

Economic Damages Argument (Commercial Litigation)

Prior to filing the case in court, an accountant who has expertise in the field of litigation support may be asked to assist in making a preliminary assessment of the potential damages so that the lawyer and client can assess the costs and benefits of filing litigation. The accountant may be called upon to assist the lawyer in understanding the discovery materials which have been produced, how these materials can be used and what additional discovery requests may need to be made.

An expert accountant who has been sufficiently exposed to the field of economic damage quantification can be of great help in developing case themes and damages argument. Putting it simply, a damages argument is the story of the differences between the plaintiff's economic status before and after the incident.

a) Importance of case themes

Research in various applied fields has demonstrated the significance of themes for organizing information and making decisions. Experienced lawyers understand that the judge needs to have some way of organizing all the information they are exposed to during a trial. To persuade the judge, the lawyer needs to develop case themes that help organize the diverse case facts and convey the case theory. Case themes can provide a bridge and a way for the judge to understand what they are hearing during a trial. For damages claims, lawyers need to develop persuasive case themes which can influence the judge in the issues of responsibility, blame and justice.

An example of a case theme is the corporate greed theme where the lawyer will portray the corporation as not having a heart or soul – it only has bank accounts and exists solely to produce profits. It only understands the language of money. So, court in this case must send the message to the corporation that the court and the public will not tolerate corporate greed over consumer safety.

b) Identify the Components or Damages

The following are some common types of damages:

- Lost profits
- Lost value
- Lost cash flows
- Lost revenue
- Extra costs
- Loss of future earnings
- Loss of goodwill.

This list is not exhaustive; often more than one of these components will be part of the final damages estimate.

Forensic accountants involved in damage quantification need specific data relevant to each of these components and need to seek the help of the aggrieved party to discover the facts relevant to each component of damage.

Clearly, accounting data would typically be of value in making the damage estimate, but some components of the damages estimate are not available directly from the accounting records. Instead, accounting experts must intelligently use the available accounting information to logically and persuasively provide the court with an appropriate measure of damages.

The expert needs to think through the logic of each separate facet of the claim, eg:

- the aspects of the plaintiff's particular situation that may affect the economic damages argument
- obvious special economic factors that may have affected the plaintiff's business
- the plaintiff's actions to mitigate losses, eg diversion of customers by the plaintiff to an associate business to mitigate the loss in an anticipation of the defendant's action (ie before the date of the damages).

All these aspects need to be examined thoroughly and tested to reach a valid conclusion. In doing so, various hypotheses need to be developed and tested, keeping in view the facts prevalent at the time of the incident.

Certain damage or loss claims need to be paid by institutions such as insurance companies. These institutions need to make a realistic estimate of the expected pay-out against the claim in order to make a proper reserve before books of accounts are closed. In such cases, the early involvement of a forensic accountant will enable a more accurate loss estimation to be made and the claim will be less prone to challenges.

c) A word of caution

Exactly what components should be included in a damages claim and how the expert defends the numbers depend on the circumstances surrounding the dispute. Although it would be desirable for the plaintiff's expert to assert a large amount of damages, the expert must be cautious. If the court believes that the expert is attempting to add illogical or unsupported items to the damages claim, it may discount the more valid damages items in the estimate as well.

d) Damage Quantification Is Not Mere Number Crunching

Regardless of the nature of claim, litigation accountants (forensic accountants) must have the ability to sense or pick up leads that others might miss so as to provide useful assistance to their lawyer. To be able to do this, it is crucial for the expert to visit the scene of the crime and not remain seated behind the desk just crunching numbers.

The process of damage quantification is not a matter of simply adding up the numbers. During the quantification process, the expert may not find information in a perfect order: some information may be available internally; some only externally; some may need re-working; and some may not be available at all. Any missing information need to be supported by appropriate assumptions in order to make the accountant's findings meaningful.

Above all, a forensic accountant must have a good understanding of legal issues so that they only involve themselves in the analysis of damages which are direct, ie factual causation, rather than those which have proximate causation. Proximate causation is normally a matter that is to be established by the lawyer.

Litigation accounting is an area which combines both science and art. It is a science because litigation accountants need to use various analytical tools such as computer forensics, regression analysis and other proven scientific methods to test and quantify the losses; it is also an art because litigation accountants need to correlate various date, the chronology of events and the prevalent facts at the time of the incident to define the true issues that have an impact on the damages sustained.

In damage quantification, it is generally not necessary to value the entire business of the entity unless there is a total destruction. In most cases, it is only a division, department or branch which would have sustained losses due to reason(s) for which the defendant might possibly be liable.