



# Loss quantification and valuation

Damages & Valuation  
Module 1.3

# Module outline





## Case study

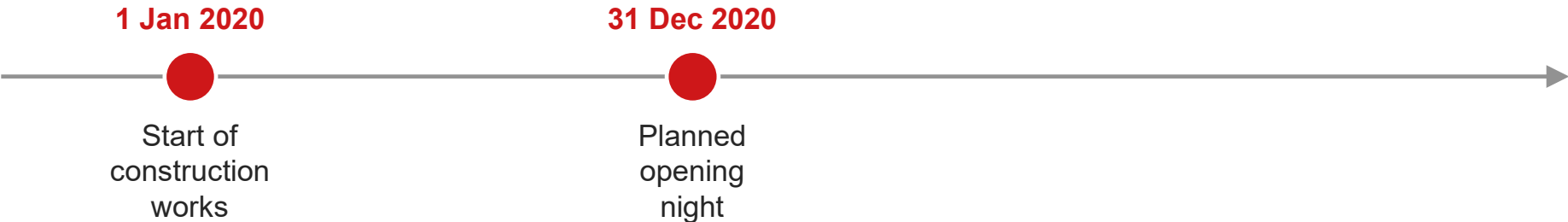


# Case study

## INTRODUCTION

### Mooch Hotels

- **Mooch Hotels** was established in 2004 and operates 11 luxury hotels in 9 different countries.
- On 1 January 2020, Mooch Hotels entered into a contract with Builders Inc. to **renovate the historic Waldorf Building** into a new hotel in London, starting immediately.
- The contract between the parties set out that Builders Inc. was responsible for the entire reconstruction of the hotel, to be completed to a high standard by the **planned opening night on 31 December 2020**.



# Case study

## INTRODUCTION

### **Mooch Hotels press release, 10 January 2020**

*Mooch Hotels is proud to announce the opening of its new hotel in London*

*The hotel, housed in London's historic Waldorf Building, will boast 500 luxury residences, including 200 Suites and 4 Presidential Suites. Guests will also benefit from a luxury spa, an Olympic-size swimming pool and a Michelin-starred restaurant in collaboration with the great Chester Ramsgate.*

*Mooch Hotel London will open its doors for a grand opening celebration on New Years' Eve 2020 and bookings will commence in June 2020.*

*Mooch Hotels was established in 2004, and now has 11 luxury hotels allowing our guests to experience 9 different countries. For more information relating to this press announcement, please contact our press team on: 0207 421 8131.*

# Case study

## INTRODUCTION

### **The Times, 15 January 2020, “Mooch Hotels to open in London”**

*Following disappointing results of its hotel in Paris, Mooch Hotels recently announced that the company has turned its sights to London for the location of its newest hotel.*

*The hotel will be housed in the grand and historic Waldorf Building, which has fallen into disrepair since the exit of the family almost 20 years ago. Our sources say that, although the location is considered prime within the London area, the building itself is structurally unsound, and will need to be entirely rebuilt on the inside.*

*Mooch Hotels’ plans include a lavish spa, a Michelin-starred restaurant with well-known chef Chester Ramsgate and even a full sized Olympic swimming pool.*

*As for its hotels around the world, Mooch Hotels is aiming to entice the most discerning of customers.*

*However, it will face stiff competition from hotels already well known in London, with both the Ritz and the Dorchester reporting their lowest occupancy rates since the economic downturn.*

*Mooch Hotel London will open in December 2020.*

# Case study

## INTRODUCTION

### The dispute

- The hotel was **not completed until 30 June 2021**, and to a standard that Mooch Hotels deemed **unacceptable**.
- As a result, Mooch Hotels (Claimant) commenced arbitration proceedings against Builders Inc (Respondent), **alleging breach of contract** and claiming for damages resulting from that breach.
- Mooch Hotels has **not started operating the hotel, and does not intend to do so**.





## Damages theory

- Damages framework
- Categories of damages





# Damages theory

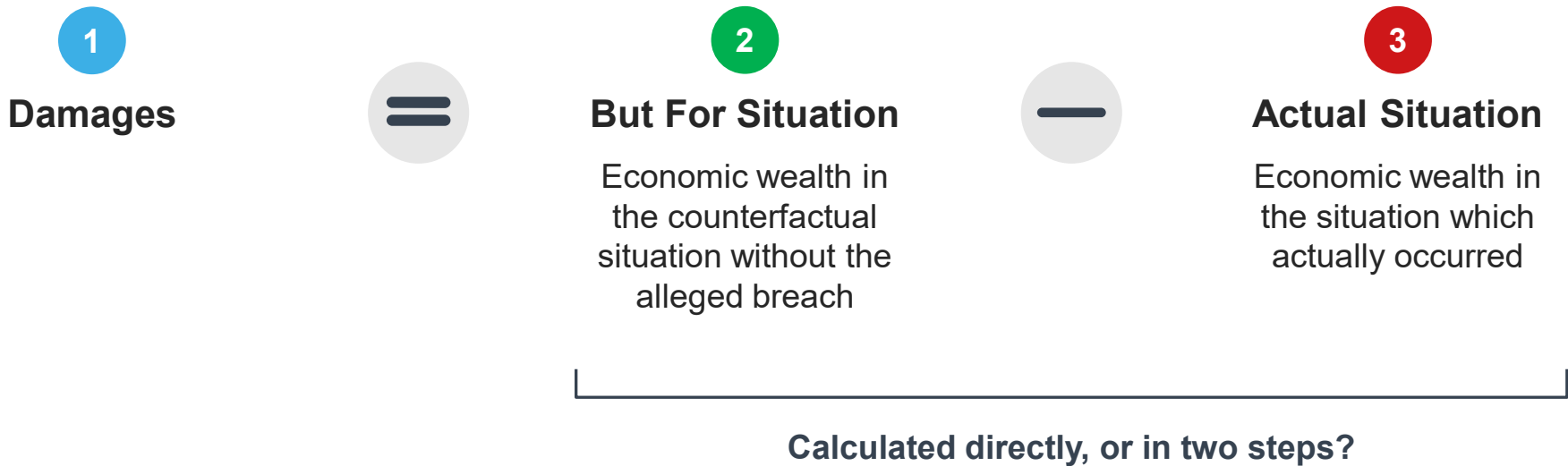
## DAMAGES FRAMEWORK

- Damages put the claimant in the situation it would have been in **but for** the wrongdoing
  - An award of damages should make up for all the consequences of the wrongdoing (**full compensation**)
  - But must be limited to these direct consequences (**no punitive damages**)
- The objective of a damages assessment is to determine a **monetary equivalent** of the loss
  - Consequences of the wrongdoing have to be assessed/valued from a financial standpoint
  - This is why financial experts are called upon
- Damages assessments rely on **standard economic and financial methods** and reasoning, including:
  - Knowledge of the business/industry and financial records
  - Application of financial valuation methodologies
  - Knowledge of accounting rules
- A financial loss is usually something **unexpected**
  - Companies' information systems are not organised properly to capture the data needed for the assessment
  - A bespoke approach is often therefore needed

