LOST PROFITS DAMAGES:

PRINCIPLES, METHODS, AND APPLICATIONS

SECOND EDITION

EVERETT P. HARRY, III
JEFFREY H. KINRICH

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Praise for *Lost Profits Damages,* First Edition

"This text is an essential addition to any professional performing lost profits calculations. Each chapter was carefully planned and written, including comprehensive examples that help the reader understand the most widely used techniques applicable to proving and computing lost profits damages."

Nathan E. DiNatale, CPA, ABV, CVA, ABAR
Partner, SC&H Group, Inc. • Sparks, MD

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"An indispensable resource that should be in the library of every forensic accountant and litigation professional who performs lost profits calculations. The content is logically sequenced and combines theoretical narratives, illustrative charts, and case examples to reinforce the concepts."

Annette M. Stalker, CPA, CFF, CFE
Founder, Stalker Forensics; Chair, AICPA Forensic and Valuation Services Executive Committee • Sacramento, CA

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Everett P. Harry, III, MBA, CPA, was the senior partner of Harry♦Torchiana LLP and for over 40 years has focused on accounting, financial, and disputes consulting involving government contracts, commercial litigation, and individual losses. Mr. Harry has extensive experience representing both plaintiffs and defendants for claims of lost profits, lost business value, and breach-of-contract damages. During his career, he also has served litigating clients on a wide variety of other matters, such as environmental remediation damages, alter ego, construction claims, fraud damages, partnership disputes, and individual losses from personal injury, wrongful death, or wrongful employment termination. Mr. Harry has presented expert testimony in the U.S. Court of Federal Claims, U.S. district courts, superior courts, arbitrations, and depositions.

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Over his 40-year career in litigation and valuation services, Mr. Kinrich has testified several hundred times on accounting, damages, valuation, and statistical issues in both state and federal courts. His work in these fields includes the preparation of hundreds of damages calculations for a wide variety of breach of contract, patent, copyright, trademark, trade secret, and other cases. A sampling of his work includes testifying about economic damages and unjust enrichment in fields as diverse as entertainment, manufacturing, wholesaling, and mortgage banking; developing a pricing methodology and valuation to calculate losses related to overcharges, misrepresentation, and breach of contract in the aerospace industry; serving as a damages expert in a service interruption case in the telecommunications industry; calculating lost profits resulting from breach of contract in the airline industry; and developing a rebuttal analysis calculating damages resulting from breach of contract in a real estate deal.

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Anne Cai, MBA, is a manager at Analysis Group. She applies consumer behavior and marketing research methods to litigation issues and strategic business problems, including false advertising, product liability, trademark infringement, patent infringement, and competition matters. Ms. Cai has extensive experience developing and evaluating quantitative and qualitative research to assess marketing, branding, and consumer perception and behavior. She specializes in survey research such as experimental studies, social media analyses, and statistical methods. Ms. Cai has assisted clients and supported leading marketing experts throughout the litigation process, from preparing expert reports to deposition and trial testimony. Her work spans a range of industries, including technology, consumer products and services, e-commerce, telecommunications, and media and entertainment. Ms. Cai holds an MBA from the Massachusetts Institute of Technology Sloan School of Management and a BS from the Massachusetts Institute of Technology.

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Ms. Kirk Fair has conducted quantitative analysis and performed industry and market research to evaluate competition, pricing, and outputs in connection with merger investigations in the U.S., Canada, and the EU. In addition to serving as a compliance monitor for several years, she also supported the U.S. Department of Justice (DOJ), the Federal Trade Commission (FTC), and the Canadian Competition Bureau (CCB) in a variety of merger investigations. Ms. Kirk Fair regularly speaks and writes on the use of surveys in litigation. She has received numerous awards for her accomplishments, including the Women@ "40 in Their 40s: Notable Women Competition Professionals" and the Concurrences Antitrust Writing Award for her coauthored article "The Tyranny of Market Shares: Incorporating Survey-Based Evidence into Merger Analysis" (*Corporate Disputes*).

Chapter 12 "Analysis of Cost Behavior"

Elizabeth A. Eccher, MS, PhD, is a clinical professor of accounting at the University of Illinois at Chicago. She retired from Analysis Group as a principal in January 2019, after 18 years in economic consulting. Previously, she taught financial and managerial accounting at the Sloan School of Management at Massachusetts Institute of Technology and worked in the heavy equipment industry as a pricing and cost analyst. Her consulting and/or testifying experience includes interpretation of financial accounting standards, damages estimation for lost sales, cost analyses, and financial analyses for transfer pricing. Dr. Eccher received her doctorate in accounting from Northwestern University and holds an MS in industrial administration from Purdue University and a BA in economics from Dominican University.

Jeffrey H. Kinrich, MBA, MS, CPA, ABV, CFF
See book editor's bio.

James H. Rosberg, MBA, PhD, is a vice president at Analysis Group and has consulted on valuation in a wide range of industries, including securities and financial services, software and social media, professional sports, medical devices, and electronics manufacturing. Dr. Rosberg has also supported experts in the areas of securities fraud, investment management, analysis of companies' cost structures, class certification, and corporate governance and has published in the field of pharmacoeconomics. Prior to working at Analysis Group, he was a consultant at The Parthenon Group in Boston and Vanguard Brand Management in London and an assistant professor at Dartmouth College and Boston College, where he taught and conducted research on the rule of law and development with a focus on the Middle East and North Africa. Dr. Rosberg holds an MBA and PhD from Massachusetts Institute of Technology and a BA with highest honors from University of California, San Diego.

Chapter 13 "Mitigation of Damages in the Lost Profits Calculation"

Scott M. Bouchner, MBA, CMA, CVA, CFE, CIRA, is a director of Forensic and Business Valuation Services at Berkowitz Pollack Brant Advisors and Accountants, a top 100 nationally ranked accounting firm. He has more than 25 years of experience in business valuation, litigation support, and management consulting. A frequent expert witness in state and federal courts, he has extensive experience advising clients involved in complex commercial disputes, preparing economic damages claims, analyzing opposing expert claims, and performing forensic investigations. Mr. Bouchner also performs due diligence for mergers and acquisitions and provides strategic business consulting services. A long-time member of the AICPA's Economic Damages Task Force, he is a frequent lecturer and was a coauthor of the AICPA Practice Aids *Calculating Lost Profits*, *Discount Rates, Risk, and Uncertainty in Economic Damages Calculations* and *Attaining Reasonable Certainty in Economic Damages Calculations*.

Mr. Bouchner holds an MBA from Columbia Business School and a bachelor's degree from George Washington University. He is a Certified Management Accountant (CMA), a Certified Fraud Examiner (CFE), a Certified Valuation Advisor (CVA), and a Certified Insolvency and Restructuring Advisor (CIRA).

Richard A. Pollack, CPA, ABV, CFF, PFS, ASA, CBA, CFE, CAMS, CIRA, CVA, CGMA, is the director in charge of Forensic and Business Valuation Services at Berkowitz Pollack Brant Advisors and Accountants, a top 100 nationally ranked accounting firm. Throughout his 45-year career, he has testified as an expert more than 200 times in state and federal courts and arbitrations, representing clients, court-appointed receivers, and federal agencies. In addition, he is active in analyzing damages and providing litigation support services.

