Patton & Sullivan LLP
OTHERS JOIN THE BAR. *WE SET IT.*

Issue No. 5 Spring 2013

Welcome to Insights

a quarterly newsletter from Patton & Sullivan designed to keep you up-to-date on legal issues that may impact your business.

Contact us: 925-600-1800

In this issue:

New Social Media Services Like Snapchat Sure to Complicate Electronic Discovery

By Randy Sullivan

There are ample signs that consumers are growing concerned about who's following their 'digital footprint.' Facebook users are in revolt over eroding privacy policies and Google is under fire for harvesting data from seemingly private communications. Now a new app is promising to solve the problem by producing self-erasing messages and photos.

Meet Snapchat, the second most popular free app for the iPhone in early February, behind YouTube and ahead of Instagram. Snapchat's website claims that more than 50 million "snaps" are sent every day. And it's up to 19th among all apps, according to the analytics firm App Annie.

This program could be a disruptive game-changer for the increasing number of online sites that make their living from gathering and mining data.

But can it really deliver what it promises? When all the posturing and geek-speak ends, the answer will likely come from the judicial system.

Snapshot is not unique in trying to serve the new-found need for

(Cont. page 2)

In The News

Consumer financial protection bureau lays out plan for new mortgage rules. READ STORY>

California department of real estate to become bureau of real estate. READ STORY>

Businessman Beware: California Supreme Court Decides Verbal Side Agreements May Be Part Of Written Contract

By John Patton

People who enter into written contracts usually want to achieve clarity as to their rights and obligations. In a decision with far-reaching consequences for businesses and consumers, and practically anyone who enters into a written contract, the California Supreme Court just issued a decision that overrules a line of cases more than 75 years

(Cont. page 2)

(New Social Media, cont. from page 1)
renewable privacy. Wickr is a free mobile app that allows users to send each other an array of impermanent media — including self-destructing text messages, videos, audio files, and PDFs. Facebook itself has a type of disappearing photo service called Poke.

And the urge isn't unique to America. In January 2012, Viviane Reding, vice president of the European Commission, proposed privacy legislation that contained a right-to-be-forgotten provision. Broadly defined, the right would affect Internet usage in 27 countries.

What emerges is a clash of competing interests – the privacy of the user versus the financial interest of the social media companies and their advertising clients.

But there's another interested constituency that has yet to be heard from – the courts and parties involved in litigation.

Given the importance of email, text messages, and other communications in litigation, these services will undoubtedly become the subject of discovery and subpoenas. Take just the employment context, where an employee claims they were harassed. This digital evidence would be invaluable to both sides of this case.

Is it truly gone, if one of these technologies is used?

Probably not. Despite any statement to the contrary, all companies, including most recently Google and its "inadvertent" collection of Wi-Fi passwords, have an interest of compiling and retaining data. While the message may be gone from the sender and receiver's systems, there are other partners to the transmission.

While the rules governing this information are in flux, for parties in litigation, often the best way around a fight with the opposition on producing information in any case is through a subpoena to the neutral third party – the social media or Internet provider. It avoids a discovery motion, and the subpoenaing party is more likely to get what they are truly after because the third party has nothing to hide.

However, even today, there are substantial hurdles in securing this information, and it is going to get more difficult.

Facebook will not routinely comply with a subpoena stating it is exempt under the Stored Communications Act. In practice, this
(Cont. page 3)

(Businessman, cont. from page 1)
old, and permits a party to claim that the true agreement differs from the written agreement.

In Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Association (Jan., 2013), the Court held that a borrower has the right to prove that side promises were fraudulently made to obtain a loan, even when those side promises directly contradict the terms of the loan documents. Prior to Riverisland, case law was uncertain whether a signing party would be allowed to prove that the writing was not the true agreement. Parties relying on the written terms frequently asserted what is known as the "parol evidence rule" to defeat lawsuits at early stages. The term "parol" has nothing to do with prison sentences. Rather, it is Latin in origin, and means "word of mouth," as opposed to written. The parol evidence rule generally holds that where the parties contemplate that their agreement is completely set forth in a written contract, the courts will not permit claims that contradictory promises were made outside the "four corners" of that contract.

