

I'll see you in court!

The role as an expert in dispute situations

IVSC-WAVO Global Valuation Conference 2019
Frankfurt/Germany, 14 June 2019
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Agenda

- | | | |
|---|---|----|
| 1 | Why expert witnesses on quantum of damages? | 3 |
| 2 | How are damages calculated? | 13 |
| 3 | Key take-aways and Q&A | 22 |

1

Why expert
witnesses on
quantum of
damages?

1

Introduction

The world is in constant dispute and stakes are high

€4.7bn

VATTENFALL 



“Swedish utility Vattenfall sues Germany on nuclear phase-out law.”

€5.0bn



“Compensation claims for overprices trucks against truck cartel could reach €5bn.”

\$600m



“Boeing faces compensation demand from airlines because of 737max ban. American Airlines and others say they already incurred losses of at least \$600m”

Depending on the dispute, various expertise is needed

Commercial disputes

Example: Defendant **prematurely terminates** a product distribution **contract** in a specific country with Claimant. Claimant sues Defendant for a **breach of contract**.

Shareholder disputes

Example: In the **general meeting**, the shareholders vote for a sale of assets to the majority shareholder. Shareholder S files an **action of voidance** against this decision.

Investment disputes

Example: Investor I has acquired **assets in country C**. Several years after, country C releases a bill under which the operation of the assets is no longer permitted. I sues C based on the **BIT** with its place of residence.

Post-M&A disputes

Example: Seller has sold his business to Buyer. After he has take control of the business, Buyer finds that during the due diligence he has received incomplete information. He sues Seller based on the **representations** made in the SPA.

Construction disputes

Example: Company C has engaged general contractor G to build a new plant. The plant is set into operation with 2 years delay. C believes this was due to errors of G and sues him.

Economic Expertise

Financial and Accounting Expertise

Industry and Technical Expertise

Parties are free to select the forum in their contracts

National Courts

at the place of jurisdiction decide, if no other dispute resolution mechanism is agreed

- Public hearings
- Multiple levels of jurisdiction
- In some countries threat of political influence

Neutral Expert

determines pre-defined items binding for both parties

- Least formal
- Only narrow scope

Arbitration

replaces national courts if contractually agreed

- Non-public
- Considered faster
- Tribunal selected by parties



DIS



There are advantages and disadvantages to the various forums. In international business, arbitration is used as dispute resolution mechanism in the majority of contracts.

Depending on his engagement, the expert has multiple roles

Party-appointed Expert

Submission of expert report on own opinion and potentially critique of opinion of the opposing expert

Expert testimony at hearing where the expert is examined by court/tribunal and parties

Internal debates with lawyers to align legal and financial arguments to a compelling trial strategy

Assistance to lawyers in the preparation of legal submissions and document production requests

Court/Tribunal-appointed Expert

Submission of expert report on own opinion and discussion of opinion of party-appointed experts

Expert testimony at hearing where the expert is examined by court/tribunal and parties

Neutral Expert

Give parties opportunity to present their case (e.g. submissions, meetings)

Submission of expert report on own opinion

Decide on cost allocation

In any case, the expert should develop his own informed and factually supported opinion

2

What are

damages?

The basic concept of damages is similar in most legal systems

The purpose of damages is to restore a claimant to the position he was in before being harmed.

In most legal systems, economic damages attempt to measure the harm a claimant has suffered because of a defendant's wrongful actions in financial terms.