Mr. Pollack holds a master's degree in finance from Florida International University and a BBA from the University of Miami, where he is actively involved with alumni groups, scholarships, and serves as an advisory board member. He holds more than 10 professional credentials and certifications, including a Florida certified public accountant (CPA) license, an Accredited in Business Valuation (ABV), Certified Fraud Examiner (CFE), and others. A highly regarded public speaker, he has taught judges, lawyers, accountants, college students, regulators, and business people throughout his career.

Chapter 14 "Using Net Cash Flow versus Accrual Net Income"

Bruce A. Strombom, PhD, is a managing principal at Analysis Group. He is an expert in applied microeconomics, industrial organization, and finance. He specializes in the application of quantitative and statistical techniques to complex business litigation, the estimation of commercial damages, and the valuation of privately held companies. Dr. Strombom has conducted assessments of class certification, liability, and damages issues in cases involving antitrust, breach of contract, false advertising, intellectual property, labor and employment, product liability, securities, and general commercial disputes. He frequently values privately held companies and ownership interests in firms in a range of industries for both litigation and mergers and acquisitions.

Prior to joining Analysis Group, Dr. Strombom was executive vice president of a middle-market merger and acquisition firm and manager in the consulting practice of Price Waterhouse. He holds a PhD in economics from UC Irvine and a BA in economics from San Jose State University.

Sheryl Clark, MA, is a former associate at Analysis Group. She has over a decade of litigation support experience involving accounting, financial, statistical, and economic analysis. Ms. Clark has consulted in areas such as accounting, intellectual property, entertainment and media, statistical sampling, health care, business valuation, class certification, ERISA, and general commercial litigation. She has extensive experience with financial modeling and assembling, managing, and analyzing large complex proprietary and public databases. Ms. Clark holds an MA in economics, a BA in quantitative economics, and a minor in studio art from Tufts University, as well as a general business studies with accounting concentration certificate from University of California, Los Angeles.

Chapter 15 "Period of Damages"

Patrick M. DeLangis, CPA, CFF, MAFF, CFE, CVA, EnCE, is a senior manager in the Forensic, Litigation and Valuation Services Group of Wipfli LLP, with over 25 years of diversified litigation, consulting, and forensic accounting experience. He has testified in federal and state courts, as well as other tribunals, in California, Oregon, and Washington. Mr. DeLangis has prepared damages analyses in matters that involve white collar crime, internal and external fraud investigations, internal controls, commercial disputes, intellectual property, employment disputes, personal injury, wrongful death, product liability, construction disputes, and shareholder disputes. He has also been certified in computer forensic investigations.

Mr. DeLangis was formerly with EisnerAmper LLP, Ueltzen & Company LLP, Matson Driscoll & Damico LLP, Berntson Porter & Company PLLC, and Navigant Consulting. He obtained his BS in accounting from Loyola Marymount University in Los Angeles.

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Ms. Fraser serves as chair of the California Society of Certified Public Accountants (CalCPA) and member of CalCPA's Forensic Services Section Steering Committee. She is also an active member of the American Institute of Certified Public Accountants' (AICPA) Forensic and Valuation Services (FVS) Executive Committee and has served on the Relations with the Bar Committee and CFF Credential Committee.

Chapter 16 "The Ability to Achieve Lost Sales as a Consideration in Damages Analyses"

Jonathan Borck, PhD, is a vice president at Analysis Group and an adjunct lecturer in public policy at the Harvard Kennedy School. He specializes in the application of statistics and economics in the areas of finance, health care, antitrust, and the environment. In statistics, Dr. Borck has helped both design and critique statistical sampling methodologies in a number of areas, including for mortgage loans and medical claims data. He has also analyzed statistical issues in the evaluation of public policies designed to reduce the prevalence of smoking in Australia. In the area of antitrust economics, he has investigated the impacts of anticompetitive practices on prices, quantities, and profits in the health care, technology, transportation, and agriculture sectors. His work on environmental topics has included the use of revealed preference and contingent valuation methods to analyze climate policies, natural gas markets, the value of water, and economic damages from environmental contamination. Dr. Borck holds a BSCE from Rice University and a PhD in public policy from Harvard University.

Aaron C. Yeater, MBA, is a managing principal at Analysis Group. His areas of expertise include the evaluation of damages in antitrust, intellectual property, and complex commercial matters in a variety of industries, including media, high technology, retail and institutional financial services, and telecommunications. He has supported expert witnesses in their preparation of damages analyses for numerous high-profile cases in the technology sector, including several antitrust matters involving Microsoft. Mr. Yeater has supported counsel for defendants in trials responding to multibillion-dollar antitrust damages claims in the multidistrict price-fixing matter *In re: TFT-LCD (Flat Panel) Antitrust Litigation*. He has also supported counsel in several matters concerning distribution of video media, including a merger of national cable companies, disputes about content licensing terms, and litigation by several broadcast networks concerning alleged copyright concerns arising from Dish Network's Hopper DVR and AutoHop service. Mr. Yeater has also consulted on litigations involving financial services firms, including investment banks, institutional investors, and credit card networks, and has provided strategic support for clients in the music, pharmaceutical technology, and agribusiness industries. Mr. Yeater holds an MBA from the Yale School of Management and a BA from the College of Social Studies at Wesleyan University.

Chapter 17 “Lost Profits for ‘New Businesses’”

W. Ira Bowman, JD, is chair of the Business and Civil Litigation Section of Godwin Bowman PC. He is a modern trial lawyer who represents clients in both the prosecution and defense of a wide range of issues in state and federal courts, including contract disputes, business-related torts, breach of fiduciary duty, fraud, partnership disputes, antitrust, copyright and patent litigation, conversion, deceptive trade practices, breach of warranty, franchiser/franchisee disputes, and negligence. He also handles a wide range of family law matters, including divorce, modifications, property division, conservatorship, and surrogacy agreements.

Mr. Bowman has acted as first and second chair in many trials and has argued before the 5th District Court of Appeals in Dallas. He has tried multiple week-long jury trials under both Texas and foreign laws. In addition to his trial experience, he has handled many more mediation and arbitration matters for clients dealing with multiple disparate issues in various jurisdictions. Mr. Bowman received a JD from Southern Methodist University Dedman School of Law and a BA from the University of Texas at Austin.

David Duffus, CPA, ABV, CFF, CFE, is a partner in the Forensic Accounting and Commercial Damages practice at HKA Global, Inc. He has more than 25 years of experience providing complex litigation, forensic accounting, and valuation services for businesses ranging from start-up entities to Fortune 100 companies. He has testified as an expert at deposition, trial, and in alternative dispute settings more than 90 times and has also served as an arbitrator/neutral accountant in post-acquisition and valuation-related disputes.

Mr. Duffus is active in the American Institute of Certified Public Accountants, where he has served as a member of the Forensic & Litigation Services Committee and chair of the Economic Damages Task Force. Mr. Duffus contributed to numerous AICPA Practice Aids on economic damages issues, including *Discount Rates, Risk and Uncertainty in Economic Damage Calculation*; *Attaining Reasonable Certainty in Economic Damages Calculations;* and *Attaining Reasonable Certainty in Economic Damages Calculation: Revenues, Costs and Best Evidence*.

