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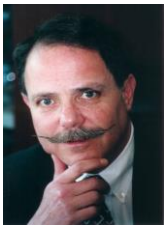
The Franchise Valuations Reporter

Our Expertise



Within the franchise, distribution and dealership context, we are experts in:

- Damages, Valuations & Expert Testimony
- Finance, Accounting and Tax
- Cyber Security and E-discovery of Electronically Stored Information

We offer a free initial consultation. If any readers have questions, you are welcome to email or phone us and we will provide our best answer as quickly as possible.

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Franchise Technology Risk Management

Our franchise law and computer forensics experts provide consulting and implementation of all aspects of cyber security, ESI management and e-discovery for franchise systems - from preparation of cyber security and ESI-related policies and procedures manuals through collection, preservation, processing, production and presentation.

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Valuations: Expert Paid $1.25 Million for 3 Week Job Delivers 'Unimpressive Piece of Work'

How Much Would it Cost for a Good Job?

A truly cost *ineffective* expert was used in the LightSquared Chapter 11 bankruptcy proceeding recently. Charles Ergen, the owner of the DISH network, acquired nearly $1 billion of the outstanding $1.5 billion in LightSquared prepetition secured debt and the issue became one of valuation. Ergen hired an expert who was given only three weeks to submit his report and was paid $1.25 million. He had no industry expertise and at his deposition, he admitted that in his report he had not even considered or reviewed earlier valuations of which there were several. The court called his report "an unimpressive piece of work" noting his lack of experience and that he applied faulty and arbitrary assumptions in valuing the assets. "Simply put, his methodology is all over the place," the court added. "Paid $1.25 million for his work, [he] delivered a superficial analysis that was not even informed by a review of [Ergen's prior valuations.]".[1]

Einstein Noah Sold At a P/E Multiple of 24.3 - Normal?
Einstein Noah Restaurant Group Inc. (BAGL:US), the chain of bagel shops backed by billionaire investor David Einhorn, agreed to be acquired by JAB Holding Co. in a deal valued at $374 million. JAB is paying $20.25 a share in cash, a 51 percent premium over Einstein Noah's last closing price.

Based on the annual numbers for 2013, as reported, the selling-price-to-net-profits and selling-price-to-EBITDA multiples are follows:

Selling Price	$374,000,000
EBITDA	$47,810,000
D&A	$18,810,000
Net Income	$14,560,000
EBITDA Multiple	7.82
Profits Multiple	25.69

[1]*In re: LightSquared Inc.,* 2014 Bankr. LEXIS 2984 (July 11, 2014)

Damages: Lost Volume Sellers

If Three Elements Present No Duty to Mitigate

Suppose a distributor entered into a contract with a manufacturer to buy all the manufacturer's production and that during the term of the contract the product became hugely popular and the manufacturer violated the exclusivity by selling to the distributor's competitors and the retail public. As far as damages theory goes, this is a classic example of the lost volume seller concept where the damages need not be mitigated and can be proved by the wrong-doer's production rather than the plaintiff's operations. The

We Write the Book

Franchise Regulation and Damages, the only treatise that covers valuations of franchises, is updated 3 times a year.

For more details, to see a Table of Contents or to place an order, go to the Wolters Kluwer Law & Business web page here.

DISCLAIMER

The information provided in this newsletter is for informational purposes only and should not be construed as legal or expert advice which can only be obtained from appropriate professionals. Franchise Valuations, Ltd. and Franchise Technology Risk Management provide such expert advice on the topics addressed herein.

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theory applies to product cases as well as those claiming services were or would have been provided.[1]

To recover lost profits under the lost volume seller theory, a party must prove three things:
(1) that the seller had the capability to perform both contracts simultaneously with the lost volume caused by the breach;
(2) that the second contract would have been profitable; and
(3) that the parties probably would have entered into the second contract even if the first contract had not terminated. The party claiming to be a lost volume seller has the burden of proving lost volume seller status by a preponderance of the evidence.

The applicable legal principles are enunciated in comment (f) to § 347 of the Restatement (Second) of Contracts which provides that, in cases in which a contract has been breached, if there is a factual finding that an "injured party could and would have entered into the subsequent contract, even if the [underlying] contract had not been broken, and could have had the benefit of both, he can be said to have "lost volume" and the subsequent transaction is not a substitute for the broken contract."[2]

Thus, in our example, the lost volume seller theory allows for the recovery of lost profits on the full extent of the production that the distributor could have sold if the distributor can prove that he could have sold the manufacturer's full production but for the breach.