# Damages theory

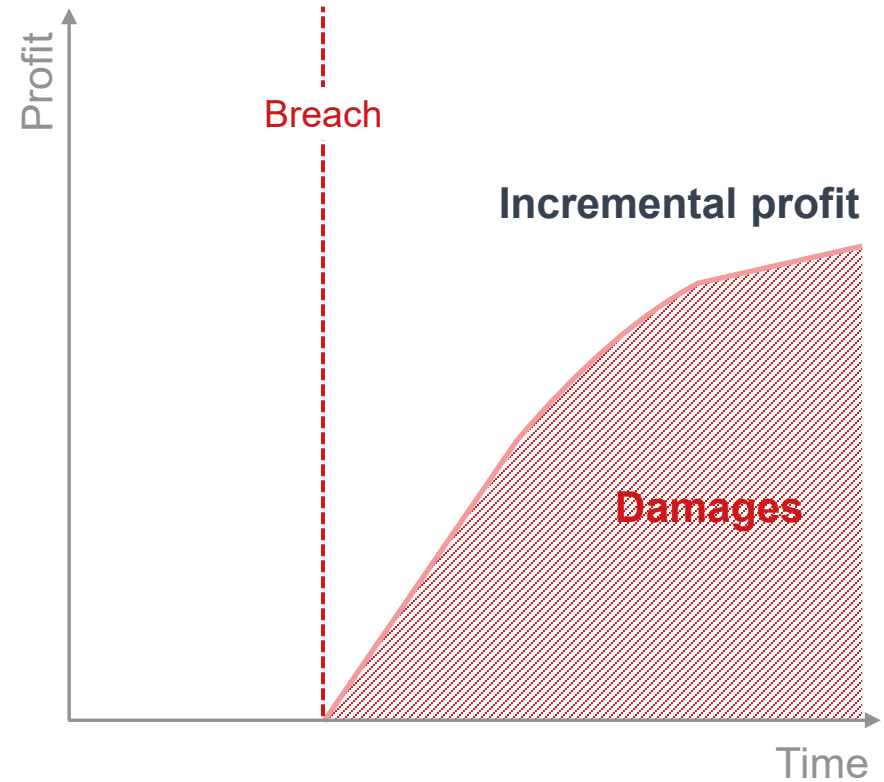
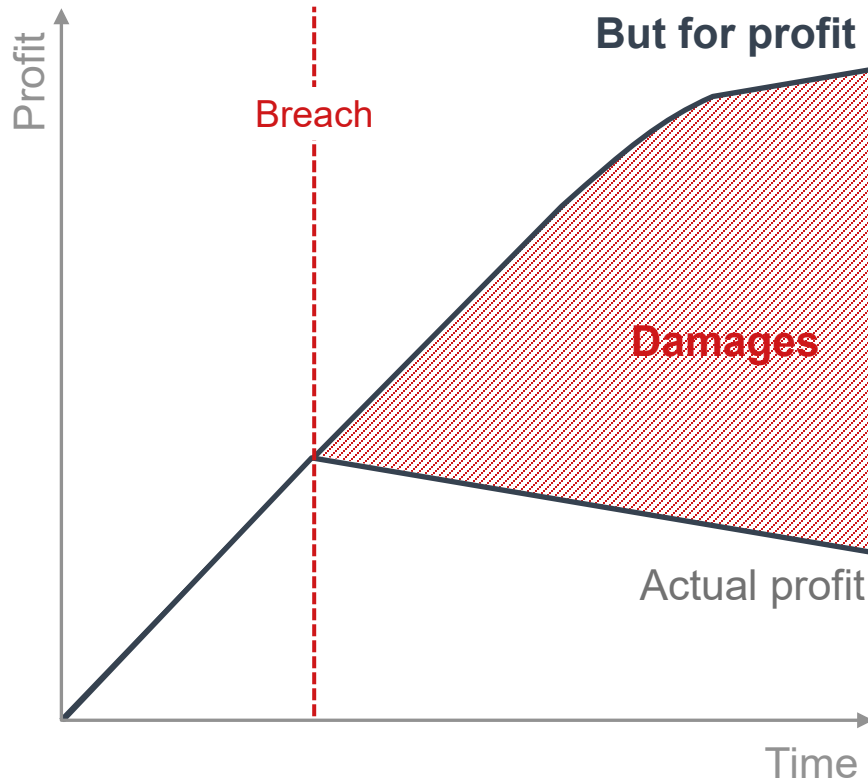
## DAMAGES FRAMEWORK

*Reparation must, as far as possible, wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed*



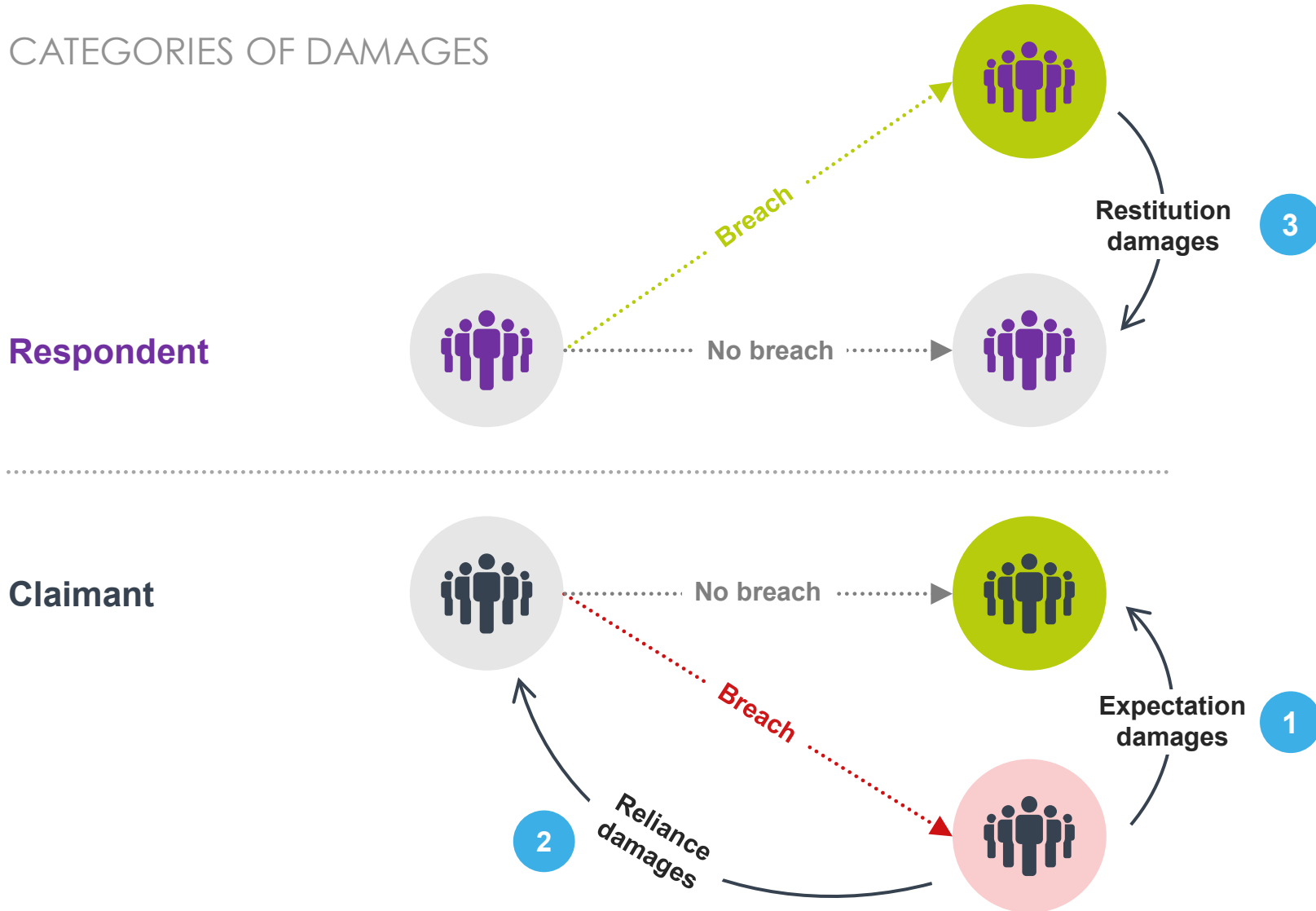
# Damages theory

## DAMAGES FRAMEWORK



# Damages theory

## CATEGORIES OF DAMAGES



# Damages theory

## CATEGORIES OF DAMAGES

<b>Head of loss</b>	<b>Typical context</b>	<b>Category of damages</b>
<b>Lost profits</b>	Commercial contractual disputes	Expectation damages
<b>Loss or diminution in value of investment</b>	Investment arbitrations Shareholder and JV disputes	Expectation / reliance damages
<b>Loss of opportunity</b>	Commercial contractual disputes and investment arbitrations	Expectation damages / reliance damages
<b>Sunk costs</b>	Commercial contractual disputes and investment arbitrations	Reliance damages
<b>Disgorgement of profits</b>	Most common in intellectual property disputes	Restitution damages
<b>Liquidated damages</b>	Commercial contractual disputes	Expectation / reliance damages

# Damages theory

## CASE STUDY

- Describe the breach, and establish the date on which the breach occurred
- Describe the Actual Situation in this case
- Describe the But For Situation in this case
- Which categories of damages could be applicable and why?
- Which heads of loss could be claimed and why?



## The Actual Situation

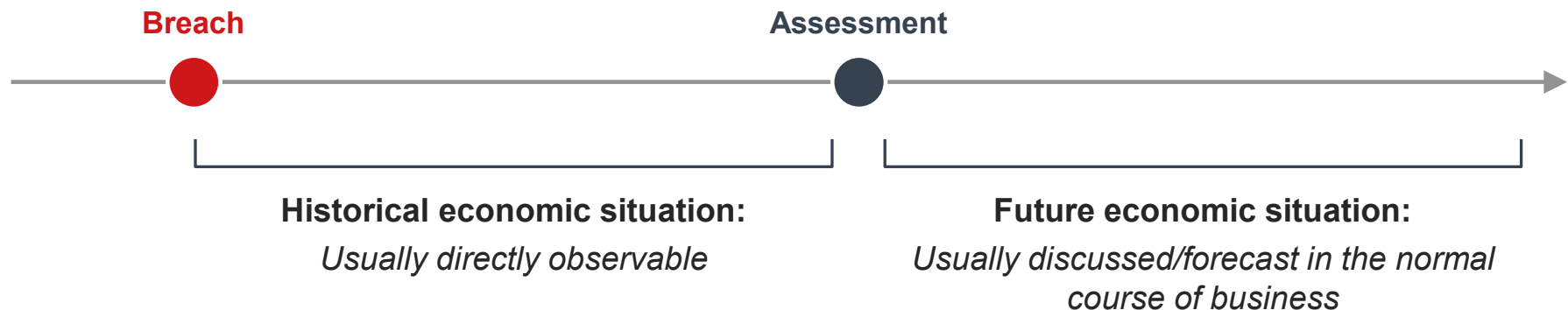
- Assessing the Actual Situation
- Mitigation



# The Actual Situation

## ASSESSING THE ACTUAL SITUATION

- By its nature, the Actual Situation to a large extent **does not require counterfactual considerations**, and direct information as to the claimant's actual economic wealth is usually available.
  - Since the Actual Situation reflects **what has actually occurred**, it is inherently **more certain** than the But For Situation, which considers what might have been.
- In some cases, the damages expert may need to consider an Actual Situation where part or all **arises in the future**:
  - Future projections are still subject to uncertainty, but likely less so than a counterfactual future.





