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ARTICLES

MEASURING COMMERCIAL DAMAGES VIA LOST PROFITS OR LOSS OF BUSINESS VALUE: ARE THESE MEASURES REDUNDANT OR DISTINGUISHABLE?

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I. INTRODUCTION***

Commercial litigation disputes frequently involve claims for damages measured as lost profits or loss of business value. For example, a

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*** The original ideas for what eventually evolved into this article were conceived as a result of the authors' collaboration in 1994 on the analysis of a multitude of damages issues in a bitterly contested commercial dispute. In November 1996, at the invitation of the National Association of Forensic Economics, the authors presented their first version of this article in Washington, D.C. This article was further refined when the authors were invited to speak at the October 1997 National Advanced Litigation Services Conference of the American Institute of Certified Public Accountants in Las Vegas, Nevada, the July 1998 Summer Conference of the National Litigation Support Services Association in Lake Tahoe, Nevada, and the August 1998 Business Valuation/Litigation Services Seminar of CPA Associates International in Atlanta, Georgia. The authors gratefully acknowledge the many useful comments and suggestions provided by attendees at the aforementioned conferences and seminars.

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plaintiff may bring an action alleging damages that have occurred prior to the date of the suit in the form of lost profits. Alternatively, a plaintiff may allege damages at the time of the suit going forward—in the form of future lost profits, lost goodwill, or loss of business value.

Federal and state laws provide different remedies depending on the type of claim brought by a plaintiff. The type of economic damages alleged (loss of profits from specific transactions, loss of business reputation or goodwill value, or the destruction of the business outright) will also often dictate which measure of damages is most applicable. However, in some cases plaintiffs seek both lost profits and loss of business value. The courts have not always clearly, nor consistently, distinguished these two types of remedies and there frequently exists confusion as to whether or not the two damage measures are redundant or overlap one another.

In many cases, both measures of damages are not justified by the type of claim alleged by a plaintiff. This is because the value of a business is ultimately determined by the profits that can be earned by the business. Lost profits are measured over a specific time period whereas the value of a business, in principle, represents the value of all future expected profits to be earned over the life of a business. These two measures of damages can overlap and great care must be exercised when both measures are used simultaneously (perhaps additively) in a damage calculation. Ultimately, the question of which measure is the most appropriate will usually depend on the applicable law of a specific jurisdiction and the circumstances of each case.

The purpose of this article is to distinguish between the measurement of damages as lost profits versus damages as loss of business value.¹ The article identifies the key components of these measurements of damages as well as reviews the types of cases and circumstances in

1. Many articles and texts which discuss estimating commercial damages acknowledge that these two possible measures of damages exist and differ but do not indicate how to decide when to use either measure. See, e.g., Carroll B. Foster et al., *Losses in Commercial Litigation*, 6 J. FORENSIC ECON. 3, 180 (1993) ("Roughly speaking, the economic damage to be calculated in a commercial suit will follow from either a lost profit or a lost asset value model. The former is frequently associated with business interruption cases, and the latter with business valuation and securities fraud cases. Either model might be appropriate in breach of contract, commercial tort, or antitrust cases, depending on the specific situation."); James Plummer, *Is the Value of a Firm the Upper Limit of Future Lost Profits in Business Litigation?*, 1 LITIG. ECON. DIG. 1, 25 (1995) ("The law recognizes both 'lost profits' and 'diminution of business value' as ways of measuring damages, but without statutory or case law guidance as to whether one of these measures of damages ought to be considered an upper limit on the other.").

which the courts have addressed this issue. Finally, the article suggests methods of properly utilizing both damage measures without redundancy.

II. METHODS OF CALCULATING BUSINESS DAMAGES

A. *Demonstrating Business Damages*

Actual or compensatory damages are those damages sustained by a plaintiff as a direct result of the defendant's conduct. These damages can include out of pocket losses as well as lost profits or loss of business value. At least two primary requirements must be met in order to bring a damage claim. First, the alleged wrongful conduct of the defendant must be the legal or "proximate" cause of the damages.² Second, the damages must be proven with reasonable certainty.³ Namely, sufficient evidence must be provided to demonstrate that damage to the plaintiff has in fact occurred.

Once causation and the existence, or fact, of damages has been established, the amount of damages may be estimated using a variety of methods. The method of quantifying damages does not necessarily have to be exact. Damage estimates are by their very nature somewhat speculative. Damage analyses are acceptable provided they are not unreasonable and are not founded on conjecture or impermissible speculation. The basis upon which a damage claim rests must be reasonable, have satisfactory support in the facts and evidence of the case, and be based upon methods which are generally supported by economic or financial theory.⁴

2. See ROBERT L. DUNN, RECOVERY OF DAMAGES FOR LOST PROFITS § 1.1 (5th ed. 1998) (discussing the legal principle of proximate causation); see also Jeffrey H. Kinrich et al., *Forensic Accounting and Litigation Consulting Services*, in ACCOUNTANTS' HANDBOOK ch. 34, §§ 34.3(b) and 34.19 (7th ed. 1990) (discussing the required proof for causation).

3. See DUNN, *supra* note 2, §§ 1.4, 1.5 (discussing concept of reasonable certainty) and § 1.6 (discussing that the *fact* of damages must be demonstrated with reasonable certainty but not necessarily the *amount* of damages); see also WILLIAM A. CERILLO, PROVING BUSINESS DAMAGES §§ 111-114 (2d ed. 1991) (discussing the distinction between the *fact* of damages and their *amount*).

4. See CERILLO, *supra* note 3, §§ 112, 121 (stating that damages do not have to be exact) and § 122 (stating that undue speculation is not permitted); DUNN, *supra* note 2, § 5.1 (stating that exact calculation is not required), and § 7.27 (stating that recovery of damages is denied if evidence of loss is too speculative).

The law also imposes a duty on an allegedly damaged party to mitigate, that is, attempt to minimize, damages that may have been suffered. If an allegedly damaged party does not take reasonable steps to avoid further loss, that party risks not being able to recover continuing damages. See DUNN, *supra* note 2, §§ 6.33-6.36; Kinrich et al., *supra* note 2, § 34.20(b).

B. *Measuring Lost Profit Damages*

Lost profits represent the difference between what a business would have earned with and without a defendant's allegedly injurious behavior.⁵ The damage period is the period in which the defendant behaved in an injurious manner or the period in which the plaintiff suffered a loss of profits.⁶

Efforts should also be taken in any damage analysis to examine the role of any other exogenous factors or other considerations not the result of the defendant's behavior, which may have contributed to the plaintiff's loss of profits. If these other factors (such as changes in general economic conditions, increased competition, mismanagement of the business, or increased costs) are partially accountable for any decreases in the plaintiff's profits, then the effect of these factors must be accounted for and deducted from any calculation of lost profits.

There exist at least three typical methods of calculating lost profit damages.⁷ A brief description of each of these methods follows:

"Before and After" Approach—Under this approach, the plaintiff compares the profitability of the plaintiff's business before and after the alleged harmful acts were committed by the defendant. Some account for future expected growth in the business may be included in this calculation.

"Yardstick" Approach—Under this approach, the plaintiff compares the profitability of the plaintiff's business to a comparable firm or other unharmed location of the plaintiff's business to determine the results which would likely have occurred but for the defendant's actions.

Company or Market Forecast Approach—Under this approach, the plaintiff uses sales projections or forecasts of expected performance for plaintiff's business or the industry to determine the likely results of defendant's harmful actions.

5. See Robert E. Hall & Victoria A. Lazear, *Reference Guide on Estimation of Economic Losses in Damages Awards*, in REFERENCE MANUAL ON SCIENTIFIC EVIDENCE 471, 477-78 (Federal Judicial Center 1994); R.F. Lanzillotti & A.K. Esquibel, *Measuring Damages in Commercial Litigation: Present Value of Lost Opportunities*, 5 J. ACCT., AUDIT & FIN. 125, 125-126 (1990).

6. See Michael J. Wagner, *The Accountant's Role in the Process of Damage Measurement*, 23 THE PRACTICAL ACCOUNTANT 52, 55-56 (July 1990) (graphically illustrating the damage period).

