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

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

SARGON ENTERPRISES, INC.,
Plaintiff and Appellant,

v.

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

After A Decision By The Court Of Appeal Second Appellate District, Division One

OPENING BRIEF ON THE MERITS

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ISSUE ON WHICH REVIEW WAS GRANTED

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

INTRODUCTION

This case raises the question whether trial courts have meaningful discretion to exclude speculative and unreliable expert opinion testimony projecting lost profits. The trial court excluded the expert testimony proffered by plaintiff Sargon Enterprises, Inc. ("Sargon") after an eight-day evidentiary hearing, summarizing its conclusions in an exhaustive 33-page order. If the trial court's careful and meticulous evidentiary ruling here is deemed an abuse of discretion, then trial courts will have been effectively stripped of any gatekeeping role over such testimony. This Court should reject such an outcome and reverse the judgment of the Court of Appeal.

This case arises out of a 23-person clinical trial that defendant University of Southern California ("University") agreed to conduct on a dental implant developed by Sargon. Sargon's expert asserted that, but for the University's improper performance of the clinical study, Sargon, a tiny start-up that never had made more than

$101,000 a year, would have grown exponentially to become a world leader in the global dental implant industry, earning ***between $220 million and $1.2 billion*** over a decade. Sargon's expert postulated these extraordinary numbers by comparing Sargon to leaders in the global dental implant industry hundreds and thousands of times larger than Sargon, using a "market drivers" hypothesis developed for this lawsuit.

As the trial court carefully explained in its order, the expert's projections were not reasonably reliable because they departed from historical performance; compared a small start-up company to multinational corporations exponentially larger by every objective business measure; relied upon a "market drivers" hypothesis that lacked any reliable basis for its key assumption that market share in the dental implant market reflects relative "innovativeness" and failed to offer any useful criteria on "innovativeness" to guide the jury; lacked any grounding in relevant dental or economic fields of expertise; and depended upon multiple factual contingencies whose occurrence was a matter of sheer speculation.

In excluding this testimony, the trial court acted well within the bounds of the discretion entrusted to it. The Evidence Code permits admission of expert testimony only if it is reasonably reliable. Moreover, as this Court repeatedly has recognized, the Evidence Code entrusts trial courts with primary responsibility for applying these restrictions upon expert testimony. This gatekeeping function is especially important in the lost profits context, because claims for prospective lost profits necessarily involve uncertainty that creates a danger of undue speculation.

Stripping trial courts of this gatekeeping function, as the Court of Appeal sought to do, would have grave implications for the administration of justice. Requiring trial courts to submit unreliable and inflated lost profit projections to the jury would pressure defendants with entirely meritorious defenses to settle in order to avoid the possibility of massive judgments that could cripple or bankrupt them. If defendants refused to enter into such "blackmail" settlements, courts would be burdened with lengthy, hotly contested disputes that would increase the cost of litigation and consume

scarce judicial resources. Finally, forcing trial courts to send inflated and speculative expert lost profits testimony to juries would discourage research universities and established businesses from contracting with start-ups, to the detriment of innovation in the State.

Accordingly, this Court should reaffirm that trial courts play an important gatekeeping function with respect to expert opinion testimony on lost profits, reverse the Court of Appeal's decision, and order the trial court's judgment reinstated.

STATEMENT OF FACTS

A. Background

This case arises from an agreement between the University and Sargon to conduct a small-scale study of a dental implant invented by Sargon's founder, Dr. Sargon Lazarof. (Slip Opn. 2, 4; Tr. Ct. Order 10, fn. 4 [21 AA 5337, fn. 4].) Dental implants are drilled into the jawbone to anchor a crown. (7 AA 1550.) Unlike most implants, which take four to six months to integrate with the bone before a crown can be fitted, the Sargon implant uses a spreading "molly bolt" designed to allow a crown to be loaded immediately. (*Ibid.*) The study arose from the interest of some

faculty members at the University's dental school in the Sargon implant. (Slip Opn. 4; 1 AA 87.)

In November 1996, the University entered into a Clinical Trial Agreement with Sargon. (1 AA 58-100.) In the agreement, the University promised to install forty implants, evaluate their safety and efficacy (1 AA 87-88) and provide interim reports (1 AA 61). Sargon promised to provide $200,000 to fund the study. (1 AA 62.)

In May 1999, Sargon sued the University, claiming that it had breached the Clinical Trial Agreement by not providing timely and complete interim reports and by not following research protocols in selecting the twenty-three patients in whom the study's forty implants were placed. (1 AA 49-50.) At trial, a jury found a breach of contract and awarded $433,000 in general damages. The trial court (Lager, J.), however, excluded Sargon's request for special damages on the ground that the $100 million or so in lost profits then claimed by Sargon were not reasonably foreseeable. (1 RA 192-207; 1 AA 127.)

The Court of Appeal for the Second District, Division One, vacated that ruling in a February 2005 unpublished opinion ("*Sargon I*"), holding that a jury could have found such damages foreseeable based upon evidence that Sargon intended to use a positive clinical study for marketing purposes. (1 AA 222-27.) Because the trial court had focused solely on whether lost profits were foreseeable, the Court of Appeal remanded, deeming it premature to consider whether Sargon's purported lost profits were reasonably certain. (1 AA 228-29, 237-38.)

On remand following *Sargon I*, the lost profits issue was taken up by a new trial judge (Green, J.). Sargon amended its complaint to add fraud and other tort claims, but all those claims were dismissed on pre-trial motions. (Slip Opn. 9-14, 16-18.) After an eight-day evidentiary hearing, the trial court excluded Sargon's proffered expert witness testimony on lost profits, and Sargon stipulated to final judgment and appealed. The Court of Appeal affirmed on nearly all grounds, including the dismissal of the fraud and other tort claims, but reversed the trial court's ruling excluding the

proffered expert witness testimony regarding lost profits. The University's petition relates solely to this last issue.

B. The Expert Opinion Testimony

On remand following *Sargon I*, Sargon proffered expert opinion testimony from James Skorheim, a certified public accountant and lawyer, concerning its lost profits, which Sargon now claimed were as much as $1.1 billion. (Slip Opn. 21.) Sargon argued, based on Skorheim's opinion, that but for the University's breach, Sargon's innovation would have made it a global leader in the implant market. (43 AA 11114-15.) Arguing that this testimony was speculative, the University moved for summary adjudication. Although the trial court denied the motion (12 AA 3124-26), it expressed doubts about Skorheim's opinion, noting the "many intermediary steps that have to be accounted for" in order for Sargon to become a market leader (2 RT 64:7-16). Sargon responded that it was "going to have that proof" at trial (2 RT 67:9-68:1), but the trial court warned Sargon that its damages might be speculative if it sought "the full amount of lost profits it alleges, and nothing less" (12 AA 3125).

The University then deposed Skorheim and, based upon the deposition, filed a motion in limine to exclude his testimony. (13 AA 3210-28.) The trial court was inclined to grant the motion in large part, but Sargon again represented that it was going "to fill in all the assumptions that Mr. Skorheim has made." (3 RT I23:4-23.) Giving Sargon the benefit of the doubt, the trial court conducted an evidentiary hearing under Evidence Code section 402. At the hearing, which lasted eight days (see 4 RT J1 through 11 RT 2069), Sargon presented four witnesses, including Skorheim, who testified over the course of six days. (See 4 RT J11-56; 5 RT K2-69; 6 RT 26-52; 7 RT 301-34; 8 RT 601-800; 10 RT 1501 through 10A RT 116.)

Skorheim opined that, but for the University's breach, Sargon's profits, which had never exceeded $101,000 a year (Tr. Ct. Order 10, fn. 4 [21 AA 5337, fn. 4]), would have increased between 1998 and 2009 to a minimum of $26 million per year (a 29,000% increase) and to as much as $142 million per year (a 157,000% increase). (Slip Opn. 25, 27; 40 AA 10248, 10251.) Skorheim estimated Sargon's total lost profits during the ten-year time period

to be ***no less than $220 million and as high as $1.18 billion.*** (*Id.* at p. 25.)

