

Economic Damages – The Critical Nature of Revenues

By David Riley, CPA/ABV/CFE, ASA, CVA, CFE, CMA, CBA

There are many elements for experts to consider when putting together a credible economic damages opinion. One of the most critical elements involves understanding the nature of economic factors influencing revenue trends.

Economic damages represent the dollar amount necessary to place the plaintiff in the same position that the plaintiff would have been in had the damaging event not occurred. Generally, the underlying theory of damages is the “but for” concept, which states that “but for” the damaging event, the plaintiff would have experienced a higher level of revenues and associated profits.

The nature of a company’s revenues consists of interrelated components, which when properly analyzed, portray an accurate and understandable economic picture. Experts can be very helpful in assisting attorneys visualize economic damages and develop their story to be presented to the trier of fact.

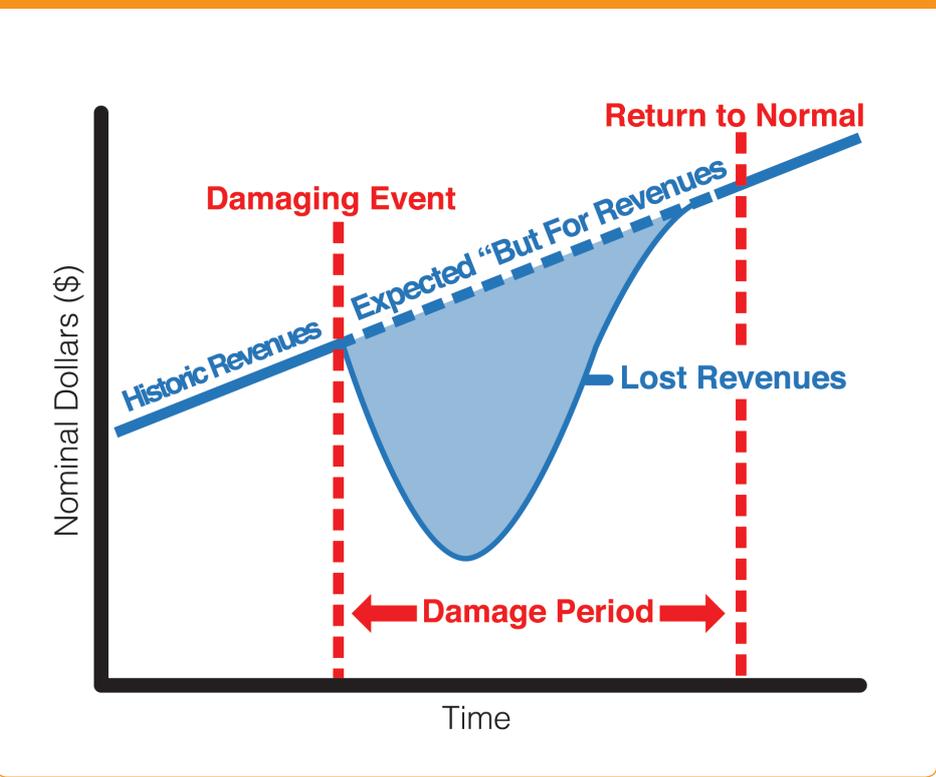
Here is an example that demonstrates a basic “but for” revenue scenario with a graph that illustrates the impact of a damaging event on revenues: (See Graphic 1)

First, a study of historic revenues is necessary to gain insight into the company’s revenue-generating capacity. For this to be accurate, the analyst must thoroughly understand the magnitude of internal and

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Graphic 1



Graphic 2



external economic drivers that affect revenues. These drivers consist of economic, industry, and company-specific factors.

Second, with an understanding of these drivers, the expert can build assumptions of how the damaging event would influence future expected revenues. These assumptions are the foundation in calculating the gap between the expected “but for” revenues and the actual revenues. With a deep understanding of the interplay of these factors, the expert can derive a credible expectation of future “but for” revenues. This allows the attorney to incorporate revenue performance attributes throughout the orchestration and navigation of trial strategies.

For illustrative purposes only, a plaintiff’s expert failed to understand the nature of revenue performance in a tortious interference case. In this case, historic revenues were declining and the plaintiff’s expert incorrectly dismissed the revenue decline as an aberration of the available data sample. Further, the plaintiff’s expert incorrectly projected “but for” revenues to increase by an annual inflation rate of 3 percent. (See Graphic 2)

The plaintiff’s expert failed to recognize that the historic decline of revenues, caused primarily by factors within the industry and the specific geographic area, were unrelated to the damaging event. Proper investigation of the performance drivers of historic revenues would have disclosed a continued decline to a normalized level of revenues.

