No. S191550
(Court of Appeals Nos. B202789 & B205034)
(Los Angeles County Super. Ct. No. BC209992 (related to No. BC263701))

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

SARGON ENTERPRISES, INC.,
Plaintiff and Appellant,
vs.

UNIVERSITY OF SOUTHERN CALIFORNIA, *et al.*,
Defendants and Appellants.

After a Decision by the Court of Appeal,
Second Appellate District, Division One

BRIEF OF WASHINGTON LEGAL FOUNDATION AND ALLIED EDUCATIONAL FOUNDATION AS *AMICI CURIAE* SUPPORTING APPELLANTS

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ISSUES PRESENTED FOR REVIEW

Did the trial court err in excluding the proffered expert opinion testimony regarding lost profits?

INTERESTS OF *AMICI CURIAE*

The interests of *amici curiae* are more fully set forth in the application for leave to file, accompanying this brief.

The Washington Legal Foundation (WLF) is a nonprofit public interest law and policy center based in Washington, D.C., with members and supporters in all 50 States. WLF devotes a significant portion of its resources to defending and promoting free enterprise, individual rights, and a limited and accountable government. WLF regularly appears before California courts and other State and federal courts in support of its view that trial courts must exclude expert testimony that does not possess sufficient indicia of reliability. *See, e.g., Lockheed Litigation Cases*, No. S132167, *appeal dism'd* (Cal., Nov. 1, 2007); *Wal-Mart Stores, Inc. v. Dukes* (2011) 131 S. Ct. 2541; *Daubert v. Merrill Dow Pharmaceuticals, Inc*. (1993) 509 U.S. 579. WLF also filed a letter-brief in this case in support of the petition for review.

The Allied Educational Foundation (AEF) is a non-profit charitable and educational foundation based in Englewood, New Jersey. Founded in 1964, AEF is dedicated to promoting education in diverse areas of study,

such as law and public policy, and has appeared as *amicus curiae* in State and federal courts on civil justice reform issues on a number of occasions.

Amici are concerned that allowing juries to hear unreliable expert testimony decreases the fairness of civil litigation and often forces defendants to pay what can accurately be termed "blackmail" settlements rather than risk the possibility (however remote) of crippling damage awards.

Amici believe that expert testimony can provide valuable assistance to the jury when the expert is both qualified to provide an opinion regarding a subject matter beyond the common experience of most jurors *and* when the opinion has evidentiary support and employs a methodology commonly accepted by those within the field. But when, as here, proffered expert testimony does not meet those prerequisites, it serves only to confuse jurors and encourages them to decide fact issues based on emotion rather than on the evidence.

STATEMENT OF THE CASE

The case comes before the Court on review of the trial court's decision to exclude proffered expert testimony. That decision is entitled to substantial deference and should be upheld unless the trial court is shown to have abused its discretion.

A jury found that USC breached a contract it entered into with

Plaintiff and Appellant Sargon Enterprises, Inc., when it conducted a contracted-for clinical trial in a deficient manner. Sargon contends that in addition to the damages already awarded to it, the breach of contract led to substantial lost profits. Sargon contends that, but for the breach, it would have transformed itself from a tiny firm into an international firm earning hundreds of millions of dollars.

The trial court held an extensive hearing on the effort of Sargon to introduce the expert opinions of James Skorheim regarding lost profits. The trial court ultimately determined that those opinions were inadmissible under Evidence Code section 801(b) because they were not sufficiently reliable. Among the factors it cited in support of that determination: (1) Skorheim's lost profit determinations were not based on Sargon's historical performance but rather on Skorheim's hypothesis that, but for the breach, Sargon's sales would have increased as much as 157,000% annually over an 11-year period; (2) although Sargon was a tiny company with a minuscule sales force, Skorheim arrived at his sales projections by comparing Sargon to six multinational companies with vastly larger marketing departments; (3) Skorheim was an accountant who lacked any specialized expertise in Sargon's field (dental implants); and (4) although Skorheim's damage estimates were based on his conclusions that growth in the dental implant

field was largely driven by innovation and that Sargon possessed innovative technology, he did not provide the jury with any guidance regarding just how innovative Sargon really was. Instead, his expert report would have advised the jury that, depending on its view of Sargon's innovativeness, lost profits ranged anywhere from $220 million to $1.18 billion. Following entry of a stipulated judgment of $433,000, Sargon appealed the exclusion of Skorheim's testimony.

