

# **DAMAGES IN A COMMERCIAL CONTEXT**

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## DAMAGES IN A COMMERCIAL CONTEXT

### I. INTRODUCTION

Courts and practitioners frequently struggle with the appropriate standards of recoverable damages in commercial litigation cases. While terms such as “lost profits,” and “benefit-of-the-bargain” are used frequently to describe damages, it is not always clear precisely what is included within these elements of damages. In addition, the remedies and damages available in commercial litigation are broad and vary with the circumstances of the particular case.

This paper does not purport to encompass every available remedy in commercial litigation. That subject could be the topic of an entire seminar unto itself. Accordingly, non-monetary sanctions or other non-monetary equitable remedies are not addressed in this paper. Similarly, damages available under the Texas Deceptive Trade Practices Act are excluded from this paper.

The scope of this paper is to provide the reader with the recognized damages recoverable for a collection of causes of action regularly pled in commercial litigation. The paper also examines the evidence necessary to establish or defeat a party’s right to recovery of commercial damages.

The paper is organized by specific causes of action and discusses the damages that are available through the common law or various statutes governing each cause of action. Additionally, the paper discusses in depth lost profits and punitive damages in commercial litigation.

### II. BREACH OF CONTRACT

#### A. General Damages v. Special Damages

Monetary damages for breach of contract are characterized either as general or special damages. *See Nobility Homes of Texas, Inc. v. Shivers*, 557 S.W.2d 77, 78 n.1 (Tex. 1977). “General” or “direct” damages naturally and necessarily flow from a wrongful act and are conclusively presumed to be a foreseeable consequence of a breach of contract or wrongful act. *See First Nat’l Bank of Hico v. English*, 240 S.W.2d 503, 507 (Tex. Civ. App.—Waco 1951, no writ). Direct damages are imposed by law whether within the contemplation of the parties or not. *See American Bank of Waco v. Thompson*, 660 S.W.2d 831, 834 (Tex. App.—Waco 1983, writ ref’d n.r.e.).

“Special damages,” on the other hand, are those “injurious consequences which are not deemed as a matter of law to have been foreseen, but which are shown as a matter of fact to have been contemplated or anticipated by the defendant.” *English*, 240 S.W.2d at 507 (citation omitted). These damages are also referred to as “incidental” or “consequential” damages. RESTATEMENT (SECOND) OF CONTRACTS § 347(b) (1981). Special damages cover losses other than the value of the breaching party’s performance, which arise naturally, although not necessarily, from the

other party’s breach. *Stuart v. Bayless*, 964 S.W.2d 920, 921 (Tex. 1998).

#### B. Pleading Damages

The mere allegation of a breach or other wrongdoing in a plaintiff’s petition is generally sufficient notice of general damages. *Sherrod v. Bailey*, 580 S.W.2d 24, 28 (Tex. Civ. App.—Houston [1st Dist.] 1979, writ ref’d n.r.e.). Special damages must be specifically pled because they vary with the circumstances of each case. TEX. R. CIV. P. 56; *Sherrod*, 580 S.W.2d at 28. Plaintiff’s counsel should therefore plead all elements of special damages with sufficient particularity in order to provide fair notice to the defendant. *Sherrod*, 580 S.W.2d at 28. Conversely, defense counsel should be mindful of a plaintiff’s pleadings and should specially except to a general prayer for damages. Defendants must also timely assert objections to the admission of evidence at trial on an issue of special damages that are not specifically requested in the plaintiff’s pleadings.

Otherwise, the issue may be tried by consent, and the plaintiff may submit the special damage issues to the jury. TEX. R. CIV. P. 67; *Sage St. Assoc. v. Northdale Const.*, 863 S.W.2d 438, 445 (Tex. 1993), *rev’d on other grounds*, 937 S.W.2d 425 (Tex. 1996).

#### C. Proving Damages

A plaintiff must prove that the contract damages were proximately caused by the breach. Similar to a tort action, “proximate cause” is made up of cause in fact and foreseeability.

##### 1. Cause in Fact

A plaintiff seeking breach of contract damages must establish that the damages sought resulted from the defendant’s breach, and would not have occurred “but for” the breach. The evidence must show that the damages are a natural, probable, and foreseeable consequence of the defendant’s conduct. *Mead v. Johnson Group, Inc.*, 615 S.W.2d 685, 687 (Tex. 1981). A plaintiff who is unable to meet this burden cannot recover damages.

For example, in *Nelson Cash Register v. Data Terminal Sys., Inc.*, 671 S.W.2d 594 (Tex. App.—San Antonio 1984, no writ), the plaintiff was a franchisee of Data Terminal Systems (“DTS”). *Id.* at 596. When plaintiff’s contract with DTS expired, the parties formed a new contract which substantially increased the plaintiff’s sales quota. *Id.* The plaintiff alleged that DTS began a campaign to put the plaintiff out of business by furnishing faulty equipment, failing to adequately train plaintiff’s personnel, and other similar conduct. *Id.* at 596-97. Based upon these actions, the plaintiff sued DTS under both contract and tort theories. *Id.* at 597. The plaintiff testified as to his belief that DTS’s breach caused a diminution in value to his business. *Id.* at 600. Only the contract issue was submitted to the jury, and the jury awarded damages to the plaintiff. *Id.* at 598. The court of appeals reversed the damages award, and concluded

that actual damages may be recovered in a breach of contract action *only when* there is a causal connection between the alleged breach and the damages resulting therefrom. *Id.* at 600. The court held there was insufficient evidence that the breaches found by the jury caused the damage to plaintiff's business. *Id.* Instead, the court found that the preponderance of the evidence showed that the permissible cancellation of the contract was the cause of the diminution in value of the plaintiff's business. *Id.*

Similarly, in *Prudential Sec., Inc. v. Haugland*, 973 S.W.2d 394, 395-96 (Tex. App.—El Paso 1998, pet. denied), the plaintiff sought damages from an alleged breach of a settlement agreement. In the settlement agreement, the parties expressly agreed to keep the terms of the agreement confidential unless disclosure was required by law. The defendant subsequently filed a Form 1099-Misc. with the Internal Revenue Service disclosing the amount of the settlement payment made to the plaintiff. *Id.* at 396. The plaintiff did not report the settlement as income and did not pay any applicable tax. *Id.* After the Internal Revenue Service assessed a deficiency, the plaintiff sued the defendant alleging breach of contract. *Id.* In denying the plaintiff relief, the court held that the plaintiff bore the burden of proving causation, and the plaintiff failed to prove the payment was not to be included in its gross income. *Id.* at 398. Thus, the plaintiff failed to sustain its burden of proof on causation and was barred from recovery. *Id.*

## 2. Foreseeability

Any natural and probable consequence of a defendant's conduct that a trier of fact may find to have been within the contemplation of the parties at the time the contract was made is a foreseeable, and therefore compensable, injury. One of the earliest cases discussing foreseeability of contract damages is *Hadley v. Baxendale*, 9 Exch. 341 (1854) in which the English court wrote:

Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.

A majority of American jurisdictions have adopted the Hadley Rule. RESTATEMENT (SECOND) OF CONTRACTS § 365 (1981); 5 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 1007 (1964).

The concept of "foreseeable" damage continues to evolve. For example, early Texas law barred damages for

loss of credit on the basis that such damages were too speculative or remote to be an element of actual damages. *See, e.g., Sterling Projects, Inc. v. Fields*, 530 S.W.2d 602, 605 (Tex. Civ. App.—Waco 1975, no writ), *overruled by Mead*, 615 S.W.2d at 688. Subsequently, the Texas Supreme Court explained that this view arose from a line of cases decided during and before the Great Depression. *Mead*, 615 S.W.2d at 688. At that time, most commercial transactions were conducted in cash. *Id.* The *Mead* court reasoned that in today's economy one's ability and freedom to enter into various commercial transactions depends upon one's credit rating. *Id.* Because it is conceivable that in today's society loss of credit could be contemplated by parties entering into a contract, such damages are now available upon proper proof. *Id.*

## 3. Certainty

Contract damages must be proven with sufficient certainty to allow a trier of fact to compute the appropriate amount of damages. This does not mean that all damages must be proven with mathematical certainty. *Wilfin, Inc. v. Williams*, 615 S.W.2d 242, 244 (Tex. Civ. App.—Dallas 1981, writ ref'd n.r.e.). A jury must simply be able to determine the appropriate damages with reasonable certainty. *Id.* at 244.

In *Wilfin*, a general contractor was sued for breach of a landscape contract. *Id.* at 243. The contractor offered only his own testimony as to the amount of profits he expected to make on the job. *Id.* at 244. He testified that he had been in the landscape business for over thirteen years and offered specific details about other jobs he had done, including jobs for the adverse party, both before and after the contract at issue. *Id.* The contractor testified that he received approximately one-third of the cost of a bid as profit. *Id.* The particular job at issue was bid at \$25,090, and the jury awarded the contractor \$8,000 for lost profits without proof of estimated costs. *Id.* Because the contractor's testimony was direct, positive, uncontroverted, and admitted without objection, the evidence was sufficient to support the award. *Id.* at 245.

Damages may not be recovered if they are too speculative and cannot be determined with reasonable certainty. *Southwest Battery Corp. v. Owen*, 115 S.W.2d 1097, 1099 (Tex. 1938). The determination as to what constitutes "reasonable certainty" depends on the facts and circumstances of each case. *Texas Instruments, Inc. v. Teletron Energy Mgmt., Inc.*, 877 S.W.2d 276, 279-80 (Tex. 1994) (citing *Southwest Battery*, 115 S.W.2d at 1098-99). Nonetheless, a party who breaches a contract cannot escape liability merely because it is impossible for the plaintiff to prove a perfect measure of damages. *Southwest Battery Corp.*, 115 S.W.2d at 1099. A distinction exists between uncertainty as to the amount of damages and uncertainty as to the existence of damages. *Id.* Uncertainty as to the existence of damages is fatal to recovery, but uncertainty as to the amount of damages will not defeat recovery. *Id.* The

rationale supporting the rule is that a breaching party should not escape liability because it is impossible for the non-breaching party to state or prove a perfect measure of damages resulting from the breach. *See Eastman Kodak Co. v. Southern Photo Materials Co.*, 273 U.S. 359, 379 (1927).

If a plaintiff produces the best evidence available and it is sufficient to prove a reasonable basis for determining the loss, the plaintiff should not be denied recovery solely because an exact amount of damages cannot be ascertained.

*Vance v. My Apartment Steak House of San Antonio, Inc.*, 677 S.W.2d 480, 484 (Tex. 1984). Instead, the amount of damages is fixed by the court or jury in the exercise of sound discretion and under proper instructions from the court. *Id.* (finding that where evidence raised question of fact as to costs of repair, jury should have been permitted to determine what repairs were necessitated by breach of contract). *See also Texas Sanitation Co. v. Marek*, 381 S.W.2d 710, 715-17 (Tex. Civ. App.—Corpus Christi 1964, no writ) (upholding jury’s answer to damage issue as supported by evidence).

#### D. Benefit-of-the-bargain

The universal rule for measuring damages for the breach of a contract is just compensation for the loss or damage actually sustained. *Stewart v. Basey*, 245 S.W.2d 484, 486 (Tex. 1952). Under this approach, a party should be awarded “neither less nor more than his actual damages.”

*Id.* Normally, however, this approach does not limit recovery to a non-breaching party’s out-of-pocket losses. Instead, the plaintiff is given his or her “benefit-of-the-bargain,” or “expectation interest,” thereby placing the plaintiff in as good a position as if the defendant had fully performed. *See Chicago, Milwaukee & St. Paul Ry. Co. v. McCaull-Dinsmore Co.*, 253 U.S. 97, 100 (1920); *R. G. McClung Cotton Co. v. Cotton Concentration Co.*, 479 S.W.2d 733, 738 (Tex. App.—Dallas 1972, writ ref’d n.r.e.); RESTATEMENT (SECOND) OF CONTRACTS § 347(a) (1981). *See also Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 817 (Tex. 1997) (defining the out-of-pocket and benefit-of-the-bargain measures of recovery).

##### 1. Service Contracts

###### a. Real Property Services

If a party contracts for services, the appropriate measure of damages for breach generally is the reasonable cost of the expected performance. *P.G. Lake, Inc. v. Sheffield*, 438 S.W.2d 952, 956 (Tex. App.—Tyler 1969, writ ref’d n.r.e.).

In building and construction contracts, the cost of repair or completion is the general measure of damages. *Rogowicz v. Taylor & Gray, Inc.*, 498 S.W.2d 352, 354-55 (Tex. Civ. App.—Tyler 1973, writ ref’d n.r.e.) (finding where correction of defects and deviations would not impair the structure as a whole, remedial cost is appropriate measure of damages). Should an award of the cost of repair involve unreasonable economic waste or threaten to impair

the structure as a whole, a different measure of damages should be used. *Hutson v. Chambliss*, 300 S.W.2d 943, 945 (Tex. 1957). *See Turner, Collie & Braden, Inc. v. Brookholow, Inc.*, 642 S.W.2d 160, 164 (Tex. 1982). In *Hutson*, the plaintiff contracted for the building of a house. After the building was constructed, he sued the contractor for breach of contract alleging various defects in the building and deviations from the terms of the contract. *Hutson*, 300 S.W.2d at 944. The court found that repair of the structure would require expenditures of large sums of money and exhaustive repairs, including rebuilding of the foundation. *Id.* at 946. The court held, therefore, that the appropriate measure of damages was the difference in value of the house as constructed and its value had it been constructed according to the contract. *Id.*

The unreasonableness of costs of repair is an affirmative defense. *P.G. Lake, Inc. v. Sheffield*, 438 S.W.2d 952, 956 (Tex. Civ. App.—Tyler 1969, writ ref’d n.r.e.). *Sheffield* involved an oil and gas lessee’s agreement to restore the lessor’s land to its original condition after drilling. *Id.* at 954. After drilling on the plaintiff’s land, the lessee failed to make any repairs to the land. *Id.* The lessor sued for breach of contract, and the jury awarded the cost of the lessor’s repairs. *Id.* The lessee appealed, arguing that the cost of repair exceeded the market value of the land damaged; therefore, an award of the cost of repair would result in economic waste. *Id.* at 955. The lessee further argued that lessor’s damages should have been limited to the diminution in the market value of the land caused by lessee’s breach. *Id.* The court recognized that allowing the lessor its cost of repair would be reasonable only if it was “possible and d[id] not involve unreasonable economic waste.” *Id.* at 956 (citation omitted). Nonetheless, the court held that minimization of damages is an affirmative defense which must be raised by pleadings and supported by proof. *Id.* Because the defendant failed to plead and prove the diminution in value to the plaintiff’s land, the court upheld the cost of repair damages awarded to plaintiff despite the resulting economic waste. *Id.*

###### b. Personal Services

In cases where a plaintiff is the seller of services, the usual measure of recovery will be the contract price that the buyer agreed to pay. However, there are several ways for buyers to limit their liability, including the doctrine of mitigation of damages. For example, damages for breach of an employment contract is the present cash value of the contract if it had not been breached, reduced by any amount the plaintiff-employee earned or should, in the exercise of reasonable diligence, have earned through other employment. *Gulf Consol. Int’l, Inc. v. Murphy*, 658 S.W.2d 565, 566 (Tex. 1983). Similarly, breach of a construction contract, resulting from the owner refusing to allow the builder to complete the work, entitles the builder to recover the contract price less what would have been the cost to the builder of completing the work. *Vance v. My Apartment*

*Steak House of San Antonio, Inc.*, 677 S.W.2d 480, 482 (Tex. 1984).

c. Substantial Performance

Defects in a plaintiff's performance may also reduce recovery under the doctrine of substantial performance. Generally, a party to a contract may not enforce the contract or recover damages for its breach unless the plaintiff's obligations have been performed under the contract. *Carr v. Norstok Bldg. Sys., Inc.*, 767 S.W.2d 936, 941 (Tex. App.—Beaumont 1989, no writ). Any such recovery will be reduced, however, by the costs of remedying the defects in the plaintiff's performance. *Id.* at 940.

2. Sales Contracts

a. Seller's Breach

The Uniform Commercial Code ("UCC") governs damages recoverable upon breach of a contract for the sale of goods. TEX. BUS. & COM. CODE ANN. § 2.102 (Vernon 1994). "Where the U.C.C. applies, it displaces all common law rules of law regarding breach of contract and substitutes instead those rules of law and procedure set forth in the U.C.C." *Glenn Thurman, Inc. v. Moore Constr., Inc.*, 942 S.W.2d 768, 771 (Tex. App.—Tyler 1997, no writ). *Accord Bacchus Indus., Inc. v. Frontier Mech. Contractors*, 36 S.W.3d 579, 585 (Tex. App.—El Paso 2000, no pet.).

When a seller of goods repudiates a contract, fails to make delivery, or delivers goods that may be justifiably rejected by the buyer, the buyer may recover the purchase price already paid, if any. TEX. BUS. & COM. CODE ANN. § 2.711(a). Texas UCC does not require that a buyer of nonconforming goods rework or re-fabricate the goods to make them conform to the original contract. *Aztec Corp. v. Tubular Steel, Inc.*, 758 S.W.2d 793, 800 (Tex. App.—Houston [14th Dist.] 1988, no writ). On proper proof, the buyer also may be entitled to recover consequential and incidental damages. TEX. BUS. & COM. CODE ANN. §§ 2.714-.715.

In *Wilson v. Hays*, 544 S.W.2d 833, 834 (Tex. Civ. App.—Waco 1976, writ ref'd n.r.e.), the plaintiff was engaged in the business of selling used building materials. The defendant, who was demolishing a building, contracted to sell the plaintiff 600,000 used bricks at a price of one cent per brick. *Id.* Prior to delivery, the plaintiff paid the defendant the full contract price of \$6,000. *Id.* The defendant then delivered only 400,000 bricks to the plaintiff. *Id.* The trial court awarded the plaintiff damages, including lost profits. *Id.* The appellate court reviewed the applicable damage provisions of the Texas UCC and held that under section 2.711, the plaintiff was entitled to recover: (1) "so much of the price as has been paid;" and (2) damages for "non-delivery or repudiation" under section 2.713. *Id.* at 835. Damages under section 2.713 are referred to as "cover." Cover allows an injured party to receive the difference between the cost of purchasing similar goods (at or within a reasonable time from the time of breach) and the

contract price of the goods not received by the injured party. See TEX. BUS. & COM. CODE ANN. § 2.712.

As the plaintiff had paid \$2,000 for 200,000 bricks he never received, he was awarded the return of the \$2,000. *Wilson*, 544 S.W.2d at 836. Additionally, at the time of the breach, the cost of cover was five cents per brick. *Id.* at 834. The appropriate measure of damages under Texas UCC sections 2.711 and 2.713 equaled the market price of the replacement brick (\$10,000), less the contract price of \$2,000, or \$8,000. *Id.* at 836.

The *Wilson* court did not allow the plaintiff to recover consequential damages in the form of lost profits as there was no evidence that the plaintiff attempted to prevent or mitigate his loss. *Id.* "Consequential damages" include any loss which could not reasonably be prevented by cover or otherwise. TEX. BUS. & COM. CODE ANN. § 2.715(b). The burden of proof regarding consequential damages is on the buyer, and there was no evidence introduced to support a jury award of consequential damages. *Wilson*, 544 S.W.2d at 836.

Where it is possible for a party to obtain cover at a price equal to or lower than that stated in the contract, the party has sustained no loss by the breach. See *Hickey v. Perkins Dry Goods Co.*, 229 S.W. 951, 954 (Tex. Civ. App.—Galveston 1921, no writ). The costs of cover are considered an item of general damages. *Hess Die Mold, Inc. v. American Plast-Plate Corp.*, 653 S.W.2d 927, 929 (Tex. App.—Tyler 1983, no writ). Allegations or findings that such damages were foreseeable to the breaching party are therefore not necessary, as general damages are deemed foreseeable. *Id.*

A non-breaching party need not show the market price of the goods if the non-breaching party elects its "cover" remedy. Where a buyer complies with the requirements of Texas UCC section 2.712, the buyer's purchase price is presumed proper and the burden of proof is on the seller to demonstrate that the cover was not properly obtained. *Laredo Hides Co., Inc. v. H & H Meat Prod. Co., Inc.*, 513 S.W.2d 210, 221 (Tex. Civ. App.—Corpus Christi 1974, writ ref'd n.r.e.).

For example, in *Mueller v. McGill*, 870 S.W.2d 673, 674 (Tex. App.—Houston [1st Dist.] 1994, writ denied), the plaintiff entered a written contract to purchase a new 1985 Porsche from the defendant. After executing the contract, the plaintiff learned that the contract was a "back up," as the car was the subject matter of an existing contract. *Id.* Prior to the promised delivery and payment, the defendant sold the car under the first contract. *Id.* The defendant and the plaintiff attempted to locate another 1985 Porsche for several months, but neither of them was successful. *Id.* At that point, the defendant offered to sell the plaintiff a 1986 model, but insisted upon renegotiating the terms of the sale. *Id.* The plaintiff refused, bought a 1986 Porsche from a different dealer, and brought suit against the defendant for breach of contract. *Id.* at 675. Pursuant to the Texas UCC, the plaintiff sought to recover the difference in price for the

substitute goods (the 1986 model) and the contract price for the 1985 model. *Id.* at 675. The trial court found, however, that the plaintiff failed to introduce any evidence to establish the market price of the 1985 car at the time of the breach, and therefore granted a directed verdict for defendant. *Id.*

The appellate court found that the plaintiff had two options in light of the defendant's breach. *Id.* at 676. First, the plaintiff could "cover" by purchasing substitute goods, in good faith and without unreasonable delay. *Id.* See also TEX. BUS. & COM. CODE ANN. §§ 2.712-.713. Second, the plaintiff could elect to recover the difference between the contract price and the market price at the time he learned of the breach. *Mueller*, 870 S.W.2d at 675. See also TEX. BUS. & COM. CODE ANN. § 2.713. Because the plaintiff elected to "cover," he was not required to show the market price at the time of the breach. *Mueller*, 870 S.W.2d at 675-76. Holding that the issue of whether the purchase of the 1986 model was done in good faith was a question for the jury, the court reversed and remanded the case. *Id.* at 676.

A buyer who elects not to "cover" a loss may recover the difference between the market value of the goods described in the contract and the contract price for those goods. TEX. BUS. & COM. CODE ANN. §§ 2.711(a)(1), 2.713. In the event that goods which do not satisfy the specifications in the contract are delivered, and the buyer accepts the non-conforming goods, the buyer's damages will be the difference between the goods as delivered and the value of the goods had they met the specifications of the contract. *Id.* § 2.714.

#### b. Buyer's Breach

Where a buyer breaches a contract to buy goods, the buyer is liable for the difference between the contract price and the market value of the goods or property at the time of the breach. TEX. BUS. & COM. CODE ANN. § 2.708(a). Should the difference in price fail to place the seller in as good a position as if the contract had been performed, the seller may recover profits that might have been made upon performance, together with incidental damages. TEX. BUS. & COM. CODE ANN. § 2.708(b); *Community Dev. Serv. v. Replacement Parts Mfg., Inc.*, 679 S.W.2d 721, 725 (Tex. App.—Houston [1st Dist.] 1984, no writ) (finding lost profits recoverable where evidence shows lost profits were a material and probable consequence of breach and the breach and amount of damages are established with sufficient certainty).

When the difference between a contract price and a market price is a sufficient remedy, the market price is considered to be the price at which the goods were sold to a third party. TEX. BUS. & COM. CODE ANN. § 2.706. If the buyer has accepted the goods, thereby precluding a resale, the seller may bring an action for the contract price. *Id.* § 2.709.

### E. Viability of Certain Types of Damages For Breach of Contract

#### 1. Lost Profits

Lost profits may be recoverable special damages in a breach of contract action, provided such loss is a natural, probable, and foreseeable consequence of the defendant's breach<sup>1</sup>. *Kold-Serve Corp. v. Ward*, 736 S.W.2d 750, 755 (Tex. App.—Corpus Christi 1987, writ dismissed w.o.j.). For example, where a buyer of productive machinery is prevented from doing business for a considerable period of time due to a seller's failure to make delivery within the agreed time, the buyer may recover any lost profits that were within the contemplation of the parties and which can be established with reasonable certainty. *Narried v. Johnson*, 339 S.W.2d 566, 568 (Tex. Civ. App.—El Paso 1960, no writ). The measure of such lost profits is "net" profits (what remains in the business after deducting from its total receipts all expenses incurred in carrying on the business), which must be shown by objective facts, figures, and data. *Id.*; see also *Turner v. PV Int'l Corp.*, 765 S.W.2d 455, 465 (Tex. App.—Dallas 1988, writ denied) (finding that lost profits must be shown with "reasonable certainty"). As it is difficult to ascertain the exact amount of profits that would be earned in the future, it is not necessary to prove the amount of lost profits by precise calculation. *Szczepanik v. First S. Trust Co.*, 883 S.W.2d 648, 649 (Tex. 1994) (per curiam). There need be only sufficient data to establish lost profits with a reasonable degree of certainty. *Id.*

A business established prior to the breach may submit evidence of its pre-existing profits, together with other facts and circumstances which indicate with reasonable certainty the amount of profits lost. *Southwest Battery Corp. v. Owen*, 115 S.W.2d 1097, 1098-99 (Tex. 1938). "It is permissible to show the amount of business done by the plaintiff in a corresponding period of time not too remote, and the business during the time for which recovery is sought. Furthermore, in calculating the plaintiff's loss, it is proper to consider the normal increase in business which might have been expected in the light of past development and existing conditions." *Texas Instruments v. Teletron Energy Mgmt.*, 877 S.W.2d 276, 299 (Tex. 1994) (quoting *Southwest Battery Corp.*, 115 S.W.2d at 1098-99).

In *Szczepanik*, 883 S.W.2d at 650, the court indicated the types of proof necessary to establish lost profits. First State Trust Company ("FST") primarily managed the retirement assets of retired airline pilots. *Id.* at 649. In 1991, *Szczepanik*, after briefly serving as president of FST, resigned and formed a new corporation (RAAI), which was a direct competitor of FST. *Id.* *Szczepanik* sued FST for payment of his salary earned during the time he had served

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<sup>1</sup>If a trial court submits a jury question on lost profits, it must also submit a question on the foreseeability of the lost profits. See *Winkle Chevy-Olds Pontiac v. Condon*, 830 S.W.2d 740, 746-47 (Tex. App.—Corpus Christi 1992, writ dismissed).

as president of FST. *Id.* FST counterclaimed for various damages resulting from the loss of customers to RAAI. *Id.*

The trial court granted RAAI an instructed verdict on the issue of lost profits. *Id.* However, the Texas Supreme Court found legally insufficient evidence of lost profits and reversed the court of appeals. *Id.* at 650. At trial, FST offered evidence that \$36 million in account assets were transferred to RAAI, and that FST collected .75% to 1% profit on account assets. *Id.* In addition, FST offered testimony that FST would have retained the accounts for the lifetime of the individual account holders but for RAAI's interference. *Id.* Finally, FST offered evidence that it handled \$350 million in assets during 1991, and expected to make a profit of \$250,000 to \$500,000 per year beginning in 1991. *Id.*

Acknowledging that lost profits need not be proven by exact calculation, the court reasoned that "the injured party must do more than show that they suffered some lost profits." *Id.* at 649. The evidence must establish the amount of lost profits with reasonable certainty. *Id.* What constitutes reasonably certain evidence of lost profits is "a fact-intensive determination," to be determined on a case-by-case basis. *Id.* "At a minimum, opinions or estimates of lost profits must be based on objective facts, figures, or data from which the amount of lost profits may be ascertained." *Id.* See also *Holt Atherton Indus., Inc., v. Heine*, 835 S.W.2d, 80, 84 (Tex. 1992). The *Szczepanik* court concluded that the evidence was legally insufficient as no evidence established how FST determined that it would make a profit of \$250,000 to \$500,000 during 1991. *Szczepanik*, 883 S.W.2d at 650. The court found that there was no established link which related the total amount of expected profits to the amount of profits FST allegedly lost. *Id.* Furthermore, there was no evidence that FST could expect to have retained all of the accounts transferred to RAAI, and therefore no proof that FST could have expected to earn profits on those accounts for any period of time. FST was therefore denied lost profits. *Id.*

Proving lost profits becomes more difficult when the profits expected are largely speculative, "as from an activity dependent on uncertain or changing market conditions, or on chancy business opportunities, or on promotion of untested products or entry into unknown or unviable markets, or on the success of a new and unproven enterprise." *Texas Instruments, Inc. v. Teletron Energy Mgmt., Inc.*, 877 S.W.2d 276, 279 (Tex. 1994). In *Texas Instruments*, an engineer hired Texas Instruments to develop a working prototype of the "T-2000" voice-activated thermostat. *Id.* at 277. There was no comparable device either in existence or on the market. *Id.* Texas Instruments agreed to do so, and the plaintiff began advertising the product for distribution. *Id.* After two years of unsuccessful attempts to develop a working prototype, Texas Instruments ceased further development. *Id.* The plaintiff sued Texas Instruments for breach of contract, breach of warranty, and DTPA

violations. *Id.* Among the damages it claimed were lost profits, which the jury awarded. *Id.*

In addressing the plaintiff's alleged lost profits, the Texas Supreme Court explained that the fact that a business is new is "but one consideration" in determining whether lost profits have been proven with reasonable certainty. *Id.* at 280. The mere hope that an untried enterprise will be successful, even if it is a realistic one, will not support a recovery of lost profits. *Id.* Citing two of its prior decisions, the court pointed out that the focus must be the experience of the persons involved in the new enterprise, the nature of the business activity, and the relevant market. *Id.* at 279-80. The Texas Instruments court distinguished *Southwest Battery Corp. v. Owen*, 131 Tex. 423, 115 S.W.2d 1097 (1938) and *Pace Corp. v. Jackson*, 155 Tex. 179, 284 S.W.2d 340 (1955) on the grounds that a functional prototype of the "T-2000" did not exist, despite the efforts of the defendant who had significant experience in developing such products. *Id.*

*Southwest Battery Corp.*, 115 S.W.2d 1097 (Tex. 1938), provides an example of an award of lost profits damages to a "new" venture. In *Southwest Battery Corp.*, the plaintiff's business involved the sale of automobile replacement batteries. *Id.* at 1098. The court found that sales were neither uncertain nor speculative. *Id.* A well established market existed for the product as demonstrated by the brief history of sales. *Id.* The evidence showed that in all likelihood, the business would have been able to sell the products for a profit. *Id.* The demand for the product far outpaced the supply available to the plaintiff. *Id.*

Similarly, in *Pace Corp. v. Jackson*, 284 S.W.2d 340 (Tex. 1955), a new business claimed damages for lost profits. The business had operated at a profit prior to the breach of contract, and the business owner had considerable experience in and knowledge of the industry. *Id.* at 348. See also *Aboud v. Schlichtemeier*, 6 S.W.3d 742 (Tex. App.—Corpus Christi 1999, pet. denied) (upholding lost profits damage award where partners had well established track record of success in similar ventures).

## 2. Mental Anguish

As a general rule, damages for mental suffering are not recoverable in a breach of contract action, or for a tort based upon a right growing out of a breach of contract. See *Rubalcaba v. Pacific/Atlantic Crop Exch., Inc.*, 952 S.W.2d 552, 558 (Tex. App.—El Paso 1997, no writ). The reason for Texas courts' reluctance to recognize mental anguish as a compensable element of damages is twofold. *City of Tyler v. Likes*, 962 S.W.2d 489, 494 (Tex. 1997). First, mental anguish is difficult to predict. *Id.* at 495. An event that would cause one person great stress could have virtually no effect upon another, making it nearly impossible for courts to determine when mental anguish is a foreseeable consequence to an action, as opposed to when no duty should be imposed to prevent the action. *Id.* Second, mental anguish is difficult to verify. *Id.* Although the Texas

Supreme Court has done away with the requirement of a “physical manifestation” of mental anguish, proof of mental anguish damages still requires direct evidence of a “substantial disruption in the plaintiff’s daily routine.” *Parkway v. Woodruff*, 901 S.W.2d 434, 444 (Tex. 1995) (requiring evidence of a “high degree of mental pain and distress” that is “more than mere worry, anxiety, vexation, embarrassment, or anger” for mental anguish damages award). To date, however, “the law has not yet developed a satisfactory empirical test for what is by definition a subjective injury.” *Likes*, 962 S.W.2d at 495.

*Rogowicz v. Taylor & Gray, Inc.*, 498 S.W.2d 352, 355-56 (Tex. Civ. App.—Tyler 1973, writ ref’d n.r.e.) illustrates the difficulty in predicting how a breach of contract will affect one person versus another. In *Rogowicz*, the plaintiffs bought a house from the defendant. *Id.* at 353.

Shortly after the plaintiffs purchased their home, they discovered foundation defects. *Id.* Although the plaintiffs pled and attempted to prove mental anguish damages, the trial court granted the defendant’s motion to strike the plaintiffs’ prayer for mental anguish damages. *Id.* at 355. The court of appeals held that this was not error, as mental anguish damages are not generally recoverable under a contract. *Id.* The court qualified the holding, however, by stating that in the rare instance mental anguish may be considered, there must be: (1) a showing of mental perturbation which is more than regret or annoyance; and (2) the breaching party’s actions were a necessary and natural result of the breach contemplated or reasonably foreseen at the time the contract was made. *Id.* at 355. In *Rogowicz*, there was no evidence that the foundation defect existed prior to the sale of the house. *Id.* at 356. As a result, the defendants could not have foreseen the defect, nor could they have foreseen the effect that it would have upon the plaintiffs. *Id.* Therefore, the evidence failed to establish that the defective foundation proximately caused plaintiffs’ mental anguish. *Id.*

Texas courts will allow recovery of mental anguish damages where a plaintiff shows that the nature of the contract is such that mental anguish is a natural result of a breach. *See, e.g., Pat H. Foley & Co. v. Wyatt*, 442 S.W.2d 904, 907 (Tex. Civ. App.—Houston [14th Dist.] 1969, writ ref’d n.r.e.) (upholding award of mental anguish damages against funeral home for mistreatment of corpse); *City of Dallas v. Brown*, 150 S.W.2d 129, 131 (Tex. Civ. App.—Dallas 1941, writ dism’d w.o.j.) (allowing mental damages in case where termination of widow’s water service was clearly wrongful and nature of contract rendered mental anguish damages foreseeable). *But see Temple-Inland Forest Prod. Corp. v. Carter*, 993 S.W.2d 88, 93 (Tex. 1999) (refusing to permit mental anguish damages resulting from an increased possibility of asbestos related disease). In contracts where mental anguish damages are allowed, the primary purpose of the contract is typically personal service directly involving the plaintiff’s peace of mind. *Pat H. Foley & Co.*, 442 S.W.2d at 907 (finding mother’s mental

concern, sensibilities, and solicitude to be the prime considerations of her contract with funeral home hired to inter her son’s body).

### 3. Liquidated Damages

A plaintiff seeking to recover liquidated damages must prove two things: “(1) that the harm caused by the breach is incapable or difficult of estimation, and (2) that the amount of liquidated damages called for is a reasonable estimate of just compensation.” *Phillips v. Phillips*, 820 S.W.2d 785, 788 (Tex. 1992). Failure to prove both of these elements will render the liquidated damages clause unenforceable as a penalty. *Id.* Whether a liquidated damages clause is enforceable is a question of law for the court, although several factual issues often need to be resolved before the legal question can be determined. *Id.*

*Phillips* involved a divorce settlement reached between the Phillips. *Id.* at 786. The couple had accumulated over \$18 million over the course of their marriage. *Id.* Rather than split their oil and gas holdings, the couple formed a limited partnership and transferred the bulk of the assets into the partnership. *Id.* Mr. Phillips agreed to work for the partnership, and Mrs. Phillips was to receive a monthly payment. *Id.* The agreement also had a clause specifying that should either party breach the contract, the other party would be entitled to liquidated damages in the amount of ten times any actual damage caused by the breach. *Id.* at 788. Mr. Phillips eventually breached the agreement, and Mrs. Phillips sought damages pursuant to the liquidated damages clause. *Id.* Applying the two-part test to the liquidated damages, the Texas Supreme Court held the clause was unenforceable as a penalty. *Id.* at 788-89. The court reasoned that damages were not incapable or difficult of estimation, as the provision assumed that actual damages would be determined prior to calculating the damages allowed under the contract. *Id.* In addition, the damages clause did not call for a reasonable estimate of actual damages because it required that actual damages be multiplied tenfold to determine the contractual damages. *Id.* at 789.

Interestingly, the *Phillips* court also held that Mr. Phillips’s failure to plead penalty as an affirmative defense did not constitute a waiver. *Id.* The court explained that illegality of a contract is an exception to the rule that affirmative defenses are waived if not properly pled. *Id.* Further, courts cannot enforce a plainly illegal contract even if the parties fail to object. *Id.* Enforcement of a penalty clause, like enforcement of an illegal contract, violates public policy. *Id.* Applying this logic, the court stated that the defense of penalty is not waived by the failure to plead it, if a penalty is apparent on the face of the petition and established as a matter of law. *Id.* In response to Justice Gonzalez’s vigorous dissent, the majority pointed out that it did “not hold that the affirmative defense of penalty need never be pleaded. Whenever the defense is not clearly established on the face of the pleadings, as it is here, it must be pleaded.” *Id.* at

790. Unfortunately, the court did not create any clear standard to determine when the affirmative defense of penalty is “clearly established on the face of the pleadings.” Prudent counsel should therefore specifically plead penalty as an affirmative defense to a liquidated damages clause.

#### 4. Nominal Damages

When a plaintiff proves that a contract was breached but fails to prove actual damages, the plaintiff may be entitled to recover “nominal” damages. *Hutchinson v. Texas Aluminum Co.*, 330 S.W.2d 895, 898 (Tex. Civ. App.—Dallas 1971, writ ref’d n.r.e.). These are damages in name only and are small or even trivial in amount. *Lucas v. Morrison*, 286 S.W.2d 190, 191-92 (Tex. Civ. App.—San Antonio 1956, no writ) (reducing jury award of nominal damages in the amount of \$100 to \$20, where the actual damages determined by the jury totaled only \$50).

Nominal damages also may be recoverable where a plaintiff proves only collateral losses that were not within the contemplation of the parties at the time of contracting. *McGuire v. Osage Oil Corp.*, 55 S.W.2d 535, 537 (Tex. Comm’n App. 1932, holding approved).

Although trivial in amount, nominal damages should be requested in order to support an award of costs. *Arnold v. Tarrant Beverage Co.*, 215 S.W.2d 894, 895-96 (Tex. Civ. App.—Galveston 1948, writ ref’d n.r.e.). Where the evidence negates the existence of any damages at all, however, nominal damages may not be awarded. *Gulf Coast Inv. Corp. v. Rothman*, 506 S.W.2d 856, 858 (Tex. 1974) (finding that where plaintiff failed to prove damages and defendant introduced evidence that plaintiff suffered no loss, an award of even nominal damages was improper).

#### 5. Exemplary Damages

Exemplary damages are generally not recoverable in contract actions. *Amoco Prod. Co. v. Alexander*, 622 S.W.2d 563, 571 (Tex. 1981). Even if a breach of contract is malicious, intentional or capricious, exemplary damages may not be recovered unless a distinct tort theory is alleged and proved. *Id.* Neither gross negligence in a breach of contract nor gross negligence in the inducement to contract will entitle a non-breaching party to exemplary damages. *D.S.A., Inc. v. Hillsboro Indep. Sch. Dist.*, 973 S.W.2d 662, 664 (Tex. 1998) (per curiam) (negligent misrepresentation); *Jim Walter Homes, Inc. v. Reed*, 711 S.W.2d 617, 618 (Tex. 1986) (breach of contract). But contractual relationships may create duties under both contract and tort law. See *Jim Walter Homes*, 711 S.W.2d at 618. “The acts of a party may breach duties in tort or contract alone or simultaneously in both. The nature of the injury most often determines which duty or duties are breached. When the injury is only the economic loss to the subject of a contract itself, the action sounds in contract alone.” *Id.*

There have been exceptions to this doctrine, however. The exception cases usually involve the existence of an extra-contractual duty imposed by law, or a tort independent

of the contract. See *McDonough v. Zamora*, 338 S.W.2d 507, 513-14 (Tex. Civ. App.—San Antonio 1960, writ ref’d n.r.e.) (holding that punitive damages are not available for the issuance of “hot” checks); cf. *Formosa Plastics Corp., USA v. Presidio Eng’rs & Contractors, Inc.* 960 S.W.2d 41, 47 (Tex. 1998) (noting that exemplary damages can be awarded for fraud in the inducement of a contract).

A party alleging that exemplary damages are recoverable due to the existence of an independent tort duty must plead and prove the independent tort in addition to the breach of contract. *Crawford v. Ace Sign, Inc.*, 917 S.W.2d 12, 14 (Tex. 1996) (per curiam) (holding that absent proof that defendant’s conduct would give rise to liability outside the contract, the action sounds in contract); *Southwestern Bell Tel. Co. v. DeLanney*, 809 S.W.2d 493, 494-95 (Tex. 1991) (finding that action was in contract and not in tort, because plaintiff’s claims against telephone company for failure to publish yellow pages advertisement arose solely from the contract, and the damages were only for economic loss); *Texas Power & Light Co. v. Barnhill*, 639 S.W.2d 331, 334 (Tex. App.—Texarkana 1982, writ ref’d n.r.e.) (denying exemplary damages where evidence was factually insufficient to prove independent tort). But see *Formosa Plastics*, 960 S.W.2d at 47 (noting that recovery of exemplary damages is allowable where fraud in the inducement of a contract is properly pleaded and proven, because a fraud action is not based solely upon the contract).

The tort and the breach of contract need not arise out of separate and distinct transactions. *Formosa Plastics*, 960 S.W.2d at 47; *Texas Power*, 639 S.W.2d at 334. Some contracts also involve special relationships that give rise to a duty enforceable as a tort. See, e.g., *Sanus/New York Life Health Plan, Inc. v. Dube-Seybold-Sutherland Mgmt. Inc.*, 837 S.W.2d 191, 199 (Tex. App.—Houston [1st Dist.] 1992, no writ) (“When special confidence is placed in one who thereby obtains a resulting superiority of position and influence, a special relationship is created.”). A party injured by a duty arising from a special relationship may be entitled to exemplary damages as a result of a breach of the fiduciary duty. *Id.* at 200; see also *Manges v. Guerra*, 673 S.W.2d 180, 184 (Tex. 1984) (holding that where suit is based on breach of fiduciary duty, and not on breach of contract, exemplary damages may be recovered).<sup>2</sup>

<sup>2</sup> Even if an award of punitive damages is allowable in a given case, the award must still pass constitutional muster. The United States Supreme Court recently reversed a Utah state court award of \$145 million in punitive damages. *State Farm Mut. Auto Ins. Co. v. Campbell*, 538 U.S. 408, 123 S. Ct. 1513, 1526 (2003). In reversing the award, the Court outlined the principles set forth in its own previous precedent, *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559 (1996). *Campbell*, 538 U.S. at *passim*. In applying *Gore*, the *State Farm* Court held that the \$145 million award in punitive damages violated the Due Process Clause of the United States Constitution for several reasons. First, the award constituted a punishment for, among other things, acts that were committed

### 6. Attorney's Fees

Generally, unless provided for by statute or contract, Texas law does not allow for the recovery of attorney's fees. *New Amsterdam Cas. Co. v. Texas Indus., Inc.*, 414 S.W.2d 914, 915 (Tex. 1967). The Texas Civil Practice and Remedies Code provides for the recovery of attorneys' fees in an action for breach of an oral or written contract. TEX. CIV. PRAC. & REM. CODE ANN. § 38.018 (Vernon 1997). To recover attorney's fees under the Code, a party must prove that he is represented by an attorney, that he has presented his claim for attorney's fees to the opposing party, and that the opposing party failed to pay the claim within thirty days of the presentment. *Id.* § 38.002.

### 7. Reliance Recovery

In contract law, theories of recovery for a breach of contract include reliance or expectancy damages. Reliance damages, similar to out-of-pocket recovery, reimburse a party for expenditures made in furtherance of the completion of contractual duties. The purpose of reliance damages is to restore the non-breaching party to the same position as that party would have been in, had the contract not existed. In certain situations, reliance damages provide an adequate remedy. For example, *Osage Oil & Ref. Co. v. Lee Farm Oil Co.*, 230 S.W. 518, 519 (Tex. Civ. App.—Amarillo 1921, writ ref'd), involved a contract whereby the plaintiff agreed to drill a well on defendant's property. After plaintiff began performance, but before completion, the defendant breached the contract and refused to compensate the plaintiff. *Id.* The court awarded the plaintiff its expenses incurred for performance prior to the breach, as well as the profits it would have earned had the contract been fully performed. *Id.* at 520-22 (finding, by implication, that the plaintiff could have engaged in business elsewhere during the frustrated performance tendered under the contract at issue); see also *Morgan v. Young*, 203 S.W.2d 837, 854 (Tex. Civ. App.—Beaumont 1947, writ ref'd n.r.e.) (allowing farmer who attempted to mitigate damages by planting a crop subsequent to defendant's breach to recover expenses of mitigation where expenses were a reasonable sum, despite the fact farmer's loss was aggravated by his attempt to mitigate).

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outside of Utah, and which may have been lawful in other jurisdictions. *Id.* at 419-424. Second, because the award of actual compensatory damages was only \$1 million, the ratio between the punishment and the actual harm was 145 to 1, a presumptively excessive award for constitutional purposes. *Id.* at 424-25. (“[F]ew awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process.”). Finally, the most relevant civil sanction under Utah law for the reprehensible conduct was \$10,000; accordingly, the Court held that the \$145 million punitive award was a constitutionally disparate civil punishment. *Id.* at 428.

Reliance damages are particularly appropriate where the profit or gain to be derived from a bargain is uncertain. See RESTATEMENT (SECOND) OF CONTRACTS § 349 cmt.a (1981). Reliance damages also may adequately compensate a party where benefit-of-the-bargain damages are not easily proven to be foreseeable. See *id.* § 351(3). This measure of damages is therefore particularly useful in the case of a new and unestablished business, where lost profits are difficult to prove with reasonable certainty.

### 8. Quantum Meruit

Ordinarily the purpose of breach of contract damages is to place a party in as good a position as if the contract had been fully performed. The purpose of restitution or quantum meruit damages, however, is to return the plaintiff to a position as if no contract had been made. *Coon v. Schoeneman*, 476 S.W.2d 439, 441 (Tex. Civ. App.—Dallas 1972, writ ref'd n.r.e.). “Generally, a party may recover under quantum meruit only when there is no express contract covering the services or materials furnished.” *Vortt Exploration Co. v. Chevron U.S.A., Inc.*, 787 S.W.2d 942, 944 (Tex. 1990); *accord Truly v. Austin*, 744 S.W.2d 934, 936 (Tex. 1988). Based upon the premise that the other party has been “unjustly enriched,” quantum meruit recovery “is appropriate where a contract is unenforceable, impossible, not fully performed, or void for other legal reasons.” *R. Conrad Moore & Assocs., Inc. v. Lerma*, 946 S.W.2d 90, 97 (Tex. App.—El Paso 1997, writ denied). The right to recover in quantum meruit does not grow out of the contract. Quantum meruit is a “contract” implied by law to prevent a party from receiving and knowingly accepting beneficial products or services without paying for the products or services provided. *Campbell v. Northwestern Nat'l Life Ins. Co.*, 573 S.W.2d 496, 498 (Tex. 1978).

Construction contracts are an exception to the general rule that quantum meruit recovery may not be obtained when there is an express contract covering the services or materials furnished. In such a case, a party may recover under either measure of damages. See *Murray v. Crest Constr., Inc.*, 900 S.W.2d 342, 345 (Tex. 1995) (per curiam) (holding where substantial performance is a condition precedent to recovery on an express contract, subcontractor could recover the amount of benefits conferred by its partial performance).

“The measure of damages in an action on quantum meruit is the reasonable value of the work performed and the materials furnished.” *Thomason v. Freberg*, 588 S.W.2d 821, 830 (Tex. Civ. App.—Corpus Christi 1979, no writ). See generally Daniel Friedmann, *Restitution for Wrongs: The Measure of Recovery*, 79 TEX. L. REV. 1879 (2001).

### F. Repudiation or Anticipatory Breach of Contract

“Repudiation” or “anticipatory breach” of a contract consists of actions by a contracting party which indicate that the party is not going to perform the contract in the future. See *Group Life & Health Ins. Co. v. Turner*, 620 S.W.2d

670, 673-74 (Tex. Civ. App.—Dallas 1981, no writ) (explaining that where insurer stopped paying insured's monthly disability payments and refused to reconsider position, insurer repudiated contract). "Repudiation" is conduct which shows a fixed intention, unconditionally declared in positive terms, to abandon, renounce, and refuse to perform the contract. *Moore v. Jenkins*, 109 Tex. 461, 211 S.W. 975, 976 (1919).

After a complete repudiation of a contract, the non-breaching party may immediately maintain a suit for damages caused by the entire breach, including the present value that would have been received had the contract been fully performed. *Murray v. Crest Constr., Inc.*, 900 S.W.2d 342, 344 (Tex. 1995) (per curiam); *Hardin Assocs., Inc. v. Brummett*, 613 S.W.2d 4, 6 (Tex. Civ. App.—Texarkana 1980, no writ). In addressing installment contract cases, the Texas courts generally permit the non-breaching party to sue for all future payments. *Turner*, 620 S.W.2d at 673-74. *But see Arenberg v. Central United Life Ins.*, 18 F. Supp. 2d 1167, 1178 (D. Colo. 1998) (questioning whether such a proposition is an accurate interpretation of Texas law).

If a contract is repudiated before performance is due, i.e., an anticipatory breach, the repudiating party may retract the anticipatory breach by notifying the promisee of its intent to perform. *Glass v. Anderson*, 596 S.W.2d 507, 510 (Tex. 1980). However, the repudiating party will lose the right to retract a repudiation if the other party brings an action on the contract or materially changes position in reliance on the initial repudiation. *Griffith v. Porter*, 817 S.W.2d 131, 135 (Tex. App.—Tyler 1991, no writ) ("If the repudiation is not accepted by the other party, the contract is kept alive for the benefit of both parties...."); *Valdina Farms, Inc. v. Brown, Beasley & Assocs.*, 733 S.W.2d 688, 692-93 (Tex. App.—San Antonio 1987, no writ) (finding no anticipatory breach where defendant retracted alleged repudiation and plaintiff failed to show that it materially changed its position in reliance on the repudiation); *Helsley v. Anderson*, 519 S.W.2d 130, 133 (Tex. Civ. App.—Dallas 1975, no writ) (holding repudiation of contract was timely retracted on contract to convey property, since both parties indicated willingness to complete transaction, vendor did not change his position in reliance upon possible repudiation, and no obligation to perform had matured).

### G. Promissory Estoppel

Under the doctrine of promissory estoppel, a promise may be binding if the promisor should reasonably expect that his promise will induce action or forbearance, the promisee substantially relies upon the promise, and the enforcement of the promise is necessary to avoid injustice. *Adams v. Petrade Int'l, Inc.*, 754 S.W.2d 696, 707 (Tex. App.—Houston [1st Dist.] 1988, writ denied) (citing "*Moore*" *Burger, Inc. v. Phillips Pet. Co.*, 492 S.W.2d 934, 937 (Tex. 1972)). Although promissory estoppel is generally a defensive plea, it may also be used by a plaintiff as a ground of entitlement to damages. *Adams*, 754 S.W.2d at 707;

*Kenney v. Porter*, 604 S.W.2d 297, 304 (Tex. Civ. App.—Corpus Christi 1980, writ ref'd n.r.e.). The damages recoverable are "not the profit that the promisee expected, but only the amount necessary to restore him to the position he would have been in had he not acted in reliance on the promise." *Fretz Constr. Co. v. Southern Nat'l Bank*, 626 S.W.2d 478, 483 (Tex. 1981); *accord Sun Oil Co. v. Madeles*, 626 S.W.2d 726, 734 (Tex. 1981). Lost profits are not allowable under a promissory estoppel theory of recovery. *Fretz Constr. Co.*, 626 S.W.2d at 483.

Promissory estoppel may also bar the application of the statute of frauds to an otherwise unenforceable oral agreement. *Exxon Corp. v. Breezevale Ltd.*, 82 S.W.3d 429, 438 (Tex. App.—Dallas 2002, pet denied.). Where there is an oral promise to sign an agreement that must be in writing, the written agreement must be in existence at the time the oral promise to execute the same is made; otherwise, there is no bar to the statute of frauds. *Id.*

## III. COVENANTS NOT TO COMPETE

### A. Damages Recoverable

A breach of a valid covenant not to compete may entitle the non-breaching party to an award of monetary damages, injunctive relief, or both. TEX. BUS. & COM. CODE ANN. § 15.51(a) (Vernon 2002). The usual measure of monetary damages for such a breach is equal to the amount of profits the promisee lost due to the breach. Because it is difficult to establish damages in a breach of noncompetition contract with complete mathematical accuracy, courts allow recovery of monetary damages based upon evidence that will enable a jury to make a fair and reasonable approximation of damages. *Arabesque Studios, Inc. v. Academy of Fine Arts Int'l, Inc.*, 529 S.W.2d 564, 569 (Tex. Civ. App.—Dallas 1975, no writ). Such awards do not have to be mathematically exact, but cannot be based upon mere speculation or conjecture. *Id.* For example, if an employee breaches a contract not to compete, a jury may consider profits made by the employee's subsequent employer "inasmuch as these profits may have, in some part, accrued to the plaintiff in the absence of the breach." *Id.* (citing *Welsh v. Morris*, 81 Tex. 159, 16 S.W. 744, 745 (1891)).

In a breach of a covenant not to compete pursuant to the sale of a business, a jury may consider several factors in determining a buyer's damages due to a seller's breach. *Chandler v. Mastercraft Dental Corp.*, 739 S.W.2d 460, 466 (Tex. App.—Fort Worth 1987, writ denied). *Chandler* involved the sale of a dental equipment manufacturing business. *Id.* at 462. The defendants sold their business to the plaintiff. *Id.* Part of the purchase agreement provided that the sellers would not compete with the buyer for a period of five years. *Id.* Two years later, however, they began competing directly with the buyer. *Id.* They brought suit against the buyer, requesting a declaratory judgment that the covenant not to compete was unenforceable. *Id.* at 463. The buyer counterclaimed for breach of the covenant not to compete, and was awarded damages by the jury. *Id.*

Despite the sellers' claim that the covenant was improperly drafted, the court of appeals upheld the award, explaining that lost profits may be determined by various factors. *Id.* at 465-66. The evidence showed that the buyer's business declined when the sellers began competing with the buyer. *Id.* at 466. There was also evidence that at least four of the buyer's customers were now doing business with the sellers.