# The Actual Situation

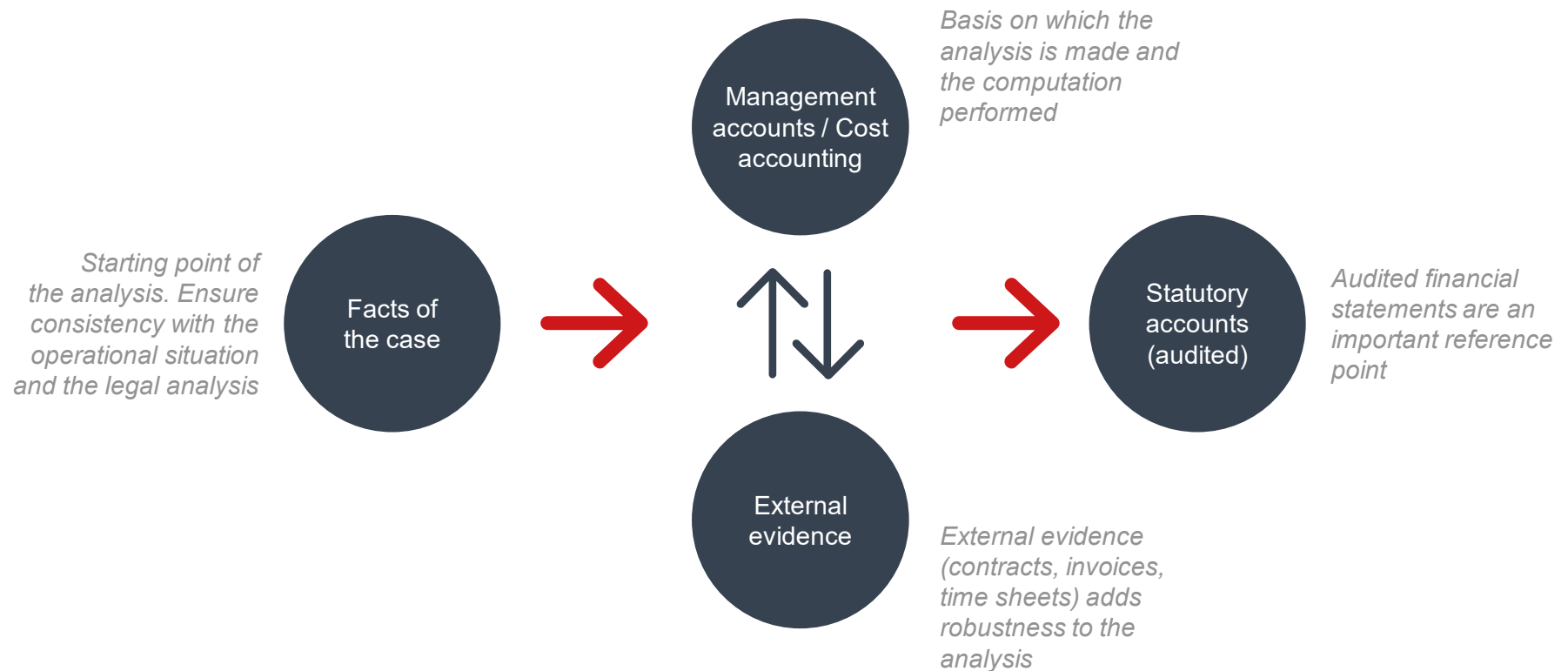
## ASSESSING THE ACTUAL SITUATION

- Objective is to prepare a comprehensive calculation of the profits reflecting the actual situation.
  - Actual sales
  - Actual costs of sales
  - Actual costs incurred resulting from business disruptions
- The Actual Situation is the starting point of the damage and so has to be robust
  - As it is “actual”, the expectations of the Court or Tribunal in terms of supporting evidence are high
  - The actual situation usually corresponds to an actual loss: if well documented, any disagreement on this part of the damage assessment should be limited
  - An audit trail must be kept so that supporting information can be reviewed by the opposing expert

# The Actual Situation

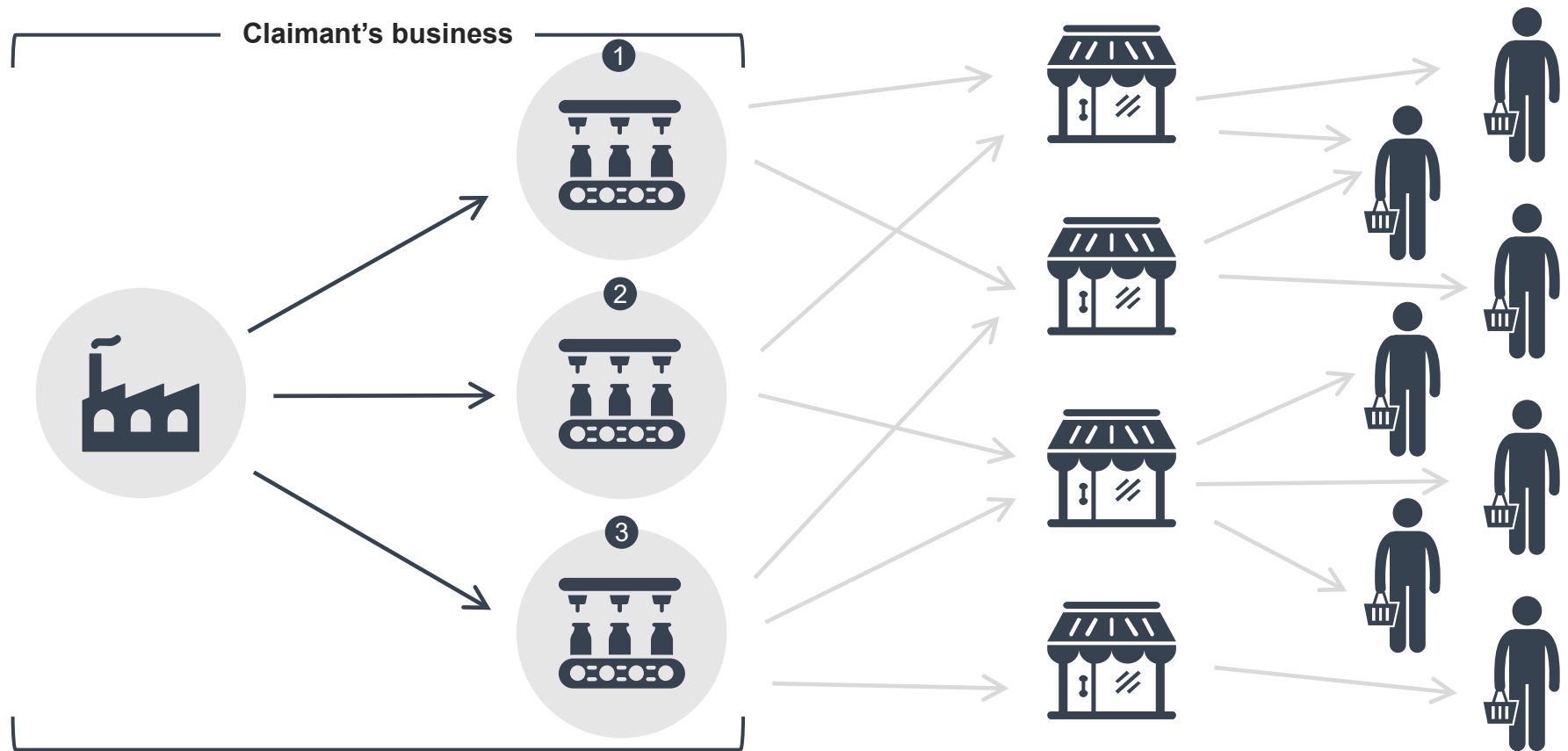
## ASSESSING THE ACTUAL SITUATION

### Key milestones of the documentation process



# The Actual Situation

## ASSESSING THE ACTUAL SITUATION



# The Actual Situation

## MITIGATION

- Damages are typically awarded against a scenario in which a claimant took all reasonable steps to reduce the losses it has suffered as a result of the respondent's wrongful acts.
  - A respondent is not liable for harm suffered by claimant to the extent that it could have been reduced by claimant taking reasonable steps.
  - However, a claimant is typically entitled to recover costs reasonably incurred in attempting to reduce harm.
- A damages calculation should therefore consider what the claimant **could have done**, rather than the mitigation steps **it actually performed** (if any).
- Tribunals are generally reluctant to reduce damages for a failure to mitigate, presuming instead that a claimant has taken steps to reduce its losses as best as reasonably possible.
  - The onus is typically on a respondent or a respondent's expert to clearly demonstrate a lack of mitigation.