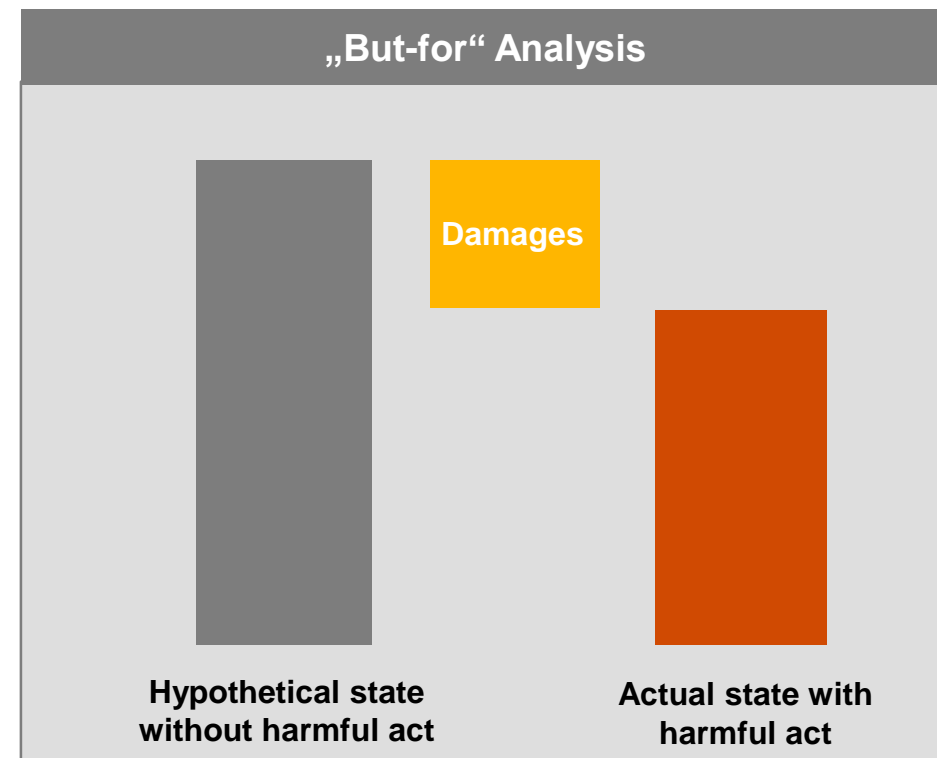
The goal of damages measurement is to quantify the claimant's loss of economic value from the defendant's harmful act.

Quantum of damages is the difference between what is and what should have been

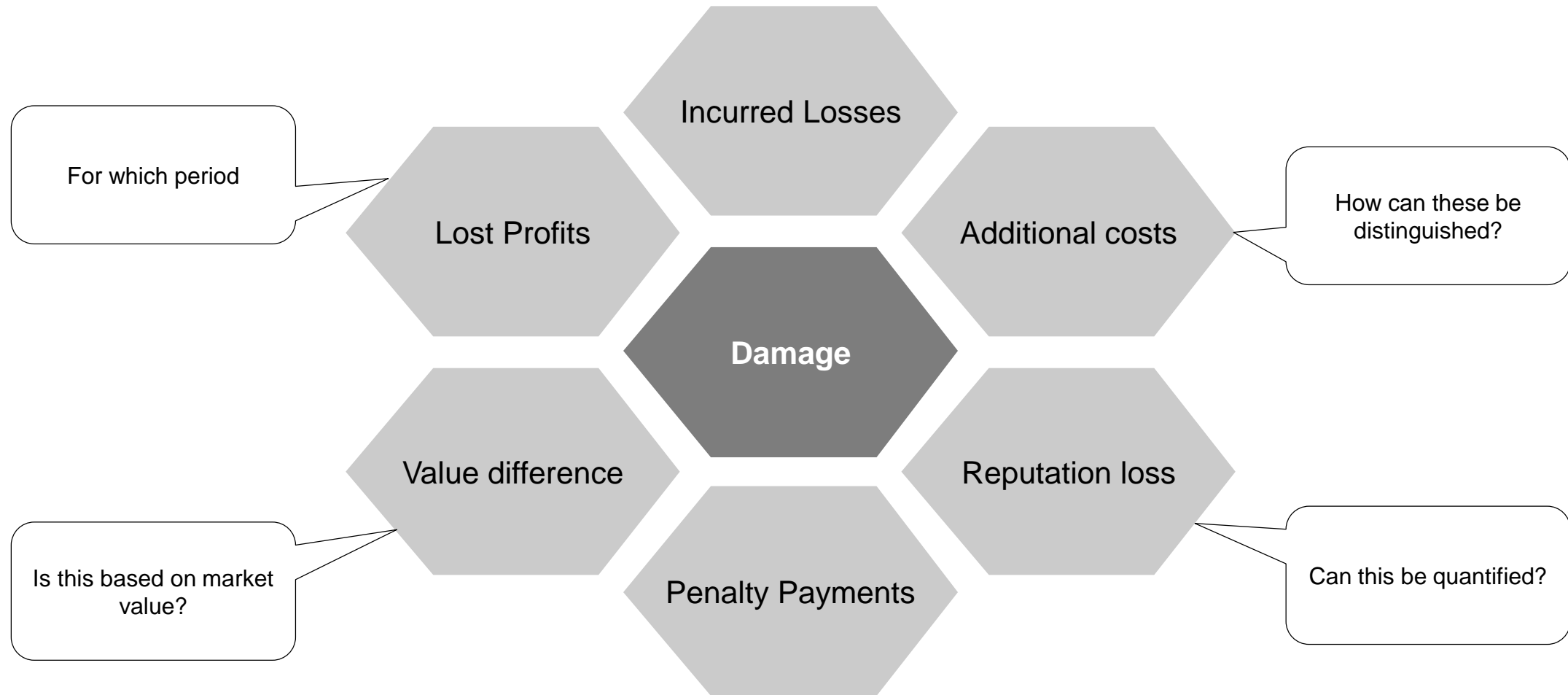
The starting point for the calculation of any damage is an assessment of the actual development after the facts. Sometimes there is just nothing left (e.g. value is zero).