A divided Court of Appeal reversed. Finding that the trial court abused its discretion in excluding Skorheim's testimony, the majority remanded the case for a new trial on the issue of lost profits. (Slip Opn 2.) While acknowledging the trial court's critique of Skorheim's lost-profits model, the appeals court held, "Technical arguments about the meaning and effect of expert testimony on the issue of damages are best directed to the jury." (*Id.* at p. 19.) It held that "[a]t the very least" the jury should be permitted to hear Skorheim's opinion that Sargon was comparable to Astra Tech (a company with annual revenues roughly ten times larger than Sargon's in 1998) and that those comparisons led him to conclude that the breach resulted in lost profits of at least $220 million. (*Id.* at p. 30.) It also faulted the trial court for its criticism of Skorheim's reliance on "innovation" as a basis for lost-profit calculation, stating that while "the

factor of innovation . . . is not easily converted into dollars and cents, . . . exactitude is not required." (*Id*.) The majority stated that USC's "evidentiary attack" was rendered "unconvincing" by the fact that USC's breach of the clinical study contract was the cause of Sargon's lost profits. (*Id.*)

Judge Johnson dissented from the ruling regarding expert testimony, stating that the majority failed to display sufficient deference to "the trial court's rejection of Sargon's alchemic approach to damages." (Slip Opn 1.) He stated that he "share[d] with the trial court a healthy dose of skepticism over Skorheim's unyielding optimistic projection for Sargon's market share growth" and that he "struggled to see a nexus between those projections and business and economic reality." (*Id.* at 7.) He made clear, however, that the principal basis for his dissent was his disagreement regarding the standard of review: "[n]othing in the trial judge's reasonable, straight-forward and clearly articulated evidentiary ruling bears even a smidgeon of arbitrariness or capriciousness." (*Id.*)

SUMMARY OF ARGUMENT

After conducting an eight-day hearing, the trial court determined that the proposed testimony of James Skorheim did not meet the standards established by Evidence Code section 801 for the admissibility of opinion

testimony by an expert witness. All the factors considered by the trial court are undeniably relevant in assessing the reliability of Skorheim's expert opinions regarding lost profits. The Court of Appeal nonetheless reversed the trial court and determined that the jury should be allowed to hear and consider Skorheim's opinions. In concluding that trial courts lack discretion to exclude expert testimony of the sort proffered by Skorheim, the Court of Appeal held that exclusion is virtually never appropriate. All that is required, the appeals court said, is that lost profits be calculated "with some reasonable basis." (Slip Opn 29.)

Amici respectfully submit that under no reasonable interpretation of the appropriate appellate review standard can the trial court be deemed to have abused its discretion in excluding the Skorheim testimony. More importantly, the decision below essentially eliminates the gatekeeping function explicitly mandated by § 801; one can reasonably conclude, after reviewing the Court of Appeal decision, that a trial court *always* abuses its discretion if it excludes expert opinions regarding lost profits. So long as the expert is astute enough to assert that he is basing his opinions on "economic and financial data, market surveys and analyses, business records of similar enterprises, and the like" (*id.* at p.30), his opinions will always meet the appeals court's "some reasonable basis" standard. That

relaxed standard of review is not faithful to § 801(b)'s requirement that expert opinions are admissible only if they are of a type that "reasonably may be relied upon."

USC's opening brief demonstrated that the trial court articulated numerous sound bases for excluding the expert testimony. (OB 29-50.) Rather than repeating those arguments here, *amici* focus on three factors that demonstrate that the proposed expert testimony cannot be deemed reasonably reliable and would not assist the trier of fact in determining the extent of Sargon's lost profits. First, Skorheim failed to demonstrate any basis for his hypothesis that lost profits could be computed solely as a function of the relative "innovativeness" of a firm entering the dental implant business. Skorheim's conclusion that a company with innovative products will have more profits than a company that lacks such products is hardly surprising. But his testimony cannot assist the trier of fact, in the absence of any guidance regarding how to measure Sargon's innovativeness and how such innovativeness translates into lost profits. Moreover, his conclusion that innovativeness is not merely a necessary but also a *sufficient* condition for economic success belies reason.

Second, no reasonable expert would have arrived at his lost-profit conclusions, as did Skorheim, by comparing Sargon to companies many

times its size. There is no reasonable basis for concluding that Sargon would have matched the market shares and profits earned by those much larger companies with established sales forces and far greater access to capital.

