Matthew Ashby (MA): Hello, everyone, and thank you for attending this webinar. We're streaming to you live from Level Twenty Seven Chambers here in George Street, Brisbane. I'm Matthew Ashby, a Partner at McGrathNicol. I'm a Chartered Accountant specialising in forensic accounting and business valuation.

I'd like to thank my co-presenter, Matthew Jones, and Level Twenty Seven Chambers for the invitation to contribute today on a topic that poses tough questions for litigants, their lawyers, experts and the courts - claims for loss of opportunity damages.

Matthew Jones will lead off by outlining the key legal principles that inform the assessment of damages in loss of opportunity cases, surveying a number of cases that highlight the evidentiary requirements to prove causation and loss. I will then return to share my perspectives on how valuation concepts may be used to inform the assessment of loss, including the treatment of risk and uncertainty inherent in such an exercise. Matthew Jones will then close by summarising some practical takeaways for those of you who may be involved in loss of opportunity cases.

If you move your mouse or tap your touchscreen you'll see some options that allow you to change the configuration of panes displaying video of the presenter and the slides. You're invited to submit questions using the chat function during the presentation which we hope to answer at the end, time permitting. If we don't get to your question during the session our contact details will be displayed at the end and you're welcome to contact Matthew Jones or me by phone or email. With that, I'll pass to Matthew Jones to get us underway. Thank you.

Matthew Jones (MJ): Thank you. Now as Matthew has indicated, I'll be speaking to the legal principles which underlie loss of opportunity claims. Because we have limited time, the focus will be on the practical issues confronting us as litigators when we need to build up or tear down the loss of opportunity case. That is, when a client approaches us asking if they have a *chance* of recovering something from the wreckage of a deal gone wrong.

We need to identify whether a claim is possible on the facts, and if it is, what might be required to prove it. Alternatively, when acting for the defendant, we need to be able to assess how the plaintiff's claim might be impacted or discounted. In particular, there's a real incentive to try to cut down these claims at an early stage. For example, at the point of pleadings, because of the risk to a defendant of substantial damages being recovered, even if there was a low percentage chance of the plaintiff making a profit from the deal. A defendant may be somewhat annoyed to be sued for damages by a plaintiff who had no more than a *chance* of making money from the deal, and equally a chance of making a loss.

DAMAGES: TURNING AN IMPRECISE SCIENCE TO A MATHEMATICAL ONE

Experts are particularly important to these types of claims because they can maximise their value by bearing in mind these principles, and they're usually absolutely critical to the formulation of the assessments.

This will be the structure of the first part of my presentation. I'll give a general introduction to what we're speaking about in terms of loss of opportunity claims. I'll speak to some of the general underlying principles. Then we'll turn to the distinction between past and future events, then the relevant two stage inquiry. That will lead us into some particular issues that arise in relation to proof. Then I'll deal with the situation of multiple related variables and make some comments about the scope for mathematical precision in relation to inherently uncertain calculations. That structure is designed to lead into and give some context to Matthew Ashby's part of the presentation.

Now, we're familiar with damages being an imprecise science, which sometimes involves a degree of guesswork and value judgement. I want to provide some context around marrying up a legal pleaded case with a mathematical precision involved in some areas of expert evidence such as accounting or engineering.

These types of claims sometimes throw up an interesting situation whereby inherently uncertain factors are given a mathematically precise percentage likelihood. A number of those uncertain factors might then be multiplied together to arrive at an aggregate final percentage likelihood. Therefore, a group of inherent uncertainties are combined to a precise final mathematical result when you might ordinarily expect variables upon variables to lead to an ever more uncertain outcome.

I suggest that the authorities are pointing towards an ever greater role for mathematical precision. So, some questions which arise today: How does that work? Is it a good thing or a bad thing? What can the legal profession learn from other disciplines? And what should experts be careful about when providing opinions on these matters?

WHAT ARE LOSS OF OPPORTUNITY CLAIMS?

What then are loss of opportunity claims? They are claims involving an assessment of hypothetical events. That is, claims which depart from the actual provable facts and necessarily involve a degree of conjecture or speculation about what would have otherwise happened had there been no breach or injury. They can include claims about a range of things and some examples which have come up in previous cases include being deprived of an opportunity to participate in a contest, losing the opportunity to negotiate a more favourable deal than what was actually achieved, a chance to develop a property, a chance to develop a new product, and losing the prospect of a renewed contract as examples.

