Case No. S191550

IN THE SUPREME COURT OF CALIFORNIA

SARGON ENTERPRISES, INC.,
Plaintiff and Respondent,

v.

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

After a Decision by the Court of Appeal, Second Appellate District,
Division One, Case Nos. B202789 & B205034
Original Appeal from the Los Angeles County Superior Court,
Case No. BC 209992 and Related Case No. BC 263071
The Honorable Terry A. Green and Marvin M. Lager, Judges Presiding

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APPLICATION FOR LEAVE TO FILE BRIEF *AMICI CURIAE* AND PROPOSED BRIEF OF AMERICAN COUNCIL ON EDUCATION AND OTHER HIGHER EDUCATION ASSOCIATIONS AND INSTITUTIONS IN SUPPORT OF APPELLANTS

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AMICI ON THIS BRIEF

American Council on Education

Association of American Universities

Board of Trustees of Leland Stanford Junior University

California Institute of Technology

Council on Governmental Relations

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APPLICATION FOR LEAVE TO FILE BRIEF *AMICI CURIAE* IN SUPPORT OF APPELLANTS

To the Honorable Tani Cantil-Sakauye, Chief Justice:

Pursuant to California Rule of Court 8.520(f), the American Council on Education, the Association of American Universities, the Board of Trustees of Leland Stanford Junior University, the California Institute of Technology, and the Council on Governmental Relations respectfully request permission to file a brief as *amici curiae* in support of appellant the University of Southern California.

No party or counsel for a party authored the proposed brief in whole or in part or made a monetary contribution intended to fund the preparation or submission of the brief. No other person or entity made a monetary contribution intended to fund the preparation or submission of the brief, other than the *amici curiae*, their members, or their counsel.

I. INTEREST OF *AMICI CURIAE*

Amici curiae are non-profit higher education associations and institutions with an interest in the fair and predictable application of California law to academic research agreements.

The American Council on Education ("ACE"), a national educational association founded in 1918, represents all sectors of American higher education. Its membership of nearly 1,800 institutions includes a substantial majority of the nation's colleges and universities. As a leading

participant in higher education affairs, ACE's purpose is to further the goals of higher education including the interests of all members of the academic community—students, faculty, administration, and the institutions themselves. ACE's initiatives address issues of national importance, including the responsiveness of colleges and universities to the nation's needs.

The Association of American Universities ("AAU"), which was founded in 1900, represents 63 public and private major research universities. AAU focuses on issues that are important to research-intensive universities, such as funding for research, research policy issues, and graduate and undergraduate education.

The California Institute of Technology and the Board of Trustees of the Leland Stanford Junior University are two of the leading research universities of the world.

The Council on Governmental Relations ("COGR") is an association of over 185 research universities and their affiliated academic medical centers and research institutes. COGR concerns itself with the influence of federal regulations, policies, and practices on the performance of research conducted at its member institutions.

II. PURPOSE OF PROPOSED BRIEF

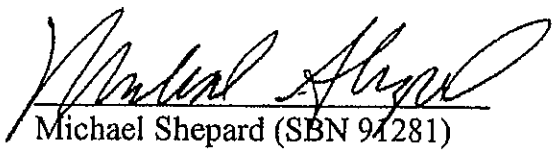
The issues raised in this case are of great significance to *amici* and their member institutions. In this dispute relating to a research agreement between a private company and an academic research institution, the plaintiff company seeks to introduce highly speculative expert testimony about its future lost profits. Allowing such testimony would turn research agreements into a high-stakes gamble for universities, opening the door to astronomical damages claims based on speculation rather than science. *Amici* have an interest in fair and predictable evidentiary rules.

If granted leave to file a brief, *amici* would contribute to the Court's understanding of the important issues in this case. The proposed brief addresses the importance of university-industry research agreements for innovation, the advancement of education, and California's economy. It also identifies likely adverse effects if trial judges are stripped of their ability to screen out speculative expert testimony on lost profits damages. As the proposed brief explains, affirmance in this case would destabilize the longstanding and productive research partnership between private industry and higher education. *Amici* respectfully submit that their familiarity with these issues will assist the Court in resolving this case.

