

A black and white photograph of two hands shaking in a firm grip, symbolizing a business deal or agreement. The hands are positioned in the upper center of the frame, with the background blurred.

Lost Profits in the Era of COVID-19

A vertical line of small white dots on the left side of the slide, extending from the top of the text area to the bottom.

July 22, 2020

Who We Are

- Columbus, OH
- Cincinnati, OH
- Indianapolis, IN
- Toledo, OH



Who We Are



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Impact of COVID-19 on Businesses

- The COVID-19 pandemic has impacted virtually every business
- Examples of negative impacts of COVID-19 include:
 - Closing of retail locations
 - Disruption of supply chains
 - Reductions in demand, volume and revenue
 - Less productive, remote workforces
 - Layoffs, furloughs and pay reductions
 - Tripping debt covenants
- For many, revenue and profit declined and the outlook is uncertain

Agenda

- Lost Profits Issues and Methodologies
- Impact of COVID-19 Pandemic on Lost Profits
- COVID-19 Report Disclosures
- Wrap-up, Questions and Answers



A black and white photograph of a person in a suit holding a magnifying glass over a stack of documents. The person's hand is visible, holding the handle of the magnifying glass. The documents are stacked and appear to be part of a binder or folder. The background is dark.

Lost Profits Issues and Methodologies

What are Lost Profits?



- A measure of damages
- A remedy a business can recover
- Types of cases include:
 - Breach of contract
 - IP infringement
 - Catastrophes (business interruption)
 - Certain torts

What is Required to Recover Them?

- “Proximate cause” or “causation”
 - Requires plaintiff to tie its damages to defendant’s alleged wrongful act
- Defendant will try to prove that an intervening cause (e.g., COVID-19) caused all or a part of the claimed damages
- Plaintiff should address other potential causes for the lost profits and explain why they are not the cause
 - Or account for other causes in the damages calculation

The “But-for” Premise

- Lost profits are premised on the “but-for” world
 - What would the plaintiff’s profits have been “but-for” the actions of the defendant?
- The lost profits methods are different approaches to developing the “but-for” world
- Needs to result in a damages calculation that is “reasonably certain”

What is Reasonable Certainty?



- Lost profits do not have to be calculated with “exactness”
- Measurement based on reliable factors, without undue speculation
- Lost profits cannot be recovered if they are “remote, speculative, hypothetical and not within the realm of reasonable certainty”

How are Lost Profits Calculated?



- Lost revenues
- Less: Incremental (saved) costs
- Equals: Lost Profits

What Methods are Used to Calculate Lost Profits?

- Before-and-After Method
- Yardstick Method
- Sales Projection Method



Before-and-After Method

- Compares the actual results of operations before the defendant's actions to the results after
- Assumptions inherent in the method
 - Past performance = future performance
 - Economic and industry conditions are the same before and after
 - Sufficient historical data is available

Yardstick Method

- Compares the plaintiff's results of operations after the damaging event to a measure representing what operations would have been "but for" the damaging event
- The plaintiff's business can be compared to:
 - An external yardstick: Industry statistics or competitor's operations
 - An internal yardstick: Another location or division conducting similar business operations

Sales Projection Method

- Requires the development of specific projections to compare to actual results to determine lost revenues and profits
- Considers both internal and external factors
- Incorporates information regarding historical operations of the company and economic, industry and market data

Projections

- Regardless of the method used, projections must be based on assumptions that are reasonable and not speculative
- Potential sources of information:
 - Historical results
 - Pre-litigation projections
 - Business plans
 - Budgets
 - Budget to actuals (indicator of how accurately management projects future results)
 - Industry data (trade groups)

Other Lost Profits Considerations...

...that may be impacted by COVID-19:

- Length of damage period
- Discount rates



Damage Period

- Typically:
 - Starts on the date of harmful act
 - Ends when the plaintiff is returned to its “but-for” position
- May be determined based on period of contract

Discounting Future Damages

“Future profits should be discounted at an appropriate rate because the purpose of the award of damages is to provide a fund that, with principal and interest, will yield the plaintiff an amount equivalent to the loss.”

- Robert L. Dunn, Recovery of Damages for Lost Profits, 5th Edition, Lawpress Corporation, 1998

Discount Rate



- Intended to represent the risk that the projected lost profits would not have occurred
- How is this risk impacted by COVID-19?

A detailed 3D rendering of a spherical virus particle with a textured, crystalline surface and several long, thin, protruding spikes. A second, smaller, and more diffuse virus particle is visible in the background to the left.

Impact of COVID-19 on Lost Profits

A vertical line of small white dots on the left side of the slide.

Impact of the COVID-19 Pandemic



- How does the COVID-19 pandemic affect:
 - The selection of the method?
 - Projecting future results?
 - The damage period?
 - The discount rate?