They often arise in claims from breach of contract where the measure of damages is the amount reflecting what the innocent party would have received had there been performance. They also arise in tort claims where the position the person would have been in if not for the injury which takes into account some issues as to what post breach steps might have been taken. And the analysis also arises in statutory claims, *Sellars v Adelaide Petroleum*, one of the key cases was a TPA case.

So, loss of opportunity assessments could be seen as covering expectation damages, and they grapple with the reality of an uncertain world while providing the successful plaintiff with fair and adequate compensation.

LOSS OF OPPORTUNITY DAMAGES - PRINCIPLES

The very basic core principles are well known. *Johnson v Perez* and *The Commonwealth v Amann Aviation* give the tests for recovery of damages in contract and tort, the amount of money, which will as nearly as money can, put the person in that same position but for the injury or the breach. Albeit with contract with the overlay of performance, which I'll come to later.

Now, the rules of pleading are particularly important in informing how these claims are run. Of the recent Queensland cases, one of the most important is *Graham & Linda Huddy Nominees Pty Ltd v Byrne*. There Justice Jackson outlined the requirements in general terms of a pleading of loss of opportunity claims, which will be familiar in relation to litigation more generally. Justice Bond put it this way in *Sanrus Pty Ltd v Monto Coal 2 (No 7)* [see slide 8]. Now, so far, none of this is different to an ordinary case. But I suggest it may be harder to achieve.

The next relevant principles indicate that in contract claims damages in the form of loss of profits should be taken as the preferred method for the assessment of damages.

First, a party to a contract has an interest in the performance of a contract, it is wrong to say that a promisor has a choice to either perform or pay damages in lieu of performance. Contracts are made to be performed, not avoided.

Second, the contract claims are the performance yardstick referred to in *Robinson v Harman*. That is, the contractual measure of damages that put the plaintiff in as near a situation as is possible by the payment of money as if the contract had been performed.

Third, *Amann Aviation* explains the relationship between expectation and reliance damages. One principle emerging from that case is that expectation damages should be considered first, and only if the expectation damages assessment is impossible to assess on the facts, not

just that the plaintiff fails to do so, but that it's impossible that reliance damages should be sought in the form of recovery of wasted expenditure.

By way of explanation, *Amann* concerned a contract with the Commonwealth and maritime surveillance flights in the 1980s over Australia's northern coastline. The Commonwealth repudiated the contract at the start of a term of a new provider. And it was impossible in the absence of any reference points on the facts for the parties to model what future performance would look like in terms of profit achieved and in particular costs of performing the contract. Therefore, the task being impossible, there was no rigorous enough basis for an assessment of expectation loss, and so reliance damages were awarded in the form of wasted expenditure.

DISTINCTION BETWEEN PAST & FUTURE EVENTS – PRINCIPLE IN MALEV J C HUTTON PTY LTD

This brings us then to that critical distinction between past and future events, and this distinction explains the entire framework for loss of opportunity damages.

Now, a number of cases refer to the principle in *Malec v J C Hutton Pty Ltd*. *Malec* was a Queensland personal injuries case which recognised the distinction between proof of actual historical facts being different from proof of potential eventualities occurring after the breach. That is, future booking from the point of the breach, even though by the time of judgment some of those historical eventualities may have come.

The principal in *Malec* was picked up in *Amann* and *Sellars*, and in short the principles are these: past claims are decided on the balance of probabilities, where there is a 51% chance that an event occurred, it is regarded as a certainty; where there is a 49% chance that historical events occurred, it's regarded as never having happened.

Future claims are different, there can be no such certainty. They involve hypothetical events. Therefore, unable to be sufficiently certain, the law must work in terms of probabilities. The probabilities may be very nearly certain or effectively negligible. But that is a matter of evidence, a 51% chance is a 51% chance, not a certainty. It would be unfair to say that a plaintiff who can show a 51% likelihood of a hypothetical outcome could recover 100% of the potential gain, just as it would be unfair for a plaintiff who could show only a 49% likelihood to get nothing. That is why there is a two stage inquiry.

The first, which is a matter of causation, is whether there was a valuable opportunity at all. This is the threshold that the plaintiff must overcome before an assessment will take place. Often the same evidence will be used with respect to the assessment of the second stage and working out whether the opportunity had value. However, the two stages need to be treated and established separately. And that raises some important questions about what the distinction means in practice.

WHAT DOES IT MEAN THAT THERE WAS NO OPPORTUNITY AT ALL?