Skorheim did not base these projections on Sargon's historical performance. (Tr. Ct. Order 8-9 & fn. 2 [21 AA 5335-36 & fn. 2].) Skorheim looked to Sargon's actual performance only for 1998, and then inexplicably doubled Sargon's actual revenues for that year. (*Ibid.*)

Rather than using historical performance to project Sargon's revenues, Skorheim used an unprecedented "market drivers" hypothesis that he invented for this case. He asserted that three "market drivers"—innovativeness, use of clinical studies, and targeting general practitioners—drive relative success in the dental implant market. (*Id.* at pp. 4, 21-22 [21 AA 5331, 5348-49].) Because all successful dental implant companies pursue clinical studies and target general practitioners (*id.* at p. 9, fn. 3 [21 AA 5336, fn. 3]), Skorheim relied upon the third "driver" as the key to market share, deeming likely market share a function of a company's relative "innovativeness" (*id.* at pp. 4-5 [21 AA 5331-32]).

Specifically, Skorheim looked to the six existing leaders of the global dental implant industry and hypothesized that, if a jury found that Sargon's implant contributed a "meaningful" level of innovation, it would have achieved a 3.75% market share by 2009, roughly equivalent to Astra Tech's market share in 1998 (8 RT 606:26-607:7, 628:15-26; 40 AA 10248); if a jury found that Sargon's implant offered a "good" innovation, it would have achieved a 5% market share, roughly equivalent to that of Dentsply and Zimmer (8 RT 633:13-634:1; 40 AA 10249); if a jury found that Sargon's implant contributed a "substantial" innovation, it would have achieved a 10% market share roughly equivalent to 3i's (8 RT 634:5-26; 40 AA 10250); and if a jury found Sargon's implant to be a "revolutionary" innovation, Sargon would have achieved the roughly 20% market share enjoyed by the two market leaders, Nobel Biocare and Straumann (8 RT 635:2-23 40 AA 10241-51).

Using these four possible market shares, Skorheim projected Sargon's lost revenues and lost profits, assuming that Sargon's revenues would "ramp up" smoothly from double its 1998 revenues

and that Sargon's profit margins would jump to the 30% enjoyed by the market leaders even though Sargon's margins had never exceeded 5%. (Slip Opn. 27; Tr. Ct. Order 8-9 & fn.2 [21 AA 5335-36 & fn. 2]; 8 RT 605:21-622:19; 40 AA 10246-10251.) The results he projected were as follows:

Table 1
Skorheim's Lost Profit Damages
Based On Innovativeness Options

	Option 1	Option 2	Option 3	Option 4
Level of Innovation	"meaningful" (Astra Tech)	"good" (Dentsply/ Zimmer)	"substantial" (3i)	"revolutionary" (Nobel/ Straumann)
Projected 2009 Market Share	3.75%	5%	10%	20%
Increase in Annual Revenue	5,046%	6,762%	13,652%	27,350%
Increase in Annual Profit	29,240%	39,131%	78,694%	157,820%
Total Lost Profits	$220,484,347	$315,364,512	$605,764,966	$1,181,018,778

Sources: 13 AA 3300-02, 3325-26, 3336-37, 3340-42; 40 AA 10241-51; 8 RT 606-07.

Skorheim offered no definition of "innovativeness" or standards to guide the jury in distinguishing among the four levels of relative "innovativeness," and conceded that he lacked any

expertise enabling him to judge a dental implant's relative innovativeness. (Tr. Ct. Order 9, fn. 3, 17, 23 [21 AA 5336, fn. 3, 5344, 5350]; 13 AA 3285-86; 4 RT J14:4-11; 10A RT 26:13-27:4.) He thus left "the jury . . . to wrestle with that tough issue" on its own. (8 RT 751; 10A RT 22-23.)

Skorheim also admitted that his projections assumed that numerous dental schools, their graduates, and veteran dentists would adopt the Sargon implant (14 AA 3598-3649; 15 AA 3794-3802), that Sargon would introduce other innovative products enabling sales increases of between 5,000% and 157,000% (Tr. Ct. Order 29 [21 AA 5356]; 11 RT 1870:15-26), and that existing market leaders would not compete with Sargon to maintain their market shares (Tr. Ct. Order 28-29 [21 AA 5355-56]).

C. The Trial Court's Evidentiary Ruling

After the eight-day section 402 hearing, the trial court excluded Skorheim's proffered expert opinion testimony, setting forth its reasons in a detailed 33-page order. (21 AA 5328-60.) The trial court found the evidence inadmissible on multiple grounds.

First, the trial court found that Skorheim's projections were not based upon Sargon's historical performance, but instead improperly used numbers "wildly beyond, by degrees of magnitude, anything that Sargon had ever experienced in the past." (Tr. Ct. Order 9 [21 AA 5336].)

Second, the trial court found that Skorheim had not compared Sargon to similarly situated companies, but instead had improperly compared Sargon with giant multinational corporations with "employees in the thousands and budgets in the billions"—companies that were "worlds apart from Sargon" by every objective business measure. (*Id.* at p. 10 & fn. 4 [21 AA 5337 & fn. 4].) The trial court observed that "[t]he only thing these established companies have in common with [Sargon] is that they all sell or make dental implants." (*Id.* at p. 10 [21 AA 5337].)

Third, the trial court found that Skorheim had failed to give guidance to the jury because he offered "no rational standards for the jury to follow in choosing" among the relative degrees of "innovativeness" that were the linchpin of the revenue and profit

projections. (*Id.* at p. 18 [21 AA 5345].) This feature of Skorheim's opinion, the trial court found, "relegate[d] the question of determining potentially more than a billion dollars in damages to pure speculation." (*Id.* at p. 21 [21 AA 5348].)

Fourth, the trial court found that Skorheim lacked any expertise for determining the importance of innovativeness to dental implants or for assessing the relative innovativeness of the Sargon implant. (*Id.* at pp. 17, 23 [21 AA 5344, 5350].)

Fifth, the trial court found that Skorheim's testimony rested on arbitrary and unfounded factual assumptions, including that Sargon would be able to make a "seamless transition" from a three-person operation to a multibillion-dollar international corporation (*id.* at p. 28 [21 AA 5355]), and that the existing multibillion-dollar market leaders would "just go quietly" rather than compete in response (*id.* at p. 29 [21 AA 5356]).

D. Sargon's Stipulation To Judgment

After Skorheim's testimony was ruled inadmissible, Sargon stipulated to a judgment of $433,000, the damages awarded at the first trial, so that it could immediately appeal the trial court's

evidentiary ruling. (21 AA 5366-70.) In so doing, Sargon chose to forego proceeding to trial based on evidence of lost profits other than Skorheim's testimony, including evidence that distributors in Japan, Korea, and Saudi Arabia had canceled contracts for millions of dollars in annual sales (5 AA 1259-64) and that individual dentists had reduced or delayed their use of the Sargon implant (32 AA 8104-13).

E. The Court of Appeal's Decision

On appeal, a divided panel of the Second District, Division One (Mallano, J., joined by Chaney, J.) held that the trial court had abused its discretion in excluding Skorheim's testimony and "return[ed] the matter to the trial court for a new trial on the issue of lost profits." (Slip Opn. 2; see also *id.* at p. 31.) The majority did not discuss the reliability of Skorheim's "market driver" hypothesis or the unsupported factual assumptions underlying it, holding instead that "[t]echnical arguments about the meaning and effect of expert testimony on the issue of damages are best directed to the jury." (Slip Opn. 19, citation omitted; see also *id.* at pp. 30-31 ["We have carefully reviewed the trial court's criticisms of Skorheim's proffered

testimony and conclude they were better left for the jury's assessment."].)

The majority discussed none of the deficiencies the trial court had identified in Skorheim's expert opinion testimony other than Skorheim's comparison of Sargon to the dental implant market leaders. Without explanation, the majority found this comparison more like the comparison found admissible in *Palm Medical Group, Inc. v. State Compensation Insurance Fund* (2008) 161 Cal.App.4th 206, in which an expert compared an occupational medical clinic to similarly sized medical providers in the same city, than the comparison found inadmissible in *Parlour Enterprises, Inc. v. Kirin Group, Inc.* (2007) 152 Cal.App.4th 281, in which an expert compared a small ice cream parlor to the national Friendly's chain. (Slip Opn. 30.) The majority also characterized the trial court's ruling as "tantamount to a flat prohibition on lost profits" in cases where a business claimed an innovative product. (*Ibid.*)

Justice Johnson dissented. Noting that admissibility of expert opinion evidence is committed to the discretion of the trial court,

and that nothing in the trial court's "reasonable, straightforward and clearly articulated evidentiary ruling" was arbitrary, capricious, or beyond the bounds of reason, he concluded that the trial court's exclusion of Skorheim's testimony should have been upheld. (Dis. Opn. 7; see also *id.* at pp. 1-6.) He criticized the majority for "ignoring the function of discretion in trial court evidentiary rulings" and "usurp[ing] the function of the trial court." (*Id.* at p. 7.) The majority's approach, he observed, "dangerously erodes the function of the trial court in making evidentiary rulings on lost profit damages." (*Id.* at p. 8.)

