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Uncovering the facts with the Ferrier Hodgson Forensics team

Damages ain't damages

Ferrier Hodgson's forensic accountants are frequently called upon to provide advice to litigating parties on the quantum of damages from claims under the Trade Practices Act ("TPA") and Fair Trading Acts ("FTA") and to give expert evidence accordingly.

While the facts and issues surrounding each matter are diverse, a common theme relates to claims for losses arising from allegedly false representations which a party has relied on in making investment or purchase decisions.

Many of the claims we see, however, are unclear on a critical point relating to the calculation of damages; being what the aggrieved party *would have done* if there had not been a contravention of the Act.

Because a fundamental notion of damages is to place the claimant in the situation they would have been if there had not been a breach, what the claimant would have done is important in the task of quantifying damages and can have a significant impact on the quantum of the claim.

If the claim is unclear or silent on what would have been done, the claimant may be losing out on a significant aspect of damages and the forensic accountant can be left with the task of calculating several different scenarios under various heads of damage, which adds to cost and may result in irrelevant or inappropriate calculations.



Relevant sections of the Acts

The relevant sections of the TPA are Sections 82 and 87, which entitle a party which has suffered loss or damage resulting from the wrongful conduct of another to claim for monetary compensation.

There are also comparable sections under the FTA of State legislation. Sections 158 and 159 of Victoria's FTA, for instance, are comparable respectively with Sections 87 and 82 of the TPA.

The remedies available under the TPA and FTA are broad and are not limited to economic loss. It is beyond the scope of this article to outline the principles of TPA and FTA remedies.

However, to illustrate the way in which calculations for a damages claim can be impacted by what the claimant would have done in the alternative, assume for the sake of simplicity that the following facts of Mrs Bloggs' case require that damages be calculated based on a tort analogy.



Damages relating to Mrs Bloggs' investment

Assume Mrs Bloggs buys a hotel business for \$10m, using saved and borrowed funds. She decides to make this purchase relying on financial information provided to her by the vendor.

Mrs Bloggs then runs the hotel business until the day her accountant informs her that the financial information the vendor provided is inaccurate and that the actual profits and assets of the business are significantly less than represented to her by the vendor.

Outraged, Mrs Bloggs engages lawyers, who prepare a TPA claim (putting aside any possible contractual claim).

What, if anything, can Mrs Bloggs claim and how could/should this be quantified? A large part depends on what she would have done (and the evidence to support it) if she had not been provided with false financial information prior to her purchase.

Depending on the background of the matter, what would have been done may be a hypothetical scenario, or fact, that can be backed up with evidence.

With an understanding of this information, calculations can be made regarding the damages to place her in that position.

Two alternatives and the impact on damages

What Mrs Bloggs would have done if there had not been a breach of the TPA can impact significantly on the heads of claim and the quantum of damages.

The following example illustrates the impact on the damage calculation assuming just two scenarios (although there may be many others); being where Mrs Bloggs would have:

- 1 Bought the hotel, but paid less for it
- 2 Not bought this hotel, but bought a different hotel

Scenario 1 – Bought the hotel, but paid less for it

This scenario is, from a calculation point of view, the simpler of the two.

Conceptually, this scenario assumes that the respondent would have actually sold to Mrs Bloggs at a lower price. If this is not supported by the evidence, this scenario may not be appropriate.

In simple terms, damages may be approached as the difference between the price paid for the hotel and the “true value” of the hotel when it was purchased (when the loss was incurred) and without knowledge of events which had not happened at the date of purchase (not always the case given several nuances that are ignored here).

This is illustrated as follows:

			Hypothetical
Amount Mrs Bloggs actually paid	A	From documents	\$10m
<i>Less</i>			
“True value” the purchaser should have paid	B	Calculated by forensic accountant	\$ 8m
Estimated capital loss	C	A - B	\$ 2m
<i>Plus</i>			
Extra borrowing costs	D	Interest	\$ 0.25m
Estimated Damages	E	C + D	\$ 2.25m



How high or low will the estimated damages amount be? It depends largely on the forensic accountant's assessment of the true value of the hotel. Based on the facts of the case, the "true value" may not actually be less than what Mrs Bloggs paid, in which case her loss will be nil.

However, if the "true value" of the hotel was less than what Mrs Bloggs paid, then it may also be reasonable to include the amount of additional borrowing costs she incurred because of borrowing an extra sum.

Scenario 2 – Not bought this hotel, but bought a different hotel

From a damages point of view, this alternative scenario involves more considerations and calculations, which may result in a higher or lower amount than calculated under Scenario 1.

If the evidence shows that Mrs Bloggs would not have bought the hotel if she had been given accurate financial data, but instead bought a different hotel, then calculations for damages should also incorporate adjustments for any trading profits or losses made by Mrs Bloggs from the acquired hotel, and also from the alternative hotel she claims she would have invested in.

This may be illustrated as follows:

			Hypothetical
Amount Mrs Bloggs actually paid	A	From documents	\$10m
<i>Less</i>			
Value of business today	B	Calculated by forensic accountant	\$ 9m
Estimated loss	C	A - B	\$ 1m
<i>Plus</i>			
Extra borrowing costs	D	Interest	\$0.2m
<i>Plus/minus</i>			
Add losses/deduct profits of acquired hotel	E	Calculated by forensic accountant	(\$0.5m profit)
<i>Plus/minus</i>			
Add profits/deduct losses of alternative hotel	F	Calculated by forensic accountant	\$ 1m profit
Estimated Damages	G	C + D + E + F	\$1.70m

How high or low will the estimated damages amount be in this scenario? It depends on several factors the forensic accountant is required to assess. It may be significantly higher or lower than any damages estimated in Scenario 1, even though there are more factors.

Firstly, Mrs Bloggs may be entitled to damages arising from a reduction in the business's value compared with what she paid. If it is established that this was caused by her ineptitude or unexpected competition, however, the damages may be less.

She may also be entitled to extra borrowing costs, but these costs may be for a different amount compared with the costs under Scenario 1.

Damages available to Mrs Bloggs may also be adjusted for profits or losses made whilst trading the hotel, having regard to her duty to mitigate her loss. Profits of the business would typically reduce the quantum of her claim, whilst losses would typically increase her claim.

These damages should then be adjusted for estimated trading profits or losses of the alternative hotel she would have purchased. Higher profits than those actually derived would increase her claim. Losses greater than those she actually incurred would reduce her claim.



Key issues

A significant consideration in calculating TPA and FTA claims is what the claimant would have done if there had not been a contravention.

Often, however, claims appear unclear or silent on the options that the claimant would have taken.

This may result in the claimant losing out on a significant aspect of the damages claim.

The forensic accountant can also be left with the task of calculating several different scenarios under various heads of damage, which adds to cost and may result in irrelevant or inappropriate claims based on the evidence ultimately before the Court.

What the claimant would have done often makes a large impact on the quantum of loss and damage and the issues surrounding each claim may increase or decrease the amount accordingly.

It is often beneficial to engage a forensic accountant to consider the issues before proceeding too far down the path of litigation.



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