III. CONCLUSION

For the foregoing reasons, *amici* respectfully request leave to file the attached brief.

Respectfully submitted,



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Dated: December 14, 2011

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PROPOSED BRIEF OF *AMICI CURIAE* AMERICAN COUNCIL ON EDUCATION AND OTHER HIGHER EDUCATION ASSOCIATIONS AND INSTITUTIONS IN SUPPORT OF APPELLANTS

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ISSUE TO BE BRIEFED AND ARGUED

Whether the trial court erred in excluding the proffered expert opinion testimony regarding lost profits.

ARGUMENT

In this case involving an academic research agreement between a private company and a university, the company, Plaintiff-Respondent Sargon Enterprises, Inc. ("Sargon"), urges the adoption of a rule that would curtail trial courts' discretion to exclude highly speculative expert testimony on alleged lost profits. Such a rule would be against the public interest. It would jeopardize the integrity of academic research, inhibit the conduct of vital research, and substantially divert essential university resources. The Court should reaffirm that trial judges retain the discretion to exclude unreliable expert testimony and should reverse the judgment of the Court of Appeal.

By requiring trial courts to admit speculative and unreliable expert testimony on supposed lost profits, Sargon's proposed rule would facilitate exorbitant damages claims against non-profit research organizations by start-up companies claiming to be the next market leader in their industry. Many start-up companies enter into clinical trial agreements with universities, but only a tiny fraction of these companies go on to match the profits of industry leaders. Exaggerated and speculative lost profit damages claims would divert university resources from the institutions' core

missions and discourage universities from conducting industry-sponsored research, to the detriment of society.

I. RESEARCH PARTNERSHIPS BETWEEN PRIVATE INDUSTRY AND UNIVERSITIES DRIVE INNOVATION AND ARE CRUCIAL TO THE VITALITY OF CALIFORNIA'S ECONOMY.

California and the nation benefit tremendously from academic research. University-industry relationships foster scientific innovation, enhance teaching and scholarship, and enable public access to pathbreaking medical and other research advances. For example, collaborations between Stanford University and California Institute of Technology scientists and private industry have brought to the world the remarkable fruits of fundamental breakthroughs in genetic medicine and given rise to much of the modern biotechnology industry. (See, e.g., Hans Wiesendanger, Stanford University Office of Technology Licensing, A History of OTL (2000), http://otl.stanford.edu/about/about_history.html; see generally Stanford University Office of Technology Licensing, http://otl.stanford.edu/.)

The products of such academic-industry partnerships spur economic growth. "Approximately $30 billion of economic activity each year, supporting 250,000 jobs, can be attributed to the commercialization of new technologies from academic institutions." (Council on Governmental Relations, The Bayh-Dole Act: A Guide to the Law and Implementing

Regulations (Oct. 1999) p. 9; see also David Roessner et al., The Economic Impact of Licensed Commercialized Inventions Originating in University Research, 1996–2007 (Sept. 3, 2009) pp. 7–8 [estimating that, over a twelve-year period, certain university-industry collaborations created more than 279,000 jobs and contributed as much as $457.1 billion to the nation's gross industrial output].) These relationships are crucial to the vitality of California's economy. Productivity gains derived through University of California research, for example, were predicted to contribute "an estimated $5.2 billion to the growth in Gross State Product and create more than 104,000 new jobs between 2002 and 2011." (ICF Consulting, California's Future: It Starts Here: UC's Contributions to Economic Growth, Health, and Culture (Mar. 2003) p. 4-9.)

II. A RULE CURTAILING TRIAL COURTS' DISCRETION TO EXCLUDE SPECULATIVE EXPERT TESTIMONY WOULD DESTABILIZE THE LONGSTANDING AND PRODUCTIVE RESEARCH PARTNERSHIP BETWEEN PRIVATE INDUSTRY AND HIGHER EDUCATION.

