Forefront

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O'Keefe

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Detroit's Emergence from Bankruptcy:

A Fresh Start or the Emperor's New Clothes?

by Patrick O'Keefe, Founder and CEO

While the legal and financial engineers have been taking a victory lap through parties and the lecture circuit over the past few months, I question whether Detroit is left in a sustainable position. The professionals have beaten their chests on the speed of the process. Generally, I agree that time is not your friend in the bankruptcy process since it is costly and often not effective. However, while Detroit clearly has financial runway by shedding massive amounts of debt, I question whether there is a plan to keep Detroit out of experiencing the same process over the next decade.

The primary revenue source for the city of Detroit, not unlike all cities, is property taxes. If property taxes don't increase the city cannot make it. Increasing millage rates is not an option since Detroit has some of the highest millage rates in the State. The best way to increase property taxes is getting more properties on the tax rolls and getting these properties on the tax rolls at their highest and best use. There was almost no discussion about this during the bankruptcy. There was talk about how to collect better, but there was a giant opportunity to provide a comprehensive plan with entitlements, zoning, and environmental clean-up which could have easily been accomplished in the bankruptcy process which would have accelerated development growth. This omission has essentially put the future of Detroit back in the hands of the very people who couldn't make the City prosper the first time. My viewpoint is Detroit will continue to be hand to mouth in dealing with public safety and education, which are two essential ingredients to develop tax base.

This bankruptcy was a unique period to position Detroit to take advantage of its natural attributes and make it a world economic power. Detroit's assets could transform the region into an international distribution center. It has a tunnel, an airport, riverfront property, underutilized industrial-zoned land and with Governor Snyder's push, a second bridge — the New International Trade Crossing. While the politicians and professionals are busy cutting ribbons on a few successes, I think they missed a great opportunity to do more in a pivotal position in Detroit's history. We could have changed our legacy from the Arsenal of Democracy to the World's Center of Commerce. An opportunity missed.

Normalizing Owner's Compensation

by Susan Koss, Partner and Managing Director

Several factors contribute to owner's compensation anomalies in a closely held company, which are not generally found in large private or publicly traded firms. For one, most small businesses are motivated to keep taxable income as low as possible at the business level. There is no pressure from outside stockholders and investors to show a profit and pay a dividend. In addition, the majority owner of a business usually has the discretion to set his or her pay based upon what the business can afford. In contrast, the owner of a non-controlling interest does not have the same ability to influence compensation amounts. Therefore, it may not be necessary to normalize owner's compensation when valuing a non-controlling interest.

There are two components of owner's compensation that are most relevant to the normalization adjustment analysis. The first is the amount of compensation that is in exchange for services provided by the owner. The second component represents compensation that is due to ownership in the form of profit distribution rather than services rendered. It is important for the valuator to get a good understanding of the roles and responsibilities of the owner(s). This understanding should be obtained through interviews with the owner(s) and other members of the company. One of the most critical areas of understanding is for the valuator to appropriately assess which responsibilities must be replaced if the owner no longer provided such services.

The valuator must determine reasonable compensation based upon replacement cost in the market. There are several sources of market data which provide such benchmarking information such as compensation databases and published surveys from industry associations and government agencies. Data can also be obtained from executive placement firms among other sources. It is important to note that a manager who has a controlling ownership interest has the ability to pay personal expenses through the business. These expenses are considered control adjustments and should be added back to the earnings of the business. Additionally, payments for traditional benefits such as medical, disability, life insurance, etc., that exceed industry benefit package norms are considered excess compensation and must also be added back to the earnings of the business.

In conclusion, the owner's compensation adjustment can make a significant impact on the value of a business. It is up to the valuator to carefully analyze the facts and critically evaluate the appropriate compensation level.

Proving Lost Profits

in Patent Infringement Cases

by Andrew Malec, Ph.D., Partner and Managing Director
and Susan Koss, Partner and Managing Director

As is the case with most complex commercial litigation matters, patent holders must first prove causality before economic damages are considered. However, patent infringement cases are unique when compared with other commercial damages cases because there are legal thresholds to be met in order to prove lost profits. Whether you are the Plaintiff's attorney or representing the Defendant in a lost profits damage case, these thresholds are imperative because, in most situations, economic damages determined by computing lost profits will be significantly greater than that computed by ascertaining a reasonable royalty. This article is not a primer on how to compute economic damages in a patent infringement matter, but instead is intended to make the reader aware of the importance of the economic factors required in proving lost profit damages. Careful consideration and understanding of these factors are integral to determining a legal strategy for a patent infringement case.

There are four factors required to prove lost profits in a patent litigation ("Panduit Factors"), which results from Panduit Corp v. Stahlin Brothers Fiber Works, Inc., 575 F2d 1152, 197 USPQ 726 (6th Cir 1978). The patent holder must show that (1) market demand existed for the infringed product; (2) acceptable noninfringing substitutes were not available to satisfy demand; (3) the patent holder must possess the ability to produce and market the product to exploit demand; and (4) lost profits can be reasonably estimated and quantified. Because the Panduit requirements to prove damages are not simply a mathematical exercise in computing lost profits, it requires careful analysis and scrutiny of the operations, industry, regulatory environment, and broader markets by the damages expert. Should the damages expert be unable to prove the top three Panduit factors, it does not matter if lost profits are ascertainable. The patent holder will not be able to prove lost profit damages and will only be entitled to damages in the form of a reasonable royalty.