So first, what does it mean that there was no opportunity at all? Two cases help demonstrate that. The first is *Gates v City Mutual Life Assurance Society Ltd*. There Mr. Gates held an any occupation TPD (total and permanent disability) policy. But he had been told by the insurance broker that he was getting a policy which would respond if he was unable to perform his occupation as a builder. The problem for Mr. Gates is that he lost no valuable opportunity. For this reason, and bear in mind that he was self-represented, he could not show that he could have or would have entered into a policy of insurance with an 'any occupation' clause. Therefore, he never had an opportunity to get an 'any occupation' policy. So loss could not be assessed by reference to any such hypothetical and it was the plaintiff's burden to prove that such a hypothetical policy existed.

Another example is *Marx v GIO Australia Holdings Ltd*. The financier there changed the interest rate on a loan facility, which he was contractually permitted to do, but it had misrepresented that it would not do so. The problem was that the loan terms were so good that the borrowers could not have done any better even at the high interest rate. So no opportunity had been lost. There was no alternative preferable line facility, so no valuable opportunity it could have been obtained.

Second, what if the evidence points to a likelihood of loss? This was the fundamental question of law which arose in *Principle Properties Pty Ltd v Brisbane Broncos Leagues Club Limited*. At first instance, Justice Jackson considered that what he described as the 'Sellars Methodology' did not apply where there was a likelihood of a loss rather than profit. But on appeal, it was confirmed, as can be seen in paragraph [16] on the slide [see slide 14], that the improbability of a profit, is no necessary bar to recovery. In that case there was a more than negligible chance of a profit, so the opportunity had *some* value. And at paragraph [28] Justice McMurdo said a likelihood that this would have been a loss-making development did not, as a matter of law, preclude the award of more than nominal damages.

Now, this makes A plaintiff asking the question "so do you think I have a chance?" dangerous to a defendant. The venture may be a speculative one with huge risks and a high likelihood of failure, but a small chance of a very high payout. That is a valuable opportunity for which substantial damages are available, if the pathway to an assessment of damages can be adequately proved on admissible evidence.

MAKING GOOD A CLAIM – THE 3 ISSUES

That that brings us to making good a claim. There are three issues.

MAKING GOOD A CLAIM – SURROUNDING CIRCUMSTANCES

The first is reliance on surrounding circumstances, which is necessary. Now that's because little weight is placed on the evidence of persons after the event saying what they would or would not have done. That is inherently self-serving and it doesn't provide an adequate basis for a judicial determination.

Experts cannot give evidence as to what a person would have done. *Sanrus Pty Ltd v Monto Coal 2 Pty Ltd (No 5)* ruled that an expert Mr. Freeman could not express an admissible expert opinion about what the joint venture partners would have done. What's required instead is reliance on the surrounding circumstances and inferences that can be drawn from them. And this is an important practical inquiry to make at the outset. Obviously, a plaintiff would say that they would have done what was necessary to achieve what in hindsight proved to be a profitable opportunity. However, different broader evidence will be needed to prove that is true.

Very complicated claims can be successful, but sometimes at uneconomical cost. Sometimes it is simply not possible to prove from surrounding circumstances what the expectation damages may have been, bearing in mind it's not just the headline receipts but it's also the costs which would have been incurred in getting there which need to be taken into account to avoid over compensation.

In turn, the fallback on reliance damages for wasted expenditure may or may not be worth the candle. Clients would obviously very much like to arrive at a landing on these issues as early as possible in the case.

MAKING GOOD A CLAIM – WHAT PROOF IS REQUIRED?

Now, the very practical question of "how much detail is required?" I'll give you a typical lawyer's answer - enough to persuade and as much as you can.

You want to establish an acceptable range and get as high in that range as is possible. At a minimum, the requirement is to show the steps which leads to the loss claimed having a rational foundation. It's no bar to a case that the final percentage likelihood of a profitable or beneficial outcome may be quite low, and as equally no bar to success, that there may still be some uncertainty as to exactly what would have happened. But there needs to be at least an arguable link, on the face of the pleading and then on the evidence, between the conduct which the plaintiff impugned and the loss alleged to have been suffered.

Birbilis Bros Pty Ltd v Chubb Fire and Security Pty Ltd & Ors is useful authority for the proposition that it is not necessary to plead or prove the actual precise transaction and a precise counterparty in a hypothetical analysis. However, the nature of the transaction needs to be adequately specified. So the goal is to prove a pathway to the loss to the highest proportion of likelihood which is possible.