Mr. Duffus earned his BA in economics and political science and his MBA in accounting and finance from the University of Pittsburgh. He is a certified public accountant (CPA), Accredited in Business Valuation (ABV), Certified in Financial Forensics (CFF), and a Certified Fraud Examiner (CFE).

Robert P. Gray, CPA, ABV, CFF, CGMA, CFE, is a member/principal at Gray Schrupp & Associates, assisting with complex commercial litigation, forensic investigations, stakeholder disputes, matrimonial services, business valuations, and other forensic accounting consulting services. He serves clients in the United States and internationally.

Mr. Gray is a member of the AICPA and has served in several leadership roles in the niche forensic and valuation services (FVS) community, providing guidance to CPAs who specialize in forensic accounting, consulting, damages analyses, business valuation, and other specialized services.

Mr. Gray is a member of the Texas Society of Certified Public Accountants (TXCPAs) and Kentucky Society of Certified Public Accountants (KSCPAs), where he has been actively involved in FLVS committees and has chaired the annual FLVS conferences for several years. He is Accredited in Business Valuation (ABV), Certified in Financial Forensics (CFF), is a Chartered Global Management Accountant (CGMA), and a Certified Fraud Examiner (CFF).

Chapter 18 "Present Value Concepts and Damages Modeling"

Douglas E. Farrow, CPA, CFE, is a partner in HKA Global's Forensic Accounting and Commercial Damage practice. Prior to joining HKA, he was a senior partner and practice leader for KPMG's Forensic in the Pacific Southwest region and lead partner of KPMG's commercial insurance claims practice for over a decade. He has over 35 years of experience assisting corporations, attorneys, and their clients with a wide spectrum of financial, economic, and accounting matters, including insurance claims and damage matters. He has extensive experience in developing damage theories and case strategy in complex litigation at all levels of dispute.

In addition to providing litigation consulting, Mr. Farrow has been involved in numerous post-acquisition disputes in the capacity of an arbitrator as well as an advisor and has in-depth experience with the preparation and negotiation of highly complex insurance claims, such as business interruption and property claims. He has worked on and prepared insurance claims involving some the world's biggest natural and man-made disasters, from gas leaks, oil spills, cyber security breaches, hurricanes, tornados, and floods to deadly epidemics and pandemics, including COVID-19.

Mr. Farrow has conducted numerous high-profile forensic accounting investigations pertaining to allegations of financial statement fraud and accounting irregularities involving matters such as under-reporting of royalty payments, employee embezzlement, self-dealing by company executives, contract compliance matters, health care fraud, and other types of fraudulent activities in a wide variety of industries.

Elizabeth Moe, CPA, CFE, is a principal in HKA Global's Forensic Accounting and Commercial Damage practice. She is a certified public accountant (CPA) with over 15 years of professional experience. Ms. Moe provides clients with a wide range of forensic services including financial, business, accounting, and fraud-related issues. She has experience in the preparation of economic damages, purchase price disputes, and analysis related to copyright, trade secret, and patent infringement litigation. Ms. Moe has also been involved in assessing the appropriate application of complex accounting rules as well as forensic accounting analyses and fraud investigations. Prior to joining HKA, Ms. Moe spent 10 years with KPMG, where she specialized in disaster recovery and insurance claims.

Chapter 19 "Discount Rates in Theory"

Jaime d'Almeida, MBA, ASA, CFE, is a principal at d'Almeida Consulting LLC. He is a frequent speaker and author, and his corporate finance expertise has been featured in numerous publications. Mr. d'Almeida has over 25 years of experience in economic and valuation analysis and consulting and has provided both deposition and trial testimony on valuation, finance, and damages issues.

Mr. d'Almeida is a lecturer in finance at Boston University's Questrom School of Business and an adjunct lecturer at Babson College's F.W. Olin Graduate School of Business, where he also received his MBA in entrepreneurship. He received his BS in electrical engineering/engineering and public policy from Carnegie Mellon University. He is an Accredited Senior Appraiser (ASA) of the American Society of Appraisers (ASA) and a Certified Fraud Examiner (CFE).

Roger J. Grabowski, FASA, is a managing director with Duff & Phelps, a Kroll Business, and a Fellow (FASA) of the American Society of Appraisers (its highest designation) accredited in

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Chapter 20 "Discount Rates in Practice"

Everett P. Harry, III, MBA, CPA
See book editor's bio.

Mark Hayden, CPA, ABV, ASA, CFA, is an expert in accounting, finance, valuation, and mathematical modeling. Mark delivers testimony during SEC hearings and in state and federal courts on a range of issues, including valuation, accounting, and the results of financial models. He briefs SEC staff on complex financial reporting topics such as relative fair value in multiple element arrangements. Mr. Hayden delivers solutions to Fortune 100 and middle-market companies, financial sponsors, and legal counsel representing defendants in complex civil litigation.

Mr. Hayden established a proven track record helping companies and stakeholders solve critical problems, resolve disputes, and measure the value of large complex transactions, first as a partner in EY's dispute resolution practice and later as a partner in Deloitte's valuation and financial modeling group. During his 30 years he has performed over 400 business valuations and valuations of complex securities, advised on numerous acquisitions, arbitrated net working capital and earn out disputes, led international accounting investigations, testified in "bet the company" litigation that resulted in zero damages for defendants, and developed decision models to assist in-house legal teams assess litigation exposure. As a managing director at Houlihan Lokey, creditor committees engaged Mr. Hayden to opine on solvency of the debtor on key dates before it filed. Mr. Hayden testifies for shareholders that object to a corporate transaction and wish to exercise their appraisal rights to determine the fair value of their shares.

Mr. Hayden is a frequent presenter and author on accounting, valuation, and mathematical modeling. He has co-authored a valuation and modeling book and served on the AICPA task force that published guidance on the valuation of securities held by private equity and venture capital funds.

Wallace Ng, CFA, is a senior vice president in the Financial and Valuation Advisory practice of Houlihan Lokey in Los Angeles. He has over two decades of financial consulting experience providing valuation and consulting services across diverse industries. Mr. Ng has performed valuations of business enterprises, business interests, and intangible assets for the purposes of financial reporting, mergers and acquisitions, restructuring, bankruptcy, tax reporting and planning, and litigation support for trials and arbitrations. Prior to Houlihan Lokey, Mr. Ng was a senior manager in the valuation and modeling group at Deloitte. Mr. Ng holds a BA in business economics (*cum laude*) from UCLA and is a Chartered Financial Analyst (CFA) charterholder.

Chapter 21 "Before-tax versus After-tax Discount Rates"

James E. Pampinella, CPA, is a senior managing director in the San Francisco office of Ankura Consulting Group and a national expert on complex commercial litigation matters, specializing in intellectual property strategic consulting and disputes. He is a certified public accountant (CPA) in the state of California, Certified in Financial Forensics (CFF), and a Certified Licensing Professional (CLP). Mr. Pampinella has experience in a wide variety of industries, including computer hardware and software, eCommerce, life sciences, and consumer and industrial products. Mr. Pampinella has testified as an expert on damages in deposition, trial (federal and state courts), and arbitrations and has presented at mediations. He also serves on the planning committee of the Intellectual Property Institute held by the University of Southern California Gould School of Law.

