UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No.	ED CV 15-01921-DFM	Date	July 17, 2018
Title	Bennion and Deville Fine Homes Inc. v. Windermere Real Estate Servs. Co. et al.		

Present: The Honorable	Douglas F. McCormick

Nancy Boehme	n/a
Deputy Clerk	Court Reporter / Recorder
Attorneys Present for Plaintiffs:	Attorneys Present for Defendants:
n/a	n/a

Proceedings: (In Chambers) Order re: Defendant's Motion in Limine to Exclude Newly Disclosed Damages Evidence

Defendant Windermere Real Estate Services Company ("Defendant") moves to exclude "all evidence and testimony related to the damages model disclosed [by Plaintiffs] on July 6 and 7, 2018." Dkt 186 at 12. For the reasons below, the motion is GRANTED.

1.0 BACKGROUND

In 2004, Defendant and Plaintiff Windermere Services Southern California, Inc. ("Services SoCal"), which is owned by Robert Bennion and Joseph Deville, entered into the Area Representation Agreement ("ARA"). See Trial Ex. 10. The ARA makes Services SoCal Defendant's area representative in California and sets out various obligations of the two parties. See id. Under the "Termination" section of the ARA, § 4.1 states that the "term of this Agreement shall . . . continue until it is terminated as follows," and then lists four ways to terminate the contract: (a) by mutual written agreement; (b) upon 180 days written notice; (c) upon 90 days written notice, if the notice includes notice of material breach that is not cured; and (d) without notice if events occur that are not relevant in this case. Id. § 4.1. The ARA provides that in the event of termination under (b), the terminating party will pay the other party the "Termination Obligation." Id. § 4.2. The ARA describes the Termination Obligation as a "run-off" payment and the fair market value of the terminated party's interest in the ARA. Id. §§ 4.2, 4.3. The ARA dictates how to calculate the Termination Obligation: "without consideration of speculative factors including, specifically, future revenue," but instead looking at "the gross revenues received under the Transaction during the twelve months preceding the termination date from then existing licensees that remain with or affiliate with the Terminating Party." Id. § 4.2.

In January 2015, Defendant sent to Services SoCal a 180-day termination notice under §

4.1(b), potentially triggering the Termination Obligation.[1] See Dkt. 85-1 at 25.

Services SoCal and the two franchisees owned by Messrs. Bennion and Deville—Bennion and Deville Fine Homes, Inc., and Bennion and Deville Fine Homes SoCal, Inc.—filed suit against Defendant in September 2015. See Dkt. 1. Plaintiffs filed a first amended complaint in November 2015. See Dkt. 31 ("FAC"). The FAC alleges that Defendant breached the ARA by failing to register a Financial Disclosure Document ("FDD") in 2014, and by failing to pay Services SoCal the Termination Obligation after sending written notice of § 4.1(b) termination in January 2015. See FAC ¶ 163.

Plaintiffs made their initial disclosures under Federal Rule of Civil Procedure 26(a) in December 2015. See Dkt. 190-1. Plaintiffs disclosed the following damages:

> 1. The fair market value of the Area Representative business at the time of termination by Defendant;
> 2. 50% of all franchise and license fees, including those resulting from a settlement of said fees, acquired by Defendant and owed to Plaintiffs pursuant to the terms of the ARA;
> 3. The non-reimbursed expenditures by the B&D Parties on technology and SEO optimization to combat the antiWindermere marketing efforts of Windermere Watch;
> 4. The depressed value of the franchise and Area Representative businesses as a result of Defendant's failure to comply with the express and implied terms of the parties' agreements;
> 5. The damages incurred by the B&D Parties in connection with the failed operation of the Solana Beach franchised location; and
> 6. The damages to the B&D Parties in connection with the numerous lost agents and listings resulting from Defendant's breaches of its express and implied obligations under the parties' agreements.

Id. at 13. Additionally, in April 2016, Plaintiffs identified their "actual damages" to include "[c]onstructively terminating the ARA thereby negating the 50% reduction in franchise fees enjoyed by the other Plaintiffs." Dkt. 190-2 at 26. Plaintiffs' interrogatory responses also claimed that Plaintiffs were "deprived of . . . the right to 50% of all franchise fees and subsequent royalties paid by all new Windermere franchisees in the Southern California region." Id. at 4.

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[1] The ARA provides that a party terminating under § 4.1(b) does not need to pay the Termination Obligation in certain circumstances. See ARA § 4.2 (stating that there will be no Termination Obligation if the termination is made in good faith based on material breach by the other party continuing after reasonable notice and opportunity to cure).