MAKING GOOD A CLAIM – PLEAD PERCENTAGE/PROPORTION OF OPPORTUNITY LOST

Now, we return again to *Huddy*. We return again because Justice Jackson at paragraph [50] gave some guidance as to what is required to properly plead a loss of opportunity case. And I'll focus in particular on the third requirement which is highlighted there [see slide 17].

His Honour's comments were obiter but they were statements by a Supreme Court Judge expressly offered as a guide as to how such claims should be pleaded, and *Huddy* has been subsequently cited in general terms with approval on a number of occasions.

Now, there's an obvious tactical concern for a plaintiff in pleading say a 60% likelihood of a first step, a 50% likelihood of a second step and a 40% chance of a third step in the assessment reasoning, because that might look like a 12% chance of a headline figure, which the plaintiff would then expect to have chiselled down at trial. However, given the subsequent treatment of Justice Jackson's guidance, paragraph [50] of *Huddy* should be seen as the law in Queensland as to what is required of any pleading of loss of opportunity damages, including the pleading of percentages for each stage of each step in that second stage assessment process. Now there's no room for a percentage in relation to the first stage, which is established on the balance of probabilities.

That said, it's clearly impermissible to plead and prove a 100% likelihood of an event occurring, as his Honour said in the fourth part of paragraph [50]. However, a 100% likelihood cannot simply be asserted without basis. Throwing the problem at the judge and hoping for the best is not permissible. I suggest that these pleading requirements have an obvious and logical public policy function. These types of claims can be difficult and expensive to prove and to defend. By their nature, they may require a lot of extraneous evidence. Imposing a rigor at the pleading stage is important to reduce the risk of wasted court resources, and party time and cost.

PROOF - TRACING THE PARTIES' CONDUCT

Another important element of these claims is the extent to which the evidence has to go into the shoes of the parties, the position of the parties at the relevant time. So the counterfactual, the hypothetical scenario, at both the pleading and the evidence stages involves considering what the parties and the relevant third parties would have done. In *Amann* for example, as you can see on the slide [see slide 19], this hypothetical exercise involves ascertaining how the contract would have turned out. Justice Brennan, at page 100, said of the hypothesis that the contract is still on foot and that assessing the contracts performance requires determination whether future conditions or eventualities would have been fulfilled. Some said that some estimate may be made when necessary. At page 103, His Honour referred to the fact that the evaluation will require analysis of those extraneous surrounding circumstances you can see referred to on the slide [see slide 20].

There is no bar to a claim that a counterparty, typically the defendant, may have had a discretion whether to take step A or step B. If extraneous circumstances allow a case to be made that the person would have most likely done A or B, that can be established even over their objection.

To take *Amann Aviation* as an example again, the court was open to the prospect on the hypothetical scenario of the Commonwealth potentially renewing *Amann*'s contract for a second term, even over the Commonwealth's extraneous case that the relevant Department Secretary had an unfettered discretion whether to renew or not, and that was accepted, and over the Commonwealth's case that the Secretary would have declined to renew, because that was a hypothetical matter and not a certainty.

Justice Dean said that insufficiency of information might be a hurdle, but opinion evidence, common sense and common experience will enable an estimate of the outcome to be achieved. Therefore, there's a required process of tracing through each step in the reasoning.

DEALING WITH MULTIPLE VARIABLES

Now, the very interesting issue of dealing with multiple variables.

That hypothetical pathfinding exercise extends to this type of problem. That is where a plaintiff needs to prove that multiple things would have all happened. That was part of the case in *Sellars* for example, that there would have been both a commercial agreement and an underwriting of shares. And both of those steps necessarily involved the conduct of others in circumstances where there was no legal obligation to do either.

There was also a series of related steps in *Principle Properties*, and I've listed them there on the screen [see slide 21]. You'll note the round numbers, this is a matter that Matthew will deal with in detail in his presentation. But I'll just note that if you multiply those percentages together, you will get to a 7% ultimate likelihood.

Also, largely by way of introduction to Matthew Ashby's part of the presentation, I would raise as an issue the scope for mathematical precision in these situations. Here inherently uncertain factors are assigned a percentage figure in a broad brush round numbers way, but then they're multiplied together, and the result is come to.