Prior to joining Ankura, Mr. Pampinella was a leader in Navigant Consulting's Intellectual Property group. Prior to rejoining Navigant, Mr. Pampinella led the Northern Pacific Intellectual Property Group for Deloitte Financial Advisory Services. Prior to joining Deloitte FAS, he worked for Navigant Consulting and Coopers & Lybrand (n/k/a PricewaterhouseCoopers) providing economic, financial, and damage consulting services on commercial litigation matters.

Renee C. Wong is a managing director in Ankura Consulting Group's Disputes & Economics practice in San Francisco. She focuses on complex litigation matters, with an emphasis on commercial damages, intellectual property infringement, breach of contract, and business valuation issues. She has analyzed, prepared, and critiqued a variety of economic damages claims, including lost profits, reasonable royalties, unjust enrichment, price erosion, and diminution of business value. Ms. Wong has more than 20 years of experience consulting to a variety of companies on financial, economic, accounting, and damages matters. She has experience in a wide variety of industries, including biotechnology, consumer electronics, medical devices and equipment, computer software and hardware, and consumer products. She has served as the expert witness on damages in matters involving patent infringement, breach of contract, and business interruption. Ms. Wong was formerly with Navigant Consulting, where she performed similar work. She holds dual BA degrees in economics and legal studies from the University of California, Berkeley.

Chapter 22 "Neutralizing Lost Profits Damages for Tax Consequences"

Kenneth D. Rugeti, CPA, ABV, CFF, is a senior managing director with FTI Consulting. He provides consulting and expert testimony in the areas of forensic accounting, damages analysis, and valuation. Mr. Rugeti has testified as an expert witness in U.S. District and Bankruptcy Courts, California State Court and arbitration and frequently serves as a joint expert, either informally or under court appointment as an expert or referee.

Mr. Rugeti is a member of the American Institute of Certified Public Accountants' (AICPA) Forensic and Litigation Services Committee and currently serves as the chair of its Economic Damages Advisory Panel. He also serves on the Steering Committee for the California Society of Certified Public Accountants' (CalCPA) Forensic Services Section and previously served as the chair of CalCPA's Economic Damages Section.

Mr. Rugeti graduated (*magna cum laude*) from the University of Southern California with a BS in business administration (finance emphasis). He then joined the Dispute Analysis & Corporate Recovery practice of Price Waterhouse LLP and ultimately formed and ran his own firm, Rugeti & Associates, for many years before joining FTI.

Chapter 23 "Pre- and Post-judgment Interest"

Gregory A. Pinsonneault, MA, CLP, is a managing director and chief executive officer at LitiNomics. He has more than 18 years of experience providing consulting services and expert testimony for economic, financial, and business issues related to commercial litigation, primarily in the calculation of economic damages. Mr. Pinsonneault has extensive experience in intellectual property disputes, including patent, trade secrets, copyright, and trademark disputes, as well as consulting on reasonable license terms for intellectual property outside the context of litigation. He has also consulted in a variety of other areas, including breach of contract, class-action issues, predatory pricing and buying, and antitrust monopolization.

Mr. Pinsonneault has consulted on more than 200 projects during his professional career and has been designated as the expert witness or non-litigation project lead in more than 90 matters. His experience spans a wide range of industries, including semiconductors, computers, software, networking equipment, mobile phones and service, casino gaming, financial services, medical devices, biotechnology, and pharmaceuticals.

Mr. Pinsonneault holds an MA in economics from the University of California, Berkeley; a BA in mathematics and economics (*cum laude*) from the University of Washington; and a BS in computer science (*cum laude*) from the University of Washington. He is a Certified Licensing Professional (CLP).

Christian Tregillis, CPA, ABV, CFF, CLP, is a partner with Hemming Morse. He analyzes financial, accounting, economic, statistical, and market issues, primarily in regard to disputes and valuations, including the negotiation of license agreements covering intellectual property. He has participated in mediations and has testified in depositions, hearings, arbitrations, and trials in state and federal courts.

Mr. Tregillis testified in over 130 matters in his 30-year career of financial consulting and investigations, which has included serving as a partner at Deloitte & Touche. He also was the leader of the Damages, Valuation, and IP practice area globally for LECG. Prior to that he led the Forensic Accounting and Litigation Consulting Group in the western U.S. for Kroll and was the leader of Kroll's Intellectual Property Services practice.

Mr. Tregillis is a past chair the Economic Damages Task Force of the American Institute of Certified Public Accountants (AICPA), for which he has taught and authored practice aids, such as "Discount Rates, Risk, and Uncertainty in Economic Damages Calculations," "Calculating Lost Profits," and "Attaining Reasonable Certainty in Economic Damages Calculations." He is also a past chair of the Economic Damages Section of the California Society of Certified Public Accountants (CalCPA) and serves on the CalCPA Council.

Chapter 24 "The Expert Report"

R. Christopher Rosenthal, MBA, CPA, ABV, CFF, ASA, AEP, is a managing member with Vallit Advisors, with more than 30 years of experience. He is responsible for hundreds of domestic and international commercial damage and valuation engagements throughout the United States, Europe, South America, and the Middle East. He has extensive experience preparing expert reports and providing testimony in federal, state, and international courts. He has worked on cases ranging from simple contract disputes involving thousands of dollars to complex litigation, where the claims being sought involved nearly half a billion dollars. Mr. Rosenthal specializes in complex commercial damages, valuation, intellectual property, and forensic accounting assignments. His clients have included public and private companies of various sizes, not-for-profit organizations, governmental entities, and individuals.

Mr. Rosenthal holds a BS in accounting from Virginia Tech and an MBA in finance from the University of Maryland. Prior to joining Vallit Advisors, he was a shareholder with a regional accounting and consulting firm, where he was the founder and director of the Forensic and Valuation Services Group.

Chapter 25 "Expert Reports and Business Valuation Standards"

Everett P. Harry, III, MBA, CPA
See book editor's bio.

William B. Stewart, Jr., CPA, ABV, CFF, CFE, is a member of Stewart & Hurst, a consulting firm providing forensic and valuation services to attorneys and their clients and a number of industries in non-litigation matters. Mr. Stewart has been a certified public accountant (CPA) for over 40 years, having been both a professional at a major public accounting firm and then chief financial officer for several large companies in the industry before beginning his current practice over 25 years ago. He is a frequent speaker at local, state, and national conferences, university guest lecturer, and coauthor of several publications. Mr. Stewart has testified in criminal, family law, bankruptcy, and civil matters in county, state, and federal courts in Texas, Utah, Tennessee, Florida, and Colorado.

Chapter 26 "The Admission of Expert Testimony: *Daubert* and Related Issues"

Douglas E. Branch, CPA, ABV, CFF, is a partner with PricewaterhouseCoopers LLP (PwC). He has testified as an expert witness in numerous depositions, trials, and hearings on matters involving transaction disputes, accounting and reporting, economic damages, complex business valuations, alter ego analyses, intellectual property, and forensic investigations, among others. Mr. Branch has also served as an arbitrator or "neutral accountant" in more than 30 transaction disputes involving net working capital or earnout determinations. Mr. Branch is the lead author of PwC's annual *Daubert* study and publication, which analyzes challenges against financial expert witnesses, and is a frequent speaker, writer, and trainer on avoiding *Daubert* challenges, particularly in the context of economic damages and valuation experts.

