



**LITIGATION SECTION STEERING COMMITTEE
ECONOMIC DAMAGES TASK FORCE
PRACTICE AID
TOPIC OVERVIEW: EX ANTE v. EX POST APPROACH TO LOST PROFITS**

INTRODUCTION

An important consideration for forensic accountants is whether lost profits should be determined as of the time of the alleged wrongdoing or as of the trial date. The corresponding issue is whether the expert should consider only information available as of the date of loss, or whether he or she should consider all known information as of the trial date.

The *ex ante* methodology computes lost profits as of the date of loss, relying only upon information known or knowable at that time. Projected future lost profits are discounted to the date of loss using a rate that reflects the risk of the asset. Prejudgment interest is then applied to the computed present value through the trial date. This approach is sometimes referred to as an expectancy-based analysis.

In contrast, the *ex post* methodology computes damages as of the time of trial, relying upon all known information at that time. Damages incurred between the date of loss and the date of trial are not discounted back to the date of loss but are measured as incurred, with prejudgment interest applied through the trial date. Future damages that extend beyond the trial date are discounted back to the trial date. This approach is sometimes referred to as an outcome-based analysis.

A final alternative is to use a hybrid approach, wherein subsequent information or hindsight is relied upon to compute lost profits, but lost profits are discounted back to the date of the loss.

BASIC ARGUMENT FOR EX ANTE

The *ex ante* methodology assumes that all lost profits are future lost profits that must be discounted back to the date of the alleged wrongdoing taking account of uncertainty. Proponents of this approach argue that since plaintiff was deprived of both asset returns *and* uncertainty surrounding those returns, it is improper to use hindsight, which effectively removes the uncertainty component. In other words, plaintiff should not be compensated for risk it did not bear.

BASIC ARGUMENT FOR EX POST

Proponents of the *ex post* methodology counter that the *ex ante* approach effectively imposes a forced sale upon the plaintiff at the time of violation, which denies plaintiff any compensation for the loss of continued ownership property rights. Using hindsight, however, correctly returns both the intrinsic risks and rewards of asset ownership to the plaintiff.

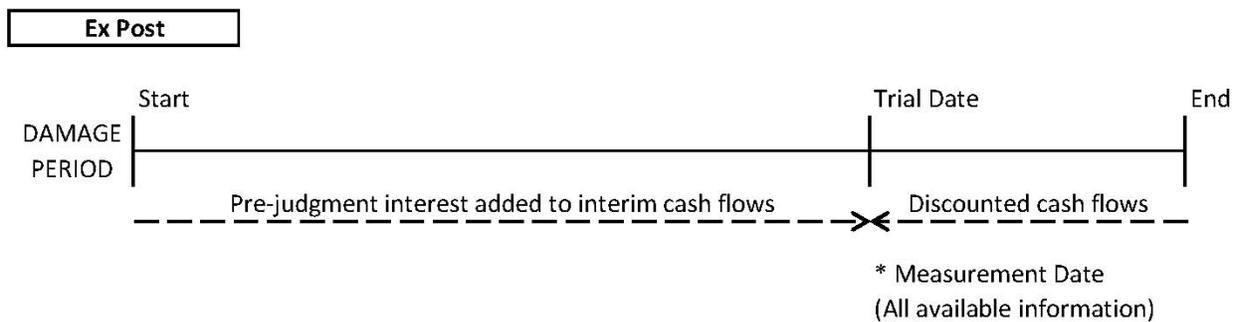
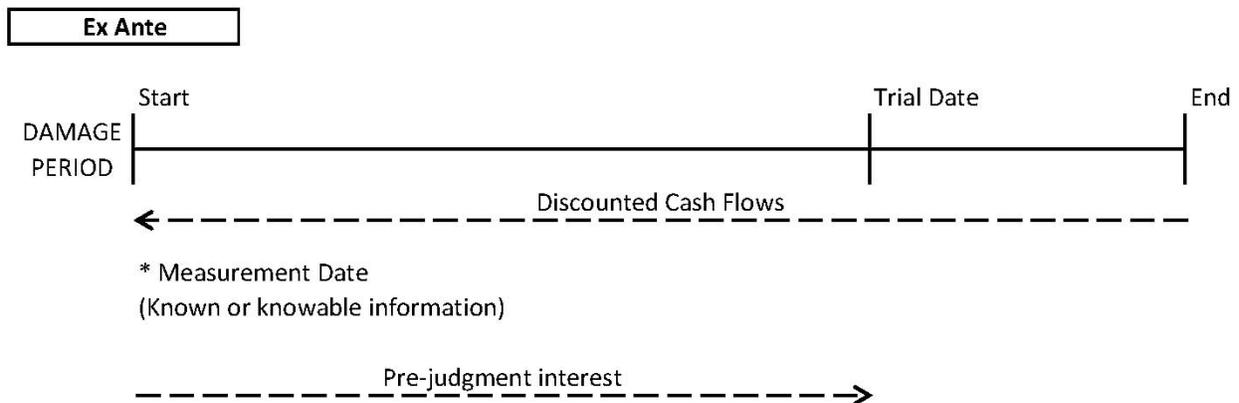
APPLICATION OF THE TWO APPROACHES

A well-known example that illustrates the differences between approaches involves a hypothetical high school yearbook signed by Janis Joplin.¹ Assume that Janis Joplin signed a yearbook before she became famous, the yearbook was stolen and destroyed, and the trial occurs years later after Ms. Joplin’s signature becomes worth a significant amount of money.

Under the *ex ante* approach, the damages award equals the value of the yearbook when it was stolen, plus pre-judgment interest until the award date. Under the *ex post* approach, the damages award equals the current value of the yearbook as of the trial date, given the inclusion of the celebrity signature.

The very different outcomes are based upon two fundamental differences between approaches: the measurement date and the use of subsequent information. Under the *ex ante* approach, damages are measured as of the date of loss and subsequent information is ignored. Conversely, under the *ex post* approach, damages are measured as of the trial date and all subsequent information is considered.

The following chart illustrates the fundamental differences between approaches.



CONCLUSION

The selection of an *ex ante*, *ex post* or hybrid approach to computing damages will most likely depend upon the specific facts of a particular case and on relevant jurisdictional case law. The experienced forensic accountant will have considered this issue and will be prepared to explain the basis for his or her selected approach.

REFERENCES

¹ A detailed discussion of arguments in favor of using an *ex ante* approach is provided in:

- Franklin M. Fisher & R. Craig Romaine, *Janis Joplin's Yearbook and the Theory of Damages*, Journal of Accounting Auditing & Finance, Volume 5, No. 1, Winter 1990, pp. 145-157.

A response to the Fisher & Romaine article that includes arguments in favor of using an *ex post* approach is provided in:

- Konrad Bonsack, *Damages Assessment, Janis Joplin's Yearbook, and the Pie-Powder Court*, George Mason University Law Review, Fall 1990.

Other useful articles and references include the following:

- Roman L. Weil et al., *Litigation Services Handbook The Role of the Financial Expert*, 4th edition, John Wiley & Sons, 2007, §8.1-8.8.
- Richard A. Pollack et al., *Calculating Lost Profits*, Practice Aid 06-4, American Institute of Certified Public Accountants, 2006, pp. 47-48, 36, 61.
- Brian P. Brinig et al., *Section 303: Conducting a Lost Profits Engagement*, PPC Guide to Litigation Support Services.
- George Roach, *Correcting uncertain prophecies: An analysis of business consequential damages*, The Review of Litigation, The University of Texas School of Law Publications, Winter 2003.