Washington v. Kellwood Company: Applying an Aggressive Lost Profits Analysis, the Plaintiff is Awarded $1

Ben R. Duffy

This discussion summarizes the related Washington v. Kellwood Company *judicial decisions. Specifically, this discussion focuses on how the insufficient and ineffective damages measurement analyses performed by the plaintiffs' expert resulted in a multimillion dollar damages award being reduced to $1.*

Introduction

Washington v. Kellwood Company,[1] involves a breach of contract claim in which the plaintiff sought compensatory damages. The United States District Court for the Southern District of New York (the "District Court"), determined that a breach of contract existed, but the plaintiffs and their damages analyst were unable to produce a reasonable and persuading lost profits analysis. After multiple attempts to demonstrate a reasonable lost profits amount, the plaintiffs were awarded $1.

The District Court decision was upheld by the Unites States Court of Appeals, Second Circuit (the "Appeals Court"), bringing an end to more than a decade of litigation.

This discussion provides insight as to why the plaintiff damages expert's damages analysis was not accepted by the Appeals Court, and why the application of a thorough and more reasonable damages analysis could have resulted in a significantly greater damages award.

Specifically, this discussion (1) summarizes the plaintiff damages expert's yardstick analysis and (2) highlights the importance of considering if the selected damages measurement methods, analysis inputs, and damages conclusions are reasonable.

Background Summary

Sunday Players

Sunday Players was a compression sportswear start-up company founded by Daryl Washington ("Washington") in 2002. Washington believed that Sunday Players had a competitive advantage due to (1) its partnership with NFL player Izell Reese and (2) its "superior" clothing designs.[2]

During its entire period of operations, Sunday Players only generated less than $200,000 in sales. Sunday Players always lacked the capital to build or to purchase a manufacturing facility. Therefore, Sunday Players required assistance from another company in order to produce its clothing and clothing samples.

Kellwood Company

Kellwood Company ("Kellwood"), a private label clothing manufacturer founded in 1961, manufactured clothing that retailers could sell under their own brand names. Kellwood also manufactured clothing under its own brand names—in order to hedge against any earnings volatility in its private label business.

Kellwood was organized into several divisions, including a performance apparel division. The Kellwood performance apparel division operated

within the company's intimate apparel division. This organization structure was selected because the process of manufacturing compression wear is similar to the process of manufacturing female undergarments.

Terms of the Agreement

Sunday Players originally approached Kellwood. Kellwood had the manufacturing capacity and the capital to allow the Sunday Players brand to grow.

Initially, Kellwood had the intention to acquire Sunday Players. However, Washington was unwilling to sell the company outright. Instead, the parties agreed to an exclusive three-year license. The license included a three-year renewal option, exercisable only by Kellwood.

The license agreement entitled Kellwood the exclusive right to produce, manufacture, advertise, promote, import, distribute, and sell the Sunday Players brand. Kellwood agreed to spend 3 percent of the revenue generated from the sale of Sunday Players branded apparel on marketing the brand.

The license agreement included a carve-out, offering Washington the right to market the Sunday Players brand directly to universities, schools, and approved independent retailers and e-commerce platforms.

The license agreement also offered Washington 5 percent of all net sales derived from the Kellwood sale of Sunday Players branded apparel. But, the license did not guarantee a minimum payment. However, the license provided for Washington to receive an annual inventory of sample clothing, not to exceed $25,000.

The license agreement did not offer an early termination right to either party. And, the license required Sunday Players/Washington to give written notice if the opposite party was suspected of breaching the license.

Marketing Efforts

Kellwood made a strategic decision to postpone the marketing of Sunday Players products directly to consumers and sports teams until the Sunday Players merchandise was available in retail stores. Kellwood unsuccessfully attempted to sell Sunday Players merchandise to May Company, Olympia Sports, Modell's, Marshall Field, and other retail stores.

