Calculating lost business profits

In this article we provide an introduction to the calculation of economic damages in lost business profits cases. We begin by discussing typical business claims that tend to result in legal claims of lost business profits. We then discuss the general economic methodologies that are used to project lost business profits. Finally, we explore the documents that are typically needed in an analysis of lost business claims.

Business profits are calculated by subtracting the cost of production from the relevant revenue stream.

In a typical lost business profits these cases, the plaintiff often alleges that defendant's actions impaired the business operation in some manner. For instance, in a recent case a food supplier was sued by a national restaurant chain for allegedly supplying tainted food to hundreds of its west coast restaurants.

After learning about the tainted food from the supplier, the restaurant chain temporarily closed the stores, some for up to 30 days while the matter was resolved. The restaurant chain noted that because of the negative publicity, food sales lagged significantly in the stores even after the stores re-opened. The restaurant chain alleged that the suppliers tainted food supply resulted in millions of dollars of lost business profits.

In the above instance, the business entity was still operational but experienced reduced income. In other instances, the business entity alleges that the other party's actions caused it to permanently cease some or all of its operations. In still other instances, the business entity asserts that it was damaged before it even began its operations. The underlying methodology used to calculate the economic value of the alleged lost business profits in the three instances tends to be similar.

Methodology

Generally, calculating lost business profits involves comparing the business profits the entitiy would have received, but-for alleged actions of the defendant, to the business profits that they actually received. Business profits that the entity would have received had the defendant's actions not occurred, is typically referred to as the 'but-for' profits. Business profits are calculated by subtracting the cost of production from the relevant revenue stream.

In the restaurant case described above, the plaintiff calculated their damages by comparing the pre- and post-incident store sales for each of the restaurants impacted by the tainted food incident. The 'but-for' sales revenue growth was projected using historical data from each store. Financial records were used to calculate the operating expenses associated with the sales revenue.

The methodology used in the restaurant example is generally referred to as the **before and after** method. The before and after method generally involves first determining the earnings picture prior to the defendants actions. Historical data on sales, costs, clients, and related areas are typically used in this calculation. The before picture is then compared to the after event business profits. In addition to the measure there is the 'yardstick approach', the but-for revenue is based on some type of external benchmark. In the 'sales projections' method, the but-for analysis is based on some other basis, such as the number of sales in the sales pipeline, for projecting anticipated revenue or profit during the damage period.

Calculating the lost business profits requires the analysis of specific data, of which there are three main categories. These are the deccription of the business (history and operation) , management and employees, and products and services it offers.

Types of business claims

There are three basic types of lost business profits claims. In some in claims, the business continues to exist, but it alleges that the other party's actions reduced its income. In others, the business alleges that the other party's actions caused it to cease some or all of its operations. In some cases, the business asserts that it was damaged before it began its operations. We calculate the economic value of the alleged lost business profits or evaluate the other party's damage claims in these cases.

Generally, the measure of damages for breach of contract is that which restores the injured party to the economic position he would have enjoyed had the contract been performed. These include compensatory damages, expectation damages, consequential damages, and liquidation damages. It is common for any number of reasons to have breach, including franchisee agreeements, supply chain issues, operation of business injures other business, and making them whole. We help calculate or rebut these claims. In cases involving tortious interfference, it is often alleged that one business is unlawfully interferering with the operation of another business. This could, for example, involve a supply chain issue.

Analyzing business damages

Generally, calculating lost business profits involves comparing the 'but-for' alleged action lost revenues and lost profits. There are generally three methodologies used in these calculations. In the "before-and-after" method, the but-for revenue is based on the historical operations of the business. In the "yardstick" approach, the but-for revenue is based on some type of external benchmark. In the "sales projections" method, the but-for analysis is based on some other basis, such as the number of sales in the sales pipeline, for projecting anticipated revenue or profit during the damage period.

Breach of contract cases often involve compensatory damages. These are damages intended to compensate the non-breaching party for losses due to the breach. The aim is to 'make the injured party whole again'.

Contracts between businesses are the backbone of the economy.

There are three types of compensatory damages. **Expectation damages** are intended to cover what the injured party expected to receive from the contract and usually have straightforward calculations based on the contract itself or market values. **Consequential damages** are intended to reimburse the aggrieved party for indirect damages besides the contractual loss; for example, loss of business profits due to an undelivered machine. They must 'flow from the breach', and be reasonably foreseeable upon entering into the contract. **Liquidation damages** are specifically provided for in the contract. These are available when damages may be hard to foresee and must be a fair estimate of what damages might be in case of breach.

Tortious interference methodology is similar to lost profits methodology, but with the benchmark point being when the interference began. Calculating lost business damages involves comparing the 'but-for' alleged action lost revenues and lost profits. There are three basic methodologies used in these calculations. In the "before-and-after" method, the but-for revenue is based on the historical operations of the business. In the "yardstick" approach, the but-for revenue is based on some type of external benchmark. In the "sales projections" method, the but-for analysis is based on some other basis, such as the number of sales in the sales pipeline, for projecting anticipated revenue or profit during the damage period.

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We help calculate and rebut alleged damages in lost business profit cases. Contact us to learn more.

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Questions or comments

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