DAMAGES FOR A DESTROYED BUSINESS:
Keeping the Plaintiff's Expert in Check

by Catherine A. Nestrick

The complaint alleges that your client's actions totally destroyed the plaintiff-business. The defendant's failure to deliver the equipment, which could not have been timely provided by anyone else in the world, caused the plaintiff to lose all its business. The defendant's failure to pay an account due resulted in the plaintiff's inability to pay its employees, and after everyone quit, the plaintiff-business was forced to shut its doors. The defendant's failure to properly program the computer controlling the plaintiff's primary manufacturing process, resulted in the plaintiff-manufacturer's loss of business and eventual shutdown. In all of these scenarios, the defendant's actions allegedly caused the total destruction of the plaintiff's business.

While you may be able to point to liability and mitigation of damages issues, one of the primary points of the litigation will be the proper measure of damages for the destroyed business. The business will likely have gone "belly-up" long before the complaint was filed, and then after years of litigation and unsuccessful settlement negotiations, the case may be tried.

The plaintiff may tender an expert report measuring the damages as of the trial date, or some other date long after the business was actually destroyed. However, the fair market value of the destroyed business should, just like the fair market value of a destroyed car, train, or plane, be measured as of the date it was destroyed. Moments before your client allegedly destroyed the plaintiff-business, what was it worth?

Published cases reiterate the principle that the fair market value of the business *on the date of destruction* is the proper measure of damages. Kenneth M. Kolaski & Mark Kuga, *Measuring Commercial Damages Via Lost Profits or Loss of Business Value: Are These Measures Redundant or Distinguishable?*, 18 J.L. & Com. 1 (1998) (emphasis added). "If a

business has not been just injured, but has been destroyed, almost all of the few cases in point hold that lost profits damages are not recoverable at all. The measure of damages is said to be the market value of the business *on the date of destruction*." *Recovery of Damages for Lost Profits*, Volume 1, Fifth Edition, section 6.24, by Robert L. Dunn.

Very few Indiana cases have commented on the proper measure of damages for a destroyed business. In *Knauf Fiber Glass v. Stein*, 615 N.E.2d 115, 128 (Ind. App. 1993), the Court commented that "when an established business is … destroyed, the measure of damages is the diminution in value of the business, with interest, by reason of the wrongful act." While the *Knauf* court did not expressly state that the fair market value must be determined as of the date of destruction, the description indicates that this result is what the court intended.

To calculate the "diminution in value" as instructed by the *Knauf* court, an expert would need to calculate the fair market value both before and after the destruction. If, in fact, the business is totally destroyed, the value after the destruction will be zero or nearly zero. The proper measure of damages is the after-destruction value (zero or nearly zero) subtracted from the before-destruction value (fair market value as of the date of destruction). Essentially, the after-destruction value is the salvage value, which should be deducted from the value immediately prior to the destruction.

Indiana is in line with a majority of the states that have addressed the issue of business destruction damages. In *Aetna v. Little*, the defendant alleged that the insurance company's failure to pay a judgment resulted in the defendant-business's total destruction. The court found that "lost profits and loss of use may be a proper item of damage if the property or business is not completely destroyed…. However, where the property or business is totally destroyed we hold the proper total measure of damage to be the *market value on the date of loss*." *Aetna v. Little*,

384 So. 2d 213 (Fla. App. 1980). *See also Ryan v. Atlantic Fertilizer & Chemical,* 515 So. 2d 324, 327 (Fl. App. 1987) (the appropriate measure of damages for destroyed business is the *fair market value on the date of destruction*); *Polyglycoat v. Hirsch Distributors, Inc.*, 442 So. 2d 958 (Fl. App. 1983) ("… if the business is completely destroyed, the proper total measure of damages is *market value on date of loss*.").

In *Achee v. National Tea*, 686 So. 2d 121, 125 (La. App. 1996), the Court held that the proper measure of damages for a destroyed business is the loss of value of the business *at the time of the destruction*. New York similarly held that since plaintiff-business's claim was that the defendant's tortious acts totally destroyed its laundry business, the appropriate measure of damages was the fair market value of the business *before destruction*." *S.A.B. Enterprises v. Village of Athens,* 164 A.2d 558, 564 (N.Y. 1990).

The Sixth Circuit likewise stated that the proper measure of damages for a destroyed business is the *difference in value of the business immediately before and after the destruction*. *Taylor v. Heller*, 364 F.2d 608, 612 (6th Cir. 1966). Texas also adheres to the principle that "the proper measure of damages for destruction of a business is measured by the *difference between the value of the business before and after the injury or destruction*. *Sawyer v. Fitts*, 630 S.W.2d 872, 875 (Tex. App. 1982).

A District Court in Delaware, applying that state's law, found that "the proper measure of damages for destruction of a business is not lost profits, but the *difference between the value of the business before and after the defendant's wrongful acts*." *True N. Composites v. Trinity Industries*, 191 F. Supp. 2d 484, 524 (D. Del. 2002).

In sum, Indiana along with the majority of courts hold that damages for a destroyed business should be calculated as of the date of destruction. This principle is consistent with the

general notion and purpose of damages. Compensatory damages are, after all, awarded to make good or to "replace the loss" caused by the wrong or injury. *Jones v. Van Patten*, 3 Ind. 107 (1851); *McCormick Piano & Organ Co., Inc. v. Geiger*, 412 N.E.2d 842 (Ind. App. 1980). In order to "replace the loss" for a destroyed business, the destroyed business should be valued at the time the loss first occurred, and not some artificial future date.

A plaintiff's expert may try to calculate the fair market value on a date other than the date of destruction. The expert may, instead, use a much later date, such as the time of the trial. In doing so, the expert will have to make some assumptions about how the plaintiff-business would have done financially, but for the destruction, between the date of destruction and the date selected to value the business. The expert may assume higher than average profits, based upon the assumption that the business would have started selling a new product resulting in the highest sales ever.

No doubt, the defendant will disagree with whatever assumptions are used. The defendant will point to the upturn in the economy, the competition in the market for the new product, internal management issues the plaintiff-business was facing, and a multitude of other factors that would have affected the business's bottom line had it not been destroyed.

Left unchecked, the plaintiff's expert can make unreasonable assumptions about the profits the plaintiff-business would have earned. The amount of profits is critical because the profits may be used by the expert to calculate the fair market value. Shannon Pratt, a noted valuation expert, explains that "the value of an asset [which would include a business] is the present value of its expected returns. *Valuing a Business: The Analysis and Appraisal of Closely Held Companies*, Fourth Edition, pg. 152, Shannon P. Pratt, Robert F. Reilly and Robert

P. Schweihs. If the returns assumed by the expert are unreasonably high, then the fair market value calculated by the expert will also be unreasonably high.

If faced with such an expert report, defense counsel should cite the inappropriate methodology used by the expert and seek an order barring the testimony.

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