To qualify as a lost volume seller, a party must prove that the portion of the manufacturer's output he did obtain was not a substitute for the opportunity that was been lost as a result of the breach.[3]

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[1] See e.g. *Gianetti v. Norwalk Hospital*, 304 Conn. 754, 43 A.3d 567, Supreme Court of Connecticut (2012); RAZORBACK CONCRETE CO. v. DEMENT CONST. CO., LLC, 688 F.3d 346 United States Court of Appeals, Eighth Circuit No. 11-3499 Filed: August 6, 2012; NATL CONTROLS, INC. v. COMMODORE BUS. MACH. INC., 163 Cal.App.3d 688, 209 Cal.Rptr. 636 (January 15, 1985)
[2]3 Restatement (Second), Contracts § 347, comment (f), p. 117 (1981)
[3]See 3 Restatement (Second), supra, § 350, comment (d), p. 129.

Trade Secrets: Recent Authorities

Actual Damages Not Required For Trade Secret Misappropriation

The California Court of Appeal in San Diego has ruled that a trial court's award of injunctive relief for trade secret misappropriation must be affirmed despite the lack of actual monetary damages.[1] The case concerned an employee who obtained a patent for a plastic molded plumbing fixture while working under an employment agreement that required him to assign the rights to any inventions and intellectual property he created during his employment to his employer. The lower court ruled that there was a misappropriation and issued an injunction.

Noting that the trial court had not assessed actual damages for trade secret misappropriation, the defendant urged the appellate court to reverse, alleging that misappropriation of trade secrets cannot be found without proof of actual damages or unjust enrichment. But the appellate court affirmed the lower court ruling.

LinkedIn Contacts May Provide Basis For Trade Secrets Claim Against Former Employee

Did a fired employee misappropriate trade secrets by maintaining LinkedIn contacts with the company's clients after his termination? Ruling on cross-

motions for summary judgment in a suit brought by a company against a former employee-turned-competitor, a federal district court in California found that fact issues remained.[2] The employee had worked for the Plaintiff for about six years and just before he got canned, he emailed himself a file containing business contact information with which he was able to keep LinkedIn contact information that he had created while employed and other files related to purchasing and billing preferences and client strategy. Armed with that information, he started his own competing company.

But before he got fired the employee signed agreements that included a clause classifying Cellular's "customer base" as proprietary information and a confidentiality statement, that he would not "knowingly disclose, use, or induce or assist in the use or disclosure of any Proprietary Information . . . or anything related to Proprietary Information . . . without the Company's prior express written consent."

In court the employee argued that his LinkedIn contacts were not a trade secret because the employer had encouraged employees to use LinkedIn and because his contacts were viewable by any other contact. The employer argued that such sharing was not automatic and the court declined to take judicial notice of LinkedIn's functions. Thus the remaining fact issues precluded summary judgment.

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[1]*Distinctive Plastics, Inc. v. Carter,* September 17, 2014, Rice, J.
[2]*Cellular Accessories For Less, Inc v Trinitas LLC*, September 16, 2014, Pregerson, D

Discovery: Electronically Stored Information

Tax Court Greenlights Use of Predictive Coding In Discovery

In consolidated cases the Tax Court has found that taxpayers could make use of predictive coding to identify non-privileged information in responding to an IRS request for information.[1] The IRS requested backup tapes and the taxpayers backed up their entire exchange servers and retained the tapes. The taxpayers acknowledged that the backup tapes contain tax-related information but asserted that the tapes also contained personal identification information, health insurance information, and other confidential information and sought to use predictive coding, a sophisticated computerized search methodology, to identify the non-privileged information in the backup tapes.

The IRS objected but the Tax Court agreed with the taxpayers that predictive coding would efficiently and economically respond to the IRS's discovery request noting that in recent years, there have been significant advances in predictive coding. According to the court, the technology industry now considers predictive coding to be widely accepted for limiting e-discovery to relevant documents and effecting discovery without an undue burden. Moreover, the process would eliminate or minimize some of the human error that might be associated with discovery.

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[1] *Dynamo Holdings Limited Partnership, et al.*, 143 TC No. 9

Estate Planning

Good Advice For Franchise Owners

Baby Boomers be advised: You need more than a will. As discussed in a recent New York Times article, other planning instruments may be required in order for business owners to preserve assets and ensure a secure future

for their families.

With 40 million people in the US aged 65+ (projected to be 55 million by 2020); with 10,000 people a day turning 65; and with 28% of franchisees now over the age of 55, baby boomer exit and succession planning is a demographic imperative. There will be a tremendous turnover in units in the coming years with franchisees and franchisors benefiting from well-planned seamless transfers. But others will be punished for failing to plan with distress sales and transfer disputes.

Franchise Valuations Ltd. offers half-day seminars to review and discuss what must be done to accomplish franchise exit and succession planning that will serve both the franchisees and the franchisors. We invite you to contact us to discuss how we can custom design a presentation for your system.