*Id.* The court held that juries may consider profits made by the sellers following a breach, as well as profits made prior to the breach. *Id.* A jury may also consider evidence comparing the profitability of two competing businesses or compare the profits of the injured business before and after the breach. *Id.*

Monetary damages will not be available for unreasonable or overbroad covenants or restrictive covenants. TEX. BUS. & COM CODE ANN. § 15.51(c) (stating that a covenant not to compete must contain "limitations as to time, geographic area, or scope of activity to be restrained"). An overbroad covenant shall be reformed by a court to be reasonable and then specifically enforced via injunction. *Id.* However, a court may not award damages based on breach of a covenant not to compete that is void and unenforceable before the covenant is reformed. *Id.*; *Weatherford Oil Tool Co. v. Campbell*, 340 S.W.2d 950, 953 (Tex. 1960). In determining whether a covenant not to compete is overly broad or otherwise unenforceable, courts will look to whether the covenant is reasonable and does not impose a greater restraint than necessary to protect the goodwill or other business interest of the promisee. TEX. BUS. & COM. CODE ANN. § 15.51(c); *see also Weatherford*, 340 S.W.2d at 952 ("[T]he restrictive covenant must bear some relation to the activities of the employee. It must not restrain his activities in a territory into which his former work has not taken him or given him the opportunity to enjoy undue advantages in later competition with his employer.").

In *Weatherford*, *Weatherford* brought suit against three of its former employees for breach of a covenant not to compete. *Id.* at 951. The Texas Supreme Court found that the agreement effectively prevented former employees of *Weatherford* from doing business anywhere in the world as it contained no territorial limitation. *Id.* at 952. "It clearly is not necessary for the protection of petitioner's business or good will that its office employees or salesmen be prevented from engaging in a competitive business wherever petitioner may elect to sell its products." *Id.* The covenant was therefore unenforceable in accordance with its terms. *Id.* Since the employer's action for damages resulting from competition occurred before a court of competent jurisdiction could prescribe a reasonable territory, the claim for damages had to "stand or fall on the contract as written." *Id.* at 953. The court declined to reform the contract,<sup>3</sup> and

found that there was no legal basis for an award of damages. *Id.* The court affirmed the appellate court's dismissal of the cause. *Id.*; *see also Juliette Fowler Homes, Inc. v. Welch Assocs., Inc.*, 793 S.W.2d 660, 662-63 (Tex. 1990) (denying monetary damages for breach of an unenforceable noncompetition clause, because in an action for damages, the enforceability of a covenant not to compete will be determined as written and may not be modified to render it reasonable and enforceable), *superseded by statute on other grounds as stated in Property Tax Assoc., Inc. v. Staffeldt*, 800 S.W.2d 349 (Tex App.—El Paso. 1990, writ denied).

## B. Liquidated Damages for Covenants Not to Compete

A liquidated damages provision in a breach of a noncompetition agreement will be valid and enforceable if its terms are reasonable. *Henshaw v. Kroenecke*, 656 S.W.2d 416, 419 (Tex. 1983). Liquidated damages must be a reasonable forecast of just compensation for the harm expected as a result of a breach. *Stewart v. Basey*, 245 S.W.2d 484, 486-87 (Tex. 1952) (holding where lease contract provision, if breached, provided for payment of damages for each and every month of unexpired lease term, provision was unenforceable), *superseded by statute on other grounds as stated in McFadden v. Fuentes*, 790 S.W.2d 736 (Tex. App.—El Paso 1990, no writ) (referring to the adoption of the UCC and its applicability to the sale of goods); RESTATEMENT OF CONTRACTS § 339 (1932). Such a provision will only be considered valid if actual damages are difficult to estimate accurately. *See Mayhall v. Proskowetz*, 537 S.W.2d 320, 322 (Tex. Civ. App.—Austin 1976, writ ref'd n.r.e.); *Stewart*, 245 S.W.2d at 486. Whether a liquidated damages provision is reasonable is a legal question for a court. *Henshaw*, 656 S.W.2d at 418. If the liquidated damages clause is not reasonable, it is unenforceable as a penalty. *Eberts v. Businesspeople Pers. Servs.*, 620 S.W.2d 861, 863 (Tex. Civ. App.—Dallas 1981, no writ). Further, liquidated damages are not appropriate in conjunction with actual damages because they are intended as complete relief. *Id.*; *Robert G. Beneke & Co. v. Cole*, 550 S.W.2d 321, 322 (Tex. Civ. App.—Dallas 1977, no writ) (finding liquidated damages provision providing for payment for breach of a covenant not to compete, but failing to exclude further liability for actual damages, unenforceable as penalty); *see also Phillips v. Phillips*, 820 S.W.2d 785, 788-90 (Tex. 1991) (discussing liquidated damages generally).

In *Eberts v. Businesspeople Pers. Servs., Inc.*, 620 S.W.2d at 862, *Businesspeople* sued *Eberts*, its former employee, to restrain him from competing in violation of a noncompetition agreement and for liquidated damages. The

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competing for a time and within an area that was reasonable under the circumstances. *Weatherford*, 340 S.W.2d at 952-53. By the time the case reached the Texas Supreme Court, however, the period of noncompetition had expired, rendering the issue of injunctive relief moot. *Id.* at 952.

<sup>3</sup>The court noted that although the covenant was unreasonable, a court of equity could have enforced the contract by granting an injunction restraining the former employees from

court granted the injunctive relief and awarded damages in an amount less than that provided for in the contract. *Id.* The appellate court upheld the injunction, finding that the defendant's actions were a material breach of his employment agreement and that the injunction was reasonably necessary to protect the plaintiff's goodwill and confidential business information. *Id.*

As for the liquidated damages provision, both parties appealed the trial court's finding. *Id.* at 863. The defendant argued that the evidence was insufficient to meet the plaintiff's burden of proof as to reasonableness. *Id.* The plaintiff, on the other hand, urged that it was entitled to recover the entire amount of liquidated damages provided for in the contract, as opposed to the lesser amount awarded by the trial court. *Id.* The court found that the evidence could not support the finding of actual damages. *Id.* There was no evidence as to the amount of commissions lost due to defendant's competition in the period between the termination of his employment and the date of the injunction. *Id.* Further, the defendant had been free to compete with the plaintiff for only three weeks before his competition was enjoined, and there was no evidence that the defendant had violated the injunction. *Id.* at 864. There was also no showing that the plaintiff lost any business due to the defendant's competition. *Id.* The contract would therefore allow for a payment of liquidated damages for any breach of the restrictive covenant, "whether the breach continues for only one day or for two years, and would authorize an injunction enforcing the restriction for any portion of the period remaining." *Id.* Therefore, the liquidated damages provision could not be considered a genuine estimate of the harm to be suffered by any single breach, and the court denied recovery.<sup>4</sup> *Id.*

Interestingly, the plaintiff in *Eberts* also argued that the liquidated damage provision was reasonable because it anticipated expenses of litigation, rather than loss of the plaintiff's goodwill. *Id.* at 865. If this were the case, however, the provision would fail to comport with the requirements of *Stewart v. Basey*, 245 S.W.2d at 486, which allowed liquidated damages only where the amount of damages are difficult to estimate. *Eberts*, 620 S.W.2d at 865. Attorney's fees are routinely proved and recovered when authorized by contract or statute. *Id.* The court therefore held that an estimate of attorney's fees and other expenses anticipated in enforcing a contract cannot support the reasonableness of a liquidated damages provision. *Id.*

The lesson is that a plaintiff may choose his or her remedies, but will not be able to recover inconsistent

remedies. Injunctive relief may be granted with damages, but only for damages that occurred before the injunction. *Id.* at 864. The common law, prior to the passage of the statute governing covenants not to compete, held that when the suit was at law for damages, the restrictive provision had to stand or fall as written and could not be reformed to make it reasonable. *DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670, 682 (Tex. 1990); *Weatherford*, 340 S.W.2d at 953. The common law has been modified by section 15.51(c) of the Texas Business and Commerce Code, which allows reformation of a covenant not to compete that contains unreasonable limitations by "impos[ing] a greater restraint than is necessary to protect the goodwill or other business interest of the promisee." TEX. BUS. & COM. CODE ANN. § 15.51(c). However, section 15.51(c) expressly provides, and has been enforced to hold, that "the court may not award the promisee damages for a breach of the covenant before its reformation and the relief granted to the promisee shall be limited to injunctive relief." *Peat Marwick Main & Co. v. Haass*, 818 S.W.2d 381, 388 (Tex. 1991) (quoting § 15.51(c)); cf. *Butler v. Arrow Mirror & Glass, Inc.*, 51 S.W.3d 787, 797 (Tex. App.—Houston [1st Dist.] 2001, no pet.) (allowing recovery of attorney fees under Texas Civil Practice and Remedies Code Section 38.001 despite reformation of covenant not to compete). *But see Perez v. Texas Disposal Sys.*, 53 S.W.3d 480, 482-83 (Tex. App.—San Antonio 2001, no pet.) (reversing an award of attorney fees to an employer from an employee for violation of a covenant not to compete), *rev'd on other grounds*, 80 S.W.2d 593 (Tex. 2002).

### C. Exemplary Damages in Covenants Not to Compete

Exemplary damages are typically unavailable in a breach of a noncompetition agreement case, even if the breach was committed with malice. *See A.L. Carter Lumber Co. v. Saide*, 140 Tex. 523, 168 S.W.2d 629, 631 (1943) (holding exemplary damages not recoverable in breach of contract to sell land, even though the breach was brought about capriciously and with malice, because the breach was not accompanied by a tort). If, however, the breach was accompanied by a tort, exemplary damages may be recovered if proper culpability is established. *First Sec. Bank & Trust Co. v. Roach*, 493 S.W.2d 612, 618-19 (Tex. Civ. App.—Dallas 1973, writ ref'd n.r.e.) (finding bank's wrongful sequestration of automobile was distinct and independent tort, thereby entitling plaintiff to exemplary damages that take into account lost earnings, mental suffering, doctor bills, and attorney's fees).<sup>5</sup>

<sup>4</sup>The court noted, however, that the contract could be enforceable if it gave the plaintiff an option to elect between injunctive relief and liquidated damages. *Eberts*, 620 S.W.2d at 864. Alternatively, had actual damages been proven, the plaintiff might have been entitled to damages for a breach that occurred before this suit was filed and to an injunction restraining subsequent breaches. *Id.*

<sup>5</sup>For a discussion of the constitutional requirements for an award of punitive damages see *supra* note 2.

## IV. USURY

### A. Statutory Usury & Remedies

#### 1. Statutory Usury

The Texas Constitution authorizes the legislature to classify loans and lenders, regulate interest, define interest, and fix maximum rates of interest. TEX. CONST. art. XVI, § 11. Pursuant to this authority, the legislature enacted Texas Revised Civil Statutes Article 5069-1.01 to -8.06 (the “Texas Credit Code”). In 1997, the Texas Legislature repealed the Texas Credit Code and enacted a “non-substantive” recodification of the Texas Credit Code by subdividing, renumbering, and renaming the applicable law into the Texas Finance Code. See TEX. FIN. CODE ANN. §§ 1.001 — 349.502 (Vernon 1998 & Supp. 2004). The following day, the legislature enacted the “Texas Credit Title,” which was a substantive revision of the then repealed Texas Credit Code. See TEX. REV. CIV. STAT. ANN. §§ 5069-1B to -1H (Vernon Supp. 1999), *repealed by* Act of May 10, 1999, 76th Leg., R.S., ch 62, § 7.18(b), 1999 Tex. Gen. Laws 62 (current version at TEX. FIN. CODE ANN. §§ 301.001-331.005). However, Title IV of the Texas Finance Code is now officially named the Texas Credit Title. See TEX. FIN. CODE ANN. § 301.001 (Vernon Supp. 2004).

As a result of the substantive amendments made during the recodification, it is imperative that the practitioner determine the applicable statutory provision. Additionally, case authority citing prior law must be carefully scrutinized to verify that the cited law was not subject to substantive revision during the transition from Texas Revised Civil Statutes Article 5069 into the current Texas Finance Code provision.

For usury causes of action arising on or after September 1, 1997 and before September 1, 1999, the Texas Government Code provides that when a substantive revision and a recodification occur during the same legislative session, the provisions should be harmonized, but in the event of conflict, the latest in date of enactment controls. TEX. GOV. CODE ANN. §311.025(b) (Vernon 1998). Fortunately, the 76th Texas Legislature cured this error for causes of action arising after September 1, 1999. See Act of May 10, 1999, 76th Leg., R.S., ch 62, § 7.18(b), 1999 Tex. Gen. Laws 62.

Generally, the question whether usury exists is determined by the law in force at the time of the contract, charge, or receipt of interest. *Standard Sav. Ass’n. v. Greater New Canaan Missionary Baptist Church, Inc.*, 786 S.W.2d 774, 775-76 (Tex. App.—Houston [14th Dist.] 1990, no writ). As a result of the statutory savings provisions incorporated into the act of recodification, the date of the contract, charge, or receipt is of great importance. For example, the 76th Texas Legislature specifically provided that the now repealed portions of the Texas Credit Code (TEX. REV. CIV. STAT. ANN. art. 5069) still apply to “an act committed or a transaction that occurs” prior to September 1, 1997. See Act of June 19, 1997, 68th Leg., R.S., ch. 1396, § 49, § 1, 1999 Tex. Gen. Laws 1008;

see also *Andrews v. Hoxie*, 5 Tex. 171, 193 (1849) (holding that contracts that are legal in their inception cannot be rendered usurious by a subsequent change in the law).

#### 2. “Interest”

Usurious interest is defined as “interest that exceeds the applicable maximum amount allowed by law.” TEX. FIN. CODE ANN. § 301.002(a)(17) (Vernon Supp. 2004). Interest is the “compensation for the use, forbearance, or detention of money.” *Id.* § 301.002(a)(4).

The definition of interest is important in determining both the viability of a usury cause of action and the available damages upon proof of a violation. When interpreting whether a charge is interest, the courts apply a substance over form analysis. If the court deems that a charge is for the use, forbearance, or detention of money, then that charge is added to any amount actually defined as “interest” by the parties. *First USA Mgmt. v. Esmond*, 960 S.W.2d 625, 627-28 (Tex. 1997) (summarizing prior decisions which distinguish between charges which are interest and charges which are not); *Gonzales County Sav. & Loan Ass’n. v. Freeman*, 534 S.W.2d 903, 906 (Tex. 1976) (holding labels used by the parties are not controlling); *Skeen v. Slavik*, 555 S.W.2d 516, 520-21 (Tex. Civ. App.—Dallas 1977, writ ref’d n.r.e.) (finding one cannot avoid usury laws by simply calling charges a “put and call” agreement or some other term); see also *First Bank v. Tony’s Tortilla Factory, Inc.*, 877 S.W.2d 285, 288 (Tex. 1994) (finding where there is no interest, there can be no usury); *Tygett v. University Gardens Homeowners’ Ass’n*, 687 S.W.2d 481, 483 (Tex. App.—Dallas 1985, writ ref’d n.r.e.) (finding late charge for overdue condominium maintenance expenses not usurious, since charge not for use, forbearance, or detention of association’s funds). *But see Pentico v. M-W, Inc.*, 964 S.W.2d 708, 715 (Tex. App.—Corpus Christi 1998, pet. denied) (holding late charges will be treated as interest when charged against payment received after the due date). If a creditor is able to prove to the court that the charge is separate and distinct consideration for some service other than the simple lending of money, the charge is not deemed to be interest. See *Greever v. Persky*, 140 Tex. 64, 165 S.W.2d 709, 712 (1942).

The “use” of money, for purposes of usury, is that charge which is contracted for when a loan is made. *Parks v. Lubbock*, 92 Tex. 635, 51 S.W. 322, 323 (1899); see also *Sunwest Bank v. Gutierrez*, 819 S.W.2d 673, 675 (Tex. App.—El Paso 1991, writ denied) (finding charge for vendor’s insurance covering collateral was separate and additional consideration, and did not constitute interest). “Forbearance” within the meaning of the usury statute occurs when there is a debt due, or to become due, and the parties agree to extend the time of its payment. See, e.g., *Tygett*, 687 S.W.2d at 483 (explaining that although debt was due, no forbearance because no evidence of agreement to extend time of payment); *Meyer v. Mack Sales, Inc.*, 645 S.W.2d 493, 495 (Tex. App.—Corpus Christi 1982, writ

ref'd n.r.e.) (finding truck buyer's challenge to charge for "floor plan interest" failed to establish that the parties agreed to extend time of payment, so payment was not interest). "Detention of money" arises where a debt has become due and the debtor withholds the debt without having the right to do so. *McDaniel v. Tucker*, 520 S.W.2d 543, 549 (Tex. Civ. App.—Corpus Christi 1975, no writ).

### 3. Civil Penalties

Once usury is proven, the statutes specifically define the penalties allowed at law. TEX. FIN. CODE ANN. §§ 305.001 - .104 (Vernon 1998 & Supp. 2004). The statute applies to contracts for commercial transactions and several types of open-end accounts.<sup>6</sup> There are four penalty classifications of a receipt or charge of usurious interest: (1) interest higher than the Legal Rate, but less than the Maximum Legal Rate;<sup>7</sup> (2) interest higher than the amount contracted for, but less than the Maximum Legal Rate;<sup>8</sup> (3) interest higher than, but less than two times the Maximum Legal Rate; and (4) interest higher than two times the Maximum Legal Rate.

#### a. No Agreement Between the Parties to Charge Interest

##### (i) Interest Charged Greater Than the Legal Rate, But Less Than the Maximum Legal Rate

In the absence of an agreement to charge interest, a creditor who charges *or* receives interest greater than the Legal Rate is liable to the obligor for an amount equal to the greater of:

- (1) Three times the difference between the Legal Rate and the amount charged or received; or
- (2) \$2,000 or twenty percent (20%) of principal, whichever is less. TEX. FIN. CODE ANN. § 305.003(a) (Vernon Supp. 2004).

<sup>6</sup>Separate rules apply to certain classes of transactions. Examples include consumer loans that are not secured by real property, motor vehicle installment sales, retail installment sales, revolving credit accounts, and manufactured home credit transactions. See TEX. FIN. CODE ANN. §§ 345.001-.357, 346.001-.206, 347.001-.506, 348.001-.518 (Vernon 1998 & Supp. 2004). If the particular contract at issue falls under one of these subjects, it may be subject to a different set of statutory penalties. See TEX. FIN. CODE ANN. § 349.001 - .503.

<sup>7</sup>"If a creditor has not agreed with an obligor to charge the obligor interest, the creditor may charge and receive from the obligor legal interest at the rate of six percent a year. . ." TEX. FIN. CODE ANN. § 302.002 (Vernon Supp. 2004).

<sup>8</sup>The Finance Code prescribes maximum rates of interest or "ceilings" on various types of transactions. TEX. FIN. CODE ANN. §§ 303.001-.502.

##### (ii) Additional Liability for Interest Charged and Received Greater Than Twice the Maximum Legal Rate

A creditor who charges *and* receives interest greater than twice the Maximum Legal Rate is liable not only for the previously mentioned penalty, but additionally for:

- (1) The principal amount on which the interest is charged *and* received; and
- (2) The interest and all other amounts charged *and* received. *Id.* § 305.004(a).

#### b. Agreement Between the Parties to Charge Interest at a Specified Rate

##### (i) Interest Contracted For, Charged *Or* Received Greater Than, But Less Than Two Times, the Maximum Legal Rate

A creditor who contracts for, charges or receives interest that is greater than the Maximum Legal Rate is liable to the obligor for the greater of:

- (1) Three times the difference between the Maximum Legal Rate and the amount of interest contracted for, charged or received; or
- (2) \$2,000 or twenty percent (20%) of the amount of the principal, whichever is less. *Id.* § 305.001(a).

##### (ii) Interest Charged *or* Received Greater Than the Amount Contracted for, but Less Than the Maximum Legal Rate

Effective September 1, 1999, a creditor who charges or receives interest in excess of the amount contracted for, but less than the applicable Maximum Legal Rate, is not subject to usury penalties, but may be liable for other remedies and relief as provided by other applicable law. *Id.* § 305.001(c). This provision relieves the unknowing or unsophisticated creditor from liability for usurious interest. Although only applicable for charges on or after September 1, 1999, this provision is likely to protect many creditors from statutory damages resulting from a debtor's successful assertion of a usury defense.

##### (iii) Additional Liability for Interest Charged and Received Greater Than Two Times the Applicable Maximum Legal Rate

In addition to the penalties described in (b)(i) above, a creditor who charges *and* receives interest in excess of two times the applicable Maximum Legal Rate is liable to the obligor for:

- (1) The principal amount on which the interest is charged *and* received; and
- (2) The interest and all other amounts charged *and* received. See *id.* § 305.002(a) (emphasis added).

c. Debtor Remains Liable on Principal Amount If Interest Charged or Received Is Less Than Twice the Legal Rate

While usurious contracts are void as to interest, a borrower remains liable to pay the principal absent additional penalties. *Clements v. Williams*, 128 S.W.2d 103, 106 (Tex. Civ. App.—Austin 1939, no writ) (finding error where lower court based usurious penalty, in part, upon payment of principal rather than of interest).

*Hardwick v. Austin Gallery of Oriental Rugs, Inc.* provides an example of the judicial analysis applied to a claim for damages under the usury statutes. 779 S.W.2d 438 (Tex. App.—Austin 1989, writ denied). *Hardwick* involved a promissory note, payable in installments and secured by liens on real property. *Id.* at 440. After four years of note payments, Austin Gallery notified *Hardwick* that it wished to pay the balance of the note and obtain a release of liens. *Id.* In return for the release of liens, *Hardwick* demanded ten percent of the principal and interest owing on the note. *Id.* *Hardwick* alleged this demand was based upon a provision in the note providing for a penalty of ten percent of the then outstanding principal and interest. *Id.* Austin Gallery agreed to pay the extra \$5,000, and then brought suit against *Hardwick* under the Texas usury statute and the Deceptive Trade Practices Act (DTPA). *Id.* The trial court awarded Austin Gallery judgment against *Hardwick* in the amount of the debt, together with attorneys' fees, post-judgment interest, and costs of court, but denied the claim for statutory damages based on DTPA and usury. *Id.*

*Hardwick* argued that the \$5,000 he demanded was not "interest" or, in the alternative, any demand for such sum constituted an accidental and bona fide error and should be reformed as the note and deed of trust contained usury savings provisions. *Id.* at 442. The appellate court held that it was immaterial that the note and deed of trust did not provide for usury on their face, and that it was also immaterial that the contract documents negated any intent to contract for usury (a usury savings provision). *Id.* at 443. Instead, Austin Gallery's usury claim rested on the allegation that *Hardwick* charged usury outside of the party's contract. *Id.* Even though *Hardwick* had not expressly contracted for this additional sum, he had "charged" and "received" the \$5,000 by intentionally demanding the additional sum. *Id.* As the act of "charging" interest was intentional, the defense of bona fide error was not available. *Id.*; accord *Lawler v. Lomas & Nettleton Mortgage Investors*, 691 S.W.2d 593, 596 (Tex. 1985); see also *Cochran v. American Sav. & Loan Ass'n*, 586 S.W.2d 849, 850 (Tex. 1979) (per curiam) (explaining that intent in usury cases is the intention to make the bargain made, not the specific intent to charge interest higher than the maximum rate). Pursuant to the usury statutes, any person who "contracts for, charges or receives interest which is greater than the amount authorized by [law] shall forfeit to the obligor three times the amount of usurious interest contracted for, charged or received." *Hardwick*, 779 S.W.2d at 442-43. Further, the court held that the \$5,000

was to be considered "interest" because the evidence established that *Hardwick* charged the additional sum as a penalty for a late payment. *Id.* at 4430 (finding that penalty is a charge to compensate the obligee for the use, forbearance, or detention of money). The court awarded Austin Gallery damages equal to three times its actual damages, as authorized by statute. *Id.*; see also TEX. FIN. CODE ANN. § 305.001 (Vernon Supp. 2004). The court denied additional recovery under section 17.50 of the DTPA due to the DTPA's prohibition of allowing recovery under 17.50 in addition to penal sums authorized by another statute. *Hardwick*, 779 S.W.2d at 445-46.

As is apparent from *Hardwick*, counsel should note that an obligee may be liable for usury in the absence of a written contract. If the interest "charged" exceeds the legal limit, a violation exists. In contracts where interest is charged or received in the absence of any written agreement, the "legal interest" rate is set at six percent (6%) per year. TEX. FIN. CODE ANN. § 302.002 (Vernon Supp. 2004).

d. Usury Involving a Charge and Receipt Exceeding Two Times the Maximum Legal Rate

In addition to recoverable damages under the general rule, the usury statutes provide an additional penalty against those who charge and receive greater than two times the maximum legal rate. TEX. FIN. CODE ANN. § 305.002 (Vernon Supp. 2004). Under the Texas Credit Title, the obligee must both charge *and* receive interest that is greater than twice the applicable legal rate. If an obligee does both, the obligee will be liable to the obligor for: (1) the principal amount of the obligation on which the interest is charged and received; (2) interest charged and received; and (3) all other charges defined by the statute. *Id.* The requirement of both a charge and receipt of twice the maximum legal rate is a change from the law prior to September 1, 1997. Claims based upon transactions occurring prior to September 1, 1997 provide the additional recovery against a creditor who merely contracted for, charged, *or* received interest greater than twice the amount authorized. TEX. REV. CIV. STAT. ANN. arts. 5069-1.01-8.06 (Vernon 1987 & Supp. 1999) (emphasis added). Under Texas Credit Title, it appears that an obligor is prohibited from recovering the additional penalty against a creditor who merely contracts for interest that exceeds double the maximum rate, if the usurious interest is never actually collected. See TEX. FIN. CODE ANN. § 305.002.

"Principal" for purposes of the additional penalties for charging more than twice the legal rate, is the amount on which the improper interest was charged and received. *Steves Sash & Door Co. v. Ceco Corp.*, 751 S.W.2d 473, 476 (Tex. 1988). An award of principal essentially cancels the indebtedness. If a debt is entirely unpaid at the time of judgment, the judgment may call for cancellation of the debt.

Alternatively, the court may award the obligor the entire amount of the debt but may not do both. See *Tri-County Farmer's Co-op v. Bendele*, 641 S.W.2d 208, 210 (Tex.

1982) (per curiam) (holding that an award of the dollar amount of a debt as well as a cancellation of the indebtedness was double forfeiture not contemplated by usury statute). Once a debt has been cancelled as a result of a finding of usury, the obligee cannot bring an enforcement action for amounts related to the indebtedness. *See Broady v. Johnson*, 763 S.W.2d 832, 835 (Tex. App.—Texarkana 1988, no writ) (requiring forfeiture of principal, interest, and attorney’s fees when party charging usurious interest in excess of double the legal rate).

#### 4. Attorney’s Fees

The Texas Credit Title provides for an award of reasonable attorneys’ fees from a creditor who is liable for a violation of sections 305.001, 305.002, or 305.003. TEX. FIN. CODE ANN. § 305.005 (Vernon Supp. 2004); *see also Broady*, 763 S.W.2d at 835 (attorney’s fees available). If no evidence is submitted to the reasonableness of attorney’s fees, however, the right to recover the fees may be waived. *Smart v. Tower Land & Inv. Co.*, 635 S.W.2d 615, 621 (Tex. App.—Dallas 1982, writ ref’d n.r.e.).

#### 5. Criminal Penalties

In addition to monetary penalties, the usury statutes provide for criminal liability. *See* TEX. FIN. CODE ANN. § 305.008 (Vernon Supp. 2004). In transactions for personal, family or household uses, the usury statutes provide for criminal liability for a person who contracts for, charges, or receives more than two times the amount of interest authorized by usury laws. *Id.*; *see also* TEX. REV. CIV. STAT. ANN. arts. 5069-1.06(2) (Vernon 1987 & Supp. 1997), *repealed by* 5069-1F.008 (Vernon Supp. 1999) (prior law).

Criminal liability arises when the obligee charges interest at twice the authorized amount *and* the underlying obligation is for personal, family, or household use. *See* TEX. FIN. CODE ANN. § 305.008 (Vernon Supp. 2004). Each contract or transaction is a separate offense. TEX. FIN. CODE ANN. § 305.008 (Vernon Supp. 2004); TEX. REV. CIV. STAT. ANN. art. 5069-1.06(2) (Vernon 1987 & Supp. 1997), *repealed by* TEX. REV. CIV. STAT. ANN. §§ 5069-1F.008(c) (Vernon Supp. 1999).

#### 6. De Minimis Violations

There will be no penalty for de minimis usury violations. In *Yates Ford, Inc. v. Ramirez*, 692 S.W.2d 51, 54-55 (Tex. 1985), the Texas Supreme Court held that although certain contracts to purchase motor vehicles violated the usury statute, none of the usurious charges exceeded \$2. Referring to the legislature’s intent in passing the usury laws, the court explained that the legislature sought to protect the citizens of Texas from abusive and deceptive practices perpetrated by unscrupulous creditors. *Id.* at 55. The small amount of the overcharges in this case “indicates the creditor made a slight error in calculating the finance

charges under a highly technical statute—not that this was an unscrupulous scheme to defraud citizens.” *Id.* As a penal statute, the usury laws must be strictly construed. *Id.* The court therefore denied recovery for the defendant’s de minimis violations. *See also Gawlik v. Padre Staples Auto Mart, Inc.*, 666 S.W.2d 161, 165 (Tex. App.—Corpus Christi 1983, writ ref’d n.r.e.) (overcharge of \$1.62 not usurious); *Wayne Strand Pontiac-GMC v. Molina*, 653 S.W.2d 45, 46 (Tex. Civ. App.—Corpus Christi 1983, writ ref’d n.r.e.) (\$5.53 overcharge for license fee not usurious); *Starness v. Guar. Bank*, 634 S.W.2d 325, 329 (Tex. Civ. App.—Dallas 1982, writ ref’d n.r.e.) (overcharge of \$7.56 over 36 months not usurious); *Thornhill v. Sharpstown Dodge Sales, Inc.*, 546 S.W.2d 151, 152-53 (Tex. Civ. App.—Beaumont 1976, no writ) (overcharge of \$.42 over 42 months not usurious).

It should be noted, however, that Justices Kilgarlin and Spears concurred in the *Yates* decision, albeit for different reasons from the majority. *Yates*, 692 S.W.2d at 56 (Kilgarlin, J. & Spears, J., concurring). The concurring justices strongly disagreed with the proposition that de minimis violations should go unpunished, arguing that the court’s holding effectively destroys the bright line created by the legislature. The concurrence also points out that even de minimis violations can become great if repeatedly committed, noting that “[i]f we multiply \$3 by the number of loans a credit corporation or car dealership establishes, the extra income to the loan company may be enormous”. *Id.* The concurring justices agreed with the result of the decision; however, they believed that the rate of interest had been calculated incorrectly and that the actual amount charged was not in violation of the statute. *Id.*

#### 7. Opportunity to Cure

Counsel should be aware that, contrary to prior law, the present usury statutes afford an obligee two distinct opportunities to correct a usury violation. First, opportunity exists prior to the obligee receiving notice of the violation from the debtor and for 60 days after the obligee has actual knowledge of the usury violation. If the obligee corrects a usury violation during that time period, there is no violation. The obligee may correct the violation through offset of a portion of the balance due or by refunding payment of the excess interest. TEX. FIN. CODE ANN. § 305.103 (Vernon Supp. 2004). The second opportunity to cure arises when the debtor provides the obligee notice of the usury violation. TEX. FIN. CODE ANN. § 305.006 (Vernon Supp. 2004).

The opportunity to cure a usury violation is not applicable when a usury counterclaim is asserted by the debtor-obligor. Therefore, prior to suit, a creditor’s counsel must have the client carefully verify calculations of interest, late fees, and any other charges which could be deemed “interest.” Counsel should encourage clients to correct all violations prior to filing suit on the underlying indebtedness.

The failure to make this pre-suit confirmation could subject a client to readily avoidable damages.

### B. Common Law Usury Remedies

Common law usury remedies are no longer available for usurious transactions. TEX. FIN. CODE ANN. § 305.007 (Vernon Supp. 2004); TEX. REV. CIV. STAT. ANN. arts. 5069-1F.007. Prior to the 1999 changes, the Texas usury law did not contain any such limitation. See TEX. FIN. CODE ANN. §§ 305.001 - .104 (Vernon 1998). This omission was corrected by the Texas Legislature in 1999. Therefore, on or after September 1, 1999, the usury statutes provide the exclusive remedy for a violation. Prior to that date, the statutory usury remedies were not exclusive. See, e.g., *Coppedge v. Colonial Sav. & Loan Ass'n*, 721 S.W.2d 933, 938-39 (Tex. App.—Dallas 1986, writ ref'd n.r.e.) (holding that the usury statute did not repeal the common law action, although parties are entitled to only one recovery for the same loss); *Commercial Credit Equip. Corp. v. West*, 677 S.W.2d 669, 679 (Tex. App.—Amarillo 1984, writ ref'd n.r.e.) (finding that language of usury statute does not express a clear intent by the legislature to overturn common law action for usury). Since the former usury statute still applies to claims arising before September 1, 1997, a plaintiff bringing such an action may presumably recover either at common law or in a statutory action. See, e.g., *Danziger v. San Jacinto Sav. Ass'n*, 732 S.W.2d 300, 304 (Tex. 1987) (finding where common law action is properly pleaded, court may award both statutory penalties and common law damages).

The common law authorizes recovery for usury even when paid voluntarily. *Bexar Bldg. & Loan Ass'n v. Robinson*, 78 Tex. 163, 14 S.W. 227, 228 (1890). The measure of common law damages is the amount of usurious interest paid less the amount that could be legally charged. Courts differ on the meaning of “usurious interest.” One view is that the amount is equal to the difference between the legal amount and the amount charged. See, e.g., *Coppedge*, 721 S.W.2d at 938-39 (holding common law allows for recovery of amount by which the interest paid exceeds the legal maximum, but not the amount of interest paid within the legal rate). The other view is more similar to the statutory penalties, and considers the common law measure of recovery “in light of” the usury statute. See *Commercial Credit*, 677 S.W.2d at 680 (holding that common law theory of recovery was inadequate to compensate plaintiff in light of additional penalties provided by usury statute). The Texas Supreme Court appears to approve this approach without expressly holding as much. See *Danziger*, 732 S.W.2d at 304 (approving damage award under plaintiff’s common law usury claim in amount of all interest paid, as well as cancellation of interest not yet paid). When common law damages are sought, attorney’s fees may be recoverable if the action is based on a contract. TEX. CIV. PRAC. & REM. CODE ANN. § 38.001 (Vernon 1997).

### C. Federal Preemption

Certain federal statutes preempt state usury laws. The Depository Institutions Deregulation and Monetary Control Act of 1980 (the “Act”), for example, preempts state usury laws as to loans made after April 1, 1980, which are secured by first liens on residential real property. 12 U.S.C.A. § 1735f-7 (West 2001); *Seiter v. Veytia*, 756 S.W.2d 303, 305 (Tex. 1988). The Act does not preempt state usury laws that pertain to usurious late charges, however. Federal statutes that authorize state-chartered federally insured banks to charge interest in excess of the state constitutional or statutory limits also preempt state usury laws. 12 U.S.C.A. § 1831d(a) (West 2001). Where Texas usury penalties are recovered and an action under the Federal Consumer Protection Act (15 U.S.C. §§ 1601 – 1693r) is commenced, the creditor has an action to collect the amount awarded in state court. TEX. FIN. CODE ANN. § 349.404(b) (Vernon 1998) (allowing an action to recover the amount of the judgment rendered under TEX. FIN. CODE ANN. §§ 349.001, 349.002, or 349.003).

### V. COMMON LAW FRAUD

As is the case for any other tort, a person injured by common law fraud may recover direct and consequential damages. *Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41, 49 n.1 (Tex. 1998); *Airborne Freight Corp. v. C.R. Lee Enters., Inc.*, 847 S.W.2d 289, 295 (Tex. App.—El Paso 1992, writ denied); RESTATEMENT (SECOND) OF TORTS § 549 (1977) (may recover pecuniary damages). Exemplary damages also are available in a fraud action. TEX. CIV. PRAC. & REM. CODE ANN. § 41.003(a)(1) (Vernon Supp. 2004); *Trenholm v. Ratcliff*, 646 S.W.2d 927, 933 (Tex. 1983).

#### A. Direct Damages

Direct damages are those that are the necessary and usual result of the defendant’s wrongful act; they flow naturally from the wrong. *Arthur Andersen & Co. v. Perry Equip. Co.*, 945 S.W.2d 812, 816-17 (Tex. 1997) (noting that actual damages available under the DTPA are those recoverable for common law fraud). Generally, direct damages may be measured in two ways: (1) by determining the out-of-pocket loss the plaintiff suffered; or (2) by determining the benefit-of-the-bargain the plaintiff lost. *Formosa Plastics*, 960 S.W.2d at 49; *Arthur Andersen & Co.*, 945 S.W.2d at 817. Courts have recognized, however, that neither the out-of-pocket nor benefit-of-the-bargain theories seem to adequately address all circumstances. One example is when the fraud is not based on the transfer of property or something else of value. *Texas Commerce Bank Reagan v. Lebo Constructors, Inc.*, 865 S.W.2d 68, 73-74 (Tex. App.—Corpus Christi, 1993, writ denied); *Sanchez v. Johnson & Johnson Med., Inc.*, 860 S.W.2d 503, 514 (Tex. App.—El Paso 1993), *modified on other grounds*, 924 S.W.2d 925 (Tex. 1996). In these situations, the plaintiff

will be forced to prove special or consequential damages and cannot rely on out-of-pocket or benefit-of-the-bargain damages. *Texas Commerce Bank Reagan*, 865 S.W.2d at 73-74.

Whether benefit-of-the-bargain damages are actually available in any given fraud action depends on the circumstances surrounding the fraud. At first glance, *Formosa Plastics* seems to settle a dispute among the courts of appeals as to whether benefit-of-the-bargain damages are recoverable in fraud cases. *Formosa Plastics*, 960 S.W.2d at 47. Previously, several courts of appeals had held that tort damages are not recoverable in a case involving an alleged breach of contract and fraud unless the plaintiff suffered an injury that was distinct, separate, and independent from the economic losses recoverable under the breach of contract claim. See, e.g., *Grace Petroleum Corp. v. Williamson*, 906 S.W.2d 66, 68-69 (Tex. App.—Tyler 1995, no writ); *Barbouti v. Munden*, 866 S.W.2d 288, 293-94 (Tex. App.—Houston [14th Dist.] 1993, writ denied); *C&C Partners v. Sun Exploration & Prod. Co.*, 783 S.W.2d 707, 719-20 (Tex. App.—Dallas 1989, writ denied). These cases based their decisions on two Texas Supreme Court opinions addressing whether an action sounds in contract or tort. See *Southwestern Bell Tel. Co. v. DeLanney*, 809 S.W.2d 493, 494 (Tex. 1991); *Jim Walter Homes, Inc. v. Reed*, 711 S.W.2d 617, 618 (Tex. 1986).

*DeLanney* and *Reed* held that when the plaintiff's injury is nothing more than the economic loss of a contract, the action sounds in contract alone and tort damages are not recoverable. *DeLanney*, 809 S.W.2d at 494; *Reed*, 711 S.W.2d at 618; see also *Miga v. Jensen*, 96 S.W.3d 207, 211 (Tex. 2002) (finding the mere fact that there is a dispute between the parties regarding the terms of an agreement does not transform a contractual disagreement into a fraud claim). *Formosa Plastics* differed from *DeLanney* and *Reed* because it was a claim based on a fraudulent inducement to contract. *Formosa Plastics*, 960 S.W.2d at 46-47. The legal duty not to fraudulently procure a contract is separate and independent from the duties established by the contract itself. *Id.* Thus, such claims are not governed by *DeLanney* and *Reed*. *Id.*

The *Formosa Plastics* court limited this holding to fraudulent inducement cases. *Id.* at 47. Therefore, *Formosa Plastics* probably does not affect prior case law addressing the circumstance where a person is seeking recovery for fraud associated with the alleged breach of contract. In these cases, benefit-of-the-bargain damages will probably still be unavailable. See, e.g., *Facciolla v. Linbeck Constr. Corp.*, 968 S.W.2d 435, 448-49 (Tex. App.—Texarkana 1998, no pet.); *Leach v. Conoco, Inc.*, 892 S.W.2d 954, 960-61 (Tex. App.—Houston [1st Dist.] 1995, writ dismissed w.o.j.); *Gold Kist, Inc. v. Carr*, 886 S.W.2d 425, 431-32 (Tex. App.—Eastland 1994, writ denied); *Collins v. McCombs*, 511 S.W.2d 745, 747 (Tex. Civ. App.—San Antonio 1974, writ refused n.r.e.). Fraud was usually alleged in these cases in an attempt either to avoid a statute of frauds

problem or to recover exemplary damages by alleging fraud in a mere breach of contract case. See, e.g., *J. Parra e Hijos, S.A. de C.V. v. Barroso*, 960 S.W.2d 161, 169 (Tex. App.—Corpus Christi 1997, no pet.) (exemplary damages); *Leach*, 892 S.W.2d at 960-61 (statute of frauds). Accordingly, these cases held that unless the plaintiff could prove injuries occurring independently from the breach of contract, the fraud claim failed to the extent the parties sought benefit-of-the-bargain damages. See, e.g., *Peco Constr. Co. v. Guajardo*, 919 S.W.2d 736, 739 (Tex. App.—San Antonio 1996, writ denied). Furthermore, if there was no contract as a matter of law, there cannot be fraud based on breach of the alleged promise, and therefore no damages are recoverable. *Bank of El Paso v. T.O. Stanley Boot Co.*, 809 S.W.2d 279, 289 (Tex. App.—El Paso 1991), *aff'd in part, rev'd in part on other grounds*, 847 S.W.2d 218 (Tex. 1992).

### 1. Out-Of-Pocket Damages

Out-of-pocket damages measure the difference between the value paid by the aggrieved party and the value received. *Formosa Plastics*, 960 S.W.2d at 49; *George v. Hess*, 100 Tex. 44, 93 S.W. 107, 108 (1906). Several courts have stated that the goal in measuring out-of-pocket damages is to provide actual compensation for injury, not profit. *Duval County Ranch Co. v. Wooldridge*, 674 S.W.2d 332, 335-36 (Tex. App.—Austin 1984, no writ). The theory is that if the plaintiff receives a sum of money that makes what the plaintiff received equal to what was actually conveyed, the plaintiff is made whole. *George*, 93 S.W. at 108.

The valuation to be used is the fair market value. *Morriss-Buick Co. v. Pondrom*, 131 Tex. 98, 113 S.W.2d 889, 890 (1938); *Traylor v. Gray*, 547 S.W.2d 644, 657 (Tex. Civ. App.—Corpus Christi 1977, writ refused n.r.e.). Such damages are generally measured as of the time of the transaction. *Arthur Andersen & Co.*, 945 S.W.2d at 817; *Leyendecker & Assocs., Inc. v. Wechter*, 683 S.W.2d 369, 373 (Tex. 1984). However, the time of the transaction is not appropriate in all situations. See, e.g., *Traylor*, 547 S.W.2d at 657 (finding in futures contract, proper measure was fair market value of cotton at time of misrepresentation less the fair market value at the time of the maturity of the crop). The fair market value is the price at which the thing of value would change hands between a willing seller, under no compulsion to sell, and a willing buyer, under no compulsion to buy, with both parties having reasonable knowledge of relevant facts. *Nelson v. Najm*, 127 S.W.3d 170, 177 (Tex. App.—Houston [14th Dist.] 2003, pet. denied); *Fisher v. Yates*, 953 S.W.2d 370, 379 (Tex. App.—Texarkana 1997, pet. denied); *State Nat'l Bank v. Farah Mfg. Co., Inc.*, 678 S.W.2d 661, 697 (Tex. App.—El Paso 1984, writ dismissed by agr.). Moreover, the definition of fair market value presupposes an existing and established market. *State Nat'l Bank*, 678 S.W.2d at 697.

As is true in any other area of law, creativity is the limit on what might be argued to constitute out-of-pocket

damages. Furthermore, such damages are necessarily case specific. The following collection of cases is intended to provide guidance as to what constitutes out-of-pocket damages and what does not. The cases are grouped into categories of similar subject matter. The collection is not all inclusive.

a. Related To Loans

- (i) *Chase Commercial Corp. v. Datapoint Corp.*, 774 S.W.2d 359 (Tex. App.—Dallas 1989, no writ)

The plaintiff in this case purchased two equipment leases from the defendant. *Id.* at 360. The defendant committed fraud by failing to tell the purchaser that the lessees had declared bankruptcy shortly before the sale of the leases. *Id.*

In reversing a directed verdict, the court found that there was some evidence regarding the plaintiff's out-of-pocket damages. *Id.* at 367-68. The plaintiff had provided evidence regarding the amount paid for the assignment of the two equipment leases. *Id.* at 367. Furthermore, evidence indicated the amount still owed on the two leases. *Id.* Finally, the leased equipment had been repossessed and had been sold for \$15,410. *Id.* The proper measurement of out-of-pocket expenses in this case would be the amounts paid by the plaintiff for the equipment leases less the amount received when the collateral was sold. *Id.*

- (ii) *Kneip v. Unitedbank-Victoria*, 734 S.W.2d 130 (Tex. App.—Corpus Christi 1987, no writ).

Two of the plaintiffs had personally guaranteed a loan of over \$200,000 to their private business. *Id.* at 132. After liquidating their business, the two plaintiffs entered into a new loan agreement with the bank whereby they borrowed the amount owed by the private business and immediately paid the business's indebtedness. *Id.* The original loan to the business was unsecured other than the personal guarantee of the two owners. *Id.* The new loan was secured by a deed of trust to 60 acres of land owned by the plaintiffs. *Id.* The jury found that the bank secured the second loan through fraud and awarded the plaintiffs \$110,000 in pecuniary losses. *Id.* at 135.

The court found that the evidence was insufficient to support the award of damages. *Id.* The evidence showed that the plaintiff incurred a charge of \$1,442.15 to obtain a title policy in connection with the closing fees on the second loan. *Id.* Evidence also showed that the plaintiffs incurred between \$2,000 and \$3,000 in expenses related to their lawyer's activities in taking depositions and paying for subpoenas and other charges related to the lawsuit at hand. (The court recognized that attorneys' fees are not recoverable actual damages in a fraud action). *Id.* Such expenses were some evidence of pecuniary loss but were insufficient to support the jury award. *Id.*

The plaintiffs also argued that the encumbrance on the 60 acres of land was some evidence of pecuniary loss. *Id.* However, the plaintiffs failed to show how the existence of

an encumbrance adversely affected them in any way. *Id.* Furthermore, the court found that the ten percent interest charged on the second loan could not be a pecuniary loss because the plaintiffs never made and never intended to make any payments on the note. *Id.*

b. Related To The Purchase Of Land

- (i) *Leyendecker & Assocs., Inc. v. Wechter*, 683 S.W.2d 369 (Tex. 1984)

The plaintiff purchased a townhouse and an accompanying lot from the defendant developers. *Id.* at 371.

The developers represented that the lot purchased by the plaintiff would be slightly larger than the standard lot, and the plaintiff relied on that representation. *Id.* at 372. The representation turned out to be false. *Id.*

The plaintiff failed to recover out-of-pocket damages because he failed to present any evidence as to the value he had paid for the 2,411 square foot shortage of land as distinct from the purchase price of the entire lot and improvements. *Id.* at 373.

- (ii) *Maeberry v. Gayle*, 955 S.W.2d 875 (Tex. App.—Corpus Christi 1997, no pet.)

In *Maeberry*, the plaintiff's uncle was appointed guardian over the plaintiff when the plaintiff's grandfather passed away. *Id.* at 877. The grandfather appointed the uncle trustee of his estate, which included a house for benefit of the plaintiff. *Id.* The uncle procured title to the house through fraud. *Id.* The court awarded the fair market rental value of the house for the time period during which the uncle controlled the house as out-of-pocket damages. *Id.* at 881.

The plaintiff's expert testified that the house had a fair market rental value of \$200 per month at the time of trial. *Id.* He also said that properties of that sort generally held their value. *Id.* The expert discounted the repairs made by the uncle stating that they were necessary to keep the house habitable and they increased the life expectancy of the house, but did not affect the rental value. *Id.* The court held this testimony was sufficient to support damages at a rate of \$200 per month for the relevant time period. *Id.*

c. Related To Service Contracts

- (i) *Latham v. Castillo*, 972 S.W.2d 66 (Tex. 1998)

In this case a client sued an attorney for fraudulent misrepresentation, stemming from the attorney's failure to file a medical malpractice claim before the expiration of the limitations period. *Id.* at 68. The attorney made representations to the client that he had filed and was actively prosecuting the claim. *Id.* The trial court granted a directed verdict in favor of the attorney. *Id.* The supreme court affirmed the directed verdict, holding that the client failed to plead or prove either out-of-pocket or benefit-of-the-bargain damages. *Id.* at 70. From the court's opinion it can be inferred that if the client had demonstrated any out-of-pocket

expenses to the attorney, a recovery might have been possible.

- (ii) *Offshore Petroleum Divers, Inc. v. Crompt*, 952 S.W.2d 954 (Tex. App.—Beaumont 1997, pet. denied)

Plaintiffs were students at a diving school. *Id.* at 955. Offshore Petroleum Divers, Inc. (OPD), made representations to the plaintiffs, via letters and telephone conversations, regarding prospective employment with OPD. *Id.* Relying on OPD's representations, the plaintiffs incurred considerable travel expenses in relocating to new jobs. When they arrived, the plaintiffs were not given the jobs as previously represented by OPD. *Id.* Plaintiffs brought an action for fraud against OPD. *Id.* at 954. After finding that the employer had committed fraud, the jury awarded each plaintiff damages for out-of-pocket expenses. *Id.*

On appeal, OPD requested that the court declare that an at will employee could not maintain a cause of action for fraud against an employer, citing the employment at will doctrine. *Id.* at 955. The court refused to make such a determination, holding that a cause of action for fraud, including misrepresentations made before and during employment, is not barred by the employment at will doctrine. *Id.* at 956. OPD further argued that since the employment relationship could not be performed within one year, the plaintiffs' cause of action for fraud was barred by the Statute of Frauds. In addition, none of the promises made by OPD were in writing. *Id.* The court dismissed this argument, noting that the plaintiffs' recovery of damages was for out-of-pocket expenses (instead of benefit-of-the-bargain damages) and, as such, their recovery was based in tort, not in contract. Holding in favor of the plaintiffs, the court stated:

[U]nder the unique circumstances of this case, allegations of fraud regarding pre-employment misrepresentations, which are evidenced by the pleadings, trial testimony, the court's charge, and the award by the jury, are not barred by the Statute of Frauds.

*Id.* at 957.

- (iii) *Hoechst Celanese Corp. v. Arthur Bros., Inc.*, 882 S.W.2d 917 (Tex. App.—Corpus Christi 1994, writ denied)

The defendant oil refinery threatened to award a maintenance contract, currently serviced by the plaintiff, to another company. *Id.* at 921. After negotiations, the parties entered a nine month contract with several new requirements imposed upon the plaintiff. *Id.* The oil refinery represented that if the maintenance company improved its performance to an acceptable level, the relationship would continue long term. *Id.* The jury found that the oil refinery misrepresented

its intentions with respect to the long term nature of the relationship and thereby committed fraud. *Id.* at 920.

The plaintiff maintenance company attempted to prove its out-of-pocket damages by establishing several categories of additional expenses it incurred with respect to the new agreement. *Id.* at 926-27. For example, it submitted evidence regarding additional training and education, expenses associated with the acquisition of a new truck, increased office space, salaries of persons assigned to the oil refinery, payroll overhead on certain excess salaries, and costs related to the oil refinery's failure to timely notify the maintenance company of the termination of the long term relationship. *Id.* at 927.

However, many of the expenses were related to performing under the contract between the two companies and were therefore not recoverable as out-of-pocket damages. *Id.* For example, the expenses related to the new vehicle were related to the maintenance company's attempt to satisfy its obligations under the contract. *Id.* Ultimately, the only expense that the court found to be recoverable as an out-of-pocket expense related to training the maintenance company's employees in a team management concept. *Id.* at 928. This element survived because there was evidence that the team management concept would not have been developed for a short term relationship. *Id.*

- (iv) *Airborne Freight Corp. v. C.R. Lee Enters., Inc.*, 847 S.W.2d 289 (Tex. App.—El Paso 1992, writ denied)

The plaintiff in this case failed to prove its out-of-pocket damages were related to its fraud claim and were not the result of the termination of the contract. *Id.* at 296. The court held that the plaintiff's damages all flowed from the termination of the contract and therefore could not support a fraud claim. *Id.* The parties entered into a contract where the plaintiff delivered packages for defendant. The evidence with respect to damages showed: (1) plaintiff acquired a building for its business; (2) plaintiff purchased additional vehicles in reliance on the defendant's fraud; (3) plaintiff hired two new employees; and (4) plaintiff borrowed \$130,000. *Id.* However, the plaintiff did not try to quantify the amount it paid for these items as compared to the value of the items the company retained after termination of the contract. *Id.*

For example, the plaintiff offered no evidence as to the amount of interest it paid. *Id.* It also offered no evidence regarding the sale of the building at a loss or failure to rent it after termination of the contract. *Id.* With respect to the two new employees, the plaintiff offered no evidence regarding unemployment benefits or any requirement to retain the two employees at a loss. *Id.* Finally, the plaintiff did not offer evidence as to whether it was unable either to sell or otherwise use the additional vehicles that it had purchased. *Id.*

## d. Related to Joint Ventures

- (i) *C&C Partners v. Sun Exploration & Prod. Co.*, 783 S.W.2d 707 (Tex. App.—Dallas 1989, writ denied)

The parties entered into three exploration and joint operating agreements with respect to three drilling prospects. *Id.* at 710-11. C&C Partners failed to pay its share of expenses. *Id.* at 711. Among other things, the jury found fraud. *Id.* With respect to out-of-pocket damages, the plaintiff offered the testimony of its accountant as to several additional expenses such as building maintenance, cost of computers, cost of materials and inventory warehouse charges that it incurred above and beyond the damages that it incurred for breach of contract. *Id.* at 719. The accountant, however, admitted that these costs were negotiated at the time the contract had been entered. *Id.* Therefore, the court held that these expenses were simply part of the breach of contract damages and were not recoverable as out-of-pocket damages. *Id.*

Note that this case was overruled by *Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41, 46 (Tex. 1998) to the extent that it held benefit-of-the-bargain damages are not available in a fraudulent inducement cause of action.

