

DAMAGES

EVALUATION AND PROOF IN BUSINESS LITIGATION

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EVALUATION AND PROOF

I. SCOPE OF ARTICLE. Although this article will discuss some of the fundamentals of the law governing the calculation of recoverable damages that would be applicable to any type of case, the article as a whole will focus primarily on general issues of compensatory damages in litigation between business entities. Damages in personal injury, employment, real estate, defamation and other types of cases brought by individuals will not be addressed at all. Nor will the article address recovery of attorneys' fees. Punitive damages, contribution, and indemnity will be mentioned, but only in passing and not in depth.

After reviewing the basic elements of potential damage recovery, the article will discuss the evaluation of potential damages in business cases by analyzing the applicable measures of recovery for the most typical causes of action arising in business disputes. The article will then discuss the law governing calculation of damages in business cases, with particular emphasis on proof of lost profits. The article will then offer a review of case histories involving the evaluation and proof of damages. As the Texas Supreme Court has noted in this context, "the real difficulty lies not so much in the statement of the rules as it does in the application of the correct rule." Southwest Battery Corp. v. Owen, 115 S.W.2d 1097, 1099 (Tex. 1938), *quoted in* Texas Instruments Inc. v. Teletron Energy Mgmt., Inc., 877 S.W.2d 276, 279 (Tex. 1994). The article will conclude with brief comments on practical considerations in the evaluation and proof of damages.

II. GENERAL PRINCIPLES OF DAMAGE RECOVERY. Potential recovery in a lawsuit begins with three basic building blocks: compensatory damages, punitive damages, and prejudgment interest. There are also some basic principles and constraints applicable to each of these elements of potential recovery. Evaluation of damages in any particular case should address each of the following principles.

A. The Basic Purpose for Compensatory Damages. "The primary purpose of awarding compensatory damages in civil actions is not to punish the defendant, but to fairly compensate the injured plaintiff." Torrington v. Stutzman, 46 S.W.3d 829, 848 (Tex. 2000). Accordingly, the standard damage questions in the Texas Pattern Jury Charges ask the jury: "What sum of money, if any, if paid now in cash, would fairly and reasonably compensate [the plaintiff] for [its] damages, if any, that resulted from" or "were proximately caused by" the conduct of the defendant found to establish liability. *See* Texas Pattern Jury Charges 110.2 (breach of contract); 110.5 (promissory estoppel); 110.18 (breach of fiduciary duty); 110.19 (fraud); 110.21 (negligent misrepresentation).

B. Punitive Damages. Exemplary damages are now governed by chapter 41 of the Texas Civil Practice and Remedies Code. Exemplary damages, which include punitive damages, are defined as “damages awarded as a penalty or by way of punishment.” TEX. CIV. PRAC. & REM. CODE § 41.001(5). Except in the cases specified by Code § 41.004(b), “exemplary damages may be awarded only if damages other than nominal damages are awarded.” TEX. CIV. PRAC. & REM. CODE § 41.004(a). As required by Code § 41.012, Texas Pattern Jury Charge 110.34 tracks the provisions and wording of Code §§ 41.001, 41.003, 41.010, and 41.011. *See also* PJC 110.35-42.

Certain statutes are exempted from the operation of chapter 41. TEX. CIV. PRAC. & REM. CODE § 41.002(d). Other statutes may provide for recovery of exemplary damages on grounds different from those stated in chapter 41. *See, e.g.*, TEX. BUS. & COMM. CODE § 27.01(c) and (d) (recovery of exemplary damages for fraud in a transaction involving real estate or corporate stock). Chapter 41 requires clear and convincing proof of these alternative grounds, however. TEX. CIV. PRAC. & REM. CODE § 41.003(c).

“Exemplary damages are not allowed for breach of contract.” Amoco Production Co. v. Alexander, 622 S.W.2d 563, 571 (Tex. 1981). “Even if the breach is malicious, intentional or capricious, exemplary damages may not be recovered unless a distinct tort is alleged and proved.” *Id.*

C. Prejudgment Interest. Prejudgment interest is now available as a matter of Texas common law in all cases not expressly governed by statute. Johnson & Higgins of Texas, Inc. v. Kenneco Energy, Inc., 962 S.W.2d 507, 528-33 (Tex. 1998) (prejudgment interest awarded on breach of contract damage recovery). As prescribed in Johnson & Higgins, an award of common law prejudgment interest tracks the rules established by statute. 962 S.W.2d at 531.