But as with most rules, there are exceptions to the parol evidence rule, and one is the "fraud exception," which allows proof that the contract was obtained by fraud. Until Riverisland, the courts' application of this exception had been far from consistent. The effect of Riverisland is to permit a party to prove that the contract contains unwritten promises that vary from the written terms, where it is claimed that the contract was procured by fraud.

Thus, it is probable that no written contract is "ironclad" when fraud is claimed. Of course, this does not mean that the party relying on the written terms won't prevail, or be able to prove that no side promises were made. It means that when disputes arise, the issue will likely be decided by proof at trial rather than
(Cont. page 3)

(New Social Media, cont. from page 2)
typically requires a motion to force a party to consent to the disclosure, and then convince Facebook to comply.

Facebook and other social media's resistance to producing such information are clear – it's bad for business. Consumers will be less likely to use the services, and the expense of complying with what would become a routine subpoena in just about every case filed would have an overwhelmingly negative impact on the bottom line. The relevancy and purposes of Facebook information can apply in any case and under almost any circumstance.

For many of these same reasons, undoubtedly Snapshot and other 'disappearing information' providers will take the same position. Yet, the circumstances are different.

Because Snapshot offers supposedly short lived messaging, it raises new questions, such as whether anything in this digital age is short lived. And how will that be handled in litigation? If the message is not captured by the receiver, is the only remedy to argue that this occurred and then put the burden on the sending party to prove it did not occur?

Another problem is the concept advanced by local bar associations in California that any effort by an attorney to become a "friend" of a represented party is an ethical violation in which the attorney is making unpermitted contact with a represented party. Other state courts have ruled that encouraging a third party to "friend" a represented party is similarly an ethical violation by an attorney.

There are a host of issues that are going to develop as this social media service grows in use and they are sure to be litigated.

For consumers, these developments pose a buyer beware challenge in selecting software and providers.

For employers, there is a challenge to traditional workplace handbooks. What's your company's policy on social media use and cooperation with investigations?

Now is the time to think it through before the changing technology comes back to bite you.

Randy Sullivan, a partner at Patton & Sullivan, specializes in business and real estate litigation. For questions or comments he can be reached at randy@pattonsullivan.com

(Businessman, cont. from page 2)
by motion at the outset of the lawsuit, as had frequently been the case before Riverisland.

What takeaway is there for people who want to ensure that the written terms of a contract control the rights and obligations of the parties? Here are some general practical suggestions:

1

1. Be careful about using form or pre-prepared contracts, especially if they may not fit the specifics of the situation. It may be better to start from scratch than trying to adapt pre-prepared terms to a specific situation.

2. Make sure that the terms are clear, legible, and understandable. Sometimes too much legalese or boilerplate can actually make the writing less clear.

3. Cover every important term that should be in the writing, so it is plainly spelled out in the contract what each side can expect as to their rights and obligations as to each such term.

4. Include a clause that confirms that there are no side agreements and that the written terms are the only terms. The clause should also state that all prior negotiations are canceled, and the agreement is the final and only agreement on the contract subjects.

5. Include a clause requiring any changes or amendments to be stated in a writing signed by all parties to be effective.

6. Where feasible, have the contract reviewed and explained by an attorney for each side, before it is signed, and have the parties acknowledge in the contract that such a review was done prior to signing,

(Cont. page 4)

Winery's goodwill case changes game

By Randy Sullivan

For many companies, goodwill is among their most valuable assets. It's the accumulated value of years of service to customers, of building your brand, of you reputation for quality.

But in a court of law, the value of goodwill is in the eye of the beholder. And, based on a recent case involving a Central Valley winery, that beholder may be a single judge, not a jury.

Consider the recent case of People ex rel. Dept. of Transp. v. Dry Canyon Enterprises, LLC, (2012) 211 Cal. App. 4th 486. The court ruled that a plaintiff cannot secure a trial on loss of goodwill, unless there was goodwill in existence prior to a taking by the government. In addition, it is the trial judge that makes this determination.