## e. Related To Construction Contracts

- (i) *Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc.* 960 S.W.2d 41, 46 (Tex. 1998)

The defendant in this case fraudulently induced the plaintiff construction contractor to bid low on a large construction project. *Id.* at 48-49. The plaintiff contractor argued that the appropriate measure of out-of-pocket damages it should be entitled to receive was the amount that it would have bid for the project if it had known the truth, minus the amount it actually bid. *Id.* at 49. The court held that this was not the proper measure of out-of-pocket damages because the calculation included expected lost profits that were not made. *Id.* at 49-50. Rather, the proper measure of out-of-pocket damages was the total of the cost of labor, materials, supplies and equipment used on the job, \$831,000, less the amount the contractor actually received, \$600,000, to equal damages of \$231,000. *Id.*

- (ii) *HOW Ins. Co. v. Patriot Fin. Servs. of Tex., Inc.*, 786 S.W.2d 533 (Tex. App.—Austin 1990, writ denied), *overruled on other grounds sub nom. Hines v. Hash*, 843 S.W.2d 464, 470 (Tex. 1992)

In this defective construction case, the court held that there were two correct measures of damages: (1) the difference in value measure; or (2) the remedial measure. *Id.* at 546. In this type of case, courts generally choose the remedial measurement if repairs are feasible. *Id.* The difference in value is shown by the difference between the purchase price of the property and the market value at the time of the fraudulent transaction. *Id.* Here, the plaintiff failed to show the market value of the property at the time of the sale. Rather, the plaintiff presented evidence of the

market value at the time of trial, which was not sufficient to show out-of-pocket damages. *Id.* at 546-47.

## f. Related To Futures Contracts

- (i) *Traylor v. Gray*, 547 S.W.2d 644 (Tex. Civ. App.—Corpus Christi 1977, writ ref'd n.r.e.)

The defendant cotton gin operator also acted as a broker between cotton farmers and purchasers of ginned cotton. *Id.* at 647. In an attempt to keep the plaintiff cotton farmer as a customer of his gin, the defendant fraudulently represented to the farmer that he had sold his cotton for \$.78 a pound when the only potential buyer had actually refused to pay more than \$.75 per pound. *Id.* at 648. The plaintiff relied on this representation and passed the chance to sell the cotton for \$.75 per pound through another broker. *Id.* at 649.

The court recognized that the general measure of damage in a fraud action is the difference between the amount with which the plaintiff parted less the value of what he received. *Id.* at 656. In this case, the appropriate measure of damages was the actual loss suffered by the plaintiff as measured by the value of the cotton crop at the time of the misrepresentation diminished by the value of the crop at harvest time when the fraud was discovered. *Id.* It was not the value of the crop as stated in the false misrepresentation. *Id.* at 657.

The value of the crop was to be measured as a computation of the market price at the relevant times. *Id.* The court held that a scarcity of sales during the relevant time period did not preclude the computation of a market price. *Id.* In this case, the proper measure was the market value of the cotton at the time of the misrepresentation, minus the lowest market value at harvest time, minus a discount for defects in the cotton that would have affected the ultimate value even under the fraudulent agreement. *Id.* Because the cotton was harvested at two different times, the market values at harvest time were adjusted accordingly. *Id.*

The court apparently used the lowest market value at the time of harvest because it forced the plaintiff to remit excess damages awarded by the jury. *Id.*

## g. With Respect To The Sale Of Goods

- (i) *Sobel v. Jenkins*, 477 S.W.2d 863 (Tex. 1972)

The seller of an automobile misrepresented that the car was new when in fact it was a composite of two used vehicles. *Id.* at 864. The correct measure of damages in this case was the difference between the amount the plaintiff actually paid and the fair market value of the automobile as delivered. *Id.* at 868.

- (ii) *Morriss-Buick Co. v. Pondrom*, 131 Tex. 98, 113 S.W.2d 889 (1938)

The defendant car dealer made fraudulent misrepresentations with respect to the sale of a new Buick. *Id.* at 889. The plaintiff put down cash and traded in his old Buick at an agreed value of \$450. *Id.* at 890. The defendant

car dealer argued that the plaintiff's damages should be measured by adding the cash paid plus the stated value of the old Buick (\$450) minus the market value of the new Buick given the misrepresentations. *Id.* However, the court held that it was the market value of the old Buick, not the value placed on it by the parties, that would be used in the measurement of the damages in the case. *Id.* The court reasoned that it is common knowledge that automobiles are exchanged not on the respective actual market values of the two but upon values arrived at after a verbal joust. *Id.* at 890. Therefore, the appropriate measure of damages in this case was the cash down payment plus the fair market value of the old Buick minus the fair market value of the new Buick. *Id.*

#### h. Relating To Leases

- (i) *Holmes v. P.K. Pipe & Tubing, Inc.*, 856 S.W.2d 530 (Tex. App.—Houston [1st Dist.] 1993, no writ)

In *Holmes*, the lessor of land failed to inform the lessee that the land was a controlled hazardous waste disposal site. *Id.* at 533-34. The lessee used the land to store several tons of oil field equipment. *Id.* at 534. After the Texas Water Commission learned of the storage of oil field equipment on top of the disposal site, it required the lessee to move the equipment at considerable expense to the lessee. *Id.* at 535.

The lessee's measure of damages included the costs incurred to move the equipment, to comply with the Texas Water Commission's orders, and to hire an environmental engineer. *Id.* at 543. The lessee also attempted to recover the rental payments it had made, but the court rejected this claim because the lessee failed to provide any evidence that the payments were a loss resulting from the fraud. *Id.*

#### i. Related To Purchase Of Stock/Companies

- (i) *Arthur Andersen & Co. v. Perry Equip. Co.*, 945 S.W.2d 812 (Tex. 1997)

The purchaser of a corporation sued the accountants hired to perform the audit on the purchased company. *Id.* at 813. The auditors represented that the purchased company was operating at a profit when, in fact, it was losing a considerable amount of money. *Id.* at 814. Though this was a Deceptive Trade Practices Act ("DTPA") case, it is informative because actual damages in this type of case are the same, whether under common law fraud or the DTPA. *Id.* at 816.

The jury was asked to consider the company's purchase price as a part of overall damages rather than being asked to find direct damages at the time of the sale and consequential damages attributable to the misrepresentation. *Id.* at 817. There was evidence that the purchase price eventually was a total loss and that it was written off by the purchaser. *Id.* There also was evidence that the purchased company was losing money at the time of the sale and continued to do so until it went into bankruptcy eighteen months later. *Id.* There was no evidence, however, of the market value of the company at the time of the sale and the

award of the sales price was not supported by the evidence. *Id.* Accordingly, the case was remanded for new trial. *Id.*

- (ii) *White v. Bond*, 362 S.W.2d 295 (Tex. 1962)

In this statutory fraud case, the plaintiffs' evidence regarding actual damages was not sufficient. *Id.* at 297-98. The plaintiffs purchased stock in a uranium mining company that purported to have clear title to certain mining claims. *Id.* at 296. There were, however, clouds on the company's titles at the time the representations were made. *Id.* The jury found fraud. *Id.*

The jury was asked to find the difference between the value of the stock as represented and the actual value of the stock. *Id.* at 297. From the evidence, the jury could infer that the stock had little or no value at the time of purchase. *Id.* Furthermore, there was evidence that the plaintiffs purchased shares at one cent per share and that the defendant said he was going to offer shares of the mining company to the public at ten cents in the future. *Id.* The defendant also represented that the plaintiffs could reasonably expect to receive three to four cents per share at a later date. However, there was no evidence as to what the fair market value of the stock would have been had the representations been true. *Id.* The court recognized the problems confronting proof of the value, but did not lower the plaintiffs' burden and found that they had failed to prove their damages. *Id.*

- (iii) *Williams v. Gaines*, 943 S.W.2d 185 (Tex. App.—Amarillo 1997, writ denied)

The defendant in this case committed fraud by failing to deliver fifty percent of the stock of a new corporation as promised. *Id.* at 188. The plaintiff sought out-of-pocket damages and the parties assumed that the out-of-pocket damages would equal the fair market value of fifty percent of the stock.<sup>9</sup> *Id.* at 192.

With respect to the valuation of stock in a closely held corporation where there is no ready market for the stock, the court recognized that the market value must be determined by something other than sales. *Id.* at 192. Furthermore, the book value is entitled to little weight. *Id.* Ordinarily, the value of the stock in such a situation is determined by the market value of the assets of the corporation minus the liabilities of the corporation. *Id.* at 193. Because the plaintiff failed to present evidence of the market value of the assets, the court remanded the case for a new trial. *Id.* at 193-94.

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<sup>9</sup>This probably is not a correct assumption. See, e.g., *Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41, 49 (Tex. 1998) (regarding the appropriate measure of damages).

j. Where Benefit-of-the-Bargain Damages Are Difficult or Impossible to Determine

(i) *Tilton v. Marshall*, 925 S.W.2d 672 (Tex. 1996)

A television evangelist was sued by several of his contributors for several causes of action, including fraud. *Id.* at 675. The contributors' fraud claims fell into two categories. The first concerned claims by Tilton, that he would personally read, touch and pray over the plaintiffs' prayer requests. *Id.* at 676. The second group of claims giving rise to the contributors' fraud claims were Tilton's allegedly fraudulent and deceitful representations of religious doctrine or belief, i.e., that the contributors' prayers would be answered by Tilton's promised actions. *Id.* at 679.

Reasoning that it was beyond judicial inquiry whether the plaintiffs' prayers would have been answered had Tilton fulfilled his promises, the Texas Supreme Court ruled that benefit-of-the-bargain damages were inappropriate. *Id.* at 680. Thus, the court held that the plaintiffs were entitled only to recover their donations to Tilton, together with any other pecuniary loss suffered as a consequence of their reliance upon his misrepresentations. *Id.*

## 2. Benefit-of-the-Bargain Damages for Fraud

Benefit-of-the-bargain damages are measured by the difference between the value as represented and the value received. *Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41, 49 (Tex. 1998). Such damages include any that might be termed loss of use and enjoyment. *Leyendecker & Assocs., Inc. v. Wechter*, 683 S.W.2d 369, 373 (Tex. 1984). Therefore, a separate award for loss of use and enjoyment would be a double recovery. *Id.*

Lost profits are recoverable only if such damages can be proved with reasonable certainty. *Formosa Plastics*, 960 S.W.2d at 50. Damages are measured at the time of the transaction. *Arthur Andersen & Co. v. Perry Equip. Co.*, 945 S.W.2d 812, 817 (Tex. 1997). Lost profits related to transactions with third parties are more appropriately classified as consequential damages, which will be discussed in greater detail below. See *Texas Commerce Bank Reagan v. Lebco Constructors, Inc.*, 865 S.W.2d 68, 74 (Tex. App.—Corpus Christi 1993, writ denied) (classifying lost profits related to lost construction contract caused by fraudulently withheld loan as special or consequential damages).

As *Formosa Plastics* settled a split among the various courts of appeals as to whether benefit-of-the-bargain damages are recoverable in a fraud action, there are few cases discussing such damages in the fraud context. Accordingly, please refer to the section on contracts for further insight on benefit-of-the-bargain damages. See *Texas Commerce Bank Reagan*, 865 S.W.2d at 74 n.2 (courts look to breach of contract damages for guidance in determining proper measure of damages). Cases discussing benefit-of-the-bargain damages in the fraud context are discussed below.

a. Related to Construction Contract

(i) *Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41 (Tex. 1998)

The defendant in this case fraudulently induced the plaintiff construction contractor to bid low on a large construction project. *Id.* at 48-49. The court held that what the contractor would have bid for the project, had he known the truth, minus the amount he actually bid, was not the proper measure for benefit-of-the-bargain damages. *Id.* at 50. Assuming that lost profits could have been proved with reasonable certainty, the proper measure of benefit-of-the-bargain damages in this case would be the anticipated profit on the original \$600,000 bid, assuming that the owner would have performed under the contract as promised, plus the actual cost of the job, less the amount actually paid. *Id.*

b. Related to Service Contracts

(i) *Green v. Allied Interests, Inc.*, 963 S.W.2d 205 (Tex. App.—Austin 1998, pet. denied)

In *Green*, the plaintiff collection agent sued his client for benefit-of-the-bargain damages related to an oral contract where the client promised to pay \$150 per hour for collection efforts related to a multi-million dollar judgment that the client had obtained from the state. *Id.* at 207. As benefit-of-the-bargain damages are the difference between the value as represented and the value received, and because the plaintiff collection agent had not received any money in payment for collection of the judgment, the court affirmed an award of \$150 per hour times the number of hours that the collection agent worked to retrieve the funds. *Id.*

(ii) *Hoechst Celanese Corp. v. Arthur Bros., Inc.*, 882 S.W.2d 917 (Tex. App.—Corpus Christi 1994, writ denied)

The defendant oil refinery threatened to award a maintenance contract currently serviced by the plaintiff to another company. *Id.* at 921. After negotiations, the parties entered into a nine month contract with several new performance requirements imposed upon the plaintiff. *Id.* The oil refinery represented that if the maintenance company improved to an acceptable level, the relationship would continue long term. *Id.* The jury found that the oil refinery had misrepresented its intentions with respect to the long term nature of the relationship and thereby committed fraud. *Id.* at 920.

The plaintiff attempted to prove its benefit-of-the-bargain damages in the case by concentrating on lost profits. *Id.* at 927. The plaintiff's expert attempted to establish loss of profits for the nine month period during which the contract was in effect. *Id.* The maintenance company was actually a construction company with a side business of performing maintenance at the oil refinery. *Id.* at 929. Instead of attempting to prove lost profits related only to the contract with the oil refinery, the plaintiff maintenance company tried to show the effects on the profitability of the company as a whole during the nine month period. *Id.* The

plaintiff's expert had taken the construction arm's profit for two years after the contract had terminated and extrapolated backward to come up with a hypothetical figure for the year during which the company was concentrating on its maintenance contract with the oil refinery. *Id.* The key flaw in the evidence was that there was no showing that the sales figures for the construction arm in 1990 and 1991 had any relevance to the year during which the maintenance contract was concluded. *Id.* This was because the construction arm's business sales increased dramatically in all three years, including the year during which the company had the maintenance contract with the oil refinery. *Id.* Furthermore, there was no evidence that the company had failed to bid on any projects because of the redirection of its efforts to the maintenance contract. *Id.*

c. Related to Purchase of Promissory Notes

- (i) *Oyster Creek Fin. Corp. v. Richwood Invs. II, Inc.*, 957 S.W.2d 640 (Tex. App.—Amarillo 1997, pet. denied)

The plaintiff in this case was the second holder of a promissory note under which the defendant was the debtor. The plaintiff sought its benefit-of-the-bargain damages (lost profits) related to its purchase of the note. *Id.* at 649. Prior to the purchase, the debtor defaulted on the note. *Id.* at 643-44. The first holder offered to sell the promissory note to the second holder for \$1.17 million. *Id.* at 643. Subsequently, the debtor sent fraudulent information regarding its financial status on which the second note holder alleged to have relied. *Id.* Ultimately, the second holder purchased the promissory note for \$1.17 million. *Id.* at 644. The court found that there was no evidence of benefit-of-the-bargain damages in this case because there was no evidence that the promissory note had changed in value because of the fraud. *Id.* at 649-50.

d. Related to Stock

- (i) *Barbouti v. Munden*, 866 S.W.2d 288 (Tex. App.—Houston [14th Dist.] 1993, writ denied)

Note that this case was overruled by *Formosa Plastics U.S.A. Corp. v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41, 46 (Tex. 1998), to the extent that it held benefit-of-the-bargain damages are not recoverable in a fraud action. Even though *Barbouti* came to this conclusion, it nevertheless discussed the plaintiff's evidence of benefit-of-the-bargain damages.

In *Barbouti*, the plaintiff contended that the defendant promised to convey twenty percent of certain foreign operations in exchange for a license to produce pipeline sealing technology developed by plaintiff. *Id.* at 291. The court noted that, even if the plaintiff had proven his fraud cause of action, he still could not succeed because he had not proven his damages. *Id.* at 296.

The plaintiff attempted to establish his benefit-of-the-bargain damages with respect to the twenty percent interest in the foreign operations using the market value of the two assets held by the foreign companies, rather than the value of

the companies that owned them. *Id.* at 297. Furthermore, he only provided evidence as to the purchase price of the assets. *Id.* He failed to offer any evidence of the value of the stock of the companies and offered no proof of the value of all the assets and all the liabilities of those companies. *Id.* Therefore, the court held that the plaintiff failed to establish the value of the interests in the foreign corporations that he alleged he was due. *Id.*

- (ii) *Khalaf v. Williams*, 814 S.W.2d 854 (Tex. App.—Houston [1st Dist.] 1991, no writ)

The plaintiff construction contractor contracted with the owner to build a nightclub in exchange for thirty percent of the stock in the nightclub. *Id.* at 856. After learning that the owner incorporated the business and failed to include the plaintiff as a stockholder, the plaintiff quit construction and sued for fraud. *Id.* The contractor testified that had he had built the club for profit, he would have made \$50,000 to \$60,000. *Id.* at 857. He also asserted that he lost \$60,000 to \$100,000 while building the club. *Id.* Plaintiff relied on a certified public accountant who testified regarding the tax returns and financial statements of the club during the years following its construction. *Id.* The accountant determined that the value of thirty percent of the club's income was \$90,000 to \$450,000. *Id.* He also determined that the value of thirty percent of the assets of the club was \$250,000. *Id.* On cross-examination, the accountant admitted that he did not consider loans from stockholders, the cost of doing business, or the addition of stockholders in his evaluation. The jury awarded actual damages in the amount of \$185,032. *Id.* The court found that the award was supported by sufficient evidence. *Id.*

e. Related to the Sale of Goods

- (i) *Schindler v. Austwell Farmers Coop.*, 829 S.W.2d 283 (Tex. App.—Corpus Christi 1992), *modified on other grounds*, 841 S.W.2d 853 (Tex. 1992)

In this case, the defendant purchased a large number of farming goods on his account with the plaintiff. *Id.* at 285. He failed to pay the account, contending that the goods for which he had not paid were actually purchased by his father and cousin. *Id.* The jury found that he had procured the goods through fraud and awarded actual damages in the amount of \$65,722.11. *Id.* at 288. The evidence consisted of invoices showing that \$193,362.28 of the products had been charged on the account and that \$127,640.27 had been received in payments and returned products. *Id.* at 287. The jury awarded the difference. *Id.*

f. Related to the Sale of Real Estate

- (i) *Prudential Ins. Co. of Am. v. Jefferson Assocs., Ltd.*, 839 S.W.2d 866 (Tex. App.—Austin 1992), *rev'd on other grounds*, 896 S.W.2d 156 (Tex. 1995)

In this case, the seller of a commercial office building misrepresented, through omission, that the building did not

contain asbestos. *Id.* at 871. The building turned out to require removal of asbestos. The plaintiff sued for fraud and the jury awarded over \$6 million in damages. *Id.* at 869.

The plaintiff presented expert testimony that the presence of asbestos in the building diminished its market value by over \$6 million. *Id.* at 874. The expert based his opinions on sales of comparable buildings known to have asbestos. *Id.* It was significant that the same defendant sold the other comparable buildings. *Id.* It also appears that the expert included the estimated cost for removal of the asbestos in his damage evaluation. *Id.* Counsel should note that the damage award was appropriate under either the out-of-pocket or the benefit-of-the-bargain theory of damages. *Id.* at 875.

### 3. Equitable Remedy of Restitution for Fraud

Texas courts have recognized that parties who file suit for fraud may also forego monetary damages as a result of the fraud and elect the equitable remedy of rescission in lieu of damages. See *Nelson v. Najm*, 127 S.W.3d 170, 176 (Tex. App.—Houston [1st Dist.] 2003, pet. denied). In *Nelson*, the plaintiff purchased a gas station from the defendant for \$175,000.00, choosing to pay \$100,000.00 in cash and executing a note for the remainder. *Id.* at 172. The defendant had failed to disclose that there was an underground waste oil storage tank on the property. *Id.* After the defendant foreclosed on the property, the plaintiff filed suit for fraud. *Id.* at 173. The trial court judgment awarded the plaintiff \$100,000.00. *Id.* at 172. On appeal, the court noted that this amount did not represent out-of-pocket or benefit-of-the-bargain-damages. *Id.* at 177. Instead, the court characterized the award as an equitable remedy in that it amounted to a return of the consideration that the plaintiff had paid. *Id.* The award was the “functional equivalent” of rescission because the plaintiff was restored to the position he had been in before entering the contract. *Id.* Thus, the equitable remedy of rescission allowed the plaintiff to recover a sum representing the consideration paid to the defendant even though this sum did not fit within the out-of-pocket or benefit-of-the-bargain measures of damages. See *id.*

### B. Consequential Damages

“Consequential damages are those damages that result naturally, but not necessarily, from the defendant’s wrongful acts.” *Stuart v. Bayless*, 964 S.W.2d 920, 921 (Tex. 1998) (quoting *Arthur Andersen & Co. v. Perry Equip. Co.*, 945 S.W.2d 812, 816 (Tex. 1997)). Though the law does not require that consequential damages result from the harm, they must be foreseeable. *Stuart*, 964 S.W.2d at 921.

The evidence must establish that the consequential damages are not too remote, uncertain or conjectural. *Reid v. El Paso Constr. Co.*, 498 S.W.2d 923, 924 (Tex. 1973). They are limited not only by the plaintiff’s evidence, but also by affirmative defenses, such as failure to mitigate and intervening causes. *Arthur Andersen & Co.*, 945 S.W.2d at

817. Finally, consequential damages must be specifically pled. *Airborne Freight Corp. v. C.R. Lee Enters., Inc.*, 847 S.W.2d 289, 295 (Tex. App.—El Paso 1992, writ denied).

Consequential damages include lost profits, *Trenholm v. Ratcliff*, 646 S.W.2d 927, 933 (Tex. 1983); loss of credit, *Beneficial Pers. Servs. of Tex., Inc. v. Rey*, 927 S.W.2d 157, 173 (Tex. App.—El Paso 1996), *vacated pursuant to settlement agreement*, 938 S.W.2d 717 (Tex. 1997); lost wages, *Sanchez v. Johnson & Johnson Med., Inc.*, 860 S.W.2d 503, 514 (Tex. App.—El Paso 1993), *modified on other grounds*, 924 S.W.2d 925 (Tex. 1996); and other miscellaneous losses. See, e.g., *Int’l Harvester Co. v. Kesey*, 507 S.W.2d 195, 197 (Tex. 1974) (crop losses caused by defective farm equipment).

Several courts of appeal have also affirmed awards of mental anguish damages in fraud cases. See, e.g., *Dillard’s Dep’t Stores, Inc. v. Strom*, 869 S.W.2d 654, 659 (Tex. App.—El Paso 1994, writ dismissed by agr.); *HOW Ins. Co. v. Patriot Fin. Servs. of Tex. Inc.*, 786 S.W.2d 533, 544 (Tex. App.—Austin 1990, writ denied), *overruled on other grounds sub nom. Hines v. Hash*, 843 S.W.2d 464, 470 (Tex. 1992). *But see Hudson & Hudson Realtors v. Savage*, 545 S.W.2d 863, 868 (Tex. Civ. App.—Tyler 1976, no writ) (holding that mental anguish damages are not recoverable in fraud cases). However, in light of the Texas Supreme Court’s reliance on the Restatement’s measure of fraud damages, and its own decisions regarding mental anguish damages in negligent misrepresentation cases, it does not seem consistent to allow recovery for mental anguish damages in a fraud case. See *Arthur Andersen & Co. v. Perry Equip. Co.*, 945 S.W.2d 812, 816 (Tex. 1997) (citing RESTATEMENT (SECOND) OF TORTS § 459 (1977) as authority for the types of damages available in common law misrepresentation cases); *Federal Land Bank v. Sloane*, 825 S.W.2d 439, 442-43 (Tex. 1991) (relying on RESTATEMENT (SECOND) OF TORTS § 552B (1977) as authority for the types of damages available in a negligent misrepresentation case).

*Federal Land Bank* held that mental anguish damages are not recoverable in a negligent misrepresentation case because the Restatement only allows recovery for “pecuniary” damages. *Federal Land Bank*, 825 S.W.2d at 442-43; RESTATEMENT (SECOND) OF TORTS § 552B. The Restatement is no different with respect to the damages available for fraudulent representations. RESTATEMENT (SECOND) OF TORTS § 549. Therefore, to be consistent, it would seem that mental anguish damages should not be available for fraud. Without a ruling by the supreme court, however, one must assume that mental anguish damages are a possibility. *But see Gunn Infinity, Inc. v. O’Byrne*, 996 S.W.2d 854, 864 n.2 (Tex. 1999) (noting in dicta that petitioners failed to assert that damages for fraud do not include mental anguish damages).

1. Mental Anguish Damages

- (i) *Beneficial Pers. Servs. of Tex., Inc. v. Rey*, 927 S.W.2d 157 (Tex. App.—El Paso 1996), *vacated pursuant to settlement agreement*, 938 S.W.2d 717 (Tex. 1997)

In this case, the defendant employee leasing company convinced plaintiff's former employer, White Well, to terminate all of its employees who would be hired by the defendant and subsequently "leased" back to White Well to perform identical work. *Id.* at 162. The defendant would then perform administrative services for the employees including, but not limited to, providing workers' compensation benefits. *Id.*

The defendant represented to the plaintiff that he would retain the same benefits including the same amount of workers' compensation coverage the plaintiff had prior to becoming employed by defendant. *Id.* at 171-72. Plaintiff sued for, among other things, fraud based on the representations of the existence and type of workers' compensation benefits provided. *Id.* at 167.

The plaintiff testified that, although he had performed according to the wishes of his employer and the insurance company, his doctors remained unpaid, he was underpaid for benefits under the Worker's Compensation Act, and he did not receive any permanent benefits. *Id.* at 175. He further testified that he had to borrow money, his brother had donated used clothes to his children, and he had to obtain food stamps for the first time. *Id.* He felt physically ill, had headaches, insomnia, and an upset stomach. *Id.* He also testified that he felt pain throughout his body and that he was worried about damage to his credit. *Id.* His wife testified that the plaintiff cried on many occasions and incessantly worried about the family. *Id.* The court affirmed the jury's award of mental anguish damages in the amount of \$75,000, finding that the evidence was legally and factually sufficient. *Id.* at 174-75.

- (ii) *Dillard's Dep't. Stores, Inc. v. Strom*, 869 S.W.2d 654 (Tex. App.—El Paso 1994, writ *dism'd* by agr.)

Plaintiff was a computer salesman for Dillard's. *Id.* at 655. In addition to selling computers, he also repaired them and, in fact, he repaired more computers than repairmen at any other Dillard's store. *Id.* at 656. Dillard's paid its employees a straight hourly rate, plus commissions. *Id.* at 655. Because the plaintiff could not sell any products while servicing computers, he was promised \$25 for each computer that he serviced. *Id.* This happened to be the same amount that the computer manufacturer paid Dillard's for each computer repaired under warranty. *Id.* at 655-56. In addition to being paid per computer, Dillard's allegedly promised to refrain from deducting the hours that he worked on computers from his commissions. *Id.* at 655. The exact opposite actually occurred; he was not paid the agreed \$25 per computer and Dillard's subtracted the hours he worked on computers from his commissions. *Id.* at 656.

The plaintiff testified that he had numerous pressures and tensions at work regarding the compensation dispute. *Id.* at 660. His immediate supervisor constantly threatened to terminate him, and they had frequent, heated altercations. *Id.* Ultimately, the pressures and tensions caused the plaintiff to resign. *Id.* He also testified that the dispute resulted in "horrendous fights" with his wife and forced him to seek psychological care. *Id.* The court held that this evidence was sufficient to support an award of mental anguish damages. *Id.* at 659-60.

- (iii) *HOW Ins. Co. v. Patriot Fin. Servs. of Tex., Inc.*, 786 S.W.2d 533 (Tex. App.—Austin 1990, writ denied), *overruled on other grounds sub nom. Hines v. Hash*, 843 S.W.2d 464, 470 (Tex. 1992)

In order to recover mental anguish damages, the plaintiff must establish more than mere worry, anxiety, vexation, embarrassment or anger. *Id.* at 542. "Mental anguish" implies a relatively high degree of mental pain and distress. It includes a mental sensation of pain resulting from grief, severe disappointment, indignation, wounded pride, shame, despair, and/or public humiliation. *Id.* Recovery for mental anguish requires direct evidence of the nature, duration, or severity of one's anguish that results in a substantial disruption of one's daily routine. *See, e.g., Saenz v. Fidelity & Guar. Ins. Underwriters*, 925 S.W.2d 607, 614 (Tex. 1996).

In *HOW Ins. Co.*, the plaintiff sued for fraud related to construction defects in her condominium. 789 S.W.2d at 536-37. The construction defects caused water leaks in the condominium's walls. *Id.* at 537. The seller was unable to fix the problem and ultimately gave up trying, and as a result, a plastic covering remained on the condominium's walls for over two years. *Id.* at 540. The plaintiff testified that she was distressed by the difficulties in obtaining repairs and by the constant leaking of water into her home. *Id.* at 542. She also testified about having to live without privacy or security. *Id.* For example, her home had been broken into, and she felt that she could no longer use it as a home. *Id.* Furthermore, the plaintiff's uncle testified that the plaintiff had become more emotional, defensive, subdued and lethargic as a result of the damage to her condominium. *Id.* The court held that the evidence was sufficient to support mental anguish damages of \$75,000. *Id.*

- (iv) *Kneip v. UnitedBank-Victoria*, 774 S.W.2d 757 (Tex. App.—Corpus Christi 1989, no writ)<sup>10</sup>

The plaintiffs in *Kneip* financed their small business with a loan from the bank. *Id.* at 758. The original promissory note was not secured, but was guaranteed by the plaintiffs. *Id.* After their business failed, they executed a

<sup>10</sup> This is the appeal after remand of *Kneip*, 734 S.W.2d 130 (Tex. App.—Corpus Christi 1987, no writ) discussed *supra*.

second promissory note, which was secured by a lien on a 60 acre ranch owned by the plaintiffs. *Id.* They claimed the bank had fraudulently induced them into signing a second promissory note by promising not to foreclose on the land and simply collect life insurance proceeds after Mr. Kneip died. *Id.* The jury found fraud but refused to award damages for mental anguish. *Id.*

The court affirmed the jury's refusal to award any damages for mental anguish. *Id.* at 759-60. The plaintiff had testified that he suffered from insomnia (but admitted that the insomnia was directly related to his arthritis), upset stomach, tension headaches and that he was required to take Valium. *Id.* at 759. Given the subjectiveness of mental anguish, the court could not say that the jury's refusal to award mental anguish damages was not supported by the evidence. *Id.* at 759-60.

## 2. Lost Profits for Fraud

(i) *Trenholm v. Ratcliff*, 646 S.W.2d 927 (Tex. 1983)

"Special damages may be recovered for losses on improvements to property purchased as a result of a misrepresentation." *Id.* at 933. Evidence that the presence of a trailer park adversely affected sales in a subdivision was sufficient to support special damages on lost sales of houses and lost profits. *Id.* The plaintiff's business was formed in 1972 and had a ten percent profit on the houses it built in 1973 and 1975. The president of a savings and loan testified that ten percent was the profit margin that builders anticipated. The evidence regarding lost profits was not too speculative, and the jury's award equal to ten percent of the costs was affirmed. *Id.* at 933.

(ii) *Reid v. El Paso Constr. Co.*, 498 S.W.2d 923 (Tex. 1973)

The plaintiff in this case alleged that the seller of certain tracts of land had fraudulently concealed that the land no longer drained properly after natural drainage routes had been filled. *Id.* at 924. After finding fraud, the jury also awarded lost profits to the buyer based on evidence that the buyer would have built apartment complexes for a third party on one of the tracts. *Id.* The court reversed the award of lost profits reasoning that they were too remote, uncertain and conjectural. *Id.*

The buyer testified regarding three tracts of adjoining land on which they had planned to build apartment units. *Id.* The fraud related to the third tract. *Id.* Prior to discovering the fraud, the plaintiffs built sixty apartment units on the other two tracts and had deeded all three tracts to a third party. *Id.* at 925. The buyer was to build an additional thirty units of apartments on the third tract. *Id.* However, when the fraud was discovered, the third party deeded all three tracts back to the buyer, and the buyer never built the additional thirty units. *Id.* Specifically, the buyer sought lost profits related to the building of the thirty additional units. *Id.*

Though the seller knew of the plan to sell the land to the third party, there was no evidence that the seller knew that the buyer had a potential contract to build thirty apartment units on the third tract of land. *Id.* Therefore, the court held that the claimed lost profits were too speculative. *Id.*

(iii) *F. S. New Prods., Inc. v. Strong Indus., Inc.*, 129 S.W.3d 606 (Tex. App.—Houston [1st Dist.] 2004, pet. filed)

The plaintiffs filed suit alleging fraud arising from the defendant's use of the plaintiff's trade secrets for the design and manufacture of dump truck axles. *Id.* at 610. The defendant had entered into a non-competition agreement with the plaintiffs but had subsequently designed and sold a dump truck axle that was remarkably similar to the defendant's latest design. *Id.* at 617-18. The court concluded that there was evidence of fraud in that the defendant had entered into the non-competition agreement with the intent to obtain the plaintiff's proprietary information and to breach the agreement. *Id.* at 620.

The jury awarded \$675,000.00 as damages for fraud. *Id.* This figure was within the range of damages estimated by the plaintiffs' expert who testified regarding the profits the defendant had obtained from the sales of the axles that were based on the plaintiffs' design. *Id.* at 624-25. Although the expert's calculations were impermissibly based on gross profits rather than lost profits, the court concluded that the defendant had failed to preserve this issue for appeal. *Id.* at 624-25. The court then concluded that there was legally sufficient evidence to support \$675,000.00 jury award based on lost profits. *Id.* at 625.

(iv) *Texas Commerce Bank Reagan v. Lebco Constructors, Inc.*, 865 S.W.2d 68 (Tex. App.—Corpus Christi 1993, writ denied)

The plaintiff's general contractor relied on the representations of defendant bank that it would fund a loan to the owner for a construction project. *Id.* at 73. The bank failed to fund the project, and when the loan was not funded, the general contractor was not paid. *Id.*

The court held that the general contractor was entitled to recover from the bank its lost profits associated with partial performance of the failed project. *Id.* at 74. The contractor's special damages in this case were measured by the difference between the amount it had already been paid and the amount it would have been paid had the loan been funded. *Id.*

This measure of damages does not seem to account for the costs that the contractor would have incurred in completing the project. Ultimately, the court remitted the award of lost profits and lowered them from \$2.5 million to \$1.7 million. *Id.* at 77. This was because the award exceeded the evidence of loss submitted through the testimony of the plaintiff's president as to lost profits.

The plaintiff also attempted to recover lost profits on other projects that it was not able to procure, allegedly

because of the fraud committed by the bank. The court impliedly held that those lost profits were also not recoverable in this action. *Id.* at 76-77.

- (v) *State Nat'l Bank v. Farah Mfg. Co.*, 678 S.W.2d 661 (Tex. App.—El Paso 1984, writ dismissed by agr.)

This case arose out of a dispute as to who should be the chief executive officer of Farah. *Id.* at 666. After Farah experienced financial difficulties caused by an extended strike and boycott of its product, its creditors forced a change in Farah's top management. *Id.* at 667-68. Farah's former CEO attempted a comeback, and the creditors threatened to call their loans. *Id.* The jury found that the creditors had committed fraud with respect to the management fight and caused damage to Farah. *Id.* at 669.

The court affirmed an award of lost profits. *Id.* at 699. The plaintiff offered the testimony of an accountant who used the "trend line methodology" to calculate lost profits. *Id.* at 679. He utilized the plaintiff's actual sales for a base period. *Id.* Because the plaintiff suffered a boycott during one year, the expert eliminated that year as an extraordinary circumstance. *Id.* He subsequently applied the trend of increasing sales that the plaintiff had enjoyed until the time period during which its business had been damaged due to the fraud. *Id.* He then calculated a projection of sales using the prior trends. *Id.* Taking the average profit rate of 10.9% of sales for the base period, he applied it to the projected sales in order to project profits. *Id.* Finally, he took the projected profits and compared them to the actual result to find lost profits. *Id.* He calculated over \$51 million in lost profits. *Id.* The jury found \$15 million in lost profits, which, the court held, that although the amount was less than the expert testified, was within the jury's discretion. *Id.* at 695.

### 3. Loss of Credit for Fraud

- (i) *Beneficial Pers. Servs. of Tex., Inc. v. Rey*, 927 S.W.2d 157 (Tex. App.—El Paso 1996), *vacated pursuant to settlement agreement without reference to the merits*, 938 S.W.2d 717 (Tex. 1997)

In this case, the defendant employee leasing company represented to its new employees that they would have the same amount of coverage for workers' compensation insurance that they had prior to becoming employees of the leasing company. *Id.* The plaintiff testified that as a result of the defendant's conduct, he had been refused a loan and received a number of creditor collection letters. *Id.* at 173. He also testified that he still owed medical bills of \$3,900. Such evidence was held sufficient to support the award of loss of credit damages. *Id.* at 173-74.

- (ii) *Duval County Ranch Co. v. Wooldridge*, 674 S.W.2d 332 (Tex. App.—Austin 1984, no writ)

This case presented a combination of claims for lost profit and lost credit. The plaintiff obtained loans based on fraudulent representations that the defendant would repay the

plaintiff with respect to other contracts before the loans became overdue. *Id.* at 336. The defendant's failure to comply with the promise was shown to have caused the plaintiff to default on the loans, resulting in damage to the plaintiff's credit. *Id.* The plaintiff presented evidence that creditors had obtained a judgment against him and that the judgment appeared on his financial statement, making it impossible to obtain additional credit. *Id.* Finally, the plaintiff testified generally to his losses, and in one particular instance, of the loss of a job which was worth between \$192,000 to \$288,000. *Id.* As the verdict was within that range, the court held that there was sufficient evidence to support the jury's verdict. *Id.*

### 4. Lost Wages for Fraud

- (i) *Sanchez v. Johnson & Johnson Med., Inc.*, 860 S.W.2d 503 (Tex. App.—El Paso 1993), *rev'd in part on other grounds*, 924 S.W.2d 925 (Tex. 1996)

The defendant employer made misrepresentations to the plaintiff regarding her status of employment after she attempted to return to work from a workers' compensation injury. *Id.* at 507. The court held that when there has been fraud in an employment relationship, damages in the form of lost wages and benefits are the appropriate remedy. *Id.* at 514.

### 5. Miscellaneous Losses for Fraud

- (i) *International Harvester Co. v. Kesity*, 507 S.W.2d 195 (Tex. 1974)

The plaintiffs in this case sought damages for crop loss resulting from allegedly defective farm equipment purchased from defendant. The court held that the general rule for assessing damages for crop loss was the market value of the lost portion of the crop, as measured at maturity, less the cost of harvesting and marketing the lost portion. *Id.* at 197. *See Helena Chem. Co. v. Wilkins*, 47 S.W.3d 486, 505 (Tex. 2001) (following measure of damages for crop loss set out in *International Harvester*, 507 S.W.2d at 197). That is, one should measure the probable yield under proper cultivation, the value of yield when mature and ready for sale, and then deduct cultivation, harvesting and marketing expenses. 507 S.W.2d at 197. In *International Harvester*, however, the plaintiffs failed to supply any factual data to support their estimates with respect to damages. They further failed to provide any information as to the size of the crop they would have planted if the machinery worked. *Id.* They also did not provide any data as to the value of the lost crop at maturity. Therefore, the court held that the evidence was insufficient to support an award of damages. *Id.*

## C. Exemplary Damages

Exemplary damages are governed by statute. TEX. CIV. PRAC. & REM. CODE ANN. §§ 41.001 - .013 (Vernon 1997 & Supp. 2004). To collect exemplary damages in a fraud case, a plaintiff must prove by clear and convincing evidence that

the harm with respect to which he is seeking recovery of such exemplary damages is fraud. *Id.* § 41.003(a)(1). Constructive fraud, however, is not sufficient to support an exemplary damage award. *Id.* § 41.001(6).

One should refer to the more detailed section on exemplary damages, *infra*, for further information. Specifically, one should pay particularly close attention to the changes made by House Bill 4 (which has now been codified under the TEX. CIV. PRAC. & REM. CODE ANN. §§ 41.001-.013 (Vernon Supp. 2004)), and the effect this legislation has on exemplary damages. See discussion in Section XXII, *infra*. The following cases are illustrative of fraud cases in which exemplary damages have been discussed.

(i) *Schlueter v. Schlueter*, 975 S.W.2d 584 (Tex. 1998)

*Schlueter* was a divorce case in which the Texas Supreme Court was faced with the question of whether a spouse could recover exemplary damages for fraud, when such spouse brings an action for divorce and an independent claim for fraud. *Id.* at 585. Mr. Schlueter transferred a substantial amount of community property to his father without his wife's knowledge prior to filing for divorce. *Id.* In her counterclaim to her husband's divorce action, Mrs. Schlueter filed a claim for divorce and brought independent causes of action for fraud, breach of fiduciary duty and conspiracy. *Id.* The jury heard the fraud and conspiracy claims in a bifurcated trial, and awarded Mrs. Schlueter compensatory damages of \$47,850 and exemplary damages of \$65,000. *Id.* at 586.

The Texas Supreme Court held that there is no independent tort cause of action for wrongful disposition of community assets by a spouse. *Id.* at 589. The court reasoned that Mrs. Schlueter's interest in the community property would be adequately protected by the Texas community property system, which requires a trial court to enter a division of a married couple's estate "in a manner that the court deems just and right" upon divorce. *Id.* at 588 (citing TEX. FAM. CODE ANN. § 7.001 (Vernon 1998)). The court noted that a trial court may consider many factors in determining a just and right division, and, after considering those factors, may order a disproportionate division of the estate. *Id.* Consequently, a wronged spouse may not recover punitive damages from the other spouse relating to the wrongful disposition of community property. *Id.* However, "if the wronged spouse can prove the heightened culpability of actual fraud, the trial court may consider it in the property division." *Id.* at 589-90.

(ii) *Trenholm v. Ratcliff*, 646 S.W.2d 927 (Tex. 1983)

In this case, a home builder specifically asked a developer whether a mobile home park located next to the planned development would remain in its current location. *Id.* at 928. Evidence indicated that the developer was aware that the mobile home park was a concern to the builders. *Id.* at 933. Evidence that the defendant purposefully represented that the mobile home park had been zoned commercial was

sufficient to support an inference that the developer had made the misrepresentation with conscious disregard for the rights of the builders and therefore supported an award of punitive damages. *Id.* Counsel is advised to compare this case with section 41.003(a) of the Texas Civil Practices and Remedies Code, which suggests a fraud finding is sufficient.

(iii) *Isaacson v. Anderson*, 982 S.W.2d 39 (Tex. App.—Houston [1st Dist.] 1998, no pet.)

The original petition in this case alleged that the defendant entered into two contracts with the plaintiffs to have remodeling and electrical work done to defendant's home. *Id.* at 39. The defendant made partial payment to the plaintiffs, but would not tender the final payment. *Id.* at 40.

The plaintiffs brought suit for payment, alleging breach of contract, quantum meruit, and fraud. *Id.* Defendant, although served with the suit papers, did not file an answer, and the trial court entered a default judgment in favor of the plaintiffs which included exemplary damages. *Id.*

Citing *Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41 (Tex. 1998), the court recognized that if a plaintiff presents evidence that is legally sufficient on each of the elements of a fraudulent inducement claim, the damages suffered as a result of such fraud sound in tort. *Isaacson*, 982 S.W.2d at 41. By not filing an answer after proper service, the defendant admitted each factual allegation in the plaintiff's petition. *Id.* Accordingly, the court held that the plaintiffs could bring both a breach of contract and a fraud claim, with the potential for recovery of exemplary damages on the fraud claim, and sustained the trial court's verdict. *Id.*

(iv) *Peco Constr. Co. v. Guajardo*, 919 S.W.2d 736 (Tex. App.—San Antonio 1996, writ denied)

In this case, the plaintiff, a lessor of construction equipment, obtained an agreement from the general contractor to enter a joint check agreement. *Id.* at 738-40. Under this agreement the general contractor would pay the subcontractor and the lessor on the same check to insure payment to the lessor for the leased equipment. *Id.* at 739. The general contractor failed to make joint payments as promised. *Id.* at 740. Evidence showed that the general contractor profited by pretending to agree to the joint check agreement. *Id.* at 741 n.8. The jury awarded three times the plaintiff's actual damages as exemplary damages. *Id.* at 741.

The court applied the factors for exemplary damages from *Alamo Nat'l Bank v. Kraus*, 616 S.W.2d 908, 910 (Tex. 1981). These factors include:

"(1) the nature of the wrong, (2) the character of the conduct involved, (3) the degree of culpability of the wrongdoer, (4) the situation and sensibilities of the parties concerned, and (5) the extent to which such conduct offends a public sense of justice and propriety."

*Peco Constr. Co.*, 919 S.W.2d at 741.

Though the court recognized that three times actual damages for exemplary damages may have been surprising in this case, they were presumptively reasonable pursuant to sections 41.007 and 41.008 of the Texas Civil Practices and Remedies Code, which, at that time, limited exemplary damages to four times actual damages or \$200,000, whichever was greater. *Id.* at 742.

(v) *Hoechst Celanese Corp. v. Arthur Bros., Inc.*, 882 S.W.2d 917 (Tex. App.—Corpus Christi 1994, writ denied)

In this case, evidence showed that the defendant oil refinery had deliberately misled its maintenance contractors into undertaking a massive restructuring without giving the company a realistic chance of continuing its relationship with the oil refinery. *Id.* at 921-23. The jury awarded over \$2 million in punitive damages. *Id.* at 923. The award was based in part on actual damages of \$702,825. *Id.* at 926.

Upon finding that several elements of the plaintiff's actual damages were not supported by evidence, the court remitted the award of exemplary damages to an amount approximately three times the amount of actual damages that were supported by the evidence. *Id.* at 931.

## VI. STATUTORY FRAUD

### A. Generally

Statutory fraud is limited to transactions in real estate or stocks. TEX. BUS. & COM. CODE ANN. § 27.01 (Vernon 2002). Statutory fraud does not apply to transactions that only tangentially involve land or stocks. *Texas Commerce Bank Reagan v. Lecco Constructors, Inc.*, 865 S.W.2d 68, 82 (Tex. App.—Corpus Christi 1993, writ denied). Actual damages are recoverable for statutory fraud. TEX. BUS. & COM. CODE ANN. § 27.01(b). Unlike common law fraud, a successful statutory fraud plaintiff may also recover reasonable and necessary attorneys' fees, expert witness fees, and costs for copies of depositions in addition to costs of court. *Id.* § 27.01(e); *Maeberry v. Gayle*, 955 S.W.2d 875, 881 (Tex. App.—Corpus Christi 1997, no pet.). The plaintiff may recover exemplary damages from either the person who made the false representation or the person who benefits from the false representation if either had actual awareness of the falsity. TEX. BUS. & COM. CODE ANN. § 27.01(c), (d). "Actual awareness may be inferred where objective manifestations indicate that a person acted with actual awareness." *Id.* § 27.01(c).

Prior to the 1983 amendment to the statutory fraud cause of action, actual damages were defined as the "difference between the value of the real estate or stock as represented or promised, and its actual value in the condition in which it is delivered at the time of the contract." Act of Sept. 1, 1967, 60th Leg., R.S., ch. 785, § 1, 1967 Tex. Gen. Laws 2343, 2603 (amended 1983) (current version at TEX. BUS. & COM. CODE ANN. § 27.01). The former statutory

definition is the same as benefit-of-the-bargain damages under the common law. *See Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41, 49 (Tex. 1998). However, the statute is now silent as to how actual damages are measured for statutory fraud. *See* TEX. BUS. & COM. CODE ANN. § 27.01(b). Presumably, a statutory fraud plaintiff can now recover either benefit-of-the-bargain damages or out-of-pocket damages plus any consequential damages under the general definition of actual damages. *See Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 816 (Tex. 1997) (actual damages include direct and consequential damages); *Kerrville HRH, Inc., v. City of Kerrville*, 803 S.W.2d 377, 386-87 (Tex. App.—San Antonio 1990, writ denied) (awarding out-of-pocket and consequential damages).

### B. Statutory Fraud Damages Cases

The following cases are representative of damage awards in statutory fraud causes of action:

(i) *McDonald v. Bennett*, 674 F.2d 1080 (5th Cir. 1982) (applying Texas law)

The plaintiff purchased a majority of the stock of a closely held corporation based on misrepresentations as to the corporation's financial status. *Id.* at 1082. The court recognized that section 27.01 of the Texas Business and Commerce Code provided for the award of actual damages as measured by the benefit-of-the-bargain. *Id.* at 1089-90. However, it further declared that out-of-pocket and consequential damages also were recoverable notwithstanding the statute. *Id.* at 1090.

The plaintiff offered evidence as to the value of the stock as represented by the defendants. *Id.* He also offered evidence that the stock did not have any value given the financial condition of the company. *Id.* Accordingly, the jury awarded the difference between the value represented and zero. *Id.* The court held that this was a proper benefit-of-the-bargain measure of damages and was supported by the evidence. *Id.* However, as the jury awarded benefit-of-the-bargain damages for common law fraud associated with the same acts, the plaintiff was not entitled to a double recovery. *Id.* at 1089-90.

(ii) *Schlumberger Tech. Corp. v. Swanson*, 959 S.W.2d 171 (Tex. 1997)

In this case, consultants for an offshore diamond mining project filed suit against the defendant corporation alleging, among other things, statutory fraud. *Id.* at 174. Plaintiffs had originally entered into a letter agreement with an entity which, through various mergers and acquisitions, transferred its interest in the project to a subsidiary of the named defendant. *Id.* at 173-74. After the project had operated for some time, the defendant represented to the plaintiffs that the diamond project was neither technologically feasible nor commercially viable. *Id.* at 174. As a result, the plaintiffs, who were at all times represented by counsel,

agreed to sell their interest to the defendant for approximately \$814,000. *Id.* In exchange, the plaintiffs agreed to relinquish all rights, claims, and interests in the project, and further released all causes of action against the defendant, known or unknown. *Id.* Moreover, the plaintiffs specifically agreed that they were not relying on any statement or representation of defendant, that they were relying on their own judgment, and that they had been represented by counsel. *Id.* Defendant thereafter sold the project for approximately \$4.1 million. *Id.*

After a trial on the merits, the jury returned a verdict awarding the plaintiffs \$15 million in actual damages and \$35 million in exemplary damages on their statutory fraud claim. *Id.* at 174-75. The trial court rendered a judgment notwithstanding the verdict based on the release, but the court of appeals reversed and rendered judgment in accordance with the jury's findings. *Id.* at 175. The Texas Supreme Court held that the release precluded all of the plaintiffs' claims as a matter of law, and rendered judgment for the defendant. *Id.*

(iii) *White v. Bond*, 362 S.W.2d 295 (Tex. 1962)

This statutory fraud case arose out of the sale of stock in a uranium mining company. *Id.* at 295. The court relied on the prior statute's definition of actual damages: that is, the difference between the value of the stock as represented and the actual value of the stock. *Id.* at 297. In this case, the evidence was not sufficient to support an award of actual damages. *Id.* The court recognized that from the testimony, the jury might have properly inferred that the shares of stock had little or no value at the time of the purchase. *Id.* However, the record was wholly silent as to what value the stock would have had if the representations had been true. *Id.* Evidence that: (1) the plaintiffs had been offered a special deal; (2) that the defendant was going to sell shares to the public at a later time at ten times the amount the plaintiff paid; and, (3) that the defendant had represented that the plaintiffs could reasonably expect to get three to four times the amount paid if they sold their stock in the future was no evidence of the market value of the stock even if the representations had been true. *Id.*

(iv) *Williams v. Gaines*, 943 S.W.2d 185 (Tex. App.—Amarillo 1997, writ denied)

In *Williams*, the court found that the evidence presented by the plaintiff to establish the fair market value of the stock in a brand new corporation was insufficient to support a jury award of \$92,500. *Id.* at 192. The plaintiff's expert testified that the two recognized methods to determine the fair market value of a corporation were the "asset method" and the "earnings method". *Id.* He based his opinion on the earnings method, claiming that it was more appropriate because the corporation at issue was a service company and did not have many assets. *Id.* The allegations of fraud centered on the defendant's failure to transfer fifty percent of the shares of a

new corporation to plaintiff in exchange for a valuable contract. *Id.*

The plaintiff's expert utilized only seven months of income and operations data from the corporation because it had been in operation for such a short time. *Id.* The expert testified that the company had shown a net profit of \$101,754; however, without offering any explanation, in his opinion, the net profit should have been \$147,754. *Id.* Taking this information along with cash flow information, the expert concocted a fair market value of \$618,000 for the stock and thus concluded that one half of the value of the stock should be \$309,000. *Id.* Nevertheless, the expert admitted that the book value of the corporation was less than zero. *Id.*

Because the corporation had never sold its stock, there was no evidence of market value of the stock by its sales. *Id.* The court noted that the book value of a corporation is entitled to little weight, if any, in determining the value of the corporate stock. *Id.* When the value of the stock cannot be shown by sales, valuation is ordinarily based on the market value of the assets of the company after deducting its liabilities. *Id.* at 193. As the expert failed to base his opinion on the assets and liabilities of the corporation, his testimony was insufficient to establish the market value of the stock. *Id.* Furthermore, the expert failed to base his testimony on information at the appropriate time. *Id.* According to the court, the expert should have based the value of the stock at the time the fraud was committed. *Id.*

(v) *Kerrville HRH, Inc. v. City of Kerrville*, 803 S.W.2d 377 (Tex. App.—San Antonio 1990, writ denied)

This statutory fraud action arose out of a real property lease. *Id.* at 380. The court affirmed an award of out-of-pocket expenses, lost profits and interest expenses arising out of the defendant city's fraud. *Id.* at 389.

