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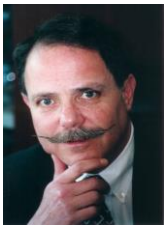
The Franchise Valuations Reporter

Our Expertise



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Expert Testimony: Restaurant Expert Beats *Daubert* Challenge

Kudos to FVR Contributor John Gordon for Withstanding Motion To Exclude and To Attorney Carmen Caruso

Since the US Supreme Court's decision in *Daubert*[1] tasked judges with a "gatekeeper" function with respect to expert testimony, Federal Courts generally engage in a three-part inquiry of (1) whether the expert is qualified; (2) whether his or her methodology is reliable; and (3) whether or not the testimony will be helpful to the trier of fact. In the recent decision in *Wilburn v. Culver Franchising System, Inc.*[2] the franchisor/defendant, CFSI, filed a motion to exclude John Gordon, a friend and contributor to this newsletter, as an expert. The Court's discussion began:

CFSI has filed a motion to strike the proposed testimony of Plaintiffs' expert witness, John Gordon. CFSI's motion is brought under Rule 702 of the Federal Rules of Evidence, which requires that expert testimony be (1) "help[ful] [to] the trier of fact to understand the evidence or to determine a fact in issue," (2) be "based on sufficient facts or data," (3) use "reliable principles and methods," and (4) "reliably appl[y] the principles and methods to the facts of the case." . . .

The Court first noted Gordon's qualifications:

Gordon is a restaurant industry analyst and management consultant with extensive restaurant operations and financial management experience. He is a certified Master Analyst of Financial Forensics (MAFF), who specializes in complex business analytical projects. Gordon's proposed testimony covers issues relevant to liability and well as issues related to damages.

Then the Court began its *Daubert* analysis by addressing CFSI's arguments to exclude Gordon's opinions on liability issues which claimed that he was not an expert in restaurant franchising or franchisor-franchisee relations. The franchisor took issue with Gordon's qualifications, "primarily because Gordon admitted that '[he has not received specific education or course work in franchising or any education through the International Franchise Association'" The Court's response was deservedly simplistic: "the notion that *Daubert* . . . requires particular credentials for an expert witness is **radically unsound**."[3] [emphasis added]

Judge Durkin went on to say, "Nothing in the text, purpose or history of Rule 702, supports the notion that formal education or training is an indispensable prerequisite to a finding of testimonial competency."

Next CFSI argued that Gordon's testimony regarding disparate treatment was not based on sufficient facts or data.[4] The Court's reply was that the Franchisor "misperceives the scope of the 'sufficient facts and data' component of Rule 702. To be sufficient, Rule 702 requires only that there **be a link** between the facts or data the expert has worked with and the conclusion the expert's testimony is intended to support." [emphasis added]

In addition, CFSI argued that Gordon's testimony regarding damages from

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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.

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lost profits should not be admitted because it was based on the Plaintiff receiving Tax Increment Financing (TIF) under a Chicago program 'to promote public and private investment across the city.' CFSI argued that Gordon's testimony regarding TIF should not be admissible because he was not an expert in the Chicago loan program. But the Court found that under FRCP 703 "An expert may base an opinion on facts or data in the case that the expert has been made aware of or personally observed." And then it quoted from another opinion, saying:

If an expert could not base his opinion on [factual] assumptions - which in turn is based on testimony - there could be little meaningful and informative expert testimony in any case in which there was a divergence of testimony.[5]

Judge Durkin went on to say, "The Court does not believe that Gordon's expert opinions fall into the category of 'opinion evidence that is connected to existing data only by the *ipse dixit* of the expert.'" His final short ruling belied the **21 pages of judicial opinion** on John Gordon that went before it by saying simply, "CFSI's [the franchisor] arguments are not properly resolved by this Court under *Daubert*; therefore, its motion to strike Gordon's testimony is denied."

