

# Recovering losses

How losses in a lawsuit are calculated by a financial expert **Interviewed by Matt McClellan**

If your company lost profits because of another company's actions, you may be able to recoup some, if not all, of that loss.

"Most civil lawsuits arise out of a plaintiff's belief they have been monetarily damaged due to actions of the defendant," says Richard Squar, Tax & Litigation Support director at Glenn M. Gelman & Associates, CPAs and Business Consultants. "If damages exist, the plaintiff's reward is recovering money to be made whole as if the losses did not occur."

It's a complicated process, and both sides will have to work with a financial expert to estimate the damages.

*Smart Business* spoke with Squar about how the recovery process works.

## When are damages due to lost profits recoverable?

There are three requirements that must be met for these damages to be recoverable:

- The defendant is proven to be at fault.
- It's found that the defendant could foresee that his actions would cause damages when he was at fault.
- Damages can be calculated with reasonable and acceptable certainty, not just through speculation.

## What is the role of a financial expert in the recovery process?

First, he or she must come up with an opinion on the damages — how much should be paid if the defendant is found to be at fault. Second, he or she should be an adviser to the lawyers, judges and juries. The expert should use clear language without getting too technical.

An often-used phrase is 'But for the fact that the damage happened, what would have happened?' This refers to an estimate of what would have happened if the damages did not occur, less what happened, less what the plaintiff did to try to minimize those damages (mitigation).

## How are monetary damages from lost profits calculated?

It doesn't have to be an exact calculation of the damages. Estimates are OK, just as long as they aren't speculative.



**Richard Squar**  
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'Speculative' is a term that the opposing counsel will use to try to discredit the expert's testimony. If the expert isn't provided with enough information and tries to make a conclusion from limited data, the other side may say he or she is just speculating as to what the number would be.

The expert has to be using some kind of tested techniques and theories that are generally accepted by peers in order to withstand the scrutiny of the opposing counsel.

## What methods are used?

The 'before-and-after' method deals with the internal data and financial trends. For example, you might look at a company's past three years and determine an average percentage of growth that occurred. From there, use that percentage to go forward from the day the damage occurred.

If the expert determines that the past trend has been that sales were increasing by 6 percent each year, then he or she might estimate what would have happened after the date the damages occurred to be a 6 percent annual increase. That gives you your projected revenues. Then you calculate your costs associat-

ed with those revenues and that tells you what would have happened but for the fact that there were damages. You then subtract the actual sales and associated costs that occurred with the damages and that gives you your lost profits and damages.

The 'yardstick' method uses some kind of benchmark or standard figure. For example, the expert looks at what type of growth trends have occurred in similar businesses and looks for comparisons. If you're a widget manufacturer, then he or she finds another company that makes something similar and finds out what that competitor's growth has been. The expert then uses that as an estimate of growth and to come up with lost profits. Your benchmark is that other growth from similar businesses in similar situations.

## How can a company ensure the financial expert has everything needed to arrive at a conclusion?

The ideal situation is when the company itself has done a summary of what it believes the damages are. It supplies any and all documentation that supports what happened compared to what would have happened. Companies can provide their budgets or any projections they've done or are continuing to do. They should make sure they identify for the expert exactly what revenue was lost. For example, if you have five product lines and one line that was damaged, you want to identify that one line along with bulk revenue numbers.

You want the expert to be working with the best available information within the context of the case. The expert usually doesn't just go in and have total access to any and all information. He or she should have access to information that is produced in the strategy of the case.

Certainly, a company can still make sure the description of the company and its history is made available to the expert. You want to make sure the expert has a very good idea of who you are as a company, so that when the expert makes assumptions or does projections, he or she can do it with a greater feel for what makes sense. <<

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