Now, the assessment of damages is often attended by uncertainty, even when dealing with actual historical facts. The assessment of damages in relation to hypothetical facts, which differ from what actually happened, necessarily involves speculation or even guesswork. So we have a world of uncertainty, pressing up against the search for rigor, often with the involvement of experts whose stock and trade is mathematical precision.

The assignment of percentages to each step in the analysis is a useful way of putting a framework around the assessment, but especially when a series of events realities are multiplied together. The mathematical result is that any loss of opportunity case with multiple steps risks being multiplied down to a very low assessed loss figure, unless some of the steps and the reasoning are near certainties.

Many of us are lawyers, at least in part because of how we struggled with mathematics at high school. We deal in risk all the time, but often not with mathematical precision. Look at how we struggled to say the percentage likelihood of a matter succeeding or failing at trial. We try to avoid giving percentage figures out of a concern that the percentage may be misleading or maybe misinterpreted. Without meaning to be too comedic about it, this might give cause for concern if lawyers are set loose with mathematical concepts, such as statistics and probabilities, without proper guidance. This in turn raises questions about what lawyers might learn from other professions about how to properly handle the mathematical assessment of probability risk.

I think this is an appropriate juncture to hand over to Matthew Ashby to help guide us through those issues.

LOSS OF COMMERCIAL OPPORTUNIY – A QUANTATIVE EXERCISE

MA: Assessing damages or loss of a commercial opportunity is often challenging. In particular, it is unavoidably a quantitative exercise. Damages are after all a monetary sum. Yet accounting and finance do not typically form part of a core legal education. It is also subject to uncertainty, particularly because it requires the analysis of a hypothetical scenario, namely the pursuit of a commercial opportunity of which the plaintiff was deprived.

The uncertainty regarding the value of a lost opportunity affects experts in relation to how they estimate plaintiff's losses, litigants and their legal advisors in relation to forensic strategy and the consideration of settlement offers, and judges who ultimately have to decide cases and assess damages where a plaintiff succeeds.

This uncertainty is undesirable because it increases the risk of parties making suboptimal decisions in relation to their disputes and it increases the risk of inaccurate damages assessments in matters that proceed to judgment. That is, plaintiffs may end up being under compensated or over compensated.

In the time available, I'd like to share some observations from a valuer's perspective about *Principal Properties* which is the case that Matthew Jones earlier referred to and outlines some valuation concepts that can assist in assessing the value of a lost commercial opportunity and suggests that however a party may choose to present its damages claim better decisions are enabled when risk affecting the claim is identified, measured, and explained.

Turning first to *Principal Properties*. To outline the case briefly, there was a call option deed for Principal Properties to buy land from Broncos for AUD 1 million within three years, with a view to building fifty-four apartments and some other facilities. Broncos repudiated the call option date by not giving its consent to Principal Properties' development application, entitling Principal Properties to terminate and claim damages.

At first instance in the Supreme Court, Justice Jackson held there was a breach of contract but there was a failure to prove loss and damage, as it was more probable than not that Principle Properties would have lost money on the project. His Honour awarded nominal damages of AUD 100 and said that if he was wrong about the failure to prove loss he would otherwise have awarded AUD 330,000.

On appeal, Principle Properties was successful in arguing the primary judge had erred by failing to correctly apply the Sellars Methodology. The Court of Appeal awarded damages of AUD 250,000 plus interest. The table on your screen compares these analyses [see slide 25].

In a little more detail, at first instance, Justice Jackson arrived at a potential gross profit associated with the opportunity of AUD 3.3 million. Achieving that profit would have been subject to a number of contingencies: a 50% chance of obtaining the necessary development approval; a 50% chance of being able to acquire the relevant land; and a 40% chance of achieving necessary pre sales of apartments for the project to proceed. Multiplying those probabilities together gives an overall probability of 10% before discounting for other risks, including financing and sales risks, as it was put in the judgment.

Multiplying a potential gross profit of AUD 3.3 million by a 10% probability gives a value of the lost opportunity of AUD 330,000. In the Court of Appeal, Justice Philip McMurdo, with whom Justice Philippides and Boddice agreed, started with a high potential gross profit of AUD 4 million, allowing for the value of management rights associated with the proposed unit development. His Honour did not disturb Justice Jackson's assessments of probability for the three identified contingencies. And while the appellant criticised the approach of multiplying probabilities Justice McMurdo considered that approach was logical.

Further, his Honour applied a 70% probability of the plaintiff obtaining the required finance, which Justice Jackson had found but not applied in his calculation to arrive at a combined probability of 7%.