The Sunday Players marketing director, prior to the Kellwood license, took a different approach to marketing the brand. This executive believed that Sunday Players should use both a "top-down" approach and a "bottom-up" approach.

The top-down approach focused on endorsements and television exposure in order to bring the Sunday Players brand to the attention of young athletes. The bottom-up approach focused on Sunday Players sponsoring local sports teams and marketing directly through social media platforms.

Between November 2003 and April 2005, the Sunday Players sales representatives sold less than $150,000 of merchandise.[3]

During August 2003, the Kellwood performance division executive met with an MTV marketing executive to discuss a potential marketing deal for Sunday Players. The MTV marketing executive entertained the idea of placing Sunday Players products on MTV television programs and advertisements. However, the deal was contingent on Sunday Players selling $500,000 worth of performance apparel prior to receiving the advertising space.

In March 2004, Kellwood and MTV came to preliminary terms on a sublicense agreement. MTV agreed to produce and air a commercial for Sunday Players for a $50,000 fee, contingent on Kellwood selling $500,000 of Sunday Players merchandise. However, against the urging of Washington and MTV, Kellwood did not sign the sublicense agreement with MTV.

Breach of Contract

During March of 2005, Kellwood terminated the exclusive license agreement with Sunday Players after selling $0 in merchandise. Kellwood had also failed to market directly to consumers during the duration of the license agreement.

Washington filed a lawsuit and claimed lost profits and lost business value due to the Kellwood breach of the license contract. Washington claimed that the Kellwood early termination "destroyed the brand," ultimately putting Sunday Players out of business.

Washington submitted a letter to Kellwood, protesting the early termination and mentioning the absence of a termination provision in the licensing agreement. Washington also protested that Kellwood did not put forth a reasonable effort to market the Sunday Players brand effectively, by failing to (1) sign a contract with MTV, (2) buy advertising, or (3) sell to stores.

Kellwood did not respond to the letter submitted by Washington.[4]

Damages Measurement Analysis

Attempt at Recovering Lost Profits

Washington hired a forensic analyst to measure the economic damages associated with the Kellwood early contract termination and inadequate marketing attempts of the Sunday Players brand.

The Sunday Player forensic analyst constructed a lost profits and a lost business value damages analysis—by applying the yardstick method of damages measurement.

The Yardstick Method

One objective of an economic damages analysis is to measure the amount of lost profits related to the damages event from the current (analysis) date through the expected end of the damages period.

The yardstick method measures economic damages on the basis that the damaged company's projection is an independent variable, or a "yardstick." An independent variable is typically one that is easier to project than company projections (e.g., a widely accepted statistic or index).

In this case, the Sunday Players damages analyst relied on the historical sales performance of Under Armour, a market leader in the compression sportswear industry, as the "yardstick" in the damages analysis.

The damages analyst considered the following factors when evaluating the comparability of Under Armour and Sunday Players:[5]

- Manufacturing capability
- Retail distribution
- Business strategies
- Brand philosophy

The damages analyst concluded that the previously discussed television contract with MTV would have been comparable to the Under Armour television contract with ESPN. And, the Sunday Player contract should lead to a similar earnings growth trajectory.

The damages analyst concluded that the Sunday Players 2005 through 2007 revenue growth corresponded with the Under Armour 2002 through 2004 revenue growth. However, the damages analyst claimed that there were differences between Under Armour and Sunday Players that support an adjustment to the Under Armour revenue to better reflect the specific circumstances and risks associated with Sunday Players. These differences include (1) the Under Armour market dominance and (2) the increasing competition from other sportswear brands.

Based on these factors, the plaintiff damages analyst reduced the 2002 through 2004 Under Armour revenue by 50 percent. Therefore, the projected Sunday Players—or Kellwood—sales of Sunday Players merchandise for 2005 through 2007 was estimated to be $82,000,000.

The damages associated with royalties that were lost during this period were measured at:

1. $213,000 for the period between the inception of the contract and the Kellwood early termination and
2. $3,570,000 from termination through the end of the contract term.