Third, Skorheim was not qualified to testify regarding Sargon's lost profits because he lacked any expertise in the dental implant field. Skorheim is a certified public accountant and attorney. (Slip Opn 21.) Accountants are trained to calculate and report on *past* profits. Nothing in Skorheim's background qualifies him to assess what characteristics of a dental implant firm will translate into future profits. Skorheim apparently read some reports about the dental implant field in preparation for his testimony, but only an individual with longstanding familiarity with the field could ever reasonably be relied on when testifying that a three-employee dental implant company was so innovative that its profits would have increased as much as 157,000% annually but for a breach of one of its contracts.

Unless this Court allows trial courts to fulfill the gatekeeping function contemplated by Evidence Code section 801, the efficiency and fairness of civil litigation will suffer. By permitting parties to place before juries speculative and unreliable opinion testimony, the decision below

encourages appeals to jury passion that create significant risk that jury awards will be based not on the evidence but on a desire to assist sympathetic parties. Defendants will feel compelled to make substantial payments to settle even the most insubstantial of lost-profit claims rather than face the prospect – however slight – that a jury will credit an expert's speculative and astronomical damage claims and return a crippling verdict.

Moreover, allowing juries to consider speculative lost-profit damage estimates will, in the long run, work to the detriment of small businesses such as Sargon. The economy cannot flourish if businesses are afraid to enter into transactions because they fear that a breach of contract will lead to a huge damage award. Such fears are likely to be particularly pronounced when the party seeking to establish a business relationship is, like Sargon in 1998, a tiny firm with dreams of large future growth. California will not be well served if, for example, its universities are unwilling to undertake clinical trials for start-up firms for fear that doing so might expose them to multi-billion dollar judgments.

ARGUMENT

I. THE TRIAL COURT WAS WELL JUSTIFIED IN CONCLUDING THAT SKORHEIM'S TESTIMONY DID NOT MEET THE STANDARDS FOR ADMISSIBILITY OF OPINION TESTIMONY BY AN EXPERT WITNESS

Evidence Code section 801 permits qualified experts to give

testimony in the form of an opinion if it relates to a subject that "is sufficiently beyond common experience that the opinion of an expert would assist the trier of fact" and if it is of a type that "reasonably may be relied upon by an expert." The trial court concluded, after conducting a lengthy hearing, that Skorheim's proposed testimony did not meet those standards.

The trial court's determination, which was based on factors that all concede are relevant in assessing admissibility, cannot plausibly be said to have amounted to an abuse of discretion – the appropriate standard of review in this case. (*People v. Ramos* (1997) 15 Cal.4th 1133, 1175.) An abuse of discretion does not occur unless, in light of the law and considering all the relevant circumstances, "the court's decisions exceeds the bounds of reason and results in a miscarriage of justice." (*Shamblin v. Brattain* (1988) 44 Cal.3d 474, 479.) The Court of Appeal did not plausibly suggest that the trial court's determination exceeded the bounds of reason. Indeed, each of the trial court's grounds for exclusion is well-founded in the record. *Amici* focus on three of those grounds.

A. Skorheim's "Market Driver" Analysis Fails to Assist Jurors by Providing a Means of Determining "Innovativeness," and Is Not Reasonably Relied on by Experts

Skorheim's conclusions regarding Sargon's lost profits were based on his "market driver" analysis. He concluded, based on his study of the

dental implant field and without any support in the economic literature, that future revenue in the field is solely a function of three market drivers: innovativeness, use of clinical studies, and targeting general practitioners. He stated that every successful dental implant firm pursues the latter two marketing strategies – they organize clinical studies in hopes of validating the efficacy of their products, and they direct their sales pitches to general practitioners in the dental field. Thus, according to Skorheim's market driver hypothesis, the sole variable that determines the future market share of a dental implant firm is its degree of innovativeness. According to Skorheim, in the absence of the breach, Sargon's market share in 2009 would have been between 3.75% (if the jury deemed Sargon's innovativeness to be "meaningful") and 20% (if the jury deemed Sargon's innovativeness to be "revolutionary"). Based on that range of projected market share, Skorheim estimated lost profits through 2009 at between $220 million and $1.2 billion.