Selecting the Method

- Before and After
 - Assumes that the “before” and “after” periods are similar
 - Seems less likely if “before” period is pre-COVID-19
- Yardstick
 - Comparison to internal or external benchmarks
 - Is recent enough data available to provide a reasonable benchmark?
- Sales Projection
 - May need to adjust previously prepared projections
 - Provides flexibility to address economic, industry and company specific impacts of COVID-19

Projecting Future Results



- How has or will COVID-19 impact:
 - The economy?
 - The industry?
 - The company?

Developing a Forecast During COVID-19

Considerations to account for when developing projections:

- How have changes in the economy impacted the business?
- How is the company's industry performing since COVID-19?
- How is the current industry performance expected to change?
- Is the company's geographic region more or less impacted by COVID-19 compared to other companies in the industry?
- Has the governmental response to COVID-19 been less or more aggressive in terms of restrictions on business?
- Who are the company's vendors and suppliers and how are they impacted by COVID-19?
- Who are the company's customers and how are they impacted by COVID-19?
- Are there new business opportunities resulting from COVID-19 that might mitigate damages?

The Current Economy



- Even more important now than previously
- Remember, damages have to be as a result of the allegations
 - Impacts from COVID-19 need to be accounted for in the damages model

What is Our Economic Future?

- How long is the disruption expected to last?
- What might the recovery look like:
 - **V-shaped recession**, whereby the economy suffers a sharp but brief period of economic decline with a clearly defined trough, followed by a strong recovery
 - **U-shaped recession**, which is longer than a V-shaped recession, and has a less-clearly defined trough
 - **W-shaped recession**, which is also known as a double dip recovery, is when the economy falls into a recession, recovers with a short period of growth, then a slower period of growth (possibly a recession), before finally recovering
 - **L-shaped recession**, or depression, occurs when an economy has a severe recession and does not return to trend line growth for many years
- Not all companies and industries will experience the same recovery

Industry Conditions

- Not all industries have been negatively impacted
- Certain industries have experienced COVID-19 driven growth:
 - Beer, Wine and Liquor Stores
 - Fruit and Vegetable Manufacturers
 - Grocery Stores
 - Home Centers and Hardware Stores
 - Internet, TV and Mail-Order Retailers
 - Janitorial Services
 - Paper Products Manufacturers
 - Pet and Animal Food Manufacturers
 - Snack Food Manufacturers
 - Soap and Toilet Preparation Manufacturers

Company Conditions

- How has or will COVID-19 impact:
 - Volume – limited inputs may reduce quantities produced
 - Price – limited supply may increase selling prices
 - Competition – competitors may go out of business
 - Substitute Products – transitions in products manufactured
 - Growth Rates – will likely depend on the “shape” of the recovery
 - Labor Force –
 - Ability to find and retain employees
 - Changes in compensation structure

COVID-19 Impact on Damage Period?

- The damage period might be affected if one of the parties to the case goes out of business as a result of COVID-19
- If the plaintiff goes out of business, as a result of COVID-19, can it recover damages past that point?
- Could the plaintiff have survived COVID-19 in the absence of the defendant's alleged wrongdoing?
- Would COVID-19 have provided grounds to cancel the parties' contract?

Impact on Discount Rate?

- Does the impact of COVID-19 and increased uncertainty about the future increase the risk of the projections?
- Is this increased risk accounted for in the discount rate?
- Is the future really more uncertain than before?
 - Or are we just projecting from a new starting point?

Other Considerations

- Will the plaintiff be able to collect an award or judgment if the defendant goes out of business because of COVID-19?