In August 2016, Plaintiffs produced recast profit and loss statements for Services SoCal.[2] See Trial Ex. 439. Defendant's counsel asked Plaintiffs' counsel who had prepared those statements, and Plaintiffs' counsel responded that it had been Plaintiffs' accountant, Greg Barton. Defendant subpoenaed Barton, who provided documents in advance of his deposition, one of which was Trial Exhibit 498, a September 2015 letter. In the letter, Barton states that the present value of Services SoCal's revenue stream, net of fees from the two Plaintiff franchisees, was $926,611. Barton describes this figure as a "starting point for negotiations." Trial Ex. 498. Attached to this letter is a one-page valuation sheet, showing Barton's analysis.[3] Id. at 2. Defendant deposed Barton in October 2016. See Dkt. 190-3 at 2.

In September 2016, Plaintiffs' damages expert, Peter D. Wrobel, opined that Plaintiffs have suffered "at least $4,237,999 in damages." Dkt. 154-4 at 25. Wrobel arrived at this figure by totaling four categories of damages: (1) the "net value" of Services SoCal as of January 2015 ($2,592,526), (2) settlement amounts withheld from Services SoCal ($66,037), (3) certain past losses and future lease obligations ($1,431,482), and (4) net unreimbursed Windermere Watch expenses ($146,954). See Dkt. 154-4 at 25-28. In both his report and deposition, Wrobel repeatedly described the first category as his calculation of the Termination Obligation. See id. at 26; see also Dkt. 169-2 at 16-17, 22-23. Wrobel arrived at $2,592,526 by calculating the present value of Services SoCal's annual operating cash flow from December 2015 to December 2020, adding to that the present value of Services SoCal's 2020 terminal cash flow,[4] and subtracting out Services SoCal's net income already earned in 2015. See Dkt. 154-4 at 30.

In April 2017, Defendant filed a motion in limine to exclude portions of Wrobel's report. See Dkt. 103. Among other things, Defendant argued that Wrobel had improperly calculated the Termination Obligation. See Dkt. 103-1 at 10-13. In June 2017, the Court denied the motion, deciding that Defendant's critiques were more appropriately raised on cross-examination. See Dkt. 141.

[2] Defendant contends that these new financials showed significantly more net income than the audited financial statements, because they included revenue from the two Plaintiff franchisees—revenue Defendant contends had not been paid to Services SoCal (or, therefore, to Defendant). Defendant further contends that Plaintiffs used these financials to increase Wrobel's Termination Obligation calculation.

[3] Defendant described this background, which Plaintiff did not contest, at the hearing on the motion in limine.

[4] The terminal capitalization rate method of valuing a business converts a single-year income amount into a value estimate for the business as a whole.

On January 31, 2018, after a discussion at a November 2017 status conference, Defendant moved for partial summary judgment.[5] See Dkt. 154. In the motion, Defendant asked the Court to determine, as a matter of law, that the ARA's Termination Obligation should be calculated (1) without considering future revenue and (2) by looking at the gross revenues received in the 12 months preceding the termination date from licensees that remained with the terminating party—i.e., as dictated by § 4.2 of the ARA. See id.

On April 3, 2018, the Court held a hearing on Defendant's partial summary judgment motion. See Dkt. 163. The Court also held a case management conference at the same hearing, and the parties selected a July 10, 2018 trial date. See id.

On April 11, 2018, the Court granted Defendant's motion for partial summary judgment, agreeing with Defendant's interpretation of the ARA's § 4.2. See Dkt. 164. The Court noted that Wrobel had not followed the ARA's unambiguous language when he calculated the Termination Obligation; Wrobel had taken into account future revenues and also considered gross revenues from licensees other than those permitted by § 4.2. See id. at 5-6. The Court permitted Defendant to file a motion in limine regarding Wrobel's opinion about the Termination Obligation. See id. at 6.

On April 25, 2018, Defendant moved to exclude Wrobel's opinion that the Termination Obligation was $2,592,526, citing the Court's partial summary judgment ruling. See Dkt. 167-1. In response, Plaintiffs argued that $2,592,526 represented not only Wrobel's calculation of the Termination Obligation, but also Services SoCal's damages due to Defendant's other ARA breaches, such as Defendant's failure to file a 2014 FDD. See Dkt. 169.

The Court held a hearing on Defendant's in limine motion at the final pretrial conference on June 18, 2018. During that hearing, Plaintiffs conceded that Wrobel never stated in his report that his $2,592,526 calculation represented anything other than the Termination Obligation. But, Plaintiffs argued, $2,592,526 also equaled the "total loss" of Services SoCal's business in January 2015 as a result of Defendant's other breaches of the ARA, such as its failure to maintain an FDD registration. Plaintiffs requested neither a trial continuance nor an opportunity to make any amendments or supplements to Wrobel's report.