STANDARD OF REVIEW

Because "[t]he qualification of expert witnesses, including foundational requirements, rests in the sound discretion of the trial court," trial court rulings concerning the admission of expert testimony should not be disturbed on appeal "[a]bsent a manifest abuse" of that discretion. (*People v. Ramos* (1997) 15 Cal.4th 1133, 1175.) Under the abuse of discretion standard, a trial court ruling will not be disturbed unless the court "exercised its discretion in an arbitrary, capricious, or patently absurd manner that resulted in a

manifest miscarriage of justice." (*People v. Lewis* (2009) 46 Cal.4th 1255, 1268, citations omitted.)

ARGUMENT

I. THE EVIDENCE CODE REQUIRES THAT EXPERT OPINION TESTIMONY CONCERNING LOST PROFITS HAVE A REASONABLY RELIABLE BASIS

The Evidence Code permits testimony by an expert who has "special knowledge, skill, experience, training, or education sufficient to qualify him [or her] as an expert on the subject to which [the individual's] testimony relates" (Evid. Code, § 720, subd. (a)), but requires that all "matter" upon which an expert relies be "of a type that ***reasonably may be relied upon*** by an expert in forming an opinion upon the subject to which his [or her] testimony relates" (*id.*, § 801, subd. (b), italics and bolding added). The Evidence Code thus requires trial courts to serve as gatekeepers of the reasonable reliability of expert opinion testimony. (See, e.g., *People v. Prince* (2007) 40 Cal.4th 1179, 1225, fn. 8; *People v. Dean* (2009) 174 Cal.App.4th 186, 199.)

This gatekeeping role is especially important where expert opinion testimony concerns prospective lost profits. Such testimony

necessarily relies upon the prediction of uncertain future events that creates the risk of undue speculation, and upon the use of financial formulas that create an illusion of precision likely to mislead or confuse a jury. The Court of Appeal decision ignored these important principles in depriving the trial court of any discretion over admissibility and relegating the reliability of Skorheim's testimony to the jury.

A. The Evidence Code Provides For The Exclusion Of Speculative Expert Opinion Testimony

As this Court has recognized, the "foundational predicate for admission of the expert testimony" is whether the testimony will "assist the trier of fact to evaluate the issues it must decide." (*People v. Moore* (2011) 51 Cal.4th 386, 405-06; see also Evid. Code, § 801, subd. (a).) An expert opinion can satisfy this essential requirement only if the opinion is reliable and not based upon mere speculation or conjecture. (*People v. Richardson* (2008) 43 Cal.4th 959, 1008-09, citation omitted.) The Evidence Code expressly requires such reliability in section 801, subdivision (b):

> If a witness is testifying as an expert, his testimony in the form of an opinion is limited to such opinion as is:

* * *

> (b) Based on matter (including his special knowledge, skill, experience, training, and education) perceived by or personally known to the witness or made known to him at or before the hearing, whether or not admissible, that is of a type that ***reasonably may be relied upon*** by an expert in forming an opinion upon the subject to which his testimony relates, unless an expert is precluded by law from using such matter as a basis for his opinion.

(Evid. Code, § 801 subd. (b), italics added.)

Thus, the factual data used by an expert must be reasonably reliable. (See, e.g., *People v. McWhorter* (2009) 47 Cal.4th 318, 361-62; *People v. Gardeley* (1996) 14 Cal.4th 605, 618.) And expert opinions must be based upon reliable principles, methods, and techniques for analyzing that data, as suggested by the Evidence Code's definition of "matter" to "includ[e]" an expert's "special knowledge, skill, experience, training, and education." (Evid. Code, § 801, subd. (b); see also *People v. Richardson, supra,* 43 Cal.4th at p. 1008; *People v. Kelly* (1976) 17 Cal.3d 24, 30.)

The Law Revision Commission's comments upon section 801 of the Evidence Code confirm this section's purpose to prohibit speculative expert testimony, stating that the reasonable reliability

requirement "continues in effect the discretionary power of the courts to regulate abuses" and in particular the authority to exclude "speculative matters":

> [U]nder existing law, irrelevant or speculative matters are not a proper basis for an expert's opinion. See Roscoe Moss Co. v. Jenkins, 55 Cal.App.2d 369, 130 P.2d 477 (1942) (expert may not base opinion upon a comparison if the matters compared are not reasonably comparable); People v. Luis, 158 Cal. 185, 110 Pac. 580 (1910) (physician may not base opinion as to person's feeblemindedness merely upon the person's exterior appearance); Long v. Cal.-Western States Life Ins. Co., 43 Cal.2d 871, 279 P.2d 43 (1955) (speculative or conjectural data); Eisenmayer v. Leonardt, 148 Cal. 596, 84 Pac. 43 (1906) (speculative or conjectural data). *Compare* People v. Wochnick, 98 Cal.App.2d 124, 219 P.2d 70 (1950) (expert may not give opinion as to the truth or falsity of certain statements on the basis of lie detector test), with People v. Jones, 42 Cal.2d 219, 266 P.2d 38 (1954) (psychiatrist may consider an examination given under influence of sodium pentothal—the so-called 'truth serum'—in forming an opinion as to the mental state of the person examined).

(Cal. Law Revision Com. com., 29B pt. 3A West's Ann. Evid. Code (2009 ed.) foll. § 801, pp. 26-27.) As the cases cited in the Comment make clear, this authority to exclude speculative expert opinion testimony encompasses not only testimony based on unfounded factual assumptions (see *Eisenmayer v. Leonardt* (1906) 148 Cal. 596,

601 [excluding stock valuation without any factual basis]), but also testimony employing speculative reasoning and methodologies (see *Long v. Cal-Western States Life Ins. Co.* (1955) 43 Cal.2d 871, 882-83 [excluding opinions of expert stemming from "[e]xperiments . . . which are largely based upon speculation or conjecture"]).

The Law Revision Commission's observations concerning the reasonable reliability requirement are entitled to substantial deference because they were included in the materials proposing the adoption of the Evidence Code. (See 7 Cal. Law Revision Com. Rep. (1965) pp. 148-50.) This deference is particularly appropriate where, as here, the Commission's proposal was "adopted by the Legislature without any change whatsoever and where the [C]ommission's comment is brief, because in such a situation there is ordinarily strong reason to believe that the legislators' votes were based in large measure upon the explanation of the [C]ommission proposing the bill." (*Jevne v. Superior Court* (2005) 35 Cal.4th 935, 947 [citation and quotation marks omitted].) Here, section 801 and its comments were adopted by the Legislature without a single change. (Compare

Stats. 1965, ch. 299, § 2 with 7 Cal. Law Revision Com. Rep. (1965) pp. 148-50.) In addition, the Judiciary Committees of both the Assembly and Senate expressly stated when they adopted the Evidence Code that the Commission's comments reflected their own intent. (See Cal. Law Revision Com., Evidence Code with Official Comments (1965) pp. 1007-08.)

B. Expert Opinion Testimony Concerning Lost Profits Poses Special Dangers Of Unreliability

Expert opinion testimony concerning prospective lost profits in particular calls for a trial court's careful scrutiny for reliability. As a form of special or consequential damages, lost profits must "be proven to be certain both as to their occurrence and their extent." (*Lewis Jorge Construction Management, Inc. v. Pomona Unified School Dist.* (2004) 34 Cal.4th 960, 975 [citing *Berge v. International Harvester Co.* (1983) 142 Cal.App.3d 152, 161].) But because such profits depend upon hypothetical or projected future events, they cannot be proven with exact certainty. (*Ibid.*) Accordingly, while lost profits need not be proven with "mathematical precision" (*ibid*), this Court has held that they are recoverable only if "the evidence makes

reasonably certain their occurrence and extent" (*Grupe v. Glick* (1945) 26 Cal.2d 680, 693, italics added).

