Trade Secrets and Noncompete Blog

Posted at 3:12 PM on June 13, 2012 by Kara M. Maciel

Virginia Supreme Court Overturns Multi-Million Dollar "Goodwill" Damages Award in Trade Secrets Conspiracy Case

Co-authored by Matthew H. Sorenson.

One of the most elusive forms of damage that a company may suffer when its trade secrets are misappropriated or its former employees breach their post-employment restrictive covenants is the loss of goodwill. Given its intangible nature, quantifying the dollar amount of the loss of a company's goodwill can present significant difficulties. Nevertheless, such damages are often very real and very significant. When seeking money damages for lost goodwill, it is essential for businesses to carefully select their supporting evidence and legal arguments. One information technology service provider recently found out the hard way when the Virginia Supreme Court slashed its $14 million verdict by over $11 million based on the company's failure to present sufficient evidence of the value of its lost goodwill.

The case, *21st Century Systems, Inc. v. Perot Systems Government Services, Inc.*, Record No. 110114 (June 7, 2012), involved a number of tort and contractual claims brought by Perot Systems Government Services, Inc. ("Perot Systems") against 21st Century Systems, Inc. ("21SCI"), a competing information technology company, and a group of former Perot Systems employees for allegedly conspiring to steal its trade secrets and millions of dollars of business. Among the damages sought by Perot Systems was the value of its lost goodwill. In attempting to prove the value of its lost goodwill, Perot Systems did not rely on data regarding the value of the business goodwill of comparable businesses that had been sold to other entities – a method approved by the Virginia Supreme Court. Instead, it relied solely on evidence from its recent purchase by Dell, Inc. ("Dell"). This ultimately proved to be a costly mistake.

Before trial, Perot Systems and its publicly traded parent entity, Perot Systems Corp. ("PSC"), were sold to Dell for $3.878 billion. In a publicly filed Form 10-K that discussed the transaction, Dell assigned approximately $1.6 billion in goodwill to Perot Systems. At trial, Perot Systems' used this $1.6 billion valuation and Perot Systems' reported annual revenues to show that for each dollar of revenue that Perot Systems received it had $2.57 of goodwill. Using this 1 to 2.57 ratio of revenue to goodwill and evidence that the defendants had succeeded in diverting $1.45 million in revenue from Perot Systems, the valuation expert calculated Perot Systems' total lost goodwill to be $3,742,843. The jury and trial court accepted this calculation and awarded the full amount to Perot Systems at the close of trial. This damage award was trebled to $11,228,529 under the Virginia Business Conspiracy Statute.

On appeal, the Virginia Supreme Court overturned the jury's award of lost goodwill damages on the grounds that it was not supported by the evidence. Specifically, the Court held that because Perot Systems' valuation expert had relied solely on data regarding the actual sale of the company to Dell and had not used any data regarding the sales of comparable businesses, Perot Systems had to demonstrate that its actual sales price reflected a loss of goodwill that had been caused by its former employees and 21SCI. The Virginia Supreme Court concluded that Perot Systems did not meet this burden because it had not presented evidence of a diminution in its fair market value or identifiable assets before it was purchased by Dell or that its sales price to Dell had been adversely affected by the actions of its former employees and 21SCI. To the contrary, the evidence showed that Dell had paid a significant premium to purchase Perot Systems and its parent entity, PSC. Accordingly, the Court found that Perot Systems' evidence was insufficient as a matter of law to sustain its award of damages for lost business goodwill. However, the Court sustained the trial court's award of several other categories of damages, including an award of $371,002 in computer forensics damages, which was trebled under the Virginia Business Conspiracy Statute to $1,113,006.

The decision in *21st Century Systems, Inc.* demonstrates the importance of using comparable sales data in establishing lost business goodwill. Although a business can attempt to prove lost goodwill by showing a decrease in its fair market value, identifiable assets, or its actual sales price that is attributable to an employee's breach of a post-employment restrictive covenant or the theft of its confidential information, such evidence can be difficult to come by. Indeed, given the variety of factors that can affect a company's fair market value, assets and sales price, showing that such changes are attributable to an employee or competitor's conduct can present a significant evidentiary challenge. Furthermore, even where such evidence is available, it may not reflect the full value of the goodwill that has been lost. Accordingly, when presenting expert testimony on the value of lost business goodwill, companies would be best served by incorporating data regarding the value of business goodwill drawn from sales of comparable companies.

Epstein Becker & Green, P.C.
1227 25th Street, NW • Suite 700 • Washington, DC 20037 • Phone: 202.861.0900

View other offices