



Lost profits vs. lost value in the calculation of economic damages

John T. Alfonsi

Lost profits vs. lost value in the calculation of economic damages

by John T. Alfonsi



John T. Alfonsi, Managing Director at **Cendrowski Corporate Advisors (CCA)**, is a recognised business valuation and economic damages expert, and has presented expert witness testimony on numerous occasions. He also provides tax planning and consulting services, and is an adjunct professor for Walsh College's Master of Science in Taxation programme.
Contact John.

Economic damages are awarded to make the plaintiff whole as a result of the defendant's actions. In breach of contract cases, the most

commonly sought damages relate to lost profits. Lost profits are the difference between the plaintiff's actual profits and the profits the

plaintiff would have realised but for the defendant's actions. Often, the economic damages are more properly measured by

lost business value – the difference between the value of the plaintiff's business immediately before and after the defendant's actions. Damages experts need to consider all the facts in determining which measure of damages is most appropriate. They must also ensure that their calculations of damages do not overlap so as to avoid a duplicate recovery of the same loss.

Both lost profits and lost business value are generally measured by

the discounted value of lost income – incremental pre-tax cash flow for lost profits, and net after-tax cash flow for lost business value. Both need to consider an appropriate discount rate, and both consider expenses – incremental expenses in lost profits and all applicable expenses in loss of business value. The threshold question is whether the lost cash flow is for a finite period (lost profits) or is permanent/indefinite (lost business value).



By way of example, assume a plaintiff entered into a 5-year contract to provide parts. After year two, the defendant terminated the contract, constituting a breach. Economic damages would be measured by the lost profits (lost revenue less the incremental expenses related to the revenue) for the remaining 3-year term of the contract. Alternatively, assume the defendant's actions resulted in a permanent loss of all or a portion of the business (e.g. destruction by fire, elimination of a division); economic damages would more properly be measured by the loss in

GGI member firm

Cendrowski Corporate Advisors

Bloomfield Hills (MI), USA

T: +1 248 540 5760

Advisory, Corporate Finance, Fiduciary & Estate Planning, Tax

Since 1983, **Cendrowski Corporate Advisors (CCA)** has provided expert client service from their offices in Bloomfield Hills, MI, and Chicago, IL. With expertise in tax planning/consulting, family offices, dispute advisory, business valuation, forensic accounting, and risk management, CCA is a CPA firm with a different perspective™.

value of the business.

Where the breach resulting in lost profits results in consequential damages such as cessation of the business, analysis of damages may include both lost profits and lost business value. Damages would be calculated using lost profits for the initial term, and lost business value as of the date the damages become permanent. The damages expert needs to be careful, however, to not overlap the periods covered under each scenario of damages.

Another difference in these calculations is the application of subsequent events. In

valuations, only information known or knowable as of the valuation date is considered; subsequent events, if not known or knowable, are ignored. In lost profits calculations, however, subsequent events are routinely considered in the determination of damages.

In summary, damages experts need to analyse whether economic damages are more appropriately measured by lost profits or by lost business value. This will be based on the facts of each specific case, and application of the most appropriate damages theory.