Lost Profits Case Example #1

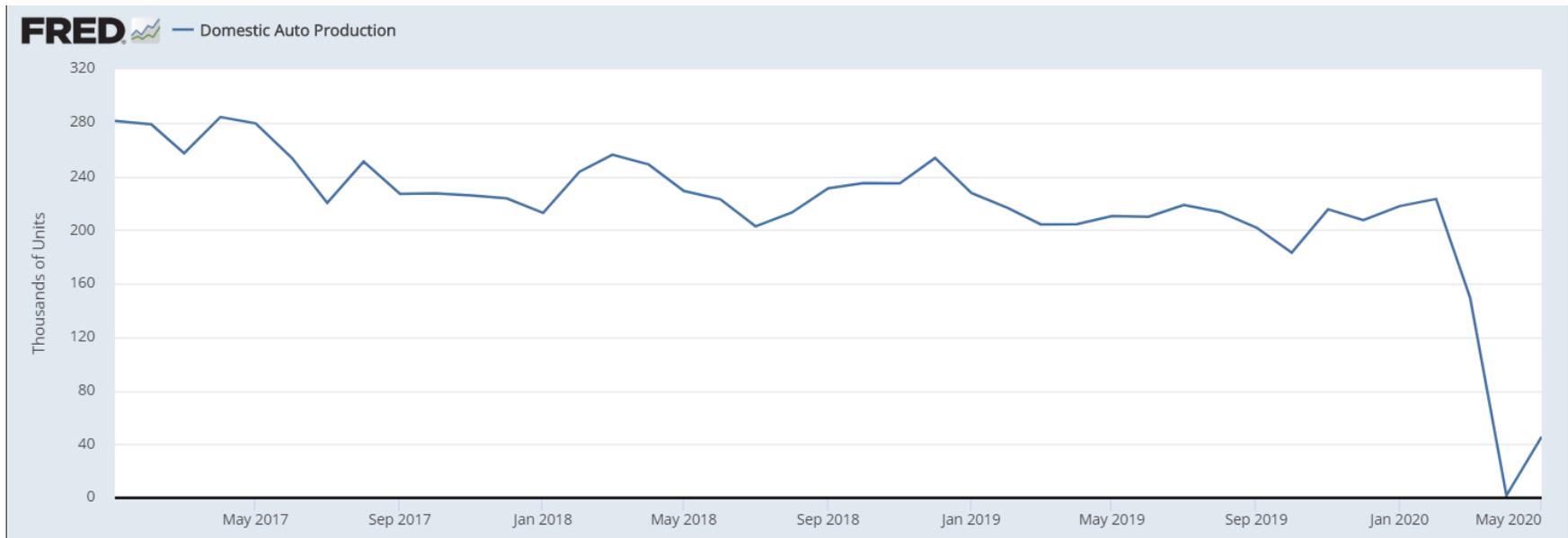
- Plaintiff manufactured and supplied “widgets” to Defendant for Defendant’s use in manufacturing an automobile component part
- Agreement between Plaintiff and Defendant expired as of March 31, 2020
- Defendant continued purchasing components from Plaintiff through that date

Lost Profits Case Example #1

- Plaintiff alleges that Defendant was required to provide Plaintiff with 12 months notice before terminating the parties' relationship
- Plaintiff is seeking to recover lost profits for the 12 months from April 1, 2020 through March 31, 2021
- Plaintiff's expert used the Before and After method and calculated damages based on the average units sold for the three prior years

Lost Profits Case Example #1

- Would this approach be reasonable to calculate damages?



- How much will auto manufacturing recover during the 12 month damage period?

Lost Profits Case Example #1 – What if...

- Plaintiff started making ventilator parts and would not have been able to sell parts to Defendant even if ordered?
- Defendant was in a state that considered it “non-essential” and its plant was closed by government order?
- Defendant closed its facility after negotiations with the local union over worker safety measures collapsed?

Lost Profits Case Example #2

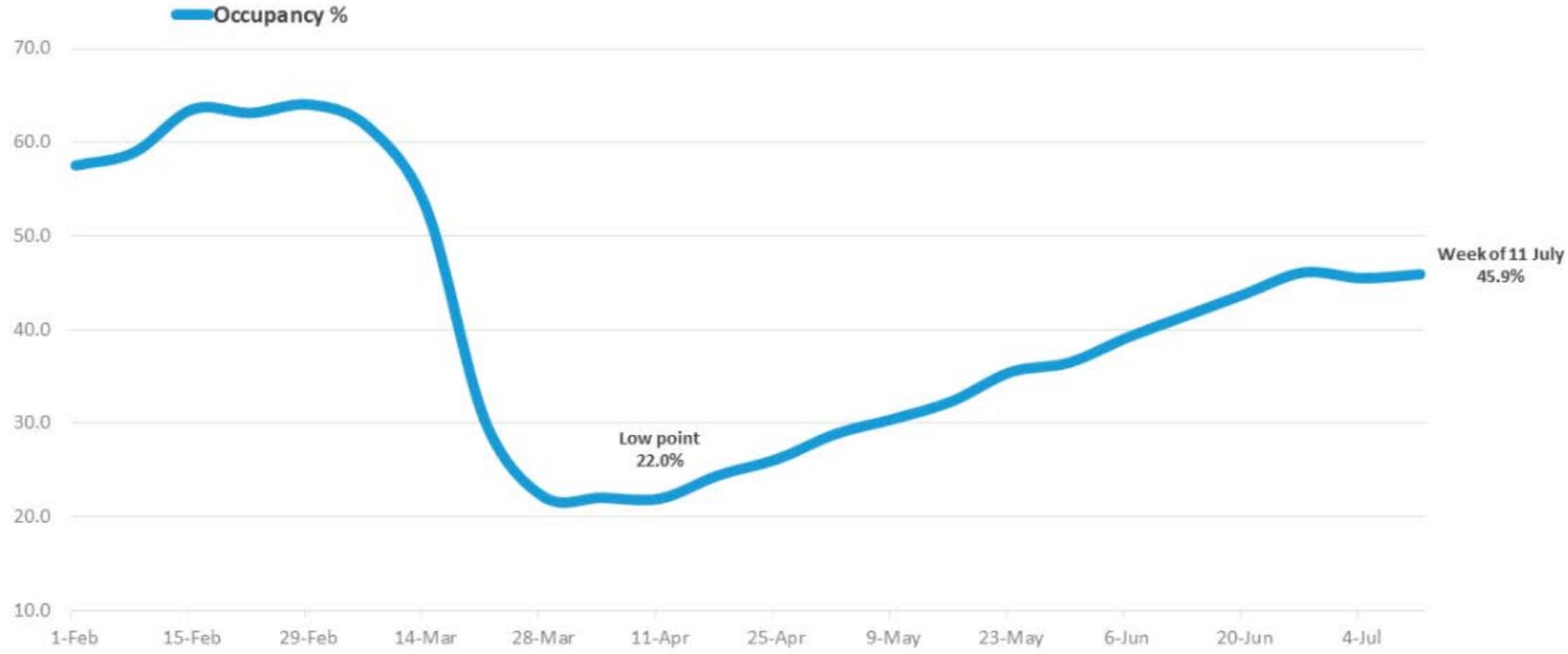
- Plaintiff sold patented sheets to the hospitality industry
- Defendant sold infringing sheets to the Plaintiff's customer
- The patent-in-suit expires at the end of 2023
- The Plaintiff is seeking to recover lost profits through the life of the patent