On June 21, 2018, the Court granted Defendant's motion in limine to exclude Wrobel's opinion about the net value of Services SoCal as of January 2015, because Wrobel's report and

[5] This status conference was held by U.S. Magistrate Judge Jay C. Gandhi, to whom the parties had consented. See Dkt. 145. Judge Gandhi told the parties at this conference about his impending departure from the Court; as a result, the parties consented in February 2018 to the undersigned. See Dkt. 159.

deposition testimony both identified that calculation as the Termination Obligation but did not calculate the Termination Obligation in accordance with the unambiguous language of § 4.2 of the ARA. See Dkt. 180 at 4-5. The Court concluded that an effort to re-characterize Wrobel's $2,592,562 calculation as some other measure of damages was outside the scope of his report. See id. at 5. The Court noted that Wrobel could still testify about his other damages opinions, and that Plaintiffs could present other evidence of damages subject to procedural and evidentiary rules. Id. at 5.

On July 6, 2018—four days before the July 10 trial date—Plaintiffs sent Defendant a five-page exhibit identifying damages of approximately $7.2 million based on the loss of future franchise and license fees due to Defendant's breaches of the ARA. See Dkt. 186 at 2. The next day, Plaintiffs sent a sixth page identifying $2 million in expenses, reducing the damages estimate to approximately $5.2 million. See id.; see also id. at 14-20 (six-page exhibit). On July 9, Plaintiffs sent a summary sheet of these new damages. See id. On July 11, Defendant filed its motion in limine to exclude this damages evidence. See Dkt. 186. The Court briefly discussed the issue with the parties and invited Plaintiffs to file an opposition, which they did on July 14. See Dkt. 190. Defendant submitted a reply on July 15. See Dkt. 191.

The Court heard argument on July 16, 2018, the fifth day of trial. At that hearing, Plaintiffs stated that the $5.2 million figure was not, in fact, the final damages computation. Rather, Plaintiffs indicated that they intended to call an expert witness to identify a discount rate of 18%, which would then result in the damages figure. Plaintiffs argued in the alternative that they should be allowed to introduce Barton's September 2015 valuation to support their damages theory.

2.0 ARGUMENTS

Defendant argues that, to the extent Plaintiffs' damages calculation represents the Termination Obligation, it suffers from the same flaws identified in the Court's partial summary judgment and Wrobel motion in limine rulings. See Dkt. 186 at 4-5. Defendant also argues that to the extent the analysis represents other damages, it should be excluded under Federal Rule of Civil Procedure 37, Federal Rule of Evidence 401, and Federal Rule of Evidence 403. See id. at 6-11.

Plaintiffs respond that the exhibits are demonstratives to be shown to Bennion, one of Services SoCal's owners, who will testify as to Services SoCal's anticipated future revenue under the ARA for ten years after 2015. See Dkt. 190 at 2-3. The seven demonstrative exhibits depict: "(1) a summation of the revenue the Bennion and Deville offices were generating at the time the ARA was terminated; (2) the future anticipated revenue to the Area Representative generated by the Bennion and Deville offices; (3) the initial franchise fees that were expected to be generated from new franchisees; (4) the monthly franchise fees that were expected to be generated by non-Bennion and Deville franchisees; (5) a summary of charts 2 through 4, (6) the future anticipated expenses of the Area Representative; and (7) a summary of charts 2 through 4 and 6." Id. at 6-7.

Plaintiffs note that these damages are not intended as a Termination Obligation calculation, but rather a different measure of Services SoCal's damages. See id. Plaintiffs argue that they identified these damages to Defendant in initial disclosures—i.e., "Plaintiffs' 50% share of monthly franchise fees generated by the Bennion and Deville franchises; and (2) Plaintiffs' 50% share of initial and ongoing franchise fees generated by non-Bennion and Deville franchisees." Id. at 4. Plaintiffs also argued that Defendant should not be surprised, because Defendant possessed the underlying data for years and heard testimony on Plaintiffs' "pursuit of lost profits through the testimony of CPA Greg Barton and damages expert Peter Wrobel." Id.

3.0 LAW

Fed. R. Civ. P. 26(a)(1)(A)(iii) provides that, as part of its initial disclosures, a party must provide "a computation of each category of damages claimed by the disclosing party." Rule 26(a)(1)(E) provides that a "party must make its initial disclosures based on the information then reasonably available to it." Rule 26(e) provides that parties must supplement or correct initial disclosures and interrogatory responses "in a timely manner if the party learns that in some material respect the disclosure or response is incomplete or incorrect, and if the additional or corrective information has not otherwise been made known to the other parties during the discovery process or in writing."