The damages analyst also calculated that Sunday Players had lost $532,500 in brand value as of March 2005. The brand value damages measurement relied on the assumption of Sunday Players achieving 50 percent of the sales of Under Armour.

Initial Decision

In the initial District Court proceedings, "[t]he jury returned a verdict in favor of Washington, stating that Kellwood breached contract, and awarded Sunday Players with $250,000 in lost profits between November 14, 2003, and March 14, 2005; $4,100,000 in lost profits between March 14, 2005, and January 31, 2007; and, alternatively, $500,000 in lost market value as of March 14, 2005."[6]

However, Kellwood put forth a post-trial challenge to the amount of damages awarded by the jury. The challenge was made in the District Court, but with a different judge presiding than the judge in the initial jury trial.

Kellwood filed a motion under Federal Rule 50(a), which states, "if a party has been fully heard on an issue during a jury trial and the court finds that a reasonable jury would not have a legally sufficient evidentiary basis to find for the party on that

issue, the court may . . . resolve the issue against the party."

According to Kellwood, the application of Rule 50(a) was justified for the following reasons:

1. First, that Sunday Players had not proven that Kellwood breached any contractual obligation. And, second, that "the license agreement's language is explicit and unambiguous that…Kellwood shall spend 3 percent of gross sales" on marketing, and Kellwood met that obligation.[7]
2. Sunday Players and its damages analyst had not provided a reasonable basis for the assumption that Sunday Players would be able to achieve 50 percent of the revenue of Under Armour, if reasonable marketing efforts had been made by Kellwood.

The District Court accepted the Rule 50(b) motion. Rule 50(b) states the following:

> If the court does not grant a motion for judgment as a matter of law made under Rule 50(a), the court is considered to have submitted the action to the jury subject to the court's later deciding the legal questions raised by the motion. No later than 28 days after the entry of judgment—or if the motion addresses a jury issue not decided by a verdict, no later than 28 days after the jury was discharged—the movant may file a renewed motion for judgment as a matter of law and may include an alternative or joint request for a new trial under Rule 59. In ruling on the renewed motion, the court may:
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> 1. allow judgment on the verdict, if the jury returned a verdict;
> 2. order a new trial; or
> 3. direct the entry of judgment as a matter of law.

The District Court (1) rejected the analyst's damages analysis and (2) determined that the award for lost profits should be set aside due to a lack of reasonable and convincing evidence of lost profits. Initially, the District Court ordered a retrial, within the District Court, but with a new jury that had not been exposed to the previous expert testimony.

The District Court referenced *Ashland Management v Janien*, which states that "The law does not require that it [damages] be determined with mathematical precision. It requires only that damages be capable of measurement based upon known reliable factors without undue speculation."[8]

In addition, the District Court cited *Freund v. Washington Sq. Press, Inc.*, which states that a plaintiff should provide a "stable foundation for a reasonable [lost profits] estimate" or the claim "fails for uncertainty."[9]

The District Court pointed out that Sunday Players did not have (1) a record of profitability or (2) a reasonable basis to justify the existence of lost profits.

Sunday Players was a start-up business, lacking capital, brand recognition, and sales contracts. Sunday Players sought the license agreement with Kellwood in hopes that Kellwood would be able to (1) provide capital, (2) grow the Sunday Players brand, and (3) manufacture its clothing.

Although Sunday Players believed that the Kellwood license agreement would allow the Sunday Players brand to grow and succeed, the District Court found that the Sunday Players arguments for lost profits lacked support due to the company's lack of sales history.

However, Washington disputed that Sunday Players was not a "new business." Therefore, Sunday Players claimed that the District Court should consider the financial history and age of Kellwood when analyzing lost profits associated with the breach of contract.[10]

An additional argument against applying the Kellwood historical sales figures to those of Sunday Players was that Kellwood did not have a record of selling branded compression wear. Although Kellwood had manufactured private label compression apparel in the past, Kellwood did not have experience selling branded compression wear to retailers. Therefore, the District Court concluded that it was not reasonable to compare the Kellwood experience in selling private label compression clothing to the hypothetical success of Sunday Players clothing.