Those rules are now codified as part of the Finance Code, chapter 304. Interest begins to accrue 180 days after written notice of the claim or the filing of suit. TEX. FIN. CODE § 304.104. Prejudgment interest accrues at the rate for postjudgment interest. TEX. FIN. CODE § 304.103. It accrues at simple interest and does not compound. TEX. FIN. CODE § 304.104. Because the minimum postjudgment rate is ten percent, TEX. FIN. CODE § 304.003(c), prejudgment interest would currently accrue at a higher than market rate of interest.

“Prejudgment interest may not be assessed or recovered on an award of exemplary damages.” TEX. CIV. PRAC. & REM. CODE § 41.007.

D. Choice of Law. Interestingly, the Texas Supreme Court analyzed choice of law separately for the issue of compensatory damages in Torrington v. Stutzman, 46 S.W.3d 829, 848-50 (Tex. 2000). As with all other issues, the Court applied the

Restatement's “most significant relationship” test. *Id.* at 848. Presumably, the law of punitive damages applicable in a Texas case would also be the law with the most significant relationship to the underlying dispute between the parties.

Much contract litigation, of course, involves contracts that contain express choice of law provisions. The enforceability of those provisions and their applicability to tort causes of action (or defenses to those tort claims) is a complex subject beyond the scope of this article. *See, e.g.*, TEX. BUS. & COMM. CODE § 35.51. It should nevertheless be noted that substantial Fifth Circuit authority holds, as a matter of the Texas law of conflicts, that the state law chosen by an applicable contract provision governs prejudgment interest issues. *See Exxon Corp. v. Burglin*, 4 F.3d 1294, 1302 (5th Cir. 1993).

E. The “One Satisfaction Rule”. Cases involving multiple defendants but not involving a tort cause of action now implicate the common law “one satisfaction rule.” “Under the one satisfaction rule, a plaintiff is entitled to only one recovery for any damages suffered.” *Crown Life Ins. Co. v. Casteel*, 22 S.W.3d 378, 390 (Tex. 2000). The “rule applies when multiple defendants commit the same act as well as when defendants commit technically different acts that result in a single injury.” *Id.* Under the rule, any “non-settling defendant is entitled to offset any liability for joint and several damages by the amount of common damages paid by the settling defendant, but not for any amount of separate or punitive damages paid by the settling defendant.” *Id.* at 391-92. However, to “limit a non-settling party’s dollar-for-dollar settlement amount to an amount representing actual damages, the settling party must tender a valid settlement agreement allocating between actual and punitive damages to the trial court before judgment. Otherwise the nonsettling party is entitled to a credit equaling the entire settlement amount.” *Mobil Oil Corp. v. Ellender*, 968 S.W.2d 917, 927 (Tex. 1998).

F. Statutory Credits for Settlements in Tort Cases. Chapter 33 of the Texas Civil Practice and Remedies Code “applies to any cause of action based on tort” other than those causes of action identified in § 33.002(b) and (c) of the Code. TEX. CIV. PRAC. & REM. CODE § 33.002(a). A claimant who is more than 50% responsible for its damages is in turn barred from recovering at all. TEX. CIV. PRAC. & REM. CODE § 33.001. This bar on recovery should not apply in business disputes based on tort causes of action. The recovery by the claimant in a business tort case, however, may well be reduced to reflect settlements under the terms of Code § 33.012 in accordance with an election timely and properly made by a non-settling defendant pursuant to Code § 33.014. *See Mobil Oil Corp. v. Ellender*, 968 S.W.2d 917 (Tex. 1998).

G. The “Collateral Source” Doctrine. Of course, recovery of damages is not reduced when the plaintiff receives compensation for its damages from a source, like insurance, that is “collateral” to the litigation rather than from a joint tortfeasor or joint

debtor. Brown v. American Transfer & Storage Co., 601 S.W.2d 931, 934-36 (Tex.1980).