Mr. Branch holds a BBA and master's degree in accounting, both from the University of Texas at Austin. He is also a certified public accountant (CPA) and holds the Accredited in Business Valuation (ABV) and Certified in Financial Forensics (CFF) credentials.

Peter W. Brown, CPA, CFF, ABV, is a partner and Forensic Services Practice leader for Green Hasson Janks LLP. He has over 30 years of experience as a forensic accountant and investigator, specializing in quantifying damages in commercial litigation and conducting internal investigations. Mr. Brown regularly serves as a third-party neutral regarding accounting matters and purchase disputes and has served as an expert witness in numerous matters. Mr. Brown's experience encompasses a variety of industries, including technology, telecommunications, entertainment, construction, and real estate.

Mr. Brown is a certified public accountant (CPA) licensed in California, Arizona, and Colorado. He also holds the Accredited in Business Valuation (ABV) and Certified in Financial Forensics (CFF) credentials issued by the American Institute of Certified Public Accountants (AICPA). Mr. Brown is a member of the AICPA's Executive Committee for Forensic and Valuation Services and a member of the California Society of CPA's (CalCPA) board of directors and chair of CalCPA's Forensic Services Section. Mr. Brown has a BS degree in managerial economics from the University of California Davis and an MBA degree from Loyola Marymount University.

Saleema K. Damji, MPA, CPA, ABV, CFF, is a director with PricewaterhouseCoopers (PWC) and has more than 15 years of experience as a forensic accountant and litigation consultant. Her expertise includes complex business disputes, deal disputes, forensic analysis, and forensic accounting investigations for clients operating in a wide range of industries, including energy and mining, technology, financial services, consumer and industrial products, construction, and telecommunications.

Ms. Damji co-led PwC's *Daubert* study for several years. The annual PwC study analyzes post-*Kumho Tire* challenges to financial expert witnesses under the *Daubert* standard, seeks to highlight trends in *Daubert* challenges to financial experts, and provides insight into the reasons behind expert exclusions.

Ms. Damji has an MPA degree from the University of Texas at Austin and a BSc (Econ) degree in economics and politics from the University of London (Queen Mary College). She is a certified public accountant (CPA) and holds the Accredited in Business Valuation (ABV) and Certified in Financial Forensics (CFF) credentials from the AICPA.

Chapter 27 "Legal Challenges to Lost Profits Damages Expert Testimony"

Stephen Mahle, JD, PhD, is a commercial litigator and financial economist with *Daubert* Counsel. He concentrates his legal practice on litigating *Daubert* issues in scientific and other expert testimony for law firms, insurance companies, and expert organizations, and counsels testifying expert witnesses on how the specifics of *Daubert* impact their testimony. His practice centers on the evaluation, proffer, and admission (or challenge and exclusion) of scientific, technical, and other expert testimony under *Daubert v. Merrell Dow*, *Frye v. United States*, and the other standards for admissibility of expert testimony.

Dr. Mahle has been a finance professor at the University of Iowa, Florida Atlantic University, and Virginia Tech and is an Olin Scholar in law and economics at the University of Virginia School of Law. He has published dozens of articles on *Daubert* and related issues. His litigation practice has included securities and commodities litigation, such as 10b-5, arbitration, and SRO proceedings; intellectual property, products liability, medical malpractice, medical device litigation, personal injury, construction defects, and employment litigation; and M&A. His website *Daubert*Counsel.com discusses some of these matters. Dr. Mahle was a lobbyist for Florida's *Daubert* legislation and argued the resulting case, *In Re: Amendments to the Florida Evidence Code* before the Florida Supreme Court, https://www.floridasupremecourt.org/content/download/323429/opinion/sc16-181.pdf.

FOREWORD

Ev Harry and Jeff Kinrich have achieved a remarkable feat as the creators, editors, and coauthors of this comprehensive book, *Lost Profits Damages: Principles, Methods, and Applications*, second edition. They have assembled an amazing team of authors who openly and directly share their knowledge. These 56 authors were carefully chosen for their expertise in lost profits damages and its many components. They represent a broad group of professionals from the accounting, economics, finance, and legal disciplines. Further, the authors represent firms of varying sizes and geographical areas spread across the United States. Their knowledge and this text are a welcome enhancement to our profession's body of knowledge. Just look at this list of accomplished authors:

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These authors possess a wide range of professional designations and academic achievement, including:

- 29 Certified Public Accountants (CPA)
- 16 Certified in Financial Forensics (CFF) with the AICPA
- 18 Accredited in Business Valuation (ABV) with the AICPA
- 13 Certified Fraud Examiners (CFE) with the ACFE
- 8 Accredited Senior Appraisers (ASA or FASA) with the ASA
- 12 Doctors of Philosophy (PhD) or Doctors of Business Administration (DBA)
- 15 Masters of Business Administration (MBA)
- 6 Juris Doctors (JD)

This book is a valuable, easy-to-navigate resource that provides explicit details on a broad array of topics, including the following:

Legal Principles for Lost Profits Damages
Expert Testimony
Methodologies for Lost Profits Damages
Ex Ante versus *Ex Post*
Business Valuation Methodology
Lost Business Value versus Lost Profits
Proving Loss Causation
Industry and Economic Research
The Use of Statistics
Projected Lost Revenue
The Use of Surveys
Cost Behavior
Mitigation
Using Net Cash Flow versus Accrual Net Income
Period of Damages
The Ability to Achieve Lost Sales
Lost Profits for "New Businesses"
Present Value Concepts and Damages Modeling
Discount Rates in Theory and Practice
Before-tax versus After-tax Discount Rates
Tax Consequences
Pre- and Post-judgment Interest
Expert Reports
Business Valuation Standards
Admission of Expert Testimony
Daubert and Legal Challenges to Expert Testimony

Never has such a stellar group of experts collaborated on lost profits damages. This will be the go-to resource for years to come.

James R. Hitchner, CPA/ABV/CFF, ASA
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LOST PROFITS DAMAGES: PRINCIPLES, METHODS, AND APPLICATIONS

PREFACE

Everett P. Harry, III, MBA, CPA
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Lost Profits Damages: Principles, Methods, and Applications was first published in 2017. It was and still is intended to provide a single source for discussion of important topics relevant to determination of lost profits damages. It is an indispensable, comprehensive reference guide and instructional tool for the analysis of business damages, especially lost profits and lost business value. It provides cutting-edge explanations, insights, and analyses germane to damages experts or litigators contending with business-related economic losses on behalf of their clients. This book is unique in presenting in-depth descriptions and assessments of many topics not meaningfully addressed in other texts or to any great extent in the general professional literature.

This second edition updates the first edition and adds a significant amount of new material. All previously published chapters were reviewed and revised as needed to reflect the most current thinking on the subject. In some instances, these previously existing chapters include valuable new material. Further, four new chapters are included.