7. See Neill W. Freeman & James A. Spielmann, *Lost Profits*, in LITIGATION SERVICES HANDBOOK: THE ROLE OF THE ACCOUNTANT AS EXPERT WITNESS ch. 30, § 30.5 (Peter B. Frank et al. eds., 1995) (noting the most common methods of measuring lost profit damages); see also Kinrich et al., *supra* note 2, § 34.21.

C. *Measuring Loss of Business Value Damages*

On the other hand, if a business is destroyed completely, for example by fire or because a defendant's actions were so harmful that a plaintiff is forced out of business, the damages may be calculated as the value of the business at the time it was destroyed.⁸

The value of the business with and without the harmful actions of the defendant can be determined using one or more of the following methods:⁹

Discounted Net Cash Flow (Economic Income) Approach—This approach is based on the premise that the value of a business enterprise is the present value of the future economic income to be derived by the owners of the business.

Capital Market (Guideline Publicly Traded Company) Approach—This approach utilizes the premise that the value of a business enterprise should be determined based on what astute and rational capital market investors would pay to own the stock in the subject company.

Comparative Market Transaction Approach—This approach determines the value of the business by comparing the subject firm to comparable firms that have been bought or sold during a reasonably recent period of time.

D. *As of What Date Should Business Damages Be Calculated?*

In calculating loss of business value or lost profits damages, a date or dates must be selected at which to value the damages. For instance, loss of business value must be calculated as of a particular date. Due to the fact that the value of a business may differ depending on the date of valuation, the amount of loss of business value damages will also be affected. In the case of lost profits, the date or dates at which damages are

8. See DUNN, *supra* note 2, § 6.24, at 500 ("If a business has not just been injured, but has been destroyed, almost all of the few cases on point hold that lost profits damages are not recoverable at all. The measure of damages is said to be the market value of the business on the date of destruction."). Alternatively, if the plaintiff's business was permanently damaged by a defendant's behavior, but not completely destroyed, the damages could be calculated as the change in the value of the business before and after the defendant's injurious behavior—net, of course, of any other exogenous or other factors not related to the defendant's actions. This calculation would involve the value of the business before and after the actions occurred or, alternatively, an estimate of the value of the business, assuming the harmful actions did not occur, compared to the actual value of the business after the actions occurred.

9. See, e.g., SHANNON P. PRATT ET AL., *VALUING SMALL BUSINESSES AND PROFESSIONAL PRACTICES* ch. 14-16, 18 (3d ed. 1998) (describing in detail the valuation methods); SHANNON P. PRATT ET AL., *VALUING A BUSINESS: THE ANALYSIS AND APPRAISAL OF CLOSELY HELD COMPANIES* ch. 9-11 (3d ed. 1996).

to be calculated may determine whether or not discounting of lost profits to present value may be required. If the relevant case law or the court resolves this issue in advance, the damage expert is not required to select the date at which to calculate damages. This, however, is not usually the case.

Several papers within the forensic economics and accounting literature discuss the significance and considerations of determining the appropriate date as of which to calculate damages.¹⁰ While that topic is beyond the scope of this article, a couple of points are worth noting. First, there is considerable controversy as to what is the appropriate date at which to calculate economic damages. Damages can, in principle, be calculated at the date of violation, the date of cessation of violation(s), at the date of trial, or at the date of recovery or award. Second, the amount of damages may differ depending on the date at which the damages are calculated. The amount of damages may differ because external economic or market conditions may (are likely to) differ depending on the dates chosen at which to calculate damages. Moreover, some dates (such as the date of violation) may require discounting lost profits to present value whereas other dates (such as the date of trial or award) may not require discounting.

E. Should a Damage Calculation Incorporate the Benefit of "Hindsight"?

A related issue regarding the timing of calculating damages arises because most cases are not tried or resolved until some time after the wrongful acts of a defendant have occurred or have ceased to have occurred. Because damages are not known with certainty at the time of a violation, the subsequent passage of time until trial or recovery may remove some (or perhaps all) of the uncertainty as to what would have occurred had the harm never occurred. The issue involves whether or not the use of data and information, or "hindsight," after the violation should be used in formulating a damage calculation.

10. See, e.g., James M. Patell et al., *Accumulating Damages in Litigation: The Roles of Uncertainty and Interest Rates*, 11 J. LEGAL STUD. 341 (1982) (discussing date to calculate damages); Franklin M. Fisher & R. Craig Romaine, *Janis Joplin's Yearbook and the Theory of Damages*, 5 J. ACCT., AUDIT & FIN. 145 (1990); Lanzillotti & Esquibel, *supra* note 5; John D. Taurman & Jeffrey C. Bodington, *Measuring Damage to a Firm's Profitability: Ex Ante or Ex Post?*, 37 THE ANTITRUST BULLETIN 57 (1992); Elo R. Kabe & Brian L. Blonder, *Discounting Concepts and Damages*, in LITIGATION SERVICES HANDBOOK: THE ROLE OF THE ACCOUNTANT AS EXPERT WITNESS ch. 37A, § 37A.4(a) (Peter B. Frank et al. eds., 1998 Supp.).

For example, a damage expert may want to use the actual performance of the plaintiff's industry or competitors during the damage period to estimate the likely performance of the plaintiff in the absence of the defendant's alleged wrongful behavior (such as the "yardstick" lost profit approach discussed earlier). Alternatively, the damage expert may prefer to use only that data or information which was available at the time of the violation (such as the company or market forecast lost profit approach also discussed earlier). Again this issue is beyond the scope of this article. However, it is worth noting that there does not exist a consensus within the forensic economics and accounting literature as to whether or not the benefit of hindsight should be used in calculating damages.¹¹

F. Should Damages Be Discounted to Present Value or Accumulated to Include Prejudgment Interest?

1. Damages calculated to the date of violation

If damages are to be calculated as of the date of violation, then the discounting of all damages to present value as of the date of violation may be appropriate.¹² The discounted value could then be carried forward by the addition of prejudgment or statutory interest to the date of trial to compensate the plaintiff for the delay between the date of the violation and the date of trial.¹³ Any delay following trial to the date of actual re-

11. See Fisher & Romaine, *supra* note 10, at 153-56 (arguing that hindsight should not be used); but cf. Lanzillotti & Esquibel, *supra* note 5, at 137-38 (presenting the alternative advantages of both using and ignoring data and information with hindsight); Jeffrey C. Bodington, *Appraising the Profits Lost by a Failed New Venture*, 4 J. FORENSIC ECON. 1, 8-11 (1990) (describing two approaches, "investment" and "opportunity," which ignore data and information after the violation and a third approach, "outcome," which does allow using data and information with hindsight); Taurman & Bodington, *supra* note 10, at 106 (arguing that the "outcome approach," which uses "hindsight," is becoming more prevalent in court cases and perhaps is even preferable to not incorporating the benefit of hindsight).

12. See Hall & Lazear, *supra* note 5, at 495 (demonstrating the calculation of the present discounted value of damages).

13. See *id.* at 491-493 (demonstrating the calculation of prejudgment interest); John R. Phillips & Neill W. Freeman, *Interest as Damages*, in LITIGATION SERVICES HANDBOOK: THE ROLE OF THE ACCOUNTANT AS EXPERT WITNESS ch. 40 (Peter B. Frank et al. eds., 1995) (summarizing the legal rules and precedents regarding prejudgment and postjudgment interest).

Several articles discuss the calculation of damages as of the date of violation. See Fisher & Romaine, *supra* note 10, at 150 (discussing the discounting of damages back to the date of violation then accumulated to the date of award); Lanzillotti & Esquibel, *supra* note 5, at 132-137 (discussing two methods of calculating *past* lost profit damages as of the date of the violation: accumulate damages from the date of violation to the date of award vs. discount the damages to the date of violation and

covery could then be compensated for by the addition of postjudgment or statutory interest.¹⁴

2. *Damages calculated as of the date of trial*

If damages are to be calculated as of the date of trial, then *future damages* (projected to occur after the date of trial) would only be discounted to the date of trial (no prejudgment interest would be necessary) and *past damages* (from date of violation to date of trial) would be accumulated, if applicable, at a prejudgment or statutory rate to compensate for the delay from the date of violation to the date of trial.¹⁵

G. *How Does One Deal with "Unestablished" Businesses?*

Unestablished businesses are those businesses which are not yet profitable or have not yet established an operating track record from which to confidently and reliably project future operating performance. These young businesses may require the use of more assumptions and reliance on fewer pieces of documented data and information in preparing

then accumulate forward to the date of award); Kabe & Blonder, *supra* note 10, at 7-8 (discussing three methods of calculating *past* lost profit damages as of the date of violation; two methods similar to those discussed in Lanzillotti & Esquibel, plus the method of the total damages without any discounting or accumulation).

