

The Three Legs of the Damages Stool...Determining Lost Profits

The purpose of a lost profits determination is to make the damaged party whole. In other words, damages awards should put the damaged party in the same financial position or condition that it would have been in "but for" the other party's wrongful actions.

The two most used approaches in determining economic damages are:

- To measure the lost profits that would have happened "but for" the wrongdoing minus the actual amount of profits realized as a result of the breach.
- To determine the lost economic value -- the diminution in value -- of a damaged business or business segment as a result of the breach.

Most financial experts and attorneys are tuned in to these methods of determining lost profits. But it's also a good idea to be aware of, and review, the three legs of the damages stool -- or the metrics that must be met for the damages claim to be accepted and hold up in a court of law:



1. Proximate Cause

There must be a link between the defendant's alleged wrongdoing and the occurrence of economic damages. It's possible that not all of the loss of profits or value resulted from the defendant's actions. It's incumbent on the expert to eliminate other possible causes of damages and adjust for their impact. For example, there could be changes in the marketplace, economy and industry that should be explored and explained by the expert.

2. Reasonable Certainty

In most jurisdictions, lost profits or damages must be determined with "reasonable certainty." According to one court case, 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 and data from which the amount of lost profits can be ascertained." (*Holt Atherton Indus., Inc. v. Heine*, 835 S.W.2d 80, 84, Tex. 1992).

The true burden is establishing the facts that underpin the determination of lost profits. This standard discourages speculation or conjecture and requires that assumptions and projections must have a "reasonable basis" and provides for the most likely outcome.

Note: The determination of lost profits or damages is not provable by fact alone, however. It is by nature what *would* have happened as opposed to what *did* happen.

In supporting reasonable certainty, the expert must consider how long the business has operated and whether or not it is a startup company. How does the business compare with other businesses? Was the plaintiff able to perform the operation on which the calculation of lost profits is based? There are many considerations that depend on the facts and circumstances of the case.

3. A Foreseeable Event

A loss is foreseeable if it would ordinarily be expected to result from a breach or if the breaching party had reason to know of particular circumstances that would make the loss likely. This serves to focus the liability only to those consequences connected to the defendant's actions.

Foreseeability is a close cousin to proximate cause in that both require a focus on the specific damages that result from the breach at hand. All other causes not related to the breach must be considered and eliminated and no unforeseen damages can be included.

For example, it is not appropriate for the expert to include damages (or lost profits) related to a "new product" that the injured party claims to have been in process but delayed or destroyed as a result of the breach -- unless there is proof of the new product's existence or planning that can be supported.

Standing on Solid Ground

As you can see, these three legs of the stool are closely related but are all important for an expert and an attorney to consider and support before submitting a damages report to the court. The attorney and expert should work together as a team to insure that the damages calculation meets all three tests and that the stool remains standing. Gryphon Valuation Consultants has assisted many attorneys and their clients with a variety of litigation issues, including the determination of lost profits. Please contact us at (702) 870-8258 for more information.

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