The trial court correctly determined that Skorheim's "market driver" hypothesis failed to "assist the trier of fact" in determining lost profits (Evidence Code section 801(a)) and therefore was inadmissible. (*See People v. Vang* (2011) 52 Cal.4th 1038, 1044.) An expert witness does not provide any useful guidance to a jury when, as here, he in essence says, "If

one runs one's company in an innovative manner that appeals to customers, one will make a larger profit." As Professor McCormick has explained, for an expert to "assist the trier of fact," "the jury must be furnished with some yardstick, rough though it be, which they can use in making their award and by which their award can be tested." (Charles T. McCormick, *Handbook on the Law of Damages* 101 (1935).) Skorheim's testimony provides no such yardstick; it provides no criteria by which the jury could differentiate among the four levels of innovativeness that he identified ("meaningful," "good," substantial," and "revolutionary"). Indeed, Skorheim even failed to provide a meaningful definition of "innovative" and a method for determining whether Sargon met that definition. The danger of allowing juries to hear expert testimony of this sort ("if you find that the plaintiff was highly innovative, then you may reasonably conclude that the plaintiff would have experienced growth at the level of a Microsoft or Google") is that it essentially licenses juries to run wild and to award astronomical damages to sympathetic litigants. It does not assist juries in resolving the factual issue they face in a lost-profits case: whether the evidence makes "reasonably certain" the "occurrence and extent" of lost profits. (*Grupe v. Glick* (1945) 26 Cal.2d 680, 693.)

Sargon argues that Skorheim's conclusion that "the degree of

innovation determines market share" is fully supported by the evidence he presented. (AB 45-46.) But even if Skorheim were correct that the market shares of the six largest implant companies are ranked in the order of their innovativeness (*i.e.*, that the largest implant company was also the most innovative of the six), that suggests at most that innovativeness is a *necessary* condition for market success – not that it is a sufficient condition. Skorheim did not address the numerous entrepreneurs that sought to market dental implants but, like Sargon, failed to become market leaders. In the absence of evidence that those firms lacked a quantifiable attribute that can be labeled "innovativeness," there is no plausible basis for concluding that a sufficiently innovative company will inevitably become a market leader. Any such assertion is belied by human experience. The business world is full of entrepreneurs who have developed truly innovative ideas, but the vast majority of them never became billionaires – and for a myriad of reasons wholly unrelated to the breach of a single contract by a party with whom they did business. For example, no expert could reasonably testify that a company's innovativeness would overcome mediocre management or an unfocused marketing plan.

Technology experts often cite IBM as a prime example of superior management winning out over innovativeness. There is universal

consensus among those experts that in the early 1950s, Remington Rand's UNIVAC computer was far more innovative than any competing product marketed by IBM, which for many years was wedded to punch card systems and resisted UNIVAC's move to magnetic storage tapes. But Remington Rand failed to compete for large federal government contracts and intentionally limited its production. As a result of its superior management and sales force, IBM was able to overcome UNIVAC's technological advantages and by the end of the 1950s had become the dominant manufacturer of mainframe computers. (*See* Matthew Lasar, *UNIVAC: The Troubled Life of America's First Computer* (Sept. 19, 2011), available at http://srdtechnica.com/tech-policy/news/2011/09/univac-the-troubled-life-of-americas-first-computer.ars.) Skorheim's assertion that Sargon (which had a handful of employees in 1998) would have become a market leader on the strength of innovativeness alone is belied by countless tales similar to Remington Rand's. In the absence of evidence of strong management and a proven sales record, no expert would reasonably rely on evidence of "innovativeness" alone (even if defined in some meaningful and quantifiable manner) as sufficient to demonstrate the likelihood of astronomical growth in sales and profits.

Sargon asserts that other courts have permitted juries to compute

damage awards on the basis of their assessment of the plaintiffs' innovativeness. (AB 47.) The two cases cited by Sargon hold no such thing. In *Amgen, Inc. v. F. Hoffman-La Roche Ltd.* (D. Mass. 2008) 581 F. Supp. 2d 160, the court determined that the defendant's drug was substantially similar to the plaintiff's and thus infringed the plaintiff's patent. The court had no occasion to consider whether either the defendant or its drug was innovative and thereby met some previously unmet consumer need. In *Bowling v. Hasbro, Inc.* (D.R.I. 2008) 582 F. Supp. 2d 192, 203, the court refused to award *any* damages to a patent holder after precluding it "from calling its expert witness on the issue of damages." The court ultimately determined that the record included sufficient evidence to justify a royalty award to the plaintiff – but based on evidence that royalty payments were an accepted industry practice, not (as Sargon represented to this Court) because the plaintiff's patent was especially innovative. (*Id.* at 207.)

The inability of Skorheim's testimony to assist jurors is most readily apparent when one considers the broad dollar range of lost profits to which he was willing to testify. Any testimony that indicates that lost profits are somewhere between $220 million and $1.2 billion and that then fails to provide any meaningful yardstick to assist the jury in measuring how to choose between those two extremes cannot be deemed to provide the sort of

helpful guidance contemplated by Evidence Code section 801. Sargon attempts to portray the broad range of lost-profit estimates as a positive attribute, stating that the practice of providing alternative damage calculations is "well recognized." (AB 47.) Many courts do not agree. As one commentator has noted:

> [C]ourts should, and generally do, look much more favorably on an estimate of lost profits where the court is confident that the claimant's actual lost profits fall within a defined range, and the claimant's estimate is within that range, even though it may be at the high end.