The plaintiff leased farm land from the city which was represented to have an adequate irrigation system for the growing of lawn grass and other nursery plants. *Id.* at 383. The irrigation system did not work. *Id.* at 383-84. Plaintiff attempted repairs which proved unsuccessful. *Id.* at 381. Plaintiff offered testimony that by the time of trial, plaintiff had spent \$360,509.15 on rent, labor, equipment leases and purchases, fuel and oil, utilities, taxes, legal fees, insurance and plants. *Id.* at 386. Of the approximately \$360,000 in damages, the plaintiff included \$82,691.62 in interest payable as of the date of trial on a bank loan taken out by the plaintiff to fund its business. *Id.*

With respect to lost profits, the sales prices of the plaintiff's products were well established, and the plaintiff offered testimony that there was a market demand in Texas for its products. *Id.* at 387. For example, each tree would sell for \$35 within a year. Taking this figure, the plaintiff projected its net profit on trees and shrubs over the life of the lease to be \$1.297 million. *Id.* It also projected net profit on the grass at \$239,000. *Id.* The jury awarded

\$246,167.53 in out-of-pocket expenses, \$25,000 in lost profits and zero dollars in interest. *Id.*

The court held that the out-of-pocket expenses were established by the evidence and given the speculative nature of future profits, the \$25,000 in lost profits was also appropriate. *Id.* Given the fact that the plaintiff had offered evidence of the existence of its loan and the amount of interest due, there was no basis for the jury's answer of zero with respect to the interest, and the court accordingly increased the plaintiff's award of damages. *Id.*

(vi) *HOW Ins. Co. v. Patriot Fin. Servs. of Tex., Inc.*, 786 S.W.2d 533 (Tex. App.—Austin 1990, writ denied), *overruled on other grounds sub nom. Hines v. Hash*, 843 S.W.2d 464 (Tex. 1992)

Under section 27.01(b) of the Texas Business and Commerce Code, a defrauded person may recover “actual damages.” In *HOW Ins.*, the court relied on a 1960 decision to interpret “actual damages” as “such damages as result directly, naturally and proximately from fraud.” *HOW Ins. Co.*, 786 S.W.2d at 546 (citing *El Paso Dev. Co. v. Ravel*, 339 S.W.2d 360, 364 (Tex. Civ. App.—El Paso 1960, writ ref'd n.r.e.)). At least in a defective construction case, the measure of damages may be either the “difference in value” measure or the “remedial” or “cost to repair” measure of damages. *Id.* Generally, a plaintiff is allowed repair costs if those costs are feasible and do not involve economic waste. *Id.* If they do involve economic waste, the plaintiff is limited to the difference in value measure of damages. *Id.*

The difference of value measure of damages is the difference between the purchase price of the property and the market value of the property at the time of the sale. *Id.* Essentially, this is the out-of-pocket measure of damages. In *HOW Ins. Co.*, there was undisputed evidence that the condominium's purchase price was \$97,650. *Id.* All of plaintiff's witnesses testified as to the market value of the property at the time of trial. *Id.* This evidence was not sufficient to establish market value at the time of the sale. *Id.*

With respect to exemplary damages under statutory fraud, a plaintiff is entitled to recover such damages if the tortfeasor made the false representation with actual awareness of the falsity. *Id.* at 545. In this case, the evidence was sufficient to find actual awareness. *Id.* The builder had accepted bids that were disproportionately low which the court found was an indicator that the subcontractor might not perform quality work. *Id.* Furthermore, the condominium's architect testified that the design specifications for the project were changed by the builder because the specifications had become economically unfeasible. *Id.* The architect also testified that he did not recommend the substitutions for the exterior walls and that he had informed the builder of improper installation. *Id.* Finally, the builder had filed an independent lawsuit against the subcontractor responsible for the defects in the plaintiff's home. *Id.*

## VII. CONSTRUCTIVE FRAUD

Constructive or legal fraud is the breach of some legal or equitable duty which, irrespective of moral guilt, the law declares fraudulent because of its tendency to deceive others, to violate confidence or to injure public interest. *Archer v. Griffith*, 390 S.W.2d 735, 740 (Tex. 1964). Constructive fraud does not require an intent to defraud. *Carnes v. Meador*, 533 S.W.2d 365, 372 (Tex. Civ. App.—Dallas 1976, writ ref'd n.r.e.). Plaintiffs in constructive fraud cases generally seek rescission of some bargain or the return of property fraudulently obtained. *Id.* See, e.g., *Texas Bank & Trust Co. v. Moore*, 595 S.W.2d 502, 505 (Tex. 1980).

Exemplary damages are recoverable in appropriate cases, most of which involve the finding of a breach of a fiduciary duty. See, e.g., *Moore*, 595 S.W.2d at 508; *InterFirst Bank Dallas, N.A. v. Risser*, 739 S.W.2d 882, 907 (Tex. App.—Texarkana 1987, no writ); *Kirby v. Cruce*, 688 S.W.2d 161, 166-67 (Tex. App.—Dallas 1985, writ ref'd n.r.e.). Please refer to section XII, *infra*, for more information on constructive fraud in fiduciary relationships.

## VIII. NEGLIGENT MISREPRESENTATION

### A. Elements

The elements of a negligent misrepresentation cause of action are: (1) representations made by defendant in the course of his business, or in a transaction which he has a pecuniary interest; (2) the defendant supplies false information for the guidance of others and their business; (3) the defendant did not exercise reasonable care or competence in obtaining or communicating the information; and (4) the plaintiff suffers pecuniary loss by justifiably relying on the representation. *Federal Land Bank Ass'n of Tyler v. Sloane*, 825 S.W.2d 439, 442 (Tex. 1991).

### B. Pecuniary Damages

Texas has adopted the measurement of damages as set out by the Restatement (Second) of Torts for negligent misrepresentation. *Federal Land Bank*, 825 S.W.2d at 442.

In a negligent misrepresentation case, the plaintiff may recover its pecuniary loss including: (1) the difference in value of what the plaintiff received in the transaction and its purchase price or other value given for it; and (2) other consequential damages that can properly be classified as pecuniary losses. *Id.*; RESTATEMENT (SECOND) OF TORTS § 552B (1977). Mental anguish damages are not a type of pecuniary loss and are therefore not available in a negligent misrepresentation case. *Federal Land Bank*, 825 S.W.2d at 442-43. The Restatement also excludes benefit-of-the-bargain damages incurred as a result of reliance on the misrepresenting damages as an available measure of damages. *Id.* at 442; *Ludlow v. DeBerry*, 959 S.W.2d 265, 276 (Tex. App.—Houston [14th Dist.] 1997, no pet.). Therefore, one may not recover lost profits related to the transaction. *Federal Land Bank*, 825 S.W.2d at 443; *cf. Texas Commerce Bank Reagan v. Lebo Constructors, Inc.*,

865 S.W.2d 68, 75-76 (Tex. App.—Corpus Christi 1993, writ denied) (lost profits are recoverable as consequential damages for negligent misrepresentation).

### C. Independent Injury Required

Following its rejection of the independent injury requirement for claims involving fraudulent inducement in *Formosa Plastic Corp. USA v. Presidio Eng'rs*, 960 S.W.2d 41, 46-47 (Tex. 1998), the Texas Supreme Court was faced with the issue of whether the elimination of the independent injury requirement extended to claims for negligent misrepresentation or negligent inducement. *D.S.A., Inc. v. Hillsboro Indep. Sch. Dist.*, 973 S.W.2d 662 (Tex. 1998). In *D.S.A.*, the plaintiff school district sued a construction management firm for breach of contract, negligent and gross negligent misrepresentation, and DTPA violations. *Id.* at 663. The district's claims stemmed from faulty work performed on an elementary school construction project. *Id.* The jury returned findings against D.S.A., awarding the district \$260,661 in actual damages, \$170,000 in exemplary damages, plus attorneys' fees. *Id.*

The supreme court found that the damages awarded by the jury for negligent misrepresentation were identical to the damages awarded for breach of contract, and the district failed to offer proof of any injury independent of contract damages. *Id.* The district argued that the supreme court's opinion in *Formosa Plastics* permitted the district to recover in tort for losses related to the subject matter of the contract, because D.S.A. had a legal duty, independent from its contractual duties, not to make misrepresentations to induce the district into the contract. *Id.* The court held that *Formosa Plastics* court's rejection of the independent injury requirement in fraudulent inducement cases does not extend to claims for negligent misrepresentation or negligent inducement, reasoning that the elimination of the independent injury requirement for negligent misrepresentation claims would, "potentially convert every contract interpretation dispute into a negligent misrepresentation claim." *Id.* at 663-64. See *MCN Energy Enters., Inc. v. Omagro De Colombia, L.D.C.*, 98 S.W.3d 766, 772 (Tex.App.—Fort Worth 2003, pet. denied) (holding that obligations and duties separately imposed by contract and by tort may co-exist, and the Texas Supreme Court's holding in *D.S.A.* did not alter that principle).

### D. Negligent Misrepresentation Damages Cases

The following cases provide insight as to the type of evidence required to prove damages in a negligent misrepresentation case:

- (i) *First Nat'l Bank of Durant v. Trans Terra Corp. Int'l*, 142 F.3d 802 (5th Cir. 1998) (applying Texas law).  
Lawyer defendants argued that a negligent misrepresentation cause of action cannot be asserted against an attorney absent an attorney-client relationship between the plaintiff and the attorney. *Id.* at 809. The Fifth Circuit

disagreed and held a bank could maintain a negligent misrepresentation claim against the lawyers arising from incorrect title opinions prepared by the lawyers issued to the bank. *Id.* at 810.

The court held that the bank would not have made the loan absent the faulty title opinion. *Id.* The court noted that the evidence supported "a measure of damages equal to the entire amount of the loan, minus the amounts secured through note payments and foreclosure, since such a measure reflects the 'pecuniary loss suffered otherwise as a consequence of the plaintiff's reliance upon the misrepresentation.'" *Id.* at 811. However, the court explained that the bank could not recover the interest the bank would have received under the terms of the note because damages for negligent misrepresentation are not allowed for failure to obtain the benefit of one's bargain. *Id.* at 811 n.28. However, the court did recognize that the bank could recover any prejudgment and postjudgment interest Texas law might allow. *Id.*

- (ii) *Allied Vista, Inc. v. Holt*, 987 S.W.2d 138 (Tex. App.—Houston [14th Dist.] 1999, pet. denied)

The plaintiff sued his former employer for breach of contract, promissory estoppel, and negligent misrepresentation. *Id.* at 140. The claims arose out of the plaintiff's decision to refuse a job offer with another company and instead open a new plant for the employer. *Id.* He based his decision on representations that he would be provided with sufficient equipment to open the new plant. *Id.*

The jury awarded the plaintiff damages equal to the salary he would have received if he had accepted the offer from the other company. *Id.* The court recognized that such damages were not appropriate because they would give the plaintiff the benefit of an employment-at-will position that never came into existence. *Id.* at 143. Further, the lost salary was not available because damages for negligent misrepresentation are limited to out of pocket damages. *Id.*

- (iii) *Metropolitan Life Ins. Co. v. Haney*, 987 S.W.2d 236 (Tex. App.—Houston [14th Dist.] 1999, pet. denied)

The plaintiff was an agent for the defendant life insurance company. *Id.* at 238. The company sold the plaintiff a computer program for use in presenting life insurance packages that allegedly was defective. *Id.* at 238-39. The defect, in turn, caused the plaintiff to misrepresent the value of a large life insurance policy to a customer who in turn threatened legal action against the agent. *Id.* at 239. The agent alleged the company negligently misrepresented the computer program causing the agent to lose commissions caused by the threatened legal action. *Id.* The court held that the lost commissions were not recoverable under the general rule that lost profits are not available in negligent misrepresentation cases. *Id.* at 246. Because the agent had failed to assert that he had parted with anything of

value, there was no evidence of out of pocket expenses to support the jury verdict. *Id.*

(iv) *Clary Corp. v. Smith*, 949 S.W.2d 452 (Tex. App.—Fort Worth 1997, pet. denied)

In *Clary Corp.*, the defendant manufacturer was found to have negligently misrepresented to the plaintiff that the plaintiff would have an exclusive distributorship of pallet products in the plaintiff's territory. *Id.* at 457-58. The jury awarded \$5,000 in damages based on the negligent misrepresentation. *Id.* at 468.

The plaintiff offered evidence that it paid \$50,000 to purchase the products necessary to start the distributorship. *Id.* The plaintiff's family was in the pallet repair business, and he wanted to purchase some of the defendant manufacturer's goods after seeing an advertisement. *Id.* at 457. The court found that the plaintiff *might* have made a much smaller out-of-pocket investment if he had not been offered the distributorship. *Id.* at 468. The court held that this was sufficient to support the award of \$5,000 for the negligent misrepresentation damages. *Id.*

## IX. TORTIOUS INTERFERENCE WITH EXISTING CONTRACT

### A. Elements

A tortious interference cause of action is established if the plaintiff proves:

- the existence of a contract subject to interference;
- a willful and intentional act of interference;
- the act was a proximate cause of the plaintiff's damages; and
- actual damage or loss resulted.

*Prudential Ins. Co. of Am. v. Financial Review Servs., Inc.*, 29 S.W.3d 74, 77 (Tex. 2000) (citing *ACS Investors, Inc. v. McLaughlin*, 943 S.W.2d 426, 430 (Tex. 1997)); *Texas Beef Cattle Co. v. Green*, 921 S.W.2d 203, 210 (Tex. 1996).

### B. Actual Damages

The general measure of damages for tortious interference with a contract is the same as the measure of damages for breach of contract-- namely, attempting to put the plaintiff in the same economic position as if the contract had been fully performed. *American Nat'l Petroleum Co. v. Transcontinental Gas Pipe Line Corp.*, 798 S.W.2d 274, 278 (Tex. 1990); *Anderson, Greenwood & Co. v. Martin*, 44 S.W.3d 200, 219 (Tex. App.—Houston [14th Dist.] 2001, pet. denied). A successful plaintiff in a suit for tortious interference with contract may be entitled to recover:

- the pecuniary loss of the benefit of the contract or the prospective relation;
- consequential losses for which the interference is the legal cause; and

- emotional distress or actual harm to reputation, if they are to be reasonably expected to result from the interference.

*Exxon Corp. v. Allsup*, 808 S.W.2d 648, 660 (Tex. App.—Corpus Christi 1991, writ denied) (citing RESTATEMENT (SECOND) OF TORTS § 774A (1977)). There is no requirement that the loss incurred be one contemplated by the parties to the contract itself at the time the contract was made. *Id.*; see also *Sulzer Carbomedics, Inc. v. Oregon Cardio-Device, Inc.*, 257 F.3d 449, 456 (5th Cir. 2001) (applying Texas law) (holding that a claim for interference with contract is one in tort and damages are not based on contract rules; therefore, it is not required that the loss incurred be one within the contemplation of the parties to the contract itself at the time the contract was made).

### C. Unjust Enrichment As the Measure of Lost Profit Damages

An unjust enrichment measure of damages is appropriate for willful interference with contractual relations, where the plaintiff's lost profits are not readily ascertainable. *Sandare Chem. Co., Inc. v. WAKO Int'l, Inc.*, 820 S.W.2d 21, 23 (Tex. App.—Fort Worth 1991, no writ). In *Sandare Chem.*, the defendant counterclaimed for tortious interference with its contractual and business relations because the defendant was not allowed to pursue its plans to manufacture and market a medical diagnostic test while the plaintiff manufactured and marketed a medical diagnostic test. *Id.* The plaintiff contended that the defendant failed to establish that the defendant had suffered damages that were ascertainable at a fixed time. *Id.* The appeals court recognized that the trial court may have determined that any lost profits suffered by the defendant were not readily ascertainable, but no actual finding was necessary when there is evidence of the interfering party's profit. *Id.* at 24. The court noted that Restatement section 774A does not directly address the issue of whether one may recover defendant's profits in the event plaintiff's profits are not readily ascertainable. *Id.*

The court stated:

If the absence of discussion concerning whether the defendant's profits may constitute the measure of damages when the plaintiff's lost profits are not readily ascertainable means that the Restatement has declined to adopt the rule as we have stated it, then we decline to adopt the Restatement section 774A as the measure of damages when the plaintiff's lost profit is not readily ascertainable because we find it not to be in accord with the authorities, which we find to support the better rule.

*Id.* Accordingly, the court held that in a tortious interference with contract case, the defendant's profits may constitute

evidence of the plaintiff's lost profits, when the plaintiff cannot show with certainty the profits it would have realized in the absence of interference. *Id.* Thus, in a suit to recover lost profits, it is not necessary that the profits be susceptible of exact calculation; rather it is sufficient that there is evidence from which the profits can be determined with a reasonable degree of certainty. *Holt Atherton Indus., Inc. v. Heine*, 835 S.W.2d 80, 84 (Tex. 1992).

In comparison, in *Marcus, Stowell & Beve Gov't Sec., Inc. v. Jefferson Inv. Corp.*, 797 F.2d 227 (5th Cir. 1986) (applying Texas law), the plaintiff was not allowed recovery of more than its actual damages despite defendant's profit from the interference. *Marcus*, 797 F.2d at 231. The court explained:

Depriving a tortfeasor of its profits serves the policy of discouraging future wrongdoing while at the same time preventing the "unjust enrichment" of a wrongdoer. *Id.* Recognizing the importance of these policies, several courts outside of Texas have approved, in particular circumstances, an award for tortious interference based on the defendant's profits. *Id.*

Nevertheless, we conclude that under Texas law the district court properly measured MSB's recovery by the amount of actual loss suffered by MSB. *Id.* Texas courts have observed that the aim of awarding damages for tortious interference is the same as that of awarding damages for breach of contract—that is, to place the injured party in the same economic position it would have been in had the contract not been breached.

*Id.* (citations omitted); *but see Sulzer Carbomedics, Inc. v. Oregon Cardiodivices, Inc.*, 257 F.3d 449, 456 (5th Cir. 2001). (holding that post-*Marcus* Texas law holds that a party found liable for tortious interference with a contract may be liable for injuries that are reasonably to be expected to result from the interference).

#### D. Exemplary Damages

To recover exemplary damages in a claim for tortious interference with an existing contract, the plaintiff is usually required to prove "actual malice." *Texas Beef Cattle Co. v. Green*, 921 S.W.2d 203, 210 (Tex. 1996); *Clements v. Withers*, 437 S.W.2d 818, 822 (Tex. 1969). However, actual malice need not be shown to recover compensatory damages for the tort of interference with an existing contractual relationship. *Texas Beef Cattle Co.*, 921 S.W.2d at 210 (also stating that Texas courts have distinguished actual malice, which triggers recovery of exemplary damages, from legal malice, which negates the justification defense).

#### E. Miscellaneous

The unenforceability of a contract is no defense to an action for tortious interference with its performance. *Stern v. Marathon Oil Co.*, 767 S.W.2d 686, 689 (Tex. 1989). A similar situation exists with regard to contracts terminable at will. *Id.* (holding that until terminated, a terminable at will contract is valid and subsisting, and third persons are not free to tortiously interfere with it).

The breaching party and the interfering party are jointly and severally liable only for actual damages incurred by the plaintiff. *Armendariz v. Mora*, 553 S.W.2d 400, 406 (Tex. Civ. App.—El Paso 1977, writ ref'd n.r.e.). There is no joint and several liability as to any award for exemplary damages unless the defendants are closely related or where the defendants conspired to violate plaintiff's rights. TEX. CIV. PRAC. & REM. CODE ANN. § 41.005 (Vernon 1994); *Warner Communications, Inc. v. Keller*, 888 S.W.2d 586, 599 (Tex. App.—El Paso 1994), *rev'd on other grounds*, 928 S.W.2d 479 (Tex. 1996).

Attorneys' fees cannot be recovered in a claim for tortious interference with contract. *Transcontinental Gas Pipeline Corp. v. American Nat'l Petroleum Co.*, 763 S.W.2d 809, 823 (Tex. App.—Texarkana 1988), *rev'd on other grounds*, 798 S.W.2d 274 (Tex. 1990).

#### X. TORTIOUS INTERFERENCE WITH PROSPECTIVE CONTRACTS OR PROSPECTIVE BUSINESS RELATIONS

To recover for tortious interference with the prospective business relations, a plaintiff must prove that the defendant's conduct was independently tortious or wrongful.

*Wal-Mart Stores, Inc. v. Sturges*, 52 S.W.3d 711, 726 (Tex. 2001). Independently tortious does not mean that the plaintiff must prove an independent tort, but instead that the plaintiff must prove that the defendant's conduct would be actionable under a recognized tort. *Id.* To recover damages for tortious interference with prospective business relationships or prospective contracts, one must have sustained actual damages proximately caused by defendant's willful and intentional action. *Exxon v. Allsup*, 808 S.W.2d 648, 659 (Tex. App.—Corpus Christi 1991, writ denied).

##### A. Recoverable Damages Similar to Damages Available for Tortious Interference with Existing Contract

The damages recoverable for tortious interference with business relations, both existing and prospective, are similar to those recoverable for tortious interference with a contract.

A plaintiff may recover such damages sustained by him as are a natural and proximate consequence of the interference.

*Sulzer Carbomedics, Inc. v. Oregon Cardio-Devices, Inc.*, 257 F.3d 449, 455-56 (5th Cir. 2001); *Sandare Chem. Co., Inc. v. WAKO Int'l, Inc.*, 820 S.W.2d 21, 23-24 (Tex. App.—Fort Worth 1991, no writ). Likewise, pecuniary and consequential losses similar to those available for tortious

interference with contract are also available as outlined in section 774A of the Restatement (Second) of Torts. *Browning-Ferris, Inc. v. Reyna*, 852 S.W.2d 540, 549 (Tex. App.—San Antonio 1992), *rev'd on other grounds*, 865 S.W.2d 925 (Tex. 1993).

Section 774A of the Restatement (Second) of Torts states:

One who is liable to another for interference with a contract or prospective contractual relation is liable for damages for:

- (a) the pecuniary loss of the benefit of the contract or the prospective relation;
- (b) consequential losses for which the interference is the legal cause; and
- (c) emotional distress or actual harm to reputation, if they are reasonably to be expected to result from the interference.

RESTATEMENT (SECOND) OF TORTS § 774A (1979).

In comparing the damages available for interference with *prospective* business relations and those available for *existing* contract or existing business relations, the description of damages for each tort is very similar. “Damages for interference with an existing contract arise when there is an occurrence of actual damages or loss . . . . Damages for interference with prospective business relations arise when actual harm or damage occur as a result of the interference.” *Browning-Ferris, Inc.*, 852 S.W.2d at 549 (citing *Juliette Fowler Homes, Inc. v. Welch Assocs., Inc.*, 793 S.W.2d 660, 664 (Tex. 1990); *Gillum v. Republic Health Corp.*, 778 S.W.2d 558, 565 (Tex. App.—Dallas, no writ)).

## B. Malice Is Required

Recovery of actual damages for tortious interference with business relations requires a finding of malice. *Deauville Corp. v. Federated Dep't Stores, Inc.*, 756 F.2d 1183, 1196 (5th Cir. 1985); *Champion v. Wright*, 740 S.W.2d 848, 854 (Tex. App.—San Antonio 1987, writ denied). That is, unless there is some contractual understanding, a party to a business relationship is protected from only malicious or unlawful interference. *Bray v. Squires*, 702 S.W.2d 266, 272 (Tex. App.—Houston [1st Dist.] 1985, no writ).

The malice required to recover for interference with prospective contracts or business relations is not the same as the “actual malice” required for recovery of exemplary damages. In regard to interference with a prospective contract or relationship, malice “is not to be understood in its proper sense of ill will against a person, but in its legal sense, as characterizing an unlawful act, done intentionally without just cause or excuse.” *Exxon*, 808 S.W.2d at 659; *Bray*, 702

S.W.2d at 272 (“Malice, in its legal sense, characterizes an act with an unlawful purpose, done intentionally, without just cause or excuse. . . . It is not necessary, in such a case, to show that there was ill-will, spite or other evil motives.”).

Although a number of cases emphasize that the plaintiff must prove the defendant acted with malice, the Texas Supreme Court case of *Wal-Mart Stores, Inc. v. Sturges* criticized the malice requirement and stated that it overlaps with the defendant’s defense of justification and creates confusion. *Wal-Mart Stores*, 52 S.W.3d at 717-18. The court did not do away with the malice requirement; however, whether malice is retained as a requirement to recover damages remains to be seen.

## C. Recovery of Lost Profits Available

Depending on the nature of the interference with business relations, a plaintiff may recover lost profits of the diminution in his or her business, in addition to damages recoverable under Restatement (Second) of Torts section 774A. “Where the interference involves the acceptance by one party of salable items intended for his competitor, there may be a recovery for loss of profits. Where the result of the interference is to put the plaintiff out of business it has been said that his damages are the difference between the value of his business in the absence of the interference and the amount realized by liquidation.” *Gonzales v. Gutierrez*, 694 S.W.2d 384, 390 (Tex. App.—San Antonio 1985, no writ).

The recovery of future lost profits is available for both tortious interference with existing contracts and tortious interference with *prospective* business relations. *Browning-Ferris, Inc.*, 852 S.W.2d at 549.

In a claim for tortious interference with business relations, it is possible to recover both “lost profits” and “loss of potential profits,” the latter giving regard to future growth of business. *Champion*, 740 S.W.2d at 856. In *Champion*, the jury submission included each of these items as separate damages. *Id.* In addition to his lost profits, plaintiff stated that the lost profit amount did not include an estimated growth percentage. *Id.* Notably, the defendant made no objection to the court’s charge, although he contended on appeal that such a question allowed the jury to award double recovery because “potential profits” could not be distinguished from “lost profits”. *Id.* “It is apparent that the jury awarded \$29,136 as compensation for money that appellee would have lost had appellee’s business not expanded and then awarded an additional 10%, or \$2,913.60, to compensate appellee for the profits he would have made had his business been allowed to grow.” *Id.*

To recover for lost profits, a party must show by competent evidence the amount of the loss with reasonable certainty. *Bradford v. Vento*, 997 S.W.2d 713, 738 (Tex. App.—Corpus Christi 1999), *aff'd in part and rev'd in part on other grounds* by 48 S.W.3d 749, 752 (Tex. 2001). It is not necessary that profits should be susceptible to exact calculations; rather it is sufficient that there is evidence from

which they may be ascertained with a reasonable degree of certainty and exactness. *Id.*

#### D. Mental Anguish Damages Recoverable

Although not generally recoverable in an action based on breach of contract, mental anguish damages are an available element of damages for an intentional tort like tortious interference with prospective contracts. *Comstock Silversmiths, Inc. v. Carey*, 894 S.W.2d 56, 57 n.2 (Tex. App.—San Antonio 1995, no writ). It is undecided whether mental anguish damages are available in a tortious interference action in which economic damages are not found. *Id.*

#### E. Availability of Exemplary Damages

Exemplary damages are available in suits involving claims for tortious interference with prospective contracts. *See Bard v. Charles R. Myers Ins. Agency, Inc.*, 811 S.W.2d 251, 263 (Tex. App.—San Antonio 1991) (explaining that punitive damages do not violate public policy or the due process clause), *rev'd on other grounds*, 839 S.W.2d 791 (Tex. 1992). To recover exemplary damages in this context, malice must be shown. *Id.* Section 41.001 of the Texas Civil Practice and Remedies Code defines the malice required to recover exemplary damages. *See* TEX. CIV. PRAC. & REM. CODE ANN. § 41.001(7).

#### F. Miscellaneous

Like tortious interference with contract claims, attorneys' fees cannot be recovered in a claim for tortious interference with business relations. *American Nat'l Petroleum Co. v. Transcontinental Gas Pipe Line Corp.*, 798 S.W.2d 274, 280 (Tex. 1990).

Similarly, counsel should also be aware that a void contract cannot provide the basis for a claim for tortious interference with a prospective contract. *Ralston Purina Co. v. McKendrick*, 850 S.W.2d 629, 638-39 (Tex. App.—San Antonio 1993, writ denied) (finding that because neither party had necessary permits to import feed into Mexico, prospective contract cannot provide the basis for plaintiff's tortious interference with a prospective contract claim).

### XI. CONVERSION

#### A. Elements

Conversion is the wrongful exercise of dominion and control over another's property in denial of or inconsistent with his rights. *Green Int'l, Inc. v. Solis*, 951 S.W.2d 384, 391 (Tex. 1997). To establish a claim for conversion a plaintiff must show (1) title, (2) right to possession, and (3) a demand for return of the property unless the possessor's acts manifest a clear repudiation of the plaintiff's rights. *El Paso Prod. Co. v. Valence Operating Co.*, 112 S.W.3d 616, 625 (Tex. App.—Houston [1st. Dist.] 2003, pet. denied).

#### B. Fair Market Value at Time of Conversion

Generally, actual damages for conversion are equal to the fair market value of the property at the time and place of the conversion. *United Mobile Networks, L.P. v. Deaton*, 939 S.W.2d 146, 147-48 (Tex. 1997).

The "place" of conversion is a reasonable area surrounding the precise location at which the conversion occurred. *Humes v. Hallmark*, 895 S.W.2d 475, 478 (Tex. App.—Austin 1995, no writ) (stating that when the conversion occurs outside city limits and near the boundary of two counties, one may look to a larger area or a broad market to value Indian artifacts rather than the precise location in Texas in which the goods were converted). The breadth of the area within which the market value at the place of conversion may be measured is determined by the nature of the object converted. *Id.* at 479. The value of items which are unique and stationary may need to be measured in a small area; the market value for other types of personalty may be measured in a much broader area if the market for that type of property is broader and more standardized. *Id.*

The "time" of conversion for purposes of determining market value also turns on the nature of the object converted. *Id.* (stating that the time within which to measure the market value of thousand-year-old Indian artifacts need not be as compressed as that for measuring the market value of stocks or commodities because the value of artifacts is not subject to the same type of market flux as is the value of stocks); *see also Miga v. Jensen*, 96 S.W.3d 207, 221 (Tex. 2002) (O'Neill, J. and Phillips, C.J. dissenting) (stating that the exception is that the measure of damages for the failure to sell or to deliver stocks and the like speculative property, or for the conversion thereof, is the highest market value which the property attains between the time when the contract required its sale or delivery, or the time of its conversion, and the expiration of a reasonable time, to enable the owner to put himself in status quo, after notice to him of the failure to comply with the contract); *Reed v. White, Weld & Co., Inc.*, 571 S.W.2d 395, 397 (Tex. Civ. App.—Texarkana 1978, no writ) (holding, with regard to stock or bonds, the just measure of damages is the highest intermediate value between the time of its conversion and a reasonable time after the owner has received notice of the conversion to enable him to replace the stock). Where the conversion involves fraud, willful wrong, or gross negligence, and the property converted is of changing or fluctuating value, the measure of damages is the highest market value between the date of the conversion and the filing of suit. *Miller v. Kendall*, 804 S.W.2d 933, 942 (Tex. App.—Houston [1st. Dist.] 1990, no writ) (finding defendant waived any error regarding limiting plaintiff's damages for converted stock by failing to request jury instruction limiting measure of damages to the value of the stock at conversion).

### C. Other Factors

If the value of the converted property to its owner is in the owner's use of the property, then the owner's actual loss is the loss of the use of the property, and the measure of damages is the intrinsic value of the property to the owner. *Williams v. Dodson*, 976 S.W.2d at 861, 864 (Tex. App.—Austin 1998, no pet.). If the property is held by the owner for the purpose of sale, however, then the owner's actual loss is the market value or what the owner would have received from its sale. *Id.*

Damages may also include other losses or expenses necessary to compensate the plaintiff for all actual losses or injuries sustained, not merely the reasonable market value of the property, as a natural and proximate result of the defendant's wrong. *Soto v. Sea Road Int'l, Inc.*, 942 S.W.2d 67, 74 (Tex. App.—Corpus Christi 1997, pet. denied) (allowing shipper/plaintiff to recover amounts it paid seller of goods, in addition to attorneys' fees and interest, as a result of custom agent's actions).

A plaintiff who establishes conversion is also entitled to return of the property and damages for loss of use during the tortfeasor's detention. *Winkle Chevy-Olds-Pontiac, Inc. v. Condon*, 830 S.W.2d 740, 746 (Tex. App.—Corpus Christi 1992, writ dismissed). Alternatively, the injured party can sue for the value of the property. *Id.*

Where the item converted is personal property and is shown to have market value, the measure of damages is the market value at the time of the conversion, plus interest from that date, and in some cases, special damages resulting from the withholding of the property or properly incurred by the owner in the pursuit of it. *Reed*, 571 S.W.2d at 397. Where, however, the article converted is unusual such that there is no real market value for it, like personal heirlooms or other household items, the actual value to the owner may be determined without resort to market value or replacement cost. *Crisp v. Security Nat'l Ins. Co.*, 369 S.W.2d 326, 329 (Tex. 1963).

A conversion should not unjustly enrich either the wrongdoer or the complaining party, and accordingly, damages for conversion are limited to the amount necessary to compensate the plaintiff for actual losses or injuries sustained. *United Mobile Networks*, 939 S.W.2d at 148. There cannot be double recovery for the value of the same item. *Id.* Therefore, a party may not recover both the loss of use of the property and the value of the property. See *Winkle*, 830 S.W.2d at 746 (eliminating \$700 award for loss of use where plaintiff also recovered lost value of vehicle); *First Nat'l Bank v. Gittelman*, 788 S.W.2d 165, 169 (Tex. App.—Houston [14<sup>th</sup> Dist.] 1990, writ denied) (finding car owner's daughter could not recover for loss of use of an automobile where mother recovered for property's market value).

A party may not recover damages for conversion based upon indebtedness that may be discharged by the payment of money generally. *Cone v. Fagadau Energy Corp.*, 68 S.W.3d 147, 165 (Tex. App.—Eastland 2001, pet. denied).

For instance in *Cone*, the working interest owner of an oil and gas lease sought damages for conversion arising out of the operator's failure to credit the full amount of revenue generated by interest in the owner's account. *Id.* at 164-65. The owner claimed a conversion because charges he disputed were deducted from his share of the revenue. *Id.* at 165. In finding the claim for damages insufficient, the court recognized that the owner had authorized control over his share of production to the operator, and proceeds attributable to interest had already been credited to the owner's account. *Id.*

Damages are determined, in part, by whether the goods are held for sale or for the well-being of the owner. *Crisp*, 369 S.W.2d at 328-29; *Williams*, 976 at 864. In *Crisp*, the Texas Supreme Court stated:

The law of damages distinguished between marketable chattels possessed for purposes of sale and chattels possessed for the comfort and well-being of the owner. In the instance of the former it judges their value by the market price. In the instance of the latter it measures their loss, not by their value in a secondhand market, but by the value of their use to the owner who suffers from their deprivation.

*Crisp*, 369 S.W.2d at 329.

### D. Exemplary Damages Available

To recover exemplary damages for conversion, the plaintiff must prove the defendant acted with malice. *Green Int'l, Inc.*, 951 S.W.2d at 391 (citing *Southwestern Inv. Co. v. Alvarez*, 453 S.W.2d 138, 141 (Tex. 1970)). To establish malicious conversion, the plaintiff must show more than bad faith and wrongful conduct; the plaintiff must show that the wrongful act was of a wanton and malicious nature. *Id.* (stating that the mere fact that the defendant failed to comply with the terms of contract, which gave the plaintiff three days notice before impounding his equipment, did not prove malicious intent). "Ill will may be implied from the knowing conversion of another's property without justification, and malice may be implied from the knowing conversion of another's property when the defendant knew or should have known he had no legal right to the property. *Transfer Prods., Inc. v. Texpar Energy, Inc.*, 788 S.W.2d 713, 715 (Tex. App.—Corpus Christi 1990, no writ).

However, without a recovery of actual damages, plaintiffs may not recover exemplary damages. *Gittelman*, 788 S.W.2d at 170.

### E. Lost Profits

One alternative theory to recovery of the fair market value in a conversion case is recovery for lost profits. This type of recovery, however, is limited to situations where the defendant had notice of the potential lost profits. *Winkle*, 830 S.W.2d at 746. The injured party must show that such

damages were within the contemplation of the parties at the time of contracting. *Id.* The plaintiff's recovery is usually determined by measuring the lost profits created by the plaintiff's inability to use the good. *Commercial Credit Equip. Corp. v. Elliott*, 414 S.W.2d 35, 43-44 (Tex. Civ. App.—Eastland 1967, writ dismissed w.o.j.).

As explained below, proving lost profits in a conversion case is not always easy. A plaintiff must do more than show lost profits. *Szczepanik v. First S. Trust Co.*, 883 S.W.2d 648, 649 (Tex. 1994). While the amount of loss need not be susceptible to exact calculation, it must be shown by competent evidence with reasonable certainty. *Id.*

In *United Mobile Networks*, the plaintiff ("UMN") sought damages from its former employee for his conversion of UMN's list of customers to which it had sold radios. 939 S.W.2d at 147. The original employment agreement had included a covenant that the defendant would not compete for three years after leaving UMN. *Id.* When the defendant voluntarily departed from UMN, he took a copy of UMN's customer list. *Id.* At trial, UMN's expert testified that the customer list had a fair market value of \$544,733.98, based on the list's customer generated income. *Id.* at 148. The jury found in UMN's favor on its conversion claim, and the trial court rendered judgment. *Id.* at 147. The court of appeals reversed and remanded the conversion claim damages findings back to the trial court based on insufficient evidence of damages. *Id.* The Texas Supreme Court granted writ to examine the proper proof of the measure of damages in a conversion action. *Id.* at 146.

The Texas Supreme Court found that because UMN's expert's valuation "presumed that UMN had lost not only a copy of the customer list, but all the customer and the business generated from the list," UMN did not offer any competent evidence to support its damages claim for conversion. *Id.* at 148. According to the court:

UMN continued to use the list and generate income from the list. UMN did not offer any evidence that because [the defendant] took the list it lost customers or income, or that it would lose the customers or future income. In fact, UMN's expert conceded that the customer list had no value under his valuation method if the customers were not generating revenue to whoever held the list. Consequently, UMN did not offer any competent evidence to support a damages award against the [defendants] for converting a copy of the customer list.

*Id.* The court rejected UMN's argument that the list's exclusive nature and the opportunity to capture business gave the list its value. *Id.* UMN did not present any evidence that the company had lost its opportunity to capture the customers' business. *Id.* According to its testimony, UMN had already captured and retained most of its customers. The court reasoned, "UMN cannot establish

damages based on something it has not lost." *Id.* Rather than remanding on the issue of conversion damages, the court rendered judgment that the plaintiff take nothing against the defendant. *Id.*

## XII. DAMAGES FOR BREACH OF FIDUCIARY DUTY

### A. Introduction

A successful plaintiff in a breach of fiduciary duty case can recover tort damages for harm caused by the breach of the fiduciary duty. *Holloway v. International Bakers Life Ins.*, 354 S.W.2d 198, 213 (Tex. Civ. App.—Fort Worth 1962), *rev'd on other grounds*, 368 S.W.2d 567 (Tex. 1963). However, as an alternative or in addition to these damages, a plaintiff may be entitled to quasi-contractual recovery. *Id.* In determining the type of damages one is entitled to for breach of fiduciary duty, however, the nature of the fiduciary duty must be considered. There are at least sixteen different contexts in which a fiduciary duty may arise, and some types of damages are only recoverable under certain fiduciary relationships. This portion of the article does not attempt to discuss all of the various fiduciary relationships and each of their available remedies.

### B. General Damages

#### 1. Restitution Type of Recovery

##### a. Reduction in Fee

In *Edwards v. Holleman*, 893 S.W.2d 115 (Tex. App.—Houston [1st Dist.] 1995, writ denied), Holleman brought suit against Edwards for breach of fiduciary duty by charging unreasonable trustee's fees, attorney's fees, and expenses under a deed of trust. Holleman purchased a house by borrowing a portion of the purchase money from Galveston S & L ("the Bank"). *Id.* at 117. Holleman also received a home improvement note on the property. *Id.* Subsequently, Holleman became delinquent on his note payments, and the bank accelerated the note. *Id.* The bank named Edwards, the bank's president, as the trustee. *Id.* Holleman found a buyer for the property on the eve of the foreclosure, thus preventing the foreclosure. *Id.* Nevertheless, the bank demanded, among other things, payment of the trustee's fees and expenses of \$18,061.31. *Id.*

The jury found that Edwards breached his fiduciary duty by seeking an additional benefit in charging an unreasonable fee. *Id.* The jury reduced the trustee's fee from \$12,036 to \$3,000, and eliminated the trustee's expenses of \$1,021.40. The court of appeals affirmed, noting that though the purchase money note provided for a reasonable trustee fee and the home improvement note provided for a five percent trustee fee if the property was sold, Edwards' fee was based on ten percent of the unpaid balance of the two notes. *Id.* at 118. Additionally, Edwards was not a third-party trustee because he was also the bank's president; much of what Edwards did as trustee was similar to what he would have done as president of the bank. *Id.*

## b. Disgorgement / Forfeiture of Fees

Under Texas law, forfeiture of fees is a well-settled equitable remedy for breach of fiduciary duty. *See Royden v. Ardoin*, 331 S.W.2d 206, 209 (Tex. 1960). To be entitled to forfeiture of fees, the plaintiff need not prove actual damages because the central purpose of this remedy is to protect relationships of trust by discouraging disloyalty. *Burrow v. Arce*, 997 S.W.2d 229, 238 (Tex. 1999). The following cases illustrate some circumstances under which forfeiture of fees will be awarded:

In *Kinzbach Tool Co. v. Corbett Wallace Corp.*, 138 Tex. 565, 160 S.W.2d 509, 510 (1942), Corbett Wallace approached G.E. Turner, an employee of Kinzbach Tool, about helping it sell the patent rights regarding a tool to Kinzbach. Wallace agreed to pay Turner a commission if he could secure the sale. *Id.* The sale was completed with Kinzbach, with the purchase price to be paid in installments. *Id.* at 511. Before the first installment became due, however, Kinzbach discovered the secret deal between Wallace and Turner. *Id.* Kinzbach then sought to cancel the commission Turner was to make by deducting it from the installments. *Id.* The court allowed Kinzbach this remedy, holding that Turner breached his fiduciary duty to his employer and had to account for the secret gain. *Id.* at 514.

In *Southern Cross Indus., Inc. v. Martin*, 604 S.W.2d 290, 292 (Tex. Civ. App.—San Antonio 1980, writ ref'd n.r.e.), the court refused to allow a broker to recover his commission on the sale of property where the evidence showed that he had planned to purchase the property from his principal and then later sell it at a profit to another buyer. The court explained that the broker breached his fiduciary duty to the principal by withholding the information concerning the prospect of other buyers. *Id.* Hence, the broker could not recover his fee when the principal eventually sold the property to another buyer, notwithstanding that the broker had made the contact. *Id.* at 293.

In *Russell v. Truitt*, 554 S.W.2d 948 (Tex. Civ. App.—Fort Worth 1977, writ ref'd n.r.e.), the plaintiffs entered into a joint venture with the defendants for the construction and management of apartments. Pursuant to the joint venture, defendants were to be the managing agent of the venture and were to receive monthly installments of \$500 from the plaintiffs. *Id.* at 951. Thereafter, the defendants entered into a secret agreement with Rubaco Builders, a builder previously rejected by the plaintiffs, to build the apartments. *Id.* In the secret agreement, the defendants agreed to share the profits of the apartment construction with Rubaco and to give Rubaco the final authority to approve the work. *Id.* The construction project ultimately failed, and the bank foreclosed on the property. *Id.*

The plaintiffs alleged that this secret contract was a breach of the defendants' fiduciary duty and that they were entitled to recover the monthly payments made to their agents. *Id.* The court agreed and upheld the jury award in the amount of \$8,000 for the monthly payments that had

been made. *Id.* The court rejected the defendants' argument that the plaintiffs did not plead that the defendants had failed to perform the agreement as managing agent. *Id.* The court explained that no special pleadings were necessary where the plaintiffs had plead and proven breach of a fiduciary duty. *Id.* at 951-52; *see also Burrow*, 997 S.W.2d at 245 (finding client entitled to fee forfeiture upon proof of breach, but amount of forfeiture dependent on each case and is to be decided by court because it is an equitable remedy).

In the context of the attorney-client relationship, it is now clear under Texas law that an attorney who breaches his or her fiduciary duty to a client may be required to forfeit all or some of his or her fee, irrespective of whether the breach caused the client actual damages, after taking into consideration the factors contained in section 49 of the Restatement (Third) of the Law Governing Lawyers. *Burrow*, 997 S.W.2d at 238-40.

## c. Recouping Commissions and Decline in Portfolio

In *Miley v. Oppenheimer & Co., Inc.*, 637 F.2d 318, 328-29 (5th Cir. 1981), the court allowed the plaintiff, an investor, to recoup the commissions she had paid to her broker after the jury determined that the broker breached its fiduciary duty in churning<sup>11</sup> her investments. The court also allowed the plaintiff to recover for the decline in the value of her portfolio in excess of the average decline in the stock market during the time which her broker handled her accounts. *Id.*

## d. Recovering the Fair Market Value of the Property, Interest, and Fees

In *Interfirst Bank Dallas, N.A. v. Risser*, 739 S.W.2d 882 (Tex. App.—Texarkana 1987, no writ) the plaintiffs, beneficial owners of stock in a closely held corporation, sued Interfirst Bank Dallas, N.A. ("Interfirst") for breach of fiduciary duty. The plaintiffs alleged that Interfirst sold their corporation's stock for an inadequate price. *Id.* at 887. The court explained that when trust property is sold for an inadequate price, the appropriate way to calculate what price should have been obtained is based on the fair market value ("FMV"). *Id.* at 895. The FMV of the stock becomes an ultimate fact issue. *Id.* The jury heard evidence from experts on both sides on what the FMV for the stock was. *Id.* at 891-94. The court held that it was not error to submit the issue of FMV to the jury even though the stock had not been sold in sufficient quantities to establish a prevailing sales price, because the expert opinion was based on other measures, such as comparable companies. *Id.* at 891. Further, the plaintiffs did not need to show that a specific

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<sup>11</sup>Churning occurs when a broker enters into transactions and manages a client's account for the purpose of generating commissions and in disregard of his client's interests. *Miley*, 637 F.2d at 324.

potential buyer was available for the stock, because the FMV was determined by looking at comparable sales. *Id.*

Once the jury determined that a breach had occurred and calculated the FMV of the stock, the trustee was liable for “any loss . . . in value of the trust estate resulting from breach of the trust.” *Id.* at 895 (quoting RESTATEMENT (SECOND) OF TRUSTS § 205 (1959)). The trustee was liable for the difference between the amount he should have received for the stock and the amount he did receive. *Id.* Thus, the award of \$1 million to the plaintiff, the difference between the fair market value of the stock (\$1.5 million) and the amount actually received (\$500,000), was appropriate. *Id.*

e. Rescission

In *Miller v. Miller*, 700 S.W.2d 941, 942 (Tex. App.—Dallas 1985, writ ref’d n.r.e.), the court allowed the beneficiary to rescind her agreement with the fiduciary. The fiduciary relationship was established because the parties were married at the time of the transaction. *Id.* at 943. Prior to their divorce, the defendant had his wife, the plaintiff, sign an agreement which, among other things, stated that if they ever divorced, she agreed to first offer to sell to him her interest in a company which they owned as community property and in which her husband was an officer and director. *Id.* The parties subsequently divorced, and the plaintiff sold her 250 shares of stock to the defendant for \$2,500. *Id.* The day after the sale, the defendant, acting in his capacity as an officer and director for the company, sold 1.5 million shares of the company to Exxon for a dollar a share. *Id.* Thereafter, the value of the company’s stock drastically increased. *Id.* at 944. The plaintiff brought a breach of fiduciary duty claim against the defendant and sought to rescind her sale to the defendant. *Id.* The court allowed the rescission because the defendant failed to prove that he did not significantly benefit from the sale. *Id.* at 947-48.

2. Recouping Profits

a. Profits Earned at the Expense of the Beneficiary

In *International Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 576 (Tex. 1963), the court held that International was entitled to recover profits that were realized by the defendants, its former officers and directors, in breach of their fiduciary duty to the corporation. *Id.* at 574-75. The defendants breached their duty when they purchased property under the name of a different corporation in order to sell the property to International at a profit. The defendants purchased the property for \$62,500 and within months of the purchase sold the property to International for \$77,500. The defendants were also in breach of their duty when they entered into an agreement with a third party to split a commission fee for the sale of International stock, without prior consent of International. *Id.* at 576. The court determined that the defendants were liable to International in the amount of the personal profits

they made in breach of their duty because they could not show how the transactions were fair to International. *Id.* at 577.

b. Usurpation of Corporate Opportunity not Applicable to all Fiduciaries

In *United Teachers Assocs. Ins. Co. v. MacKeen & Bailey, Inc.*, 99 F.3d 645, 647-49 (5th Cir. 1996), MacKeen, an actuary, was hired by UTAIC to determine which blocks of business from other insurance companies had redundant reserves so that UTAIC could purchase these companies and use the redundant reserves for investment purposes. UTAIC had MacKeen determine what the reserves were for National Foundation Life (“National”), a company which was selling off a block business, known as Heart/Cancer. *Id.* MacKeen determined that there was \$7.8 million in redundant reserves and gave this information to UTAIC so that it could bid on the business. *Id.* Thereafter, UTAIC and National exchanged several counteroffers. *Id.* During these negotiations, MacKeen also gave this information to National. *Id.* As a result, National decided not to sell off its Heart/Cancer block business. Prior to the \$7.8 million adjustment being publicly announced, MacKeen purchased a significant amount of stock in National’s parent corporation. *Id.* The stock price subsequently rose when the adjustment was made public, and MacKeen made over \$200,000 in profit. *Id.* Thereafter, UTAIC brought suit for breach of a fiduciary duty and usurpation of a corporate opportunity. *Id.*

The court concluded that MacKeen breached his fiduciary duty to UTAIC when he disclosed the amount of the reserves to National (although the Fifth Circuit rejected the notion that actuaries are, as a matter of law, fiduciaries). *Id.* at 650. As a result of this breach, UTAIC was unable to purchase the Heart/Cancer block business of National and sustained a \$240,000 loss. *Id.* at 651. Although the court held MacKeen liable to UTAIC for this amount, it also held that UTAIC could not recover for the amount of profit MacKeen made when he purchased stock of National’s parent corporation on the theory of usurpation of a corporate opportunity. *Id.* The court explained that corporate usurpation was only available against fiduciaries who are major shareholders, officers or directors of a corporation. *Id.* Since MacKeen was neither, UTAIC could not recover. *Id.* The court rejected the notion that corporate usurpation should be used to disgorge interest surreptitiously acquired by any fiduciary of a corporation. *Id.* The court also explained that there was no evidence that UTAIC was interested in the stock that MacKeen purchased, and, therefore, the stock was not considered a corporate opportunity. *Id.* Hence, corporate usurpation is not applicable to all corporate fiduciaries.

c. Lost Profits & Carrying Cost

In *NRC, Inc. v. Huddleston*, 886 S.W.2d 526 (Tex. App.—Austin 1994, no writ), Huddleston was a home builder who had contracted to sell one of his homes to the

McGinleys for \$130,000. Huddleston's real estate agent was NRC. *Id.* at 527. NRC drew up the earnest money contract and received the check. *Id.* The contract was signed on February 8, 1986, with a closing date of March 7, 1986. *Id.* However, the McGinleys were unable to obtain financing. *Id.* Thereafter, Huddleston contracted with another couple for the sale of the house for \$153,000. *Id.* NRC discovered this contract and contacted the McGinleys to encourage them to file a lawsuit for specific performance and a lis pendens on the property. *Id.* The McGinleys followed NRC's directives, resulting in Huddleston being unable to sell the house to the other couple and eventually losing the property in a foreclosure sale. *Id.* at 528.

Huddleston countersued and joined NRC as a defendant for breach of fiduciary duty. *Id.* During discovery, Huddleston discovered that the check which NRC received for the earnest money was never deposited in an escrow account because there were insufficient funds in the checking account. *Id.* Although the Real Estate Commission's rules mandate that this information be conveyed to the seller, NRC did not tell Huddleston of this fact. *Id.* At trial, the jury found that NRC breached its duty to Huddleston and awarded him \$23,042 in actual damages and \$50,000 in punitive damages. *Id.* The jury also awarded \$13,958 for his DTPA cause of action. *Id.*

At trial, Huddleston presented evidence that the sales price of the lost purchase was \$153,000 and that his note on the house was \$116,000. *Id.* at 531. Huddleston also testified that he had carrying costs such as tax, interest, maintenance, and insurance of about \$1,327 per month. *Id.*

The court upheld the jury verdict noting that there was sufficient evidence to show lost profits and out-of-pocket expenses. *Id.* at 532.

### 3. Constructive Trust

A plaintiff in a breach of fiduciary duty case may also be entitled to equitable remedies for such a breach. *Hoggett v. Brown*, 971 S.W.2d 472, 494 (Tex. App.—Houston [14<sup>th</sup> Dist.] 1997, pet. denied). Such equitable remedies include the creation of a constructive trust. *Id.* A transaction provides the basis for a constructive trust when the legal title to property is obtained by a person in violation, express or implied, of some duty owed to one who has an equitable interest in the property. *Id.* Thus, in order to prevent unjust enrichment of the legal holder, such person is deemed to hold the property as a trustee for the beneficial use of that party which has been wrongfully deprived of its rights. *Fitz-Gerald v. Hull*, 150 Tex. 39, 237 S.W.2d 256, 262 (1951) (quoting RESTATEMENT OF RESTITUTION § 160 (1936)).

### C. Consequential Damages

Because breach of fiduciary duty is considered a tort, consequential damages are available. In a trust context, section 114.001(c) of the Texas Property Code specifically states that a trustee who commits a breach is charged with any damage caused as result of the breach. TEX. PROP.