Since Sunday Players lacked sales history, lost profits could only be proven by comparing Sunday Players to a similar business with a sales record and obtainable financial data. Therefore, Sunday Players was limited to comparing itself with a public company. However, the majority of similar public companies were significantly larger than Sunday Players.

The District Court decided that the following were the important issues with the Sunday Players damages analyst selection of Under Armour as a comparable company.[11]

1. Lack of Causation: Sunday Players failed to prove that the marketing strategy of Under Armour would have been successful for Sunday Players.

2. Lack of Comparability: The sales history of Under Armour could not be used as a proxy to estimate the level of sales Sunday Players would have achieved because the companies vary significantly.
3. Lack of Understanding: There was not a common understanding between Washington and Kellwood that Sunday Players could have obtained 50 percent of the Under Armour revenue at the time the contract initiated.

While the facts of the case and certain information presented by Sunday Players supports the argument that the Kellwood breach of the license agreement was harmful, the District Court did not accept the Sunday Players claims for lost profits.

For the reasons discussed above, the jury's damages award was vacated, and a new damages trial was ordered in the District Court.

The District Court determined that at the subsequent trial, Sunday Players would not be permitted to apply the testimony of its damages analyst, under Federal Rules of Evidence 403. This was because the damages analyst's measurement presented a danger of "unfair prejudice" and "misleading the jury."[12,13]

The District Court determined that the jury at the subsequent trial was to be instructed on nominal damages, in the instance that Sunday Players cannot provide reasonable evidence for its lost profits claim.

Reattempt at Recovering Lost Profits

Before proceeding with a retrial, the District Court required that Sunday Players present enough nonspeculative evidence to warrant a retrial. This presented a second opportunity for Sunday Players to prove a realistic and supportable damages amount, since it was determined that Kellwood had in fact breached the license agreement.

Additional Evidence

After the District Court dismissal of the initial damages analysis, with measured damages of $4.35 million, Sunday Players increased its damages claim to a range of $5 million to $140 million.

Additional evidence that Sunday Players attempted to admit to the retrial included the following:

1. Profit projections produced by Kellwood
2. The Sunday Players business plan
3. MTV's projections and an MTV retail marketing executive's testimony
4. Washington's testimony
5. Sunday Players co-owners' testimony
6. The Sunday Players previous marketing strategist's testimony

The Kellwood profit projections and the Sunday Players business plan were not admitted as new evidence. This was because (1) both documents were available during the initial trial and (2) Sunday Players had the opportunity to present the documents as evidence at that time.

"Federal Rule of Civil Procedure 59(e) and Local Civil Rule 6.3 govern motions for reconsideration, and these rules are intended to ensure the finality of decisions and to prevent the practice of a losing party examining a decision and then plugging the gaps of a losing motion."[14]

The District Court considered the MTV projections to be solely hearsay. Since the MTV retail marketing executive did not perform the projections, could not produce the projections, and could not speak on behalf of MTV, the MTV projections were not admitted as evidence.

Washington's testimony as an experienced accountant was also not admitted. This is because the testimony was not admissible under Rule 701. Federal Rules of Evidence 701 only allows lay opinion testimony when it is "not based on scientific, technical, or specialized knowledge."

The testimonies of Curley Kelly, Izell Reese, and Christopher Plumlee were not admitted for the same reason as Washington's testimony, under Federal Rules of Evidence 701.

Sunday Players also attempted to reopen discovery and hire a new damages analyst. However, the District Court denied this request on the grounds that Sunday Players had intentionally and strategically relied on a single analyst in the first trial. And, that damages analyst had "engaged the jury in a flight of fancy that resulted in a multimillion dollar lost profits verdict for a company that sold less than $200,000 of merchandise in its entire history."[15]

Final District Court Ruling

The District Court determined that a retrial would be an exhaustive and unproductive use of the resources of the trial court and that it was unnecessary to proceed with a retrial.