As the basis for the damage calculation, a hypothetical state (so called but-for scenario) needs to be developed.

To calculate the damages, the difference between the actual developments and the but-for scenario is derived.



The measure for the quantum of damage differs by case



2

How are damages
calculated?

1

Value vs.

lost profits

Economic damages may have a one-time character such as diminished value or come from a reduced profit stream

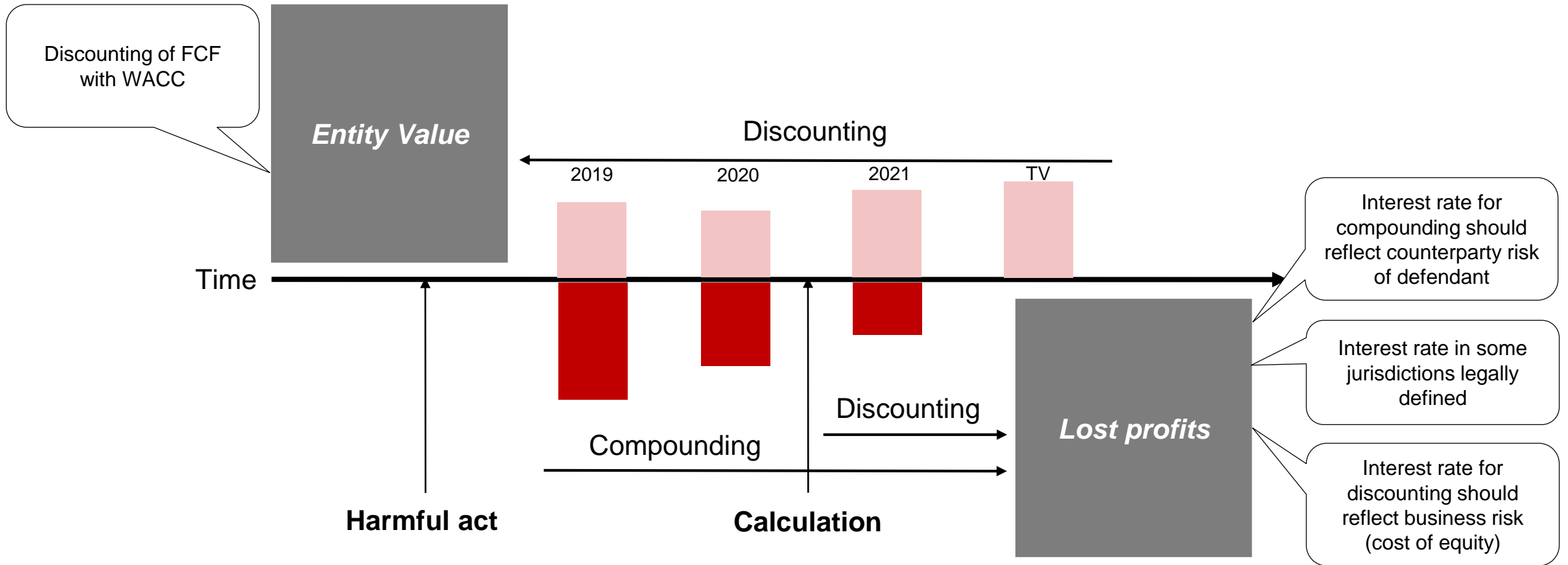
Business value

- Free cash flows
- Terminal value
- Expected values
- Knowledge as at valuation date, no hindsight

Lost profits

- Accounting profits
- Definite loss period
- Estimated values for past, expected values for future
- Knowledge up to date of calculation incl. hindsight