CODE ANN. § 114.001 (Vernon Supp. 2004); *see also Meyers v. Moody*, 693 F.2d 1196, 1214 (5th Cir. 1982) (interpreting the words “any loss” to include consequential damages).

#### 1. Mental Anguish

In *Perez v. Kirk & Carrigan*, 822 S.W.2d 261, 267 (Tex. App.—Corpus Christi 1991, writ denied), the court held that mental anguish damages could be awarded for breach of a fiduciary duty. In *Perez*, the plaintiff, a truck driver, argued that the defendants, the law firm of Perez's employer, created a fiduciary relationship with him by implying that they were his attorneys as well as his employer's attorneys. *Id.* at 263. The defendants approached the plaintiff following a catastrophic accident he was involved in that resulted in the death of twenty-one children. *Id.* The defendants obtained a statement from plaintiff regarding the incident. *Id.* Thereafter, the defendants gave the statement to the district attorney for criminal prosecution. *Id.* at 264. The plaintiff sued for breach of fiduciary duty and alleged that the dissemination of his statement caused him mental anguish. *Id.* He alleged that he suffered public humiliation and emotional distress when the firm turned over his supposedly confidential statement to the district attorney. *Id.* The defendants argued that they could not have caused any mental anguish by turning over the statement because it only revealed the plaintiff's version of what happened. *Id.* at 266. The court disagreed, holding that the plaintiff made a valid claim for mental anguish given that the statement was made in a private and confidential meeting. *Id.* at 267; *see also Navistar Int'l Transp. Corp. v. Crim Truck & Tractor Co.*, 791 S.W.2d 241, 245 (Tex. App.—Texarkana 1990) (recognizing breach of a fiduciary duty as a tort cause of action which may allow recovery for mental anguish), *aff'd*, 823 S.W.2d 591 (Tex. 1992).

### D. Exemplary Damages

Exemplary damages are also available for a breach of a fiduciary duty. However, in awarding exemplary damages for a breach of fiduciary duty, the issue is not whether there is an intentional injury, but rather whether the fiduciary intended to gain an additional benefit for himself or herself. *Hawthorne v. Guenther*, 917 S.W.2d 924, 936 (Tex. App.—Houston [1<sup>st</sup> Dist.] 1996, writ denied); *Edwards v. Holleman*, 893 S.W.2d 115, 120 (Tex. App.—Houston [1<sup>st</sup> Dist.] 1995, writ denied). Malice is not a required element of exemplary damages when there is an intentional breach of a fiduciary duty. *Hawthorne*, 917 S.W.2d at 936 (finding that the admitted element of intent was supported by the record). To support an award of exemplary damages, however, there must be a finding of an aggravated factor, whether it be intent, self dealing, or malice. *Id.* Exemplary damages are also proper when self-dealing by a fiduciary has occurred. *Texas Bank & Trust Co. v. Moore*, 595 S.W.2d 502, 510 (Tex. 1980).

### 1. Secret Negotiations

In *Annesley v. Tricentrol Oil Trading, Inc.*, 841 S.W.2d 908, 910 (Tex. App.—Houston [14th Dist.] 1992, writ denied), the court concluded that exemplary damages were appropriate where the evidence showed that the corporation's president entered into secret negotiations with her successor under which the successor was permitted to keep the corporation's seats on the New York Mercantile Exchange as his personal assets. The court concluded this was sufficient to establish that the president's breach of fiduciary duty to the corporation was committed intentionally and was sufficient to support an award of exemplary damages. *Id.*

### 2. Numerous Bad Acts

In *Hawthorne*, the court sustained an award of punitive damages even though the jury did not specifically find that the defendant acted intentionally. 917 S.W.2d at 937. The court found intent based on the defendant's behavior. *Id.* The defendant failed to distribute partnership proceeds to the plaintiff, yet admitted that she received and spent the plaintiff's share of the partnership proceeds, amounting to more than \$440,000. *Id.* at 936. Additionally, the defendant made a substantial loan to herself from the partnership funds and sold most of the assets of the partnership without informing the plaintiff. *Id.* Finally, the defendant instructed the partnership's accountant to withhold information from the plaintiff. *Id.* The court concluded that based on this conduct, it was apparent the defendant was acting intentionally. *Id.* at 937.

### 3. Self Dealing

In *Interfirst Bank Dallas, N.A. v. Risser*, 739 S.W.2d 882, 905 (Tex. App.—Texarkana 1987, no writ) InterFirst sold the stock of a company which was held in trust to one of its commercial bank clients, which was also the issuing company. The jury determined that InterFirst did not receive the fair market value for the stock, that it made no efforts to seek the best possible price for the stock by publicizing its sale, that it failed to notify the beneficiaries, and that it failed to get an outside appraisal of the stock prior to sale. *Id.* The court concluded that this evidence was enough to support the conclusion that InterFirst sold the stock in bad faith and was self dealing to the detriment of the beneficiaries of the trust. *Id.* The court held that exemplary damages were appropriate. *Id.* at 908.

### 4. Ousting from Partnership

In *Horton v. Robinson*, 776 S.W.2d 260, 265 (Tex. App.—El Paso 1989, no writ), the court affirmed a jury finding that the defendants breached their fiduciary duty to the plaintiff by ousting him from the company in which they each owned a one-third share and in which they agreed to equally share profits. The court also affirmed an award of punitive damages. *Id.* at 266. There was evidence to show that the defendants: (1) were cutting the plaintiff out of

distributions; (2) received dividends while the plaintiff did not; (3) received excessive salaries; and (4) were paid for fictitious directors' meetings. *Id.* at 264. During the years that this occurred, the plaintiff's expert, a certified public accountant, testified that \$486,240 in profits should have been divided equally so that each partner received \$162,080. *Id.* at 263. Instead, the evidence showed that approximately \$360,000 was paid as director's fees and salaries to the defendants. *Id.* The court noted that this evidence clearly showed that one of the fiduciaries intended to gain an additional benefit for himself. *Id.* Accordingly, the court found no error in the award of \$160,000 in actual damages and \$175,000 in exemplary damages. *Id.* at 266.

### 5. Secret Profit

Exemplary damages may be assessed against a party who breaches a fiduciary duty by attempting to obtain a secret profit for himself. *Kirby v. Cruce*, 688 S.W.2d 161, 167 (Tex. App.—Dallas 1985, writ ref'd n.r.e.) (citing *Holloway*, 368 S.W.2d at 584-84). In *Kirby*, the court held that the defendant was liable for exemplary damages where the defendant schemed with other individuals to form a joint venture and secretly profited from the investors. *Id.* According to the scheme, the defendant represented to the investors that the venture properties cost more than they actually did. *Id.* at 164. The evidence also showed that the defendant had no intention of ever paying his pro rata share of the cost required to close the venture. *Id.* Additionally, he prepared false closing statements that contained a false purchase price, increased cash disbursements, and subordinated liens for each venture property. *Id.* Because the defendant and another conspirator failed to pay their share of the closing cost, the bank foreclosed on the properties. *Id.* Thereafter, the investors lost their contributions and brought suit. *Id.* The court upheld the jury's award of punitive damages, stating that punitive damages are permissible where a fiduciary breaches his duty in an attempt to obtain secret profits for himself. *Id.* at 166-67.

### E. Attorney's Fees

Attorney's fees may be available for breach of a fiduciary duty. *See* TEX. PROP. CODE ANN. § 114.064 (Vernon 1995); TEX CIV. PRAC. & REM. CODE ANN. § 38.001 (Vernon 1997); *see also Risser*, 739 S.W.2d at 908.

## XIII. DEFAMATION

### A. Introduction

Common law defamation consists of a communication that either: (1) harms the reputation of another by lowering the person in the estimation of the community; or (2) deters others from associating or dealing with the person. RESTATEMENT (SECOND) OF TORTS § 559 (1977). This definition encompasses both libel and slander. *Delta Air*

*Lines, Inc. v. Norris*, 949 S.W.2d 422, 426 (Tex. App.—Waco 1997, writ denied). Libel is defined as:

a defamation expressed in written or other graphic form that tends to blacken the memory of the dead or that tends to injure a living person's reputation and thereby expose the person to public hatred, contempt or ridicule, or financial injury or to impeach any person's honesty, integrity, virtue, or reputation or to publish the natural defects of anyone and thereby expose the person to public hatred, ridicule, or financial injury.

TEX. CIV. PRAC. & REM. CODE ANN. § 73.001 (Vernon 1997). "Slander is a defamatory statement that is orally communicated or published to a third person without legal excuse." *Randall's Food Mkts. v. Johnson*, 891 S.W.2d 640, 646 (Tex. 1995); *Campbell v. Salazar*, 960 S.W.2d 719, 725 (Tex. App.—El Paso 1997, pet. denied).

The damages resulting from libel or slander are personal and generally cannot be measured by a fixed standard or rule. *Frank B. Hall & Co. v. Buck*, 678 S.W.2d 612, 630 (Tex. App.—Houston [14th Dist.] 1984, writ ref'd n.r.e.). The amount to be awarded rests largely in the discretion of the jury, and an appellate court will not disturb the verdict unless it appears from the record to be excessive or the result of passion, prejudice or other improper influence. *Id.* (citing *Winkel v. Hankins*, 558 S.W.2d 889, 894 (Tex. Civ. App.—Eastland 1979, writ dismissed). Nonetheless, in determining what damages are available in a defamation cause of action, it is critical that the cause of action be identified as either libel or slander, since slanderous statements require proof of special damages when the statement is not per se defamatory. *See Buck v. Savage*, 323 S.W.2d 363, 368 (Tex. Civ. App.—Houston [1st Dist.] 1959, writ ref'd n.r.e.). The following remedies are typically available to a plaintiff who has established liability for defamation: nominal damages; general damages; special damages; and exemplary damages.<sup>12</sup>

## B. Nominal Damages

Nominal damages are generally recoverable upon a finding that a statement constitutes actionable defamation. *See Pridemoor v. San Angelo Standard, Inc.*, 164 S.W.2d 859, 860 (Tex. Civ. App.—Eastland 1942, writ ref'd w.o.m.). A cause of action based on libel per se or slander per se will entitle the plaintiff to an award of at least nominal damages. *Maass v. Sefcik*, 138 S.W.2d 897, 899 (Tex. Civ. App.—Austin 1940, no writ). In the past, an award of nominal damages alone would not have supported an award

of exemplary damages. *See Brown v. Petrolite Corp.*, 965 F.2d 38, 49 (5th Cir. 1992) (holding that \$1 nominal damage award could not support exemplary damage award). For actions filed after September 1, 1995 and before September 1, 2003, the Texas Civil Practice and Remedies Code allows exemplary damages, even if only nominal damages are awarded, if the plaintiff establishes malice by clear and convincing evidence. TEX. CIV. PRAC. & REM. CODE ANN. § 41.004(b) (Vernon 1997). For actions filed on or after September 1, 2003, however, exemplary damages may be awarded only if damages other than nominal damages are awarded. TEX. CIV. PRAC. & REM. CODE ANN. § 41.004 (Vernon Supp. 2004).

## C. General Damages

Damages recoverable in a defamation suit include compensation for injuries to character or reputation, injuries to feelings, mental anguish and other similar wrongs and injuries incapable of money valuation. *Vista Chevrolet, Inc. v. Barron*, 698 S.W.2d 435, 441 (Tex. App.—Corpus Christi 1985, no writ) (citing *West Texas Utils Co. v. Wills*, 164 S.W.2d 405, 412 (Tex. Civ. App.—Austin 1942, no writ); *Houston Belt & Terminal Ry. v. Wherry*, 548 S.W.2d 743, 753 (Tex. Civ. App.—Houston [1st Dist.] 1976, writ ref'd n.r.e.) (discussing general and special damages)). These damages are referred to as general damages or actual damages.

When the utterance is defamatory per se, the existence of actual damages is presumed. *See Leyendecker & Assocs. v. Wechter*, 683 S.W.2d 369, 374 (Tex. 1984) (finding plaintiff was not required to prove damages for mental anguish because those damages are presumed). Actual damages are those which necessarily and directly result from the defamation. *Bolling v. Baker*, 671 S.W.2d 559, 569 (Tex. App.—San Antonio 1984, writ dismissed w.o.j.). The law presumes actual damages, and they are recoverable under a general averment and without proof that they have been incurred. *Id.*; *Wherry*, 548 S.W.2d at 753. They include injuries to character, reputation, or feelings, mental suffering or anguish, and other like wrongs." *Bolling*, 671 S.W.2d at 559; *Wherry*, 548 S.W.2d at 753. Hence, actual damages do not need to be specially pleaded or proven. *See Evans v. McKay*, 212 S.W. 680, 685 (Tex. Civ. App.—Dallas 1919, writ dismissed w.o.j.). Under the United States Constitution, presumed damages require a showing of actual malice. *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 349 (1974).

Actual damages can include damages for injury to reputation. For example, in *Brown v. Petrolite Corp.*, 965 F.2d 38, 45-46 (5th Cir. 1992), the plaintiff, a corporation, was allowed to recover money needed to advertise in order to restore its reputation. The defendant, a competitor of the plaintiff, published a disparaging report about the plaintiff's product and circulated it to the plaintiff's existing and prospective clients. *Id.* at 42. At trial, an expert for the plaintiff testified that the plaintiff would have to redouble its advertising efforts to counteract the disparaging report. *Id.*

<sup>12</sup>Injunctive relief may also be available in a defamation case, subject of course to constitutional guarantees of free speech. *See generally Markel v. World Flight, Inc.*, 938 S.W.2d 74 (Tex. App.—San Antonio 1996, no writ).

at 46. The expert calculated that this would require over \$650,000 in advertising. An economist for the plaintiff also testified that the plaintiff would suffer millions of dollars in lost profits. *Id.* An economist for the defendant testified at his deposition that such publication could have resulted in \$60,000 in lost profits for the plaintiff. *Id.* Although the defendant's economist recanted this testimony at trial, the court upheld a jury award of \$60,000 in actual damages. *Id.*

#### D. Special Damages

Special damages also may be recovered in a defamation suit. *Peshak v. Greer*, 13 S.W.3d 421, 427 (Tex. App.—Corpus Christi 2000, no pet.) (libel). Special damages are damages that do not flow naturally from the alleged wrong and are not readily foreseeable. Where items of special damage are claimed, they must be specifically alleged. *See* TEX. R. CIV. P. 56.

##### 1. Defamation Per Se v. Defamation Per Quod

Certain types of statements are considered so damaging to a reputation that the statements are considered defamatory as a matter of law and are considered defamatory per se. *Alaniz v. Hoyt*, 105 S.W.3d 330, 345 (Tex. App.—Corpus Christi 2003, no pet.) (libel). A statement is defamatory per se if it imputes to another the commission of a crime; affects a person injuriously in his office, business, profession or occupation; or falsely and maliciously or wantonly accuses a woman of being unchaste. *Id.* at 346. Where statements are defamatory per se, the law presumes injury to one's reputation. *Bradbury v. Scott*, 788 S.W.2d 31, 38 (Tex. App.—Houston [1st Dist.] 1990, writ denied) (libel). Thus, in such cases, a plaintiff need not prove special damages in order to recover. But if special damages are sought by the plaintiff, he must specially plead them. TEX. R. CIV. P. 56. All other defamatory statements are defamatory per quod and require allegation and proof of special damages. *Kelly v. Diocese of Corpus Christi*, 832 S.W.2d 88, 91 (Tex. App.—Corpus Christi 1992, writ dismissed) (slander).

A corporation can recover damages for injury caused to its business by defamatory words published concerning the conduct of its business, without any allegation or proof of special damage. *Gulf Constr. Co. v. Mott*, 442 S.W.2d 778, 784 (Tex. App.—Houston [14<sup>th</sup> Dist.] 1969, no writ). If the defamatory words, however, are such that they would not affect a person in one type of business more than they would affect a person in any other type of business, trade, or profession, then the defamation is not per se and special damages must be proved. *Braugh v. Enyart*, 658 S.W.2d 221, 226-27 (Tex. App.—Corpus Christi 1983, writ refused n.r.e.); *Buck v. Savage*, 323 S.W.2d 363, 368 (Tex. Civ. App.—Houston 1959, writ refused n.r.e.); *see also Sunward Corp. v. Dunn & Bradstreet, Inc.*, 811 F.2d 511, 537 (10th Cir. 1987) (finding that the law of defamation does not cover every publication error which may lower business traffic, e.g., a mistake in an address, name or telephone number). Defamation of a business is actionable without proof of

special damages if the words touch the business in a way that is harmful to one engaged in that particular office, business, or profession. *Mott*, 442 S.W.2d at 784. Hence, statements about a business are actionable per se when the statements “touch” the business in the same way it would touch a person. *Id.* (finding statements that a contractor's credit is valueless because of bankruptcy and that he is not qualified are actionable per se). Also, as noted above, the First Amendment requires that a showing of actual malice is made before an award of presumed damages. *Gertz*, 418 U.S. at 349.

##### 2. Elements of Special Damages

Special damages in a defamation context include damages for lost income, loss of employment, loss of earning capacity, and loss of future opportunities. *McQueen v. Fulgham*, 27 Tex. 463 (1864) (slander, loss of health); *Peshak*, 13 S.W.3d at 427 (libel, loss of earning capacity); *Wenco Inc. v. Nazario*, 783 S.W.2d 663, 667 (Tex. App.—El Paso 1989, no writ) (slander, loss of employment); *Shearson Lehman Hutton, Inc. v. Tucker*, 806 S.W.2d 914, 922 (Tex. App.—Corpus Christi 1991, writ dismissed w.o.j.) (slander, lost income); *Houston Belt & Terminal Ry. v. Wherry*, 548 S.W.2d 743, 753 (Tex. Civ. App.—Houston [1st Dist.] 1976, writ refused n.r.e.) (libel, loss of employment). In order to recover special damages, a plaintiff must prove that the damages were proximately caused by the publication of the defamatory statement. *Kelly*, 832 S.W.2d at 91.

There is no generally accepted method for proving damages suffered by a corporation. If the libeled party's business is injured as a direct and proximate result of the defamation, evidence concerning the extent of the injury is a proper matter for the jury's consideration. *British Overseas Airways Corp. v. Tours & Travel of Houston, Inc.*, 568 S.W.2d 888, 894 (Tex. App.—Houston [1st Dist.] 1978, writ refused n.r.e.). Any evidence that tends to tie lost business or profits to an actionable defamatory statement is highly relevant in proving causation. *Id.*

##### 3. Lost Profits

###### a. Before and after test

In calculating lost profits, some courts compare a business' profits before and after the alleged defamatory statement. *British Overseas Airways Corp.*, 568 S.W.2d at 894. In *British Overseas Airways Corp.*, Tours and Travel (“T&T”), a travel agency, sued the airline for defamation after the airline sent a telex message to a travel association advising that T&T was in default of an amount owed to the airline. Upon report of a default, the travel association reported this information to its members. *Id.* As a result of this report, T&T argued that it was unable to earn commissions because association members would no longer utilize its services. *Id.* At trial, an economic analyst testified that T&T's value before the message was sent was \$40,000, and that after the message, T&T's value was zero. *Id.* at 894. The analyst also testified that the year the message was

sent, T&T lost \$10,000 in sales and the following year it lost \$1,542, whereas in the two previous years, T&T had made over \$7,000 in profit. *Id.* The court concluded that this was sufficient evidence to uphold a jury verdict in the amount of \$25,000. *Id.*; see also *Texas Plastics v. Roto-LITH, Ltd.*, 250 F.2d 844, 852 (5th Cir.) (using the before and after test to determine the effect of the defendant's statements that the plaintiff was a cheap chiseler, a crook, and had taken advantage of customers), *cert. denied*, 356 U.S. 957 (1958).

b. Newly established business

In the case of a newly-established business, however, lost profits are not as easily calculated. In *Golden Bear Distrib. Sys., Inc. v. Chase Revel, Inc.*, 708 F.2d 944, 946-47 (5th Cir. 1983), Golden Bear of Texas sued the defendant for defamation after it published an article about an investment fraud lawsuit that the attorney general had filed against Golden Bear of California. Golden Bear of Texas and Golden Bear of California were separate entities. The only connection was the similar name and Golden Bear of Texas's obligation to purchase vending machines from Golden Bear of California. *Id.* The article, however, did not make any distinctions between the entities. *Id.* Rather, it stated that the company's operation was consistent throughout the country. *Id.* After the publication of this article, Golden Bear of Texas rapidly lost business and was forced to file for bankruptcy. *Id.* at 947. At trial, the jury awarded Golden Bear of Texas \$30,000 in actual damages for lost profits. *Id.*

Chase appealed, attacking the jury award on the basis that the loss in profits could not be established with reasonable certainty because Golden Bear of Texas had been in business for less than six months. *Id.* at 950-51. Citing *Atomic Fuel Extraction Corp. v. Slick's Estate*, 386 S.W.2d 180, 188 (Tex. Civ. App.—San Antonio 1964, writ ref'd n.r.e.), the Fifth Circuit noted that Texas law permits the recovery of the expected profits of a business only if "there was some data and history of profits from an established business." 708 F.2d 951. The Fifth Circuit held that despite Golden Bear of Texas's short business life, Golden Bear of Texas presented evidence that during the first few months of operations it had earned a profit and further that business dropped immediately after the publication of the article. *Id.* The court concluded that this was sufficient evidence to award lost profits and reasoned that it is the record for profitability, rather than the age of the business, which determines whether lost profits are recoverable. *Id.*; see also *Hiller v. Manufacturers Prod. Research Group of N. Am., Inc.*, 59 F.3d 1514, 1518 (5th Cir. 1995) (stating "a business's failure to demonstrate a history of profitability should be considered, but is not independently dispositive, in deciding whether lost profits may be recovered").

4. Exact Proof Of Business Loss Is Not Needed

In *MMAR Group Inc., v. Dow Jones & Co., Inc.*, 987 F. Supp. 535, 541 (S.D. Tex. 1997), the court upheld a jury award of \$22.7 million for the business defamation of

MMAR, a securities investment firm. The court held that there was legally sufficient evidence to support the conclusion that the five defamatory statements which were published in the Wall Street Journal were the proximate cause of the securities investment firm's failure. *Id.* To show that the firm's business was ruined because of the statements, one of the firm's former customers, who was experienced and knowledgeable in securities trading, testified that the defamatory statements would make customers less likely to do business with the firm. *Id.* at 540. MMAR's representatives also testified that the company's failure was caused by the defamatory statements. *Id.* This was corroborated, to some extent, with evidence that showed a sudden decline in MMAR's business twenty-one days following the publication of the libelous statements. *Id.* MMAR also offered evidence that the loss of business caused by the libel was so severe that the business had to be closed to avoid greater losses. *Id.* An expert testified as to the value of MMAR before and after the statements and calculated the diminished value of MMAR between \$32 million and \$42 million. *Id.* at 539-40.

Defendant Dow Jones argued MMAR was a doomed business that failed because it was in a different lawsuit and because of a NASD investigation. *Id.* at 538. Dow Jones further argued that the statements published were not the proximate cause of MMAR's failure. *Id.* The court disagreed, holding that "[p]roof of business loss or destruction attributable to certain tortious conduct is difficult . . . proof of the exact amount of the loss or damage caused by the tortious conduct, as opposed to other business factors, is generally elusive." *Id.* at 540-41. Difficulties in proof, however, will not prevent an injured business from recovering damages where the evidence shows that the damages are based on a just and reasonable inference. *Id.* (citing *Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U.S. 555 (1931)).

5. Loss of Time/Loss of Earnings

In *Vista Chevrolet Inc., v. Barron*, 698 S.W.2d 435, 440 (Tex. App.—Corpus Christi 1985, no writ), the court recognized that a plaintiff who is successful in a defamation suit can recover for loss of time. The court explained that loss of time is recoverable as a special damage when the jury is properly instructed that loss of time means loss of earnings. *Id.* It is error if the jury is not given an appropriate definition to guide them in determining loss of time. *Id.* at 441.

In *Vista Chevrolet*, the court refused to allow recovery for loss of time because the plaintiff had only presented evidence of amount of time he lost and failed to produce any competent evidence of the value of his time. *Id.* at 440. The plaintiff, a former partner of Vista Chevrolet, sued the dealership for defamation after it reported to the police that he had stolen a dealership vehicle. *Id.* at 436. While the plaintiff testified that the report to the police caused loss of time, he failed to show what the value of this time was. *Id.*

at 440. The court explained that loss of time is composed of two elements: time and rate. *Id.* The court further explained that loss of time was distinguishable from decreased earning capacity. *Id.* at 441. Because the jury was not instructed that loss of time meant loss of earnings, however, it was error to submit “loss of time” as an element of damages. *Id.* at 441-42.

#### 6. Decreased Earning Capacity

If a jury instruction on decreased earning capacity would not be duplicative of an instruction on loss of earnings, decreased earning capacity may be submitted to the jury as an item of special damages. *Vista Chevrolet*, 698 S.W.2d at 441-42.

### E. Exemplary Damages

In actions filed before September 1, 2003, exemplary damages are recoverable in a defamation case only if the plaintiff established, through clear and convincing evidence, that the harm suffered for which the plaintiff seeks damages resulted from fraud, malice or a willful act or omission. TEX. CIV. PRAC. & REM. CODE ANN. § 41.003(a) (Vernon Supp. 2004). In actions filed on or after September 1, 2003, the plaintiff must establish, through clear and convincing evidence, that the harm resulted from fraud, malice or gross negligence. *Id.* For cases filed after September 1, 2003, the definition of malice no longer includes the definition of gross negligence; instead, gross negligence stands alone as an independent basis for the award of damages. *Id.* § 41.001(7). Moreover, exemplary damages will only be awarded if the jury is unanimous in regard to finding liability for the exemplary damages and the amount of exemplary damages. *Id.* § 41.003(d).

#### 1. Malice Standard

When seeking exemplary damages in a defamation case, it is important to understand the different forms of the term “malice” in order to avoid confusion. Different standards of malice apply, depending on whether the cause involves a private figure or public figure/official.

In a private defamation action against a defendant who is not asserting a qualified privilege regarding a matter of private concern, a plaintiff is required to show only common law malice to justify an exemplary damage award. *Snead v. Redland Aggregates Ltd.*, 998 F.2d 1325, 1335 (5th Cir. 1993); *Leyendecker & Assocs. v. Wechter*, 683 S.W.2d 369, 375 (Tex. 1984). To show common law malice under Texas law, a plaintiff must show either ill will or utter recklessness. *Snead*, 998 F.2d at 1335 n.14; *see also WFAA-TV, Inc. v. McLemore*, 978 S.W.2d 568, 571 (Tex. 1998).

Private individuals can hold media defendants accountable for libel by proving negligence, but recovery for such negligence is limited to actual damages. *Sherman v. Times Herald Printing Co.*, 671 S.W.2d 700, 702 (Tex.

App.—El Paso 1984, no writ) (citing *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 349-50 (1973)).

In any defamation action where the plaintiff is a public figure or official, the plaintiff must establish a higher degree of fault in order to justify an exemplary damage award: a plaintiff must prove the defendant published a defamatory falsehood with “actual malice”. *Huckabee v. Time Warner Entertainment Co. L.P.*, 19 S.W.3d 413, 420 (Tex. 2000); *McLemore*, 978 S.W.2d at 571.

“Actual malice” is a term of art, focusing on the defamation defendant’s attitude toward the truth of what it reported. *McLemore*, 978 S.W.2d at 573. Actual malice is defined as a publication of a statement with knowledge that it was false, or with reckless disregard of whether it was false or not. *New York Times Co. v. Sullivan*, 376 U.S. 254, 279-80 (1964); *McLemore*, 978 S.W.2d at 574. Actual malice in a defamation context does not include ill will, spite or evil motive, but rather requires sufficient evidence to permit conclusion that the defendant, in fact, entertained serious doubts as to the truth of his publication. *See Huckabee*, 19 S.W.3d at 420; *see also Fort Worth Star-Telegram v. Street*, 61 S.W.3d 704, 710 (Tex. App.—Fort Worth 2001, pet. denied); *Garcia v. Burris*, 961 S.W.2d 603, 606 (Tex. App.—San Antonio 1998, pet. denied).

Section 41.003 of the Texas Civil Practice & Remedies Code requires that a plaintiff prove fraud, malice, or gross negligence if the action was filed on or after September 1, 2003. Section 41.001(7) defines “malice” as “a specific intent by the defendant to cause substantial injury or harm to the claimant” for all cases filed on or before September 1, 2003. TEX. CIV. PRAC. & REM. CODE ANN. § 41.001(7).

For a non-wrongful death action filed before September 1, 2003, the plaintiff must prove fraud or malice. TEX. CIV. PRAC. & REM. CODE ANN. § 41.0001(7) (Vernon 1995) (amended 2003). The definition of malice in section 41.001(7) applicable to cases filed before September 1, 2003, provides the following:

- (A) a specific intent by the defendant to cause substantial injury to the claimant; or
- (B) an act or omission
  - (i) which when viewed from the standpoint of the actor at the time of its occurrence involves an extreme degree of risk, considering the probability and magnitude of the potential harm to others; and
  - (ii) of which the actor has actual subjective awareness of the risk involved, but nevertheless proceeds with conscious indifference to the rights, safety, or welfare of others.

*Id.*

This statutory malice standard should not be confused with actual malice or with common law malice. A plaintiff must now prove statutory fraud, malice, or gross negligence in addition to either common law or actual malice (depending on the case) in order to be awarded exemplary damages. See *infra*.

2. Nominal Damages Will No Longer Support Exemplary Award

In an action filed before September 1, 2003, exemplary damages can be awarded even if only supported by nominal damages if the plaintiff could show by clear and convincing evidence that there was malice as defined by the previous version of Texas Civil Practice & Remedies Code, section 41.001(7)(A). TEX. CIV. PRAC & REM. CODE ANN. § 41.004 (Vernon 1995) (amended 2003). In an action filed on or after September 1, 2003, exemplary damages cannot be awarded if only nominal damages are awarded. *Id.*

In determining the amount of exemplary damages, a jury must consider evidence, if any, relating to:

- the nature of the wrong;
- the character of the conduct involved;
- the degree of culpability of the wrongdoer;
- the situation and sensibilities of the parties concerned;
- the extent to which such conduct offends a public sense of justice and propriety; and
- the net worth of the defendant.

*Id.* § 41.011 (Vernon 1997).

Both federal and state courts do not look with favor on exemplary damage awards in libel cases because such awards, usually unbridled and unrestricted by anything but the jury’s own feelings and conscience, tend to inhibit the exercise of First Amendment rights. *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 350 (1974); *A.H. Belo Corp. v. Rayzor*, 644 S.W.2d 71, 86 (Tex. App.—Fort Worth 1982, writ ref’d n.r.e.). Since there is no set ratio between actual and exemplary damages which is considered reasonable, each case involving the award of exemplary damages must dangerously stand on its own. *Campbell v. Salazar*, 960 S.W.2d 719, 729 (Tex. App.—El Paso 1997, pet. denied); *but see State Farm Mut. Auto. Ins. v. Campbell*, 538 U.S. 408, 425 (2003) (holding that “few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process”). Appellate courts have been reluctant to set awards aside unless an award is so large as to indicate it was the result of passion or prejudice. *Salazar*, 960 S.W.2d at 729.

As a result, the 1995 amendments to the Texas Civil Practice and Remedies Code placed a cap on the amount of exemplary damages that may be awarded:

Exemplary damages awarded may not exceed an amount equal to the greater of:

- (1)(A) two times the amount of economic damages; plus
- (B) an amount equal to any non-economic damages found by the jury, not to exceed \$750,000; or
- (2) \$200,000.

TEX. CIV. PRAC. & REM. CODE ANN. § 41.008(b) (Vernon Supp. 2004).

3. Exemplary Damages against a Corporate Defendant

In *Green Tree Fin. Corp. v. Garcia*, 988 S.W.2d 776, 778 (Tex. App.—San Antonio 1999, no pet.), a jury awarded plaintiffs \$34,562.28 in actual damages and \$2.25 million in exemplary damages for defamation and violations of the Texas Debt Collection Act and Texas Deceptive Trade Practices Act. The appeals court found the evidence to be legally and factually sufficient to support the plaintiffs’ claims of damage to character and reputation. *Id.* at 785-86. The court found, however, that the trial court abused its discretion in refusing to submit a necessary instruction in the jury charge relating to the predicate requirements for imposing exemplary damages against a corporation. *Id.* at 783-84.

The court stated that Texas Pattern Jury Charge section 110.31, now section 110.35, “Instructions on Exemplary Damages Assessed Against Master for Acts of Servant,” should have been submitted to the jury. *Id.* at 784. Section 110.35 provides:

Exemplary damages can be assessed against [*Don Davis*] [*ABC Corporation*] as a principal because of an act by an agent if, but only if,

- a. the principal authorized the doing and the manner of the act, or
- b. the agent was unfit and the principal was reckless in employing him, or
- c. the agent was employed in a managerial capacity and was acting in the scope of employment, or
- d. the employer or manager of the employer’s ratified or approved the act.

STATE BAR OF TEXAS, TEXAS PATTERN JURY CHARGES PJC 110.35 (2002). Because the exemplary damage award in the case was not separable from the jury’s liability determination, the court reversed the trial court’s entire judgment and remanded the case to the trial court for a new trial. *Garcia*, 988 S.W.2d at 784.

#### 4. Failure To Retract Does Not Support Malice, Nor Does Defendant's Balance Sheet

In *MMAR Group Inc., v. Dow Jones & Co., Inc.*, 987 F. Supp. 535, 549 (S.D. Tex. 1997), the jury awarded \$200 million in exemplary damages to the plaintiff. The court held this amount was grossly excessive and not based upon the evidence. *Id.* at 543-44. The court found that the defendant had not acted with malice and that its refusal to retract the article was not evidence of malice. *Id.* at 548. There was evidence of the writer's discrepancies in her investigation. *Id.* at 545-46. Additionally, the court acknowledged there was evidence of personal animosity between the writer and those acting for the plaintiff and that this was proper evidentiary consideration. *Id.* at 545. Accordingly, there was evidence for a jury to find that the writer wrote the article with actual malice—knowledge of the falsity or with serious doubts as to the truth. *Id.* Nonetheless, the court held that the defendant was not liable for defamation. *Id.* at 538. There was no evidence independent of its employee's actions that it published the article with actual malice, nor was there sufficient evidence to make the defendant vicariously liable for the acts of the writer, who was not a management level employee. *Id.* at 546. The court found the award to have been influenced by the defendant's balance sheet, which showed \$2 billion in annual revenues, rather than by the evidence. *Id.* at 550.

#### 5. Self-Publication May Support Award of Exemplary Damages

Although the general rule in Texas is that a plaintiff cannot complain of a defamation that he “consented to, authorized, invited or procured,” *Lyle v. Waddle*, 188 S.W.2d 770, 772 (Tex. 1945), Texas appellate courts have recognized a limited exception in differing forms when the plaintiff is compelled to repeat the statement.

In *Chasewood Constr. Co. v. Rico*, 696 S.W.2d 439, 444-48 (Tex. App.—San Antonio 1985, writ ref'd n.r.e.), the court upheld an exemplary damage award in the amount of \$1.5 million to a subcontractor who was ordered off the job site for allegedly stealing materials. The award was based on a finding of defamation by self-publication. *Id.* at 444. Although the general contractor did not make the defamatory statement to a third person, the court concluded that he should have reasonably expected that the subcontractor would have to tell his work crew, which was over one hundred employees, the reason they had to leave the job site, and that the crew would tell others. *Id.*

Unlike *Chasewood*, other Texas courts have refused to recognize the compelled self-publication exception under a simple foreseeability test. In *Accubanc Mortgage Corp. v. Drummonds*, 938 S.W.2d 135, 147 (Tex. App.—Fort Worth 1996, writ denied), plaintiff Drummonds claimed that the reasons listed in his letter of termination were false, and therefore defamatory. Drummonds did not contend that Accubanc communicated these reasons to anyone, but asserted that he was required to self-publish them in order to

obtain new employment. *Id.* The court noted that usually, communication of defamatory statements to a defamed party, who then in turn communicates them to a third party, was not self-publication. *Id.* The court conceded that self-publication occurs when the defamed person's communication of the defamatory statements to the third person was made without an awareness of the defamatory nature, and the circumstances indicated that communication to a third party was likely. *Id.* at 148.

Because the evidence showed that Drummonds knew immediately of the defamatory nature of the termination letter, the court held that Drummonds could not prove self-publication, and consequently could not prove a case of defamation. *Id.* Unable to prove actual damages, he was not entitled to exemplary damages. *Id.* at 150. *See also Austin v. Inet Techs.*, 118 S.W.3d 491, 499 (Tex. App.—Dallas, 2003, no pet.) (finding plaintiffs who tried to rely on the self-publication doctrine, failed to meet the elements of the doctrine because they were aware of the defamatory nature of the communications at the time they self-published it); *Gonzales v. Levi Strauss & Co.*, 70 S.W.3d 278, 283-84 (Tex. App.—San Antonio 2002, no pet.) (finding plaintiffs who tried to rely on the self-publication doctrine, failed to meet the elements of the doctrine because they were aware of the defamatory nature of the communications at the time they self-published it).

The Texas Supreme Court has not ruled on the viability of the compelled self-publication doctrine in Texas; therefore, whether self-publication will support an award of exemplary damages may differ from one jurisdiction to the next. The Fifth Circuit considers the self-publication doctrine to be an open question in Texas. *See Duffy v. Leading Edge Prods., Inc.*, 44 F.3d 308, 312 n.5 (5th Cir. 1995); *see also Austin*, 118 S.W.3d at 499 (discussing unresolved issues).

#### F. **Special Mitigation of Damages Rules in Libel Actions**

In determining the extent and source of actual damages and to mitigate exemplary damages, a defendant in a libel action may give evidence of the following matters if they have been specially pleaded:

- (1) all material facts and circumstances surrounding the claim for damages and defenses to the claim;
- (2) all facts and circumstances under which the libelous publication was made; and
- (3) any public apology, correction, or retraction of the libelous matter made and published by the defendant.

TEX. CIV. PRAC. & REM. CODE ANN. § 73.003(a) (Vernon Supp. 2004). Additionally, to mitigate exemplary damages, the defendant may give evidence of the intention with which the libelous publication was made if the matter has been specially pleaded. *Id.* § 73.003(b).

## XIV. BUSINESS DISPARAGEMENT

### A. Introduction

Actions for business disparagement have not been codified and are not covered by Chapter 73 of the Texas Civil Practice and Remedies Code. The elements of a claim for business disparagement are: (1) publication of disparaging words about the plaintiff's economic interests, (2) falsity, (3) malice, (4) lack of privilege, and (5) special damages. *Prudential Ins. Co. of Am. v. Financial Review Servs., Inc.*, 29 S.W.3d 74, 82 (Tex. 2000); *Hurlbut v. Gulf Atlantic Life Ins. Co.*, 749 S.W.2d 762, 766 (Tex. 1987). Although the two causes of action - defamation and business disparagement - share similar elements and involve the imposition of liability for injury sustained through publications to third parties, the two torts protect different interests. *Newsom v. Brod*, 89 S.W.3d 732, 735 (Tex. App.—Houston [1st Dist.] 2002, no pet.). An action for defamation protects the plaintiff's personal reputation while an action for business disparagement protects the plaintiff's economic interests. *Dickson Constr., Inc. v. Fidelity & Deposit Co. of Md.*, 960 S.W.2d 845, 850 (Tex. App.—Texarkana 1997, writ denied). Disparagement of a business is more akin to slander of title because both require proof of special damages. *Id.* An award of damages in a business disparagement case requires that plaintiff show evidence of a direct pecuniary loss resulting from disparaging statements made by defendant. *Hurlbut*, 749 S.W.2d at 767.

An injured party may sue for both defamation and business disparagement in the same suit so long as that party avoids duplication of damages. *Williamson v. New Times, Inc.*, 980 S.W.2d 706, 711 (Tex. App.—Fort Worth 1998, no pet.). The two torts also have different statutes of limitations, which may affect a plaintiff's case. *Id.* at 710-11. In *Williamson*, the plaintiff failed to plead or prove that she suffered harm to a business or property interest separate and apart from the personal harm she already suffered. *Id.* at 711. The gravamen of her business disparagement claim was libel and slander and, therefore, she was not entitled to pursue her claims under the two-year statute of limitations for business disparagement. *Id.* The court affirmed the trial court's decision that her claims were time-barred under the one-year statute of limitations for defamation cases. *Id.*

### B. Compensatory Damages

A plaintiff that is successful in a business disparagement case is entitled to recover compensatory damages for the pecuniary losses sustained due to the disparagement. The amount plaintiff recovers is based directly on the losses shown to establish the special damages as an element in the plaintiff's prima facie case. *See, e.g.,* W. PAGE KEETON, PROSSER & KEETON ON TORTS § 128 at 976 (5<sup>th</sup> ed. 1984). Proof of special damages is a "central part of the plaintiff's case in an action for a business disparagement." *Hurlbut*, 749 S.W.2d at 767. This element may be satisfied only by a showing of actual pecuniary loss on the part of the plaintiff. *Id.* The pecuniary loss claimed

by the plaintiff must have been actually realized or liquidated. *Id.* Pecuniary loss is required because the tort of business disparagement provides redress for economic injuries and not for injuries to reputation. *Id.* This distinguishes the business disparagement cause of action from defamation.

#### 1. Nexus

In proving special damages, the plaintiff is required to demonstrate a nexus between the disparaging statement and the pecuniary loss: "The communication must play a substantial part in inducing others not to deal with the plaintiff with the result that special damages, in the form of loss of trade or dealings, is established." *Hurlbut*, 749 S.W.2d at 767 (citing RESTATEMENT (SECOND) OF TORTS § 632 (1977)). For example, special damages are demonstrated when the disparaging statements cause a loss of particular sales or particular customers. KEETON, § 128 at 971. "General, implied or presumed damages, which are available in defamation, are not sufficient as a ground for recovery in a disparagement claim." *Id.*

#### a. Evidence of Direct Loss

In *Johnson v. Hospital Corp. of Am.*, 95 F.3d 383, 391 (5th Cir. 1996), the court, interpreting Texas law, rejected the argument that the disparagement need not be the sole, or exclusive factor causing the plaintiff's damages, as long as it is a substantial factor. In *Johnson*, the plaintiffs were physicians practicing in the defendant's environmental care unit. *Id.* at 386. The plaintiffs' hospital privileges were suspended pending an investigation into their administering improper antigens. *Id.* at 387. The improper administrations had the potential to jeopardize the hospital's Medicare payments. *Id.* At trial, the plaintiffs offered evidence of loss of patients and earnings; but they failed to present evidence that this loss was a direct result of the alleged disparagement. *Id.* at 390-91. Instead, the plaintiffs argued that the disparagement was a substantial factor in bringing about the loss. *Id.* at 391. The court held that to prove special damages the plaintiff had to "provide evidence of *direct*, pecuniary loss attributable to the false communications of the defendants." *Id.* (emphasis added). Presumably, the plaintiffs would have been successful if they had had a patient testify that the reason he stopped being treated by the plaintiffs was because of the disparagement. *See, e.g.,* *MMAR Group Inc. v. Dow Jones & Co., Inc.*, 987 F. Supp. 535, 539-40 (S.D. Tex. 1997) (finding direct evidence of pecuniary loss where witness testified as to the impact the disparaging communication had on his dealing with the business); *F.D.I.C. v. Perry Bros., Inc.*, 854 F. Supp. 1248, 1274-76 (E.D. Tex. 1994) (discussing direct evidence of pecuniary loss), *aff'd in part sub nom. Nations Bank v. Perry Bros., Inc.*, 68 F.3d 466 (5th Cir. 1995).

b. Damages When a Business Is Destroyed

When a business has been completely destroyed by the tortious acts of another, the measure of damages is the market value of the business on the date of the loss, rather than the loss of expected profits. *See Gulf Atlantic Life Ins. Co. v. Hurlbut*, 696 S.W.2d 83, 99 (Tex. App.—Dallas 1985), *rev'd on other grounds*, 749 S.W.2d 762 (Tex. 1987); *Sawyer v. Fitts*, 630 S.W.2d 872, 874 (Tex. App.—Fort Worth 1982, no writ). Consequently, a plaintiff must offer evidence of the valuation of the business in order to recover. *See, e.g., MMAR Group Inc.*, 987 F. Supp. at 539-40; *Hurlbut*, 696 S.W.2d at 99.

c. Loss of Credit

In *Perry Bros.*, 854 F. Supp. at 1274, 1255-56, Perry Brothers Inc. (“Perry”), sued Nations Bank (“NCNB”) for business disparagement. Perry had been a longstanding NCNB borrower. *Id.* at 1255. During a critical reorganization that Perry was undergoing, of which NCNB was aware, NCNB classified Perry’s note as “substandard” and sent the note to the special asset bank which handled volatile notes. *Id.* at 1256. NCNB then communicated this information regarding Perry’s credit strength to Perry’s vendors and others with whom Perry did or sought to do business. *Id.* at 1257. NCNB also returned \$130,000 in checks stamped “insufficient funds” drawn on Perry’s NCNB accounts even though there were sufficient funds. *Id.* at 1258.

Based on the disparaging statements, Perry sought damages for loss of credit. *Id.* at 1274-75. Perry presented evidence from one of its vendors that one of the reasons it withdrew its credit from Perry was because of the notice that it received from NCNB regarding Perry’s credit strength. *Id.* at 1257. Perry also presented evidence that NCNB’s statements caused it to lose credit standing and business with other companies, resulting in \$6 million in damages. *Id.* at 1258. NCNB argued that Perry’s loss, if any, was not reasonably ascertainable. *Id.* at 1275. The court disagreed with NCNB and held that Perry did not have to establish, with precision, an exact amount of credit damages suffered because of the obvious credit disparagement done by NCNB. *Id.*

Allowing for the recovery of loss of credit is also consistent with the Texas Supreme Court’s decision in *Mead v. Johnson Group, Inc.*, 615 S.W.2d 685, 688 (Tex. 1981), which determined that loss of credit is a recoverable damage in breach of contract cases and is not considered too remote or speculative. *See also Hallmark v. Hand*, 833 S.W.2d 603, 612 (Tex. App.—Corpus Christi 1992, writ denied). Loss of credit also is recoverable under the general measure of damages for fraud. *Duval County Ranch Co. v. Woolridge*, 674 S.W.2d 332, 335-36 (Tex. App.—Austin 1984, no writ).

C. Consequential Damages

In a business disparagement suit, damages to reputation or consequential mental distress are not recoverable. *Hurlbut*, 696 S.W.2d at 99; *Dwyer v. Sabine Mining Co.*, 890 S.W.2d 140, 143 (Tex. App.—Texarkana 1994, writ denied).

D. Exemplary Damages

There are no Texas cases addressing whether exemplary damages are available in a business disparagement case; however, exemplary damages presumably are available subject to section 41.003 of the Texas Civil Practice and Remedies Code. The type of malice needed to recover exemplary damages is distinct from the malice which is needed to establish a prima facie case for business disparagement. In a business disparagement case, the defendant acts with malice “only if he knew of the falsity or acted with reckless disregard concerning it, or if he acted with ill will or intended to interfere in the economic interest of the plaintiff in an unprivileged fashion.” *Hurlbut*, 749 S.W.2d at 766 (citing RESTATEMENT (SECOND) OF TORTS § 623 A, cmt. g (1977)); *cf. TEX. CIV. PRAC. & REM. CODE ANN § 41.001(7)* (Vernon Supp. 2004). Hence, findings of both actual malice and common law malice would be required in order to recover exemplary damages.

E. Product Disparagement

In *Aldridge Co. v. Microsoft Corp.*, 995 F. Supp 728, 737-38 (S.D. Tex. 1998), the plaintiffs alleged that Microsoft disparaged their product, the Cache86 disk cache program (“Cache86”). According to the plaintiffs, Windows95, a product of Microsoft, would display defamatory messages when Cache86 was used on Windows95. *Id.* at 736-39. The messages allegedly caused the demise in sales of Cache86. *Id.* at 739. The plaintiffs sued Microsoft for, among other things, defamation, business disparagement, and antitrust product disparagement. *Id.* Microsoft was granted summary judgment on the product disparagement claim under the de minimis presumption. *Id.* at 751.

Under the de minimis presumption, Microsoft proffered that the effects, if any, from the alleged disparaging statements were de minimis. *Id.* at 748-49. In order to rebut this presumption, the plaintiffs had to show that the alleged statements were: (1) clearly false; (2) clearly material; (3) clearly likely to induce reasonable reliance; (4) made to consumers having little understanding of the subject matter; (5) continued for extended time periods; and (6) not readily susceptible to counter-statement, explanation, or neutralizing effort or offset by the plaintiffs. *Id.* at 749 (citing *National Ass’n of Pharm. Mfrs., Inc. v. Ayerst Lab.*, 850 F.2d 904, 916 (2d Cir. 1988)). The plaintiffs were unable to show that the statements continued for extended periods because the message would only appear once when the Cache86 was first used or that the statements were not

readily susceptible to explanation or neutralization. *Id.* at 750-51.

#### F. False Disparagement of Perishable Food Product Act

In 1995, the Texas Legislature created a cause of action for the false disparagement of perishable food products (“FDPFP”), referred to as the “veggie libel law.” TEX. CIV. PRAC. & REM. CODE ANN. §§ 96.001-.004 (Vernon 1997). The FDPFP prohibits a person from disseminating in any manner information relating to a perishable food product to the public when the person knows the information is false and the information states or implies that the perishable food product is not safe for consumption by the public. *Id.* § 96.002(a). A person who violates the statute is liable to the producer of the perishable food product for damages and any other appropriate relief arising from the dissemination of information. *Id.* § 96.002(b).

The FDPFP does not explicitly provide what damages are recoverable. The statute merely provides that damages are recoverable. The language used by the statute is not limiting and implies that general, special, and exemplary damages may be available to a successful plaintiff, provided the plaintiff meets the necessary standards.

A violation of the statute was alleged in *Texas Beef Group v. Winfrey*, 11 F. Supp. 2d 858 (N.D. Tex. 1998), *aff’d*, 201 F.3d 680 (5th Cir. 2000). In *Winfrey*, a group of Texas cattle ranchers sued Oprah Winfrey after her popular television show aired a segment on Bovine Spongiform Encephalopathy (“BSE”), also known as “mad cow disease.” *Id.* at 862. BSE is a fatal brain disease in cattle which has been linked to a similar fatal brain disease in humans. *Id.* at 860. After Winfrey’s show on BSE, the plaintiffs contended that the price of beef immediately crashed. *Id.* at 862. The court granted the defendants’ motion for directed verdict because any statements made about the beef industry were not “of and concerning” the plaintiffs and, therefore, the issue of damages was moot. *Id.* at 864.<sup>13</sup> In deciding the merits of the case the court looked to defamation law for guidance. *See Id.* Presumably, when the issue of damages arises in a future case, traditional defamation damages may be recoverable.

### XV. CIVIL CONSPIRACY

Civil conspiracy involves a combination by two or more persons to accomplish an unlawful purpose or to accomplish a lawful purpose by unlawful means. *Firestone Steel Prods. Co. v. Barajas*, 927 S.W.2d 608, 614 (Tex. 1996); *Triplex Communications, Inc. v. Riley*, 900 S.W.2d 716, 719-20 (Tex. 1995); *see also Elliott v. Tilton*, 89 F.3d 260, 264 (5<sup>th</sup> Cir. 1996). It is a means of extending liability beyond the

primary actor as opposed to an independent tort. *Carroll v. Timmers Chevrolet, Inc.*, 592 S.W.2d 922, 925 (Tex. 1979).

The elements of a civil conspiracy are: (a) two or more persons; (b) an object to be accomplished; (c) a meeting of the minds or course of action; (d) one or more overt unlawful acts; and (e) damages proximately resulting from those acts. *Massey v. Armco Steel Co.*, 652 S.W.2d 932, 934 (Tex. 1983). In Texas, a plaintiff may recover damages that naturally flow from a civil conspiracy. *Fenslage v. Dawkins*, 629 F.2d 1107, 1110 (5th Cir. 1980); *St. Louis Southwestern Ry. Co. of Tex. v. Thompson*, 102 Tex. 89, 113 S.W. 144, 147 (Tex. 1908). This flexible damages rule is necessary because of the wide variety of causes of action that can form the predicate of a conspiracy.

#### A. Lost Profits For Conspiracy

In *Holt Atherton Indus., Inc. v. Heine*, 835 S.W.2d 80, 84 (Tex. 1992), the Texas Supreme Court emphasized the well-established guidelines for the recovery of lost profits. Texas courts have allowed recovery of lost profits in civil conspiracy cases where lost profits are available under the underlying tort. *Commodity Credit Corp. v. Transit Grain Co.*, 157 F. Supp. 527, 538 (S.D. Tex. 1957) (fraudulent course of dealings); *Nix v. Born*, 870 S.W.2d 635, 639 (Tex. App.—El Paso 1994, no writ) (breach of fiduciary duty); *Horton v. Robinson*, 776 S.W.2d 260, 263 (Tex. App.—El Paso 1989, no writ) (violation of fiduciary duty).

These courts follow the well-established guidelines for the recovery of lost profits set out in the *Holt Atherton* case.

Recovery for lost profits does not require that the loss be susceptible of exact calculation, but the amount of the loss must be shown by competent evidence with reasonable certainty. *Holt Atherton*, 835 S.W.2d at 84. Moreover, the opinions or estimates of lost profits must be based on objective data from which the amount of lost profits can be ascertained. *Id.* It is not necessary to produce in court the documents supporting the opinions or estimates. *Id.*

For example, in *Nix*, 870 S.W.2d at 637, Born was the owner of 52 contiguous residential lots. Born entered into a 90-day exclusive listing agreement with Nix in his capacity as authorized agent and licensed sales representative of the real estate broker, who was Nix’s wife. *Id.* The agreement called for the sale of 22 of the lots at a listing price of \$66,000. *Id.*

Approximately two weeks later, Nix relayed an offer to Born from a buyer, G&M Development, to buy all 52 lots for \$42,000. *Id.* Born rejected the offer and made it clear that she was only interested in selling 22 of the lots. *Id.* Despite Born’s instructions, Nix continued to bring to Born new offers to purchase all 52 lots, until finally, Born agreed to accept the offer to buy all of the lots for a total price of \$80,000. *Id.* After closing the sale, Born learned for the first time that Nix had been or had become a partner of the buyer. *Id.* at 638.