# The Actual Situation

## MITIGATION

- The idea of “reasonableness” of the steps is key, and the legal team and the damages expert should consider:
1. The extent of the legal duty to mitigate, in particular if a claimant is requesting specific performance.
  2. The extent to which the claimant was fully aware of the impact of the alleged breaches at the time.
  3. Claimant’s contemporaneous assessment of its mitigation options.
  4. Cost/benefit analyses, and uncertainty, of potential mitigation options.
  5. Claimant’s own business model and typical market/industry practice.

# The Actual Situation

## MITIGATION

→ Steps for mitigation can take the form of:

1. Reducing or ceasing investment in the activity impacted by the alleged breach.
2. Reducing or ceasing loss making operations that have suffered from the alleged breach.
3. Seeking reasonable alternatives to continue the full operations initially intended, such as repairing an asset impacted by the alleged breach or contracting a third party in place of the respondent.
4. Focussing efforts on other operations, to the extent that such efforts would not have been possible had the intended operations continued without the alleged breach.
5. Attempting to sell, rather than abandon, an investment or asset that is impacted by the alleged breach.

# The Actual Situation

## CASE STUDY

- What is the perimeter of Mooch Hotels' business that is affected by the breaches?
- What are the financial consequences for Mooch Hotels up to June 2021 of the breaches?
- What is Mooch Hotels' current and future economic situation considering its decision to not operate the hotel?
- How could Mooch Hotels have mitigated their losses up to June 2021?
- How might Mooch Hotels mitigate future losses?



## The But For Situation

- Reversing the alleged breaches
- Information & assumptions





# The But For Situation

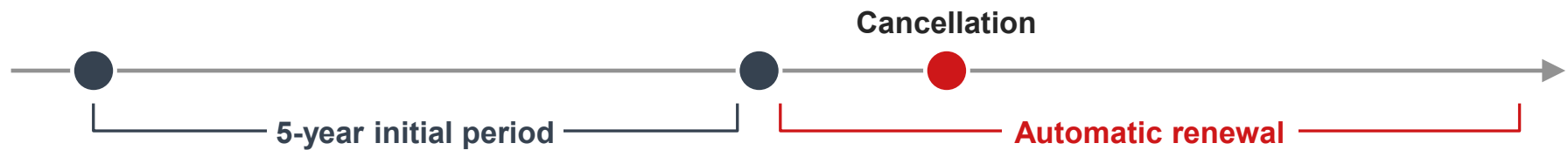
## REVERSING THE ALLEGED BREACHES

- The first consideration when assessing the But For Situation is defining the acts whose consequences must be reversed:
  - Usually, this will be the breaches of the contract or treaty by the respondent itself.
  - In some contexts the But For Situation may reverse the respondent's contemporaneous non-payment of compensation or liquidated damages as relevant under the treaty or contract.
- The But For Situation should then be constructed based on the most probable course of events had those acts not been committed, taking into account the parties' independent and rational decision making.
  - In particular, a But For Situation must consider legitimate and lawful conduct available to the respondent.
- Best practice is to set out a clear statement of what occurred, followed by:
  - A description of what the respondent should have done instead of the wrongdoing; and
  - A definition of the economic situation absent the wrongdoing.
- Damages assessed in this way isolate the loss of value the harmful act caused and exclude any change in a claimant's economic situation due to other factors.

# The But For Situation

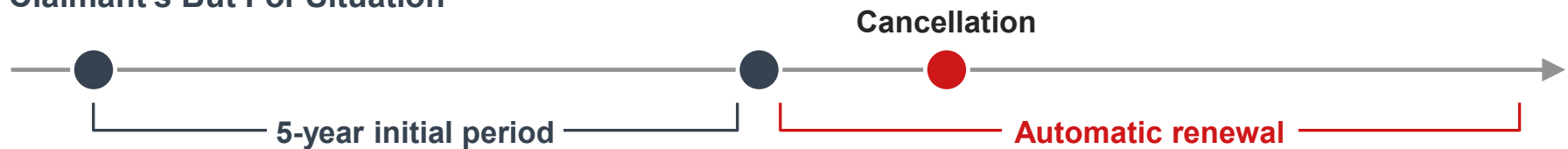
## REVERSING THE ALLEGED BREACHES

- Consider a case where a business contracts a supplier for the purchase of goods over an initial 5-year period, but the contract provides for automatic renewal unless either party provides notice of cancellation.

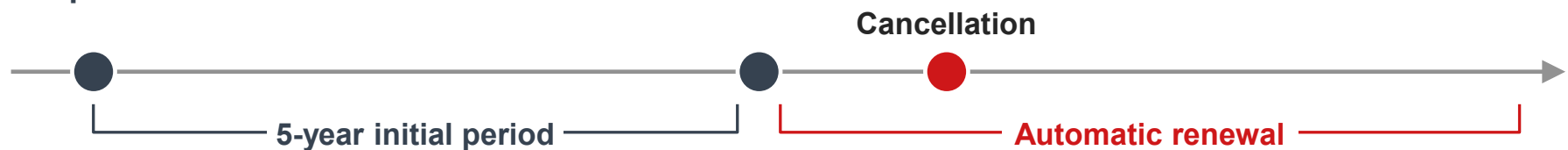


- Supplier (claimant) alleges that the purchaser unlawfully terminated the contract as it did not provide proper notice of cancellation.

### Claimant's But For Situation



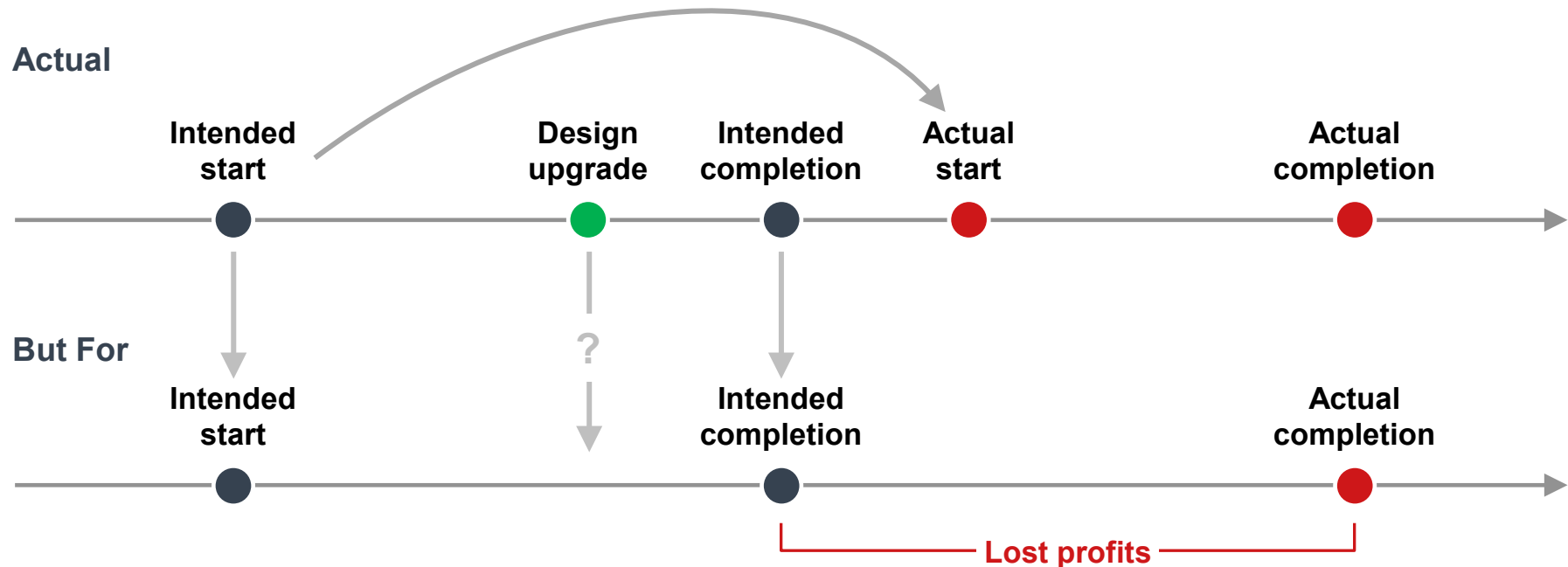
### Respondent's But For Situation



# The But For Situation

## REVERSING THE ALLEGED BREACHES

- The most common area that leads to issues in assessing damages is separating the effects of the wrongful conduct from the effects of other factors that would have affected the economic welfare of the damaged party.
- In some cases, options that became available in the Actual Situation may no longer be rational or feasible in the But For Situation.