H. Required Election of Remedy Among Multiple Causes of Action. Texas law also prohibits “double recovery” of the same damages for multiple causes of action. When the jury awards damages under multiple theories of recovery for the same loss, the defendant may require the plaintiff to elect the cause of action under which satisfaction will be recovered for that single loss. Waite Hill Services, Inc. v. World Class Metal Works, Inc., 959 S.W.2d 182, 184-85 (Tex. 1998).

I. Mitigation of Damages. A “plaintiff’s recovery of damages is limited not only by his own evidence, but also by the defendant’s evidence of the plaintiff’s failure to reasonably mitigate losses.” Arthur Andersen & Co. v. Perry Equipment Corp., 945 S.W.2d 812, 817 (Tex. 1997). *See* Texas Pattern Jury Charge 110.25.

III. EVALUATING DAMAGES: THE MEASURES OF RECOVERY. Beyond the basics identified in the previous section, evaluating the potential for recovery in any particular case involves identifying the appropriate measure of recovery established by law for the cause of action at issue. Recent decisions of the Texas Supreme Court have specified the appropriate measure of damage recovery in the most common causes of action arising in general business disputes.

A. The Direct/Consequential Distinction. For common law causes of action, compensatory damages are either “direct” or “consequential.” Arthur Andersen & Co. v. Perry Equipment Corp., 945 S.W.2d 812, 816 (Tex. 1997).

“Direct damages are the necessary and usual result of the defendant’s wrongful act; they flow naturally and necessarily from the wrong.” *Id.* “Direct damages compensate the plaintiff for the loss that is conclusively presumed to have been foreseen by the defendant from his wrongful act.” *Id.* It is important to note that because foreseeability is presumed, proximate causation is not at issue in connection with direct damages. Accordingly, the Texas Pattern Jury Charges for direct damages ask the jury to identify an amount that will compensate the plaintiff for damages that have or will have “resulted from” the defendant’s conduct. *See, e.g.*, PJC 110.2 (direct breach of contract damages). [The comments to PJC 110.2 acknowledge that this phrase is “derived from” the decision in McKnight v. Hill & Hill Exterminators, 698 S.W.2d 206, 209 (Tex. 1985). Notably, the McKnight case did not involve direct damages in a breach of contract case. The phrase is well chosen, regardless of the relevance of its source.] Because the law presumes that direct damages were foreseen and necessarily flow from the wrong, the law in many instances prescribes the measure of direct damages for particular causes of action, as discussed below.

“Consequential damages, on the other hand, result naturally, but not necessarily, from the defendant’s wrongful acts.” Perry Equipment, 945 S.W.2d at 816. “[C]onsequential damages need not be the usual result of the wrong, but must be foreseeable, and must be directly traceable to the wrongful act and result from it.” *Id.* (citations omitted). Damages that “are too remote, too uncertain or purely conjectural . . . cannot be recovered.” *Id.* Consistent with these principles, Texas Pattern Jury Charge 110.4 for breach of contract consequential damages asks the jury to calculate particular damages “that were a natural, probable and foreseeable consequence” of the proved breach of contract. Likewise, Pattern Jury Charge 110.20 for fraud consequential damages asks the jury to calculate damages “proximately caused by” the fraud. *See* PJC 100.9 (definition of “proximate cause”).

B. Breach of Contract Measures of Damages. The basic measure of direct compensatory damages in a breach of contract case is the sum of money that would “put the plaintiff in the same economic position he would have been in had the contract” been performed. *See American National Petroleum Co. v. Transcontinental Gas Pipe Line Corp.*, 798 S.W.2d 274, 287 (Tex. 1990), *cited with approval in Formosa Plastics Corp. USA v. Presidio Engineers and Contractors, Inc.*, 960 S.W.2d 41, 47 (Tex. 1998). How this measure of recovery applies in a particular case to determine direct damages, of course, depends on the particular nature and terms of the contract as well as the nature of the defendant’s conduct in violation of those terms. *See, e.g., Gulf Coast Investment Corp. v. Rothman*, 506 S.W.2d 856, 857 (Tex. 1974). Evaluating damages for a particular breach of contract, therefore, requires a thought experiment to determine the plaintiff’s economic position had the contract been performed rather than breached and identifying an appropriate means for valuing the difference between that economic position and the plaintiff’s economic position as a consequence of a breach.