Unfortunately, for the plaintiff’s legal team, a trial strategy was developed based on their expert’s damage opinion of \$7 million. After two weeks of trial presentation and 90 minutes of deliberation, the jury found damages to be \$0.

A better understanding of revenue generating capacity from the plaintiff’s expert may have led to a more realistic and favorable outcome for the plaintiffs. A complete and thorough investigation of the economic, industry, and company-specific factors should have led the plaintiff expert to opine a lesser and more reasonable amount of damages. The plaintiff’s counsel, armed with a more reasonable damage amount, would most likely have developed a litigation strategy more aligned with obtaining a favorable outcome for their client.

It is critical for a credible expert to understand the full scope of the company’s revenues before the damaging event and during the damage period. A lack of understanding can lead to dire consequences including, but not limited to:

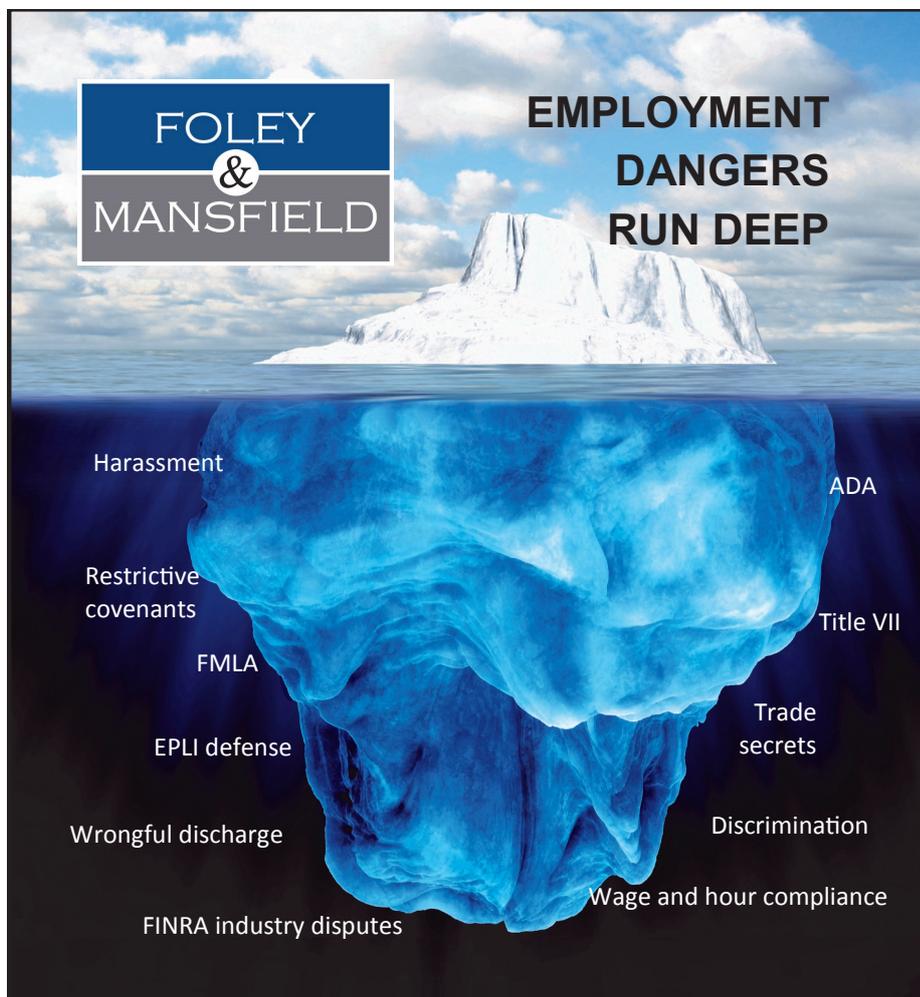
- Causing lead attorneys to develop inef-

fective trial strategies. Unfortunately, garbage-in from the expert can mean garbage-out by the attorney.

- Interfering with an economically efficient resolution throughout the litigation process. For example, the strategic nature of a trial is dramatically different from a \$700,000 allegation when compared to a \$7 million allegation.
- Causing the “weakest link” of both the legal arguments and the damage arguments to exist before the litigation process even begins. The attorney starts behind the 8 ball without even knowing it.
- Causing the presented economic story

to lack substantive evidence. The trier of fact will merely perceive the allegations to be no more than wishful thinking.

The above example shows that many elements are critical in painting a credible economic picture in damage cases. One of the primary roles of an expert in litigation is to analyze and communicate the economic factors affecting historic and expected “but for” revenues. Proper analysis will assist attorneys with their litigation strategies and allow presentation of credible evidence to the trier of facts.



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