The District Court stated that "Litigation is not an interative process." Therefore, the plaintiff's motion for a retrial was denied and the District Court offered the plaintiff a nominal award of $1.[16]

The District Court referenced *Parrish v. Sollecito* in stating that a reconsideration motion is not "a vehicle for a party dissatisfied with the court's ruling to advance new theories that the movant failed to advance in connection with the underlying motion, nor to secure a rehearing on the merits with regard to issues already decided."

Instead a "motion for reconsideration should be granted only when the defendant identifies an intervening change of controlling law, the availability of new evidence, or the need to correct a clear error or prevent manifest injustice."[17]

Appeals Court Decision

Washington appealed the District Court decisions to (1) exclude the damages measurement methodologies employed by the Sunday Players damages analyst, (2) deny the motion for a new trial on damages, and (3) award nominal damages in the amount of $1.

However, the Appeals Court upheld each of the District Court decisions.[18]

The Appeals Court affirmed the District Court opinion regarding the shortcomings of the plaintiff's expert's lost future profits analysis. The Appeals Court affirmed that "a new venture whose profits are 'purely hypothetical' and that would require 'untested' sales to 'hypothetical' consumers does not support a damages award."[19]

The Appeals Court determined (1) that the District Court was correct to opine that Under Armour was not a reasonable "comparator" and (2) that the damages analysis based on this comparator was so unfounded that it failed to establish any legal basis for awarding lost-profits damages.

The Appeals Court also determined that the District Court was correct to opine that the lost business value analysis provided by the plaintiff's damages analyst failed under the same premise as the lost future profits damages analysis. That is, both the lost business value damages analysis and the lost future profits analysis relied on Under Armour revenue as a "yardstick" comparison.

Practical Considerations

This case provides important lessons both for economic damages analysts and for litigation attorneys.

This case illustrates the importance of (1) selecting a reasonably comparable "yardstick" comparator in a yardstick analysis, (2) selecting reasonable economic damages measurement methods, and (3) considering the reasonableness of the overall damages conclusion.

In order to produce a supportable yardstick analysis, the damages analyst should carefully select the "yardstick." In this case, the yardstick applied by the Sunday Players damages analyst was not determined to be a reasonable basis for measuring lost profits.

When the subject company is a start-up, with no history of generating material revenue, a large publicly traded company is not likely to be a reasonable yardstick comparator. A damages analyst should consider if a guideline company would be reasonable for comparison in a business valuation analysis before relying on it as a comparable in a yardstick damages analysis.

The assumption that Sunday Players, having lacked sales history, could have achieved even half of the success that Under Armour had displayed was unsupportable.

In the instance that a reasonable yardstick cannot be determined for a lost profits measurement analysis, then the analyst may consider other damages measurement methods. Even if the analyst believes that the yardstick analysis is fair and reasonable, support provided by the application and consideration of multiple lost profit measurement methods may improve the damages analysis.

In the case of Sunday Players, the damages analyst may have reached a more reasonable damages conclusion by applying the "but for" method, or a lost profits method that incorporated projections available at the time the damages occurred.

In fact, in desperation, the plaintiffs attempted to introduce draft budgets for Sunday Players for consideration by the Appeals Court. This effort was rejected by the Appeals Court because Sunday Players had not established a foundation for introducing the new evidence. Had the damages analyst relied on the "but for" method and the more reasonable projections in the initial proceedings, the District Court may not have overturned the jury's initial damages award.

This lesson is valuable not only to damages analysts, but also to litigation counsel. Litigation counsel should work closely with damages analysts to ensure that the measurement methods being applied are reasonable, and that the damages analyst has all necessary information to conduct a supportable analysis. In the case of Sunday Players, both the damages analyst and the litigation counsel should have realized the absurdity of applying the yardstick method in the manner they did.