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[1] *Daubert v. Merrell Dow Pharmaceuticals*, 509 US 579, (US SCt 1993)

[2]No. 13 C 3269 (United States District Court, N.D. Illinois, Eastern Division, September 29, 2015)

[3]Citing *Tuf Racing Prods v. Am. Suzuki*, 223 F.3d 585, 591 (CA 7, 2000)

[4]This was a civil rights case brought under 42 USC §1981

[5]*Richman v Sheahan*, 415 F. Supp. 2d 929, 942 (ND IL 2006

Expert Witnesses: They Must Be Talking About Us

In a paper entitled "Pressure Points in Franchise Litigation", just delivered to the ABA Forum on Franchising in New Orleans, Deborah S. Coldwell and Michael Einbinder[1] wrote the following about expert witnesses:

a. When To Use Them

In franchise cases, expert testimony has been allowed on the regulatory scheme governing franchises, the customs and practices in the industry, the likelihood of confusion, competitive effects, causation, and **damages**, just to name a few. Often times, the franchisee or an employee of the franchisor may be qualified and able to provide expert testimony on these or other issues. Sometimes, however, you may need to spend the money to hire an expert who can devote the time an employee may not have to help prepare your case. The **expert can also provide a fresh look at the evidence** and help to spot any issues you may have missed or have not had an opportunity to focus on. **Hiring an expert can also be used to facilitate a settlement discussion,** as the opposition may wish to avoid the added expense of retaining their own expert

to rebut your expert's opinion or report. [Emphasis added.]

b. How Best To Identify Them

While looking for an effective expert for trial, you should pursue relatable candidates with **superb oral communications skills**. Experts with these skills can help you break down complicated legal theories into easily-understood points for a jury to digest. In some instances,you may want to **consider an expert solely for their credentials or experience**. For example, if there is little case law on a disputed legal issue, hiring the expert who has the most knowledge on the subject, **such as the author of the**

treatise, may help you to convince the court that your analysis of the law is correct. Or, consider hiring the individual that is objectively the most respected authority on a technical issue. This will make it difficult for your opponent to find someone (with credibility) able to rebut that expert's opinions. While these types of experts may not ultimately testify at trial, they may gain you an advantage during pre-trial settlement discussions. [Emphasis added.]

Publisher's Note: Forsaking modesty, I have to say Franchise Valuations Ltd. fits all those descriptions. Keep us in mind if you need an expert!

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[1] Of Haynes and Boone, LLP, Dallas, TX and Einbinder & Dunn, LLP, New York, NY, respectively.

Valuations

Chancery Savages Accounting Firm Over Manipulated Valuation

The Delaware Court of Chancery is involved in many valuation decisions because of the state's corporation-friendly environment. Thus, it frequently rules on valuations and has, on occasion, found major flaws with erroneous or even "motivated" valuations. But few opinions have been as scathing as that of Vice Chancellor Laster, in *Fox v. Cdx Holdings*[1] in which he wrote that a major accounting firm's work on a spin/merge transaction "reached a new low."

The Court wrote:

The Grant Thornton report deserves separate mention because its contents were so flawed as to support both an inference of bad faith and a finding the process was arbitrary and capricious. Previous Delaware decisions have criticized erroneous or seemingly motivated analyses by financial advisors,[footnote omitted] but the Grant Thornton report reached a new low. As Grant Thornton's employees recognized, they were "just copying PwC's report and calling it [their] own. . . ." The copy job was so blatant that the output matched PwC's, even when the inputs differed. And when Grant Thornton did its own work, it made fatal errors, such as using the materially lower figure for nine-month trailing revenue rather than twelve-month projected revenue.

Grant Thornton was capable of valuing TargetNow and Carisome as going concerns. Grant Thornton did so in 2011 three times formally and one time in draft. Grant Thornton also prepared a formal valuation for an ASC 350 impairment analysis. Each time, Grant Thornton used management projections and a combination of the DCF and comparable company methods. Each time, Grant Thornton valued TargetNow and Carisome at multiples of the value it reached for the Spinoff. For the Spinoff, Grant Thornton abandoned its prior methodologies and reached a valuation so much lower as to be itself suggestive of bad faith.

At trial, the defense witnesses wisely tried to distance themselves from Grant Thornton's work by conceding that it was flawed and arguing that no one relied on it. But the report nevertheless reflects on the integrity of the process. It is an example of action "so egregiously unreasonable" as to be "essentially inexplicable on any ground other than subjective bad faith."

[citation omitted]

IRS Assault on Valuation Discounts For FLPs Is Looming

In recent months, one persistent rumor has circulated in the blogosphere dedicated to estate and gift tax issues. It's that the IRS is about to eliminate or at least limit the application of discounts related to family limited partnerships (FLPs) and similar structures.

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[1]2015 Del. Ch. LEXIS 194 (July 28, 2015)

Cyber-Security

As Online Data Theft Escalates, Banks Look to Retailers to Bear the Losses