Several articles also discuss the theoretical selection of an appropriate interest rate. See Roman L. Weil, *Compensation for the Passage of Time*, in LITIGATION SERVICES HANDBOOK: THE ROLE OF THE ACCOUNTANT AS EXPERT WITNESS ch. 37 (Peter B. Frank et al. eds., 1995) (discussing the conceptual issues of selecting the appropriate interest rate for accumulating past damages forward to the date of payment); Fisher & Romaine, *supra* note 10, at 148 ("prejudgment interest should be awarded at the risk-free rate"); Lanzillotti & Esquibel, *supra* note 5, at 134 ("the sum of the discounted expected lost profits is compounded forward to the time of the award using the risk-free rate"); Patell et al., *supra* note 10, at 363 ("the defendant's debt rate becomes the correct accumulation rate"); Michael S. Knoll, *A Primer On Prejudgment Interest*, in LITIGATION SERVICES HANDBOOK: THE ROLE OF THE ACCOUNTANT AS EXPERT WITNESS ch. 40A, at 10, (Peter B. Frank et al. eds., 1998 Supp.) ("prejudgment interest should be compounded and calculated at a short-term rate that reflects the defendant's cost of unsecured borrowing").

14. See Phillips & Freeman, *supra* note 13 (summarizing the legal rules and precedents regarding postjudgment interest).

15. See Fisher & Romaine, *supra* note 10, at 150 (arguing that one-time violations should be discounted to the date of violation and then accumulated to the date of recovery). These authors also appear to argue that "continuing" or ongoing violations should not be discounted but only accumulate to the date of recovery. See *id.* at 152. One apparent difficulty with the authors suggested approach is the ability to distinguish "one time" from "continuing" violations. For example, is the breach of a long term contract one time (at date of breach) or continuing (because the breach extends over the term of the contract)? See Lanzillotti & Esquibel, *supra* note 5, at 137-38 (discussing the case of a trial and damage award occurring prior to the cessation of the violation(s) and recommending the accumulation of "past" damages before the date of the trial/damage award and the discounting of "future" damages).

a damage calculation than would be required for an "established" or "mature" business.

Until recently, the courts generally did not allow lost profit or loss of business value damages for an "unestablished" business.¹⁶ However, with the increased sophistication of damage analysis and methods, the courts will now consider damages for unestablished businesses which are sufficiently documented and are not perceived as unduly speculative or not calculated with reasonable certainty.¹⁷

III. THE LEGAL PERSPECTIVE ON COMMERCIAL DAMAGES MEASURED BY LOST PROFITS AND/OR LOST BUSINESS VALUE

A. *Placing Judicial Decisions Regarding Commercial Damages in Context*

There is a voluminous body of case law which discusses the issue of damages in the context of commercial disputes.¹⁸ The courts seem to struggle from a legal perspective, however, with the task of providing definitive guidance as to the distinction between lost profits and loss of business value. Although there certainly are published cases which address these topics, as the discussion below demonstrates, the guidance from the courts is less than clear.

Before analyzing specific cases, some general observations about the context in which commercial damages issues are addressed by the courts is warranted. Rational business decision making regarding how litigation over commercial disputes should be conducted, and what resources should be devoted to those efforts, necessarily involves quantification of potential damages, and the components of those damages. As a practical matter, however, lawyers and their clients often devote a disproportionate amount of time in the early stages of litigation to the question of whether liability can be established and the potential defenses to that liability.

All too often, it is only after a deadline for the exchange of expert reports is set and/or a trial date looms on the horizon, that the parties involved in commercial litigation focus on a more precise analysis of dam-

16. See DUNN, *supra* note 2, § 4.3, at 345 ("Most recent cases reject the once generally accepted rule that lost profits damages for a new business are not recoverable.").

17. See Bodington, *supra* note 11, at 7-14 (discussing damage estimation techniques for unestablished businesses); see also Isaac D. Barchas & Roman L. Weil, *Lost Profits Damages to New Businesses*, in LITIGATION SERVICES HANDBOOK: THE ROLE OF THE ACCOUNTANT AS EXPERT WITNESS ch. 31 (Peter B. Frank et al. eds., 1995).

18. See, e.g., DUNN, *supra* note 2.

ages issues. As a direct consequence, issues concerning damages are less likely to be addressed and extensively briefed as part of pretrial civil motion practice than liability issues are. Given that most civil commercial disputes settle before trial, there are fewer opportunities for judges to address damages issues except in the context of post-trial motions, in which, typically, a "laundry list" of liability and damages issues are raised for consideration. This partially explains the sometimes more superficial analysis of damages issues in the published case law, as compared to the attention devoted to liability issues.¹⁹

There are other possible explanations for this phenomenon. One is that judges are former lawyers, and more specifically, generally, former litigators. Lawyers and judges often have liberal arts backgrounds as college undergraduates. In addition, law schools devote little time to finance, accounting and economic topics. Ultimately, this lack of finance, accounting and economic sophistication may at times put judges in the awkward position of having to make Solomon-like pronouncements regarding complicated commercial damages issues. In stark contrast, the financial experts called upon by the parties to testify on damages issues in most instances have devoted their careers to an analysis of commercial damages topics. Notwithstanding these potential impediments to in-depth and scholarly analysis, the courts do not hesitate to squarely address damages issues when necessary, and in particular, lost profits and business valuation issues, but do so with predictably mixed results.

The following analysis of selected case law attempts to identify the general themes articulated by the courts when faced with issues regarding situations in which lost profits and/or diminution of business value damages might be appropriate. This is by no means intended to be an exhaustive analysis of all of the published case law discussing these topics. However, a sufficient number of cases were reviewed in order to identify cases representative of the various positions adopted by the courts.

As noted above, plaintiffs in commercial cases sometimes seek lost profits damages, loss of business value damages, or both. Unfortunately, the published case law does not always clearly or consistently distinguish between these two measures of damages. There is some confusion as to whether or not these two measures of damages are redundant or overlap one another.

19. Moreover, after trial, judges are generally loathe to tamper with the factual findings of a jury, and legal issues not raised previously might be found to be waived.

B. Destruction of a Business

A good starting point for this discussion is the one situation in which the courts seem to be in agreement. When a business is completely destroyed, published cases reiterate the principle that the market value of the business on the date of loss is the proper measure of damages.²⁰

In *Aetna Life & Casualty Co. v. Little*, an insurance carrier appealed a jury finding that the carrier, in bad faith, failed to satisfy a personal injury judgment for which coverage was provided. As a result, the insured's business was destroyed when the insurer did not satisfy the judgment and the business could not pay. The court stated, "Lost profits and loss of use may be a proper item of damages if the property or business is not completely destroyed. . . . However, where the property or business is totally destroyed we hold the proper total measure of damage to be the market value on the date of loss."²¹

A separate issue in destroyed business cases is whether an unestablished business, without a track record, can be valued with reasonable certainty. Notwithstanding the general principle articulated in *Aetna*, whether business value damages are appropriate in the destruction of the unestablished business scenario depends on the facts. Plausible arguments can be made that it is simply too speculative to attempt to place a business value on the neophyte business.

A recent lender liability case from the Second Circuit reaches the same result as *Aetna*.²² Indeed, the Second Circuit went so far as to say that, "when the breach of contract results in the complete destruction of a business enterprise and the business is susceptible to valuation methods, such an approach provides the *best* method of calculating damages."²³

C. Lost Profits

As discussed above, the courts have found that in the destroyed business situation, loss of business value, rather than lost profits, is the ap-

20. *Aetna Life & Casualty Co. v. Little*, 384 So. 2d 213 (Fla. Dist. Ct. App., 4th Dist. 1980) (illustrating that market value on date of loss is the proper measure of damages). *But see* Allen S. Joslyn, *Measures of Damages for the Destruction of a Business*, 48 BROOKLYN L. REV. 431, 431-32 (arguing that in situation involving a destroyed business, either lost profits or going concern value method of calculating damages is appropriate but plaintiff is not entitled to both).