Thoughtful economic analysis is critical in order to prove that lost profits are recoverable. If the alleged infringer can demonstrate that there is no demand for the patented feature; the patent holder may fail the first requirement of the Panduit Factors. For example, consumers who purchased the patented product may have been unaware, or placed no value on the patented feature which would fail the first requirement.

The second requirement of the Panduit Factors is up to interpretation in terms of defining "acceptable", "noninfringing", and "substitutes." As such, it requires an understanding of any technical advantages provided for by the patent, an understanding of the competitive products in the marketplace, and an understanding as to why consumers are buying that particular product. Product, consumer behavior, and other economic analysis are critical to demonstrate that the alternative products in the marketplace are inferior and that they do not have the same benefits as the patented feature. Consequently, the buyer would not have purchased the product, but for the infringing features and product benefits. Alternative products may also be unreliable, cost more, or have higher maintenance costs than the patented product. As such, it underscores the need for the damages expert to do a thorough market analysis to address the degree of substitutability of the patented product.

For the third requirement, the Plaintiff must also show its ability and capacity to manufacture and market the product in order to prove that it could have made the sale but for the infringement. For example, if the patent holder needs to increase production capacity, obtain different distribution channels, or secure additional key raw materials in order to produce and effectively market the additional units, it would fail Panduit's third requirement.

If one passes the top three requirements of the Panduit Factors, then the damages expert's computation of lost profits needs to be reasonably estimated and not involve speculation.

As noted in this article, rigorous economic analysis is critical in proving lost profits in a patent litigation. Simply computing reasonable and non-speculative lost profits is insufficient to satisfy the aforementioned Panduit Factors. Of course, patent law entitles the patent holder to receive damages adequate to compensate for the infringement, but in no case less than a reasonable royalty. However, as noted above, damages awarded for a reasonable royalty may very well be less than damages awarded based on lost profits. As such, general counsel and external counsel need to understand how Panduit Factors affect the damage theory applied for patent litigation and how that affects litigation strategy.

Counsel would be well-advised to seek pre-litigation consulting services from an economic damages expert experienced in Panduit to determine the applicable damage theory instead of possibly being surprised at trial. Further, a Plaintiff's attorney who is retained on a contingency basis is most likely advantaged with a lost profits damage award vis-a-vis a reasonable royalty damage award. If lost profits cannot be proven due to failure of one or more of the Panduit Factors, then taking on that matter could be a costly endeavor for the law firm.

Getting Ready to Sell Your Business?
Now's the Time To Prepare

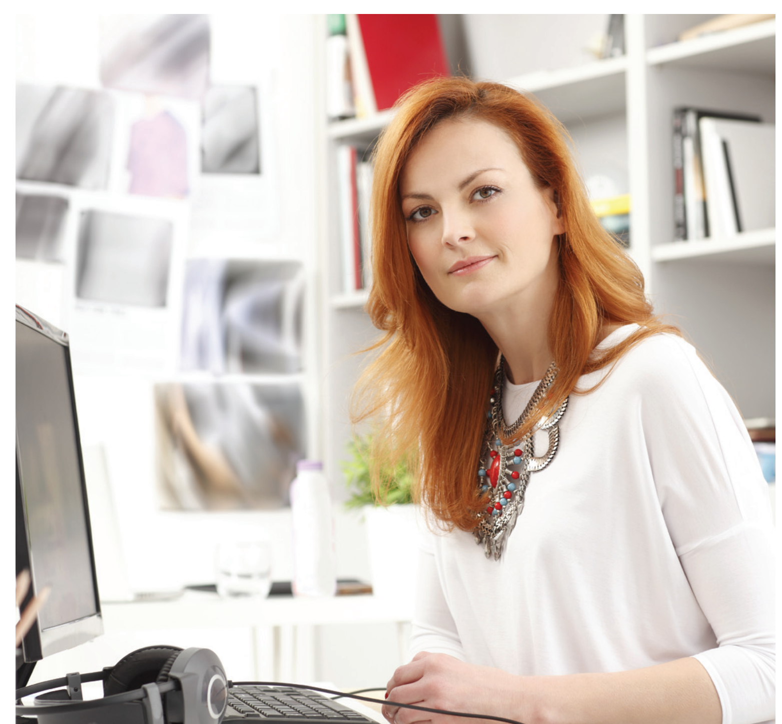
by David Distel, Partner and Senior Managing Director

Good news for Sellers is that over the last 18 months the valuation multiples have returned to normal levels and so has leveraged financing that will help fuel transactions. This change positively impacts many sellers who have been patiently waiting for the M&A market to improve following the Great Recession. The lesson learned from the dark years after the economic collapse in 2008 is that economic markets fluctuate. It is impossible to know for sure when or how steep the economic markets will fall (or rise). The market forces that impact valuation multiples used to price sales for ownership and investors alike, can happen suddenly, be long lasting, and are completely out of the sellers' control.