Under the Evidence Code, an expert's opinion must be "[b]ased on matter . . . that is of a type that reasonably may be relied upon by an expert in forming an opinion upon the subject to which his testimony relates." (Evid. Code, § 801, subd. (b).) The rule confides to the trial judge a crucial gatekeeping function. He or she must screen unreliable expert testimony from the jury's consideration, determining whether the underlying

methodology is based in science and logic. The trial court has "wide discretion to exclude expert testimony . . . that is unreliable." (*People v. McWhorter* (2009) 47 Cal.4th 318, 362.)

The expert testimony at issue in this case vividly illustrates the dangers of curtailing this judicial gatekeeping function. The expert would have invited the jury to predict Sargon's future lost profits by comparing Sargon—a company with fewer than twenty employees and around $100,000 in annual profits at its peak—to the six most successful dental implant companies in the world. The Court of Appeal summarized the expert's methodology as follows:

> [The expert] would have opined that had USC not breached its contract, Sargon would have obtained a market share comparable to a handful of the world's leading dental implant companies. Using this analysis, the jury would have compared Sargon with companies having a market share of 4.8 percent, 7 percent, 17 percent, and 22–23 percent, with profits from $220 million on the low end to $1.1 billion on the high end. The jury would have been asked to select the company most comparable to Sargon and award the corresponding amount for lost profits.

(Typed Opn. 28–29.)

That flawed approach would have lured the jury into a form of reasoning long known to be dangerously tempting yet fallacious. Decision makers err when they make predictions based on resemblance between two things while ignoring the background odds or "base rate." (See Amos Tversky & Daniel Kahneman, Judgment Under Uncertainty: Heuristics and

Biases (1974) 185 Science 1124, 1124–26; see also Jonathan J. Koehler, When Do Courts Think Base Rate Statistics Are Relevant? (2002) 42 Jurimetrics J. 373, 401 ["Nearly thirty years ago, the influential researchers Amos Tversky and Daniel Kahneman . . . identified the failure to understand the relevance of base rates . . . to be 'one of the most significant departures of intuition from the normative theory of prediction.' "].) It would be erroneous, for example, to predict that a child will grow up to win a Nobel Prize based on her outstanding performance in school, without considering the very low odds that *any* child will win a Nobel Prize. Too, the long odds against any given start-up company becoming an industry leader must figure in the lost-profits calculus.

For reasons having little to do with the "innovativeness" of their products (AB 50), the great majority of start-up companies fail entirely or achieve only modest success. Of the hundreds of companies that enter into clinical research agreements with universities, the number that go on to replicate the commercial successes of industry leaders is miniscule. And while many new drugs and medical devices are approved each year by the Food and Drug Administration, only a tiny fraction become "blockbuster" products. This overwhelming rate of failure is not driven by a lack of innovation; indeed, a majority of entrepreneurs believe their company offers some advantage over its competitors. (Scott Shane, Why Do Most

Start Ups Fail? (Sept. 26, 2011) Small Business Trends, http://smallbiztrends.com/2011/09/why-do-most-start-ups-fail.html.) Many promising start-up companies stumble because of poor management, unfavorable market conditions, insufficient financing or simply bad luck.

The exceedingly low background odds of success should be incorporated into any prediction of a start-up company's future profits. Sargon's expert would have turned the proper inquiry on its head. To ask a jury to predict, based on a comparison to industry success stories, the future profitability of a technology start-up company is to invite a grossly inflated probability judgment. As the trial court pointed out, the projections of Sargon's expert unrealistically assumed that Sargon "would have made the seamless transition from a three-person operation to sharing industry leadership with Nobel Biocare, a multi-million dollar international corporation."

If trial judges are not permitted to screen out baseless expert theories of that sort, clinical research agreements will become "ticket[s] in a litigation lottery." (*Moore v. Regents of the Univ. of Cal.* (1990) 51 Cal.3d 120, 146.) Start-up companies would be encouraged to circumvent the long and uncertain process of developing and marketing a product, resting instead on bare claims that they would have been the next Google or Amgen if the sponsored research had turned out as they had hoped. Trial

judges must have the freedom to separate speculation from scientifically rooted expert opinion.