(Robert M. Lloyd, *The Reasonable Certainty Requirement in Lost Profits Litigation: What It Really Means* (2010) 12 TRANSACTIONS 11, 28.) When, as here, an expert's high-end estimate of lost profits exceeds his low-end estimate by more than 400% (and by $1 billion), there can be little confidence that the expert has provided any reasonable degree of certainty regarding the "occurrence and extent" of lost profits.

The cases cited by Sargon do not support its position that the propriety of such a broad range of lost profits is well accepted. The sole California decision cited by Sargon never addressed the use of alternative damage calculations. (*Bay Guardian Co. v. New Times Media* LLC (2010) 187 Cal.App.4th 438.) Moreover, in one case cited by Sargon, the court stated that it was "a cause for pause" that the plaintiff's expert provided two

lost-profit calculations that varied by 100%, but it concluded that the expert had provided a reasoned explanation for the disparity. (*Brennan's Inc. v. Dickie Brennan & Co.* (5th Cir. 2004) 376 F.3d 356, 374.) In other cited cases, the courts determined lost profits without commenting on what conclusions should be drawn from the fact that the plaintiff's expert supplied a range of lost profit estimates. (*See, e.g., Miller v. Cudahy Co.* (D. Kan. 1984), 592 F. Supp. 976, 991-92, *aff'd in part* (10th Cir. 1988) 858 F.2d 1149.) Notably, the range in lost profit estimates for the plaintiff farmers in *Miller* derived entirely from "three basic variables" (yields per acre, prices per bushel of corn, and production costs per acre), which the expert explained thoroughly to the jury and for which the parties introduced quantifiable evidence at trial. (*Id.*) Those cases contrast sharply with this case, in which the expert failed to provide a meaningful definition of the sole variable on which he relied (innovativeness) and failed to supply the jury with a yardstick by which it could measure Sargon's degree of innovativeness.

In sum, the trial court acted well within its discretion in determining that Skorheim's "market driver" hypothesis did not meet the standards established by Evidence Code section 801 for the admission of expert opinion testimony.

B. Skorheim Sought to Compare Sargon to Companies That Were Not Reasonably Comparable

Skorheim arrived at his lost-profit figures by comparing Sargon to the six market leaders in the dental implant field: Nobel Biocare, Straumann, 3i, Dentsply, Zimmer, and Astra Tech. Each of those companies was well established in the field and had annual sales in 1998 that were many times larger than Sargon's. Nobel Biocare's sales were 96 times larger. Rather than basing his lost profit figures on Sargon's historical performance, he derived those figures by hypothesizing that, but for the breach, Sargon would have achieved a market share comparable to that of the six industry leaders. The trial court acted well within its discretion in rejecting that hypothesis; no reasonable expert would have deemed Sargon comparable to well-established companies with large sales forces and annual sales that dwarfed Sargon's. As the Law Revision Commission has explained with regard to § 801, an expert "may not base [an] opinion upon a comparison if the matters compared are not reasonably comparable." (Cal. Law Revision Com. com., 29B pt. 3A West's Ann. Evid. Code (2009 ed.) foll. § 801, p. 25.)

Judge Johnson concluded that Sargon was not reasonably comparable to the six market leaders, explaining in his dissenting opinion:

"The trial court concluded Sargon relied on data that was not

> analogous to Sargon's business. Skorheim used industry leaders, all multi-million and multi-billion dollar international companies. '*The only thing these established companies have in common with [Sargon] is that they all sell or make dental implants. In all other respects, in areas the MRG report deems relevant, such as size, history, product line, sales force, access to financing, among others, they are worlds apart from Sargon.*'" (Maj. opn. *ante*, at p. 27, italics added.) At the Evidence Code section 402 hearing, Skorheim could not identify any other business metric Sargon had in common with the industry leaders other than the three drivers. For example, while Sargon had a five percent profit in 1997, he used Nobel Biocare and Straumann's profits, which were at 30 percent. "As a result, Skorheim's 'projections are wildly beyond, by degrees of magnitude, anything Sargon has ever experienced in the past. . . .'" (Maj. opn. *ante*, at p. 27.)

Slip opn. at 5-6.