Born sued Nix, his wife, and G&M Development alleging, among other things, conspiracy to breach fiduciary

<sup>13</sup>Note that the court did not grant the defendants’ motion for summary judgment as to the business disparagement claim. *Id.* at 864-65.

duties. *Id.* After a jury finding for Born on her civil conspiracy claim, the trial court rendered judgment, awarding Born a total of \$230,800 in actual and exemplary damages, plus prejudgment interest, jointly and severally against each of the three defendants. *Id.*

On appeal, Nix challenged the legal and factual sufficiency of the evidence supporting the jury's finding of \$76,000 in lost profits. *Id.* at 639. Nix maintained that the only evidence of the property's market value came from Born's own testimony. *Id.* Nix argued that since the only evidence on lost profits was elicited from Born, the testimony was insufficient to support a lost profits award. *Id.* The appellate court rejected Nix's argument. *Id.* In affirming the trial court's judgment, the court held that an owner of real property is competent to testify as to the market value of his property. *Id.* at 639. The appellate court also noted that other testimony further supported the jury's verdict. *Id.* at 639-40.

In *Horton*, 776 S.W.2d at 263, the court of appeals also upheld a jury's award of lost profits. Robinson sued Horton & Griggs for conspiring to violate fiduciary duties owed to Robinson by ousting Robinson from a financial services company formed by the three parties. *Id.* at 262. Horton and Griggs refused to provide Robinson with his share of the profits of the company and refused to permit Robinson to inspect the company books and records. *Id.* After a trial on the merits, the jury returned a verdict in favor of Robinson and awarded \$160,000 in actual damages, representing his share of the lost profits. *Id.* at 262-63. The trial court entered judgment on the verdict and the defendants appealed.

On appeal, the defendants argued that there was insufficient evidence to support the jury's award of lost profits. *Id.* at 263. The primary evidence on lost profit damages came from a certified public accountant who examined the various financial documents relating to the company, including tax returns and monthly financial statements. *Id.* By defining profit as total income less reasonable, ordinary, and necessary business expenses, the CPA reached the conclusion that the company had \$486,240 in profits available for distribution to the three stockholders, which would equal \$162,080 to each of the three owners. *Id.* The court of appeals held that this evidence was sufficient to support the jury's verdict. *Id.*

### B. Out-of-pocket Expenses/Consequential Damages for Conspiracy

A plaintiff may recover out-of-pocket expenses and consequential damages as "damages naturally flowing from a civil conspiracy if such damages are available for the underlying tort." *See Operation Rescue - Nat'l v. Planned Parenthood of Houston & S.E. Texas, Inc.*, 937 S.W.2d 60, 83 (Tex. App.—Houston [14th Dist.] 1996), *modified by* 975 S.W.2d 546 (Tex. 1998) (tortious interference). In *Operation Rescue*, doctors who performed abortions and ten women's clinics sued anti-abortion groups and their leaders for injunctive relief and damages in connection with abortion

protest activities under theories of tortious interference and invasion of privacy and property rights. *Id.* at 67. The court of appeals not only upheld a jury award for cost of repairs and alterations for property damage, but also upheld a jury award for costs associated with increased security and safety measures and damages. *Id.* at 83-84.

### C. Mental Anguish For Conspiracy

The Fifth Circuit has upheld an award of mental anguish damages to a civil conspiracy plaintiff where the underlying torts support such damages. *Fenslage v. Dawkins*, 629 F.2d 1107, 1110 (5th Cir. 1980).<sup>14</sup> In *Dawkins*, the plaintiff sued her ex-husband and various relatives of her ex-husband, alleging that the defendants conspired to take and conceal her children from her and conspired to intentionally inflict emotional distress. *Id.* at 1108. The Fifth Circuit stated, "[t]he wrongs committed in the instant case fall within the Texas rule that damages are recoverable for mental suffering unaccompanied by physical suffering when the wrong complained of is a willful one intended by the wrongdoer to produce mental anguish or from which such result could be reasonably anticipated as a natural consequence." *Id.* at 1110.<sup>15</sup>

### D. Disgorgement of Defendant's Profits

A plaintiff may also be able to recover the profits made by a defendant in a conspiracy where the underlying tort justifies it. *See Commodity Credit Corp. v. Transit Grain Co.*, 157 F. Supp. 527, 538 (S.D. Tex. 1957). In *Commodity Credit Corp.*, the court entered judgment disgorging profits from the defendants that they received by manipulating the quality of grain withdrawn from a grain elevator. *Id.* at 529-30. The plaintiff sued the grain elevator superintendent and a Canadian wheat depositor for fraudulently conspiring to give the Canadian wheat depositor preferential treatment at the expense of other grain depositors. *Id.* at 530.

The scheme was as follows: deposited wheat is classified as grade 1, 2, 3, 4 and 5, and sample grade, with sample grade being the lowest quality. *Id.* at 531-34. To qualify as grade 1 wheat, the wheat must meet certain criteria such as, weigh at least 60 lbs. per bushel, contain no more than two percent (2%) damaged kernels, and not more than one percent (1%) of foreign material. *Id.* Similar criteria apply to grades 2, 3, 4, and 5, as well as sample classifications. *Id.* The Canadian wheat depositor deposited

<sup>14</sup>The Texas Supreme Court has also held that damages for mental anguish are recoverable against civil conspirators under proper circumstances. *St. Louis Southwestern Ry. Co. of Tex. v. Thompson*, 102 Tex. 89, 113 S.W. 144, 147 (1908).

<sup>15</sup>In *dicta*, one Texas court of appeals has said mental suffering damages would not be recoverable in suits involving interference with property rights. *See Phillips v. Latham*, 523 S.W.2d 19, 27 (Tex. Civ. App.—Dallas 1975, no writ).

sample grade wheat which was mixed with, for example, grade 1 wheat that far exceeded the minimum grade 1 criteria. *Id.* The sample wheat would be added to the grade 1 wheat until the minimum grade 1 criteria was met. Similar mixing was done with grades 2 and 3 quality wheat. *Id.*

To prevent the conspirators from being unjustly enriched by their fraudulent course of dealings, the court measured the plaintiff's recovery by disgorging the defendants' profit. *Id.* at 538. The plaintiff was awarded the difference between the cost of the Canadian wheat and the market price of the wheat for which the Canadian wheat was substituted. *Id.* at 540.

### E. Exemplary Damages For Conspiracy

Courts applying Texas law have also allowed civil conspiracy plaintiffs to recover exemplary damages where the underlying tort supports such an award. *See In re Performance Nutrition, Inc.*, 239 B.R. 93, 116 (N.D. Tex. 1999) (awarding exemplary damages against defendants who conspired to breach fiduciary duties to plaintiff); *Akin v. Dahl*, 661 S.W.2d 917, 921-22 (Tex. 1983) (upholding an award of exemplary damages against defendants who acted in a conspiracy in malicious prosecution of guardianship and mental illness proceedings), *cert. denied*, 466 U.S. 938 (1984); *Operation Rescue - Nat'l v. Planned Parenthood of Houston & S. E. Texas, Inc.*, 937 S.W.2d 60, 84 (Tex. App.—Houston [14th Dist.] 1996, *modified by* 975 W.W.2d 546 (Tex. 1998); *Nix v. Born*, 870 S.W.2d 635, 639 (Tex. App.—El Paso 1994, no writ); *Horton v. Robinson*, 776 S.W.2d 260, 263 (Tex. App.—El Paso 1989, no writ).

An award of both exemplary damages and actual damages based on conspiracy to defraud and not the underlying fraud claim results in an impermissible double recovery. *Hart v. Moore*, 952 S.W.2d 90, 98 (Tex. App.—Amarillo 1997, *pet. denied*). In *Hart*, the plaintiff sued the defendant for, among other things, conspiracy to defraud. *Id.* at 95. In reaching its decision, the court analogized damages for civil conspiracy to treble damages allowed under the DTPA because both, the court said, are punitive in nature. *Id.* at 98. Since a party is not entitled to recover both exemplary damages and treble damages under the DTPA, the court held that a party cannot recover exemplary damages and actual damages under a conspiracy to defraud theory. *Id.*

## XVI. UNFAIR COMPETITION

“The law of unfair competition is the umbrella for all statutory and nonstatutory causes of action arising out of business conduct which is contrary to honest practice in industrial or commercial matters.” *American Heritage Life Ins. Co. v. Heritage Life Ins. Co.*, 494 F.2d 3, 14 (5th Cir. 1974). Within the broad scope of unfair competition are various causes of action including trademark infringement and misappropriation. *See* W. PAGE KEETON, PROSSER & KEETON ON TORTS § 130 at 1013-30 (5th ed. 1984); *see also*

*Conan Props., Inc. v. Conan's Pizza, Inc.*, 752 F.2d 145, 156 (5th Cir. 1985).

### A. Trademark Infringement

Under 15 U.S.C.A. § 1117 (West 1998 & Supp. 2003), a violation of any right of a registrant of a mark registered in the Patent and Trademark Office, or a violation under 15 U.S.C. § 1125(a), (c), or (d)<sup>16</sup> entitles a plaintiff, subject to the provisions of 15 U.S.C. §§ 1111<sup>17</sup> and 1114<sup>18</sup> and equity, to recover: (1) defendant's profits; (2) any damages sustained by the plaintiff; and (3) the costs of the action. In exceptional cases, the court may award reasonable attorney's fees to the prevailing party. 15 U.S.C. § 1117(a).

#### 1. Defendant's Profits for Trademark Infringement

In assessing profits, the plaintiff is required to prove defendant's sales only. 15 U.S.C.A. § 1117(a) (West 1998 & Supp. 2004). Defendant must prove all elements of cost or deduction claimed. *Id.* Several Federal courts have required a showing of willfulness before a plaintiff is entitled to recover the infringer's profits. *See SecuraComm Consulting Inc. v. Securacom Inc.*, 166 F.3d 182, 190 (3rd Cir. 1999) (holding that “a plaintiff must prove that an infringer acted willfully before the infringer's profits are recoverable”); *Bishop v. Equinox Int'l Corp.*, 154 F.3d 1220, 1223 (10th Cir. 1998) (finding that “an award of profits requires a showing that defendant's actions were willful or in bad faith”); *Minnesota Pet Breeders, Inc. v. Schell & Kampeter, Inc.*, 41 F.3d 1242, 1247 (8th Cir. 1994) (stating that an accounting of profits may be awarded based on various theories “if a registered owner proves willful, deliberate infringement or deception”); *George Basch Co., Inc. v. Blue Coral, Inc.*, 968 F.2d 1532, 1537 (2d Cir. 1992) (“a finding of defendant's willful deceptiveness is a prerequisite for awarding profits”). Such a requirement appears contrary to the plain language of § 1117 and

<sup>16</sup>Section 1125(a) imposes civil liability on persons who use false designations of origin or false descriptions on or in connection with goods or services or any container for goods. Section 1125(c) provides for equitable and legal remedies for dilution of famous marks. Section 1125(d) imposes civil liability on persons engaged in certain acts of cyberpiracy. 15 U.S.C.A. § 1125 (West 1998 & Supp. 2004).

<sup>17</sup>Pursuant to § 1111, if a trademark registrant fails to give the public notice that his or her trademark is registered, a defendant is not liable for profits and Lanham Act damages unless the defendant had actual notice of the mark's registration. 15 U.S.C.A. § 1111 (West 1997).

<sup>18</sup>Section 1114 governs innocent infringement by printers and publishers, as well as registration of domain names. Under certain circumstances, § 1114 limits the plaintiff's remedy to injunctive relief, and under other circumstances, injunctive relief is not available at all. 15 U.S.C.A. § 1114 (West 1997 & Supp. 2004).

contrary to the United States Supreme Court's indication that an accounting of profits for trademark infringement follows as a matter of course after infringement is found. *Hamilton-Brown Shoe Co. v. Wolf Bros. & Co.*, 240 U.S. 251, 259 (1916). Nonetheless, many courts have held that an accounting of the infringer's profits is not automatically granted. See, e.g., *Pebble Beach Co. v. Tour 18 I Ltd.*, 155 F.3d 526, 554 (5th Cir. 1998); *Lindy Pen Co. v. Bic Pen Corp.*, 982 F.2d 1400, 1405 (9th Cir.), cert. denied, 510 U.S. 815 (1993). The courts base the willfulness requirement on a United States Supreme Court case holding that an injunction alone would "satisfy the equities of the case" where the infringer was not shown to be guilty of "fraud or palming-off." See *Champion Spark Plug Co. v. Sanders*, 331 U.S. 125, 131 (1947).

The Fifth Circuit has adopted a factor-based approach to the determination of whether an award of profits is appropriate in trademark infringement cases. The factors to be considered include, but are not limited to "(1) whether the defendant had the intent to confuse or deceive, (2) whether sales have been diverted, (3) the adequacy of other remedies, (4) any unreasonable delay by the plaintiff in asserting his rights, (5) the public interest in making the misconduct unprofitable, and (6) whether it is a case of palming off." *Quick Techs., Inc. v. Sage Group Place*, 313 F.3d 338, 348-49 (5th Cir. 2002); *Seatrax, Inc. v. Sonbeck Int'l, Inc.*, 200 F.3d 358, 369 (5th Cir. 2000); *Rolex Watch USA v. Meece*, 158 F.3d 816, 823 (5th Cir. 1998); *Pebble Beach Co.*, 155 F.3d at 554.

In *Quick Techs.*, the court stated that it was obvious that willful infringement is an important factor which must be considered when determining whether an accounting of profits is appropriate. *Quick Techs.*, 313 F.3d at 349. Yet, the Fifth Circuit declined the opportunity to adopt a bright-line rule in which a showing of willful infringement is a prerequisite to an accounting of the infringer's profits. *Id.* Instead, the court reaffirmed the circuit's factor-based approach. *Id.*

Some federal district court judges have ignored two of the three purposes served by disgorging the infringer's profits. In *Elvis Presley Enters., Inc. v. Capece*, 950 F. Supp. 783, 803 (S.D. Tex. 1996), rev'd, 141 F.3d 188 (5th Cir. 1998), the district court denied plaintiff's request for an accounting of profits based on the absence of evidence showing lost or diverted sales. In so holding, the court ignored the two primary reasons for an accounting of defendant's profits, namely, to remedy unjust enrichment and deter future infringement. See *Maltina Corp. v. Cawy Bottling Co, Inc.*, 613 F.2d 582, 584-85 (5th Cir. 1980). The decision in *Elvis Presley* appears to be contrary to holdings of the Fifth Circuit that evidence of actual confusion or diverted sales is not necessary. See *Taco Cabana Int'l, Inc. v. Two Pesos, Inc.*, 932 F.2d 1113, 1126 (5th Cir. 1991), aff'd, 505 U.S. 763 (1992); *Boston Prof'l Hockey Ass'n v. Dallas Cap & Emblem Mfg., Inc.*, 597 F.2d 71, 75 (5th Cir. 1979). On appeal, the decision in *Elvis*

*Presley* was reversed by the Fifth Circuit, and the plaintiff was awarded injunctive relief. *Elvis Presley, Inc.*, 141 F.3d 188, 191 (5th Cir. 1998). The court did not, however, reach the accounting of profits question because the plaintiff's attorney waived the question by signing a pretrial order that failed to request an accounting. *Id.* at 206.

In *Maltina Corp. v. Cawy Bottling Co, Inc.*, 613 F.2d 582, 583 (5th Cir. 1980), a Cuban company that brewed and distributed a dark, non-alcoholic, carbonated beverage under the trademarks "Malta Cristal" and "Cristal" was nationalized by the Cuban government. Julio Blanco Herrera, the president and majority stockholder of the company, fled to the United States after the nationalization. *Id.* Both trademarks were registered in Cuba and in the United States. *Id.* When Herrera arrived in the United States, he formed the Maltina Corporation and assigned the Cristal trademark to it. *Id.* Because of insufficient backing, the Maltina Corporation was never able to produce more than \$356 worth of Cristal. *Id.*

Cawy Bottling Company also attempted to register the Cristal trademark, but its attempt was rejected by the Patent Office because of Herrera's prior registration. *Id.* at 583. After Cawy's attempted registration and with knowledge of Maltina's ownership of the trademark, Cawy began producing and distributing malta under the Cristal label in February of 1968. *Id.* Maltina sued Cawy for trademark infringement and unfair competition seeking an injunction, an accounting, and damages. *Id.* The district court adopted a magistrate's recommendation and awarded Maltina \$55,050 in gross profits from the sale of Cristal, \$35,000 as damages to Maltina, and an injunction enjoining Cawy from any further infringement of Maltina's trademark. *Id.* at 584.

On appeal to the Fifth Circuit, Cawy argued that an accounting was inappropriate. *Id.* Although Maltina never sold any appreciable amount of Cristal in the United States and therefore could not claim that Cawy diverted any of Maltina's sales, the court held that a diversion of sales is not a prerequisite to an award of an accounting. *Id.* at 585. The court based its decision on remedying an infringer's unjust enrichment from the use of the plaintiff's property and deterring future infringement. *Id.*

The Fifth Circuit has reaffirmed *Maltina* in later cases, holding that neither the absence of competitors nor the failure of proof showing diversion of the trademark owner's sales are defenses to plaintiffs' claim for defendant's profits under 15 U.S.C. § 1117(a). See *Texas Pig Stands, Inc. v. Hard Rock Café Int'l, Inc.*, 951 F.2d 684, 695 (5th Cir. 1992). It is important to recognize, however, that a plaintiff will not be entitled to the defendant's profit if the defendant can establish that his profits were the result of something other than infringement of the trademark. *Texas Pig Stands*, 951 F.2d at 696. Likewise, a plaintiff will not be able to recover the defendant's profits in a false advertising case under the Lanham Act when the plaintiff fails to present evidence that the defendant benefited from the alleged false

advertising. *Logan v. Burgers Ozark Country Cured Hams, Inc.*, 263 F.3d 447, 464-65 (5<sup>th</sup> Cir. 2001).

The *Maltina* rule comes from the United States Supreme Court's decision in *Mishawaka Rubber & Woolen Mfg. Co. v. S.S. Kresge Co.*, 316 U.S. 203, 206 (1942), in which the Court found that a plaintiff is not entitled to profits demonstrably not attributable to the unlawful use of its mark. See also *Maier Brewing Co. v. Fleischmann Distilling Corp.*, 390 F.2d 117, 124 (9th Cir. 1968) (finding plaintiff is not entitled to profits demonstrably not attributable to the unlawful use of his mark and placing the burden of proving this upon the infringer).

Interestingly, in at least one case, the Fifth Circuit failed to place this burden on the defendant. In *Texas Pig Stands*, 951 F.2d 684, the Fifth Circuit refused to allow the plaintiff, Texas Pig Stands, to recover the defendant's profits even though infringement was established. The court stated, "[t]he reason why Hard Rock Cafe's profits were not awarded was not based on (i) absence of competitors or (ii) no evidence of diversion; it was, rather, based solely on the lack of evidence showing that any of defendant's profits were the result of its infringement of the mark." *Texas Pig Stands, Inc.*, 966 F.2d 956, 957 (5th Cir. 1992) (on rehearing). If there was no evidence establishing that the defendant's profits were not the result of the infringement, then the defendant failed to meet its burden under *Mishawaka*. Thus, in *Texas Pig Stands*, the Fifth Circuit may have erred in not awarding the plaintiff the defendant's profits because in the absence of any evidence, the defendant failed to meet its burden of proving that the profits were demonstrably not attributable to the infringement.

The Fifth Circuit cast further light on a plaintiff's ability to recover lost profits for trademark infringement in *Pebble Beach Co. v. Tour 18 I, Ltd.*, 155 F.3d 526 (5th Cir. 1998). In *Pebble Beach*, the plaintiffs were owners and operators of famous golf courses around the nation, including Pebble Beach, Pinehurst, and Sea Pines. *Id.* at 532. The defendant, Tour 18, owned and operated two golf courses in Texas, one in Humble and the other in Flower Mound. *Id.* at 533. The courses are composed of golf holes copied from famous golf courses around the country, including the plaintiffs' courses. *Id.*

The plaintiffs sued Tour 18 under the Lanham Act for service-mark and trade-dress infringement, unfair competition, and false advertising. *Id.* at 535. Pebble Beach also asserted a claim for copyright infringement based upon maps used by Tour 18 in designing and constructing their courses. *Id.* Pebble Beach and Pinehurst had incontestable federal service-mark registrations in their respective names, but none of the plaintiffs had a registration for their golf-hole designs. *Id.* at 533-34.

After a bench trial, the district court entered judgment for the plaintiffs on their infringement, dilution, and unfair competition claims for Tour 18's use of their names and the image of a lighthouse that is the signature mark of Sea Pines' Harbour Town Golf Links' eighteenth hole. *Id.* at 535. The

court also entered judgment for Sea Pines for Tour 18's copying of its golf-hole design. *Id.* The district court entered an injunction against Tour 18, but denied plaintiffs' requests for damages, accounting of profits, and attorneys' fees. *Id.* at 536. The plaintiffs appealed the trial court's denial of an accounting of profits and award of attorneys' fees. *Id.*

The Fifth Circuit held that the district court did not err in failing to award lost profits. *Id.* at 555. The court listed six factors a court should consider when determining whether an award of profits is appropriate: (1) whether the defendant had the intent to confuse or deceive; (2) whether sales have been diverted; (3) the adequacy of other remedies; (4) any unreasonable delay by the plaintiff in asserting his rights; (5) the public interest in making the misconduct unprofitable; and (6) whether it is a case of palming off. *Id.* at 554. The court further held that once an award of profits is found to be appropriate, a plaintiff is only entitled to those profits attributable to the unlawful use of the mark. *Id.* The court ruled that the district court's finding that there were no diverted sales nor palming off in this case, as well as the district court's implied finding that the infringement was not willful, supported the district court's decision to deny an accounting of profits. *Id.* at 555. Therefore, the court affirmed the trial court's denial of profits. *Id.*

The United States Supreme Court has held that the deduction of federal income and excise profit taxes from an infringer's gross sales to arrive at defendant's profits is discretionary with the court. *LP Larson, Jr., Co. v. Wm. Wrigley, Jr., Co.*, 277 U.S. 97, 100 (1928). In *LP Larson*, the Court found that the nature of the infringement is relevant in determining whether to allow such a deduction, but if the infringement is "one of conscious and deliberate wrong doing", no deduction for taxes should be allowed. *Id.* The Court reasoned that such a deduction would be unfair where the plaintiff would have to pay income tax on the profits it received from the infringer. *Id.*

The Restatement takes the position that income tax paid by the infringer should not be deductible in computing recoverable profits because the defendant can claim the profits paid under the judgment as a deductible business expense. RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 37 cmt. g (1995). For example, assume that an infringer earns pretax profits of \$1,000 by infringing the plaintiff's mark and pays \$500 in tax (fifty percent tax rate). If the plaintiff wins a \$1,000 judgment against the infringer, and the infringer is allowed a \$500 credit for the tax the infringer paid, then consider the outcome. The infringer is able to take a \$500 tax deduction paid for the \$500 paid to the plaintiff, which would be worth \$250 at the assumed fifty percent rate. The plaintiff must now pay federal income tax on the \$500 judgment (\$250 at the fifty percent rate), which leaves the plaintiff with \$250 of the judgment. As a result of the infringer's wrongful conduct, the infringer made \$250, in the form of a tax deduction, and the plaintiff made the same

amount in the form of a judgment after taxes. Obviously, this does not discourage infringement.

Similar problems arise in determining the extent to which an infringer who sells several different brands of goods, only one of which is infringing, may apportion costs to the infringing good. If the infringer can trace gross income from the infringing good, overhead costs should be apportioned in the same proportion as gross sales. *See, e.g., American Honda Motor Co. v. Two Wheel Corp.*, 918 F.2d 1060, 1064 (2d Cir. 1990) (allocating expenses of infringing goods by applying infringer's ratio of net profits to total sales). However, courts have developed two methods of apportioning overhead costs such as rent and utility cost. Under the "incremental approach," only direct production costs are allowed to be deducted. MCCARTHY ON TRADEMARKS § 30:68 (4th ed. 1997). Under the "full absorption" approach, overhead costs are fully apportioned. *Id.*; *see also Polo Fashions, Inc. v. Craftex, Inc.*, 816 F.2d 145, 149 (4th Cir. 1987) (applying full absorption approach); *Warner Bros., Inc. v. Gay Toys, Inc.*, 598 F. Supp. 424, 431 (S.D.N.Y. 1984) (applying full absorption approach); James M. Koelemay, Jr., *A Practical Guide to Monetary Relief and Trade Mark Infringement Cases*, 85 TRADEMARK REP. 263, 288 (1995) (listing various types of costs that the courts have allowed or not allowed in deductions).

The Restatement takes the position that any portion of expenses that would not have been incurred if the infringing goods had not been manufactured is properly deductible. RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 37 cmt. h (1995). If the manufacture or marketing of the infringing good caused no increase in general expenses, no portion should be deducted. *Id.* Thus, distribution of profits to stockholders, expenses incurred in changing infringing labels, and attorneys' fees incurred during the trade mark infringement litigation cannot be deducted. *Maltina Corp. v. Cawy Bottling Co.*, 613 F.2d 582, 586 (5th Cir. 1980); *W. E. Bassett Co. v. Revlon, Inc.*, 435 F.2d 656, 665 (2d Cir. 1970); *Aladdin Mfg. Co. v. Mantle Lamp Co.*, 116 F.2d 708, 713 (7th Cir. 1941).

## 2. Plaintiff's Actual Damages for Trademark Infringement

According to the United States Supreme Court, the plaintiff can recover damages for all injuries caused by the infringer's wrongful act regardless of whether the infringer anticipated or contemplated the injuries. *Hamilton-Brown Shoe Co. v. Wolf Bros. & Co.*, 240 U.S. 251, 259 (1916). The courts have allowed plaintiffs to recover for a wide variety of damages. *See, e.g., Taco Cabana Int'l, Inc. v. Two Pesos, Inc.*, 932 F.2d 1113, 1125 (5th Cir. 1991) (accepting plaintiff's "headstart" theory of damages incurred in markets of plaintiff's logical area of expansion thereby precluding plaintiff from receiving profits and licensing fees that it otherwise would have realized and upholding jury awards of \$306,000 for loss profits and \$628,300 for lost income from franchise fees and royalties), *aff'd*, 505 U.S. 763 (1992); *Broan Mfg. Co. v. Associated Distrib., Inc.*, 923

F.2d 1232, 1238-39 (6th Cir. 1991) (accepting plaintiff's theory that mistaken product liability claims by consumers against the plaintiff arising from defendant's trademark infringement would result in defense costs, judgments, and settlements); *U-Haul Int'l, Inc. v. Jartran, Inc.*, 793 F.2d 1034, 1037, 1041 (9th Cir. 1986) (permitting award of \$13.6 million spent in corrective advertising by plaintiff even though amount plaintiff spent was more than double the amount of the original false advertising by the defendant); *Obear-Nester Glass Co. v. United Drug Co.*, 149 F.2d 671, 674 (8th Cir. 1945) (identifying allowable damages such as lost profits, reduction in price of goods, damage to goodwill), *cert. denied*, 326 U.S. 761 (1945); *Aladdin Mfg. Co. v. Mantle Lamp Co.*, 116 F.2d 708, 717 (7th Cir. 1941) (awarding damages for injury to goodwill and nullification of advertising expenses); *Neles-Jamesbury, Inc. v. Bill's Valves*, 974 F. Supp. 979, 981 (S.D. Tex. 1997) (describing jury award of damages for product recall and advertising); *Big O Tire Dealers, Inc. v. Goodyear Tire & Rubber Co.*, 408 F. Supp. 1219, 1233-35 (D. Colo. 1976) (upholding plaintiff's theory of damages based on the amount of money plaintiff would have to spend on corrective advertising), *modified*, 561 F.2d 1365 (10th Cir. 1977), *cert. dismissed*, 434 U.S. 1052 (1978).

The Seventh Circuit has criticized the corrective advertising theory of recovery by analogizing trademark damages to vehicle damage. *See Zazu Designs v. Loreal S.A.*, 979 F.2d 499, 506 (7th Cir. 1992). In *Zazu*, the Seventh Circuit concluded that to justify damages for corrective advertising, a plaintiff must demonstrate that corrective advertising is the least expensive way to proceed. *Id.* The Ninth Circuit has also discussed the problem and concluded that overcompensation can be avoided by instructing the jury to award damages only to the extent that the amount of money needed for corrective advertising does not exceed the damage to the value of the plaintiff's trademark. *Adray v. Adry-Mart, Inc.*, 68 F.3d 362 (9th Cir. 1995), *reprinted as amended*, 76 F.3d 984, 989 (9th Cir. 1996).

The Fifth Circuit has held that royalties normally received for the use of a mark are the proper measure of damages for misuse of those marks. *See Boston Prof'l Hockey Ass'n v. Dallas Cap & Emblem Mfg., Inc.*, 597 F.2d 71, 76 (5th Cir. 1979). Similarly, trade secret misappropriation damages typically embrace some form of royalty. *Taco Cabana Int'l, Inc.*, 932 F.2d at 1128.

## 3. Enhanced Damages for Trademark Infringement

15 U.S.C. § 1117(a) also gives the court the discretionary power to increase damages for any sum above the amount found as actual damages, not exceeding three times such amount. In addition, the court has the discretion to increase or decrease an award based on profits if the

award is either inadequate or excessive. *Id.*<sup>19</sup> Just as the courts have engrafted a willful prerequisite in forcing the defendant to account for his profits, the courts have also required a finding of willful infringement before damages will be enhanced. *See, e.g., Taco Cabana Int'l*, 932 F.2d at 1127; *Boston Prof'l Hockey Ass'n, Inc.*, 597 F.2d at 77; *Joy Mfg. Co. v. CGM Valve & Gauge Co., Inc.*, 730 F. Supp. 1387, 1395 (S.D. Tex. 1989) (“[I]n light of CGM’s continuing history of the kind of conduct at issue in this case and the willfulness of its acts, the damages and profits awarded to the plaintiff will be tripled.”); *Holiday Inns, Inc. v. Airport Holiday Corp.*, 493 F. Supp. 1025, 1028 (N.D. Tex. 1980) (“Defendants did not undertake to use plaintiff’s marks innocently. They knew that Plaintiff had marks for the Great Sign, the name Holiday Inn and the script rendering of Holiday Inn that appeared on the subsidiary sign. Indeed, the subsidiary sign bore upon its face the symbol (R) indicating the registration of the Holiday Inn mark. This is flagrant disregard of the rights of Plaintiff. Full knowledge of the proprietary nature of the mark and the infringement and misuse of the mark is the height of flagrancy and willful conduct for which a maximum award should be made.”), *aff’d*, 683 F.2d 931 (5th Cir. 1982).

Assuming the requisite willfulness finding is made, appellate courts have emphasized that trial judges have wide discretion in enhancing monetary awards. *Taco Cabana Int'l, Inc.*, 932 F.2d at 1127 (acknowledging “the trial court’s superior capacity to discern the elements of equitable compensation”); *Holiday Inns, Inc. v. Alberding*, 683 F.2d 931, 935 (5th Cir. 1982). In addition, the Fifth Circuit has taken the position that increased damages also may be justified in cases where the defendant withholds or misrepresents its sales records. *Boston Prof'l Hockey Ass'n*, 597 F.2d at 77.

#### 4. Alternative Statutory Damages for Cyberpiracy

Section 1125(d)(1) provides for a civil action against a person who registers, traffics in, or uses an internet domain name that is identical or confusingly similar to a distinctive mark or famous mark. 15 U.S.C.A. § 1125(d)(1) (West 1998 & Supp. 2004). Such a person must have a bad faith intent to profit from that mark. *Id.* As an alternative to recovery of actual damages and profits, a plaintiff pursuing a § 1125(d)(1) action may elect statutory damages “in the amount of not less than \$1,000 and not more than \$100,000 per domain name, as the court considers just.” 15 U.S.C.A. § 1117(d); *see also E&J Gallo Winery v. Spider Webs, Ltd.*, 286 F.3d 270, 278 (5<sup>th</sup> Cir. 2002) (affirming \$25,000 statutory damage award against cybersquatter); *Shields v.*

*Zuccarini*, 254 F.3d 476, 486-87 (3<sup>rd</sup> Cir. 2001) (affirming court award of \$10,000 for each infringing domain name even though names only used for sixty days after passage of § 1117(d)). The Fifth Circuit compared the anti-cybersquatter statutory damage award to the copyright damage award which “not merely compels restitution of profit and reparation for injury but also is designed to discourage wrongful conduct.” *E&J Gallo Winery*, 286 F.3d at 278 (quoting *F.W. Woolworth Co. v. Contemporary Arts, Inc.*, 344 U.S. 228, 233 (1952)).

#### 5. Prejudgment Interest for Trademark Infringement

Although § 1117 does not explicitly provide for prejudgment interest, such an award should be within the discretion of the trial court. The Seventh Circuit has taken the position that “the time has come . . . to announce a rule that prejudgment interest should be presumptively available to victims of federal law violations.” *Gorenstein Enter., Inc. v. Quality Care-USA, Inc.*, 874 F.2d 431, 436 (7th Cir. 1989). At least two United States District Court cases have allowed recovery of prejudgment interest where enhanced damages and attorneys’ fees were awarded. *Interstate Battery Sys. v. Wright*, 811 F. Supp. 237, 246 (N.D. Tex. 1993); *Joy Mfg. Co.*, 730 F. Supp. at 1396.

#### 6. Attorneys’ Fees for Trademark Infringement

In *Fleischmann Distilling Corp. v. Maier Brewing Co.*, 386 U.S. 714, 721 (1967), the United States Supreme Court held that attorneys’ fees are not recoverable under § 1117. The Court based its decision on the absence of language in the statute, as it existed at that time, evidencing Congress’s intent to allow recovery of attorneys’ fees. *Id.* In response to *Fleischmann*, Congress amended the Lanham Act in 1975 by adding the sentence “The court in exceptional cases may award reasonable attorney fees to the prevailing party.” PUB. L. NO. 93-600, § 3, 88 Stat. 600 (1975). The Senate Judiciary Committee felt that attorneys’ fees should be available in cases where the infringement could be characterized as fraudulent, deliberate, willful or malicious. S. REP. NO. 93-1400, 93d Cong., 2d Sess. 2, *reprinted in* 1974 U.S.C.C.A.N. 7132, 7133.

Typically, intentional or willful infringement has been sufficient to meet the “exceptional case” requirement. *Rolux Watch USA, Inc v. Meece*, 158 F.3d 816, 824 (5<sup>th</sup> Cir. 1998) (stating that the “exceptional case” is one in which the infringement can be characterized as malicious, fraudulent, deliberate, or willful); *Pebble Beach Co. v. Tour 18 I, Ltd.*, 155 F.3d 526, 555-56 (5<sup>th</sup> Cir. 1998) (finding an award of attorneys’ fees generally requires a showing of a high degree of culpability on the part of the infringer such as bad faith or fraud); *Texas Pig Stands, Inc. v. Hard Rock Cafe Int'l, Inc.*, 951 F.2d 684, 697 (5th Cir. 1992) (reversing award of attorneys’ fees in absence of “a high degree of culpability on the part of the infringer, for example, bad faith or fraud”); *Taco Cabana Int'l, Inc. v. Two Pesos, Inc.*, 932 F.2d 1113, 1127 (5<sup>th</sup> Cir. 1991) (approving an award of attorney’s fees

<sup>19</sup>Violations of § 1114(1)(a), which governs reproductions, counterfeits, copies or imitations of registered marks, mandates judgment for three times profits or damages, whichever is greater together with a reasonable attorney’s fee, unless the court finds extenuating circumstances. 15 U.S.C.A. § 1117(b).

where defendant brazenly copied plaintiff's trade dress). In cases involving intentional infringement, the Ninth Circuit held that it is an abuse of discretion not to award attorney's fees. *Playboy Enters., Inc. v. Baccarat Clothing Co., Inc.*, 692 F.2d 1272, 1276-77 (9th Cir. 1982). Courts have refused to find willful infringement where the infringer made efforts to create elements of dissimilarity. See, e.g., *Texas Pig Stands, Inc.*, 951 F.2d at 698 (finding that defendant's actions were not "sufficiently swinish" to bring the case to the "exceptional" level necessary to award attorney's fees); *Roulo v. Russ Berrie & Co.*, 886 F.2d 931, 942-43 (7th Cir. 1989) (agreeing with trial court's decision not to award attorneys' fee when defendant made a conscious effort to create dissimilarities between defendant's and plaintiff's goods), cert. denied, 493 U.S. 1075 (1990); cf. *Joy Mfg. Co.*, 730 F. Supp. at 1396 (awarding attorney's fees where defendant reconditioned and painted valves and affixed unauthorized new name plates to make valves look like new). Attorney's fees may be awarded to a prevailing defendant in cases in which "a plaintiff's case is groundless, unreasonable, vexatious, or pursued in bad faith" such that is "exceptional." *Waco Int'l, Inc. v. KHK Scaffolding Houston, Inc.*, 278 F.3d 523, 536 (5<sup>th</sup> Cir. 2002).

## B. Misappropriation

The tort of misappropriation takes root in federal common law. The United States Supreme Court first set forth a guideline for misappropriation in *International News Serv. v. Associated Press*, 248 U.S. 215 (1918). Adopting the reasoning of *International News Service*, the Dallas Court of Appeals recognized the tort of misappropriation in *Gilmore v. Sammons*, 269 S.W. 861, 863 (Tex. Civ. App.—Dallas 1925, writ ref'd). The elements of a cause of action for misappropriation are: (1) the creation of the plaintiff's product through extensive time, labor, skill, and money; (2) the defendant's use of that product in competition with the plaintiff, thereby gaining a special advantage in that competition; and (3) commercial damage to plaintiff. *United States Sporting Prods., Inc. v. Johnny Stewart Game Calls, Inc.*, 865 S.W.2d 214, 218 (Tex. App.—Waco 1993, writ denied); see also *Dresser-Rand Co. v. Virtual Automation, Inc.*, 361 F.3d 831, 839 (5<sup>th</sup> Cir. 2004). At least one Texas court of appeals has held that both compensatory and exemplary damages are recoverable for misappropriation, in addition to injunctive relief. *U.S. Sporting Prods., Inc.*, 865 S.W.2d at 219-20.

In *U.S. Sporting Prods., Inc.*, the plaintiff captured animal sounds on tape in the animal's natural habitats and sold those recordings to hunters and photographers who used them to draw animals into close range. *Id.* at 216. United States Sporting Products (Sporting Products) allegedly copied sounds from nineteen of the plaintiff's tapes and marketed them in competition with the plaintiff. *Id.* The plaintiff brought suit for misappropriation. *Id.* After a trial on the merits, the court entered judgment for the plaintiff for damages as found by the jury for \$209,000 in actual

damages and \$482,125 in exemplary damages. *Id.* The court also granted permanent injunctive relief requiring Sporting Products to stop selling the tapes and to recall tapes from distributors and dealers they could identify. *Id.*

On appeal, Sporting Products argued that the plaintiff was entitled to injunctive relief only and could not recover monetary damages for misappropriation. *Id.* at 219. The court rejected this argument, holding that actual and exemplary damages were recoverable for misappropriation, although not expressly stating what elements of actual damages are available under this cause of action. *Id.* The court also held that implied or legal malice is the appropriate standard for assessing exemplary damages for misappropriation. *Id.* at 222. Based on these holdings, the court affirmed the trial court's judgment against Sporting Products. *Id.* at 223.

## XVII. RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT ("RICO")

Under 18 U.S.C.A. § 1964(c) (West 2000), "[a]ny person injured in his business or property by reason of a [RICO] violation . . . shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorneys' fee." The United States Supreme Court has construed the "by reason of" language to incorporate the traditional requirements of proximate causation. See *Holmes v. Securities Investor Protection Corp.*, 503 U.S. 258 (1992). In the RICO context, proximate causation requires "some direct relation between the injury asserted and the injurious conduct alleged." *Id.* at 268. Once such a direct relationship is established, the cases allow a flexible array of damages subject to the limitations which typically apply in ordinary tort cases. See *Bieter Co. v. Blomquist*, 987 F.2d 1319, 1329 (8<sup>th</sup> Cir.), cert. denied, 510 U.S. 823 (1993). Thus, the measure of damages is the harm caused by the predicate acts. *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 497 (1985).

The damages must be "established by competent proof, not based upon mere speculation and surmise." *Fleischhauer v. Feltner*, 879 F.2d 1290, 1299 (6<sup>th</sup> Cir. 1989), cert. denied, 493 U.S. 1074 (1990). When all is said and done, a plaintiff injured by civil RICO violations deserves a "complete recovery." *Liquid Air Corp. v. Rogers*, 834 F.2d 1297, 1310 (7<sup>th</sup> Cir. 1987), cert. denied, 492 U.S. 917 (1989).

### A. Lost Profits For RICO Violations

Lost profits are a proper measure of recovery for civil RICO violations. See, e.g., *Terminate Control Corp. v. Horowitz*, 28 F.3d 1335, 1343 (2<sup>d</sup> Cir. 1994) (awarding lost profits on thirty-six contracts on which plaintiff was the low bidder but which were not awarded to plaintiff because of defendant's RICO violations); *Liquid Air Corp.*, 834 F.2d at 1309 (awarding lost rent to plaintiff); *Sound Video Unlimited, Inc. v. Video Shack, Inc.*, 700 F. Supp. 127, 142 (S.D.N.Y. 1988) (agreeing with other courts that RICO does

not bar recovery of lost profits as long as the lost profits are not speculative or uncertain and they result from the defendant's RICO violation); *DeMent v. Abbott Capital Corp.*, 589 F. Supp. 1378, 1386 (N.D. Ill. 1984) (noting that damages sustained by victim of a RICO violation include lost profits).

In *Liquid Air Corp.*, 834 F.2d at 1300, the plaintiff, Liquid Air, leased compressed gas cylinders to the defendant, D&R. After D&R terminated operations, it did not return the rented equipment in a timely fashion. *Id.* When Liquid Air began charging D&R a higher rate for the unreturned cylinders, D&R obtained the services of a Liquid Air employee who, over the course of the next seven months, generated nineteen false invoices making it appear as if the cylinders were being returned when in fact D&R still had them. *Id.*

On appeal, the defendants challenged the jury's award of lost rent provided for in the lease contract and argued the proper measure of damages was the fair market value of the cylinders. *Id.* at 1310. The Seventh Circuit rejected the defendant's argument and held that the proper measure of damages was the fair market value of the cylinders and the lost rent. *Id.* The court reasoned that the plaintiff injured by a civil RICO violation deserves a "complete recovery" and to restrict damages to the fair market value of the cylinders would deprive the plaintiff of its rights under the contract and would not fully compensate the plaintiff for its losses. *Id.* In addition, the court had to distinguish between lost rent and lost profits because Illinois law did not allow recovery for lost profits in contract actions. *Id.* The court said the lost rent awarded was rent that was due and owing at the time the cylinders were converted and was easily calculable. *Id.*

In *Terminate Control Group v. Horowitz*, 28 F.3d 1335 (2d Cir. 1994), New Life sued the New York City Board of Education, the Board's division of school buildings ("DSB"), and several named and unnamed employees of the DSB alleging a scheme of solicitation of kickbacks in connection with the awarding of DSB building repair, maintenance, and construction contracts. The jury awarded damages to the plaintiff for, among other things, lost profit due to work that the plaintiff was prevented from completing, and lost profits on thirty-six contracts on which the plaintiff was the low bidder but was not awarded contracts. *Id.* at 1340.

On appeal, the defendants argued that the loss of profits on the unawarded municipal contract was not a compensable RICO injury. *Id.* at 1343. The defendants based their argument on New York law which bars an entity that submits a low bid on a public contract from any recovery of damages from a municipality for rejecting the low bid. *Id.* The Second Circuit rejected the defendant's argument on two grounds. First, the plaintiff was seeking recovery from individual defendants, not a municipality. *Id.* Second, the New York law barring recovery was based on the view of New York courts that a bidder does not have a vested property interest in a public works contract. *Id.* Since 18

U.S.C. § 1964(c) entitles a person to recover damages for injury to his business or property, and since the plaintiff contended it suffered a business injury not a property injury, the New York law was inapplicable. *Id.*

### B. Out-of-pocket Damages For RICO Violations

Under certain circumstances, courts may measure the plaintiff's recovery based on the amount that the plaintiff paid or was out-of-pocket. *See, e.g., Aetna Casualty Sur. Co. v. P & B Autobody*, 43 F.3d 1546, 1570 (1st Cir. 1994) (finding plaintiff insurer could recover full amount paid on fraudulent claims); *Ticor Title Ins. Co. v. Florida*, 937 F.2d 447, 451 (9th Cir. 1991) (awarding reimbursement for payments made and expenses incurred based on fraudulent federal tax lien); *Fleischhauer v. Feltner*, 879 F.2d 1290, 1300 (6th Cir. 1989) (investor's damages limited to amounts actually invested); *City of Chicago Heights v. Lobue*, 914 F. Supp. 279, 283 (N.D. Ill. 1996) (allowing city to recover amount of money it was over-billed).

### C. Decrease in Property Value For RICO Violations

The Ninth Circuit has held that a RICO plaintiff can recover for the diminution of the fair market value of a property interest. *Oscar v. University Students Co-Op Ass'n*, 939 F.2d 808, 811 (9th Cir. 1991). In *Oscar*, apartment tenants sued the residents of neighboring student housing cooperatives alleging that the residents engaged in massive drug law violations and interfered with the quiet enjoyment of their property. *Id.* at 810. The plaintiffs characterized their loss as economic based on the money paid for their leasehold interests. *Id.* at 811. In allowing the plaintiffs to recover for the diminution of the fair market value of their property interests, the court reasoned that such an injury is conceptually no different than if a portion of the apartment had been flooded or damaged by fire. *Id.* at 812.

### D. Personal Injuries and Emotional Distress For RICO Violations

It is well settled that personal injuries are not recoverable under 18 U.S.C. § 1964(c). *Sedima, S.P.R.L. v. Imrex Co., Inc.*, 473 U.S. 479, 524 (1985); *Reiter v. Sonotone Corp.*, 442 U.S. 330, 339 (1979). The phrase "business or property" retains restrictive significance and excludes personal injuries suffered and mental anguish. *Reiter*, 442 U.S. at 339; *Sedima*, 473 U.S. at 501; *see also Diaz v. Gates*, 354 F.3d 1169, 1171 (9th Cir. 2004) (stating courts have consistently held that personal injuries are not recoverable under RICO); *Genty v. Resolution Trust Corp.*, 937 F.2d 899, 918 (3d Cir. 1991) (finding medical expenses incurred in treatment of illnesses caused by toxic waste not recoverable under RICO); *Grogan v. Platt*, 835 F.2d 844, 848 (11th Cir. 1988) (deciding that RICO does not permit recovery for economic aspects of personal injuries inflicted by predicate acts involving murder); *Drake v. BF Goodrich Co.*, 782 F. 2d 638, 644 (6th Cir. 1986) (finding RICO

damages unavailable in wrongful death action against employer for injury sustained by exposure to vinyl chloride in work environment).

### E. Lost Wages Recoverable For RICO Violations

Although the decisions in the personal injury context and the wrongful death context have refused to allow recovery for any element of damage which include lost wages, the Second Circuit has allowed a recovery of lost wages outside the personal injury context. *Jund v. Town of Hemstead*, 941 F.2d 1271, 1285 (2d Cir. 1991). In *Jund*, a city sanitation worker sued in connection with a coercive political contribution scheme. *Id.* at 1275. In 1970, Jund applied to work as a helper in a sanitation truck. *Id.* at 1273.

To get hired, Jund was required to support the local Republican committee by selling football raffle tickets on a weekly basis. *Id.* Jund did so and was hired. *Id.* Two years later, Jund was promoted to sanitation truck driver in exchange for a \$100 political contribution. *Id.* at 1274. Following the promotion, Jund was demoted back to sanitation helper. *Id.* When Jund asked for an explanation, he was told by the department supervisor that he was demoted because he did not actively support the Republican party. *Id.*

On May 4, 1976, Jund was injured while working as a helper. *Id.* After his injury, a course of similar political discrimination continued, until finally Jund filed suit against the county of Nassau and the Nassau County Republican Committee. *Id.* Although the Second Circuit affirmed the district court's rejection of Jund's argument that he was entitled to damages for his injury, because the RICO violations caused his demotion, the court upheld the district court's determination that Jund was entitled to lost wages from the date of his demotion until the date of his injury. *Id.* at 1286. Thus, at least in the Second Circuit, a RICO plaintiff can recover lost wages caused by a RICO violation.

### F. Treble Damages For RICO Violations

Unlike the Lanham Act, where enhanced damages are within the discretion of the trial court and where a willfulness requirement has been read into the statute by the courts, under RICO, treble damages are mandatory. 18 U.S.C.A. § 1964(c) (West 2000) ("Any person injured by a RICO violation shall recover three fold the damages he sustains"); *M.D.O. Dev. Corp. v. Kelly*, 735 F. Supp. 591, 593 (S.D.N.Y. 1990) (stating treble damages mandatory for violations of the Act).

The Ninth Circuit has held that it is permissible to receive both a treble damage award under RICO and a punitive damages award under state law. *Neibel v. Transworld Assurance Co.*, 108 F.3d 1123, 1131 (9th Cir. 1997). The court based its decision on the text of the RICO statute which states, "nothing in this title shall supercede any provision of federal, state, or other law imposing criminal penalties or affording civil remedies in addition to those provided for in this title." *Id.* at 1130-31. The Supreme

Court has interpreted that section to mean that "under RICO, the states remain free to exercise their police powers to the fullest constitutional extent in defining and prosecuting crimes within the respective jurisdiction." *United States v. Turkette*, 452 U.S. 576, 586 (1981); see also *United States v. Deshaw*, 974 F.2d 667, 671-72 (5th Cir. 1992) ("RICO's statutory language reflects congressional intent to supplement, rather than supplant, existing crimes and penalties").

In a similar vein, the Fourth Circuit has held that any offsets of credits for settlement deductions, for example, are credited to the defendants only after trebling damages. *Morely v. Cohen*, 888 F.2d 1006, 1013 (4th Cir. 1989); *Burlington Indus. v. Milken & Co.*, 690 F.2d 380, 391 (4th Cir. 1982) (settlement deductions made after trebling in antitrust cases), *cert. denied*, 461 U.S. 914 (1983).

### G. Attorney's Fees For RICO Violations

As with the trebling of damages, the language of 18 U.S.C.A. § 1964(c) suggests that a reasonable attorney's fee is mandatory. 18 U.S.C.A. § 1964(c) ("Any person injured in his business or property . . . shall recover threefold the damages that he sustains and the cost of the suit, including a reasonable attorneys' fee."). The courts have been liberal in applying the attorney fees provision of § 1964(c). For example, "where time spent on unsuccessful issues is difficult to segregate, no reduction of fees is required." *Hensley v. Eckerhart*, 461 U.S. 424, 435 (1983); *Abell v. Potomac Ins. Co.*, 946 F.2d 1160, 1169 (5th Cir. 1991) (citing *City of Riverside v. Rivera*, 477 U.S. 561, 569-74 (1986) (plurality opinion), *cert. denied*, 504 U.S. 911 (1992)); see also *Terminate Control Corp. v. Horowitz*, 28 F.3d 1335, 1343 (2d Cir. 1994) ("It was not an abuse of discretion for the district court to decline any further reduction on the basis of an apportionment between claims and/or parties"). In addition, the Third Circuit has refused to apply a proportionality rule to reduce large attorney fee awards in cases where a jury finds relatively small RICO damages. See *Northeast Women's Ctr. v. McMonagle*, 889 F.2d 466, 474-75 (3d Cir. 1989) (upholding \$64,964.11 award of counsel fees and costs where jury awarded \$875 in actual damages).

The First Circuit allowed a RICO plaintiff to recover attorney's fees incurred in separate lawsuits that were consolidated and in doing so held the defendants in the separate lawsuits jointly and severally liable for attorney's fees incurred both before and after the consolidation. *Aetna Cas. Sur. Co. v. P & B Autobody*, 43 F.3d 1546, 1570 (1st Cir. 1994). Finally, a district court in Louisiana has allowed a RICO plaintiff to recover, as part of attorney's fees, expenses which are not included in the normal attorney billing rate and which are not covered as costs under Federal Rule of Civil Procedure 54(d). *Hertz Corp. v. Caulfield*, 796 F. Supp. 225, 229-30 (E.D. La. 1992) (allowing plaintiff to recover long-distance telephone calls, photocopy charges, medical records, postage, travel expenses, expenses for

expert witnesses, hotel expenses for an investigator, expenses for process servers, costs of videotape deposition, replay of deposition at trial, and various other expenses).

#### H. Prejudgment Interest for RICO Violations

Since § 1964(c) is silent on the subject of prejudgment interest, the award of prejudgment interest should be discretionary with the trial court. *Estates of Yaron Ungar v. Palestinian Authority*, 304 F. Supp. 2d 232, 237 (D.R.I. 2004); *City of New York v. Rapdell Assocs.*, 703 F. Supp. 284, 288 (S.D.N.Y. 1989) (“whether to award prejudgment interest in cases arising under federal law has in the absence of a statutory directive been placed in the sound discretion of the district courts”) (quoting *Waterside Ocean Navigation Co., Inc. v. International Navigation Ltd.*, 737 F.2d 150, 153-54 (2d Cir. 1984)).

Most courts have suggested that an award of interest is generally improper where the statute itself provides for treble damages. *Mitsubishi Motors v. Solar Chrysler-Plymouth, Inc.*, 473 U.S. 614, 636 (1985) (“Section 4 of the Clayton Act provides the injured party with ample damages for the wrongs suffered”); *Wickham Contracting Co., Inc. v. Local Union #3 Int’l Bhd. of Electric Workers, AFL-CIO*, 955 F.2d 831, 835 (2d Cir. 1992); *Estates of Yaron Ungar*, 304 F. Supp. 2d at 240 (declining to award prejudgment interest when statute awarded treble damages); *Nu-Life Constr. Corp. v. Board of Educ.*, 789 F. Supp. 103, 104 (E.D.N.Y. 1992) (“Therefore, it appears that interest awards under RICO are similarly unnecessary to fairly compensate a successful plaintiff.”). However, if a separate basis for recovery of prejudgment interest exists under state law, a court may be willing to award prejudgment interest based on the state law claim. *See, e.g., In re Crazy Eddie Sec. Litig.*, 948 F. Supp. 1154, 1169 (E.D.N.Y. 1996) (refusing to decide whether prejudgment interest can be awarded under RICO since prejudgment interest was being awarded pursuant to state law claims).