# The But For Situation

## INFORMATION & ASSUMPTIONS

- Whilst a But For Situation is counterfactual, its construction must be based, as much as possible, on valid evidence and information.
- A damages expert should assess the reliability of available information.
- Typically, the most reliable evidence is that which is complete, free from error and not subject to biases or other external influences.
- It is not, however, an exact science and requires professional judgement. Ultimately, all information used should, as much as possible, be cross checked with other data sources.

# The But For Situation

## INFORMATION & ASSUMPTIONS

- In rough decreasing order of presumptive validity are the following sources of information that are typically used in assessing a But For Situation:
1. Official government publications and databases
  2. A company's audited financial statements and filings
  3. A company's accounting records maintained in the normal course of business
  4. A company's operating reports prepared for management in the normal course of business
  5. A survey designed by the damages expert with assistance from survey professionals
  6. A marketing research study conforming to established standards for these studies
  7. Industry reports and other materials prepared by third party organisations and consultants
  8. Newspaper articles
  9. A company's study of damages from the harmful event, prepared in the normal course of business
  10. A company's study of damages, prepared for the purpose of the dispute

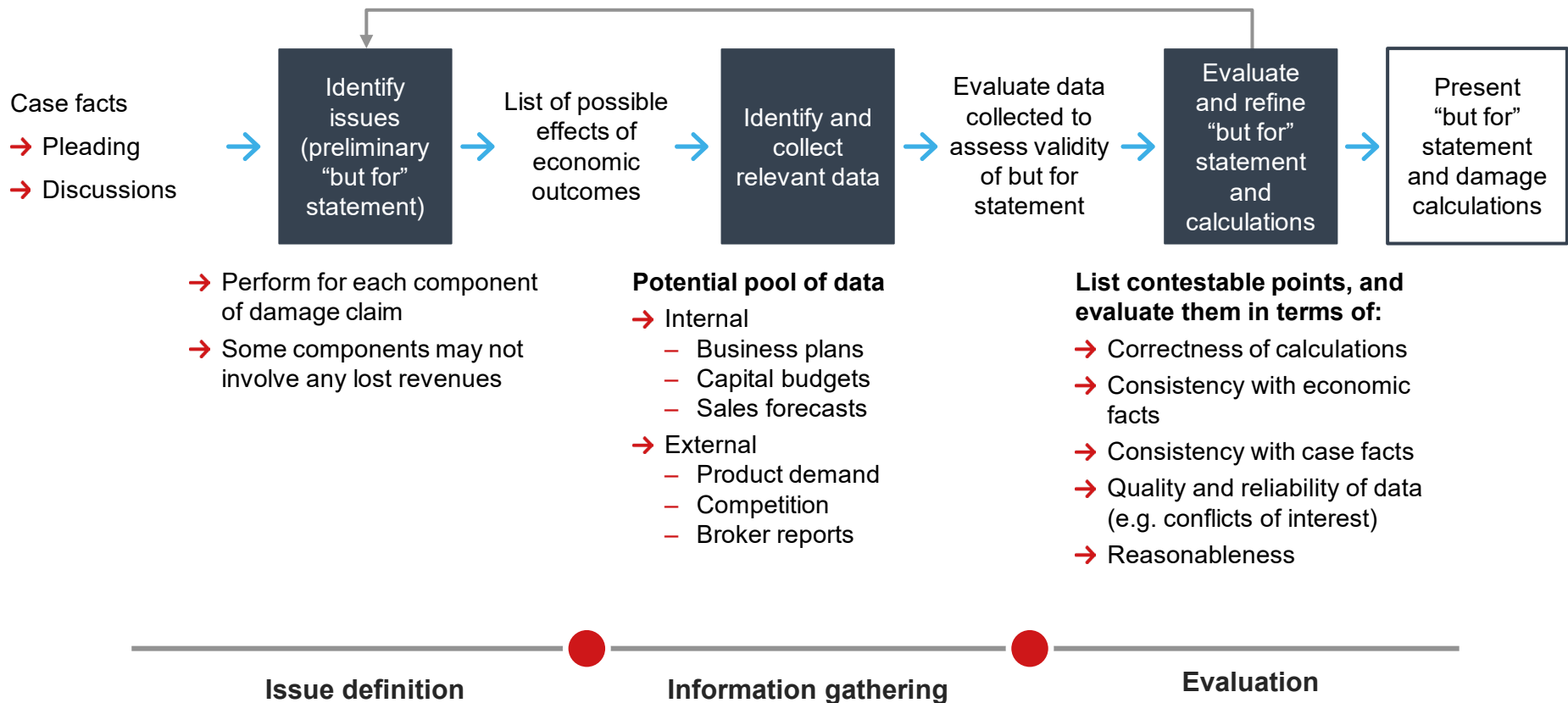
# The But For Situation

## INFORMATION & ASSUMPTIONS

- It is important to understand the areas of a damages assessment which are sensitive to assumptions:
  - Individually, by using other reference points; or
  - Collectively, by benchmarking the reasonableness of the conclusions resulting from those assumptions.
- Differences between the expert's assumptions and other reference points should be rationalised as much as possible.
- Generally speaking, where a given input is particularly subjective or sensitive, best practice is to apply a more conservative or prudent assumption.
- For subjective assumptions, scenario modelling can be an effective technique.

# The But For Situation

## INFORMATION & ASSUMPTIONS



# The But For Situation

## INFORMATION & ASSUMPTIONS

- Consider a case where an expert must determine prices that would have existed in the absence of a cartel. Potential methods for estimating prices in the But For Situation without the cartel can be:
1. By reference to prices from another similar region with similar demand and supply conditions but without a cartel.
    - However, it is often difficult to find comparators, and it can be hard to know whether the similar area is not also subject to cartel pricing.
  2. By reference to prices before or after cartel.
    - However, this comparison may be misleading because of changes in other factors that affect price, and it may be difficult to know when a cartel begins or ends.



# The But For Situation

## CASE STUDY

- Describe (i) the breach that has to be reversed in the But For Situation, (ii) what Builders Inc would have done in the But For Situation to avoid breaching the contract and (iii) the financial situation that Mooch Hotels would have been in but for the breach.
- Explain how each piece of information listed on the following slide could be used to determine Mooch Hotel's economic wealth in the But For Situation?
- Describe the assumptions that the expert would need to make to assess damages in the But For Situation.

# The But For Situation

## CASE STUDY

→ The following information is available:

1. Construction costs recorded in Mooch Hotel's accounting system
2. Booking records in Mooch Hotel's booking systems from June 2020 to December 2020
3. Forecasts prepared by Mooch Hotels when appraising the investment decision, albeit with a different start date and not including the restaurant
4. Forecasts prepared by Mooch Hotels for the arbitration, including the restaurant
5. Emails sent by Mooch Hotels to Builders Inc in December 2020 notifying the delay, quoting estimated lost revenue in January 2021
6. Mooch's estimate of damages prepared for its Request for Arbitration
7. Newspaper articles on the Waldorf Hotel project, describing facilities quoted by Mooch representatives and providing estimates of room and facility prices
8. Financial performance of Mooch Hotel's other hotels in Mooch's management accounts
9. Financial statements of hotel operators
10. Market forecasts for tourism in UK prepared by research groups
11. Market forecasts for the size of the hospitality industry in the UK, including various KPIs, prepared by hospitality real estate firms
12. UK inflation and GDP estimates from financial and government institutions



## Introduction to valuation

- What is valuation?
- Bases of value
- Valuation approaches
- Valuation date



# Introduction to valuation

## WHAT IS VALUATION?



Generation of future profits/cash flows to the owner



Accounts for risks, uncertainties and volatility associated with the cash flows

Accounts for the time value of money over the economic life of the asset



Point in time:  
Usually not appropriate to use subsequent information



**Valuation is not a science. However, practitioners follow generally accepted principles and standards. These principles are published by, e.g.:**  
***International Valuation Standards Council***  
***American Society of Appraisers***  
***Industry-specific bodies (RICS, CIM)***

# Introduction to valuation

## BASES OF VALUE

*A statement of the fundamental premises on which the valuation will be based*

### For example:

- The nature (and date) of the **transaction**
- The **relationship** and **motivation** of the parties
- The extent to which the asset being valued is **exposed to the market**

The appropriate basis of value:

- Depends on the **purpose** of the valuation
- Can be defined or asserted in **contracts, treaties, statutes and accounting standards**

The basis of value is different from:

- The valuation approach or method
- Type or state of the asset at the valuation date

# Introduction to valuation

## BASES OF VALUE

### Market value

*The estimated amount for which an asset should exchange on the valuation date between a **willing buyer and a willing seller** in an **arm's length transaction**, after **proper marketing** and where the parties had each acted **knowledgeably, prudently and without compulsion***