The Court of Appeal cited *Palm Medical Group, Inc. v. State Comp. Ins. Fund* (2008) 161 Cal.App.4th 206, in support of its conclusion that Skorheim acted reasonably in deriving Sargon's expected earnings from the experiences of six vastly larger companies. But the facts of that case are markedly different from those here, and serve to illustrate that the decision below essentially requires trial courts to abdicate their gatekeeping function. *Palm Medical Group* involved lost profit calculations for a medical clinic that had been improperly excluded from a preferred provider network. The plaintiff's expert based his lost profits opinion on gross revenues of other local clinics that had not been excluded from the network. Notably, the clinics deemed "comparable" by the expert were similar in size and services

to the plaintiff, and the defendant did not argue otherwise. Rather, the defendant's only complaint was that the expert's opinion was too "speculative" and "failed to account for any of the other potential reasons why Palm failed to meet its income expectations." *Id.* at 227. The court rejected that criticism in light of the defendant's failure to offer "any evidence" that any factor – other than exclusion from the preferred provider network – would have "negatively affected" the expert's profit estimates. *Id.* In sharp contrast to the expert opinion in *Palm Medical Group*, Skorheim's lost profits calculations were for a start-up company (Sargon) whose annual revenues were but a minute fraction of the companies that Skorheim deemed comparable to Sargon. Nothing in *Palm Medical Group* lends support to the appeals court's holding that the trial court abused its discretion by concluding that Sargon was not "reasonably comparable" to the six much-larger companies. Indeed, in light of that holding, we fail to comprehend how a district court would ever be permitted to exclude expert opinions on such grounds.

A ruling that expert witnesses may base a firm's damages on comparisons to wholly dissimilar companies is particularly troubling in a case, as here, raising claims for future lost profits. Because such claims are by definition counter-factual, they are highly speculative in nature and thus

prone to abuse. That is particularly true where, as here, the firm is very young and has no history of ever having generated substantial profits. Accordingly, this Court has required that more careful scrutiny be given to lost profit claims than to other damage claims. (*See, e.g., Grupe v. Glick*, 26 Cal. 2d at p. 693.) Courts from other jurisdictions have been equally cautious. (*See, e.g., Schonfeld v. Hilliard* (2d Cir. 2000) 218 F.3d 164, 172 (evidence of profits from new venture given greater scrutiny because of lack of track record); *Roboserve, Ltd. v. Tom's Foods, Inc.* (11th Cir. 1991) 940 F.2d 1441, 1451 (same); *Kenford Co. v. County of Erie* (N.Y. 1986) 493 N.E.2d 234 (same).)

In sum, no reasonable expert would have derived a figure for Sargon's lost profits based on a examination of the profits of vastly larger firms that could not reasonably be compared to Sargon.

C. Skorheim Was Not Qualified to Assess Which Characteristics of a Dental Implant Firm Will Translate Into Future Profits

Before he was retained by Sargon, Skorheim had no background in the dental implant field. Nor did he have any specialized knowledge of the role of innovativeness in the success of start-up companies. His training was as an accountant and a lawyer. As such, his opinions regarding the allegedly unique nature of the dental implant field (that is, the allegedly

unique importance of innovativeness as an indicator of future success in the field) were not admissible under Evidence Code section 801(b) because he lacked the "special knowledge, skill, experience, training, and education" to render an expert opinion on that subject.

While CPAs are often called upon to provide expert testimony regarding the financial condition of businesses whose affairs become subject to litigation, it is important to keep in mind that the reading of crystal balls is not one of the skills taught to CPAs as part of their training. As one legal commentator (relied upon by Sargon in its brief) has noted:

> [C]ourts need to keep in mind that what accountants are trained to do is calculate and report on past profits. In spite of the fact that many CPAs have qualified as business appraisers or lost profits analysts, the mere fact that a person has years of experience as a CPA does not automatically qualify them as an expert to predict future profits or value a business.
>
> It should be clear too that a witness may be qualified to testify as to one aspect of the damages in a case and not as to others. A marketing expert might be qualified to project sales but not to opine as to the net profits the plaintiff would earn from that level of sales, and a CPA might be able to determine that profits that would result from a given level of sales, but not to opine on whether the plaintiff's sales would reach that level.

Robert M. Lloyd, *Proving Lost Profits After Daubert: Five Questions Every Court Should Ask Before Admitting Expert Testimony* (2007) 41 U. RICH. L. REV. 379, 390.

