DealersEdge

DEALER BUSINESS BRIEFING

Best practices for dealerships CFOs, Controllers and Office Managers

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Behind the scenes: Putting a price tag on unusual, unexpected economic damages

Imagine the vehicles at your dealership are damaged by paint overspray from a construction project at the church next door. Or your business becomes harder to access when the state highway authority gets rid of the nearby exit ramp. Perhaps an elderly woman inappropriately walks through your repair bay – carrying a baby in her arms – and trips, badly injuring her knee. Among her lawsuit claims: loss of sexual relations.

Think we're making this stuff up? We're not! In fact, businesses often face exposure – or may be entitled to damages – resulting from unusual valuation conundrums. Just talk to Stanley P. Stephenson, Ph.D., managing principal of San Francisco-based economic consulting and litigation support firm Litigation Economics, LLC. Its clients are plaintiff and defense attorneys seeking guidance and expertise in complex cases involving economic damages.

Stan – who has done valuation work for 30 years and was previously an Economics professor at Pennsylvania State University, an assistant vice president at Aetna Life and Casualty, and a regional commissioner with the U.S. Department of Labor's Bureau of Labor Statistics – recently sat down with *Dealer Business Briefing* to walk us through some of the considerations involving valuation.

"The common theme is 'What's it worth?'" says Stan. "Attorneys know the law; they don't know how to put a number on it," so they often retain a forensic accountant and/or an economist to assess the damages.

"Accountants are helpful if tax, generally accepted accounting standards or related issues are central, an economist is used if there are questions of competition, industry, or income projection," adds Stan.

Although each valuation story is unique, it's worthwhile familiarizing yourself now – before a crisis may strike – with some factors that could be considered in a damages assessment. Valuation studies presented to juries or during settlements can help result in more favorable outcomes.

Take, for example, a case Litigation Economics was called in for regarding a man killed in a motorcycle accident. His wife, who claimed insufficient instructions and design flaws made the bike dangerous, sued the dealer and manufacturer, seeking damages based on lifetime income expected – multiplying lost annual earnings by expected years until retirement. This number was sharply reduced when it was taken into consideration that the decedent was an overweight smoker, convicted felon, drug user, and hepatitis B sufferer who had only work-ed six months in the prior six years.

Big questions

With litigation, two major questions are asked to help determine economic damages, says Stan: 'but-for' and mitigation. For an explanation of these terms and additional valuation questions that are considered, see "What's it worth?"

A valuation expert can also help answer such difficult questions as "What is the cost of creating a customer list?" (an important consideration should an ex-employee abscond with yours) and "How much economic damages may be incurred if a business owner is killed?"

Case studies

If you're wondering about the elderly woman mentioned above, her lawsuit did not include loss of earnings because she was already retired, but it did include medical expenses, physical therapy, and so-called "household production" – work done at home which has market value like cleaning, shopping, cooking, etc. (Fortunately, the economist was not asked to value her loss of sexual activity.)

In the exit ramp situation – an eminent domain case whose outcome is pending – the business's earnings are being projected forward and also being compared to other similar businesses in the area. "Those earnings will never come back again – the state is not going to change the exit ramp," says Stan.

As for the paint incident, the church insisted the dealership was not entitled to lost profits because it was not a profitable dealership at the time of the overspray. The appeals court rejected this argument, but greatly reduced the damages originally awarded by the trial court, finding serious flaws in the logic of the dealership's valuation expert (*Waggoner Motors, Inc. v. Waverly Church of Christ* – Tenn. App. 2004). The lessons here: you don't have to be profitable to be awarded damages, but your valuation better be credible.

Stan notes that "experience is more important than credentials" for valuation experts, but says they should hold some sort of business accreditation from an organization such as the American Society of Appraisers (ASA), National Association of Certified Valuation Analysts (NACVA), or American Institute of Certified Public Accountants (AICPA). ❖

For a look at some valuation considerations in the absence of litigation, go to **www.dealersedge.com** *and click on Free Stuff. Stanley P. Stephenson may be reached at* **stan@litigationeconomics.com.**

What's it worth?

Litigation may involve commercial issues or torts. Tort cases refer to some wrong committed against a person or business. For an auto dealer, this could include such things as personal injury, wrongful death, products liability, premises liability, etc. – even employment disputes. Commercial cases can involve loss of business value or lost profits arising from trade secret misappropriation; unfair trade practices; business interruption due to a flood, fire, or earthquake; etc. Lost profit damages may also be due to construction defects in building caused by such things as water intrusion, mold, etc.

With litigation, two major valuation questions are asked:

- **The 'but-for' option**: If not for the event leading to the damages, what would have been the result?
- **Mitigation**: What actually happened as a result of some actions by the defendant? For example, if a storm or flood destroys the dealer's office, can operations continue using a temporary office or trailer?

Some other valuation issues that are considered: Are the damages permanent or temporary? Are these 100 percent or some other partial amount? (For example, can the dealership continue in business even on reduced capacity or is loss total?) When do damages start and stop? What is the discount rate used to translate future income (or earnings) into value as of date of trial (or date of loss)?

Source: Stanley P. Stephenson, Ph.D., Managing Principal, Litigation Economics, LLC

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