### XVIII. ANTITRUST

#### A. Generally

Under Section 15 of the Clayton Act, any private person “injured in his business or property by reason of anything forbidden in the anti-trust laws . . . shall recover three fold the damages by him sustained, and the cost of suit, including a reasonable attorneys’ fee.” 15 U.S.C.A. § 15 (West 1997).<sup>20</sup> In the anti-trust context, it is well-established that

the plaintiff’s burden of establishing the amount of damages is less severe than his burden of proving the fact of damage. *Bigelow v. RKO Radio Pictures, Inc.*, 327 U.S. 251, 264 (1946); *Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U.S. 555, 563 (1931). Because in many cases the nature of the wrong makes ascertainment of damages difficult, the Supreme Court has emphasized that in such cases evidence showing the extent of damage as a matter of just and reasonable inference, is sufficient. *Bigelow*, 327 U.S. at 264. All that is necessary, is that damages not be the result of mere speculation or guess. *Id.*

#### B. Lost Profits and Future Loss of Profits for Antitrust Violations

There are two relatively well-established methods by which a plaintiff can prove lost profits in private anti-trust suits: the “before and after” method and the “yardstick” method. *Park v. El Paso Bd. of Realtors*, 764 F.2d 1053, 1068 (5th Cir. 1985), *cert. denied*, 474 U.S. 1102 (1986). Under the before and after method, profits earned by the plaintiff before the impact of the unlawful conduct are compared to profits earned after the unlawful conduct. *Id.* at 1068. The actual measure of damages is the difference between what the plaintiff would have made in a market without the defendant’s unlawful conduct and what the plaintiff in fact made. The yardstick method, on the other hand, consists of studies of the profits of businesses comparable to the plaintiff’s business. *Id.*

A third method for determining lost profits, termed the “market share” method, estimates the market share the plaintiff would have had absent the defendant’s illegal conduct and compares it with the total profits the plaintiff would have realized if the estimated market share had been achieved. *General Leaseways, Inc. v. National Truck Leasing Ass’n*, 830 F.2d 716, 726 (7th Cir. 1987). The estimated market share is generally determined by looking at the plaintiff’s market share before or after the violation in a related market unaffected by the illegal conduct. *Id.*

Generally, the yardstick method has been used in cases where the plaintiff is driven out of business by an anti-trust violation before the plaintiff is able to establish a sufficient earnings record to allow an estimation of lost profits. *See Private Treble Damage Anti-Trust Suits: Measure of Damages for Destruction of all or Part of a Business*, 80 HARV. L. REV. 1566, 1573 (1967). Obviously, the biggest limitation on the yardstick method is that the comparable business must be as nearly identical to the plaintiff’s business as possible, yet be unharmed by the violation. *Id.* at 1575; *see also Richfield Oil Corp. v. Karseal Corp.*, 271 F.2d 709, 713-16 (9th Cir. 1959) (anti-trust plaintiff was successful in proving the amount of damage using sales of a comparable product), *cert. denied*, 361 U.S. 961 (1960). In any event, regardless of which test is used, the fact that damages are

<sup>20</sup>Section 15.21 of the Texas Free Enterprise and Anti-trust Act is substantially similar to its federal counterpart. The most significant difference is that under the Texas statute, treble damages are not allowed unless the unlawful conduct is found to be willful or flagrant. *See* TEX. BUS. & COM. CODE ANN. § 15.21(a)(1) (Vernon 2002). Because of the scarcity of cases applying Section 15.21 and because Texas courts look to federal

judicial interpretation of the anti-trust act, this portion of the paper will focus on federal law.

uncertain in amount will not defeat a plaintiff's recovery. *Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U.S. 555, 563 (1931) ("Where the tort itself is of such a nature as to preclude the ascertainment of the amount of damages with certainty, it would be a perversion of fundamental principles of justice to deny all relief to the injured person, and thereby relieve the wrongdoer from making any amend for his acts").

In antitrust cases where the plaintiff goes out of business or is forced to sell his business, there are generally three categories of damages: (1) damage prior to going out of business or the sale of business, which consists of lost profits in the operation of the business by reason of defendant's unlawful conduct; (2) the difference between what the fair market value of the plaintiff's business would have been at the time of sale in the absence of the defendant's unlawful conduct and the actual sales price plaintiff receives; and (3) lost future profits following the time of sale. *See Pollock & Riley, Inc. v. Peril Brewing Co.*, 498 F.2d 1240, 1245 (5th Cir. 1974).

As a fundamental rule, the plaintiff cannot recover both loss of future profits and the difference between fair market value and the amount the plaintiff received at the time of sale since this would result in a double recovery. *Pollock*, 498 F.2d at 1244. However, a plaintiff can receive past lost profits and the diminution in market value of plaintiff's business. *Id.* at 1245. In addition, a plaintiff can receive lost profits and future profits even if the plaintiff's business might still be operated successfully after judgment. *Lehrman v. Gulf Oil Corp.*, 464 F.2d 26, 45 (5th Cir. 1972); *see also Green v. General Foods Corp.*, 517 F.2d 635, 663 (5th Cir. 1975) (upholding award of lost profits and future profits); *Poster Exchange, Inc. v. National Screen Serv. Corp.*, 431 F.2d 334, 340 (5th Cir. 1970) (rejecting defendant's argument that plaintiff should only be able to recover damages after defendant's unlawful refusal to deal with plaintiffs).

In *Green v. General Foods Corp.*, 517 F.2d at 639, an independent distributor of General Foods products successfully sued General Foods alleging that General Foods' pricing scheme constituted unlawful price resale maintenance and that his distributorship was terminated because of his failure to adhere to the unlawful pricing system. The Fifth Circuit upheld the plaintiff's lost profit award which was based on the difference between the substantially higher profit margin on plaintiff's accounts that were not subject to General Foods' pricing regime and a substantially lower net profit margin on plaintiff's accounts that were subject to General Foods' pricing regime. *Id.* at 661. Plaintiff's method of calculating lost profits also took into consideration some loss of business due to higher prices that the plaintiff was required to charge. *Id.* The court upheld the plaintiff's lost profits analysis before termination and characterized it as "just and reasonable estimates based upon relevant data." *Id.* at 663. With respect to future profits, the court also upheld the plaintiff's future lost profits

analysis, which was based on plaintiff's net profit for various years preceding the termination of the distributorship. *Id.* at 664.

Other Fifth Circuit decisions have allowed plaintiffs considerable leeway in calculating damages. *See, e.g., Business Elec. Corp. v. Sharp Elecs. Corp.*, 780 F.2d 1212, 1220 (5th Cir. 1986) (upholding damage award based on profits of business in same product area with similar customers and similar sales volume); *Pierce v. Ramsey Winch Co.*, 753 F.2d 416, 429 (5th Cir. 1985) (upholding lost profit award based on plaintiff's net profit per winch times the projected number of winch sales where sales projections were based on defendant's representation as to other distributors' yearly revenue, the plaintiff's testimony, and a similar distributor's projected sales); *Associated Radio Serv. Co., v. Page Airways, Inc.*, 624 F.2d 1342, 1361 (5th Cir. 1980) (upholding award of lost profits based on plaintiff's past profit per airplane multiplied by the number of airplanes that plaintiff serviced before defendant's unlawful conduct); *Poster Exchange, Inc. v. National Screen Serv. Corp.*, 431 F.2d 334, 340 (5th Cir. 1970) (upholding damage award based on net receipts of the parties). As the Fifth Circuit has noted, "[o]nce the fact of injury is established, the jury has considerable leeway in assessing the amount of damages." *Cherokee Lab., Inc. v. Rotary Drilling Servs., Inc.*, 383 F.2d 97, 106 (5th Cir. 1967), *cert. denied*, 390 U.S. 904 (1968).

The Fifth Circuit's decision in *Park v. El Paso Bd. of Realtors*, 764 F.2d 1053 (5th Cir. 1985), provides a good example of what kind of evidence will not satisfy the relaxed burden of proof. In *Park*, a real estate broker filed suit against the city board of realtors and sixty-eight realty companies alleging that the defendants conspired to boycott the plaintiff and engaged in a price fixing conspiracy and retaliation for the plaintiff's attempt to provide the public with lower real estate commissions. *Id.* at 1057.

In support of plaintiff's damage claim, the plaintiff relied solely on the testimony of an expert witness who calculated plaintiff's damages by estimating how much plaintiff's business would have grown in the absence of the unlawful conduct. *Id.* at 1067. The expert theorized that the lower commission prices offered by the plaintiff would have induced homeowners to list their properties with the plaintiff, and as a result, plaintiff would have captured twenty percent of the city's real estate market within approximately five or six years. *Id.* The expert also estimated that the plaintiff would have realized thirty percent profit on his total revenues. *Id.* at 1067. Unfortunately, plaintiff's expert provided no basis for these figures and made numerous assumptions.

With respect to market share, the expert failed to provide any evidence that homeowners base their choice of real estate brokers on price or that other brokers in the city would not have lowered their own rates to compete with the plaintiff. *Id.* The expert did not study any other real estate markets, and the expert admitted that he was unaware of any

real estate business in the country boasting a twenty percent market share. *Id.* In sum, the expert provided no basis for his estimation that plaintiff's business would have captured twenty percent of the city real estate market. Accordingly, the court held that there was insufficient evidence to support the jury's award. *Id.*

### C. Treble Damages for Antitrust Violations

As in the RICO context, treble damages for successful anti-trust plaintiffs are mandatory. *Green v. General Foods Corp.*, 517 F.2d 635, 639 (1975). Under 15 U.S.C.A. § 15, any person injured in his business or property "shall recover threefold the damages by him sustained." In addition, in order to effectuate the public policy purposes of the Clayton Act, damages are trebled before deducting, offsetting or crediting any amount for settlement. *Sciambra v. Graham News*, 841 F.2d 651, 657 (5th Cir. 1988). However, at least two circuits have held that a plaintiff cannot receive both treble damages and state law punitive damages from the same "course of conduct." *Fineman v. Armstrong World Indus.*, 980 F.2d 171, 218 (3d Cir. 1992); *SuperTurf, Inc. v. Monsanto Co.*, 660 F.2d 1275, 1283 (8th Cir. 1981).

### D. Attorney's Fees for Antitrust Violations

Section 15 also requires that a successful plaintiff recover reasonable attorney's fees and costs of suit. 15 U.S.C.A. § 15 (1997). To recover attorney's fees, the plaintiff does not have to establish the amount of damages. *Sciambra v. Graham News*, 892 F.2d 411, 415 (5th Cir. 1990). All that is required is that the plaintiff establish an anti-trust violation and the fact of damage. *Id.* Thus, an attorney's fee award is not dependent upon compensatory damages. *Id.*

The determination of a reasonable attorney's fee involves a two step procedure. See *Hensley v. Eckerhart*, 461 U.S. 424, 433 (1983). Initially, the district court must determine the reasonable number of hours expended on the litigation and the reasonable hourly rates for the participating lawyers. *Id.* Then, the court must multiply the reasonable hours by the reasonable hourly rates. *Id.*; *Blum v. Stensen*, 465 U.S. 886, 888 (1984). The product of the multiplication is the "lodestar," which the district court can either accept or adjust upward or downward, depending on the circumstances of the case. *Id.* at 897. The court should also consider twelve other factors including whether the fee agreement is fixed or contingent.<sup>21</sup>

<sup>21</sup>Other factors include: (1) the time and labor required; (2) the novelty and difficulty of the questions presented; (3) the skill requisite to perform the service properly; (4) the preclusion of other employment because of the case; (5) customary fees; (6) the time limitations imposed by the client or circumstances; (7) the amount involved and results obtained; (8) the experience, reputation, and ability of the attorneys; (9) the undesirability of the case; (10) the nature and length of the professional

## XIX. SPECIAL ISSUES IN THE RECOVERY OF LOST PROFITS AS CONSEQUENTIAL DAMAGES

### A. Introduction

It is well settled that lost profits, both past and future, can be recovered as consequential damages in most commercial litigation cases. As stated *infra*, consequential damages or special damages must be specifically pled. TEX. R. CIV. P. 56; *Henry S. Miller Co. v. Bynum*, 836 S.W.2d 160, 164 (Tex. 1992) (Phillips, C.J., concurring); *Harvey v. Crockett Drilling Co.*, 242 S.W.2d 952, 954 (Tex. Civ. App.—Waco 1951, no writ).

The distinction between consequential damages and direct damages is important. Direct damages are those damages that flow directly from the harm and which are conclusively presumed to have been foreseen by the parties. *Bynum*, 836 S.W.2d at 163 (Phillips, C.J., concurring); *Mead v. Johnson Group, Inc.*, 615 S.W.2d 685, 687 (Tex. 1981). Consequential damages, on the other hand, are those damages which the court finds were reasonably within the contemplation of both parties at the time the contract is made and which the parties could foresee as the probable result of a breach. *Stuart v. Bayless*, 964 S.W.2d 920, 921 (Tex. 1998) (per curiam). Put another way, direct damages are the necessary and usual result of the defendant's wrongful act and flow naturally and necessarily from the wrong whereas consequential damages result naturally but not necessarily from defendant's wrongful acts. *Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 816 (Tex. 1997). Under common law, consequential damages need not be the usual result of the wrong, but must be foreseeable and directly traceable to the wrongful act and result from it. *Id.* at 816.

Generally stated, in order to recover consequential lost profits, there must be "reasonably certain" evidence of those lost profits. Texas courts continue to grapple with the application of the reasonable certainty standard. The basic standard of proof necessary for recovery of lost profits was articulated by the Texas Supreme Court in *Texas Instruments, Inc. v. Teletron Energy Mgmt., Inc.*, 877 S.W.2d 276 (Tex. 1994). In *Texas Instruments*, Teletron sued Texas Instruments for its failure to produce a new and unique voice prompted programmable thermostat, referred to as a T-2000. *Id.* at 277. Teletron sought past and future lost profits. *Id.* The jury found in favor of Teletron and awarded, among other damages, \$500,000 for past lost profits and nothing for future lost profits. *Id.* The trial court refused to award Teletron the \$500,000 lost profits and granted Texas Instruments' motion notwithstanding the verdict as to this finding. *Id.* The court of appeals modified the judgment to include the \$500,000 for lost profits. *Id.*

In addressing the argument that Teletron was not entitled to recovery for lost profits because they had not

relationship with a client; (11) awards in similar cases; and (12) whether the fee is fixed or contingent. *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714, 717-19 (5th Cir. 1974).

been proved with reasonable certainty, the court restated the general rule for the recovery of lost profits first expounded in *Southwest Battery Corp. v. Owen*, 131 Tex. 423, 115 S.W.2d 1097, 1098-99 (1938):

The rule as announced by the decisions of the courts of this State is summarized . . . as follows: “In order that a recovery may be had on account of lost profits, the amount of the loss must be shown by competent evidence with reasonable certainty. Where the business is shown to have been already established and making a profit at the time when the contract was breached or the tort committed, such pre-existing profit, together with other facts and circumstances, may indicate with reasonable certainty the amount of profits lost. It is permissible to show the amount of business done by the plaintiff in a corresponding period of time not too remote, and the business during the time for which recovery is sought. Furthermore, in calculating the plaintiff’s loss, it is proper to consider the normal increase in business which might have been expected in light of past development and existing conditions.” In the early decisions a rigid rule affecting the right of recovery for lost profits was announced. Modern business methods have caused a relaxation of that hard rule.

*Texas Instruments*, 877 S.W. 2d at 279 (quoting *Southwest Battery Corp.*, 115 S.W.2d at 1098-99) (citations omitted).

As noted in *Texas Instruments*, “the real difficulty lies not so much in the statement of the rules as it does in the application of the correct rule.” 877 S.W.2d at 279 (quoting *Southwest Battery Corp.*, 115 S.W.2d at 1099). Again, “[w]hat constitutes reasonably certain evidence of lost profits is a fact intensive determination.” *Id.* (quoting *Holt Atherton Indus., Inc. v. Heine*, 835 S.W.2d 80, 84 (Tex. 1992)).

The general standard for recovery of lost profits was also discussed in *Szczepanik v. First S. Trust Co.*, 883 S.W.2d 648 (Tex. 1994) (per curiam). In *Szczepanik*, suit was brought by First Southern Trust Company (FST) against Retired Advisors of America, Inc. (RAAI) for loss of customers whose retirement assets FST had managed. RAAI had been formed by certain officers and employees who had left FST. *Id.* at 649. FST attempted to offer evidence of the lost profits it had sustained and would sustain as a result of the transfer of assets to RAAI. *Id.* The court held that there was no evidence of lost profit damages and that the petitioners were entitled to an instructed verdict on damages. *Id.* at 650. The court noted that the evidence elicited from the testimony of FST’s secretary and treasurer was pure speculation and there was nothing in the record to show how FST determined the

amount of lost profits. *Id.* Further, there was nothing in the record that related the total amount of profits FST expected to make beginning in 1991 to the profits FST lost as a result of the transfer of retirement accounts to RAAI. *Id.* The court found that FST failed to produce any evidence that it expected to retain all of the transferred accounts for any length of time. *Id.*

Rather, the uncontradicted evidence shows that the individual account holders could transfer their accounts to another trustee or retirement fund manager at any time. Without evidence that FST could have expected to retain the \$36 million in retirement accounts for any length of time, there [was] no evidence that FST could have expected to earn profits on those accounts for any period of time.

*Id.* at 650.

Does the fact that the business entity is new affect its ability to recover lost profits? Potential lost profits are generally not denied simply because an enterprise is new. While *Southwest Battery* appears to bar the recovery of lost profits because a business is new, the supreme court in *Texas Instruments* corrected such misreading:

The fact that a business is new is but one consideration in applying the “reasonable certainty” test. In *Southwest Battery* the Court endorsed enforcement of a rule denying recovery of lost profits “where the enterprise is new or unestablished”. But this rule does not deny recovery by a new business simply because it is new; it denies recovery “on the ground that the profits which might have been made from such businesses are not susceptible of being established by proof to that degree of certainty which the law demands.” The mere hope for success of an untried enterprise, even when that hope is realistic, is not enough for recovery of lost profits. When there are firmer reasons to expect a business to yield a profit, the enterprise is not prohibited from recovering merely because it is new.

The “enterprise” referred to in *Southwest Battery* is not the business *entity*, but the *activity* which is alleged to have been damaged. This distinction is important. . . . The focus is on the experience of the persons involved in the enterprise and the nature of the business activity, and the relevant market.

*Texas Instruments*, 877 S.W.2d at 280 (citations omitted). See also *National Union Fire v. Insurance Co. of N. Am.*, 955 S.W.2d 120, 131 (Tex. App.—Houston [14th Dist.]

1997), *aff'd sub nom. Keck v. Nat'l Union Fire Ins. Co.*, 20 S.W.3d 692 (Tex. 2000).

Furthermore, the *Texas Instruments* court, relying on *Pace Corp. v. Jackson*, 155 Tex. 179, 284 S.W.2d 340 (1955), indicated that a relevant factor to be considered in determining a new business's right to recover lost profits would be the fact that it had operated successfully both before and after the occurrence of the event for which a claim for lost profits was made. The court distinguished *Pace* and *Southwest Battery* from the case before it on grounds that the prior cases allowing recovery involved established products:

Indeed, there is no evidence that a thermostat like the T-2000 has ever been produced and sold by anyone. The very viability of the product is in doubt in this case. The businesses in the former cases actually operated at a profit, albeit for a short time; Teletron never did. Teletron's expectations were at best hopeful; in reality, they were little more than wishful . . . . Teletron's evidence that a strong market existed for its unique thermostat at a moderate price is beside the point; no such product ever existed.

877 S.W.2d at 280-81.

The question of evidentiary sufficiency to sustain a claim for lost profits is illustrated by *Holt Atherton Indus., Inc. v. Heine*, 835 S.W.2d. 80 (Tex. 1992). *Holt Atherton* involved the failure of Holt Machinery Company to pay for the repairs to the plaintiffs' bulldozer based on an oral warranty. *Id.* at 82. The plaintiffs claimed they sustained lost profits over a thirteen month period due to loss of use of the bulldozer. *Id.* at 84-85. During the relevant period, the plaintiffs had two bulldozers that operated about half of the time because business was slow. *Id.* at 85. Based on this testimony, the court stated that the plaintiffs never offered any evidence showing that there was enough work to keep two bulldozers working full-time during the period that the defendant had retained possession of the bulldozer. *Id.* In addition, the plaintiffs never showed that they were entitled to recover lost profits for the entire thirteen month period. *Id.* According to one plaintiff's testimony, defendant only kept the bulldozer for eight months before starting repairs. *Id.* Although the plaintiffs testified that they lost several contracts because they did not have the bulldozer available, they were not able to specify which contracts they lost, how many they lost, or how much profit they would have had from the contracts or who would have awarded them contracts. *Id.* Thus, the supreme court denied the claimants' recovery for lost profits.

In order to recover lost profits, evidence must be offered that establishes the loss of actual profits. As the supreme court stated in *Szczepanik*:

[R]ecovery of lost profits does not require that the loss be susceptible to exact calculation. However, the injured party must do more than show that they suffered some lost profits. The amount of the loss must be shown by competent evidence with reasonable certainty. What constitutes reasonably certain evidence of lost profits is a fact intensive determination. At a minimum, opinions or estimates of lost profits must be based on objective facts, figures, or data from which the amount of lost profits may be ascertained. Recovery of lost profits must be predicated on one complete calculation.

883 S.W.2d at 649 (citations omitted).

The amount of loss must be shown by competent evidence with a reasonable degree of certainty, and such evidence may be elicited through testimony from a witness as to what profits would have been. *Naegeli Transp. v. Gulf Electroquip, Inc.*, 853 S.W.2d 737, 740 (Tex. App.—Houston [14th Dist.] 1993, writ denied). In proving lost profits, however, it is not always mandatory that testimony concerning lost profits be supplemented by the financial records from which the knowledge is gained if the person testifying has firsthand knowledge of the financial data. *Pena v. Ludwig*, 766 S.W.2d 298, 304 (Tex. App.—Waco 1989, no writ).

The fact intensive determination incorporated in the reasonable certainty test for lost profits requires a showing of either the historic profitability of an activity, or the actual existence of contracts from which the amount of lost profits can be ascertained with a reasonable degree of certainty. *D/FW Commercial Roofing Co. v. Mehra*, 854 S.W.2d 182, 187 (Tex. App.—Dallas 1993, no writ). In addition, the Texas Supreme Court has approved of the introduction of verifiable future contracts in lieu of past profitability as a method of proving lost future profits. *Federal Land Bank Ass'n v. Sloane*, 825 S.W.2d 439, 441 (Tex. 1991).

Proof that a business operated at a loss, without more, is not evidence that will sustain, with reasonable certainty, a claim for lost profits. *Turner v. PV Int'l Corp.*, 765 S.W.2d 455, 466 (Tex. App.—Dallas 1988), *writ denied*, 778 S.W.2d 865 (Tex. 1989) (per curiam). Similarly, testimony stating the amount of lost income, standing alone, is not sufficient to prove lost profits. *Holt Atherton*, 835 S.W.2d at 84. Moreover, the lack of a profit history, the entry into unknown or unviable markets, or new and unproven enterprises, the promotion of untested products, and the existence of changing market conditions or chancy business opportunities are all factors that may preclude a claimant's recovery for lost profits. *Document Imaging, Inc. v. IPRO, Inc.*, 952 F. Supp. 462, 469 (S.D. Tex. 1996). *See also Capital Metro. Transp. Auth. v. Central Tenn. Ry. & Navigation Co.*, 114 S.W.3d 573, 580-81 (Tex. App.—Austin 2003, pet. denied).

The importance of substantiating a claim for lost profits on objective, rather than speculative, evidence, is underscored by *Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41 (Tex. 1998), the Texas Supreme Court reduced the amount of recoverable lost profits by finding the plaintiff's lost profit testimony too uncertain.

In *Formosa*, Presidio sued Formosa Plastics, in part, for fraudulently inducing it to enter into a construction contract. *Id.* at 43. The jury found that Formosa had defrauded Presidio, enticing it to make a low bid on the proposed construction project by misrepresenting in the bid package the scheduling, delivery of material, and responsibility for delay damages. *Id.* at 44. The trial court suggested a remittitur, in lieu of the damages awarded by the jury, to \$700,000 for tort damages and \$467,000 for contract damages. *Id.* Presidio elected the tort damages, thus accepting the trial court's remittitur for \$700,000 in actual damages and \$10 million in punitive damages. *Id.* The supreme court sustained the liability finding, thus holding that Presidio was entitled to recover the difference between the anticipated value of the contract and the actual value it received (i.e., "benefit-of-the-bargain" damages) – which included Presidio's expected profit margin. *Id.* at 49-50.

However, the court found no support for the entire amount of the "benefit-of-the-bargain" damages awarded by the jury despite specific testimony from Presidio's president on how it would have actually bid had no misrepresentations been made by Formosa, and on what its profit would have been. *Id.* at 50-51. Given the fact that Presidio calculated its damages claim on the premise that it would have been awarded the contract by bidding the project at an amount which Formosa had in fact rejected, the court sanctioned a "proper calculation" of the "benefit-of-the-bargain" damages: "while a benefit-of-the-bargain measure can include lost profits, it only compensates for the profits that would have been made if the bargain had been performed as promised . . . [The] doubling of Presidio's bid is entirely speculative because there is no evidence that Presidio would have been awarded the project if it had made a \$1.3 million bid." *Id.* at 50. Having found Presidio's evidence as to its damages (including lost profits) inadequate to sustain the trial court's remittitur, the supreme court reversed the award for damages and remanded the case for new trial. *Id.* at 52. Thus, *Formosa* illustrates that an award for contract damages – which includes lost profits – will not be sustained if the evidence underlying the calculation of such damages is premised on the award of a hypothetical contract (i.e., speculative evidence).

While lost profits must be established with reasonable certainty by objective evidence, no single method for measuring lost profits has been specifically adopted by the Texas Supreme Court to cover all circumstances under which a claim for lost profits may be made. *Holt Atherton*, 835 S.W.2d at 85. A complete calculation of lost profits is

required under any method chosen by a party. *Id.* The calculation must include the costs or expenses the claimant would have incurred in pursuit of the venture – had the event giving rise to the claim for lost profits never occurred – because "lost profits" mean "net profits." *PV Int'l Corp.*, 765 S.W.2d at 465. In other words, the claimant is entitled to recover as lost profits "what remains in the conduct of a business after deducting from its total receipts all of the expenses incurred in carrying on the business." *Id.* (quoting *R. A. Corbett Transp., Inc. v. Oden*, 678 S.W.2d 172, 176 (Tex. App.—Tyler 1984, no writ)). As explained by one court:

[I]n the calculation of net profits, allowance should be made for expenditures that the plaintiff would have been compelled to make, and also for the value of the plaintiff's time. Generally, loss of profits because of the diminution of "gross receipts" is measured by the loss of "net profits" and not the loss of "gross receipts" except for the actual expenses which would have been incurred had the "gross receipts" been received or fixed with reasonable certainty.

*Copenhaver v. Berryman*, 602 S.W.2d 540, 544 (Tex. Civ. App.—Corpus Christi 1980, writ ref'd n.r.e.) (citations omitted). See also *Helena Chem. Co. v. Wilkins*, 18 S.W.3d 744, 758 (Tex. App.—San Antonio 2000), *aff'd* 47 S.W.3d 486 (Tex. 2001).

The Texas Legislature, through enactment of Article 13 of House Bill 4, amended the Texas Civil Practices and Remedies Code to encompass all damages (not simply exemplary damages) sought to be recovered in a tort claim. See TEX. CIV. PRAC. & REM. CODE ANN § 41.003(a) (Vernon Supp. 2004). Amongst the many changes brought about by the Bill are the expansion of the definition of "economic damages" to include actual economic loss, and the definition of the terms "compensatory damages," "future damages," "future loss of earnings" to conform to the general provisions of the revised Civil Practices and Remedies Code. *Id.* § 41.001. Moreover, the amended Texas Civil Practices and Remedies Code now requires claimants to prove their loss of earnings or earning capacity net of any federal income tax payment or liability. *Id.* § 18.091(a). Courts are also directed to instruct juries as to whether any of the claimant's recovery of compensatory damages is subject to state or federal income taxes. *Id.* § 18.091(b). For an extended discussion of House Bill 4's provisions and effects, see Section XXII.

Generally stated, plaintiffs who have successfully recovered lost profits have done so in one of two ways: through the use of either (1) comparisons to past periods of profit or similar enterprises, whether their own or others; or (2) financial experts who have presented articulate and well-founded damage models which include verifiable

mathematical calculations and identification of lost contracts. Regardless of which approach is used, courts will look to various factors including the experience of the principals, establishment of the industry, the novelty of the product or enterprise, whether the enterprise is ongoing or new, and the past profitability of the business or like businesses. No single element will allow or prohibit recovery of lost profits. Instead, as noted above, entitlement to lost profits is a fact intensive inquiry.

### B. Cases Upholding Recovery for Lost Profits

1. In *DSC Communications v. Next Level Communications*, 107 F.3d 322, 329 (5th Cir. 1997), the court allowed recovery of future lost profits in a breach of contract, diversion of corporate opportunity, and misappropriation of trade secrets suit against former employers who had taken the development plan of a proposed new Switched Digital Video (“SDV”) communication product. Even though the SDV was not fully developed and no market had been established, plaintiff’s damage expert presented a damage model that included assumption of future market share, basing his assumption on data obtained from respected sources in the telecommunications market. *Id.* at 329. The court also noted plaintiff’s history of strong performance in the field was indicative of the likely success “of this revolutionary new product.” *Id.* The court reasoned:

While SDV technology represents a new product the intensive market research DSC presented at trial, coupled with the known history of the telecommunications industry and the success of the Lightspan product, established with sufficient certainty that SDV technology is likely to generate significant profits. Even if a product is not yet fully developed, a plaintiff is not prevented from recovering future lost profits if it was hindered in developing that product, and the evidence shows the eventual completion and success of that product is probable. As well, DSC has traditionally been a leader in producing technology used in telecommunications. Its history of strong performance is indicative of the likely success of this revolutionary new product.

. . . No one can definitively say what the future holds for SDV technology, or [plaintiff] and [defendant] in particular. However, uncertainty surrounding precisely how the industry will evolve does not reduce all analysis about future developments to mere speculation.

*Id.* at 329-30.

2. In *Helena Chem. Co. v. Wilkins*, 47 S.W.3d 486, 504-06 (Tex. 2001), the Texas Supreme Court held that there was some evidence of lost profit to support the jury’s damage award. The plaintiff sued the defendant for Deceptive Trade Practice Act violations, breach of express and implied warranties, and fraud for losses they incurred after planting seed from the defendant. *Id.* at 491. The plaintiffs offered testimony regarding the market value of their lost crops, which was based on the United States Agricultural Stabilization Conservation Services farm-shield data. *Id.* at 505. The plaintiffs also offered testimony regarding transportation costs, grain elevator drying costs, lease expenses, and the actual price of the seed. *Id.* at 506. The court found that the plaintiffs had presented some evidence to support a damage award under the proper calculation: “(1) the lost crops market value, and (2) the harvesting and marketing expenses they would have incurred on that last part.” *Id.* at 505.
3. In *White v. Southwestern Bell Tel. Co., Inc.*, 651 S.W.2d 260 (Tex. 1983), the plaintiff used pre-existing profits as proof of future profits. In that case, the plaintiff/shop owner sued Southwestern Bell for its incorrect listing of his business’ telephone number in the phone book. *Id.* at 262. Of course, it was impossible for the plaintiff to show with any certainty the number of orders he lost because of the incorrect listing. *Id.* The evidence showed, however, that White had been an established business for thirty-three years and that it had consistently shown profits. *Id.* Further, the court reasoned that flower sales were not an uncertain or speculative business. Evidence showed that for the years 1974 through 1980, except one, gross sales increased. *Id.* White’s accountant testified that there was a projected loss of gross receipts in the amount of \$40,000. *Id.* The plaintiff testified that twenty-five to thirty percent of his gross receipts are profit. *Id.* The court held that under the facts of this case, it could not be said, as a matter of law, that White was not entitled to recovery for his lost profits. *Id.* at 263. Therefore, the trial court’s order granting defendant’s motion for instructed verdict was overturned. *Id.*
4. In *Anthony Equip. Corp. v. Irwin Steel Erectors, Inc.*, 115 S.W.3d 191, 203-05 (Tex. App.—Dallas 2003, pet. dismissed by agr.), a subcontractor (Irwin) sued an equipment lessor (Anthony) for damages arising from an accident that occurred during the construction of Texas A&M’s sports arena. The general contractor for the construction project hired Irwin to erect the steel structure for the arena. *Id.* at 197. In order to place a steel truss into position, Irwin leased a crane and a crane operator from Anthony to work in tandem with Irwin’s own crane and crane operator. *Id.* Irwin directed Anthony’s crane operator during the “tandem lift.” *Id.* When Anthony’s and Irwin’s cranes elevated

the steel truss to the desired height, Anthony's crane operator intentionally released his end of the truss – causing the truss to fall eighty (80) feet and damaging the arena and Irwin's own crane. *Id.* Irwin alleged that the negligent acts of Anthony's employee caused Irwin to lose a bid to help construct the United Spirit Arena at Texas Tech University and lost. *Id.* at 204. Irwin sued Anthony for its profits. *Id.* At trial, the jury awarded Irwin \$250,000 in lost profits as a result of losing the United Spirit Arena bid due to Anthony's negligence. *Id.*

On appeal, Anthony challenged the legal sufficiency of Irwin's evidence concerning the award for lost profits. Anthony alleged that Irwin failed to present any evidence concerning the actual costs and profits of the ultimate winner of the United Spirit Arena project. *Id.* at 203. The court of appeals disagreed and upheld the jury award. The court of appeals reiterated the well-established rule that an award for lost profits must be premised on "reasonably certain" evidence, the sufficiency of which is a fact-intensive determination that is intended to be flexible enough to accommodate all of the situations in which such damages are sought. *Id.* at 204. The court then determined that Irwin proffered evidence that established its existence as an ongoing business and its high profit margin (supported by financial data for a four (4) year time frame before the accident and the absence of debt financing). *Id.* at 204-05. Moreover, Irwin established that its largest customer (and general contractor for both the Texas A&M and United Spirit Arena projects), Hirshfeld Steel, "blackballed" Irwin as a result of the accident and the accompanying lawsuit. *Id.* at 205.

5. In *Carter v. Steverson & Co.*, 106 S.W.3d 161, 165-67 (Tex. App.—Houston [1<sup>st</sup> Dist.] 2003, pet. denied), a personnel placement agency (Steverson) sued a former employee (Carter) based on an employment agreement that contained a one-year non-competition clause. Carter was fired for cause by Steverson and was hired two weeks later by a new employer (who had never before engaged in personnel placement) to place personnel. *Id.* at 164. Carter placed individuals whom she had met while employed at Steverson with several of Steverson's own clients. *Id.* Steverson sued Carter and her new employer for the profits that Steverson alleged it lost as a result of the alleged breach of contract, tortious interference with contract, misappropriation of trade secrets, and violation of the Texas Personnel Placement Act (TPPA). *Id.* The jury awarded Steverson, as compensatory damages, the amount of profits Steverson alleged it would have earned from the placement commissions had Carter respected the terms of the employment agreement. *Id.* at 165. On appeal, Carter and her employer argued that Steverson's evidence as to lost profits was too speculative and uncertain to sustain the jury's award

for lost profits. In particular, the appellants argued that the evidence did not establish with reasonable certainty that the same prospective employers would have sought the same prospective placements through Steverson. *Id.* at 166. The court of appeals disagreed and cited Steverson's evidence concerning, (1) its unique placement database and contacts with employers in the Houston area; (2) Carter's knowledge of Steverson's trade secrets and the particularities of Steverson's clients and placement applicants; (3) the fact that Carter's employer had never engaged in placing personnel before hiring Carter and that Carter placed personnel with many of Steverson's clients after being hired; and (4) the fact that Carter's employer paid applicants slightly more, and charged placement client slightly less, than Steverson. *Id.* at 166-67. Thus, the court upheld the award of lost profits because the jury had before it both favorable and unfavorable evidence substantiating Steverson's claims to lost profits with reasonable certainty. *Id.* at 166.

6. In *Munters Corp. v. Swissco-Young Indus., Inc.*, 100 S.W.3d 292, 295 (Tex. App.—Houston [1<sup>st</sup> Dist.] 2002, no pet.), an industrial components contractor (Swissco) entered into an agreement with a turbine manufacturer to supply a system that would improve the performance of the manufacturer's turbines. Swissco obtained parts for the system from a component manufacturer (Munters), who designed the necessary parts based on the tolerances and specifications dictated by the turbine manufacturer. *Id.* at 295-96. Under the terms of the agreement, the turbine manufacturer was not obligated to compensate Swissco unless the system functioned as desired. *Id.* at 295. Despite assurances from Munters that the specified parts would perform as necessary, the system failed due to Munters' defective parts, and the turbine manufacturer terminated Swissco's contract. *Id.* at 296. As a result, Swissco declared bankruptcy. *Id.* Swissco sued Munters for the profits Swissco alleged it lost as a result of Munters' deceptive trade practices. *Id.* After a bench trial, Swissco was awarded \$974,886 in lost profits. *Id.* On appeal, Munters argued that Swissco failed to provide evidence that established the amount of Swissco's lost profits from the terminated agreement with reasonable certainty. *Id.* The court of appeals disagreed and cited the testimony of Swissco's accountant which established that Swissco had existed as a profitable company with annual income within the range of \$500,000 to \$2 million each year. *Id.* at 300. Moreover, Swissco's accountant provided an exhibit that calculated Swissco's lost profits by discounting its estimated cash inflows (based on historical accounting data) and liquidation value between the date Swissco filed for bankruptcy and the date it started new operations. *Id.* at 301. Even though Munters' expert witness

contradicted the testimony of Swissco's accountant, the court upheld the award for lost profits and stated that the trial court "[a]s sole finder of fact . . . was free to believe that [Swissco's accountant] gave a reasonably certain estimate on lost profits, while disbelieving the testimony of [Munters' witness]." *Id.* at 302.

7. In *Goose Creek Consol. Indep. Sch. Dist. v. Jarrar's Plumbing, Inc.*, 74 S.W.3d 486, 491 (Tex. App.—Texarkana 2002, pet. denied), the school district (Goose Creek) entered into a contract with a general contractor to build three elementary schools. The general contractor engaged a subcontractor (Jarrar) to install the plumbing at the three schools. *Id.* Shortly after the schools were occupied by Goose Creek, school officials and students noticed that raw sewage backed up into most of the rooms that had floor drains, and other rooms filled with sewer gas, which made the affected areas unusable for variable periods of time. *Id.* at 495. Goose Creek sued Jarrar for economic damages Goose Creek alleged it suffered as a result of the "loss of use" (a concept similar to lost profits) of the affected areas caused by Jarrar's negligent installation of the plumbing works at the three elementary schools. *Id.* The jury awarded Goose Creek economic damages for the loss of use of the affected areas within each elementary school caused by Jarrar's negligence. *Id.* at 492.

On appeal, Jarrar argued that Goose Creek failed to present sufficient evidence to establish with a "fair degree of certainty" the amount of economic damages it allegedly suffered from the loss of the use of the affected areas. *Id.* at 495. The court stated that Goose Creek's evidence "attempted to quantify the loss of valuable use by providing estimates based on objective facts, figures, and data, from which some value can be ascertained, which is the minimum required to show the loss with reasonable certainty." *Id.* at 499. In upholding the jury award for loss of value, the court specifically noted that Goose Creek provided a formulation that calculated the diminution of value based on (1) the original cost of each of the elementary schools; (2) the straight-line value of the schools over their expected useful lives; (3) the estimates – as provided by each of the schools' principals – of the percentage of time sewage and sewage gas remained in, and affected, the schools; and (4) the cost of interest on bonds incurred by the school district for the periods during which the school facilities remained unusable. *Id.* at 498. The court concluded its analysis of the damages issue by deferring to the jury's consideration of the matter:

The calculations presented by Goose Creek provided one basis on which the jury could award an amount for loss of use. Testimony provided

information on which to evaluate the proposed calculation, and the jury could have altered the calculation it [sic] if it had disagreed that it was a reasonable estimate of the lost use. The evidence provided more than speculation, even if it did not provide the jury with specific details about the degree of presence in the affected areas.

*Id.* at 499.

8. In *Foust v. Estate of Rollins*, 21 S.W.3d 495, 504-06 (Tex. App.—San Antonio 2002, pet. denied), the court upheld a jury award for lost profits as their measure of damages for lost crops. The defendant had asserted that the award was improper because the plaintiff had failed to present figures of loss income that were gross rather than net. *Id.* at 505. The court reiterated that in a suit for lost profits from crop loss the measure of damages is the market value of the crops plus all expenses of cultivating and bringing the crops to market. *Id.* at 505 (citing *International Harvest Co. v. Kesity*, 507 S.W.2d 195, 196 (Tex. 1974); *Engelman Irrigation Dist. v. Shield Bros., Inc.*, 960 S.W.2d 343, 351 (Tex. App.—Corpus Christi 1997), *pet. denied*, 989 S.W.2d 360 (Tex. 1998) (per curiam)). The court found that the plaintiff had in fact introduced evidence which took into account the expenses of cultivating and bringing the crops to market, because they had grown the crops out to maturity at the suggestion of the defendant, and had thus saved no expenses in fertilizer, herbicide application, irrigation, labor, harvesting, or transportation and ginning costs. *Id.* at 506.
9. In *Two Thirty-Nine Joint Venture v. Joe*, 60 S.W.3d 896, 911 (Tex. App.—Dallas 2001, pet. denied), the plaintiff sued the defendant lawyer for malpractice and breach of fiduciary duty and duty of loyalty arising out of the defendant's failure to disclose that as a member of the city council he would or could take positions that would effect the real estate transactions of the plaintiff. The court concluded that the plaintiff's evidence of lost profits was sufficient to raise a fact issue and overcome the defendant's motion for summary judgment. *Id.* at 911. The plaintiffs presented evidence through an expert that the loss of the real estate sale cost it \$119,770 in carrying costs and that a reasonable value in investing the proceeds from the sale would have produced a rate of return calculated by the rates of return on an average investment of another real estate opportunity for total estimated damage between \$1,442,157 and \$1,939,590. *Id.* The court noted with approval that the expert's affidavit not only contained the statements of the expert but also attached documentation showing the damages calculations based on the proceeds that it would have been realized had the sale been completed. *Id.*

10. In *Vingcard v. Merrimac Hospitality Sys., Inc.*, 59 S.W.3d 847, 862-65 (Tex. App.—Fort Worth 2001, pet. denied), the court found that the plaintiff submitted sufficient evidence to support a jury award for lost profits. The plaintiff submitted evidence regarding the projected sales of two computer units via its expert witness who based his calculations on the facts, figures, and data and his many years of experience in the touch-screen based computer industry. *Id.* at 864. The court found these factors provided sufficient reason to expect that the units would have yielded a profit and to support an award for lost profits. *Id.*

### C. Cases Disallowing or Reducing Recovery of Lost Profits

1. In *DIJO, Inc. v. Hilton Hotels Corp.*, 351 F.3d 679, 685-87 (5th Cir. 2003), a hotel-property developer (DIJO) sued a casino management company (Grand Casinos) and a hotel chain (Hilton Hotels) for damages arising from a breach of a contract to develop certain realty into a hotel and casino resort. DIJO obtained from one of Grand Casinos' subsidiaries a 49-year lease to realty adjoining one of Grand Casinos properties in Tunica, Mississippi. *Id.* at 681. DIJO planned to build a hotel on the leased property in order to host casino patrons. *Id.* Shortly after DIJO obtained its lease, however, Grand Casinos and Hilton Hotels announced the creation of a joint venture that consolidated their respective gaming interests. *Id.* The creation of the joint venture culminated long-standing confidential discussions between both parties that preceded DIJO's lease. *Id.* However, Hilton Hotels became aware of DIJO's lease only after the joint venture was formed, and executives of the new joint venture subsequently decided to terminate Grand Casino's preexisting arrangement with DIJO. *Id.* Consequently, Grand Casinos informed DIJO of the joint venture's decision, offered to buyout DIJO's leasehold, and placed DIJO's development project on hold. *Id.* at 681-82. After DIJO demanded a buyout price of \$1.5 million, however, Grand Casino reversed its prior position and offered to proceed with the development project. *Id.* at 682. However, DIJO believed that the project was "unsalvageable" and sued Hilton Hotels, Grand Casinos, and the joint venture for breach of contract, tortious interference, and the accompanying lost profits. *Id.* During trial, DIJO's vice president and a representative of the putative lender for the project testified as to the amount of profits DIJO lost as a result of the defendants' actions. *Id.* at 685. The jury awarded DIJO lost profits in the amount of \$8 million. *Id.* On appeal, the defendants alleged that the trial court improperly admitted the testimony of DIJO's witnesses concerning its lost profits in violation of Federal Rule of Evidence 701. *Id.* The court of appeals agreed with the defendants as to the representative of DIJO's putative lender; although the representative was a well qualified and experienced representative of DIJO's commercial lender, he did not have first-hand knowledge about DIJO or its operations. *Id.* Rule 701, the court emphasized, required of a lay witness first-hand knowledge of the facts observed in order to give credible testimony about such facts. To hold otherwise would allow lay witnesses to proffer expert testimony without complying with the requirements of Rule 702. *Id.* at 685. Accordingly, the testimony of the representative of DIJO's lender concerning "generic industry" lost profit information was not credible and should have been excluded. *Id.* at 685. However, the testimony of DIJO's vice president was admissible under Rule 701 because he was actively involved in DIJO's operations and was well acquainted with its history. *Id.* at 687. Nevertheless, the vice president's testimony, the court concluded, was not "reasonably certain" evidence sufficient to support the jury's damage award because the lending representative's erroneously-admitted testimony prejudiced the defendants' substantial rights. *Id.* The jury's damage award for lost profits, the court noted, was virtually identical to the lending representative's lost-profit estimate. *Id.* Moreover, the district court's admission of the testimony caused DIJO to prevent its damages expert from testifying – testimony which, if proffered, would have nearly halved the \$8 million lost-profits estimate. *Id.* Accordingly, the court of appeals reversed the jury award for damages and remanded the case to the district court to resolve the damage award issue. *Id.* at 687-88.
2. In *Burkhart Grob Luft und Raumfahrt GmbH & Co. KG v. E-Systems, Inc.*, 257 F.3d 461, 467-68 (5th Cir. 2001), the Fifth Circuit upheld the district court's decision not to submit the issue of the plaintiff's lost profits to the jury. Plaintiff manufacturer sued defendant contractor for breach of contract and duty of good faith and fair dealing, interference with business opportunities, and fraud arising out of an agreement to develop a bid for a government contract to build a surveillance aircraft. *Id.* at 464-65. Applying Texas law, the court reiterated that a disappointed bidder must be able to show that it would have received the contract in dispute absent the wrongful conduct of the defendant. *Id.* at 467. Noting that a new business is not precluded from recovery based solely on its newness, the court still found that there must be competent evidence on which to base damages. *Id.* at 468. Without evidence to support its contention that it would have been the winner in the bidding contest for the contract, the plaintiff could not have the issue of damages submitted to the jury. *Id.* The court distinguished the case before it from *Aboud v. Schlichtemeier*, 6 S.W.3d 742, 747 (Tex. App.—Corpus Christi 1999, pet. denied), in which the court

sustained an award of lost profits in a case arising out of a proposal to build a cancer treatment center in El Paso. 257 F.3d at 468. In that case, the plaintiff produced evidence that the partners were experienced physicians, that they had developed such enterprises in the past, that El Paso needed such a treatment center, and that such a center was likely to be profitable. *Id.* (citing *Aboud*, 6 S.W.3d at 747). Unlike the plaintiffs in *Aboud*, the plaintiff in the case before the Fifth Circuit did not present sufficient evidence to prove lost damages. *Id.*

3. In *Great Pines Water Co., Inc. v. Liqui-Vox Corp.*, 203 F.3d 920, 922-24 (5th Cir. 2000), the court set aside jury determinations regarding lost profits and consequential damages for counterclaims, including breach of contract and violations of the DTPA. On appeal, the plaintiff argued that the defendant had produced insufficient evidence to support an award for either lost profits or consequential damages, and focused on the inadequacy of evidence for the number of customers who cancelled the defendant's water service because of the plaintiff's defective products. *Id.* at 922. The court noted that while the recovery of lost profits did not require that the loss be susceptible to exact calculations, the amount of loss should be shown by reasonably certain evidence, and when lost profits are dependent on a plaintiff's lost contracts with customers, Texas law requires that such contracts be proven with reasonable certainty both as to existence and number. *Id.* at 922-23.

At trial, the defendant had presented three witnesses who testified as to how many customers were lost due to the plaintiff's conduct. *Id.* at 923. While these witnesses presented an approximate number of customers that cancelled service with the defendant, the defendant did not produce any definitive evidence such as contemporary business records, service cancellation slips, relevant computer entries, or customer complaint list on the central issue of how many customers had cancelled due to the problems with the plaintiff's product. *Id.* The trial court had excluded a survey presented by defendant as to how many customers had cancelled service due to the plaintiff's product being unreliable, but allowed the defendant's witnesses to testify as to their observations and discussions with an unknown number of customers who had complaints. *Id.* These witnesses could not produce customer correspondence or records reflecting the customers' reasons for terminating the defendant's service, and had to agree that they had customer cancellations for numerous reasons unrelated to plaintiff's product failures. *Id.* The court found that, based on established Texas law regarding lost profits, the defendant's witnesses provided only speculative testimony as to the number of customers lost because of dissatisfaction with plaintiff's product.

*Id.* at 924. The Fifth Circuit Court of Appeals found that the "disparate figures [were] the product of guesswork by interested parties, and Texas courts have consistently refused to award lost profits on such unprincipled predicates." *Id.* Because the jury's determination of lost profit or consequential damage was based on this legally insufficient evidence, the court found that the findings were necessarily arbitrary and unsupported. *Id.*

4. *Kerr-McGee Corp. v. Helton*, 133 S.W.3d 245, 252-256 (Tex. 2004), various owners of oil and gas leases (Helton et al.) sued an oil and gas operator (Kerr-McGee) for a breach of the implied warranty against drainage and the accompanying loss in royalties. Helton and others owned mineral interests to a section of land in Wheeler County that Kerr-McGee was exploring and developing for natural gas extraction. *Id.* at 248. Kerr-McGee drilled approximately seven gas wells in the land next to Helton's section, and two wells on Helton's section. *Id.* at 248, 249. Of the nine wells Kerr-McGee drilled, only two wells proved to be substantially profitable and were not on Helton's section. *Id.* Of the two wells drilled on Helton's section, one was a dry hole and the other was a marginal producer. *Id.* The natural gas deposit underlying Helton's and the surrounding sections of land was very difficult to map and exploit. *Id.* at 249. Nevertheless, Helton and the other leaseholders sued Kerr-McGee alleging that its refusal to drill a well on their section as close as possible to the first lucrative gas well on the abutting section constituted a breach of Kerr-McGee's implied duty to prevent drainage. *Id.* At trial, the leaseholders proffered testimony of their expert witness as to the amount of profits (and, thus, royalties) that the hypothetical gas well would have produced if drilled by Kerr-McGee. *Id.* On cross examination, however, the same expert witness acknowledged that his productivity estimates (on which his lost profits calculations were based) were not premised on any objectively provable facts. *Id.* at 250. Kerr-McGee moved to strike the testimony of Helton's witness, but the trial court denied this motion, found that Kerr-McGee breached its implied warranty to Helton, and awarded Helton and the other plaintiffs approximately \$864,000 in lost royalties. *Id.* The court of appeals affirmed the trial court's damages award. *Id.* at 250-51. On appeal to the Texas Supreme Court, Kerr-McGee alleged that Helton did not establish the amount of damages he suffered with reasonable certainty because the testimony offered by Helton's expert witness was speculative and unsupported by any facts. *Id.* at 254.

The supreme court noted that an expert's opinion, to be considered reliable evidence, should be based on data capable of being independently evaluated. *Id.* at 253. Further, the supreme court stated that one measure of damages for an operator's breach of the

implied warranty against drainage was the amount of royalties the leaseholder would have received from an offset well on his property. *Id.* The amount of the royalties must be measured by the value of the oil or gas obtainable through reasonable diligence – and the value of such production (as with lost profits) must be proven with reasonable certainty. *Id.* The court noted that Helton’s expert witness, a petroleum engineer, premised his production estimates on the location of the hypothetical well and numerous accepted bas production records of the surrounding area. *Id.* However, the expert witness conceded that the hypothetical well would have tapped the underground natural gas reserve at a thinner part of the formation than the two actual and highly profitable wells – a factor that bore on the hypothetical well’s production levels. *Id.* at 254. The expert also could not specifically explain how his estimates took into account other factors such as the type of soil underlying the hypothetical well, and the manner in which the hypothetical well would have been drilled to minimize surface damage. *Id.* at 255. In short, Helton’s witness could not explain how he used the production data to formulate his production estimates – the analytical gap between the expert’s opinion and the data on which it was based was simply too great. *Id.* (quoting *Gammill v. Jack Williams Chevrolet, Inc.*, 972 S.W.2d 713, 726 (Tex. 1998)). Accordingly, the supreme court agreed with Kerr-McGee’s objection and vacated the jury’s damages award. *Id.* at 256.