Under this "reasonable certainty" standard, courts have found evidence of lost profits insufficient where their occurrence or their amount is speculative or remote. (See, e.g., *Lewis Jorge Construction, supra,* 34 Cal.4th at pp. 975-77 [lost profits on future construction projects "uncertain and speculative" where based upon highly contingent future events like effect on future construction contracts of reduction in bonding capacity]; *Warner Constr. Corp. v. City of Los Angeles* (1970) 2 Cal.3d 285, 301-02 [amount of damage from deprivation of capital "entirely uncertain"]; *S.C. Anderson, Inc. v. Bank of America* (1994) 24 Cal.App.4th 529, 536-38 [evidence of lost construction bids speculative]; *California Shoppers, Inc. v. Royal Globe Ins. Co.* (1985) 175 Cal.App.3d 1, 62-63 [evidence of lost profits caused by insurer's failure to defend lawsuit found speculative].)

This is especially so in cases involving start-ups and other newer businesses that are not yet established. (See, e.g., *Grupe v. Glick, supra,* 26 Cal.2d at p. 693 [lost profits for such businesses is

"generally objectionable for the reason that their estimation is conjectural and speculative"]; *Gerwin v. Southeastern Cal. Assn. of Seventh Day Adventists* (1971) 14 Cal.App.3d 209, 221-23 [denying lost profits from new hotel venture because speculative]; see also *Mindgames, Inc. v. Western Pub. Co., Inc.* (7th Cir. 2000) 218 F.3d 652, 658 (opn. of Posner, C.J.) ["[A] start-up company should not be permitted to obtain pie-in-the-sky damages upon allegations that it was snuffed out before it could begin to operate"].)

For example, in *Kids' Universe v. In2Labs* (2002) 95 Cal.App.4th 870, the Court of Appeal held expert opinion testimony insufficient to sustain a lost profits judgment where a small family-run toy store claimed $50 million in lost profits, arguing that its new website and access to a Web portal would have enabled it to compete with eToys, the leader in the Internet toy marketing business, but for flooding caused by the defendant that damaged the store. (*Id.* at pp. 887-88.) Finding this hypothesis "rife with speculation" (*id.* at p. 887), the court noted that any such outcome depended upon numerous contingencies, including whether the toy store's website would have

attracted viewers; whether those viewers would have purchased goods; whether the toy store would have been able to attract the venture capital needed to expand; and whether the toy store would have been able to operate the website profitably (*id.* at pp. 887-88).

Where expert opinion testimony concerning lost profits is based upon speculation or conjecture, California courts including this Court have held it not only insufficient to support a damages award but also inadmissible. (See *Eisenmayer v. Leonardt, supra,* 148 Cal. at p. 601 [affirming exclusion of expert testimony concerning value of unissued stock based upon speculativeness]; see also *Parlour Enterprises, supra,* 152 Cal.App.4th at p. 287 [holding expert testimony on lost profits "so speculative that the trial court should have excluded the opinion" where it rested on comparing a small ice cream parlor to the nationwide Friendly's chain]; *Westrec Marina Mgmt v. Jardine Ins. Brokers Orange County, Inc.* (2000) 85 Cal.App.4th 1042, 1050-51 [affirming exclusion of lost profits testimony based on unreasonable comparison between insurance on a boat and insurance on a marina].)

The Court of Appeal was incorrect to reject these settled precedents, and likewise incorrect to deem exclusion of speculative expert opinion testimony "tantamount to a flat prohibition on lost profits" in cases where a business claims lost profits from an innovative product. There are numerous well-established means to project such profits—none of which Skorheim employed here. *First,* an expert can analyze a business's historical performance with respect to other products. (See *Grupe v. Glick, supra,* 26 Cal.2d at p. 692; *DSC Communications Corp. v. Next Level Communications* (5th Cir. 1997) 107 F.3d 322, 329-30 [permitting expert to estimate defendant's lost profits for a new technology based upon its historical performance with a product involving older technology]. See generally 1 Dunn, Recovery of Damages for Lost Profits (6th ed. 2004) §§ 5.7-5.11, pp. 430-41.)

Second, an expert can compare a business's performance to that of an entity of similar size, work force, assets, sales, revenues, and management structure. (See, e.g., *Nelson v. Reisner* (1958) 51 Cal.2d 161, 171. See generally 1 Dunn, Recovery of Damages for

Lost Profits, *supra*, § 5.12, pp. 441-47.) In any such comparison, however, "the business used as a standard must be as nearly identical to the plaintiff's as possible" (*G.M. Brod & Co., Inc. v. U.S. Home Corp.* (11th Cir. 1985) 759 F.2d 1526, 1538-39, citation omitted), and comparison of disparate companies is properly deemed speculative and inadmissible (see, e.g., *Berge v. International Harvester Co., supra*, 142 Cal.App.3d at pp. 161-62; see generally 1 Dunn, Recovery of Damages for Lost Profits, *supra*, § 5.13, p. 447).

Third, a party can use other methods such as pre-litigation projections, computations from contracts, market surveys, and econometric analyses to show lost profits. (See, e.g., *Humetrix, Inc. v. Gemplus S.C.A.* (9th Cir. 2001) 268 F.3d 910, 919 [contracts completed and in process, pilot projects, and defendants' performance in foreign markets]; *Northeastern Tel. Co. v. AT&T Co.* (D. Conn. 1980) 497 F.Supp. 230, 248-49 [pre-litigation projections and cross-elasticity studies]; *ID Security Systems Canada v. Checkpoint Systems, Inc.* (E.D. Pa. 2003) 249 F.Supp.2d 622, 690-92 [contractual calculations]. See generally 1 Dunn, Recovery of Damages for Lost Profits, *supra*,

§§ 5.14-5.19, pp. 449-66.) Here, Skorheim relied upon no such well-established method, and the trial court did not abuse its discretion in finding his testimony inadmissible as speculative and unfounded.

II. THE TRIAL COURT DID NOT ABUSE ITS DISCRETION IN EXCLUDING SARGON'S PROFFERED EXPERT OPINION TESTIMONY CONCERNING LOST PROFITS

The trial court excluded Skorheim's testimony only after affording Sargon an eight-day evidentiary hearing, setting forth its reasons in a comprehensive and well-considered 33-page ruling in which it made numerous express findings of fact. (21 AA 5328-60.) As Justice Johnson correctly recognized in dissent (Dis. Opn. 7), the trial court was well within its broad discretion under the Evidence Code in so ruling, and the Court of Appeal misapplied the abuse of discretion standard in reversing. The trial court's ruling found Skorheim's testimony inadmissible for multiple reasons that both separately and in combination overwhelmingly support the decision to exclude that testimony as lacking any reasonably reliable basis.

A. Skorheim's Testimony Failed To Look To Historical Performance

Historical performance is a traditional and reliable method for establishing lost profits. (See, e.g., 3 Dobbs, Law of Remedies (2d ed. 1993) § 12.4(3), p. 72). Experts can determine lost profits with reasonable reliability by extrapolating from "[h]istorical data" concerning "past business volume" (*Berge v. International Harvester Co., supra,* 142 Cal.App.3d at p. 161), applying conservative growth rates to past profits (see e.g., *Heiner v. Kmart Corp.* (2000) 84 Cal.App.4th 335, 341-42), and relying upon a plaintiff's past experience in operating similar enterprises (see, e.g., *S. Jon Kreedman & Co. v. Meyers Bros. Parking-Western Corp.* (1976) 58 Cal.App.3d 173, 185; *Lucky Auto Supply v. Turner* (1966) 244 Cal.App.2d 872, 883; 1 Dunn, Recovery of Damages for Lost Profits, *supra,* § 5, pp. 413-66).

As the trial court found, however, "Sargon's *historical performance played no role* in determining Mr. Skorheim's market projections, except to the extent that Sargon's data showed it had some sales." (Tr. Ct. Order 8-9, fn. 2 [21 AA 5335-36, fn. 2], italics

added.)[1] Instead, Skorheim projected Sargon's market share in 2009 based on his "market drivers" analysis and then worked backwards to determine supposed lost profits over the prior decade. (*Ibid.*)

Nor did Skorheim even use Sargon's actual historic revenues within his "drivers" analysis. He instead arbitrarily doubled Sargon's actual 1998 revenues of $1,748,612 (40 AA 10242) to $3,679,680 in opining that Sargon would have obtained a 1% market share within a year (40 AA 10248; 8 RT 608-11). Skorheim also disregarded Sargon's actual profit margin, which was 5.20% in 1997 and 5.76% in 1998. (Tr. Ct. Order 8 [21 AA 5335]; 40 AA 10243.) Instead Skorheim applied to Sargon the 30% profit margin enjoyed by Nobel and Strauman—the market leaders. (*Id.* at 8 [21 AA 5335]; 8 RT 614-16.)