Lost Profits Case Example #2



U.S. Hotel Occupancy

Weeks ending with specified dates



Source: STR. 2020 © CoStar Realty Information, Inc.

Lost Profits Case Example #2 – What if...

- The hospitality industry customer contracts with nearby colleges and universities to provide housing for COVID-19 infected students?
- Governments mandate that hotel sheets are “single use” items?

Lost Profits Case Example #3

- Plaintiff manufactures and sells hand sanitizer
- Plaintiff has a contract with Defendant to provide bottles
- Defendant failed to provide bottles during April and May 2020 due to a COVID-19 outbreak that infected 75% of its workforce and significantly reduced its capacity
- Plaintiff's largest customer found another supplier for hand sanitizer
- Plaintiff is suing to recover its lost profits

Lost Profits Case Example #3

HEALTH CARE · Published April 22

Coronavirus expected to rocket hand sanitizer sales for next seven years

Consumer hygiene during coronavirus is projected to grow the market 11.9%

Demand for hand sanitizers up 1,400% and sellers are rationing supplies

BY KATE GIBSON

UPDATED ON: MARCH 2, 2020 / 3:24 PM / MONEYWATCH



HEALTH AND SCIENCE

Sales of hand sanitizer are skyrocketing due to the coronavirus, leading to rationing and price hikes

PUBLISHED TUE, MAR 3 2020·9:22 AM EST | UPDATED WED, MAR 4 2020·1:25 AM EST

Lost Profits Case Example #3 – What if...

- The Plaintiff was already at 100% capacity before COVID-19?
- The Plaintiff's largest (and lost) customer decides it is going to discontinue selling hand sanitizer in re-fillable bottles like those sold by the Plaintiff?
- The Defendant claims that the outbreak at its facility is a "force majeure" event that voids the contract?

Expert Report Disclosures

- Did the expert consider the economic, industry and company environments as affected by COVID-19?
 - Are the considerations reasonable?
 - Are the disclosed in the report?
- Are any assumptions adjusted because of COVID-19?
 - If so, how?
 - Are the adjustments reasonable?
 - Are they disclosed in the report?

Business Interruption Claims

- Similar to lost profits calculation, but governed by language of insurance policy rather than statutes and case law
- Most insurers are taking the position that COVID-19 losses are not covered because there is no physical damage to the property to “activate” business interruption coverage
- Cases have already been filed - this issue will be litigated in the coming months/years

Comparison of Lost Profits and BI Claims

	Lost Profits	Business Interruption
Period	Period of damage	Provided in policy
Premise	"But for" World	"But for" World
Purpose	To make plaintiff whole	To provide contractual benefits under policy

Questions?



Our Webinar Series Has Concluded

Replays of the prior webinars in the series are available on [our website](#):

- *June 23, 2020*
 - [Impact of COVID-19 on Business Value: A General Overview](#)
- *July 1, 2020*
 - [Lower Company Values Create Estate Planning Opportunity](#)
- *July 8, 2020*
 - [Financial Implications in Family Law Matters](#)
- *July 15, 2020*
 - [Exploring The M&A Environment During Uncertain Times](#)

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