- "The Use of Surveys in Lost Profits Analysis" – Lost profits may involve an envisioned product or service for which but-for demand is difficult to prove with existing customer preference and related empirical market data. A well-designed survey executed by competent professionals may establish whether customer demand would have existed for the lost business opportunity, and at what price.
- "Lost Profits for 'New Businesses'" – New business damages once were rejected by courts as inherently speculative and uncertain. Case law has evolved to accepting such claims if proven under the same legal standards as applied to an established business that is claiming lost profits damages.
- "Neutralizing Lost Profits Damages for Tax Consequences" – Damages experts often assume that business income taxes may be ignored in damages calculations, especially when any damages award will be subject to income taxation. This assumption is not always correct. The computed damages may be misstated if the expert does not consider potential tax rate and timing differences when modeling the past and future damages.
- "The Admission of Expert Testimony: *Daubert* and Related Issues" – This new chapter provides background and foundational information about the requirements for the admissibility of expert testimony, as well as an assessment of trends and statistical data related to its application in the courts. It provides a foundation for the following chapter, which is a more nuanced assessment of the legal rules and cases relevant to the admissibility of expert testimony.

Lost profits damages is not a new topic; its theory and practice are addressed in many existing professional and scholarly articles, monographs, and books. But until now, many such writings have typically addressed a single topic, or at best a handful of the many topics of interest to the lost profits analyst. Others have addressed the entire subject, but have also included other, more tangential subjects and issues. Consequently, professionals wishing to enhance their knowledge of lost profits damages in a more comprehensive manner are challenged to identify, obtain, and digest a sufficiently large cross-section of the most relevant publications. As a practical matter, many of the seminal articles on lost profits damages are often difficult to locate and obtain and, even if available, may require payment of fees before delivery and receipt.

Lost Profits Damages: Principles, Methods, and Applications is intended to provide a remedy. Our goal is to make this volume a practical, easy-to-use, single-source reference for practitioners: certified public accountants, economists, financial analysts, and others who are tasked with selecting an appropriate methodology for determining damages from lost profits, carrying out the analysis, and potentially defending their work during proceedings.

This book is a useful resource for all those interested in determining lost profits, from the less experienced practitioner through the most seasoned expert. An analyst or potential testifying expert with little prior experience in determining lost profits damages may review the book from the first chapter through the final page to gain an overall understanding of the theory and practice for computing lost profits and to identify critical issues and concerns to be addressed during the engagement. On the other hand, more experienced practitioners may consult particular chapters of interest to refine their thinking about an approach to computing the plaintiff's loss or the bases for critiquing a claim prepared by an opposing expert. Finally, the litigating attorney seeking published guidance on the determination of lost profits will find valuable insights from the alternative points of view included in this book that delineate the issues, concerns, and pros/cons of the various approaches and methodologies for calculating lost profits damages.

To aid the book's utility as a reference, we have sequenced its chapters broadly in the same order that work steps are performed and decision points are encountered in the typical lost profits engagement. The chapters progress from an overview of the nature of lost profits damages and the broad legal principles for proof of such loss through the preparation of an expert report, if required. The intervening chapters illustrate many alternative methodologies and techniques employed by practitioners for the determination of lost profits damages, as well as specific issues and types of calculations that will need to be included.

The final chapter addresses typical legal challenges to the expert's work that may arise, if at all, after completion of the expert's study and the disclosure of the expert's findings. The chapter provides the lost profits damages expert with ideas about proactive steps to be taken during the development of the expert's findings and opinions to avoid or minimize this litigation risk.

This book is full of advice. In giving advice on lost profits analyses—as in so many other professional endeavors—the use of the phrase "it depends" is warranted. Except for the broad legal principles controlling the proof of lost profits, there are few, if any, universal, one-size-fits-all methodologies for the computation of lost profits damages. Each methodology or technique will have its own strengths and weaknesses and may be either more or less appropriate for any given set of circumstances. Information presented in this book, including relevant legal decisions, is selected expressly for illustrating and sensitizing the reader to the variety of approaches, methods, and techniques for determining lost profits damages that might be considered in a court case. In many cases, contrary or opposing viewpoints are presented, with their strengths and weaknesses highlighted. Throughout this book, whenever a chapter advises that some action or analysis "must" or "should" be done (or similar words), the reader is advised to subconsciously add the phrase "when appropriate, depending on circumstances." As always, professional judgment is an important part of a lost profits analysis.

A few other caveats and explanations:

- A significant portion of this book discusses the difference between *ex ante* and *ex post* analyses. We often (but not exclusively) refer to *ex ante* analyses as business valuation methods and to *ex post* analyses as lost profits methods. Some might consider this language to be too restrictive and prefer to equate *ex ante* analyses with using information known or knowable on the damages date and *ex post* analyses with using information known or knowable up to the trial date. We are sympathetic with this view but choose to use the phrasing we do because it is less wordy and easier to write. As we discuss in the text, both the business valuation and lost profits approaches can be applied to information available through any particular date.
- Each chapter is authored by one or more individuals, each of whom speaks in his or her own voice. Some chapters are more academic or legal; others provide more practical advice. While we have attempted to impose an overall style to the book, each author uses words differently. For example, when talking about the professional carrying out a lost profits analysis, the authors may describe that individual as the analyst, damages analyst, expert, appraiser, valuation professional, accountant, business valuation expert, or another similar term. When used in this book, these terms are synonymous unless context requires otherwise. Similarly, the words "company" and "firm" are used interchangeably. And some authors refer to "the plaintiff" while others merely say "plaintiff." Other similar situations should be obvious in context.
- Throughout the book, the term *attorney-client* is used to indicate the attorney who retains the analyst's services. We are aware that there are occasions where the underlying business entity, rather than the attorney, is the retaining party. At times, the expert may confer with the attorney's underlying client, as well as the attorney-client. Considering this possibility, and in appropriate circumstances, the term *attorney-client* may have broader applicability and include the underlying client.
- This book uses both "but-for" and "but for," with and without a hyphen. Following standard style guides, we hyphenate the phrase when it is used as an adjective before a noun, such as "the but-for world," but use it unhyphenated when talking about, for example, something occurring "but for the alleged wrongdoing."
- Some accounting terms, such as *net income*, may be used without being defined. Often, the term *net income* is used in its damages sense, meaning incremental revenues minus incremental profits, rather than in its accounting sense of total revenues minus total costs. The proper intent should be clear in context; the reader is advised to focus on the concepts being communicated rather than overly formal definitions that may apply differently in different situations.
- Another term of art is *calculation*. In this book, it is used in its ordinary English sense. In the business valuation profession, the word *calculation* is sometimes used to describe a particular type of limited valuation or agreed-upon procedure. Unless specifically referenced, we do not use it in that fashion.

Lost Profits Damages: Principles, Methods, and Applications reflects the dedication and commitment of a large number of people. The chapter authors were selected for their demonstrated, peer-recognized expertise in lost profits damages and related fields. They represent a healthy mix of professionals from the accounting, economics, finance, and legal disciplines. Further, the authors represent firms of varying sizes and geographical areas spread across the United States. A full listing of the contributing authors, along with individual

summary biographies, appears after the Table of Contents. In addition, the book would not be in print without the support and contributions of many other individuals and organizations contributing ideas and the time to review chapter drafts and provide suggestions. We would like to especially thank the Steering Committee of the Forensic Services Section, California Society of Certified Public Accountants, for its early encouragement and support as this book came into reality.