- Presumes open and competitive market
- Reflects highest and best use
- Takes no account of special value

### Equitable value

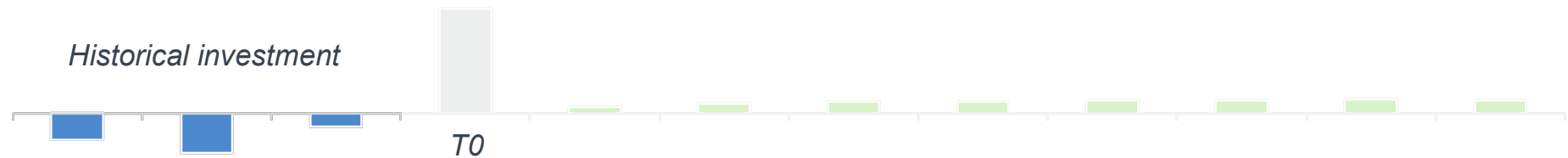
*The estimated price for the transfer of an asset between **identified knowledgeable and willing parties** that reflects the **respective interests** of those parties*

- Commonly used in judicial contexts and under shareholders' agreements
- What is fair between specific parties
- Broader than Market Value: may take account of special value

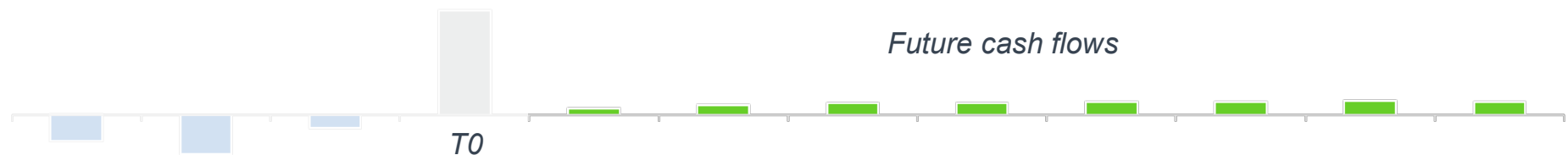
# Introduction to valuation

## VALUATION APPROACHES

**Cost approach:** an investor will pay no more for an asset than **the cost of an identical or equivalent** one



**Income approach:** the value of an asset reflects the **future cash flows** that the asset holder will receive



**Market approach:** the value of an asset is consistent with the **price paid for similar assets** in recent transactions



*Wherever possible, use multiple methods to ensure consistency*

# Introduction to valuation

## VALUATION APPROACHES

**Cost approach:** an investor will pay no more for an asset than **the cost of an identical or equivalent** one

- Net book value
- Replacement cost
- Reproduction cost

**Income approach:** the value of an asset reflects the **future cash flows** that the asset holder will receive

- Discounted cash flow method
- Dividend discount model
- Real options valuation

**Market approach:** the value of an asset is consistent with the **price paid for similar assets** in recent transactions

- Trading multiples
- Transaction multiples
- Industry-specific metrics (e.g. value per unit of mineral resource/value per user)

*Wherever possible, use multiple methods to ensure consistency*



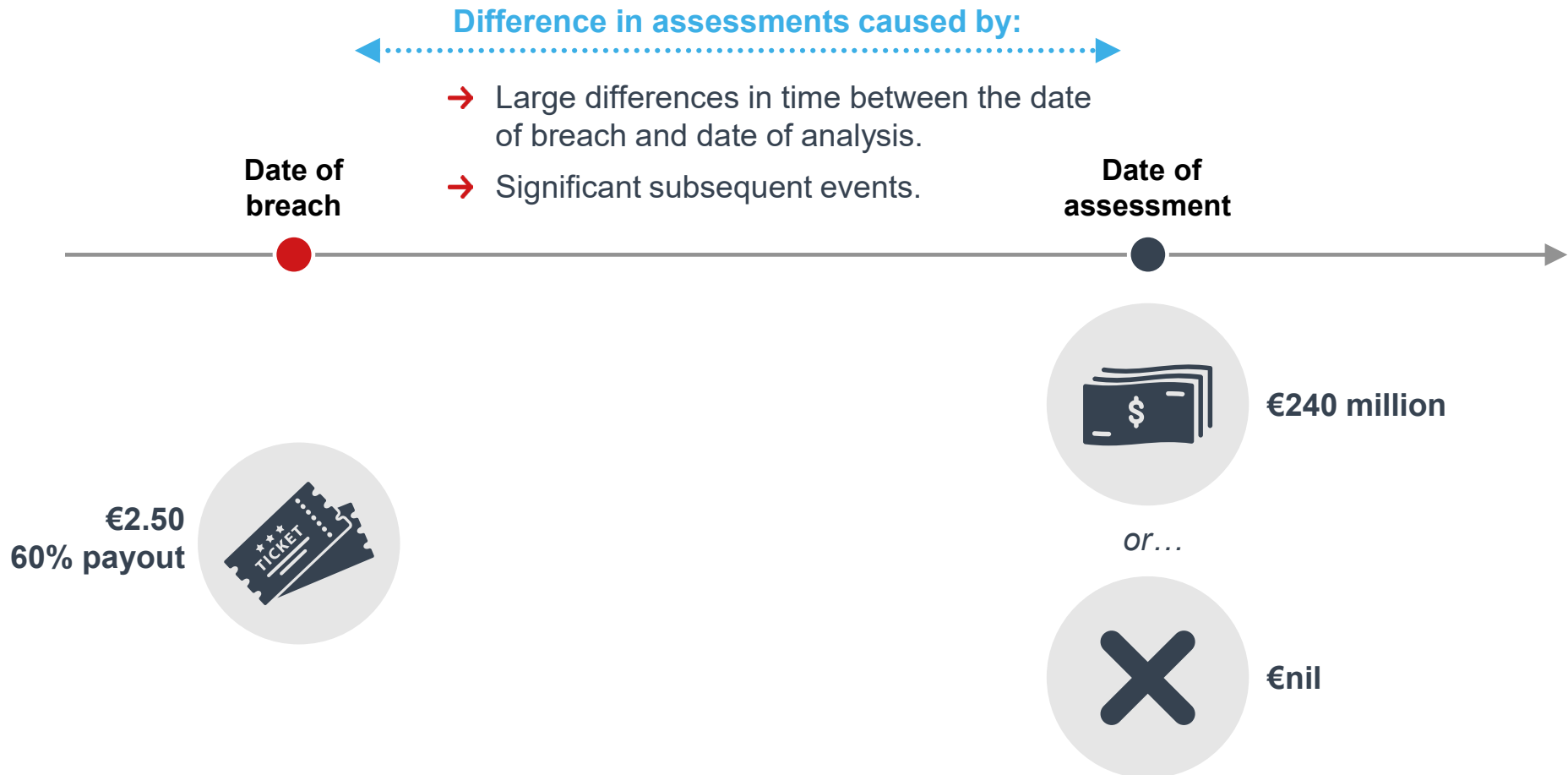
# Introduction to valuation

## VALUATION DATE

- Every valuation is performed as of a point in time.
- In non-contentious valuation contexts, the valuation date is usually obvious:
  - in the context of an **investment decision**, this is usually the **date on which the analysis** is performed;
  - in the context of **financial reporting**, this is usually the **most recent date of financial statements**;
  - in the context of **tax reporting**, this is usually the **date on which a chargeable gain arises**.
- In assessing damages, the choice of valuation date can be a key issue, as damages may be claimed based on expectancy or outcome:
  - **Expectancy (“ex ante”)**: Damages are assessed at the **date of the breach**, using information **known or knowable at the time**, with subsequent unexpected events being disregarded;
  - **Outcome (“ex post”)**: Damages are assessed as at the **date of the analysis** (and can be subsequently updated), using **all information available**.