Skorheim's departures from historical analysis in doubling Sargon's 1998 revenue base and predicting that its profit margins would increase six-fold from 1998-99 levels are even more

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[1] In deposition, Skorheim conceded that he did not use Sargon's "historical sales figures" or "financial results" other than for "background" because he did not "really see how that would be relevant." (13 AA 3307-13; 15 AA 3652-56.)

speculative than the expert testimony rejected as "entirely speculative" in *Berge v. International Harvester Co., supra,* 142 Cal.App.3d 152, 163. There, the Court of Appeal held that an expert's calculation of lost profits for a trucking business could not use the "average national net profit of owner-operators employing drivers" in place of a solo trucker's actual track record, as such a national average "had no relation whatsoever to [the plaintiff's] operation." (*Id.* at pp. 162-63.) The same is true of Skorheim's departure from historical analysis here.

B. Skorheim's Testimony Failed To Look To Comparable Companies

Experts can also determine lost profits with reasonable reliability by extrapolating from the experience of other comparable businesses, but only where there is "substantial similarity between the facts forming the basis of the profit projections and the business opportunity that was destroyed." (*Kids' Universe v. In2Labs, supra,* 95 Cal.App.4th at p. 886, citation omitted; see also *Berge v. International Harvester Co., supra,* 142 Cal.App.3d at pp. 162-63 [requiring evidence of "similar businesses operating under similar conditions"

such as "in the same area and with the same equipment"]; *Parlour Enterprises, supra,* 152 Cal.App.4th at p. 290 [requiring evidence of "profit and loss experience . . . sufficiently similar . . . to be relevant to the question of plaintiffs' alleged lost profits," citation omitted]; *Gerwin v. Southeastern Cal. Assn. of Seventh Day Adventists* (1971) 14 Cal.App.3d 209, 222 ["operating history" must be similar]; see also 3 Dobbs, Law of Remedies, *supra,* § 12.4(3), p. 73 [noting that "yardstick" evidence is most useful when, among other things, "the plaintiff's business bears a close comparison to another business which furnishes the yardstick" and "the products and services involved are standardized"].)

Where an expert calculates lost profits based upon the performance of a business that is *not* substantially similar, as here, that testimony is properly excluded as speculative and unreliable. (See, e.g., *Parlour Enterprises, supra,* 152 Cal.App.4th at pp. 290-91 [noting that expert testimony that used the performance of a large chain of ice cream parlor restaurants to calculate the profits lost by several small ice cream parlor restaurants was so speculative it

should have been excluded]. See generally 1 Dunn, Recovery of Damages for Lost Profits, *supra*, § 5.13, p. 447 ["[E]vidence of the experience of others will be excluded or held insufficient to support a judgment for plaintiff when plaintiff has failed to demonstrate comparability or to make all the computations necessary to adjust for noncomparability"].) In explaining that "speculative matters are not a proper basis for an expert's opinion," the Law Revision Commission's comments on section 801 specifically noted that an expert "may not base [an] opinion upon a comparison if the matters compared are not reasonably comparable." (Cal. Law Revision Com. com., *supra*, foll. § 801, p. 25 [citing *Roscoe Moss Co. v. Jenkins* (1942) 55 Cal.App.2d 369, pp. 379-80 [rejecting comparison between two water wells drilled nearby but in a different manner and to a different depth]; see also *Schonfeld v. Hilliard* (2d Cir. 2000) 218 F.3d 164, 171, 174 [rejecting comparisons between a proposed news network and established networks including CNN as lacking the requisite "high degree of correlation"].)

The trial court properly found Skorheim's comparison between Sargon and global dental implant market leaders unreliable. Sargon was a tiny start-up company that never had more than 15 or 20 employees (15 AA 3744-46; Tr. Ct. Order 10, fn. 4 [21 AA 5337, fn. 4]) and had never made over $101,000 in profits in any year (40 AA 10242-43; 44 AA 11428). The global market leaders, by contrast, had "employees in the thousands and budgets in the billions" that were "worlds apart from Sargon" by every objective business measure (Tr. Ct. Order 10 & fn. 4 [21 AA 5337 & fn. 4]):

Table 2
Comparison Between Sargon And The Industry Leaders

	Sargon ('98)	Astra Tech/ AstraZeneca ('99)	Dentsply ('98)	Biomet 3i ('00)	Nobel ('98)
Employees	<20	>55,000	>6,000	>4,000	>1,000
R&D Expenses	$46,000	$2,923,000,000	$18,200,000	$40,208,000	$8,741,808
Net Sales	$1,748,612	$18,445,000,000	$795,122,000	$920,582,000	$164,747,305
Net Profits	$101,113	$1,143,000,000	$34,825,000	$173,771,000	$5,868,080
Assets	$544,977	$19,816,000,000	$895,322,000	$1,218,448,000	$243,261,260
Market Share (2007)	N/A	4.8%	7%	17%	22-23%

(Slip Opn. 23.) For example, in 1998, the market leader Nobel had over 1,000 employees (50 times more than Sargon); $164 million in net sales (96 times more than Sargon); $8.7 million in research-and-development costs (190 times larger than Sargon); $243 million in

assets (486 times more than Sargon); and net profits of just under $6 million (58,000 times more than Sargon).[2] The disparity in financial resources with the other market leaders is even greater. Thus, "Skorheim could not identify any business metric, or any objective financial measure . . . that Sargon had in common with any of the 'big six'" in the dental implant industry. (Tr. Ct. Order 10, fn. 4 [21 AA 5337, fn. 4].) As the trial court aptly observed, "[t]he only thing these established companies have in common with Plaintiff is that they all sell or make dental implants." (*Id.* at p. 10 [21 AA 5337].)

The University is unaware of a single published decision holding admissible expert testimony that a tiny start-up would have grown into a market leader hundreds or thousands of times larger.[3] To the contrary, the only reported cases involving comparisons

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[2] Nobel's profits in 1998 were depressed by its $81 million acquisition of the leading U.S. dental implant manufacturer, Steri-Oss. (37 AA 9569, 9577, 9581, 9590.) By 2001, Nobel's profits were over $26 million. (37 AA 9697.)

[3] In *Sanchez-Corea v. Bank of America* (1985) 38 Cal.3d 892, relied upon by Sargon in the Court of Appeal (see AOB 51-52), expert lost profits testimony did not compare a start-up to a market leader, but rather used the performance of one of the plaintiff's competitors to confirm the validity of a three-year profit projection. (38 Cal.3d at p. 907.)

between start-ups and market leaders have rejected the comparisons. In *Parlour Enterprises*, for example, the plaintiff sought damages for interference with its attempt to open three ice cream parlor restaurants. (152 Cal.App.4th at pp. 285-86.) The plaintiff's expert calculated the lost profits for these restaurants based in part upon the profitability of "Friendly's," a chain of three hundred restaurants that likewise serve ice cream as well as other food. (*Id.* at p. 290.) The Fourth District held that the difference in size, location, sales, budgets and other business metrics made any comparison between the restaurants "so speculative" that the expert's testimony could not sustain the verdict and, indeed, noted that the trial court abused its discretion by not excluding the testimony. (*Id.* at p. 287; see also *id.* at p. 290 [noting the expert's "cursory description of Friendly's business model failed to establish its profit and loss experience is sufficiently similar to Farrell's to be relevant to the question of plaintiffs' alleged lost profits"].)

