Breach of Contract – Damages Calculations

by Chris Hamilton, CPA, CFE, CVA

The calculation of damages from the breach of a contract involves the analysis of historical financial data, analysis of the current status of the parties involved, and projections of future economic activity. In most breach cases there is a basic formula used to calculate damages. In simple terms, the difference between what would have happened without the breach of contract and what did happen as a result of the breach of contract is the economic damage. Quantifying that difference is based on a combination of actual verifiable data, assumptions, and projections.

Phases of Damage Calculations

There are three phases of most damage calculations. First is the period from the commencement of the contract to the date of the "event" (breach). Generally, this is the period where data is most available, relevant, and reliable. The second phase is the period from the date of the breach to the date of trial. The information in this period is also reliable and relevant but, depending on the circumstances surrounding the breach, may not be readily available. The third phase is the period of time from date of trial into the future. This is the period where economic activity is projected and is, by definition, the least reliable or available. It is also the phase where assumptions play a significant role in the calculations. It must be prepared and presented in a form, though, that is relevant and persuasive.

Role of the Expert

The role of the expert in a breach of contract matter is to assist the parties in quantifying the damages. This may involve assistance in discovery, developing reasonable assumptions, reading and interpreting contracts, compiling financial data, and presenting the data. Discovery will be based on the theory of damages being pursued and an experienced forensic accountant can drive a more efficient process of collecting and using relevant data.

Presentation of Results is Key

Presentation of the conclusions and the basis for the conclusions is often critical to the success of the engagement. There are a lot of experts who can do an adequate or even superior job in the analysis stage but cannot present the data in a form that is understandable and reasonable for a trier of fact to adopt. Conversely, there are experts who tell a good story but do not have the analytical skills required. They either have others do the analysis and step in personally only to provide the testimony or they do scant analytical work and rely on their testifying skills to carry the day. Finding both skills in one expert brings efficiency to the damages phase of the case. Regardless of the venue (jury trial, bench trial, or arbitration) the ability to present the conclusions in an easily understood presentation that is backed up with substantial data not only can win the case, it can also assist in settling the case before incurring the expense of a trial.

Traps to Avoid

The following are some traps to avoid when retaining an expert to provide consultation and/or expert witness work in the damages phase of a breach of contract matter:

- Retaining the damages expert right before trial (at the last minute) is common but dangerous. Depending on the circumstances, clients are sensitive to litigation costs and

there is a working theory that the damage phase will be addressed if/when there is a decision that the damage actually took place. By doing so, any advantage of having a financial expert assisting with discovery and development of damages theories is lost. Additionally, experienced and busy financial experts will either be unavailable or have a policy of not taking on "last minute" cases.

- Telling the expert what you want the damages to be is ultimately self-defeating. Reputable experts will not allow themselves to be used in that manner. Often, it comes out in trial either directly or by implication and has a negative impact on results.
- Retaining an expert that is weak either analytically or in presentation skills is an unnecessary compromise. The expert should be allowed to prepare the necessary analysis as well as design exhibits with the client and lawyers that are clear, expressive, and persuasive. This is often an interactive process that results in a smooth presentation.

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