Disregard for the trial court's gatekeeper function is especially harmful in the context of research agreements, where predictions about profits a company supposedly would have made are inherently unreliable. Clinical trial agreements and other research sponsorship arrangements are unlike commercial contracts in which a particular result is promised. Until a clinical trial has been conducted, its results are uncertain. Whether a study will turn out favorably or unfavorably for a corporate sponsor, much less whether the findings will lead to a measurable increase in profits, is unknown. As one Nobel laureate aptly observed, "research is risky: if you knew the outcome, it would not really be research. There is an inherent uncertainty about research." (Joseph P. Stiglitz, Economic Foundations of Intellectual Property Rights (2008) 57 Duke L. J. 1693, 1712.) Indeed, it is precisely because the results are not foreordained, and the outcome is thus perceived as credible, that companies sponsor clinical trials conducted by unbiased academic researchers. Translating those uncertainties into reasonable predictions of a company's future success is a delicate task that calls for careful consideration of the underlying probabilities.

If, as Sargon proposes, trial judges were stripped of their discretion to scrutinize and screen out unreliable predictions of future success, the

fruitful partnership between industry and academia would be destabilized. The prospect of enormous lost profit claims, driven by baseless expert testimony, would tend to undermine the integrity and independence that are vital to academic research. Researchers bringing to light unfavorable results would be susceptible to an increased risk of litigation from a sponsor dissatisfied with research outcomes.

The threat of seeing speculative lost-profits evidence submitted to a jury would also skew the research agenda toward risk-avoidance and away from collaborative advancement of new therapies and other valuable innovations vital to the nation's scientific needs. Faced with "the whip of a giant 'lost future profits' award," (*Postal Instant Press, Inc. v. Sealy* (1996) 43 Cal.App.4th 1704, 1718), research institutions may conclude that they must reduce significantly, or avoid, research activity sponsored by industry. Such an outcome would impede research and its benefits to public health and well-being and would weaken California's economy.

Finally, wildly exaggerated damages based on speculative profitability projections would drain limited institutional resources. As federal and state budgets have tightened, academic institutions, which generally charge sponsors modest amounts to conduct clinical research, have had to perform research with ever more carefully husbanded resources. Fueled by unreliable testimony, lost-profit liability under

research agreements would divert resources from core academic missions—teaching, research, and public service—to for-profit business ventures.

CONCLUSION

For these reasons, we urge the Court to reaffirm that trial judges retain "wide discretion" to exclude unreliable expert testimony. (*People v. McWhorter* (2009) 47 Cal.4th 318, 362.) Because the trial court in this case properly excluded the speculative testimony of Sargon's expert, the judgment of the Court of Appeal should be reversed.

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Dated: December 14, 2011

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CERTIFICATE OF COMPLIANCE

Pursuant to California Rule of Court 8.520, the foregoing Brief Amici Curiae is double-spaced and printed in Times New Roman 13 point font. It is 9 pages long and contains 1,792 words (excluding the cover page, the tables, the signature block, this certificate, and the proof of service). In preparing this certificate, I relied upon the word count generated by Microsoft Word 2010.

Executed on December 14, 2011, at San Francisco, CA.

Michael Shepard

PROOF OF SERVICE

I hereby declare that I am a citizen of the United States, am over 18 years of age, and am not a party in the above-entitled action. I am employed in Washington, D.C., and my business address is Hogan Lovells US LLP, 555 Thirteenth Street, NW, Washington, D.C. 20004.

On **December 14, 2011**, I served the attached document described as **AMICI CURIAE APPLICATION AND PROPOSED BRIEF** on the interested parties in this action as follows:

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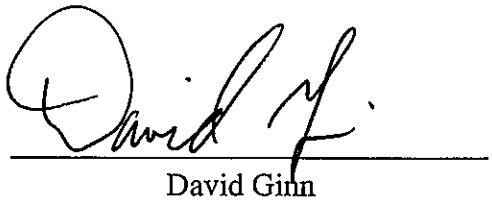
I, David Ginn, declare under penalty of perjury that the foregoing is true and correct.

Executed on **December 14, 2011**, at Washington, D.C.



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