21. *Aetna*, 384 So. 2d at 216 (noting that implicit in the *Aetna* decision was a recognition that the destroyed business was an established ongoing concern) (citations omitted).

22. *See* *Indu Craft, Inc. v. Bank of Baroda*, 47 F.3d 490 (2d Cir. 1995).

23. *Id.* at 496 (emphasis added).

propriate measure of damages.²⁴ In certain situations, it is clear that only lost profits are available as an element of damages. For example, a plaintiff may allege the breach of a contract that has a fixed term. In such a scenario, the plaintiff's damages should be limited to the profits lost during the term of the contract.²⁵

In *Mark Seitman & Assocs., Inc. v. R. J. Reynolds Tobacco Co.*, the parties had a contract under which Reynolds agreed to sponsor a tabloid to be published by Seitman in exchange for being the exclusive advertiser.²⁶ The contract had a five-year term provided that Reynolds could terminate the contract by giving notice on or before March 1st of any contract year.²⁷ Reynolds terminated the contract and a jury found in favor of Seitman holding that Reynolds had wrongfully and prematurely terminated the contract.²⁸ Because Seitman had no other tabloid business apart from that which was provided by the contract with Reynolds, the cancellation of the contract caused Seitman to go out of the tabloid publishing business.²⁹ The jury awarded Seitman lost profits in the amount of the value of plaintiff's business and out-of-pocket close down costs of the tabloid business.³⁰ On appeal, Reynolds challenged the business value damages award. Applying North Carolina law, the Eleventh Circuit held that Seitman could only recover lost profits for the remainder of the contract term until the point at which Reynolds could properly terminate the contract.³¹ Indeed, the Eleventh Circuit stated that business value damages were particularly not appropriate in this case because Seitman's business of tabloid publishing only had a value to the extent that Reynolds elected to renew the contract, which in fact, it did not choose to do.³²

24. See *supra* Section III.B. and cases discussed therein.

25. See, e.g., *Mark Seitman & Assocs., Inc. v. R. J. Reynolds Tobacco Co.*, 837 F.2d 1527 (11th Cir. 1988) (limiting damages to profits).

26. *Id.* at 1529.

27. See *id.*

28. See *id.* at 1530.

29. See *id.* at 1529.

30. See *Mark Seitman & Assocs., Inc. v. R.J. Reynolds Tobacco Co.*, 837 F.2d 1527, 1529 (11th Cir. 1988).

31. See *id.* at 1532.

32. See *id.* (refusing to award business value damages). Another example in which lost profits as damages would be appropriate for a limited period is in the context of a breach of warranty when an allegedly defective product is sold which is either resold or used as part of the manufacture of another product for sale. See *id.* Damages in the form of lost profits should be limited to the period during which the allegedly defective product was supplied and used. See *id.*

D. *Lost Profits and Loss of Business Value Damages*

1. *Double Recovery Not Allowed*

The value of a business, or any asset for that matter, is generally considered to be the net present value of all future benefits (*i.e.*, cash flows) that the owner may expect to derive from it.³³ Obviously, a decrease or "loss" of business profits results in a diminution of present business value.³⁴ Accordingly, several courts have recognized that to award a plaintiff both alleged lost profits and the alleged diminution in value of a business results in a "double recovery" and is impermissible. Unfortunately, the analysis accompanying such decisions is not always a model of clarity.

For example, the Indiana Court of Appeals addressed this issue in *Knauf Fiber Glass v. Stein*.³⁵ In the court's 16-page opinion, it devotes approximately one-half page to the damages issue. It is helpful to quote at length here the court's discussion of the disputed jury instruction regarding damages:

KFG also challenges Final Instruction No. 23, which reads:

If you find for Ashcraft Trucking, Inc., on any one of its claims, and if you further find that Knauf Fiber Glass, GmbH's actions

33. See RICHARD A. BREALEY & STEWART C. MYERS, *PRINCIPLES OF CORPORATE FINANCE* 73 (5th ed. 1996) ("Value today always equals future cash flow discounted at the opportunity cost of capital."); Fisher & Romaine, *supra* note 10, at 149 ("[T]here is no difference in principle between a claim for a stream of lost profits and a claim for the destruction of an asset. An asset is in fact worth the present value of the profit stream associated with it; to turn the matter around, the possession of a profit stream is the possession of an asset worth the present value of the stream.").

34. Accounting "profits," are not necessarily "cash flows," and, for example, for entities holding real estate, they are often quite different. The courts often use these terms interchangeably without regard to the potential significant differences. See BREALEY & MYERS, *supra* note 33, at 90:

Cash flows and accounting income are often very different. For example, the accountant labels some cash outflows *capital investment* and others *operating expenses*. The operating expenses are, of course, deducted immediately from each year's income. The capital expenditures are depreciated according to an arbitrary schedule chosen by the accountant. Then the depreciation charge is deducted from each year's income.

See *id.* Neill W. Freeman & James A. Spielmann, *Lost Profits*, in *LITIGATION SERVICES HANDBOOK: THE ROLE OF THE ACCOUNTANT AS EXPERT WITNESS* ch. 30, at 1 (Peter B. Frank et al. eds., 1995) ("Lost profits occur when an entity is precluded from earning the profits that would ordinarily inure but for another party's action. In some cases, particularly those involving significant capital transactions, lost cash flow measures damages better than lost accounting earnings. For purposes of this chapter, "lost profits" encompass lost cash flow."); see also Michael J. Wagner, *How Do You Measure Damages? Lost Income or Lost Cash Flow?*, 169 J. ACCT. 28 (February 1990).

35. 615 N.E.2d 115 (Ind. Ct. App. 1993), *rev'd on other grounds*, 622 N.E.2d 163 (Ind. 1993).

caused Ashcraft to be rendered bankrupt, then you may consider as damages the value of Ashcraft Trucking, Inc., any lost profits it would have earned and earnings that would have been reasonably earned on the lost profits and the value of the business.

Record at 2425. KFG contends the instruction allows speculation and permits double recovery. According to KFG, the value of a business includes future earnings and thus a plaintiff cannot receive both the fair market value of its business plus damages for loss of future profit.

We agree the instruction could be interpreted as allowing double recovery. More importantly, however, the instruction is confusing, awkwardly worded, and represents an inaccurate statement of the law. When an established business is injured, interrupted, or destroyed, the measure of damages is the diminution in value of the business, with interest, by reason of the wrongful act. The diminution may be measured by loss of profit. Damages for lost profits are confined to net profits.

In the case before us, the instruction does not mention diminution in value and it is not clear whether "earnings" on the lost profits are the same as "interest" on loss profits. Further, even if we were to liberally construe the instruction as meaning diminution in the value of Ashcraft Trucking, the conjunction "and" suggests that lost profits may be awarded along with the company's diminished value. Clearly, the law is otherwise.³⁶

The foregoing quotation is of interest for several reasons. Perhaps most significantly, the court states its ultimate conclusion that "[c]learly, the law is otherwise" without a single citation to any other precedential authority, an unusual event. Perhaps of equal interest is the jury instruction at issue. If judges sometimes have difficulty understanding complicated commercial damages issues, imagine how the jury in this case felt when receiving the Court's instructions!

Another case from Colorado also illustrates the redundancy concept.³⁷ In *Forsyth v. Associated Grocers of Colo., Inc.*, a grocer brought an action for deceit by misrepresentation against a cooperative which recommended the purchase of a grocery store.³⁸ In one part of the jury instructions used in the case, there was a reference to the plaintiffs' claim for lost profits; yet in another section, the instructions stated that the jury was to award damages as "the difference between the market value of the business on the date the plaintiffs purchased it and what its value would have been on that date had the false representations made by [defendant] to the [plaintiffs] been true."³⁹ The *Forsyth* court reasoned

36. See *id.* at 128 (citations omitted).

37. See *Forsyth v. Associated Grocers of Colo., Inc.*, 724 P.2d 1360 (Colo. 1986) (discussing double recovery).

38. *Id.*

39. *Id.* at 1364.

that the jury could easily have been misled into including lost profits as an element of damage in addition to diminution or loss of business value. The court concluded that "such a result would lead to an improper double recovery."⁴⁰

2. *Lost Future Profits/Loss of Goodwill*

Depending on your perspective, the courts provide clearer direction or further muddy the waters on the "double recovery" issue when discussing lost *future* profits in conjunction with lost business value. Some confusion arises because the courts roughly equate lost future or prospective profits of a business with the term "goodwill," which, of course, is a term of art for financial and accounting professionals.