For particular types of contract, of course, court decisions have established the proper measure of direct damages applicable to those types of contracts. The *Restatement (Second) of Contracts*, at §§ 346-56, offers a fairly comprehensive discussion of the theories underlying contract damages. The Uniform Commercial Code, of course, prescribes specific measures for recovery of direct damages in cases involving sales contracts. TEX. BUS. & COMM. CODE §§ 2.706, 2.708, 2.709, 2.711, 2.712, 2.713, 2.714. Demonstrating how breach of contract damages entail both fact-specific analysis and a variety of possibilities for valuing the amount necessary to give the plaintiff the benefit of its bargain, Texas Pattern Jury Charge 110.3 offers a sampling of alternative measures of recovery applicable to breach of a contract to paint a truck.

C. Tortious Interference Measure of Direct Damages. The measure of direct compensatory damages for tortious interference with a contract is essentially the same as for breach of contract, “to put the plaintiff in the same economic position he would have been in had the contract interfered with been actually performed.” *American National Petroleum Co. v. Transcontinental Gas Pipe Line Corp.*, 798 S.W.2d 274, 287

(Tex. 1990), *cited with approval in Formosa Plastics Corp. USA v. Presidio Engineers and Contractors, Inc.*, 960 S.W.2d 41, 47 (Tex. 1998). Not surprisingly, Texas Pattern Jury Charge 110.22 explicitly incorporates the alternative measures of contract damages suggested in PJC 110.3.

D. Fraud Measures of Recovery. “Texas recognizes two measures of direct damages for common-law fraud: the out-of-pocket measure and the benefit-of-the-bargain measure.” *Formosa Plastics Corp. USA v. Presidio Engineers and Contractors, Inc.*, 960 S.W.2d 41, 49 (Tex. 1998). “The out-of-pocket measure computes the difference between the value paid and the value received, while the benefit-of-the-bargain measure computes the difference between the value as represented and the value received.” *Id.*; see Texas Pattern Jury Charge 110.19. The decision in *Formosa Plastics* makes clear that the contract measure of damages can be recovered for fraudulent inducement “irrespective of whether the fraudulent representations are later subsumed in a contract or whether the plaintiff only suffers an economic loss related to the subject matter of the contract.” 960 S.W.2d at 47.

E. Negligent Misrepresentation Measure of Recovery. Direct damages for negligent misrepresentation are limited to the out-of-pocket measure of recovery. *D.S.A., Inc. v. Hillsboro Independent School District*, 973 S.W.2d 662 (Tex. 1998) (per curiam), *citing Restatement (Second) of Torts* § 552B. Texas Pattern Jury Charge 110.21 appropriately tracks the language of the *Restatement (Second)*.

F. Lost Profits as Consequential Damages. The most important type of consequential damage recoverable in a business case is lost profits. Texas cases have acknowledged that lost profits, if properly supported with appropriate evidence, can be recovered for breach of contract and fraud. *Southwest Battery Corp. v. Owen*, 115 S.W.2d 1097 (Tex. 1938) (lost profits caused by breach of contract), *cited with approval in Texas Instruments, Inc. v. Teletron Energy Mgmt., Inc.*, 877 S.W.2d 276, 280 (Tex. 1994); *Formosa Plastics Corp. USA v. Presidio Engineers and Contractors, Inc.*, 960 S.W.2d 41, 49 n.1 (Tex. 1998) (“foreseeable profits from other business opportunities lost as a result of the fraudulent misrepresentation”). Conceptually, lost profits should likewise be recoverable for tortious interference. Consequential damages recoverable in a negligent misrepresentation case are limited to the “pecuniary loss” suffered as a consequence of the plaintiff’s “reliance” on the misrepresentation. *D.S.A., Inc. v. Hillsboro Independent School District*, 973 S.W.2d 662 (Tex. 1998) (per curiam), *quoting Restatement (Second) of Torts* § 552B.

G. Measures of Damage When the Contract is Unenforceable. When a plaintiff bases a claim on an oral promise, that promise is often unenforceable as a contract either because the statute of frauds forbids its enforcement or because the jury concludes that no enforceable contract was ever formed. In these circumstances, the plaintiff may still assert alternative causes of action for damages. The plaintiff may