The damages analyst should have requested and considered any available projections when deciding what damages measurement methods to apply. Likewise, the litigation counsel should have ensured

that the relevant projections were obtained during discovery.

Finally, both the damages analyst and litigation counsel should consider the reasonableness of any conclusions reached before submitting an expert report.

The Sunday Players damages analyst got lost in the weeds when applying the yardstick method, considering specific product offerings and making adjustments to the Under Armour revenue to reflect prevailing market conditions. The damages analyst failed to consider that no reasonable level of adjustments could account for the vast difference in size and maturity between Sunday Players and Under Armour.

Both the District Court and the Appeals Court were quick to recognize this fatal flaw in the plaintiff's damages measurement analysis. That is, a market leader with hundreds of millions of dollars in revenue was nowhere near a reasonable "yardstick" comparator for Sunday Players.

The Sunday Players litigation counsel should have considered the reasonableness of the damages conclusion and not submitted an expert report that could be so easily dismissed by both the District Court and the Appeals Court. Prior to submitting an expert report, the litigation counsel should be prepared to defend their damages analyst's methodology and conclusions.

Further, given a second chance to submit a more reasonable damages measurement analysis, the plaintiff submitted an even higher range of damages. By submitting a damages measurement range of $5 million to $140 million, after the initial damages award of $4.35 million was vacated as unreasonable, the District Court had no choice but to conclude that the plaintiffs had no intention of pursuing a realistic damages award. The litigation counsel should have seen the writing on the wall and submitted a damages measurement range that was potentially palatable to the District Court.

Conclusion

This case study highlights the importance of putting forth a damages measurement analysis that is both reasonable and supportable. This lesson applies to (1) the inputs relied on in applying a damages measurement method, (2) the methods relied on in conducting a damages measurement analysis, and (3) the conclusions reached in the damages measurement analysis.

In the case of Sunday Players, (1) Under Armour was not a reasonable yardstick comparator for a start-up company, (2) the yardstick method was likely not the most appropriate method available given the lack of comparable publicly traded companies, and (3) damages measurement conclusions ranging from $4.35 million to $140 million were not reasonable for a company with total sales of less than $200,000.

If the Sunday Players damages analysis had been more reasonable, and if other methods for measuring lost profits had been applied, then Sunday Players may have received a significantly greater award than $1.

Notes:

1. Washington v. Kellwood Company, 05-CV-10034 U.S. Dist. Ct., 2016 WL 3920348 (S.D.N.Y. July 15, 2016).
2. Id.
3. Id. at *3.
4. Id.
5. Id. at *4.
6. Id.
7. Id.
8. Ashland Management, Inc. v. Janien, 82 N.Y.2d 395, 403 (N.Y. App. 1993).
9. Freund v. Washington Sq. Press, Inc., 34 N.Y.2d 379 (1974).
10. Washington v. Kellwood Company at *7.
11. Id.
12. Federal Rules of Evidence 403 states that the court may exclude relevant evidence if its probative value is substantially outweighed by a danger of one or more of the following: unfair prejudice, confusing the issues, misleading the jury, undue delay, wasting time, or needlessly presenting cumulative evidence.
13. Washington v. Kellwood Company at *13.
14. TufAmerica, Inc. v. Diamond, 12-cv-3529 (AJN), 2016 WL 3866578 (S.D.N.Y. July 12, 2016).
15. Washington v. Kellwood Company, 05-CV-10034 U.S. Dist. Ct., 2016 WL 5680374 at *8 (S.D.N.Y. Sept. 30, 2016).
16. Id. at *1.
17. Parrish v. Sollecito, 253 F. Supp. 2d 713, 715 (S.D.N.Y. 2003).
18. Washington v. Kellwood Company, 714 Fed. Appx. 35 (2nd Cir. 2017).
19. Id. at 40.

Ben Duffy is an associate in our Atlanta practice office. Ben can be reached at (404) 475-2326 or at brduffy@willamette.com.