In the typical commercial case, a plaintiff claims that it has lost profits in the past and that the business's goodwill has been damaged by the alleged bad acts of the defendant or defendants. The question that the courts have had to address is whether a claim for diminished going concern value or goodwill and a claim for loss of future profits are redundant.

Goodwill is a part of the value of a business and is defined as "[t]hat intangible asset which arises as a result of name, reputation, customer patronage, location, products and similar factors that have not been separately identified and/or valued but which generate economic benefits," or "the value of a well-respected business name, good customer relations, high employee morale, and other such factors expected to translate into greater than normal earning power."⁴¹

While business goodwill is understood by the courts to represent a portion of, or contributes to, the value of a business, the courts have at times nevertheless confused goodwill with lost profits. This confusion has blurred the courts' distinction between lost goodwill versus lost profits and has resulted in the courts not definitively stating how these two damage measures are distinguishable from one another. The courts appear to view lost future or "prospective" profits, beyond the period of injurious behavior by a defendant, as being equivalent to lost business value in the form of loss of goodwill or business reputation.

In reaching such a conclusion, the First Circuit in *Farmington Dowel Prods. Co. v. Forster Mfg. Co.*, a federal antitrust case, reasoned:

40. *Id.* at 1365.

41. AMERICAN SOCIETY OF APPRAISERS, BUSINESS VALUATION STANDARDS 20 (1997); JOHN DOWNES & JORDAN E. GOODMAN, BARRON'S DICTIONARY OF FINANCE AND INVESTMENT TERMS 157 (2d ed. 1987).

Moreover, it seems crystal clear to us that [future] lost profits . . . could not be properly awarded in addition to "going concern" value To do so would result in a clear duplication: [plaintiff] would get its present value as a going concern plus its future profits, but the latter figure would be a major element in determining the former figure. The Clayton Act gives treble damages, but it does not contemplate the damages that will be sextupled.⁴²

Similarly, the Sixth Circuit, in a breach of contract case applying Michigan law, stated the same principle.⁴³ In this case, the Sixth Circuit said the damages for loss of value to a business and loss of future profits are duplicative because "the loss of value is based on loss of future profits, to allow both would be to permit a double recovery."⁴⁴ A federal court in Louisiana in a breach of contract and fraud action stated the proposition this way:

Because goodwill is measured by customers' tendency to patronize the business, any decline in the value of the business' goodwill will "be reflected by, and included in, any recovery of lost future profits." Accordingly, one cannot make a meaningful distinction between business reputation and good will in the accounting sense. Because [plaintiff] was awarded lost future profits, it cannot also recover damages for loss of goodwill.⁴⁵

3. "Slow Death" Scenario

There is a variation on the "destroyed business" situation which also gives rise to issues as to the calculation of damages by lost profits or diminution in business value. We call this the "slow death" scenario. That is, the alleged bad acts of a defendant cause a business to lose profits over a period of time but then ultimately destroy the business concern.⁴⁶

In *Jim's Hot Shot Serv.*, the Supreme Court of North Dakota opined that:

42. *Farmington Dowel Prods. Co. v. Forster Mfg. Co.*, 421 F.2d 61, 82 (1st Cir. 1970).

43. *See American Anodco, Inc. v. Reynolds Metals Co.*, 743 F.2d 417 (6th Cir. 1984).

44. *Id.* at 424 (citations omitted).

45. *Walle Corp. v. Rockwell Graphic Sys. Inc.*, 1992 U.S. Dist. LEXIS 14433 at *23 (E.D. La. 1992) (citations omitted). In at least one case, a court allowed "loss of goodwill" damages even though the plaintiff's business was not profitable. In *Shepherd Components, Inc. v. Brice Pedrides-Donahue & Assocs., Inc.*, the court reasoned that: "Even though profitability may be related to 'good will,' the two do not necessarily depend upon each other." 473 N.W.2d 612, 618 (Iowa 1991).

46. *See, e.g., Jim's Hot Shot Serv., Inc. v. Continental Western Ins. Co.*, 353 N.W.2d 279 (N.D. 1984) (discussing destruction of business concern).

Generally, one cannot recover his damages both diminution in value of a business as well as loss of future profits because future profit potential is a factor utilized in calculating market value and, as such, is compensated for in the diminution of value award. . . . However, loss of profits prior to cessation of a damaged business is properly allowable as an element of damages in addition to an allowance for a market value diminution because the interim profit losses experienced prior to liquidation of the business are not reflected or compensated for in the market value determination.⁴⁷

The Texas Supreme Court reached a similar decision in *City of San Antonio v. Guidry*.⁴⁸ In *Guidry*, a restaurant owner brought an inverse condemnation action against the city to recover damages for temporarily restricted access due to street construction. On appeal, the city argued that the jury charge permitted Guidry a double recovery for lost profits and the lost value of his restaurant business. The court reasoned, however, that:

It is certainly true that Guidry could not lawfully recover for the two kinds of damages during the same time period. . . . The ability of a business to make a profit is reflected in its market value. But here, there was a period of lost profits before Guidry closed the restaurant.⁴⁹

The court held that the restaurant owner was entitled to recover the market value of the closed restaurant and lost profits which occurred before the restaurant was closed.⁵⁰

4. Cases In Which "Double Recovery" Was Allowed

There are reported cases in which it was decided that the plaintiff *could* recover both alleged lost profits and alleged lost business value.⁵¹ The sole justification for this result enunciated by the *Atlas Building* court was as follows:

The jury was instructed that in determining damages, it might consider as one of the elements, any profits that may have been lost by appellee in its business; and that it might also consider as another element of damages the extent to which the value of appellee's profit or the net worth of its assets had been diminished as a result of the price discrimination. The appel-

47. *Id.* at 284 (citations omitted).

48. 801 S.W.2d 142 (Tex. App. 1990).

49. *Id.* at 150.

50. *See id.*

51. *See, e.g., Atlas Bldg. Prod. Co. v. Diamond Block & Gravel Co.*, 269 F.2d 950 (10th Cir. 1959) (allowing double recovery); *see also Jim-Bob, Inc. v. Mehling*, 443 N.W.2d 451 (Mich. Ct. App. 1989).

lant objected to this instruction on the grounds that it permitted the jury to assess double damages for one wrongful act. . . . We think both loss of profits in business and diminishment of the assets were proper elements of damage, and the trial court did not err in so submitting the case to the jury.⁵²

The court offered no further analysis or discussion on the issue of double recovery.⁵³

In *Jim-Bob, Inc. v. Mehling*, the Michigan Court of Appeals offered a lengthier explanation.⁵⁴ Despite the greater length, and maybe because of it, the analysis is even more suspect. The analysis was as follows:

Moreover, while the testimony concerning the value of plaintiff's business was, in part, indirectly based upon profits, we do not believe an award of damages for both loss of business and loss of profits gave plaintiff a double recovery in this case. A real estate agent specializing in sales of businesses like plaintiff's testified that plaintiff's business was worth approximately \$80,000. In arriving at that figure, he did not specifically incorporate profits, rather, the witness testified that in forming the valuation he looked to an earlier purchase offer of \$65,000, the business' location, and its gross sales, purchases and rent. Arguably, in considering the latter combined factors, the real estate agent indirectly was considering something approaching a profit figure. The witness also stated that such a business "should" turn a profit equal to 30% of its gross sales. However, he further testified that he had no information of the actual profit or loss status of plaintiff's business. Thus, the witness's 30% return figure seems to have been, in essence, something along the lines of an industry average. It would appear that, to the extent that that figure would have implicitly played a role in the witness's valuation of any such business, it did so irrespective of that business's actual profit or loss history or expectancy. Viewed in this light, we do not believe that the valuation figure of \$80,000 on plaintiff's business really included any meaningful profit component with specific regard to plaintiff's business. Accordingly, we find no improper "double recovery" for lost profits in this case.⁵⁵

Whether lost profits and lost business value are redundant does not depend on the method used to make the business valuation. The judge in *Jim-Bob* obviously missed this point.