This book came about in part because Jim Hitchner's Valuation Products and Services made the early commitment to support our project and become our publisher. Preparation of this second edition was dependent upon the continuing support of Valuation Products and Services. Particular gratitude is expressed for those working with our publisher to make this second edition come to life, particularly Karen Warner and Janet Kern, VPS professional publications consultants and editors, for their untiring devotion to honing our book concept and providing suggestions for improving the readability of our technical material.

The editors would like to thank our firms, Harry♦Torchiana LLP and Analysis Group, for their support though this book's long development cycle. In particular, we appreciate the time and energy devoted by Peter Rybolt and David Owens of Analysis Group to provide editorial suggestions and carefully proofread all of the chapters. This book certainly took longer than either of us expected; our firms' support during the process was invaluable. We would also like to thank our spouses, Robin Morales and Juli Kinrich, for their moral and emotional support.

Finally, we are indebted to Robert L. Dunn for his vision in identifying the need for this book and participating in its early development, including preparation of the initial content outline and selection of a book publisher. Bob was perhaps the nation's leading legal authority on the subject of lost profits. His treatise, *Recovery of Damages for Lost Profits*, now in its 6th edition, is a common reference on the desks of many practitioners, and served as a reference to many of this book's authors. Bob's tragic death in a 2013 automobile accident was a great loss to all professionals involved with lost profits damages. While Bob did not survive to be a co-editor and chapter author, his fingerprints are still found throughout this publication.

Although the book editors and other professionals reviewed the chapter drafts and provided suggestions to the individual authors, ultimate responsibility for each chapter's content, accuracy, and originality remains with the respective chapter authors. The editors do not necessarily agree with positions taken by the authors of the various chapters.

Reader comments, ideas, suggestions, and other reactions to this book may be helpful in preparing the next edition. Please feel free to send your comments to Everett Harry at eph@htcpa.com or Jeff Kinrich at jeff.kinrich@analysisgroup.com.

Everett P. Harry, III
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January 2022

CHAPTER 1

INTRODUCTION TO LOST PROFITS

John C. Jarosz, Robert L. Vigil, and Michael J. Chapman

Introduction

A lost profits damages award is the primary source of relief in a wide variety of commercial litigation matters. Such an award is meant to provide compensation to an injured party (plaintiff) for the benefits it was denied due to a defendant's alleged wrongdoing. In short, lost profits are computed as the difference between the financial performance an injured business should have realized—but for the alleged wrongdoing—and the financial performance it did or will realize in light of that wrongdoing.

This book is intended to provide guidance to practitioners (primarily expert witnesses and the lawyers with whom they work) in evaluating the eligibility for and quantification of such damages across the wide range of disputes for which they may be appropriate. This book provides not only a discussion of the theory and foundations underlying lost profits damages, but also practical guidance for their calculation and the presentation of associated testimony.

Lost profits analyses are based on accounting, finance, marketing, and economic principles, which will be discussed in later chapters. They are also based on a host of legal principles, which will be discussed throughout the ensuing chapters. A lost profits evaluation, at its core, seeks to determine how a business should have performed, absent some unlawful actions or events. Accordingly, consideration should be given to the variety of factors that impact actual business performance. Expert testimony is often critical to an evaluation of lost profits; that testimony should be based on solid factual foundations derived from contemporaneous business documents, percipient witness interviews and testimony, and other relevant information. This book seeks to provide guidance on how to evaluate and then weave all that evidence together.

Overview of Lost Profits

Description

Lost profits is a form of compensatory damages, with the overriding goal of an award being to make an injured party whole for its losses. Lost profits damages seek to compensate the injured party for the difference between its financial position in the but-for world (i.e., the world that would have existed had there been no alleged wrongdoing) and its financial position in the actual world (i.e., the world that did or will exist).

Lost profits can be calculated in several ways. (See Chapter 3, "Alternative Methodologies for Lost Profits Damages"; Chapter 4, "*Ex Ante* versus *Ex Post*"; Chapter 5, "Business Valuation Methodology"; and Chapter 6, "Contrasting the Lost Business Value and Lost Profits Methodologies.") One method calculates the difference between the injured party's but-for profits (i.e., the difference between its but-for revenues and its but-for costs) and its actual profits (i.e., the difference between its actual revenues and actual costs). Another method calculates lost profits in three steps. First, the injured party's incremental revenues are calculated as the difference between its but-for revenues and its actual revenues. Second, the injured party's incremental costs are calculated as the difference between its but-for costs and its actual costs. Third, the injured party's lost profits are calculated as the difference between its incremental revenues and incremental costs. Another approach for estimating lost profits is to subtract the actual value of the injured business from the value the business would have had in the absence of the alleged wrongdoing. Though requiring somewhat different inputs and analytical steps, these various methods rely on the same underlying foundations. All seek to estimate the difference between but-for and actual performance.

With all of these methods, usually the most difficult—and also the most important—building block is the determination of what the financial performance of the injured party would have been had there been no allegedly wrongful actions. The revenues/costs/profits/value in that world serve as the baseline against which the company's actual financial position should be compared in order to determine the amount required to fully compensate it for the consequences of the alleged wrongdoing. The objective is to estimate, as reliably as possible, the losses the injured party likely realized as a result of the unlawful actions at issue. In carrying out this exercise, it is not necessary to determine the losses with absolute certainty, but it is necessary that these calculations be supported by sufficient, credible evidence such that the resulting conclusions are not speculative.

Lost profits damages may be available to compensate for past or future harm. For past lost profits, estimation of what would have happened in the but-for world is often fairly straightforward because it can be based on historical events that have actually occurred. Though past performance may also be useful in estimating the but-for performance for future periods, the uncertainty associated with how the future will unfold may make analysis of future lost profits more difficult.

At the core of lost profits is an estimation of lost *economic profits.* Economic profits can be thought of as the difference between the revenues that have been received (or will be received) and the avoided costs of the inputs that would have been used to generate those revenues. A party's economic profits may not always be equivalent to accounting-based *accrued profits*. In some cases, a better estimator will be *cash flows*, especially when they are materially different from accrued profits. (See Chapter 14, "Using Net Cash Flow versus Accrual Net Income.") Though cash and accrued profits will converge over time, they often differ over a limited period. In practice, many calculations are of lost *accrued profits*, either because of ease and custom or because they do not differ substantially from cash flows.

Legal Context

Lost profits damages claims arise in a wide variety of litigation contexts, across both contract and tort cases. (See Chapter 2, "Legal Principles for Lost Profits Damages and Related Expert Testimony.") Although all approaches share the fundamental goal of making the injured party economically "whole," the nature of the estimation exercise in the various kinds of cases can differ.

Contract Cases

With breach-of-contract claims, an award of compensatory damages is intended to ensure that the non-breaching party receives the "benefit of the bargain" that was promised in the contract. That is, the goal of lost profits damages is to put the non-breaching party in the financial position that it would have been in if the obligations of the contract had been performed as specified. Contracts that are often the subject of lost profits damages claims include sales contracts, warranty agreements, supply contracts, and license agreements, among others.