Multiplying a potential gross profit of AUD 4 million by a 7% probability gives a value of the profit opportunity of AUD 280,000.

Justice McMurdo then allowed for the chance that the project would be loss making by reducing that amount by a further AUD 30,000 to arrive at damages for the lost opportunity of AUD 250,000.

I would make the following observations in relation to the Court of Appeal's analysis. The Court of Appeal decision actually contains no explicit calculation of an allowance for the chance of loss. However, mathematically, the award of AUD 250,000 implies an allowance of AUD 30,000, which is equivalent to a 93% chance of a AUD 33,258 loss, as highlighted in the table on your screen [see slide 26].

The chart above that table shows the probability distribution of possible outcomes implied by the Court of Appeal's judgment. In summary, it shows what's known as a Bernoulli distribution with two possible outcomes, a 7% chance of a AUD 4 million profit and a 93% chance of a AUD 32,000 loss.

It's interesting, at least to me, to think of the property development having only two potential financial outcomes. In reality, one might imagine something closer to a normal distribution or Bell curve where there is an expected average profit or loss and a range of possible higher or lower outcomes around it.

Naturally, the Court's assessment had regard to the nature and extent of evidence before it. As a general proposition, it suggests that it's worth considering how damages rewards might be influenced by the rigor of analysis presented to the courts by litigants and their experts.

THE RATIONAL INVESTOR

A further thing I would note about the Court of Appeal's judgment in *Principle Properties v Broncos* is that Justice McMurdo's leading judgment also contains a number of interesting references to the perspective of a "rational investor", including this one, which I'll paraphrase "I would also accept that a commercial opportunity which no rational investor would pursue would be a valueless opportunity. That is, an opportunity the loss of which would not be compensable."

Now according to finance theory, a rational investor will only invest in projects it expects to add value. That is projects with positive net present values, or in other words, projects that are expected to deliver a rate of return on investment that exceeds the cost of capital. Therefore, any defendant may seek to show that an opportunity was valueless by presenting an analysis that indicates a negative present value. That could occur either because the project or an opportunity would generate losses, or because any profits it might earn would be insufficient to deliver a rate of return that a rational investor would require in order to commit funds to the opportunity.

As a concluding observation on *Principle Properties*, I note the cash flows associated with Principal Properties' project were expected to be incurred or received over a multi-year period. But it's not evident that the loss analysis included any discount to a present value as at the date of breach, prior to the addition of prejudgment interest.

VALUATION CONCEPTS

Now I'll outline some general valuation concepts that can assist in assessing the value of a lost commercial opportunity, particularly in the more complex case of an opportunity to earn profits over a period of time.

From a valuation perspective, and subject to any modifications according to legal principle, a commercial opportunity can be valued much like any other asset. According to valuation theory, the value of any asset is equal to the net present value as at the valuation date of the future cash flows expected to be derived from the asset. Those cash flows could be derived by using the asset to generate profits or by selling it.

A net present value calculation requires a valuation date, an estimate of the expected future cash flows, and a discount rate that reflects the time value of money and the level of risk associated with the expected cash flows. The value determined in that manner should be the statistical expected value, or mean. That is the probability weighted average of all possible outcomes. In its purest form, that's precisely what a discounted cash flow valuation should reflect.

For a given opportunity with a range of possible outcomes the probability distribution of those outcomes could be normally distributed, like the bell curve in the middle chart on your screen [see slide 29]. Or it may be skewed like the charts on either side, or it may have a differently shaped distribution altogether.

In the normal distribution, the expected value or mean is the same as the most likely outcome, or mode, at the peak of the curve.

In the other distributions, to the left and right of the screen [see slide 29], you can see that the value we're interested in, the mean, identified by the red dot, is greater or less than the mode.

The key insight here is that analysing only the most likely outcome may not give an accurate value of a lost opportunity.

RISKS

Quantifying loss of opportunity damages can be similar to quantifying damages in other cases involving a loss of profits, except that loss of opportunity damages are subject to an additional layer of uncertainty which may reflect a number of things. For example, a lack of certainty as

to whether the plaintiffs could and would have pursued the opportunity and dependencies on the actions of the parties. For example, governments providing regulatory approvals, or banks providing finance in order for the opportunity to be realised.

Because the opportunity was not pursued, there's likely a lack of historical financial performance by which to judge the reasonableness of expected cash flow projections. Often there's a lack of an active market for the relevant type of commercial opportunity.