"[T]he 'computation' of damages required by Rule 26(a)(1)(C) contemplates some analysis," enough so that the opposing party can "understand the contours of its potential exposure and make informed decisions as to settlement and discovery." City & Cty. of San Francisco v. Tutor-Saliba Corp., 218 F.R.D. 219, 221 (N.D. Cal. 2003); see also Frontline Med. Assocs., Inc. v. Coventry Health Care, 263 F.R.D. 567, 570 (C.D. Cal. 2009) (finding insufficient disclosure of damages based on "lost referrals" because the plaintiff provided "no computation whatsoever" for that category). While a computation of damages may not need to be detailed early in the case, as discovery proceeds, the plaintiff is required to supplement its initial damages computation to reflect the information obtained through discovery. See Tutor-Saliba Corp., 218 F.R.D. at 222.

Fed. R. Civ. P. 37(c)(1) states that if a party fails to provide information as required by Rule 26(a) or (e), the party is not allowed to use that undisclosed information at trial unless the failure was substantially justified or is harmless. The burden is on the party facing exclusion of its expert's testimony to prove the delay was justified or harmless. See Yeti by Molly, Ltd. v. Deckers Outdoor Corp., 259 F.3d 1101, 1106 (9th Cir. 2001). The district court's decision to exclude evidence is discretionary, and the court is given "particularly wide latitude . . . to issue sanctions under Rule 37(c)(1)." Hoffman v. Construction Protective Services, Inc., 541 F.3d 1175, 1178 (9th Cir. 2008) (citation omitted).

4.0 ANALYSIS

Plaintiffs had not previously disclosed, through initial disclosures or otherwise, the computation of damages provided on July 6 and 7 in the form of several slides showing that the lost license and franchise fees resulting from the termination of the ARA would cause Plaintiffs' lost profits of approximately $5.2 million from 2015-24. By seeking to introduce this new damages evidence, Plaintiffs plainly violated Rule 26(a)'s requirement to provide a "computation of each category of damages claimed" and Rule 26(e)'s requirement that the information be updated if disclosure is incomplete or incorrect.

Plaintiffs argue that in the initial disclosures and written discovery, Plaintiffs identified damages made up of "(1) Plaintiffs' 50% share of monthly franchise fees generated by the Bennion and Deville franchises; and (2) Plaintiffs' 50% share of initial and ongoing franchise fees generated by non-Bennion and Deville franchisees." Dkt. 190 at 4. But Plaintiffs' initial disclosures are far more limited. The only reference in the initial disclosures to franchise and license fees identified "50% of all franchise and license fees, including those resulting from a settlement of said fees, acquired by [Defendant] and owed to the B&D parties pursuant to the terms of the [ARA]." Dkt. 190-1 at 13.

One reasonable reading of Plaintiffs' initial disclosures is that they identified Plaintiffs' entitlement to receive 50% of any franchise and license fees "acquired by" Defendant after Services SoCal's termination as the Area Representative. The jury has heard testimony about Defendant's continued efforts to collect delinquent fees owed by some owners after Services SoCal's termination.

A broader reading of this disclosure would suggest that Plaintiffs sought to recover damages associated with losing the 50% reduction in franchise fees enjoyed by the Bennion & Deville franchisees under the ARA. Plaintiffs' interrogatory responses more unequivocally identify that Plaintiffs' damages include this lost 50% reduction. But even this broader reading of Plaintiffs' disclosure and interrogatory responses do not contain a "computation" under which Plaintiffs are entitled to the discounted value of lost profits of several million dollars over the ten years after the ARA's termination.[6]

The Court agrees with Defendant that Plaintiffs' late disclosure contains several speculative

[6] Even now, Plaintiffs have not disclosed a final damages computation. Rather, as stated at the hearing on this motion in limine, they intend to ask an expert (presumably Barton, who was not disclosed as an expert witness) to reduce the number disclosed in the slides by applying a discount rate.

assumptions that Defendant should not have to address for the first time during trial. Plaintiffs' new computation assumes that license and franchise fees would continue to flow, in the same amounts, for ten years; that Services SoCal would add 1.7 new franchisees each year; and that franchise fees from non-Plaintiff franchisees would increase by about 5% every year. See Dkt. 191 at 14-20. Moreover, Plaintiffs' new model does not address Defendant's right to terminate the ARA without cause with 180 days' written notice. See ARA § 4.1(b). Nor does it reconcile the recast Services SoCal financial statements upon which it is based with Services SoCal's audited financial statements, which Defendant contends showed losses of about $80,000 in 2015. See Dkt. 191 at 8. Even if some of these assumptions were built into Barton's September 2015 computation or Wrobel's Termination Obligation computation, Defendant should not be forced to scramble to address them in this new context half-way through trial.

