



---

LITIGATION CONSULTING

# Potential Issues in Using Business Appraisal as the Measure of Damages in Litigation—Dealer Termination

---

By Rodney J. Bosco, MAFF, CVA, CFE, and David J. Ottenbreit CVA, CFE

**B**usiness-to-business litigation typically stems from alleged action/inaction of one party and its impact(s) on another party. The form of such action or inaction (for example, a contract breach or a tortious act) will often dictate the appropriate theories of actual or compensatory damages allegedly suffered by the plaintiff from the alleged wrongful conduct. A common type of commercial dispute, and the focus of this article, involves situations in which a manufacturer has allegedly “wrongfully” terminated a contract with a distributor or dealer of the manufacturer’s products.

Damages experts retained by terminated dealers are increasingly adopting a theory of financial harm premised on the loss of a “business,” whether or not the dealership remains in some reduced or altered form after the termination. Proceeding from that point of view presents the damages expert with a wide array of options, based on traditional valuation theory, in which to calculate an opinion of value that has been “lost.” But beware; damages estimation can place additional investigative burdens on the damages expert that, if overlooked, can result in a finding that overstates the actual financial impact of the termination on the dealership. In this article we hope to provide, by way of examples, insights into the types of inquiries that can help valuation analysts serving as damages experts mitigate such concerns.

## HOW DOES THE EVENT IMPACT THE MEASURE OF ECONOMIC HARM?

Damages stemming from a contract breach or a tortious

act must first be established in fact. That is, did the defendant engage in the alleged *wrongful conduct* (as defined in either contract or tort law)? If so, do the facts show that such conduct was the *proximate cause* of the harm incurred (or alleged to have been incurred) by the plaintiff? Only when these “yes/no” questions have been answered in the affirmative does the issue of the *amount* of damages—or how much the plaintiff has been harmed from a financial perspective—become a relevant inquiry.

Often, establishing the fact of damages is not part of the scope of work for the damages expert—he or she may be asked by counsel to assume that liability and causation will be established such that some form of monetary compensation will be required to make the plaintiff “whole.” That being said, the damages expert’s opinions can be more defensible if he or she can independently establish a linkage between the wrongful act and damages based on the application of accounting, economic, and finance principles to the facts of the case. Such an approach plays to the strengths of experts certified in financial forensics or business valuation (such as NACVA’s MAFF and CVA credential holders), as the three disciplines are foundational elements of these practitioners’ body of knowledge.

For example, a damages expert may be asked to assume that the terminated dealer may not be able to ever again contract with the manufacturer to distribute the product line at issue. This assumption, on its face, may appear reasonable and is unlikely to be challenged. What is the implication of adopting that assumption on the estimation of damages? One

inference that could be made is that the *period of damages* never ends. Such a scenario would seem to be tailor-made for a business valuation approach to damages, as the premise of value applied in most business valuations is as a “going concern,” and thus the value of a business is based on projected future earnings that stretch into perpetuity. However, the facts and circumstances of the underlying litigation at issue may conflict with this particular inference made from a seemingly reasonable assumption. Thus, it is important for the damages expert to make certain inquiries to assess the reasonableness of assuming a damages period with no end. Examples of such inquiries are discussed in the following section.

### POTENTIAL AREAS OF INQUIRY

One potential avenue of inquiry is to explore whether the terminated dealer, at the time of the alleged harm, had contemplated selling the business, including the contract at issue, in the foreseeable future. Perhaps the owner was nearing retirement age and had either retained a consultant to assist with a future sale of the business or had been entertaining offers from potential buyers. In such a scenario, the alleged wrongful conduct may have denied the dealership the opportunity to effectuate the foreseeable future sale, and a hybrid damages calculation based on lost profits/cash flows for a finite period of years followed by a sale of the business might be appropriate. Moreover, the data points compiled from the offers and/or the damages expert’s research may well form a basis for the future sale price. In contrast, if the underlying contract prohibits the dealer from transferring its dealership rights to another entity, then a perpetuity-based valuation calculation may not be appropriate and a finite period of damage under discounted profits/cash flow methods should be considered in its stead. A similar judgment may be appropriate if the contract was made with the *owner* of the terminated dealership and the owner is deemed to not be a party to the lawsuit.