Different interest rates are used for discounting and compounding in damage calculation



2

But-for

scenarios

No matter if lost profits or a diminished business value is calculated, a robust but-for scenario is required

The but-for scenario should differ from what actually happened only with respect to the harmful act

Only effects that can be proven with reasonable certainty should be considered. Speculation should be left out

The occurrence of the harmful act is typically assumed by the expert without doing any own analysis

Example:

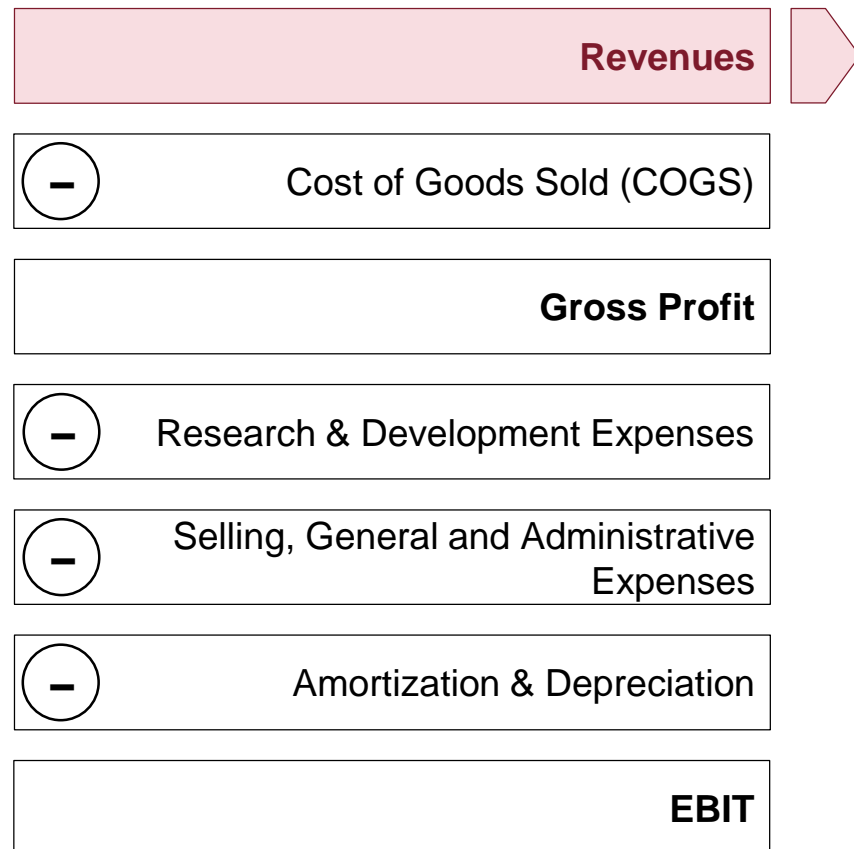
Distribution Agent has a contract with Manufacturer under which he exclusively sells Manufacturer's products for a commission of 10% of sales. Distribution Agent pays its salesmen a variable bonus of 2% of sales.