This case stems from wine made by Dry Canyon Enterprises from grapes in Paso Robles and Madera. Specifically, the state condemned a strip of land that was home to 1,466 of the vines grown for the firm's estate cabernet off of Highway 46 in Paso Robles. The state paid the winery $203,500 for the land and vines. The only issue to be tried was whether the winery was entitled to damages for the loss of goodwill resulting in the loss of the acreage used to grow the estate cabernet.

Ordinarily, a business owner is entitled to a jury trial on the amount of goodwill lost by a government taking. In this case, however, after the plaintiff presented their expert testimony and other evidence on loss of goodwill, the trial court granted a motion for judgment and dismissed the plaintiff's case ruling that the expert opinion on the loss of goodwill was inadmissible.

The jury was denied the right to rule on whether there was a loss of goodwill.

Plaintiff's primary hurdle was that the winery had not yet turned a profit and it appears from the decision had only sold a few vintages. In the wine world, it very much appears to have still been in a start-up stage.

On appeal, the court addressed the winery expert's two methods for calculating the loss of goodwill. The court also recognized that (Cont. page 5)

(Businessman, cont. from page 3)
and that the contract was a product of negotiation, and attorney review for each side.

While doing these things does not guarantee that a party will not later claim that there were promises made that are different from the writing, it will greatly increase the chances that the written document will be upheld, and should decrease the chances of a lawsuit on that basis. And it should be noted that even if such a claim is made, in order to prevail, the claimant likely must still prove the elements of fraud in order to recover, including that the other party acted with fraudulent intent, and that the claimant reasonably relied on the alleged unwritten promise (which may be hard to prove if the contract appears to be clear and complete).

The real takeaway from Riverisland is that clarity is even more important than it ever was in the world of contracts.

John Patton, an attorney with Patton & Sullivan, specializes in real estate transactions, land use entitlement and zoning work. For questions or comments he can be reached at john@pattonsullivan.com

(Winary's, cont. from page 4)
the judge is the gatekeeper on expert opinions. Therefore, in all future cases the damage theory needs to be properly designed for admission.

The first method used by the winery's expert was the 'cost to create' methodology. The court ruled that allowing all of the costs/expenses incurred to develop the business to equate with the value of the business's goodwill rarely is acceptable.

The court echoed a prior ruling by finding that the 'cost to create' method may only be used when there is clear proof of preexisting goodwill, and a total loss of that goodwill. The primary problem with the winery's expert conclusion here was that the winery had not yet posted a profit. Moreover, in calculating the 'cost to create,' the expert used all of the winery's costs, instead of focusing on the cost associated with developing the vines and the estate cabernet. Since this was a partial taking, the expert needed a more focused approach if the damage theory were to have any chance of being accepted by the trial judge. While this author does not know the underlying business operations well enough for the plaintiff, the 'cost to create' valuation method would have had a better chance if the plaintiff had not allocated all the costs of its operations to reach the valuation.

The second theory was the 'premium pricing' methodology invented by plaintiff's expert. The method involved the expert deciding that the estate cabernet wine would "fetch a premium price of $10.62 more per bottle than a hypothetical but inferior" wine grown elsewhere. Then the expert multiplied this figure by the number of bottles that would no longer be produced because of the taking for the next 15 years. The expert did this even though the product had not yet been profitable in the winery's business. The court found this method entirely speculative and flatly rejected it as a methodology for calculating loss of goodwill.

This case is important because it makes clear the judge is the gatekeeper on damage theories. With more cases and less resources, this gives the court a reason to dismiss a case. It is therefore important that all facets of a case be presented in a compelling fashion. This is even greater in the case of representing a new business that has not shown profits, but may have shown great promise.

The moral of the story is that in any damage case, the damage theory should be thoroughly vetted in advance of trial, because the court is the gatekeeper for your expert's damage theory. And it's that beholder's eye that needs to be convinced by facts, not speculation.

Randy Sullivan, a partner at Patton & Sullivan, specializes in business and real estate litigation. For questions or comments he can be reached at randy@pattonsullivan.com