In finding *Palm Medical Group, supra,* 161 Cal.App.4th 206 "more on point than *Parlour Enterprises*" (Slip Opn. 30), the Court of

Appeal misconstrued those cases and improperly substituted its judgment for the trial court's. In *Palm Medical Group,* the trial court admitted expert lost profits testimony comparing companies of roughly similar size, not companies many orders of magnitude larger as in *Parlour* and this case. The plaintiff in *Palm Medical Group* was an occupational medical clinic that claimed lost profits when it was excluded from a preferred provider network. Its expert compared the plaintiff to other providers in the network within the same city, reasoning that the plaintiff "had the capacity to serve a similar volume of patients." (*Palm Medical Group, supra,* 161 Cal.App.4th at pp. 227-28.) Skorheim's testimony far more closely resembled the expert opinion deemed inadmissible in *Parlour Enterprises* than the opinion testimony that helped sustain the jury's award in *Palm Medical.*

The Court of Appeal also improperly substituted its judgment for the trial court's in holding that Sargon was reliably compared to Astra Tech, the industry leader with the smallest market share. The court noted that Astra Tech's sales and market share were only

about ten times greater than Sargon's. (Slip Opn. 30.) But ten times is a substantial difference in an industry with dozens of companies with a market share like Sargon's yet only five with a market share greater than Astra Tech. (5 RT K52:22-54:21; see also Hovenkamp, Federal Antitrust Policy (3d ed. 2005) p. 682 [noting yardstick method applies only "if the plaintiff's firm and the firm used for comparison stand in the same relative position" in the market].) Even more important, as the trial court recognized (Tr. Ct. Order 10-11 [21 AA 5337-38]), comparability should be based upon factors like size, budget, capitalization, and access to financing. By those measures, Astra Tech could not be more different than Sargon: while Sargon is a small start-up with limited resources, Astra Tech is part of AstraZeneca, a conglomerate which has nearly $20 billion in assets, annual revenues exceeding $18 billion, and annual profits exceeding $1.1 billion. (38 AA 9788, 9820, 9844-46.) Although for some unexplained reason the Court of Appeal apparently disagreed, the trial court plainly did not abuse its discretion in finding speculative a comparison between such vastly different businesses.

C. Skorheim Employed An Unprecedented "Market Driver" Hypothesis That Was Speculative And Failed To Assist The Jury

Expert opinion testimony is properly excluded where speculative or conjectural (see, e.g., *People v. McWhorter, supra,* 47 Cal.4th at pp. 361-62; *People v. Richardson, supra,* 43 Cal.4th at p. 1008) or lacking "the foundational predicate for admission of . . . expert testimony"—namely, the capacity to "assist the trier of fact to evaluate the issues it must decide" (*People v. Moore, supra,* 51 Cal.4th at p. 405, citation omitted; see also Evid. Code, § 801, subd. (a) [permitting expert opinions only if "[r]elated to a subject that is sufficiently beyond common experience that the opinion of an expert would assist the trier of fact"]). The trial court did not abuse its discretion in excluding Skorheim's testimony based upon its finding that his newly concocted "market drivers" hypothesis failed to meet either of these fundamental criteria.

Despite six days of testimony at the section 402 hearing, Skorheim failed to identify any economic or scientific basis for his hypothesis that relative "innovativeness" is the key "market driver" determining relative market share in the dental implant industry.

Skorheim testified that he relied only upon his ability to reach "financial conclusions based upon my experience, analyzing a lot of high technology fast paced environments" (8 RT 747:22-24; see also 8 RT 746:23-25) and to draw inferences from third-party research materials:

> [I]t's an oversimplification to say all I'm doing is parroting back to you what I read in the materials. I read that material. I rationalize the evidence, and I reach inferences about that as to how that evidence would impact the financial outcomes in the dental implant industry. ...
>
> I'm reaching inferences based upon my 30 years of experience, and I'm sharing with you based upon that what I believe to be the reasonably supported financial outcomes and prospects for Sargon had they not had their difficulties with USC.

(8 RT 748:9-749:24.)

As the trial court properly found, such conclusory testimony does not provide a reasonably reliable basis for an expert opinion. An expert opinion "unaccompanied by a reasoned explanation connecting the factual predicates to the ultimate conclusion . . . has no evidentiary value because an expert opinion is worth no more than the reasons upon which it rests." (*Dina v. People ex rel. Dept. of*

Transp. (2007) 151 Cal.App.4th 1029, 1049, citation omitted; see also *Eisenmayer v. Leonardt, supra,* 148 Cal. at p. 601 [excluding expert's calculation of the value of a would-be company's stock because expert failed to describe the facts on which the opinion was based].) The trial court did not abuse its discretion in finding that Skorheim's "market drivers" hypothesis lacked any reliable basis.

Nor did the trial court abuse its discretion in concluding that the "market driver" hypothesis failed to assist the jury. Skorheim projected Sargon's lost profits by estimating future market share based on relative level of innovativeness, but failed to offer any criteria for distinguishing "meaningful" from "substantial," "good" or "revolutionary" levels of "innovativeness," or for determining whether one company is more innovative than another. Indeed, Skorheim expressly disclaimed any goal or capacity to make these distinctions: "I'm not here to measure innovativeness. I'm not. I will agree with you on that, counsel." (8 RT 749:7-9; see also 13 AA 3326:13-20 ["Q. Is there some way you can help us quantify what a substantial competitive advantage is or—or give us some

understanding what that is? A. Again, I'm not a—I'm not a technician in this industry, so all I can offer is the information that's included in the materials that I've reviewed in reaching my conclusions."].)

Skorheim also failed to explain how the jury could possibly rank Sargon's innovativeness in relation to the leaders in the dental implant industry, given the variety of possible types and degrees of innovation in dental implant technology. For example, Straumann introduced single-stage implants (11 RT 1816:22-1817:21), surface treatments (6 RT 45:1-11), and a snap-on impression system (4 RT J75:19-78:6), while 3i innovated in prosthetic parts and surface treatments (11 RT 1818:12-1820:3) and Zimmer acquired innovations in an internal "hex" and an implant coating (11 RT 1820:4-26). As the trial court properly recognized:

> Some innovations may seem humdrum—say, seat belts or cupholders in automobiles—yet dramatically improve safety, convenience, and sales. Other innovations have pizzazz—say, a car that parallel parks itself—and yet may be too expensive or of too little utility to drive up sales.
>
> Here, if the market analysis were presented to the jury they would be called upon to 'rank' the innovativeness

> of Zimmer's hydroxyapatite coating to enhance healing, with Astra Tech's roughened surface treatment and 'MicroThread,' with Straumann's 'one-stage' process and 'SLA' design, with Dentsply's 'progressive Thread Design' and with Sargon's (alleged) 'immediate load' feature. That would be a meaningless exercise.

(Tr. Ct. Order 19 [21 AA 5346] [quoting 13 AA 3224:20-28].)

Instead, Skorheim left all these judgments about application of the "market drivers" hypothesis to the unguided discretion of the jury, stating that "the jury is going to have to wrestle with that tough issue." (8 RT 751:11-15.) Thus, as the trial court found, Skorheim gave "no rational standards for the jury to follow[]" in determining innovativeness and instead called for nothing but a "subjective and speculative response." (Tr. Ct. Order 18, 21 [21 AA 5345, 5348].)

D. Skorheim Lacked Qualifications In The Relevant Fields Of Expertise

Under the Evidence Code, an individual may testify as an expert only if that individual has "special knowledge, skill, experience, training, or education sufficient to qualify him [or her] as an expert on the subject to which [the individual's] testimony relates." (Evid. Code, § 720, subd. (a).) This special knowledge must

concern the particular subject of the expert's testimony. (See *People v. Watson* (2008) 43 Cal.4th 652, 692 [an expert's qualifications are "relative to the topic and fields of knowledge about which the person is asked to make a statement," citations omitted].) "Qualifications on related subject matter are insufficient." (*People v. Hogan* (1982) 31 Cal.3d 817, 852; see also *Korsak v. Atlas Hotels, Inc.* (1992) 2 Cal.App.4th 1516, 1523 ["[T]he courts have the obligation to contain expert testimony within the area of the professed expertise"].)

The trial court found that Skorheim lacked expertise in the dental implant industry or in the economics of innovation. Skorheim—an attorney, certified public accountant, certified valuation analyst, certified fraud examiner, and certified forensic accountant—has testified as an expert witness in numerous cases. (4 RT J12:5-10, 14:8-16:21; 13 AA 3238-3247.) But he has no expertise in the dental implant industry (13 AA 3276-77, 3285-86; 43 AA 11059; 4 RT J14:4-13), and admitted that he was "not a technologist" and lacked the expertise to draw any conclusions concerning

innovativeness. (Tr. Ct. Order 9, fn. 3, 17, 23 [21 AA 5336, fn. 3, 5344, 5350]; 13 AA 3342:12-18; 4 RT J33:10; 10A RT 23:6-24:10, 26:13-27:4.) Accordingly, the trial court did not abuse its discretion in excluding Skorheim's testimony for the additional reason that he lacks any expertise qualifying him to opine on innovativeness in the dental implant industry as a determinant of market share. (Tr. Ct. Order 22-26 [21 AA 5349-53].)