Cases, such as *Atlas Building* and *Jim-Bob*, which state that both lost profits damages and lost business value damages can both be awarded to a plaintiff are wrongly decided. Such decisions ignore the ba-

52. *Atlas Bldg.*, 269 F.2d at 958-59. *But see* *Protectors Ins. Serv., Inc. v. United States Fidelity & Guar. Ins. Co.*, 132 F.3d 612, 617 (10th Cir. 1998) (refusing to permit double recovery).

53. *See Atlas Bldg.*, 269 F.2d at 958-59.

54. 443 N.W.2d 451 (Mich. Ct. App. 1989).

55. *Id.* at 464.

sic economic fact that a business valuation, however performed, is a measure of the anticipated profits or cash flows of the business. Fortunately, cases harboring this misimpression appear to represent the minority position.⁵⁶

E. The Theoretical Limit on Lost Profits Damages

The case law reflects the economic reality that a claim for lost profits and loss of business value damages has the potential to be redundant or duplicative. As noted above, at any specific point in time, the value of a business is ultimately determined by the profits expected to be earned from the future operation of the business. In theory, the present value of any claim for lost profits (valued as of the same date) cannot exceed the value of the business as of the date of loss.⁵⁷ However, no published cases came to our attention which explicitly recognize this economic principle.

IV. DISTINGUISHING LOST PROFITS FROM LOSS OF BUSINESS VALUE

The identification and quantification of the most appropriate form of damages in a commercial litigation case is of great importance to the parties and their attorneys and experts. Given the confusion that exists in the courts, and perhaps among experts, regarding the distinction between lost profits and loss of business value, a discussion of the key differences between these measures of damages may be of use to attorneys and to experts. The following is a discussion of a suggested method and ap-

56. It is quite possible that some of the cases espousing the position permitting both lost profits and lost business value recovery may be explained by noting that the court's intention was to only allow lost past profits together with lost business value. The published cases, however, often do not provide sufficient detail in the opinion to determine if this is the case. *See, e.g., City of Tyler v. Fowler Furniture Co.*, 831 S.W.2d 399 (Tex. App. 1992) (holding that evidence was sufficient to support damage award for lost profits and decline in business value but is unclear as to whether lost profits include loss of future profits).

57. *See James Plummer & Gerald McGowin, Key Issues in Measuring Lost Profits*, 6 J. FORENSIC ECON. 3, 238 (1993) (recognizing that it would be "unusual" for the present value of lost profits to substantially exceed the value of the firm). *See also* Plummer, *supra* note 1, at 27 (noting, however, that the appraised value of a business may result in a value less than the present value of lost profits—even if the exact same profits are being considered in both calculations). Indeed, if different technical assumptions (for example, with respect to the effect of taxes on profits or business value, using different discount rates, etc.) are used in the calculation of lost profits versus business value, the alleged lost profits may in fact exceed the value of the business—calculated in such a fashion. Nevertheless, as a general proposition—without assuming different technical assumptions—the present value of any claim for lost profits should not, in theory, exceed the value of a business itself (if valued as of the same date).

proach in which to distinguish lost profits from loss of business value damages.

The following discussion includes some graphs, which will hopefully illustrate, in at least a stylized fashion, the key distinctions between the different measures of damages which have been identified in this paper. The damage measures depicted in these graphs are generalized examples and are intended only to illustrate the main concepts of the suggested approach. The examples are not intended to be an exhaustive set of the numerous possible circumstances which could arise in a particular case.

A. *Lost Profits Damages*

The lost profit measure of damages is probably the most straightforward measure of damages conceptually—although the actual calculations and analysis required in any particular case may be quite involved. Damages in the form of lost profits are measured over a damage period, which is defined to coincide with the period of injurious behavior by the defendant.⁵⁸

Exhibit I depicts graphically the lost profits measure of damages. Damages are measured as the difference between what a business could have reasonably expected to earn during the damage period relative to what was actually earned.⁵⁹ The lost profits are depicted as the shaded area in Exhibit I. Actual profits are typically available from financial records whereas projected profits must be determined using methods such as those discussed previously in this article.⁶⁰

B. *Loss of Business Value Damages*

In the case of a business destroyed immediately, loss of business value damages can be depicted as in Exhibit II. These damages are depicted as the present value of all future profits which the business could reasonably have expected to earn after the defendant's injurious behavior.

As discussed previously, the value of a business may be determined in a variety of ways, including, but **not** necessarily limited to, the present

58. As will be seen in a later discussion, however, a plaintiff business may in fact suffer damages beyond the period in which the defendant's injurious behavior occurs.

59. For simplicity of exposition, Exhibit I depicts profits to be increasing over time as is the case with most healthy or growing businesses. This is not necessarily the case for every damaged business and the expected future profits of any given business may in fact be increasing, flat, or decreasing, depending on future expected firm-specific, industry, and general business conditions.

60. See *supra* note 7 and accompanying text.

value of future expected profits. If a business is valued as the present value of future expected profits, it is worth noting that any calculation of the present value of lost profits (as of the same date as the valuation date) must, in theory, be a subset of the value of the business. However, as with the previous discussion of lost profit damages, this is based on the assumption that loss of business value damages are calculated as of the date of inception of the alleged injurious behavior by the defendant.⁶¹

Loss of business value damages are therefore represented as the present value at $t=0$ of the shaded area in Exhibit II.

C. Cases Which Claim Both Lost Profits and Loss of Business Value for the Same Time Period

Most of the confusion (in the existing case law) between lost profits and loss of business value damages could be resolved if the courts and attorneys recognized that both of these calculations are measuring the same thing—the profits of the plaintiffs' business following the defendants' allegedly harmful behavior.⁶² Lost profits are the shortfall in actual profits (during the damage period) relative to those reasonably expected had the defendants' allegedly harmful behavior not occurred. Loss of business value (in the case of an immediately destroyed business as a result of a defendants' allegedly harmful behavior) includes all expected profits as of the date of the defendants' allegedly harmful behavior. As Exhibit III demonstrates, any measure of lost profits (in the absence of out of pocket losses during the damage period) must, by definition, be a subset of the value of the business calculated at the same point in time—the inception of a defendants' allegedly harmful behavior.

Therefore in determining the appropriate measures of damages—and to avoid any “double recovery” situations—attorneys, experts, and the courts must focus on the timing of the alleged damages. Specifically, claims for lost profits and loss of business value cannot be for the same time period. For example, for both measures of damages to be recoverable, the loss of business value claim must be for a period (and therefore for profits) different than the period for which lost profits are claimed. Cases such as *Knauf* and *Forsyth* both come to the correct conclusion that both lost profits and loss of business value are not recoverable.⁶³

61. See *supra* note 10 and accompanying text.

62. See Lanzillotti & Esquibel, *supra* note 5, at 126 n.2 (noting the economic and conceptual equivalence of lost profits and loss of business value [“going concern” value] damages and the frequent confusion between these alternative measures within the legal literature).

63. See *Knauf Fiberglass v. Stein*, 615 N.E.2d 115 (Ind. Ct. App. 1993), *rev'd on other grounds*,

This is so, despite each decision's tangled or unsubstantiated reasoning, because the damages claimed would be for the same period of profits. Cases such as *Atlas Building* and *Jim-Bob* do not come to the correct conclusion because these cases do allow recovery of the same period's profits twice, once in the form of lost profits and another in the form of business value and are based on faulty or incomplete reasoning.⁶⁴

Using this same logic, cases involving claims for lost **future** profits in addition to loss of goodwill business value are not appropriate as they would allow double recovery to occur.⁶⁵ Claims for both lost future profits and loss of goodwill business value, measured as a function of expected future profits, would be for profits over the same time period and therefore be redundant. Ironically, cases such as *Farmington Dowel* and *American Anodco* reach the correct decision not to allow both claims for damages because they would represent a double recovery based on the recognition that goodwill business value is a function of future expected profits.⁶⁶ This is ironic since other decisions cited previously regarding lost profits and loss of business value claims do not seem to recognize the direct relationship between lost profits and loss of business value as measured by the profits of a business over the same time period.⁶⁷

D. Cases with "Slow Death" of a Business

These types of cases are somewhat more complicated because they involve the timing and extent of damages. "Slow death" business value damages are for a plaintiff's business which suffers lost profits (or possibly even out of pocket losses) initially, followed by the eventual destruction of the plaintiffs' business.