# Introduction to valuation

## VALUATION DATE



# Introduction to valuation

## VALUATION DATE

### Ex ante

### Ex post

Fully accounts for risks in the But For Situation

Risks in the But For Situation may be reduced through hindsight

May be easier to cleanly reverse only those factors which were caused by the alleged breaches

Information on the actual outcome of the breach is typically readily available

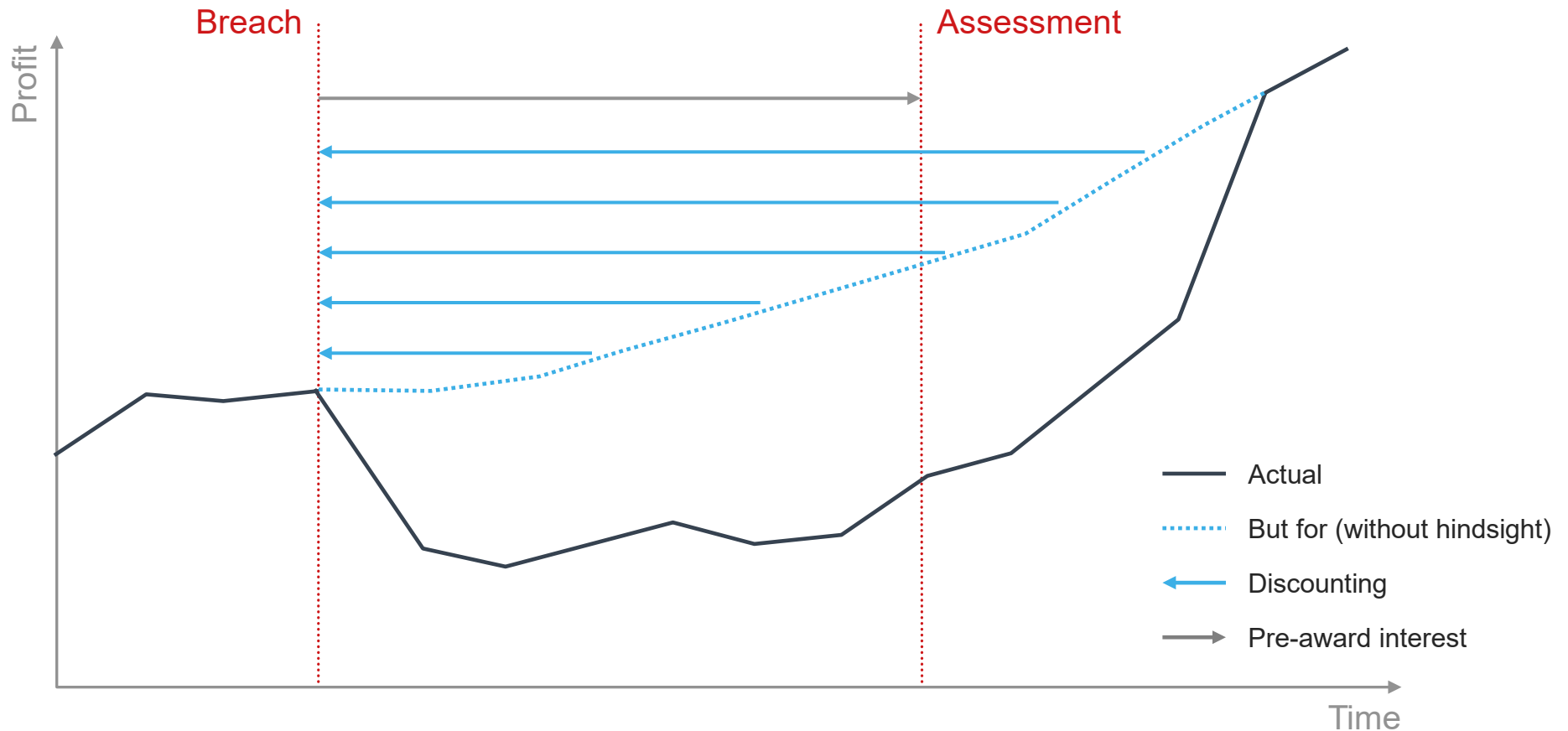
Reduces the risk of assessing damages which are unforeseeable and reflects the compensation that would be due at the date of breach.