5. In *Miga v. Jensen*, 96 S.W.3d 207, 213 (Tex. 2002), the court found that, with respect to the breach of contract claim, the evidence submitted by the plaintiff was not sufficient to show that plaintiff suffered reasonably certain business losses resulting from defendant’s breach. Plaintiff sued the defendant, in part, for lost profits resulting from a breach of a stock option contract. *Id.* The court stated that the standard for recovery of lost profits in Texas is damages for the loss net income to a business measured by a reasonable certainty. *Id.* Furthermore, the court held that plaintiff did not testify about what particular profit plaintiff expected, or that the parties contemplated a particular resale of the stock; therefore, there was no reasonable certain profit. *Id.* In essence, the court held that in applying the general standard for recovery of lost profits in Texas, the correct measure of damages for breach of contract claim is: “the difference between the price contracted to be paid and the value of the article at the time when it should have been delivered. *Id.* at 215. Finally, the court stated that to award plaintiff damages based on the appreciative value of the stock would be to make him better off than he would have been had the agreement for sales stock been honored by giving him an investment free of risks other shareholders undertook. *Id.* at 216.

6. In *United Mobile Networks, L.P. v. Deaton*, 939 S.W.2d 146, 147 (Tex. 1997), a radio service sued two former employees, a husband and wife, for breach of a noncompetition agreement, tortious interference with contract, conversion and civil conspiracy. When the plaintiff, Mr. Deaton, left United Mobile Networks (“UMN”) in 1993, he took a copy of UMN’s customer list with him. *Id.* at 147. Deaton continued to sell radios, and was an employee of a radio business his wife began after she was fired from UMN. *Id.* UMN claimed that the Deatons’ business activities constituted a violation of a noncompetition agreement and were predicated on a variety of torts. *Id.* UMN’s expert calculated conversion damages based on the income that listed customers generated for the company. *Id.* at 148. The expert conceded that his valuation was only valid if the customers generated income for whomever held the list. *Id.*

The Texas Supreme Court found the court of appeals should have rendered judgment reversing a damage award for conversion because there was no evidence to support it. *Id.* Under *Prewitt v. Branham*, 643 S.W.2d 122, 123 (Tex.1982), one must prove damages to recover for conversion. 939 S.W.2d at 147. Damages for conversion are generally measured by the fair market value of the property at the time and place of conversion. *Id.* at 147-48. (citing *Prewitt*, 643 S.W.2d at 123). However, one may not recover damages in excess of the actual loss or injury sustained as a result of the conversion. *Id.* at 148. A plaintiff should not be unjustly enriched by a recovery for conversion. *Id.* UMN’s evidence of damages was insufficient because it did not include a showing of actual damages from the loss of the list; UMN did not prove which, if any, customers were lost due to the conversion. *Id.* Any value arising from the exclusivity of the list was not testified as to, and thus may not be recovered on. *Id.* UMN cannot establish damages based on something it has not lost. *Id.*

7. In a cause of action based on negligent misrepresentation, benefit-of-the-bargain damages, including lost profits, are not recoverable. *Federal Land Bank Ass’n v. Sloane*, 825 S.W.2d 439, 442 (Tex. 1991). Section 552B of the Restatement (Second) of Torts (1977), which defines the measure of damages available for negligent misrepresentations claims, has been adopted in Texas and limits recovery to “pecuniary loss” only. *Id.* at 442-43. Section 552B(2) states, “the damages recoverable for a negligent misrepresentation do not include the benefit of the plaintiff’s contract with the defendant.” *Id.* at 442. In *Sloane*, the Sloanes spent money for improvements and construction of their chicken raising business based on representations from the defendant that their loan was approved. *Id.* at 440-41. The defendant subsequently informed the plaintiffs, however, that their

loan request had been denied. *Id.* at 441. The jury found in favor of plaintiffs and awarded, among other things, \$28,500 for past and future lost profits based on a prospective agreement with Pilgrim's Pride that they would "feed out broilers" for the Sloanes once the chicken houses were constructed. *Id.* The court of appeals reversed the award of lost profits, and the Texas Supreme Court affirmed. *Id.* at 442-43. Significantly, the supreme court noted that the Sloanes did not claim that the bank agreed to loan them money and then breached that agreement; rather, the plaintiffs claim that the bank *did not* agree to loan them money, yet negligently misrepresented that it had made such an agreement. *Id.* at 442.

In rejecting the plaintiffs' argument that they should receive damages for the profits they anticipated from the Pilgrim's Pride contract, the court stated that the Sloanes would not have received the contract regardless of whether the misrepresentation was made.

*Id.* at 443. The court held:

Under the legal theory of this section of the Restatement, they should not, therefore, receive the benefit of a bargain that would never have taken place. The sole reason the Sloanes did not get the Pilgrim's Pride contract is because the bank did not give them the loan money to build acceptable chicken houses. The Sloanes' claim to these damages is impermissibly predicated on giving them the benefit of the loan.

*Id.* The court did not reach the issue of whether plaintiffs had proven their lost profit damages with reasonable certainty. *Id.*

8. In *Villanueva v. Gonzalez*, 123 S.W.3d 461, 467-468 (Tex. App.—San Antonio 2003, no pet.) an accountant (Villanueva) sued an attorney (Gonzalez) for a breach of a putative contract in which Villanueva agreed to allow Gonzalez to underwrite his bail bonds with the value of Villanueva's real property. In exchange, Gonzalez agreed to share the fees generated by such bonds with Villanueva. *Id.* at 463. At trial, Gonzalez moved for summary judgment on the breach of contract claim alleging that his contract with Villanueva violated section 1704.252(9) of the Texas Occupations Code, which prohibits an attorney from sharing with a non-attorney fees or commissions derived from bail bonds. *Id.* at 465. The trial court granted Gonzalez's summary judgment motion, but allowed Villanueva to proceed on his fraud claim against Gonzalez. *Id.* at 464. The jury awarded Villanueva \$13,000 in lost profits on his fraud claim, but the trial court granted Gonzalez's motion for judgment notwithstanding the verdict. *Id.* at 467-68. On appeal, Villanueva alleged that the trial court improperly granted Gonzalez's
9. In *Aquila Southwest Pipeline, Inc. v. Harmony Exploration, Inc.*, 48 S.W.3d 225, 245-46 (Tex. App.—San Antonio 2001, no pet.), the court upheld the trial court's finding that there was insufficient evidence to support the jury's award on lost profits. The plaintiff oil and gas producer sued the defendant pipeline for breach of contract arising out of purchases made by the defendant from the plaintiff. *Id.* at 232. The plaintiff's expert used the following methodology to produce his calculation of damages: "(1) look at surrounding wells that were applicable to this case to know what the ultimate recoveries would be; (2) know the cost of operating a well; (3) know the prices on the liquids and gas; (4) determine whether there was water in the well and the cost of removing the water; and (5) calculate the taxes." *Id.* at 246. The expert acknowledged that his methodology was "not an exact science." *Id.* The expert experienced problems in making his calculations because the wells at issue were used by the producer only one or two days a month to maintain the lease, both wells were plugged and no longer producing, the railroad commission was unable to provide the expert with relevant figures, and the figures the expert did have came from a test years before. *Id.* The court found that although the expert's methodology was sound, he did not have non-speculative facts with which to calculate the damages, and therefore there was no evidence to support the jury's findings on lost profits. *Id.*
10. In *Edmunds v. Sanders*, 2 S.W.3d 697, 705-06 (Tex. App.—El Paso 1999, pet. denied), the court found that the jury's damage award, including the finding of lost

profits, was legally insufficient in a case brought by a joint venturer to recover for conversion of the joint venturer's business and equipment and tortious interference with contract. The jury had awarded \$432,206 in lost profit damages for the tortious interference claims. *Id.* The court reiterated Texas law on lost profits: that the amount of lost profits must be shown by competent evidence with reasonable certainty, that the opinions or estimates of lost profits must be based on objective facts, figures, or data, that the plaintiff must demonstrate one complete calculation of lost profits, and that a party must show either a history of profitability or the actual existence of future contracts from which lost profits can be calculated with reasonable certainty. *Id.*

The plaintiff in this case, operated a tool and die and plastic injection molding business in Florida and had come to El Paso to set up a joint venture. *Id.* at 700. However, the plaintiff did not present evidence of a history of profitability nor a showing of future contracts in the plaintiff's claim for conversion of business, temporary conversion of equipment, and tortious interference with his prospective contracts with the customers in El Paso. *Id.* at 705. The court found that the plaintiff's evidence was not based on a calculation of net profits, but instead was based on an average percentage of profits for similar businesses as shown in certain trade manuals. *Id.* The plaintiff's expert had explained that these manuals provided benchmarks for profits that a company should return expressed as a percentage of the value of the company's assets. *Id.* The plaintiff's expert had based his calculations on the success of the plaintiff's business in Florida, but under cross-examination, the expert had to admit that his calculation was a "yardstick" comparison measurement to comparable companies in comparable industries, and not a projection of lost net profits based on projected revenues minus projected operating expenses for this particular business. *Id.* at 706. The court found that the expert's calculations were not based on the history of the business's profitability or on the existence of future contracts as required to show lost profit damages. *Id.* Therefore, the court found that there was no evidence of the correct legal measure of damages on the record, and found that the jury's damage finding was legally insufficient. *Id.*

## XX. EXEMPLARY DAMAGES

Exemplary damages, for the most part, are governed by Texas Civil Practice and Remedies Code sections 41.001-.013 (Vernon Supp. 2004). This statute does not apply to causes of action under the following statutes: Texas Free Enterprise and Antitrust Act of 1983; Deceptive Trade Practices-Consumer Protection Act, except as provided in section 17.50 of that Act; or an action under Chapter 21,

Insurance Code. TEX. CIV. PRAC. & REM. CODE ANN. § 41.002(d) (Vernon Supp. 2004).

### A. Burden of Proof

#### 1. Actions Filed Before September 1, 2003

For the most part, to recover exemplary damages, one must prove by clear and convincing evidence that the harm suffered was a result of fraud or malice. TEX. CIV. PRAC. & REM. CODE ANN. § 41.003(a) (Vernon 1997).<sup>22</sup> In certain wrongful death actions, one may rely on gross negligence. *Id.* § 41.003(a)(3). The evidence must be clear and convincing and the burden may not be satisfied by establishing ordinary negligence, bad faith or a deceptive trade practice. *Id.* § 41.003(b). "Clear and convincing" means "the measure or degree of proof that will produce in the mind of the trier of fact a firm belief or conviction as to the truth of the allegations sought to be established." *Id.* § 41.001(2).

A finding of fraud, without more, is sufficient to establish a basis for exemplary damages. TEX. CIV. PRAC. & REM. CODE ANN. § 41.003(a)(1); *Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41, 47 (Tex. 1998). In all other cases, the claimant must show the defendant acted with malice. "Malice" is defined as: . . .

- (A) specific intent by the defendant to cause substantial injury to the claimant; or
- (B) an act or omission:
  - (i) which when viewed objectively from the standpoint of the actor at the time of its occurrence involves an extreme degree of risk, considering the probability and magnitude of the potential harm to others; and
  - (ii) of which the actor has actual, subjective awareness of the risk involved, but nevertheless proceeds with conscious indifference to the rights, safety, or welfare of others.

*Id.* § 41.001(7).

#### 2. Actions Filed On or After September 1, 2003

For actions filed on or after September 1, 2003, the burden of proof continues to be the clear and convincing standard. TEX. CIV. PRAC. & REM. CODE ANN. § 41.003(a) (Vernon Supp. 2004). Moreover, proof of fraud or malice continue to be elements that may be proven to recover

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<sup>22</sup> The Civil Practice and Remedies Code sections cited in Section XX(A)(1) and XX(B)(1) of this paper were repealed by H.B. 4. See Act approved June 11, 2003, 78th Leg., R.S., H.B. 4 § 13.02-.09.

exemplary damages. *Id.* § 41.003(a) (1) – (2). However, gross negligence has been added as a harm causing element that may be proven for recovery of exemplary damages and the definition of malice has been re-worked. *Id.* §§ 41.003(a)(3), 41.001(7).

The new definition of malice incorporates only language of “specific intent by the defendant to cause substantial injury or harm to the claimant” from the former statute. *Id.* § 41.001(7). The remainder of the definition under the prior version of the statute has been subsumed by the definition of gross negligence. *Id.* § 41.001(11). Therefore “gross negligence” is defined as:

. . . an act or omission:

- (A) which when viewed objectively from the standpoint of the actor at the time of its occurrence involves an extreme degree of risk, considering the probability and magnitude of the potential harm to others; and
- (B) of which the actor has actual, subjective awareness of the risk involved, but nevertheless proceeds with conscious indifference to the rights, safety, or welfare of others.

TEX. CIV. PRAC. & REM. CODE ANN. § 41.001(11) (Vernon Supp. 2004).

The new version of the statute no longer allows for recovery of exemplary damages for willful acts or omissions, or gross neglect in wrongful death actions. *See* former TEX. CIV. PRAC. & REM. CODE § 41.003(a)(3) (Vernon 1997). Most importantly however, the new version of the act mandates that exemplary damages may only be recovered if there is unanimous jury finding in regard to “liability for and the amount of exemplary damages.” TEX. CIV. PRAC. & REM. CODE ANN. § 41.003(d) (Vernon Supp. 2004). Additionally, the section requires a jury instruction regarding the unanimity requirement. *Id.* § 41.003(e).

Despite the previously mentioned sections on exemplary damage awards, the legislature was silent on how these sections should effect a general liability question, if at all. Therefore, it is uncertain whether, in cases where exemplary damages are sought, the legislature intended that the jury have a unanimous finding on the general liability question in order to award exemplary damages.

## B. Limits on Exemplary Damages

### 1. Actions Filed Before September 1, 2003

In most instances, punitive damages may be awarded only if the plaintiff was also awarded something other than nominal damages. TEX. CIV. PRAC. & REM. CODE ANN.

§ 41.004(a) (Vernon 1997)<sup>23</sup>; *Schlueter v. Schlueter*, 975 S.W.2d 584, 589 (Tex. 1998). However, if the plaintiff proves the defendant acted with malice, an award of nominal damages is sufficient to support an award of exemplary damages. *Id.* § 41.004(b). In no event, however, may exemplary damages be awarded if the claimant elects to have his recovery multiplied under another statute. *Id.*

Further, exemplary damages are limited in amount by statute. *Id.* § 41.008. Except for certain felonies listed in Texas Civil Practice and Remedies Code section 41.008(c), an award of exemplary damages may not exceed an amount equal to the greater of:

- (1) (A) two times the amount of economic damages; plus
- (B) an amount equal to any non-economic damages not to exceed \$750,000; or
- (2) \$200,000.

*Id.* § 41.008(b). Economic damages are defined as compensatory damages for pecuniary loss and do not include exemplary damages, or damages for physical pain and mental anguish, loss of consortium, disfigurement, physical impairment, or loss of companionship and society. *Id.* § 41.001(4).

### 2. Actions Filed On or After September 1, 2003

For these actions, factors precluding recovery continue to be similar to the prior version of the statute, with minor but important changes. For example, under the new version of the Section 41.004, exemplary damages may only be awarded if damages other than nominal damages are awarded. TEX. CIV. PRAC. & REM. CODE ANN. § 41.004(a) (Vernon Supp. 2004). Former Section 41.004(b), allowing exemplary damages upon a showing of malice even when only nominal damages have been awarded has been omitted from the current section. *See* former TEX. CIV. PRAC. & REM. CODE § 41.004(b) (Vernon 1997).<sup>24</sup> Section 41.004(b) now solely precludes exemplary damages when a claimant elects to have his recovery multiplied under another statute. TEX. CIV. PRAC. & REM. CODE ANN. § 41.004(b) (Vernon Supp. 2004).

Exemplary damages continue to be limited by amount for actions filed on or after September 1, 2003. *Id.* § 41.008. The guidelines prescribing limitations on the amount of exemplary damages that may be awarded are identical to the previous version of the section. What is different, however, is that the section has been modified to apply to all damages cases, not just those in which the claimant seeks exemplary damages. *Id.* § 41.004(a). Additionally, the section has been modified to make the section applicable to injury to a child, elderly individual, or

<sup>23</sup> *See* note 22, *supra*.

<sup>24</sup> *See* note 22, *supra*.

disabled individual, if the proscribed conduct occurred while providing health care as defined in Section 74.001 of the Texas Civil Practice and Remedies Code.

### C. Constitutional Limitations on Exemplary Damages

To the extent that an exemplary damages award falls within the limits of section 41.008, it is presumptively valid. *Peco Constr. Co. v. Guajardo*, 919 S.W.2d 736, 742 (Tex. App.—San Antonio 1996, writ denied) (finding award that fell within prior statutory limits to be presumptively valid). However, exemplary damages must be reasonably proportionate to the award of actual damages in order to satisfy Due Process. *Alamo Nat'l Bank v. Kraus*, 616 S.W.2d 908, 910 (Tex. 1981). Factors to consider in determining whether an award is reasonable include: (1) the nature of the wrong; (2) the character of the conduct involved; (3) the degree of culpability of the wrongdoer; (4) the situation and sensibilities of the parties concerned; and (5) the extent to which such conduct offends a public sense of justice and propriety. *Id.* See also *Ellis County State Bank v. Keever*, 888 S.W.2d 790, 798 (Tex. 1994). These factors were subsequently codified under the Civil Practices and Remedies Code. TEX. CIV. PRAC. & REM. CODE ANN. § 41.011 (Vernon 1997).

The United States Supreme Court has developed three guideposts to determine whether an exemplary damage award passes constitutional muster. *BMW of N. Am. v. Gore*, 517 U.S. 559 (1996). These guideposts are: (1) the degree of reprehensibility of the defendant's conduct; (2) the disparity between the harm or potential harm suffered by the plaintiff and his punitive damage award; and (3) a comparison of the punitive damages awarded and other civil penalties that could be imposed for similar misconduct. *Id.* at 574-75; see *Owens Corning Fiberglas Corp. v. Malone*, 972 S.W.2d 35, 45 (Tex. 1998). One court has held that the first two guideposts are subsumed in the *Kraus* factors, and noted in dicta that the last *BMW* guidepost was addressed by the Texas legislature. *Apache Corp. v. Moore*, 960 S.W.2d 746, 748-49 (Tex. App.—Amarillo 1997, writ denied).

In *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S.408, 418 (2003), the United States Supreme Court applied the three guideposts and held that a \$145 million punitive damages award was unreasonable and disproportionate to the wrong committed, which amounted in \$1 million in compensatory damages. *Id.* at 418. Therefore, the punitive damages award was in violation of the Due Process Clause of the Fourteenth Amendment to the United States Constitution. *Id.*

In applying the first guidepost, the Court stated that in awarding punitive damages, the degree of reprehensibility of the defendant's conduct is the most important indicator of the reasonableness of the award. *Id.* at 419. Punitive damages should be awarded when the defendant's culpability is so reprehensible as to warrant the imposition of further sanctions to achieve punishment or deterrence. *Id.* In *Campbell*, the punitive damages were originally awarded for

the nationwide activities of State Farm rather than for the conduct towards Campbell in the State of Utah. *Id.* The Court noted that a State's legitimate concern in imposing punitive damages to punish a defendant is for activities committed within the State's jurisdiction, and not for unlawful acts committed outside the State's jurisdiction. *Id.* at 421-22.

Lawful out-of-state conduct may be used as evidence if it demonstrates the deliberateness and culpability of the defendant's action in the State where the tort was committed, but the conduct must be connected to the specific harm suffered by the plaintiff. *Id.* at 422. Furthermore, the Court stated: "a defendant should be punished for the conduct that harmed the plaintiff, not for being an unsavory individual or business." *Id.* at 423. For the same reasons, punishing a defendant for recidivism cannot be justified in the context of civil actions, unless the conduct in question replicates the prior transgressions. *Id.* Therefore, the reprehensibility guidepost does not permit courts to expand the scope of the case so that a defendant may be punished for any malfeasance. *Id.* at 424. If there is no conduct similar to that which harmed the plaintiff, the conduct that harmed the plaintiff is the only conduct relevant to the reprehensibility analysis. *Id.*

In applying the second guidepost, the Court stated there is no bright-line ratio between the harm to plaintiff and the punitive damages award. *Id.* at 424-25. The Court, however, noted that "in practice, few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process." *Id.* at 425. Ultimately, since there is no clear benchmark, the precise award depends on the facts and circumstances of the defendant's conduct and harm to plaintiff. *Id.* In essence, a court must ensure the measure of punishment is both reasonable and proportionate to the amount of harm to plaintiff and general damages recovered. *Id.* at 426. Moreover, "The wealth of a defendant cannot justify an otherwise unconstitutional punitive damages award." *Id.* at 427.

Finally, the Court applied the third guidepost and held that punitive damages are not a substitute for the criminal process, and the remote possibility of a criminal sanction does not automatically sustain a punitive damages award. *Id.* at 428. The Court held that the careful application of the guideposts in *Campbell* would justify a punitive damages award at or near the amount of compensatory damages, but not at the unreasonable and disproportionate amount of \$145 million. *Id.*

### D. Exemplary Damages Against a Corporation or Other Principal

A corporation or other principal is not automatically liable for punitive damages for the acts of its employees and agents. Rather, the plaintiff must establish an independent basis for liability beyond mere respondeat superior.

*Hammerly Oaks, Inc. v. Edwards*, 958 S.W.2d 387, 390-91 (Tex. 1997). Texas has adopted the RESTATEMENT (SECOND) OF TORTS approach, which states that a corporation or other principal is liable for punitive damages resulting from the acts of its employees or agents when:

- (1) The principal authorized the doing and the manner of the act;
- (2) The agent was unfit and the principal was reckless in employing him;
- (3) The agent was employed in a managerial capacity and was acting in the scope of employment; or
- (4) The employer or manager of the employee ratified or approved the act.

*Id.* RESTATEMENT (SECOND) OF TORTS (1979).

The Texas Supreme Court has used the “vice principal” analysis to explain “the dichotomy between the doctrine of respondeat superior and the liability of the corporation for its own actions.” *Id.* A “vice principal” includes four different classes of corporate agents:

- (1) corporate officers;
- (2) those who have authority to employ, direct, and discharge servants of the master;
- (3) those engaged in the performance of nondelegable or absolute duties of the master; and
- (4) those to whom a master has confided the management of the whole or a department or division of his business.

*Id.* at 391 (quoting *Fort Worth Elevators Co. v. Russell*, 70 S.W.2d 397, 402 (Tex. 1934), *overruled on other grounds by Wright v. Gifford-Hill & Co.*, 725 S.W.2d 712, 714 (Tex. 1987)). A “vice principal” includes “one who represents the corporation in its corporate capacity.” *Id.* Neither the vice principal’s title nor degree of responsibility is determinative. *Id.*

The Texas Supreme Court has elaborated on the “vice principal” doctrine. A reviewing court should not only judge individual elements or facts, but should take a broad look at all of the facts and circumstances, the act or omission of the corporation, and determine whether the act or omission of the corporation contributed to a plaintiff’s alleged damages. *Mobil Oil Corp. v. Ellender*, 968 S.W.2d 917, 922 (Tex. 1998). In regard to some actions done in the workplace, a corporation can be liable for the actions of a vice principal regardless of whether the vice principal acted within the course and scope of employment. *GTE Southwest, Inc. v. Bruce*, 998 S.W.2d 605, 618 (Tex. 1999).

Authorization from the principal can be either express or implied from a conscious failure to instruct employees. *See King v. McGuff*, 149 Tex. 432, 234 S.W.2d 403, 404-05 (1950) (assuming that a fact question was created when

evidence showed that the employer consciously failed to instruct employees to turn off appliances that could ignite gasoline used to clean floors). Reckless hiring has been found in situations where the employer could have learned pertinent information about the employee simply by following up on references. *Wilson N. Jones Mem’l Hosp. v. Davis*, 553 S.W.2d 180, 183 (Tex. Civ. App.—Waco 1977, writ ref’d n.r.e.).

As stated above, an employer also may be liable for punitive damages based on the managerial capacity of the actor. *Hammerly Oaks*, 958 S.W.2d at 391. A manager is an employee who has been committed with management of the company’s affairs with respect to the enterprise under the employee’s charge. *Fidelity & Guar. Ins. Underwriters, Inc. v. Saenz*, 865 S.W.2d 103, 115 (Tex. App.—Corpus Christi 1993), *rev’d on other grounds*, 925 S.W.2d 607 (Tex. 1996); *Southwestern Bell Tel. Co. v. Wilson*, 768 S.W.2d 755, 764 (Tex. App.—Corpus Christi 1989, writ denied). More specifically, a manager has the authority to employ, direct and discharge servants, or engage in non-delegable duties for the employer. *Saenz*, 865 S.W.2d at 115. Counsel should be aware that an employer may be liable even if the manager or vice principal was performing non-managerial functions at the time of the injury. *Ramos v. Frito-Lay, Inc.*, 784 S.W.2d 667, 669 (Tex. 1990).

Ratification also provides a basis for exemplary damages against a corporation or other principal. *Ellender*, 968 S.W.2d at 921. Ratification exists when the principal accepts the benefits of the agent’s tortious actions with full knowledge of the details of the situation. *St. Joseph Hosp. v. Wolff*, 94 S.W.3d 513, 536 (Tex. 2002); *Land Title Co. v. Stigler, Inc.*, 609 S.W.2d 754, 756 (Tex. 1980); *Ebner v. First State Bank*, 27 S.W.3d 287, 303 (Tex. App.—Austin 2000, pet. denied); *Wilson*, 768 S.W.2d at 764; *Wal-Mart Stores, Inc. v. Odem*, 929 S.W.2d 513, 530 (Tex. App.—San Antonio 1996, writ denied). The party asserting ratification has the burden of proof. *Wilson*, 768 S.W.2d at 764; *BancTexas Allen Parkway v. Allied Am. Bank*, 694 S.W.2d 179, 181 (Tex. App.—Houston [14th Dist.] 1985, no writ). Mere denial of liability does not constitute ratification, and where silence is the basis of ratification it must be shown that the principal possessed knowledge of all material facts. *Wilson*, 768 S.W.2d at 764; *BancTexas Allen Parkway*, 694 S.W.2d at 181.

## XXI. ECONOMIC LOSS RULE

While Texas jurisprudence rarely uses this term to describe the underlying theory, the “economic loss” rule generally precludes recovery of purely economic loss in cases sounding in tort. *See generally Coastal Conduit & Ditching, Inc. v. Noram Energy Corp.*, 29 S.W.3d 282, 285 (Tex. App.—Houston [14<sup>th</sup> Dist.] 2000, no pet.); William Powers, Jr. and Margaret Niver, *Negligence, Breach of Contract, and the “Economic Loss” Rule*, 23 TEX. TECH L. REV. 477 (1992). In deciding whether the economic loss rule is applicable to a certain case, courts must determine

whether the case is based in contract or tort law. Texas courts have consistently applied two cases in determining the applicability of the rule.

First, in *Jim Walter Homes, Inc. v. Reed*, 711 S.W.2d 617, 618 (Tex. 1986) the court found that while a contractual relationship may create duties under both contract and tort law, the nature of the injury generally determines which duty is breached. See also *Dewitt County Electric Coop., Inc. v. Parks*, 1 S.W.3d 96, 105 (Tex. 1999) (“The measure of damages standing alone, is not always determinative of whether a tort claim can co-exist with a breach of contract claim.”). Therefore, when “the injury is only the economic loss to the subject of a contract itself, the action sounds in contract alone.” *Reed*, 711 S.W.2d at 618.

Since the plaintiffs’ only injury in *Reed* was that the house they were promised, and for which they paid, was not the house they received, their losses were based on breach of contract and not tort. *Id.*

Second, in *Southwestern Bell Tel. Co. v. Delaney*, 809 S.W.2d 493, 494 (Tex. 1991), the plaintiffs sought recovery in a negligence and DTPA action for the defendant’s cancellation of a Yellow Pages advertisement. Again, the court found that “[w]hen the only loss or damage is to the subject matter of the contract, the plaintiff’s action is ordinarily on the contract.” *Id.* The court found that the defendant’s duty to publish the plaintiff’s advertisement arose solely from the contract between the parties, and the plaintiff’s lost profits damages were only economic losses for failure to perform on the contract. *Id.* at 495.

Other decisions have followed the reasoning of *Reed* and *Delaney* in barring lost profits in negligence actions. *Hininger v. Case Corp.*, 23 F.3d 124, 127 (5th Cir. 1994) (precluding economic losses as lost profits based on negligence theory in suit against component supplier), *cert. denied*, 513 U.S. 1079 (1995); *Coffey v. Fort Wayne Pools, Inc.*, 24 F. Supp. 2d 671, 687 (N.D. Tex. 1998) (negligence claims against manufacturer of pool component part barred since claims based on failure of contractor to complete pool on time); *Indelco, Inc. v. Hanson Indus. N. Am.-Grove Worldwide*, 967 S.W.2d 931, 932-33 (Tex. App.—Houston [14th Dist.] 1998, *pet. denied*) (economic loss due to defective product damaging itself recoverable under contract action, not tort); *Thomson v. Espey Huston & Assocs., Inc.*, 899 S.W.2d 415, 421-22 (Tex. App.—Austin 1995, *no writ*) (recovery for negligent performance of a contract by engineering firm allowed under contract law, not tort, unless negligence caused damage beyond subject of contract itself).

Moreover, Texas courts have continued to impose the economic loss rule in other situations as well. *D.S.A., Inc. v. Hillsboro Indep. Sch. Dist.*, 973 S.W.2d 662, 663-64 (Tex. 1998) (*per curiam*) (finding economic loss rule precluded recovery under negligent misrepresentation claim); *Crawford v. Ace Sign, Inc.*, 917 S.W.2d 12, 14-15 (Tex. 1996) (*per curiam*) (finding nonperformance of contract was not actionable under DTPA); *Murray v. Ford Motor Co.*, 97 S.W.3d 888, 892 (Tex. App.—Dallas 2003, *no writ*) (finding

economic loss rule precluded recovery in tort for damage to the defective property itself even when collateral property was damaged); *Equistar Chems., L.P. v. Dresser-Rand Co.*, 123 S.W.3d 584, 590 (Tex. App.—Houston [14th Dist.] 2003, *pet. filed*) (holding that the economic loss rule applies to component replacement parts); *K. P. Meiring Constr. v. LaQuinta Inns*, No. 04-02-00425-CV, 2003 Tex. App. LEXIS 1048, at \*2-3 (Feb. 5, 2003) (holding economic loss rule prevented summary judgment on fraud claims when damages other than benefit-of-the-bargain were pleaded); *Dennis Jewelry Co. v. Sonitrol Mgmt. Corp.*, No. 04-01-00279-CV, 2003 Tex. App. LEXIS 804, at \*6-8 (Jan. 29, 2003) (holding that theft of items previously contracted to be protected was damage to the subject matter of the contract; therefore, the economic loss rule precluded negligence damages); *Trans-Gulf Corp. v. Performance Aircraft Servs.*, 82 S.W.3d 691, 695 (Tex. App.—Eastland 2002, *no pet.*) (finding economic loss rule barred recovery for negligent repair work when the only damages claimed were economic); *Coastal Conduit & Ditching, Inc. v. Noram Energy Corp.*, 29 S.W.3d 282, 290 (Tex. App.—Houston [14th Dist.] 2002, *no pet.*) (finding economic loss rule prevented recovery of additional expenses incurred as the result of a gas company failure to mark gas lines when the gas company owed no duty and there was no personal injury or property damage); *Weber v. Domel*, 48 S.W.3d 435, 436-37 (Tex. App.—Waco 2001, *no pet.*) (finding economic loss rule precludes award of exemplary damages in cases over breach of lease); *Facciolla v. Linbeck Constr. Corp.*, 968 S.W.2d 435, 448-49 (Tex. App.—Texarkana 1998, *no pet.*) (finding economic loss rule precludes recovery of identical damages under fraud and contract claims).

While Texas courts have generally barred recovery of economic loss when an action sounds only in tort, the Texas Supreme Court created an exception in *Formosa Plastics Corp. USA v. Presidio Eng’rs and Contractors, Inc.*, 960 S.W.2d 41 (Tex. 1998). In *Formosa*, a contractor sued a project owner for, among other claims, fraudulent inducement. The court noted the history of Texas cases in determining whether a case sounded in contract or tort and that courts should examine both the nature of the remedy sought by the plaintiff and the source of the duty owed to the plaintiff. *Id.* at 45. The court, however, rejected the application of *Delaney* to preclude tort damages in fraud cases. *Id.* at 46.

The court noted that it was “well established that the legal duty not to fraudulently procure a contract is separate and independent from the duties established by the contract itself.” *Id.* The court found that tort damages were not precluded simply because the fraudulent representations only caused economic loss. *Id.* at 47. Furthermore, the court noted that section 41.003(a)(1) of the Texas Civil Practices and Remedies Code authorized exemplary damages for fraud without making an exception based on the type of losses sustained. *Id.* Therefore, the court held that “tort damages are recoverable for a fraudulent inducement claim

irrespective of whether the plaintiff only suffers an economic loss related to the subject matter of the contract.” *Id.*; see also *Eastman Chem. Co. v. Niro, Inc.*, 80 F. Supp.2d 712, 717 (S.D. Tex. 2000); *Metro Nat’l Corp. v. Dunham-Bush, Inc.*, 984 F. Supp. 538, 553 (S.D. Tex. 1997).

## XXII.RECENT DEVELOPMENTS

### A. Texas Supreme Court Cases

In *Mustang Pipeline Co., Inc. v. Driver Pipeline Co., Inc.*, 134 S.W.3d 195, No. 04-02-0290-CV, 2004 Tex. LEXIS 365, \*16-17 (April 23, 2004) (Tex. 2004), the Texas Supreme Court addressed the burden of proof on damages when a party seeks to recover the costs of completion in a breach of contract case. In *Mustang Pipeline*, Mustang contracted with Driver to construct 100 miles of pipeline near Longview, Texas. *Id.* at \*2. During the bidding process, Mustang stressed that time was of the essence and that construction had to be completed by a date certain. *Id.* When it was clear that Driver could not finish the project by the specified date, Mustang sued for breach of contract to recover the costs of completion, lost profits, and attorney’s fees. *Id.* at \*3-4.

Both parties raised the other’s material breach as an affirmative defense. *Id.* at 4. The jury found that Driver failed to comply with the terms of the contract, but also found that Mustang was not justified in terminating the contract. *Id.* at \*4. It awarded Mustang \$2,104,601.00 in damages for Driver’s breach of contract, and awarded Driver \$2,515,958.00 for Mustang’s wrongful termination. *Id.* at \*4-5. Both parties moved for judgment notwithstanding the verdict. *Id.* at \*5. Mustang contended that once the jury found that Driver breached the contract, it could not also find that Mustang wrongfully terminated the contract. *Id.* The trial court denied Mustang’s motion. *Id.* Driver’s motion for J.N.O.V. asked the trial court to disregard the jury’s finding that Driver breached the contract, and asked the court to set aside the damages award to Mustang. *Id.* The trial court refused to disregard the jury’s finding on breach; however, the court granted Driver’s motion to set aside Mustang’s damage award. *Id.*

Both parties then appealed. *Id.* The court of appeals affirmed the trial court’s judgment. *Id.* at \*6. In affirming the trial court’s decision to disregard the jury’s damage award to Mustang, the court of appeals held that Mustang did not meet its burden to show its damages were reasonable and necessary. *Id.* at \*7.

On appeal to the Texas Supreme Court, the court affirmed the court of appeals’ determination that Mustang offered no evidence to prove that its damages were reasonable and necessary, and therefore the damages award should be disregarded. *Id.* at \*16. The court held, “The party seeking to recover the cost of completion in a breach of contract case has the burden to prove that the damages sought are reasonable.” *Id.* at \*14-15 (citing *Dallas Ry. Terminal Co. v. Gossett*, 156 Tex. 252, 294 S.W.2d 377, 382 (Tex. 1956)). When only the amounts charged and paid

is presented as evidence for costs of completion, reasonableness and necessity has not been shown. *Id.* at \*15.

The court noted that Mustang’s expert provided testimony to prove its out-of-pocket costs; however, the court reasoned that such evidence without more does not establish that the damages were reasonable and necessary. *Id.* Moreover, the court pointed out that the expert was careful to limit his opinion solely to what it cost the third-party to complete the contract, and not whether that contract amount was a reasonable cost to build a pipeline. *Id.*

Finally, the court stated there was evidence that the contract entered into with the third-party was substantially higher than what the third-party initially bid in an attempt to obtain the job. *Id.* at \*16. Accordingly, the court held that the judgment notwithstanding the verdict was properly granted in favor of Drive Pipeline. *Id.* at \*17.

In *Southern Union Co., et al., v. City of Edinburg*, 129 S.W.3d 74, 92 (Tex. 2003), one of the issues was whether the trial court erred in awarding punitive damages based on Southern Union’s failure to perform material obligations under a city ordinance. The court held that city ordinances were merely contracts with a city, and therefore “mere failure to perform a contract is not evidence of fraud.” *Id.* Consequently, in the absence of fraud in the inducement of the contract, exemplary damages were not recoverable by the City of Edinburg. *Id.*

In *Columbia Hospital Corp. of Houston v. Moore*, 92 S.W.3d 470,471 (Tex. 2002), the Texas Supreme Court held that prejudgment interest assessed under subchapter P of the Medical Liability and Insurance Improvement Act, TEX. REV. CIV. STAT. art. 4590i (the “Act”), was subject to the damages cap set forth in subchapter K of the Act.

Katherine Moore died after undergoing surgery. *Id.* at 471. Her family and estate brought suit against the hospital and the two doctors who treated her. The jury found in Moore’s favor and determined actual damages to be \$3 million. *Id.* The trial court applied the damage cap in subchapter K, section 11.02, of the Act and reduced the hospital’s liability for actual damages to \$1,305,691. *Id.* However, the court added \$300,487.79 in prejudgment interest to the capped amount pursuant to subchapter P, section 16.02, of the Act. *Id.*

The hospital appealed on the grounds that the trial court should not have excluded the prejudgment interest from the subchapter K damage cap. *Id.* Moore argued that the addition of subchapter P’s prejudgment interest provisions evidenced an intent by the Legislature to exclude prejudgment interest from the damage cap and that the only way to give effect to the mandatory language (“the judgment must include prejudgment interest on past damages found by the trier of fact”) in section 16.02(b) of subchapter P is to add prejudgment interest to the capped amount. *Id.* at 472.

A divided Texas Supreme Court sided with the hospital and relied on its decision in *Horizon/CMS Healthcare Corp. v. Auld*, 34 S.W. 3d 887 (Tex. 2000), which had reconciled

the damages cap in subchapter K with another prejudgment interest statute. The court found that the addition of subchapter P to the Act did nothing to change the nature of prejudgment interest awarded under subchapter P; prejudgment interest under subchapter P was compensation allowed as additional damages for loss of the use of money payable as damages from the date of the claim to the date of the judgment. *Id.* at 473. The court also found that the intent of the Act and subchapter K was to limit, not expand, a healthcare provider's liability and that subchapter P's purpose was also to reduce such liability by closing a loophole which had previously allowed claimants to receive prejudgment interest on future damages. *Id.* at 473-74. Thus, allowing prejudgment interest under subchapter P to be capped by subchapter K achieved the goals of both subchapters. *Id.* Just as in *Auld*, the court found that the damage cap was not irreconcilable with subchapter P's mandatory prejudgment interest award; prejudgment interest is awarded but it is subject to the cap. *Id.* at 474. Finally, the court looked at the legislative history of subchapter P to determine if the Legislature intended to uncapped prejudgment interest that had previously been capped. *Id.* The court decided that there was no evidence in the legislative history of such intent and held that the decision in *Auld* was still controlling. *Id.*

In *Miga v. Jensen*, 96 S.W.3d 207 (Tex. 2002), the court decided how to properly measure the damages to be awarded when an option contract for the purchase of stock is violated. Miga was hired by Jensen to help run a privately owned phone company. *Id.* at 209. In addition to his salary, Miga received a 6% ownership interest in the phone company. *Id.* When the phone company became a wholly owned subsidiary of another company called Matrix Communications, Miga's 6% interest in the phone company was converted into a 4.8% ownership interest in Matrix Communications. *Id.* At about this same time Miga set up a meeting between Jensen and the principals of Pacific Gateway Exchange ("PGE"), a privately owned company involved in the telecommunications business. *Id.* Jensen purchased 11,020 shares of the common stock of PGE. *Id.* Miga helped PGE secure several major clients. *Id.* To reward and encourage Miga, Jensen offered Miga an option to purchase 4.8% of Jensen's interest in PGE at Jensen's original cost. *Id.* The option allowed Miga to purchase 528.96 shares of PGE stock for \$40,800. *Id.*

About seventeen months after Jensen's offer, Miga resigned from Matrix Communications. *Id.* Miga tried to exercise the option to purchase PGE stock at this time but Jensen refused. *Id.* After several more fruitless attempts to exercise the option, Miga sued Jensen. *Id.* While the lawsuit was ongoing, the PGE stock split 940 for 1 and PGE made an initial public offering of the stock. *Id.* The stock reached a peak price of \$45.75 per share and was worth \$35.75 per share at the time of the trial. *Id.*

The jury found for Miga and awarded him \$1,034,400, the difference between the value of the stock at the time

Miga tried to exercise the option and the option price for the stock. *Id.* at 209-10. Miga was also awarded \$17,775,686 for what was described as "lost profits" by the court. *Id.* at 210. This amount approximated what the PGE stock would have been worth to Miga at the time of the trial had Miga been allowed to purchase the stock ( $[528.96 \times 940] \times \$35.75$ ). *Id.* The trial court awarded Miga both amounts and also granted Miga \$4,486,385.86 in prejudgment interest. *Id.* On appeal, the appellate court struck the award for \$1,034,400 as a double recovery and the prejudgment interest amount was found to be inequitable. *Id.* The "lost profits" award of \$17,775,686 was affirmed. *Id.*

The trial court had, at neither party's request, submitted a "lost profits" question to the jury which asked the jury to determine the amount of lost profits Miga suffered as a natural, probable and foreseeable consequence of Jensen's failure to comply with the option contract. *Id.* at 213. On appeal to the Texas Supreme Court, Jensen argued that that the trial court committed error when it submitted this "lost profits" question to the jury. *Id.*

The court considered the "lost profits" award and determined that it was not in fact an award for lost profits because lost profits are damages for the loss of net income to a business measured by reasonable certainty and there had been no testimony from Miga that he had suffered any business losses or had a particular profit expectation for the PGE stock. *Id.* In fact, Miga testified that he would not have sold the PGE stock had he received it. *Id.* The court felt that the "lost profits" award was actually the market gain of the stock measured at the time of the trial and that such an award was incorrect because, under the rule in Texas, damages in a breach of contract case are to be measured at the time of the breach. *Id.* at 213-14.

The court held that because the option contract was breached by Jensen on the day that Miga first attempted to exercise the option, the proper measure of damages was the difference between the value of the stock at the time of the breach and the option price. *Id.* at 215. The court noted that measuring damages at the time of the breach might be inadequate if the option contract was anticipatorily breached, such as when an option holder's right to exercise the option has vested but the other party repudiated the agreement before the option holder could exercise the option because, in such a case, the time for delivery of the stock could not be determined. *Id.* at 216. However, the court declined to state how damages should be measured under those circumstances because those were not the facts in the case before it. *Id.* The court also stated that its holding did not preclude an award for lost profits when an option, contract involving the purchase of stock is breached; Miga, however, was not entitled to such an award because he did not request it and offered no evidence in support of such an award. *Id.*

**B. New Legislation****1. H.J.R. No. 3: Amendment to Article III of the Texas Constitution**

On September 13, 2003, Texas voters voted to amend the Texas constitution and abolished any damage awards which do not compensate a party for his or her pecuniary losses or damages. Joint resolution H.J.R. No. 3, Tex. H.R.J. Res. 3, 78th Leg., R.S. (2003), amended Article III of the Texas Constitution by adding Section 66. Section 66 gives the Texas legislature the power to limit awards for non-economic damages. Tex. Const. art. III, § 66 (Vernon Supp. 2004).

Subsection (b) of Section 66 states that the legislature may, by statute, “determine the limit of liability for all damages and losses, however characterized, *other than economic damages*, of a provider of medical or health care with respect to treatment, lack of treatment, or other claimed departure from an accepted standard of medical or health care or safety, however characterized, that is or is claimed to be a cause of, or that contributes or is claimed to contribute to, disease, injury, or death of a person.” *Id.* (emphasis added). In subsection (a) the term “economic damages” is defined to mean “compensatory damages for any pecuniary loss or damage.” *Id.* The term does not include loss or damage for “past, present, and future physical pain and suffering, mental anguish and suffering, loss of consortium, loss of companionship and society, disfigurement, or physical impairment.” *Id.* The ability of the Legislature to limit non-economic damages applies regardless of whether the claim or cause of action arises under or derives from: (i) the common law; (ii) a statute; or (iii) other law, including causes of action based in tort, contract, or any other theory or combination of theories of liability. *Id.*

Although subsection (b) only applies to medical malpractice type claims, subsection (c) allows the Legislature to limit a defendant’s liability for non-economic damages in any civil lawsuit after January 1, 2005. *Id.* Like subsection (b), subsection (c) applies regardless of how or under what theory of liability the claim for non-economic is brought. *Id.* Although subsection (c) could potentially do away with exemplary damages and any other type of damage award which does not compensate a party for his or her pecuniary losses or damages, it will take a three-fifths vote of all the members elected to each house of the Texas Legislature before this could occur.

**2. H.B. 4: The Omnibus Civil Justice Reform Act**

A summary of the major portions of HB 4 (codified generally at TEX. CIV. PRAC. & REM. CODE ANN. §§ 33, 41, 42, 74 (Vernon Supp. 2004)), which took effect on September 1, 2003 with regard to damage awards, is as follows:

A. Article 2, (codified at TEX. CIV. PRAC. & REM. CODE ANN. §§ 42.001-.005 (Vernon Supp. 2004)), allows either party in a lawsuit to make a settlement offer. If a

defendant makes a written settlement offer in compliance with TEX. CIV. PRAC. & REM. CODE section 42.003 which is rejected by a plaintiff and the plaintiff’s final judgment is less than 80% of the defendant’s settlement offer, the plaintiff has to pay those litigation costs incurred by the defendant which were incurred after the date of the defendant’s settlement offer. TEX. CIV. PRAC. & REM. CODE ANN. § 42.004 (Vernon Supp. 2004). If the defendant rejects a settlement offer made by the plaintiff and the plaintiff recovers in excess of 120% of the plaintiff’s settlement offer, the defendant will have to pay the plaintiff’s post-settlement offer litigation costs. *Id.* Litigation costs are moneys actually spent and obligations actually incurred that directly relate to the lawsuit including court costs, the reasonable fees of up to two expert witnesses, and reasonable attorney’s fees. *Id.* The settlement offer provisions in section 42 do not apply to: (i) class actions; (ii) shareholder derivative actions; (iii) actions brought by or against a governmental unit; (iv) actions brought under the Family Code; (v) actions brought to collect workers’ compensation benefits; or (vi) actions filed in a justice of the peace court. TEX. CIV. PRAC. & REM. CODE ANN. § 42.002 (Vernon Supp. 2004).

B. Article 4, (codified at TEX. CIV. PRAC. & REM. CODE ANN. § 33.002-.004, .011-.013 (Vernon Supp. 2004)), which applies to any cause of action filed on or after July 1, 2003, gives a defendant an opportunity to reduce his or her damages by allowing the defendant to file a motion which designates another person as a Responsible Third Party. TEX. CIV. PRAC. & REM. CODE ANN. § 33.004 (Vernon Supp. 2004). The definition of Responsible Party in section 33.011 of the Texas Civil Practice and Remedies Code has been changed to mean “*any* person who is alleged to have caused or contributed to causing in any way the harm for which recovery of damages is sought . . .” *Id.* § 33.011 (emphasis added). A Responsible Party need no longer be a person over whom the court would have had jurisdiction, who could have been but was not sued, or who is or may be liable for the damages claimed by a claimant. *Id.* § 33.004. This change allows the responsibility of a party who is not being sued or who could not be sued to be determined by the trier of fact, potentially reducing the defendant’s percentage of responsibility and the damages for which the defendant will be liable. *Id.*

Texas Civil Practice and Remedies Code section 33.012 is also amended, so that a claimant’s damage award is reduced by the percentage of responsibility of each person who settled with the claimant rather than the dollar amount of the settlement. *Id.* § 33.012.

C. Article 6, (codified at TEX. FIN. CODE ANN. § 304.003 (Vernon Supp. 2004)) reduces the total amount a defendant might have to pay by reducing the post judgment interest rate and limiting the periods when

prejudgment interest may be assessed. The post judgment interest rate is now equal to the prime rate published by the Federal Reserve Bank of New York. *Id.* If the prime rate is less than 5%, then the post judgment rate is 5%. *Id.* If the prime rate is more than 15%, the post judgment rate is 15%. *Id.* The minimum and maximum post judgment interest rates are thus each reduced by 5% from 10% and 20% respectively. *Id.* Further, prejudgment interest may not be assessed or recovered on awards of future damages, and it is no longer possible, for prejudgment interest to accrue during periods of delay in a trial. *Id.*

D. Numerous sections have also been added to Chapter 74 of the Texas Civil Practice and Remedies. Subchapter G codified as section 74.301, limits the liability of physicians, health care providers and health care institutions for non-economic damages suffered by a claimant. TEX. CIV. PRAC. & REM. CODE ANN. § 74.301 (Vernon Supp. 2004). The term “claimant” includes all persons claiming to have sustained damages as the result of the bodily injury or death of a single person. *Id.* § 74.001(2). Each claimant is limited to a recovery of \$250,000.00 regardless of the number physicians or health care providers other than health care institutions sued or the number of separate causes of action which are brought. *Id.* § 74.301(a).

When a claimant sues a single health care institution, the health care institution’s liability for non-economic damages is also limited to \$250,000.00 per claimant. *Id.* § 74.301(b). If a final judgment is rendered against more than one health care institution, each health care institution’s liability is limited to \$250,000.00 per claimant but the total amount that each claimant may receive when suing multiple health care institutions is capped at \$500,000.00. *Id.* § 74.301(c).

E. Article 13 made numerous changes to Chapter 41 of the Civil Practice and Remedies Code which will made it more difficult for a claimant to recover exemplary damages. TEX. CIV. PRAC. & REM. CODE § 41.001-.004, .008, .010-.015 (Vernon Supp. 2004). However, the cap on exemplary damage amounts was not reduced. Chapter 41 now applies to an action in which a claimant seeks any damages, not just exemplary damages, and establishes the maximum damages that may be awarded in an action subject to Chapter 41, including an action for which damages are awarded under another Texas law. However, if the other law establishes a lower maximum damage amount, Chapter 41 will not apply with regard to damages.

Several of the definitions in section 41.001 have been changed and others have been added.

- ❖ The term “Claimant”, § 41.001(1), is no longer limited to persons who are seeking exemplary damages but now means a person seeking recovery of damages.

- ❖ A “Defendant”, § 41.001(3), is a person from whom damages are sought.
- ❖ The term “Economic Damages”, § 41.001(4), now means compensatory damages intended to compensate a claimant for actual economic or pecuniary loss and does not include exemplary damages or non-economic damages.
- ❖ “Exemplary Damages”, § 41.001(5), are damages awarded as a penalty or by way of punishment, but not for compensatory purposes, and includes punitive damages. Exemplary damages are neither economic nor non-economic damages.
- ❖ The term “Malice”, § 41.001(7), has been pared down to mean a specific intent by the defendant to cause substantial injury or harm to the claimant. The second half of the old definition of “Malice” is now contained in the new definition of “Gross Negligence”.
- ❖ “Compensatory Damages”, § 41.001(8), means economic and non-economic damages but not exemplary damages.
- ❖ “Future Damages”, § 41.001(9), means damages that are incurred after the date of the judgment but does not include exemplary damages.
- ❖ “Future Loss of Earnings”, § 41.001(10), means a pecuniary loss incurred after the date of a judgment and includes loss of income, wages, or earning capacity as well as loss of inheritance.
- ❖ “Gross Negligence”, § 41.001(11), is an act or omission: (i) which when viewed objectively from the standpoint of the actor at the time of its occurrence involves an extreme degree of risk, considering the probability and magnitude of the potential harm to others; and (ii) of which the actor has actual, subjective awareness of the risk involved, but nevertheless proceeds with conscious indifference to the rights, safety, or welfare of others.
- ❖ “Non-economic Damages”, § 41.001(12), means damages awarded for the purpose of compensating a claimant for physical pain and suffering, mental or emotional pain or anguish, loss of consortium, disfigurement, physical impairment, loss of companionship and society, inconvenience, loss of enjoyment of life, injury to reputation, and all other nonpecuniary losses of any kind other than exemplary damages.
- ❖ “Periodic Payments”, § 41.001(13), means the payment of money or its equivalent to the recipient of future damages at defined intervals.

Section 41.003(a) now states that a claimant may only be awarded exemplary damages if he or she proves by clear and convincing evidence that the harm for which the claimant seeks recovery of exemplary damages results from: (i) fraud; (ii) malice; or (iii) gross negligence. Section

41.003(c) remains unchanged, and a claimant may still recover exemplary damages allowed by another statute if the claimant proves by clear and convincing evidence that the other statute is applicable to the claimant's situation.

The big change to section 41.003 is contained in the new subsection (d). Subsection (d) basically equates exemplary damages with criminal penalties and states that exemplary damages may only be awarded if the jury "was unanimous in regard to finding liability for and the amount of exemplary damages." Section 41.003(d) would seem to give civil defendants the due process rights which the United States Supreme Court stated were necessary when requiring a civil defendant to pay exemplary damages. *See, State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 416 (2003), discussed supra in Section XX(C).

That part of former section 41.004(b) which allowed a claimant to recover exemplary damages even if the complainant was only awarded nominal damages as long as the complainant established by clear and convincing evidence that the harm for which exemplary damages were sought was the result of malice has been deleted. Section 41.004(b) now simply says a complainant may not be awarded exemplary damages if the complainant elects to have his recovery multiplied under another statute. TEX. CIV. PRAC. & REM. CODE ANN. § 41.004(b) (Vernon Supp. 2004).

Another change in Article 13 which functions to limit the amount of damages a defendant has to pay is the addition of a subchapter D to Chapter 18 of the Civil Practice and Remedies Code. *Id.* § 18.091(b). This new subchapter states that if a claimant seeks recovery for loss of earnings, loss of earning capacity, loss of contributions of a pecuniary value, or loss of inheritance, the claimant must present evidence of the loss net of any income taxes or unpaid tax liabilities the claimant would have owed on the claimed loss. *Id.*