Skorheim was undoubtedly qualified to testify regarding the state of

Sargon's finances in 1998, as well as regarding the likely financial ramifications of specific business transactions Sargon agreed to or contemplated entering into in that era. But nothing about his background and training qualified him to opine about the allegedly unique nature of the dental implant field. Moreover, he lacked any basis for judging the likelihood that significant numbers of dentists would find Sargon's dental implant technology to be superior to that of competing companies. He was undoubtedly qualified to tell the jury that companies with innovative ideas that will appeal to customers are more likely to succeed than companies that lack such ideas, but that sort of expert testimony is inadmissible under Evidence Code section 801(a) because it does not tell jurors anything that they do not already know. If Sargon wanted to introduce expert testimony regarding the likelihood that Sargon would have experienced astronomical growth in a highly competitive field because of its innovativeness, it should have retained a witness who had some experience in the field and thus had some basis for reaching such a conclusion. Especially "where there are tens or hundreds of millions of dollars at stake and the party clearly has the resources to find and hire the people best qualified to testify, a court should not accept less." (*Id*. at p. 391.)

II. THE LEGISLATURE'S DECISION TO ASSIGN AN ACTIVE GATEKEEPING ROLE TO TRIAL COURTS IS SUPPORTED BY IMPORTANT PUBLIC POLICY CONSIDERATIONS

The Court of Appeal concluded that trial courts should play at most a minimal gatekeeping role with respect to expert testimony on lost profits. It held, "Technical arguments about the meaning and effect of expert testimony on the issue of damages are best directed to the jury." (Slip Opn 19.) As evidenced by Evidence Code section 801, the California legislature disagrees, concluding that trial courts should play an active role in assessing the admissibility of expert testimony. *Amici* submit that sound public policy concerns support the legislature's decision.

Courts have long recognized that businesses cannot function effectively in a legal atmosphere that permits huge damages to be awarded against a party found to have breached a contract. Companies will be reluctant to enter into business transactions if they thereby open themselves up to damage awards that can vastly exceed any income they could possibly hope to receive under the contract. Centuries of common law have established that modern commerce cannot survive unless reasonable limits are imposed on the power of juries to punish contract breaches by awarding breach-of-contract damages unsupported by competent evidence. (*See, e.g.*, *Hadley v. Baxendale* (1854) 9 ExCh. 341.) Thus, two centuries ago Justice

Joseph Story denied a claim for damages by plaintiffs whose ship had been improperly detained by privateers during the War of 1812. He reasoned that crediting large yet uncertain lost profits claims would be "in the highest degree unfavorable to the interests of the community." (*The Lively* (C.C.D. Mass. 1812) 15 F. Cas. 631, 634.)

This Court explicitly relied on *Hadley v. Baxendale* in concluding that strict limits must be imposed on the award of lost profits as an item of damages in a contract case. (*Lewis Jorge Construction Mgmt, Inc.* (2004) 34 Cal. 4th 960.) The Court explained that such limitations further the public interest by "serv[ing] to encourage contractual relations and commercial activity by enabling parties to estimate in advance the financial risks of their enterprises." (*Id.*, at p. 968.) (*See also* McCormick, *supra*, at p. 105 (the requirement that lost profits be proven with certainty "was developed, and has been used, chiefly as a convenient means of keeping within the bounds of reasonable expectation the risk which litigation imposes upon commercial enterprise.").)

The Court of Appeal justified its relaxed gatekeeping standard in part by stating that USC would not be facing gargantuan lost-profit claims if it had not breached its contract with Sargon:

> If USC had not sabotaged the clinical study of the Sargon implant, Sargon would have had a successful clinical trial to its credit and a

> prominent university using the implant at its dental school. But it was denied. Through its wrongful conduct, USC allegedly caused the loss of profits and has made the proof of lost profits all the more difficult, thereby rendering its evidentiary attack unconvincing.

(Slip Opn 30.)

Nothing in Evidence Code section 801 supports such a "they're getting what they deserve" gatekeeping standard. Sargon, like any breach-of-contract plaintiff, was entitled to recover lost profits that it could demonstrate were the product of USC's breach. But the fact of that breach does not lessen Sargon's burden of proving lost profits through competent evidence.[1]

Indeed, allowing juries to consider speculative lost-profit damage estimates will, in the long run, work to the detriment of small businesses such as Sargon. As noted above, business are likely to be reluctant to enter into transactions when they fear that a breach of contract will lead to huge damage claims. Such fears are likely to be particularly pronounced when the party seeking to establish a business relationship is, like Sargon in 1998, a tiny firm with dreams of large future growth. Neither California nor the

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[1] The Court of Appeal upheld the trial court's dismissal of Sargon's claim that it was defrauded by USC. (Slip Opn 16-18.) Accordingly, there are no grounds for awarding damages against USC based on anything other than its breach of contract.

small business community will be well served if, for example, its universities are unwilling to undertake clinical trials for start-up firms for fear that doing so might expose them to multi-billion dollar judgments.