May better reflect the principle of full reparation

# Introduction to valuation

VALUATION DATE

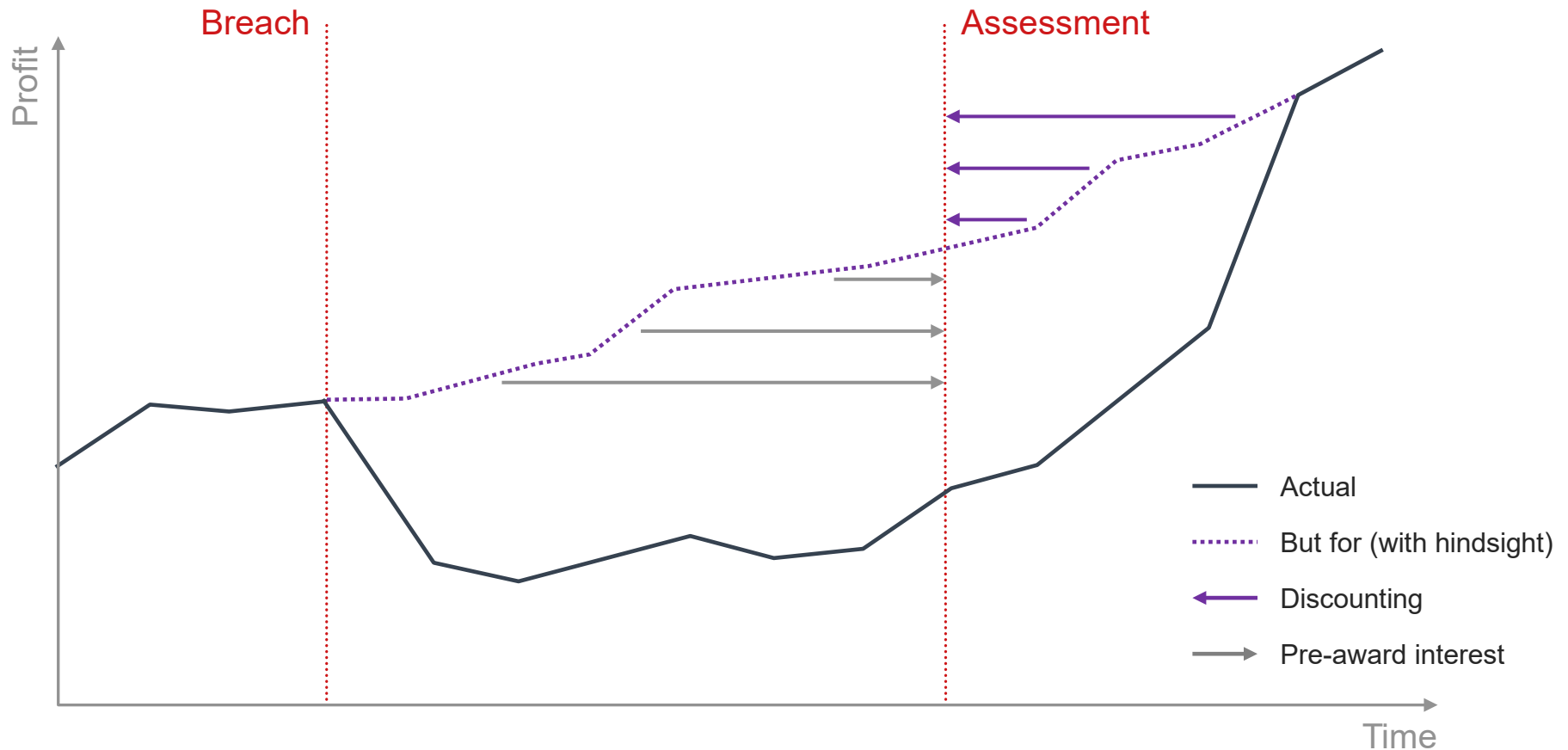
## Ex ante valuation



# Introduction to valuation

VALUATION DATE

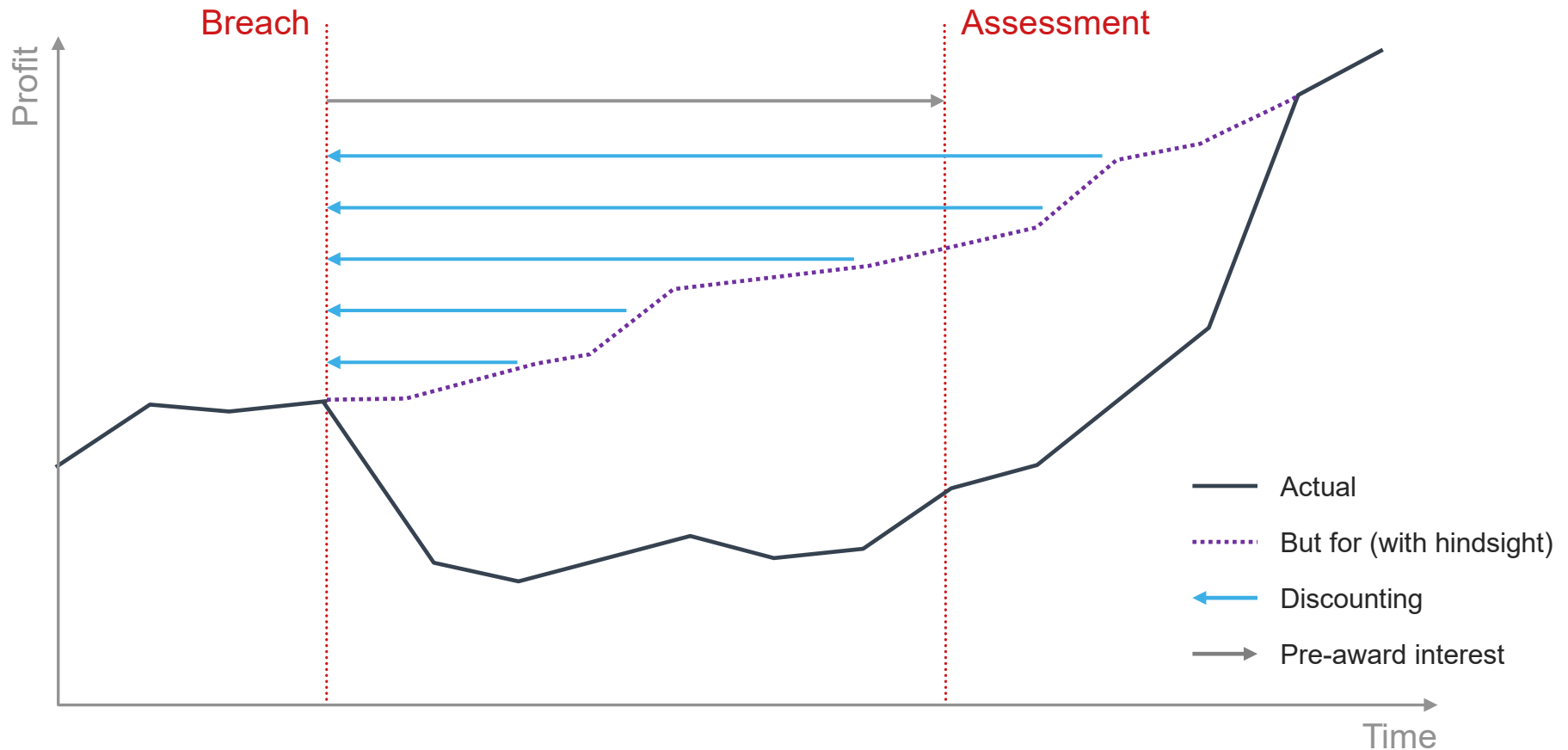
## Ex post valuation



# Introduction to valuation

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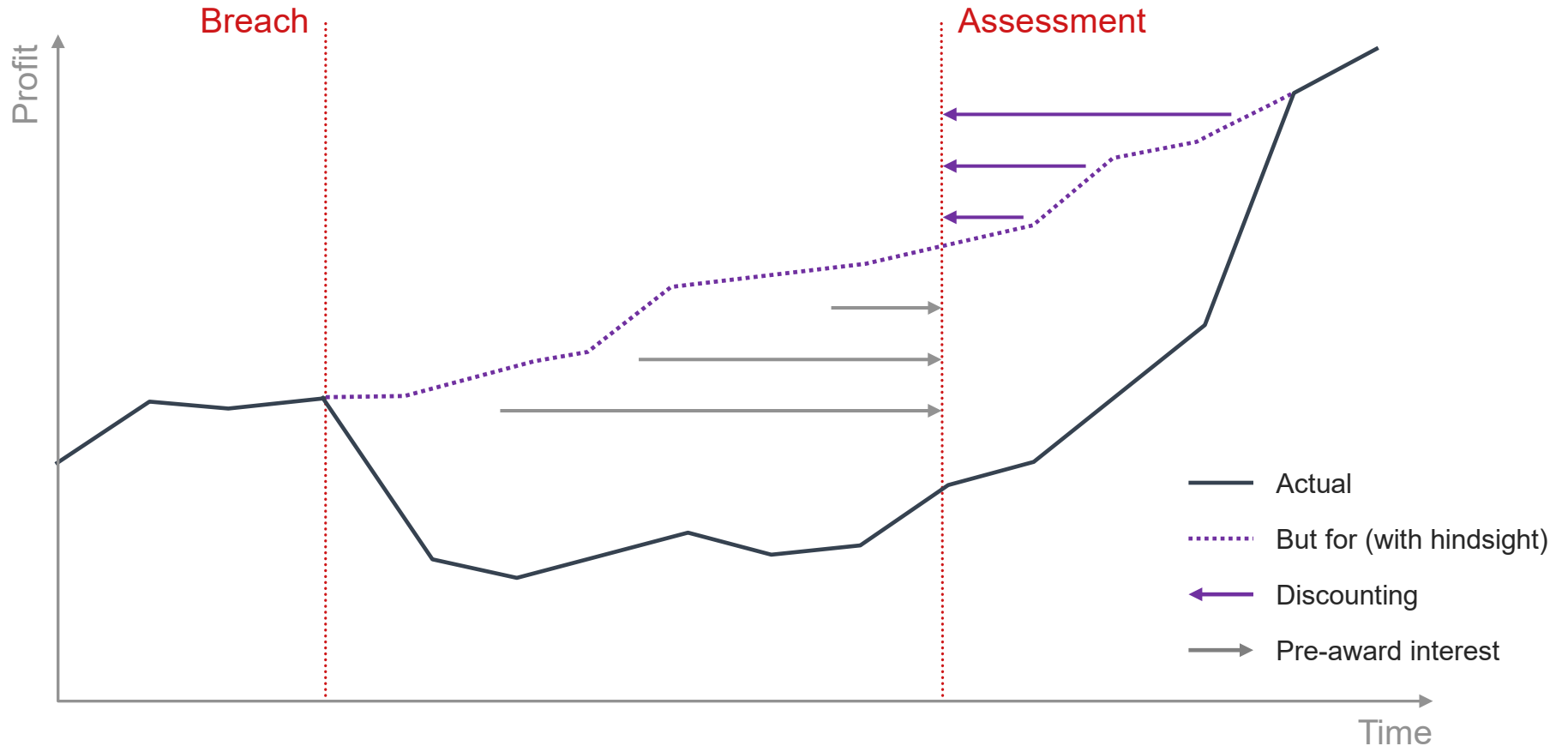
## Hybrid approach



# Introduction to valuation

VALUATION DATE

## Alternative approach



# Introduction to valuation

## CASE STUDY

- How might each valuation approach (cost, market and income approach) be utilised in assessing the damages to Mooch Hotels? What are the limitations of each approach?
- What valuation date options are there in this case?
- Which valuation date would be most appropriate and why?





## About us



# About us

ACCURACY IS THE SOLE FULLY INDEPENDENT ACTOR IN ITS FIELDS OF EXPERTISE,  
WITH A TRULY GLOBAL REACH AND SECTOR COVERAGE



1 partnership  
with 58 partners



540  
professionals



Across 13 countries



## OUR OFFICES

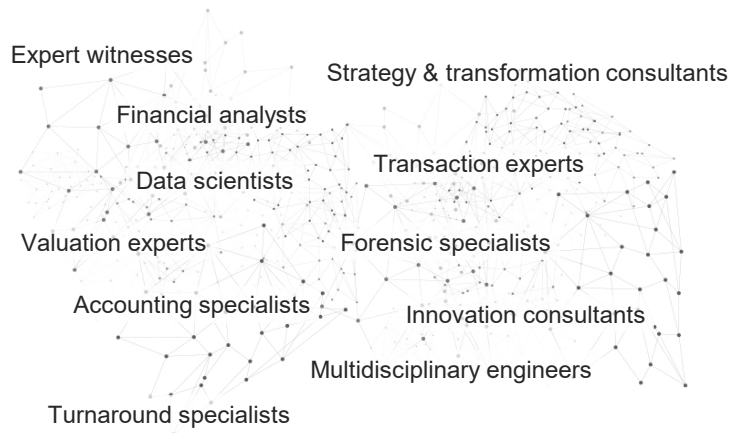
Amsterdam  
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Beijing  
Casablanca  
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We serve our clients all around the world

# About us

We provide advice and expertise to decision-makers and stakeholders for their strategic and critical issues.

## 1 Our people combine various skills and share strong values



- | INTEGRITY
- | TRANSPARENCY & OPENNESS
- | STEWARDSHIP
- | COURAGE
- | TRUST
- | SHARING

## 2 Our strength is to connect strategy, facts and figures



## 3 Our results enable you to decide

- A tailor-made approach for high-value-added solutions
- Clear, pragmatic and business-oriented conclusions

# About us

## OUR BUSINESS AREAS

### TRANSACTIONS & INVESTMENTS



Transactions



Valuation & investment



Project advisory



Post-M&A

### DISPUTES & CRISES



Disputes & arbitration



Recovery



Investigation & forensic services



Project disputes

### CORPORATE STRATEGY & FINANCE



Group & portfolio strategy



Public equity & stock performance



Value creation incentives



Strategic & financial planning

### BUSINESS PERFORMANCE



Market & business strategy



Business model innovation & technology



Digital solutions & smart reporting



Transformation

# About us

## FOCUS ON DISPUTES

DISPUTES & CRISES



We offer you Disputes  
and Arbitration

Engineering, financial, valuation, strategic and accounting expertise of dispute situations on all continents and in all jurisdictions.



We help you  
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shareholders and debtors in distressed or underperforming situations, turning and optimisation, or rebalancing the balance sheet.



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to see  
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ulent and criminal matters.



Our  
and  
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all

and delay & quantum expert witnesses provides advice  
and owners, in all kinds of construction and infrastructure dispute  
d in all jurisdictions.

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