E. Skorheim Relied Upon Unsupported Factual Assumptions

As this Court has recognized, "an expert opinion may not be based upon assumptions of fact that are without evidentiary support." (*People v. Richardson, supra,* 43 Cal.4th at p. 1008, citation omitted.). Accordingly, "an expert's opinion based on assumptions of fact without evidentiary support . . . may be excluded from evidence." (*Dee v. PCS Property Management, Inc.* (2009) 174 Cal.App.4th 390, 404, citation omitted; *see also People v. Gardeley, supra,* 14 Cal.4th at p. 618 ["Like a house built on sand, the expert's opinion is no better than the facts on which it is based," citation omitted].) This is especially true where the opinion is based "upon a

multitude of assumptions that require speculation and conjecture." (*Schonfeld, supra,* 218 F.3d at 172, citations omitted.)

As the trial court properly found, Skorheim's opinion was based upon multiple assumptions without any factual basis. *First,* Skorheim assumed that, within a decade, Sargon's implant would be widely embraced by dental schools, by the graduates of those schools, and by veteran dentists. Indeed, Skorheim admitted that, for Sargon to achieve the growth he projected, the following contingencies would have to occur:

- 33 U.S. dental schools (59% of all U.S. schools) would adopt the Sargon implant and teach it to their students;
- 55 foreign dental schools (35% of all international schools) would do the same;
- 678 new graduates of the University's dental school graduates would begin using the Sargon implant in practice;
- 4,100 other new U.S. dental school graduates would begin using the Sargon implant in practice;
- 6,435 new international graduates would begin using the Sargon implant in practice;
- 16,492 veteran dentists would be trained and begin using the Sargon implant in practice; and

- each of these over 25,000 dentists would place over 100 implants a year and would use the Sargon implant 35% of the time they place implants.

(14 AA 3598-3649; 15 AA 3794-3802.) Skorheim had no evidentiary support for any of these assumptions, which the trial court aptly described as a "Field of Dreams" analysis. (Tr. Ct. Order 30 & fn. 13 [21 AA 5357 & fn. 13].)

Second, Skorheim assumed that Sargon would make a seamless transition in ten years from a small start-up with only a handful of employees into a multibillion dollar international corporation. (Tr. Ct. Order 28 [21 AA 5355].) Skorheim offered no evidence to support this assumption, but simply assumed, without support, that Sargon would invest in research and development and create innovative new products and coatings. (6 RT 41:18-42:8; Tr. Ct. Order 29 [21 AA 5356].)

Third, Skorheim assumed that the existing market leaders would not make any competitive response. Skorheim conceded that he was assuming that one of those leaders would "fall out of the top six and maybe be dissuaded from participating" in the industry

altogether (6 RT 40:7-25), but offered no basis for assuming that one of these companies would "just go quietly" and abandon its investment in the dental implant industry. (Tr. Ct. Order 29 [21 AA 5356].) Skorheim's failure to consider possible competitive reaction further supports the trial court's decision to exclude his testimony. (See, e.g., *Trademark Research Corp. v. Maxwell Online, Inc.* (2d Cir. 1993) 995 F.2d 326, 333 [finding claimed lost profits speculative in part because the plaintiff's accounting expert assumed competitors "would take no measures to counter [plaintiff's] ascendency"]; *Murphy Tugboat Co. v. Crowley* (9th Cir. 1981) 658 F.2d 1256, 1262-63 [holding assumption that competitor would not reduce prices in response to plaintiff's competition speculative].)

Fourth, Skorheim assumed that, if the University had issued a favorable report, 200 or more dentists would buy at least 20 more implants each, thereby doubling Sargon's profits in 1998. (Tr. Ct. Order 8, fn. 2 [21 AA 5335, fn. 2].) Although Sargon pointed to evidence that the release of a favorable report would have increased sales (ARB 50-53), it failed to point to any evidence justifying

Skorheim's assumption that sales would have doubled within a year—a growth rate that Skorheim admitted had never previously resulted from a clinical study. (13 AA 3317:24-3319:1.)

Fifth, Skorheim assumed that Sargon would increase its profit margins to the level of Nobel and Strauman, even though its actual "keep" factor was six times lower than theirs. (Tr. Ct. Order 8 [21 AA 5335].) Skorheim failed to explain how the cost structure of these companies, which were many times larger than Sargon, was comparable, much less why he assumed that Sargon would enjoy the same profit margin immediately.

This cascading series of unfounded assumptions makes Skorheim's testimony unreliable for reasons similar to those found in *Kids' Universe,* which rejected as "rife with speculation" the plaintiff's expert's assertion that an Internet toy retailing start-up would have become a market leader but for a flood of the toy store. (*Kids' Universe v. In2Labs, supra,* 95 Cal.App.4th at pp. 887-88.)

III. TRIAL COURTS SHOULD BE AFFORDED DISCRETION TO EXCLUDE UNRELIABLE EXPERT OPINION TESTIMONY ON LOST PROFITS

The Evidence Code entrusts trial courts with primary responsibility for ensuring that expert opinion testimony is reasonably reliable, and, as Justice Johnson emphasized in his dissent, trial courts are in the best position to apply those restrictions accurately and efficiently. If the meticulous decision of the trial court in this case after an extended evidentiary hearing is deemed an abuse of discretion, then such an appropriate role for the trial courts would be all but destroyed.

A. The Evidence Code Supports A Strong Gatekeeping Role For Trial Courts

The Evidence Code explicitly entrusts trial courts with responsibility for determining the admissibility of expert testimony. Before an expert opinion may be offered, "[t]he judge must be satisfied that the proposed witness is an expert." (Cal. Law Revision Com. com., *supra,* foll. § 720, p. 316.) If challenged, a witness's qualifications "must be shown before the witness may testify as an expert." (Evid. Code, § 720, subd. (a).) Similarly, trial courts may

require experts to disclose the reasons for their opinions and the matter upon which the opinion is based (*id.*, § 802), and if there is an objection to an expert's testimony, trial courts are required to exclude any opinion "that is based in whole or in significant part on matter that is not a proper basis for such an opinion" (*id.*, § 803; see also Imwinkelried & Faigman, *Evidence Code Section 802: The Neglected Key to Rationalizing the California Law of Expert Testimony* (2009) 42 Loy. L.A. L. Rev. 427, 440-42 [authority to restrain unreliable expert testimony is implicit in section 802]).

As this Court has recognized, trial courts have long enjoyed broad discretion in exercising this gatekeeping role over the reliability of expert testimony. "The qualification of expert witnesses, including foundational requirements, rests in the sound discretion of the trial court." (*People v. Ramos, supra,* 15 Cal.4th at p. 1175.) Moreover, this discretion is "necessarily broad" because an expert's qualifications depend upon the particular subject of the expert's opinion, and therefore "[a]bsent a manifest abuse, the court's determination will not be disturbed on appeal." (*Ibid.*) "It is

for the trial court to determine, in the exercise of a sound discretion, the competency and qualification of an expert witness to give his opinion in evidence, and its ruling will not be disturbed on appeal unless a manifest abuse of that discretion is shown." (*Miller v. Los Angeles Flood Control Dist.* (1973) 8 Cal.3d 689, 701 [citation and quotation marks omitted].) Similarly, "[i]t is settled that a trial court has wide discretion to exclude expert testimony ... that is unreliable." (*People v. McWhorter, supra,* 47 Cal.4th at p. 362 [excluding testimony as "unduly speculative"].) Accordingly, a trial court's ruling on the admissibility of an expert's testimony will not be disturbed unless the trial court "exercised its discretion in an arbitrary, capricious, or patently absurd manner that resulted in a manifest miscarriage of justice." (*People v. Lewis* (2009) 46 Cal.4th 1255, 1286, citations omitted.)

