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Lost Profits and Economic Damages Newsletter

Number 3 - Calculating Lost Revenues with the Yardstick, Contract and Defendant's Profits Methods

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 "Yardstick" (or "Benchmark") Method, Terms of the Contract Method and Use of the Defendant's Profits Method used to calculate the loss of revenues. Our next edition will explain the various methods to calculate the avoided costs associated with generating the loss of revenue.

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 "Yardstick" (or "Benchmark") Method

A common approach to estimating revenues lost because of a harmful act, event or infringement is the "Yardstick" method which compares the plaintiff's revenues against those of a similar business, product, or comparable measure (i.e., a Benchmark). The best "yardstick" for a closely-held business is a business of similar size and nature in the same geographic area as the plaintiff. Examples of possible yardsticks that might be employed in the calculation include:

* The performance of the plaintiff at a different location, or a "sister-store";
* The plaintiff's actual experience versus past budgeted results; the most useful types of budgets are those that were produced in the normal course of

business prior to the litigation;
* The actual experience of a similar business unaffected by the defendant's actions;
* The plaintiff's competitors; (excellent sources of comparative information, but difficult to obtain);
* Comparable experience and projections by non-parties;
* Industry averages and statistics; and
* Pre-litigation projections; similar to budgets, the most useful types of projections are those that were produced in the normal course of business prior to the litigation and not produced specifically for the litigation.(1)

Terms of the Contract

In some instances, the lost profits calculation is made in relation to a specific contract in which many of the elements of the calculation may be set forth. A damage model can be developed that calculates the revenues and in some cases expenses anticipated under the terms of the contract. Examples of usable variables include the number of units to be sold, unit prices, term or time period, specific machinery plaintiff is to purchase and maintain, inventory or pre-order levels plaintiff is to maintain, methods of delivery, etc.(1)

Use of the Defendant's Profits

In certain situations, such as cases involving unfair competition or the misappropriation of trade secrets, an accounting of the profits realized by the defendant may be used as the measure of the plaintiff's lost profits. In obtaining an accounting of the defendant's profits, the plaintiff is generally only entitled to receive value of the unjust enrichment of the defendant through disgorgement, i.e., the defendant is required to surrender profits attributable to the misappropriation or bad act to the plaintiff. To the extent that profits are attributable to other factors, the defendant would not have to disgorge those amounts.(1)

In some jurisdictions (and for some causes of action), the plaintiff only has the burden to identify the revenues associated with the misappropriation,whereas the defendant has the burden to prove both the costs incurred in generating the revenues as well as apportioning the profits between the misappropriation and other profit generators. In some trade secret actions, the defendant does not even have to make a profit from actual use of the purloined information, only project profits internally that the plaintiff may use as a basis for a lost profits claim.(1)

Previous issues:

#1 - The general and legal concepts associated with Lost Profits.
#2 - The "Before and After" Method of calculating lost revenues.

1) Excerpts from the AICPA Practice Aid 06-4, "Calculating Lost Profits".

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