The approach to risk in damages, I suggest, should be to capture all of it once and none of it twice.

In order to avoid overcompensating a plaintiff, risks affecting a lost opportunity must be accounted for in the estimation of cash flows, or the discount rate, or a seller's type discount by the court.

In order to avoid under compensating a plaintiff by double counting risks through a seller's type discount it's important for expert reports to be clear about how they have treated risk, including what risks are already accounted for in their assessments of cash flows and the discount rate.

At the same time, it may be better for expert's calculations to not account for certain risks that are more appropriately left to the court to assess and apply discounts to.

OTHER LOSS ISSUES

Another issue is the date of assessment. That can be important for a number of reasons.

Assume for the purposes of illustration that the date of assessment is T=2 in the chart on your screen [see slide 31] being the date on which the price lost its opportunity as a result of the defendant's breach of contract. Any costs incurred prior to the valuation date, in the area shaded grey, are commonly referred to as sunk costs. They're not relevant to whether it would be economically rational to continue to pursue the opportunity as at the date of assessment. Only the future cash flows are used in a net present value calculation that's relevant to that decision. While the sunk costs affect the overall investment return of a project they did not affect the value of the opportunity at the posited date of assessment.

Depending on the facts of the case, there may be an argument that some or all of those sunk costs could be claimed as wasted costs.

Another consideration is the extent to which the law may permit hindsight in assessing events and conditions that would have transpired after the date of assessment. Such hindsight should not affect the expected cash flows that a rational investor would consider in deciding whether

to pursue the opportunity as at the assessment date. However, it may affect an assessment of the cash flows that the plaintiff would actually have been able to derive from the opportunity had it not been prevented from pursuing it. If permitted, as a matter of legal principle, this is a departure from normal valuation practice where only information that was reasonably knowable as at valuation date is taken into account.

Where hindsight shows better than expected conditions, this would increase the plaintiff's loss. In that case it would be more advantageous for the plaintiff's counterfactual scenario to involve realising the opportunity for itself, rather than selling it for a price based on expectations at the date of assessment.

Conversely, where hindsight chose worse than expected conditions, this would decrease the plaintiff's loss. In that case, it might be more advantageous for the plaintiff's counterfactual scenario to involve selling the opportunity at or about the date of assessment rather than realising the opportunity for itself and ending up disappointed with the benefits it would ultimately have delivered.

PRESENTING CLIENT LOSS OF OPPORTUNITY DAMAGES - PRACTICALITIES

With those concepts in mind, let's consider a practical approach to presenting a client the loss of opportunity damages.

One might conceive a spectrum ranging from a conservative approach that attempts to account for all risks and contingencies affecting the opportunity. At the other end of the spectrum, a presentation of an ambit claim representing the plaintiff's best case outcome that ignores risk altogether.

If reasonable inputs and assumptions are used in estimating the theoretically correct risk adjusted answer a positive net present value will indicate, helpfully for a plaintiff, that a rational investor would have pursued the opportunity and the value of that opportunity.

However, such an analysis may involve many inputs and assumptions that will need to be supported by evidence at trial. And the court may well make different assessments in relation to risk adjustments and other inputs after hearing all of the evidence which would alter the analysis.

On the other hand, a difficulty with presenting an ambit claim is that it will not represent a reasonable estimate of the plaintiff's loss. An analysis based on best case assumptions and without any adjustment for risk is unlikely to represent the expert's opinion of loss.

A plaintiff may consider a middle ground approach where its quantum expert is asked to estimate loss assuming the plaintiff could and would have pursued the opportunity, taking into

account only normal business valuation type risks for the nature of the opportunity concerned. Other threshold risks associated with the plaintiff's ability to pursue the opportunity are expressly excluded from that analysis and left as matters for the court to address through a seller's discount.

Even a plaintiff making an ambit claim may wish to develop an estimate of the correct value as early as possible in order to identify risks for which its ambit claim may be subject to discounting and to ascertain whether its claim is truly one likely to be worth pursuing.

Now understand there may be other considerations for lawyers in relation to pleadings, disclosure, and privilege to weigh up but such matters are beyond my scope today.

From a defendant's perspective, a thorough but reasonable approach to incorporating adjustments for risk may helpfully show a negative NPV, indicating that no valuable opportunity was lost, or a low positive NPV, increasing the prospects of an inexpensive settlement or a more favourable outcome at trial.