A key factor affecting the eligibility for lost profits damages in many breach-of-contract cases is whether the profits that were lost as a result of the breach were foreseeable or within the contemplation of the parties at the time of contracting. To evaluate foreseeability, courts often look at the terms of the contract itself, including the nature, purpose, and circumstances of the contract, as well as other information that may have been known by the parties at the time the contract was executed. Expectations and projections are often critical to the estimation.

Tort Cases

Lost profits also are available as damages in a variety of tort cases. Fraud, misrepresentation, tortious interference, and certain types of unfair competition are examples of torts that may give rise to lost profits damages. The objective of the analysis in these cases is to restore the injured party to the financial position it would have been in if the tort in question had not occurred. In this context, lost profits calculations often consider, but are not as closely tied to, the parties' contemporaneous expectations and projections. The fact that no prior agreement existed between the parties may affect the availability and magnitude of damages that may be recovered. Eligibility for lost profits damages in tort cases depends on the likelihood that the profits that are alleged to have been lost would have been realized in the absence of the wrongdoing. Specific rules govern the availability of lost profits damages in certain types of cases. Two such cases are *patent infringement* cases and *antitrust* cases.

Patent Infringement

Lost profits damages are a well-established form of compensation available to parties whose patent rights have been infringed, provided that the injured party is able to adequately prove that the profits in question are likely to have been earned but for the alleged infringement.

Courts have created a standard framework for the awarding of lost profits damages in patent infringement cases. To be eligible for lost profits damages, the patent holder typically must prove four things:

1) that there was demand for the patented product;
2) that the patent holder's competing product was an acceptable alternative to others in the marketplace;
3) that the patent holder could have made and sold additional units; and
4) that the patent holder's profit rate can be reasonably estimated. (See Chapter 16, "The Ability to Achieve Lost Sales as a Consideration in Damages Analyses.")

As a practical matter, the calculation of lost profits in patent infringement cases requires the patent holder to prove that infringing sales would have been made by the patent holder but for the infringement, to quantify the sales that were displaced, and to demonstrate the amount of profit the patent holder would have made on those lost sales.

Antitrust

Lost profits damages are also available in antitrust matters. Such damages can result, for example, from market foreclosure, where exclusionary acts discourage competition and result in injury to competition. Forbidden exclusionary practices include certain exclusive-dealing contracts, concerted refusals to deal, resale price maintenance and non-price restraints, and tying arrangements where a competitor in the business of the tied product is injured. In these situations, the alleged wrongdoing impairs or eliminates the plaintiff's participation in the marketplace. As such, an antitrust plaintiff's damages should reflect the difference between its performance in a marketplace free of the antitrust violations and its actual performance in the marketplace affected by the anticompetitive conduct.

Generally speaking, the mechanics of calculating lost profits damages in antitrust cases are similar to those when calculating such damages in other contexts (i.e., the difference between the injured party's financial performance in the but-for versus actual world). However, an antitrust plaintiff also must prove that the lost profits damages reflect antitrust injury, which is defined as an injury of the type that antitrust laws were intended to prevent. Given that the antitrust laws are focused on the consumer, this means that the injured party must demonstrate that competition was injured as a result of the unlawful conduct at issue. Antitrust laws protect competition, not competitors.

Elements of a Lost Profits Claim

After liability is proven (which is a prerequisite to the recovery of damages and often is assumed by a damages expert), the party seeking lost profits damages typically must establish three elements: (1) proximate cause, (2) reasonable certainty, and (3) foreseeability.

Proximate Cause

Proximate cause refers to the legal requirement that plaintiff's damages must be the natural, direct, and uninterrupted consequence of defendant's wrongful act. In other words, there must be sufficient evidence showing that, but for the alleged wrongdoing of the defendant, there would have been no injury. (See Chapter 7, "Proving Loss Causation.") As part of this analysis, the injured party must show that the harm flowed directly from the unlawful conduct at issue. That is, the harm must not be remote or unduly consequential.

Even if the claimant is able to establish a causal link between the alleged wrongdoing and lost profits, the defendant may be able to avoid an award of lost profits damages by demonstrating that some intervening cause—such as a voluntary and independent business decision by the claimant, an unexpected input price shock, or a decline in consumer spending—is primarily responsible for the losses suffered by the claimant. The defendant's actions need not be shown to be the *sole cause* of the plaintiff's injury, but they must be shown to be a significant or material cause of injury.

Reasonable Certainty

Reasonable certainty refers to the requirement that lost profits damages must be estimated using reliable methods and evidence. Although absolute precision is not required, the lost profits claim must not be remote, speculative, or hypothetical (i.e., it must be within the realm of reasonable certainty).

In seeking lost profits damages, a plaintiff is required to establish not only the *fact* of damages (i.e., that some profits were lost due to the alleged wrongdoing), but also the *amount* of damages, though somewhat more uncertainty is allowed in establishing the amount of damages versus the fact of damages.

Foreseeability

Foreseeability refers to the requirement that losses claimed by the plaintiff are the predictable consequence of defendant's alleged misconduct (i.e., are foreseeable and probable). In some cases, foreseeability is assessed based on the contemplation of both parties. In other cases, it is assessed based on more objective information.

Additional Considerations

In addition to the three core elements of lost profits described above, other important considerations include the determination of the relevant damages period, the injured party's obligation to mitigate its losses, and the time value of money.

Damages Period

Determining when the harm to plaintiff begins and ends is critical to adequate quantification of lost profits damages. (See Chapter 15, "Period of Damages.") In practice, identifying the beginning of the damages period is often easier than establishing the end because the negative effects of unlawful business conduct may extend well beyond the point when the unlawful conduct ceases.

From an economic perspective, the damages period should continue until the unlawful conduct ceases to affect the profits of the injured party, which depends on the specific circumstances of the case at hand. From a legal perspective, however, the damages period may be limited. In a breach-of-contract case, for instance, lost profits damages often may extend only through the life of the breached contract, not beyond.

Mitigation

In considering lost profits damages, it is often important to account for actions taken (or actions that should have been taken) by the injured party in response to the alleged wrongdoing. (See Chapter 13, "Mitigation of Damages in the Lost Profits Calculation.") The injured party should not be compensated for the damage it could have avoided (or actually did avoid) by reasonable efforts and expenditures. The burden of proof for establishing the availability and magnitude of mitigation opportunities is on the defendant; however, a plaintiff's expert may preempt any challenge by considering possible mitigation in conjunction with the expert's damages study.

In practice, an injured party's ability and obligation to mitigate losses associated with a defendant's unlawful conduct may be limited by a variety of factors, including the financial position of the injured party, the magnitude of the costs associated with mitigation compared to the expected benefits, supply limitations facing the injured party, and technical or marketplace barriers to pursuing alternative options.

Given such potential obstacles or disincentives to mitigate, the determination of the magnitude of a mitigation offset, if any, depends on the specifics of each case. For instance, in the case of a distributor alleging that the defendant refused to provide necessary supplies, the injured