

Calm Before the Storm

Preparing a Damages Case for COVID-19 Impacted Litigation

As the COVID-19 pandemic tightened its grip around the globe, public health concerns rightfully rose to the forefront of business activity. However, as shelter-in-place orders were issued and quarantines were enforced, businesses quickly began experiencing the severe economic toll of this pandemic. In the weeks to months that follow, the economic fallout likely will prove immense. Outside of government stimulus programs, corporations and small businesses alike will seek additional monetary remedies. Historically, litigation is one such vehicle to obtain monetary relief.

During the massive public health-induced shutdowns both in the United States and extending across the globe, conceivably a vast number of business-to-business contracts were inevitably breached. Supply chain disruptions in concert with customer order cancellations can wreak havoc on long-standing business agreements. For example, deliveries of necessary inputs for production were likely delayed or outright canceled. This failure of performance would, in turn, have a cascading effect across multiple downstream firms and industries. After recovering from the

initial shock of these mandated shutdowns, understanding the legal obligations associated with these breaches becomes paramount. In an effort to keep businesses afloat in the short term while also protecting long-term viability, key stakeholders must consider whether their company is a likely target of breach of contract litigation or, conversely, should be the aggressor in pursuing legal remedies. Such assessments should first start with a review of the executed contracts and an understanding of potential liability hurdles or defenses contained within those agreements.

Contract Terms

Contracts often contain force majeure clauses that may provide relief from obligations associated with an event or effect that can be neither anticipated nor controlled. In addition, if the contract does not contain an applicable force majeure clause, doctrines in contract law may provide relief from obligations depending on the relevant jurisdiction. These doctrines may include impracticability, impossibility, and frustration of purpose. Parties may be granted relief if performance is rendered excessively difficult or impossible by unforeseen events or circumstances. Further, parties may be excused from performance if the reason for making the contract is partially or completely frustrated by a supervening event or by circumstances which are not the fault of either party.



Damages Considerations

Assuming liability thresholds are met, a basic understanding of how damages are routinely calculated in breach of contract disputes becomes important. Potential litigants armed with this information can more readily prepare now for future litigation. While parties may employ various theories of damages, commonly plaintiffs will seek damages associated with lost profits resulting from the breach. However, in cases where the breach resulted in a business ceasing to operate, lost business value may also be considered.

Lost profit damages represent the difference between the profits that the plaintiff would have realized but-for the defendant's bad act, in this case a failure to perform, and the profits the plaintiff achieved. Before lost profits can be determined, lost revenue must be derived. Typically, one of four approaches are employed:

- Before-and-after approach
- Forecast approach
- Yardstick approach
- Market share approach

All approaches seek the same outcome: determining the lost revenue as a result of the breach by comparing past and/or future performance of either the company or its industry competitors to its actual revenues during the loss period. As such, detailed financial statements, company forecasts, industry projections, and market share reports are useful for establishing lost revenue.

This pandemic is no time for potential plaintiffs to get lax in their tracking of financial data, especially since many businesses are in the middle of the loss period. Care should be exercised that financial statements are updated as they would be in the ordinary course of business. Business records kept in the normal course of business generally offer less uncertainty to the ultimate trier of fact. Additionally, plaintiffs may also gather all potentially relevant budgets, forecasts, and/or financials from segments or offices possibly unaffected by COVID-19 mandated shutdowns. Finally, correspondence with customers, especially as it relates to canceled orders, may prove helpful. Companies who find themselves as defendants in breach of contract disputes should also consider requesting this information from the plaintiff as part of the discovery process.

After lost revenues are derived, appropriate costs must be subtracted to arrive at lost profits. Various methodologies exist to calculate the costs that would be incurred to generate the additional revenue, otherwise known as incremental costs. Cost estimations are routinely performed through regression analysis or account analysis (whereby fixed and variable costs are identified), among other generally accepted methodologies. Often, the approach is dependent on the data available.

Not unlike steps needed to ensure adequate documentation for determining lost revenues, potential plaintiffs should continue to track costs as they would in the ordinary course of business. Proactively identifying costs as either fixed or variable with supporting documentation such as invoices, contracts, and leases may prove useful. Additional documents to procure might include labor or payroll reports, shipping records, tax returns, and any correspondence with suppliers. Potential defendants should likely pursue a plaintiff's cost information in its entirety during the discovery process in order to make their own determination as to what qualifies as an incremental cost.

Other Issues

Another issue for potential litigants to consider in breach of contract disputes is causation. Proximate cause should be established between the defendant's acts and the plaintiff's damages. Future plaintiffs may consider what documentary evidence would be sufficient to demonstrate a causal nexus between the alleged loss and the breach. Potential defendants may brainstorm on other material factors that may have affected the plaintiff's financial performance irrespective of the alleged breach.

Finally, potential plaintiffs have a duty to mitigate the actions caused by the offending party. Plaintiffs should take prudent actions to reduce claimed damages. For example, during the loss period, certain costs may be avoidable or certain revenues may be realized by selling to alternate customers. Plaintiffs should exercise this duty during the loss period and defendants should seek discovery on this topic when litigation arises.

When To Call A Financial Expert

As the COVID-19 pandemic rages, all businesses find themselves in uncharted territory. Adept financial experts can help. Seasoned financial experts routinely assist in breach of contract disputes, from offering input on document requests and production, to deriving appropriate damages methodologies and strategies, and finally to forming and delivering expert opinions. With decades of experience and definitive expertise, reputable financial experts can support clients navigating this unprecedented storm.

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