 89 (1985) ("Objection is sometimes raised that a poll, although conducted according to generally accepted statistical methods, involves impermissible hearsay. Just as an accurate summary will not be admissible if the data as summarized are inadmissible, a statistically sound poll will similarly not be admissible if what it estimates is inadmissible. Polls, however, are most frequently used in situations where the issue is what people believe, not the truth of what they believe. In such situations, their statements about those beliefs would be admissible under Federal Rule of Evidence 803(3) and therefore the poll, if conducted properly, would also be admissible.")
13. *Harold's Stores, Inc. v. Dillard Department Stores*, 82 F.3d 1533 (10th Cir. 1996); *Brunswick Corp. v. Spinit Reel Company*, 832 F.2d 513, 522 (10th Cir. 1987); See also, *Jack B. Weinstein and Margaret A. Burger, Weinstein's Evidence* § 901 (b)(9)[03] at 901-140 (1995).
14. *Id.*
15. *Harold's* at 1545.
16. *Manual for Complex Litigation* (1981).
17. *Harold's* at 1544.
18. *Harold's* at 1544-45.
19. 82 F.3d 1533 (10th Cir. 1996).
20. *Manual for Complex Litigation*, Third, 521.493 at 1010 (1995) ("In some cases, sampling techniques may provide the only practicable means to collect and present relevant data.")
21. 933 P.2d 282 (Okla. 1997).
22. *Florifax* at 291.