The Court is not persuaded that Trial Exhibit 498, Barton's September 2015 "valuation," satisfies the computation requirement. Defendant had no reason to think that the CPA's September 2015 valuation represented a computation of Plaintiff's damages in this case. Barton, not Plaintiffs, disclosed the computation to Defendant in response to a subpoena. Plaintiffs have not provided any evidence that they ever presented Barton's September 2015 valuation as a Rule 26(a) computation of damages.

Plaintiffs also argue that Defendant has had the figures underlying the new demonstratives all along, which amounts to disclosure of the computation. See Dkt. 190 at 7-8. "This argument, of course, contradicts the plain language of Rule 26(a), which requires Plaintiffs to disclose their 'computation' of lost profits, and cases have rejected the claim that the mere possession of raw financial data by the opposing party satisfies Rule 26." Spin Master, Ltd. v. Zobmondo Entm't, LLC, No. 06-3459, 2011 WL 13127349, at *6-7 (C.D. Cal. Sept. 15, 2011) (citing cases), vacated on reconsideration in part, 2011 WL 13127211 (C.D. Cal. Oct. 13, 2011). "Although Plaintiffs argue that Defendants have known this information all along, that is not the point. Noncompliance with Rule 26 cannot be justified by the fact that the other side already had the information. That would eviscerate the rule . . . ." Id. "And even if Defendants possessed all the financial information. . ., Plaintiffs could have readily provided to Defendants the items and dates that would comprise the universe of their lost profits claim. Yet, Plaintiffs failed to disclose even this minimal information. To consider Plaintiffs' failure here to be justified because the calculation was 'simple' and Defendants possessed the financial data that would prove Plaintiffs' lost profits would write into Rule 26 an … exception that does not exist there." Id.

Thus, the question is whether Plaintiffs have carried their burden to show that these failures were substantially justified or harmless. They have not. Had Plaintiffs moved to supplement Wrobel's report shortly after the Court's April 2018 partial summary judgment ruling—e.g., with a new Termination Obligation calculation comporting with the ARA—the issue presented would be less clear-cut. Then, there were three months until trial, and under certain circumstances, the Court might have found, if not substantial justification, then harmlessness, and permitted a limited reopening of discovery. Now, trial is underway and permitting the injection of new damages computations would either disrupt the trial significantly or compel Defendant to address the computations without the benefit of a deposition or their own expert's review. Late Rule 26(a) disclosure that requires discovery to be reopened and postponement of a trial date supports a finding that failure to disclose was not harmless. See Hoffman, 541 F.3d at 1180 ("Later disclosure of damages would have most likely required the court to create a new briefing schedule and perhaps re-open discovery, rather than simply set a trial date. Such modifications to the court's and the parties' schedules supports a finding that the failure to disclose was not harmless.").

Plaintiffs' new damages theory and computation would cause undue prejudice and surprise to Defendant without any reasonable ability to cure that prejudice.[7] Contrast Spin Master, 2011 WL 13127349, at *8 (finding harmlessness where trial had already been continued several months for another reason, giving defendants time to address the new disclosure).

5.0 CONCLUSION

Defendant's motion in limine as to Plaintiffs' lost profits exhibits and related testimony is accordingly GRANTED. Plaintiffs may introduce testimony about the value of the ARA's 50% reduction in franchise and license fees for Plaintiffs' franchises. Thus, for example, one of Plaintiffs' principals could testify that the ARA gave Plaintiffs a monthly benefit of $2,500 for each office. But additional testimony that sets forth a computation of how that monthly benefit should comprise Plaintiffs' damages due to Defendant's breach is excluded.

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[7] Plaintiffs have cited Lanard Toys Ltd. v. Novelty, Inc., 375 F. App'x 705, 713 (9th Cir. 2010), for the proposition that the Court should consider four factors to determine whether to exclude evidence under Rule 37, one of those factors being bad faith or willfulness. Even under these factors, Plaintiffs have not met their burden. See Hoffman, 541 F.3d at 1180 ("[W]e reject the notion that the district court was required to make a finding of willfulness or bad faith to exclude the damages evidence. To the contrary, the portion of Rule 37 relied on by the district court has been described as 'a self-executing, automatic sanction to provide a strong inducement for disclosure of material.'" (citation omitted)).