FINANCIAL MODELS AND MEASURING RISK

I think it is fair to say that any loss of opportunity involving loss of profits is likely to require the preparation of a financial model of greater or lesser complexity. A financial model is just an abstract representation of a real world financial situation, and it's commonly prepared using spreadsheet software such as Microsoft Excel.

Depending on the quality of inputs to the model and the skill of the analyst, a financial model is very adaptable to valuing a commercial opportunity, measuring uncertainty associated with the opportunity, and incorporating flexibility to accommodate changes in assumptions.

It is often informative to build sensitivity analysis and scenario analysis into a financial model. Sensitivity analysis shows the effect on loss of varying individual inputs by certain percentages or increments. For example, how would the loss estimate change if the court decides the plaintiff's future sales would be 10% or 20%, lower than the point of that assumed?

Modelling multiple scenarios allows the court to see the impact on loss of adopting different combinations of assumptions. Such assumptions can relate to uncertain factual matters, which are for the court and not the expert to determine and uncertain financial or risk related assumptions, which the expert may be qualified to estimate but which the court may determine should be higher or lower.

I suggest that however a party may choose to present its damages claim, better decisions are enabled when risk affecting that client is identified, measured and explained. Accordingly, forensic accountants are often asked to perform this type of analysis as an independent

expert with a view to giving evidence in the case, or as a consulting expert working behind the scenes on early case assessment forensic strategy, preparing a brief for an independent expert. And so on.

To sum up my key message, assessing damages for a loss of opportunity is a quantitative exercise, subject to uncertainty. Therefore, I suggest that applying valuation concepts, and being clear about the treatment of risk may help to avoid suboptimal decisions and unexpected litigation outcomes.

Thanks for your attention. I'll now hand you over to Matthew Jones, to make some concluding remarks.

CLAIMING FOR LOSS OF OPPORTUNITY FOR A MORE PROFITABLE DEAL

MJ: Thank you. Late in Matthew Ashby's presentation we received a question through the Q&A chat function, which I'm going to make an attempt at dealing with on the fly. And then I'll have one practical takeaway which arose from what Matthew has said.

Now, the question posed this issue "What about the situation where a party on negligent advice adopted a particular course in a particular restructure which itself turned out to be profitable but could have with different advice restructured a deal and obtained a more profitable outcome?"

I think the facts and the principles referred to in *Sellars* help in dealing with that question. That situation involved two potential deals, both of which were beneficial, but one of the first which was being negotiated would have been more profitable than the second deal which was actually done. Therefore, I'd suggest that it is possible and open to a plaintiff's lawyer to make that type of claim. The issue would be the usual one of avoiding double counting because any profit that was in fact received in the actual deal would need to be taken into account so there wasn't double assessment.

Now, the general takeaway, which I think emerges from what Matthew has said, applied to the legal principles is to attempt to adopt language and engineering that these types of cases are in evidence an integration exercise and they involve integration between pleadings, lay evidence, and expert evidence, early in the matter and throughout up to trial.

Now dealing with each of those.

Pleadings, as we've seen, the pleadings have to, as a gatekeeper proposition, reach the requisite standard. The pleadings are going to need to be updated as the matter progresses and as the evidence develops so that the case is properly articulated, and the *Sanrus V Monto* procedural decisions demonstrate the need for the pleaded case to be properly put.

Now lay evidence, at the outset, needs to be assessed to work out is it likely that the lay evidence is going to support the case at trial. And as the lay evidence has developed throughout the matter it has a lot of work to do because there are likely to be a large number of assumptions underlying the expert's opinions that need to be made good, particularly background circumstances and proving those objective decisions that the parties faced.

Now, expert evidence as well, it's not something that can be left to the end. Expert opinion evidence and calculations of the type Matthew has taken you through are likely to be relevant to the questions of whether to run the case at all and are likely to inform how the pleading is structured. And that expert evidence might come by trial from a number of different experts, all of whom need to be tied together. And they also need to be linked to the lay evidence. So that is not to say these claims are impossible, they're certainly not, but they are an involved task which needs to be thoroughly planned and managed from the outset.

Now, having said that and bearing in mind the time, we think that's an appropriate place to conclude. We'd like to thank all of you for your time and attention today. It's been a pleasure working on this presentation and arranging it for to be presented and recorded for future years. And we look forward to welcoming you to another webinar in the future.

Liability limited by a scheme approved under professional standards legislation