622 N.E.2d 163 (Ind. 1993); *Forsyth v. Associated Grocers of Colo., Inc.*, 724 P.2d 1360 (Colo. 1986).

64. See *Atlas Bldg. Prod. Co. v. Diamond Block & Gravel Co.*, 269 F.2d 950 (10th Cir. 1959); *Jim-Bob, Inc. v. Mehling*, 443 N.W.2d 451 (Mich. Ct. App. 1989).

65. Losses of goodwill business value damages are those **future profits**, after the damage period, which are alleged to occur as a result of a defendants' previous allegedly harmful behavior. These damages are for a period beyond and after the alleged damage period for which lost profits would be calculated. Loss of goodwill damages would therefore be claimed in addition to any lost profit damages.

66. See *American Anodco, Inc. v. Reynolds Metals Co.*, 743 F.2d 417 (6th Cir. 1984) (refusing to allow double recovery of damages); *Farmington Dowel Prods. Co. v. Forster Mfg. Co.*, 421 F.2d 61 (1st Cir. 1970).

67. It should be noted that claims for lost **past** profits and for lost **future** profits (including, for instance, "goodwill business value") damages can be appropriate and have been held recoverable in some cases. This type of damage calculation can be performed using the "lost prospective profits" method which was held recoverable as a measure of lost goodwill in *AM/PM Franchise Ass'n v. Atlantic Richfield Co.*, 584 A.2d 915 (Pa. 1990). In this method, the lost goodwill is calculated after the end of the defendant's injurious behavior and is measured by the **future** lost profits which are reasonably expected to occur thereafter.

In this type of case, lost profit damages are alleged for the period from the inception of the defendant's allegedly harmful behavior to the ultimate destruction of the business. The question then arises as to whether or not the lost value of the business, as of the time of destruction, may also be claimed. Cases such as *Jim's Hot Shot Service* and *Guidry* appear to allow the recovery of both these elements of damages.⁶⁸ What is not clear, however, is whether the courts in these cases required that the calculations be done in a non-redundant manner.

If the lost profits of the plaintiff's business, prior to the date of final destruction, are added to the alleged "lost" value of the business (valued at the inception of the defendant's alleged harmful behavior), there could exist an element of double recovery. Such a situation is depicted in Exhibit IV(A). The lost profits (Area A) are included in the value of the business (Area B1 plus A plus B2) and therefore represent a double recovery for the lost profits.⁶⁹

The situation can be avoided if the lost value of the business is calculated using only those profits after the date of destruction. Such a situation is depicted in Exhibit IV(B). In this calculation, where lost profit damages equal Area A and lost value of the business equals Area B2, there is no double recovery for the lost profits prior to the date the business was destroyed.

V. CONCLUSIONS

Based upon a review of representative rulings, the courts have not always clearly stated the correct circumstances in which to use lost profits or loss of business value to measure commercial damages. Where the courts do recognize a distinction between these measures of damages, it has not been applied consistently. With these rulings in mind, several illustrations of the way in which lost profits and loss of business value can be calculated have been identified and examined in this article.

At least three key findings have emerged from this examination. First, in any assessment of damages in a commercial case, recognition must be given to the fundamental economic principles that:

- 1) The current value of a business, or any asset, is the net present value of all future benefits (i.e. cash flows) that the owner may expect to derive from it, and

68. See *City of San Antonio v. Guidry*, 801 S.W.2d 142 (Tex. App. 1990) (allowing double recovery); *Jim's Hot Shot Serv., Inc. v. Continental Western Ins. Co.*, 353 N.W.2d 279 (N.D. 1984).

69. The damages, of course, are Area (B1 plus A plus B2) less Area (B1). Area B1 represents the profits the business earned before its destruction, for which the defendant would be entitled to claim as a credit.

- 2) A decrease, or "loss," of future business profits results in a diminution of the current business value.

Second, without accepting these fundamental principles, the courts have not developed a logical and consistent approach to analyzing and deciding the appropriate measure of lost profits and/or diminution of business value damages in commercial cases. As a result, some courts have decided that the law will permit an award of damages which is not consistent with the aforementioned economic principles. Finally, great caution must be exercised when making a damage claim and calculation to avoid any redundancy between lost profits and loss of business value.

