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Lost Profits and Economic Damages Newsletter

Number 2 - Calculating Lost Revenues with the Before and After Method

The Lost Profits newsletter series focuses on the concepts and methods used to calculate economic damages from lost profits. In this edition, we explain the "Before and After" Method used to calculate the loss of revenues. Our next edition will explain the "Yardstick" (or "Benchmark") Method, Terms of the Contract Method and Use of the Defendant's Profits Method.

If you would like to see the entire five-part series, Click Here.

Please remember that each engagement is unique and the concepts discussed in this newsletter may not always apply exactly as stated herein. Note that we are not a law firm and are not offering legal opinions, only our financial forensic interpretations.

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The "Before and After" Method

The most straightforward approach to estimating revenues lost as a result of the alleged wrongful event, act or infringement is to conduct a "Before and After" analysis. Under this method, the plaintiff's revenues before the alleged breach or tort are compared to the revenues after the event and any reduction is presumed to be caused by the defendant's actions. The underlying theory is that "but for" the defendant's actions, the revenues would have been earned. The expert must verify that the plaintiff's operations before and after the alleged wrongful event were comparable and the causation can be positively linked. Important differences such as an owner who worked 40 hours per week in the business before the event and only works 25 hours per week after the event, or any other unusual and/or non-recurring event should be considered in estimating the amount of lost revenues that relate directly to the alleged breach or tort.(1)

For example, assume the manager of The Cajun Restaurant breaches his employment contract with the LLC and establishes a competing restaurant that opens 1/1/2014. The manager's contract required him to provide services to the LLC through 12/31/2015 and contained a two-year noncompete clause. Under the terms of the contract, the manager was restricted from competing with the LLC through 12/31/2017 and is liable for any damages from the breach. Assume the LLC's gross revenues were $1.5 million in 2013 (the year before the competition) and dropped to $1.0 million in 2014. Further assume that a new manager was hired on 1/1/2015 and revenues returned to $1.5 million in 2015.

It appears that the manager's actions caused the LLC to lose $500,000 of revenues in 2014. Damages in subsequent years were mitigated by the fact that the LLC hired a replacement in 2015, resulting in revenues returning to $1.5 million in 2015. The before and after method offers a quick and understandable estimation of the amount of revenues lost by the LLC as a result of the manager's breach of contract. The expert should research whether any other reason may be the cause of the loss of revenues. For example, suppose the city road department started a major road and intersection rebuilding project right in front of the restaurant in March of 2014 that lasted for six months. The expert must consider and analyze whether or not the road project caused the loss versus the manager's breach.

Previous issues:

#1 - The general and legal concepts associated with Lost Profits.

1) *PPC's Guide to Litigation Support Services*, Vol. 1, 12th Ed., 2007, Thomson.

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