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Lost profits should be determined as of the time of the breach

In commercial real estate cases, defendants should not be allowed to use the date of the trial, which would allow them to benefit from post-breach changes in the market.

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In February 2009, President Barack Obama described the recent real estate market collapse as a "crisis unlike any we've ever seen before" and a crisis "that not only threatens the stability of our economy but also the stability of families." But should the dramatic shifts in the market that occurred in the past few years affect the amount a commercial real estate plaintiff may recover for claims arising before the Great Recession? Whether post-breach market fluctuations should diminish a plaintiff's lost-profits recovery has become an increasingly important issue in commercial real estate cases that are coming to trial in the aftermath of the real estate market collapse.

Black-letter law dictates that in breach-of-contract cases implicating lost profits, plaintiffs are entitled to recover their "expectancy damages"; plaintiffs can recover what they reasonably anticipate they would have earned had the breach not occurred. Another well-accepted axiom of contract law is that a plaintiff's damages are to be determined at the time of the breach and later events, such as fluctuations in market value after the breach, do not affect the plaintiff's measure of damages.

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However, the recent market downturn has sparked litigation about whether that general rule should apply in situations in which the plaintiff is seeking to recover its lost future profits in a market that has been dramatically affected by the global financial crisis. In essence, because of decreasing property values between 2008 and today, defendants in real estate litigation are increasingly taking the position that a plaintiff's damages should be far lower — or even nonexistent — because damages should be calculated at the time of trial instead of the time of the breach. Accordingly, defendants have increasingly begun to argue that courts should depart from the general rule of measuring damages as of the date of breach and instead consider post-breach changes in the market when determining plaintiffs' lost-profit damages. And in some instances these arguments have begun to work.

For example, In November 2010, the U.S. District Court for the District of Columbia sided with the defendants in a commercial real estate dispute, holding that the plaintiff's lost-profit damages should be calculated based upon the post-breach market conditions at the time of trial. That decision reduced the plaintiff's claimed damages from $33 million to just $6.7 million. *Capitol Justice LLC v. Wachovia Bank N.A.*, No. 1:07-cv-02095 (D.D.C. Nov. 22, 2010) (order denying plaintiff's motion in limine).

A similar situation occurred when Gray Development Group purchased part of a master planned community in northeast Phoenix called Desert Ridge in 2004 to develop an apartment complex. Construction was set to begin in mid-2006, but

because of various breaches by the defendant committed in late 2005 through 2006, Gray Development was prevented from building and forced to abandon the project. In February 2007, the plaintiff filed a civil lawsuit seeking to recover the future lost profits, and the case eventually came to trial in June 2010. The plaintiff argued that lost-profit damages should be measured as of the time of the breach in 2006. The defendants argued for a damages assessment based on 2010 market conditions. Under the defendant's trial date framework, the plaintiff's measure of damages was completely dependent on when the case was tried, and damages would be driven by the market data at that moment, which would make when the breach actually occurred irrelevant in determining damages.

Using the defendant's trial-date framework, depending on which arbitrary date a case actually goes to trial, a plaintiff can recover anywhere from zero to millions of dollars. This can be true even though in all situations the defendant committed the same breach, in the same way, at the same time, and against the very same plaintiff, in connection with the same commercial real estate project. The only variable is the date the case actually goes to trial, and when a case goes to trial is arbitrarily affected by trial-setting factors that are unrelated to the facts of the case, and largely are outside the parties' control.

The trial-date framework is especially troubling when you consider how easy it can be for a party to manipulate the date a case actually goes to trial. For instance, a plaintiff could choose to hold the filing of its lawsuit, awaiting a time when the market is more advantageous to its damages calculation. Alternatively, depending on the market trend, either party could use a number of different pretrial delay tactics — confected discovery disputes, multiple summary judgment motions, interlocutory appeals — to push off the trial until the market is more favorable for their position.

Although courts in several jurisdictions, including Arizona in *Rhue v. Dawson*, 841 P.2d 215 (Ariz. Ct. App. 1992), have applied the general damages rule to future lost-profit damages in commercial real estate cases, holding that "market fluctuations after the contract is breached are not relevant in measuring contract damages," a majority of jurisdictions have not had the opportunity to address the issue. After careful consideration, the Arizona trial court discussed earlier allowed the plaintiff to put on its proof of lost-profit damages based on 2006 market data and permitted the defendant to cross-examine the plaintiff's expert and offer rebuttal evidence on his failure to consider post-breach actual market conditions in his analysis. *Epicenter Partners LLC v. Northeast Phoenix Partners*, No. LC2007-000011 (Maricopa Co., Ariz., Super. Ct. March 9, 2010) (order denying in part defendants' motion for summary judgment). As juries often do, this Arizona jury adopted a common-sense approach and declined the defendant's invitation to give the defendants the "benefit" of the collapse of the U.S. real estate market when awarding plaintiff Gray Development its full measure of lost-profit damages.

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