As Justice Johnson recognized in his dissent, this discretion is well-founded. Trial courts are properly entrusted with discretion over determinations involving facts that are "endlessly variable," and it is therefore "not possible to devise a rule of law or a principle

of decision to cover any group of situations." (Dis. Opn. 2, quoting Rosenberg, *Appellate Review of Trial Court Discretion* (1978) 79 F.R.D. 173, 181.) That is the situation here: because "the subjects upon which expert testimony may be received are too numerous to make statutory prescription a feasible venture," section 801 "formulate[s] a general rule" that "leav[es] to the courts the task of determining particular detail within this general framework." (Cal. Law Revision Com. com., *supra*, foll. § 801, p. 26.) Moreover, trial courts have the opportunity to observe and examine the expert in section 402 hearings like the one conducted in this case. (See *Noonan v. Cunard Steamship Co.* (2d Cir. 1967) 375 F.2d 69, 71 (opn. of Friendly, J.).)

B. A Strong Gatekeeping Role For Trial Courts Facilitates The Fair And Efficient Conduct Of Civil Litigation

In holding that the shortcomings in Skorheim's testimony identified by the trial court were "better left for the jury's assessment," (Slip Opn. 19, 31, quoting *Heiner v. Kmart Corp.* (2000) 84 Cal.App.4th 335, 347), the Court of Appeal effectively required the trial court to abandon any gatekeeping function. Affirming this approach would undermine the fair and efficient conduct of civil

litigation and would remove a significant check on error and injustice.

By definition, expert testimony concerns issues that are beyond the common knowledge of jurors. (Evid. Code, § 801, subd. (a).) As Judge Friendly observed, "a jury's common sense is less available than usual to protect it" against unreliable expert testimony. (*Herman Schwabe, Inc. v. United Shoe Machinery Corp.* (2d Cir. 1962) 297 F.2d 906, 912.) This is particularly true with expert opinions concerning lost profits because of the "delusive impression of exactness" that an array of figures can convey. (*Ibid.*; see also Tomlin & Merrell, *The Accuracy and Manipulability of Lost Profits Damages Calculations: Should the Trier of Fact Be "Reasonably Certain?"* (2006) 7 Tenn. J. Bus. L. 295, 298 [noting the tendency of jurors to favor simple methods of calculation].) Even when cross-examination discloses the defects in expert testimony, jurors often accept the testimony anyway and render excessive verdicts. (See, e.g., Lloyd, *Proving Lost Profits After* Daubert: *Five Questions Every*

Court Should Ask Before Admitting Expert Testimony (2007) 41 U. Rich. L.Rev. 379, 381-85 [collecting examples].)

Moreover, lost profits projections are easy to manipulate (see, e.g., Tomlin & Merrell, *supra,* 7 Tenn. J. Bus. L. at pp. 304-06, 314-15; Hill et al., *Increasing Complexity and Partisanship in Business Damages Expert Testimony: The Need for a Modified Trial Regime in Quantification of Damages* (2009) 11 U. Penn. J. Bus. L. 297, 358-65), and experts often give in to the temptation to do so (see PriceWaterhouseCoopers, Daubert *Challenges to Financial Experts: A Ten-Year Study of Trends and Outcomes 2000-2009* at pp. 6-7 [finding that 45% of motions to exclude financial experts succeed in whole or in part]; see also Weinstein, *Improving Expert Testimony* (1986) 20 U. Rich. L.Rev. 473, 482 ["An expert can be found to testify to the truth of almost any factual theory, no matter how frivolous."]). Such manipulation can be checked only by a strong role for trial courts in excluding such testimony. (See Posner, *The Law and Economics of the Economic Expert Witness* (Spring 1999) 13 J. Econ. Persp. 91, 93-94; Tomlin & Merrell, *supra,* 7 Tenn. J. Bus. L. at p. 304.)

If trial courts were deprived of discretion to screen out speculative and unreliable expert opinion testimony on lost profits at the outset, there would be several adverse consequences for civil litigation. *First,* the threat of massive verdicts based on hyperinflated lost profits testimony like Skorheim's would deter many defendants from risking trial and force them to accept "blackmail settlements" worth much more than the plaintiff's actual damages. (See Letter from Washington Legal Foundation as Amicus Curiae Supporting Petition for Review, April 12, 2011, at p. 5.) A billion-dollar verdict such as the one Skorheim was prepared to support here would cripple (and often bankrupt) all but a handful of the largest corporations. (*Ibid.*) Even a small risk that a jury would award such an amount is enough to force many defendants to settle. (H. Friendly, Federal Jurisdiction: A General View (1973) p. 120; *Castano v. American Tobacco Co.* (5th Cir. 1996) 84 F.3d 734, 746.)

Second, admission of unreliable and inflated expert testimony on lost profits would increase the burden and cost of litigation even if defendants forego settlement and proceed to trial. Such testimony

forces defendants to spare no expense in seeking to discredit the expert in order to avoid potentially staggering judgments.

Third, the admission of unreliable and inflated expert testimony on lost profits would increase burdens on the already scarce resources of the court system. If plaintiffs were free to present speculative and inflated lost profits testimony, they would insist on going to trial more frequently and would demand more time for those trials. And, if evaluation of unreliable expert testimony were deferred until after trial, post-trial proceedings and appeals would be lengthier and more hotly contested as well.

Fourth and finally, permitting start-up companies to claim lost profits based on speculative and unreliable expert opinion testimony ultimately would harm research and innovation in the State. Research universities would be loath to incubate and test the products of start-ups if they could be sued by them for gargantuan sums for the slightest reporting deficiency. And established businesses would be wary of contracts with start-ups if those contracts could become "ticket[s] in a litigation lottery." (*Moore v.*

Regents of the University of California (1990) 51 Cal.3d 120, 146.) The Evidence Code should not be distorted to allow start-up companies to make unsubstantiated claims that, but for a contractual breach, they would have become the next Google—thereby avoiding the risks, costs, and sacrifices that most entrepreneurs must shoulder.

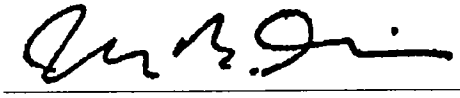
As *amicus* American Council on Education points out, the adverse effect on university partnerships and contracts with start-up companies will be especially great. (Letter from American Council on Education as Amicus Curiae Supporting Petition for Review, April 11, 2011, at pp. 4-5.) The objective clinical testing provided by universities is especially important for new, cutting-edge technologies. But if such testing were to subject universities to potentially limitless liability that would cripple their ability to accomplish their main educational missions, universities would be less willing to accept this risk, with attendant harm to public-private partnerships that historically have proved so useful in encouraging the development of new businesses in this State.

For all these reasons, the trial courts should continue to be afforded broad discretion to exclude unreliable expert testimony.

CONCLUSION

The judgment of the Court of Appeal should be reversed and the trial court's judgment reinstated.

DATED: June 24, 2011 Respectfully submitted,



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CERTIFICATE OF COMPLIANCE

(Cal. Rules of Court, rule 8.204)

Pursuant to California Rule of Court 8.204, the foregoing Opening Brief On The Merits is double spaced and printed in proportionally spaced 13-point Palatino Linotype typeface. It is 60 pages long and contains 10,784 words (excluding the tables, this certificate, and the proof of service). In preparing this certificate, I relied upon the word count generated by Microsoft Word 2003.

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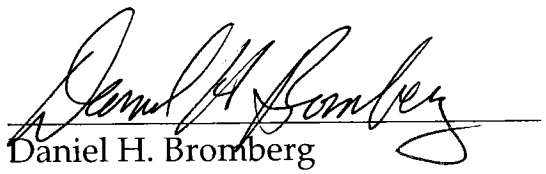

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PROOF OF SERVICE

I am employed in the County of San Mateo, State of California. I am over the age of eighteen years and not a party to the within action; my business address is 555 Twin Dolphin Drive, 5th Floor, Redwood Shores, California 94065-2139.

On June 24, 2011, I served true copies of the foregoing document described as **OPENING BRIEF ON THE MERITS** on the interested parties in this action as follows:

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I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

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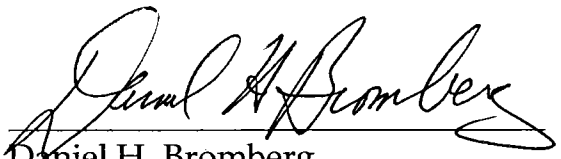

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