Exhibit I
Lost Profit Damages

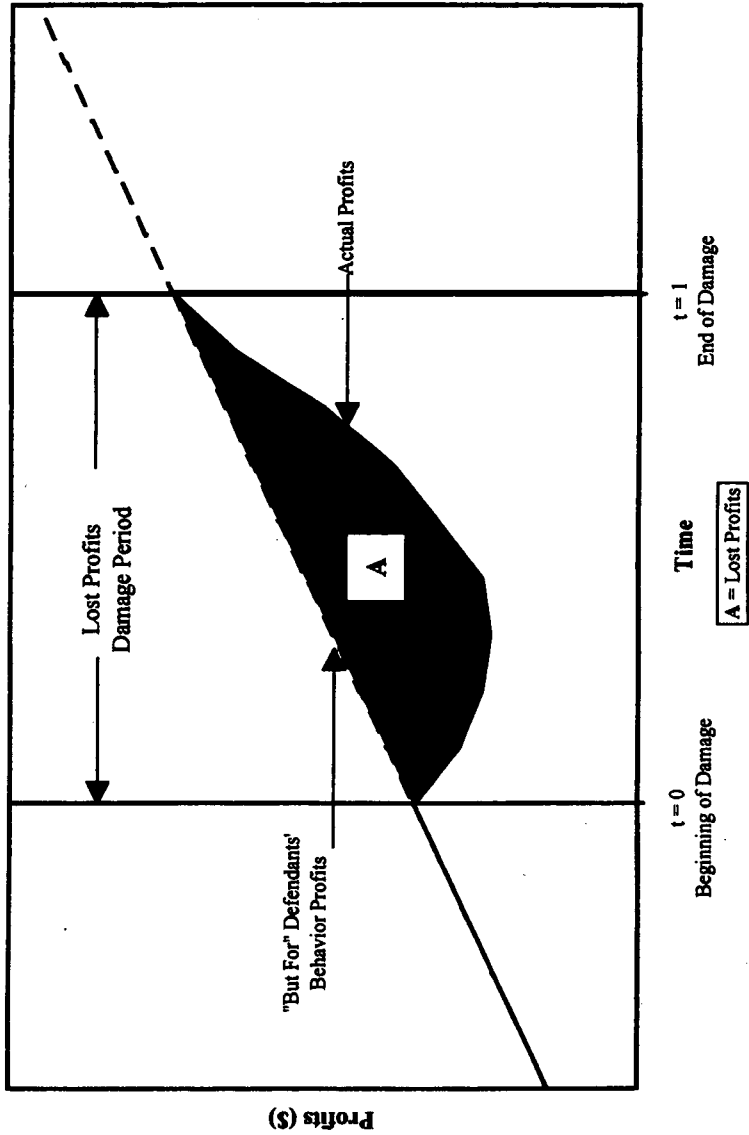


Exhibit II
Loss of Business Value

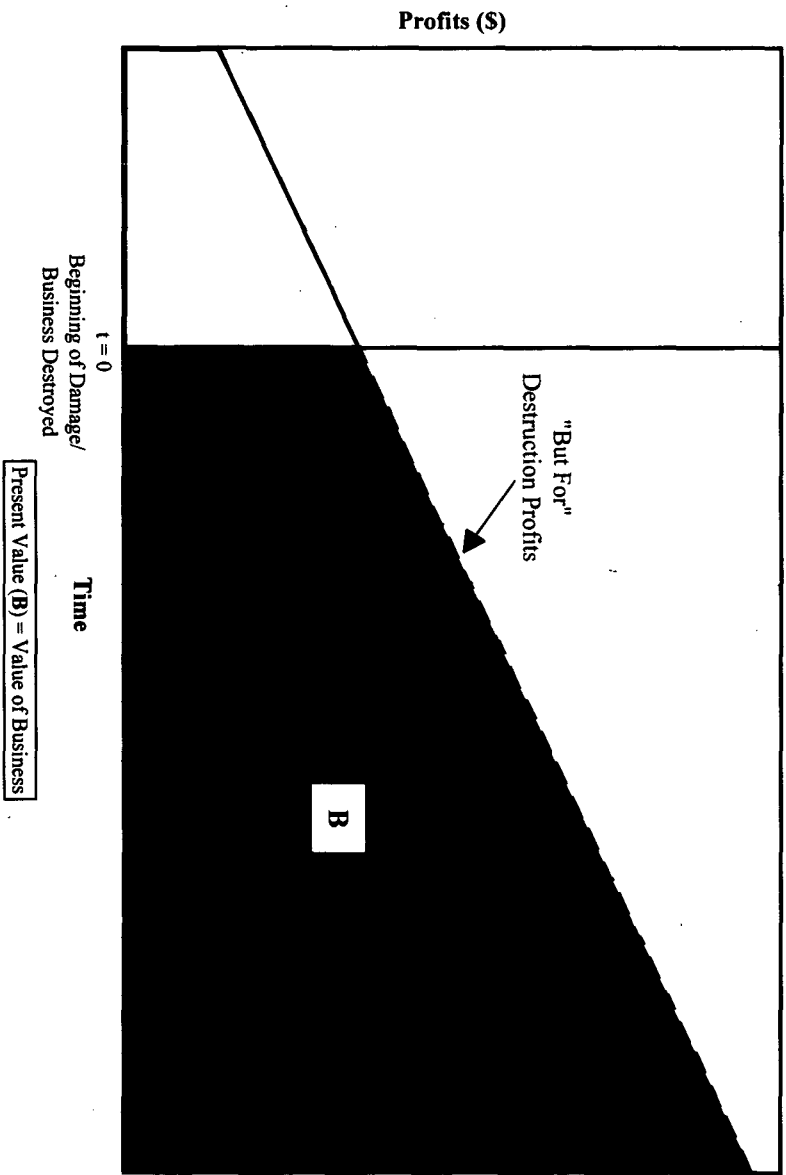


Exhibit III
Lost Profit and Loss of Business Value Compared

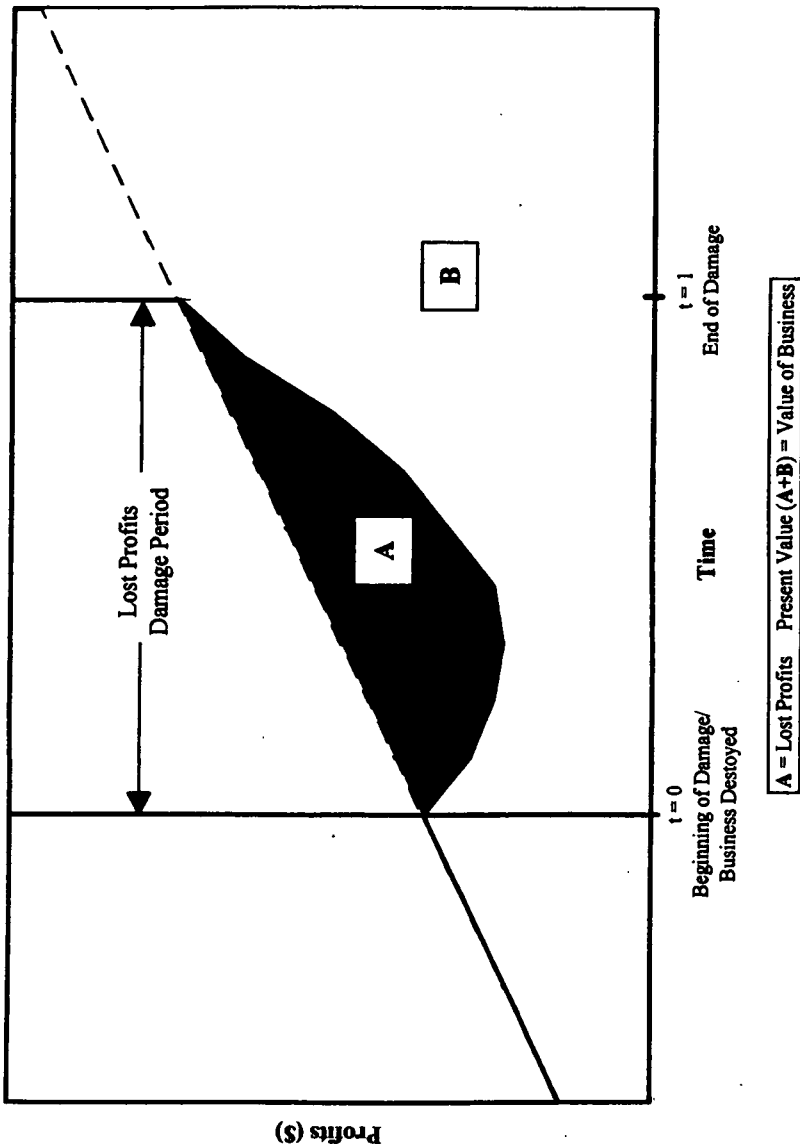


Exhibit IV (A)
"Slow Death" of Business
Incorrectly Calculated

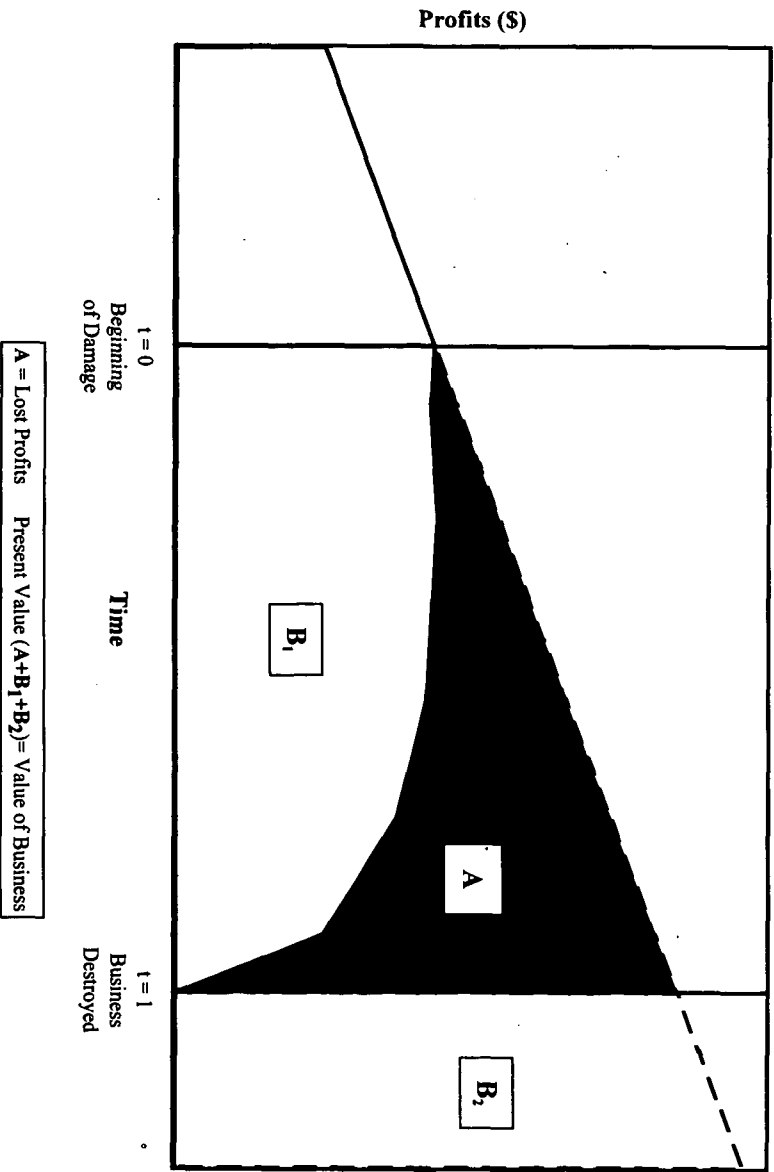


Exhibit IV (B)
"Slow Death" of Business
Correctly Calculated