Another area for the damages expert to consider relates to the product and geographic markets for the product line at issue. For example, through discovery or independent research, the damages expert may learn that there are four major brands for the product line, and only two of the brands have coverage in the terminated dealer’s sales territory. In such a situation, the loss of the defendant’s product line may present the terminated dealer with an opportunity to substitute a competing line from one of the other brands. Damages are thus likely to be finite, lasting

until the dealer ramps up to a mature status with the new line. However, a finding that the major brands are all represented in the dealer’s sales territory may provide a reasonable basis for the damages expert to assume a longer period of financial loss.

A third potential investigation is more subtle but still within the realm of the damages expert with valuation training. Distributing a product line entails ongoing activities by management, the sales staff, and the parts and service departments. It also requires the acquisition and allocation of various types of resources, including space (for product inventory, parts and service bays), financial reserves (e.g., floor planning), equipment (e.g., computer systems, service trucks, tools), and related infrastructure. To the extent that such time and resources become available as a consequence of the termination, other product lines that may have been resource- or time-constrained may be in a position to have their operations expanded, allowing the terminated dealer to recoup a portion of its lost cash flows. Alternatively, property or other assets dedicated to the terminated product line (including debt service on floor planning) may now be available to be redirected to other profitable purposes. These mitigating consequences would likely not show up in a damages calculation based on a valuation of the lost product line as a going concern. However, they are relevant considerations in calculating compensatory damages in the civil litigation context.

While the above inquiries may be applicable in a dealer termination setting, the facts and circumstances of each dispute will inform the damages expert as to the full scope of work required to generate findings that can withstand scrutiny by the opposing party and, ultimately, the trier of fact. Examples of additional areas that may be relevant avenues of inquiry include: the renewal terms in the distribution agreement (and the number of times the agreement has been renewed), the potential for product obsolescence, the long-term viability of the manufacturer, and whether the goodwill embodied in the current owner(s) is transferable to potential buyers (assuming the owners no longer operate the business after the sale). Sources of such information may be contained in information gathered by counsel through the discovery process, including deposition transcripts and exhibits, interrogatories, and requests for production of documents. The damages expert can assist in such information gathering by suggesting questions or document requests,

either to compile relevant information or to set the stage for adopting a key or sensitive assumption (i.e., an inquiry for relevant information was requested but not provided by the adverse party).

### SUMMARY

By engaging in inquiries such as those discussed above, the business appraiser serving as a damages expert can ascertain and support the extent to which standard business valuation approaches can be considered in estimating damages, or whether temporal or cash flow adjustments should be made to recast the valuation approach to fit the standard required by the court.

VE



*Rodney J. Bosco, MAFF, CVA, CFE, is a director with Gnarus Advisors LLC. He has provided advisory and expert testimony services in adversarial settings for more than thirty years and specializes in assessing the financial impact associated with commercial disputes. Mr. Bosco also prepares appraisals of ownership interests in privately held businesses and conducts investigations involving quantitative analysis or empirical research. Mr. Bosco has been retained as an expert in damages analysis, statistics, and survey research. E-mail: [rbosco@gnarusllc.com](mailto:rbosco@gnarusllc.com)*



*David J. Ottenbreit is a principal with Gnarus Advisors LLC. Mr. Ottenbreit has more than fifteen years of consulting experience in civil, criminal, and regulatory matters, assessing the financial impact associated with commercial claims, performing business valuation impairments, and investigating allegations of fraud and regulatory noncompliance. Mr. Ottenbreit has been retained as an expert in damages analysis in matters in federal and state courts and in arbitration. E-mail: [dottenbreit@gnarusllc.com](mailto:dottenbreit@gnarusllc.com)*