

Economic damages:

Recovering What Was LOST



A business can suffer economic damages arising from a variety of illegal conduct. Common examples include breach of contract, patent infringement and commercial negligence. If your company finds itself headed to court looking to recover lost profits, diminished business value or both, it's important to know how the damages might be determined.

What methods are commonly used? The goal of any economic damages case is to make your company, the plaintiff, “whole” again. In other words, one critical question must be answered: Where would your business be today “but for” the defendant’s alleged wrongdoing? When financial experts calculate economic damages, they generally rely on the following methods:

Before-and-after. Here, the expert assumes that, if it hadn’t been for the breach or other tortious act, the company’s operating trends would have continued in pace with past performance. In other words, damages equal the difference between expected and actual performance. A similar approach quantifies damages as the difference between the company’s value before and after the alleged “tort” (damaging incident) occurred.

Yardstick. Under this technique, the expert benchmarks a damaged company’s performance to external sources, such as publicly traded comparables or industry guidelines. The presumption is that the company’s performance would have mimicked that of its competitors if not for the tortious act.

Sales projection. Projections or forecasts of the company’s expected cash flow serve as the basis for damages under this method. Damages involving niche players and start-ups often call for the sales projection method, because they have limited operating history and few meaningful comparables.

An expert considers the specific circumstances of the case to determine the appropriate valuation method (or methods) for that situation.

What’s next? After financial experts have estimated lost profits, they discount their estimates to present value. Some jurisdictions have prescribed discount rates, but, in many instances, experts subjectively determine the discount rate based on their professional opinions about risk. Small differences in the discount rate can generate large differences in final conclusions. As a result, the subjective discount rate is often a contentious issue.

The final step is to address mitigating factors. What could the damaged party have done to minimize its loss? Most jurisdictions hold plaintiffs at least partially responsible for mitigating their own damages. Like discount rates, this subjective adjustment often triggers widely divergent opinions among the parties involved.

Are you prepared? You probably don’t relish the thought of heading to court to fight for economic damages. But these situations can occur — often quite unexpectedly — and it’s better to be prepared than surprised. Contact us for more information.