Manufacturer violated the contract and generated sales of 1,000 by selling the products on his own account.

What is the right but-for scenario?

Practical issues when developing the but-for scenario

Revenues



Deriving the Top Line

- How have the **actual sales** develop before and after the harmful act (before and after approach)?
- How did sales of **peer companies** develop in the same period (benchmark approach)?
- What would **contractual payments** have been? What did the original **business plan** without considering the harmful act look like?
- What are the **key drivers** of sales with respect to price and volume (e.g. by division, product, industry, geography, seasonality)?
- How have the **market, the competition** and the key drivers developed since the intervention considering hindsight? Are there major **changes** in the market? If so, how do these affect sales?
- What were the **assumptions for the key drivers** in the business plan? How did those differ from the actual development afterwards?
- Did **one-off effects** occur that were not considered in the business plan?

Base your but-for scenario on provable facts or relations (e.g. production capacity, market share, actual developments of peers, historic relations, etc.)

Practical issues when developing the but-for scenario

Cost base



Deriving Operating Expenses

- How have the **actual costs** develop before and after the harmful act?
- How is the fixed/variable **cost structure**? What costs have been saved due to lower revenue?
- What did the **cost planning** in the business plan look like? What were the underlying assumptions (FX rates, commodity prices, etc.)
- What **trends** in cost drivers can be identified in the period since the harmful act considering hindsight (e.g. wage growth, commodity prices, etc.)?
- How has the **FX** development impacted cost?
- What are the company's **main cost drivers** (e.g. by division, product, industry, geography, typical transactions)?

In many cases a thorough analysis of fixed and variable costs is the starting point for deriving the cost base in the but-for scenario.

Practical issues when developing the but-for scenario

D&A and CAPEX

	Revenues
−	Cost of Goods Sold (COGS)
	Gross Profit
−	Research & Development Expenses
−	Selling, General and Administrative Expenses
−	Amortization & Depreciation
	EBIT

Deriving Investment and depreciation

- Is there enough unused **capacity** to produce the sales volumes? Consider **additional capex** to realize sales volumes in but-for scenario.
- What is the level of **maintenance capex** and the level of **expansion capex**?
- What has **historical capex level** been?
- Higher expansion capex **increase amortization & depreciation**.
- Have assets be **impaired** after harmful act? Is this to be reverted in but-for scenario?

As the but-for scenario might considerably differ from the actual developments, the hypothetical utilization of production capacities requires special attention.

3

Key take-aways
and Q&A

Key take-aways and Q&A

- The substance of the dispute and the method of damage calculation defines the expertise and experience required
- No matter if party-appointed, court/tribunal-appointed or neutral expert, you should develop your own informed opinion based on facts. Only then will your expert testimony be convincing
- The measure for the quantum of damage differs by case but always aims at quantifying specific loss in economic value
- The but-for scenario should isolate the effects of the harmful act and not consider any other effects
- Be careful in choosing the right interest rates for compounding past losses and discounting expected losses

Any questions?

Read more on Post-M&A Disputes

Available under: https://www.deutscheranwaltspiegel.de/wp-content/uploads/2019/05/FinanzSpiegel-DRUCK_Ausgabe-01-2019.pdf

FinanzSpiegel 2019/2020

Erfolgreiche Unternehmensstrategie und
Transaktionspraxis in herausfordernden Zeiten



Thank you.

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