The Court of Appeal's relaxed gatekeeping standard also reduces the efficiency and fairness of civil litigation. By permitting parties to place before juries speculative and unreliable opinion testimony, the decision encourages appeals to jury passion that create significant risk that jury awards will be based not on the evidence but on a desire to assist sympathetic parties.

Under the Court of Appeal's interpretation of Evidence Code section 801, plaintiffs raising breach-of-contract claims will have little difficulty introducing opinion testimony that the defendants' conduct resulted in millions (or even billions) of dollars of lost profits, regardless how speculative that opinion may be. If a defendant's motion to exclude such opinion testimony is denied (a likely occurrence under the appeals court's standard), it will be virtually forced to settle the case – even when it believes that the plaintiff's claims lack merit. A billion dollar judgment would cripple (and often bankrupt) all but a handful of the largest corporations in this country. Even a 1% chance that the jury would award damages of that magnitude is enough to force a defendant to settle the case

for a substantial sum. If settlement is a viable option, no rational president of a corporation would take a 1% risk of bankrupting his enterprise, even though he determines that there is a 99% probability that the plaintiff will recover nothing or a relatively modest judgment. The Court of Appeal's lax gatekeeping standard significantly increases the likelihood of such "blackmail settlements." (Henry Friendly, *Federal Jurisdiction: A General View* 120 (1973). *See Castano v. American Tobacco Co.* (5th Cir. 1996) 84 F.3d 734, 746 (stating that judicial decisions creating "insurmountable pressure" to settle even weak claims is tantamount to "judicial blackmail"; "the risk of facing an all-or-nothing verdict presents too high a risk, even when the probability of an adverse judgment is low").)

Rules that lead to settlement of lawsuits without any relation to the underlying merits of the suits undermine the aims of the common law. Contract law is designed to encourage individuals to abide by their promises to others, or else to provide compensation for the damages flowing from their breach of promise. Its purposes are undermined by rules of procedure that force breach-of-contract defendants to pay substantial settlements not justified by any reliable opinions regarding damages incurred as a result of a breach of contract. The Court of Appeal decision operates in just that fashion – it substantially loosens restraints on the introduction of unreliable

opinion evidence, a decision that inevitably will lead to an increase in the number of "blackmail settlements."

It is not an adequate response to state that defendants are free to introduce the testimony of their own expert witnesses to counteract the testimony of the plaintiff's experts. First, that response overlooks the policy choice of the California legislature, which adopted Evidence Code section 801 because it disapproved an "anything goes" approach to expert witnesses and because it wanted trial judges to play a meaningful gatekeeping role with respect to expert testimony. Second, experience has shown that juries very often lack the expertise necessary to critically assess the damage theories propounded by experts. As Judge Richard Posner has explained, juries are often incapable of looking behind the dazzling credentials of many expert witnesses, and thus trial judges play an indispensable role in "protect[ing] juries from being banboozled by technical evidence of dubious merit." (*SmithKline Beecham Corp. v. Apotex Corp.* (N.D. Ill. 2003) 247 F. Supp. 2d 1011, 1042 (Posner, J., sitting by designation).)

In sum, significant public policy considerations support strict enforcement of Evidence Code section 801 to ensure that unreliable and/or unhelpful expert testimony is not introduced into evidence. The trial court carefully examined numerous, admittedly-relevant factors before

determining that Skorheim's proposed testimony failed to meet the § 801 standards, and a ruling that his decision constituted an abuse of discretion would run counter to the public policy considerations enumerated above.

CONCLUSION

Amici curiae respectfully request that the judgment of the Court of Appeal be reversed and that the trial court's judgment be reinstated.

Respectfully submitted,

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Dated: December 15, 2011

CERTIFICATE OF COMPLIANCE

I, Richard Samp, hereby certify that pursuant to Rule 8.520(c)(1) of the California Rules of Court, the enclosed Brief of Washington Legal Foundation, *et al.*, as *amici curiae* in support of Defendants and Appellants is produced using 13-point Times New Roman type including footnotes, and contains approximately 6,521 words. I rely on the word count of the computer program (WordPerfect X5) used to prepare this brief.

_____
Richard A. Samp

Dated: December 15, 2011

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