However, there is another key variable within the seller's control that can increase the proceeds upon exit, which is the recurring financial performance measured in revenues, earnings, and cash flows generated. Fortunately, there are many steps that can be taken to drive profit improvement that range from installing new management, new product/market expansion, strategic acquisitions/divestitures, facility consolidation, technology investments, and redesigning production methods.

One significant area for consideration where many companies lose sales, profit margin and cash flow is order fulfillment. Some symptoms of suboptimal practices in order fulfillment are defective inventories resulting in excess scrap or rework, inability to fill orders timely, proliferating SKU levels resulting in overproduction, frequent discounting to liquidate surplus or obsolete inventories, and declining profitability. Fixing the problems in order fulfillment requires a holistic and integrated approach involving a cross-functional team that may include your sales, operations, supply chain management, information technology, and finance functions.

Each situation is unique and can involve complex analysis. However, there are five areas to investigate that will get your process started:



Order to Production Process – Bring your cross-functional team together to solve your problem. Outside professional help can also frequently enhance the outcome by offering best practice solutions. As the team outlines the process, the benefits include a better overall understanding of what is happening, both the good and the bad so that it can be enhanced.

Forecasting Practices – Forecasting your production needs should be a critical part of your process. Too often the sales forecast comes from an optimistic sales force whose 'worst nightmare' is running out of stock (after all, this could undermine sales commissions). Accordingly, forecasts, if not vetted properly, can drive up production and inventory levels well beyond sales needs, resulting in surplus inventory, higher borrowing costs from bloated working capital levels, and ultimately, in profit damaging sell offs. Conversely, under-producing due to conservative sales forecasts creates the opposite problem where lost revenues, earnings, and cash flow is the result of shortages in product availability. Also, production costs increase as facilities become underutilized.

Supply Chain – Review the supplier base including, but not limited to, the number of suppliers, locations, terms/pricing, minimum order quantities, lead times, and level of defects. This is a good opportunity to re-examine the methods and key performance indicators that are used to manage your key external suppliers to mitigate supply chain risk. This analysis will result in more reliable, timely, and cost effective raw material and finished product sourcing.

Technology – Review and implement new strategies to tightly integrate your company with your customers on one end and your suppliers and/or operations on the other end. Are you leveraging your order to production module to initiate your production for new sales? Improvements in technology, if designed and implemented properly, will also reduce risk cycle time from order to delivery, inventory levels, and costs associated with administration.

Product Life Cycle Management – Review and amend the practices for new product launches, ongoing management of order fulfillment, and product discontinuation. A well-designed and properly implemented product management policy will maximize margins on new products. It will also reduce the risks associated with production defects, SKU proliferation, discounting excess inventories, and bloated inventories tying up excess capital.

Each of these five areas is typically not managed well in most organizations. Why? They are challenging and require constant focus. However, when order fulfillment challenges are addressed proactively, the sellers will reap a much larger reward upon exit than if they leave it undone.

What to Consider Before
Migrating to the Cloud

by Linda McConkey, Managing Director

Continued evolutions in the options around Cloud and the possible benefits to be gained are worth revisiting if you have not evaluated Cloud options recently. The pace of obsolescence of hardware and the related on-going cost of support and maintenance for the required infrastructure of your company could be higher than the cost of migrating to a cloud solution, or partially cloud-based solution.

The varieties of options are expanding, with a clear benefit to small to middle market companies that want to utilize enterprise-class capabilities that provide business continuity/disaster recovery and operational standards that they would be unable to afford otherwise. Cloud services can also allow smaller enterprises to get these operations running, generally, in a much smaller timeframe, as they don't have the resource and financial challenges related to 'typical' on-site IT infrastructure.

The variety of Cloud services available and the cost savings that can be associated with Cloud computing can provide small to middle market companies the ability to redirect capital, reduce overall IT services and resources costs, and provide a level of reliability they are not currently able to achieve.

Cloud services require the same level of assessment around, fit, options, needs, costs as any other IT solution. And as a solution, should be evaluated around some key criteria and some higher-level filters as well as across the company's primary objectives and roadmap around core/key systems and solutions. For example:

- Are you considering a Private or Hybrid Cloud?
- Are the primary issues infrastructure, applications, or both?
- Are there older legacy systems running in on-premise hardware that have dependencies that prevent them from being migrated to the Cloud?
- Does the company plan to grow at a rate that Cloud scalability is a key factor?
- What level of performance does the company need – and does the Cloud offer a cost-competitive or cost-reducing mechanism for doing so?

There are additional points of consideration as with any solution, but the availability and proliferation of variety in the Cloud computing arena make this an even better time to evaluate overall IT strategy and roadmaps, to ensure that technology is enabling growth in a company, and to investigate whether or not it's time to start the migration process.

Litigation Support Corner
A Look at the Year Ahead

by Andrew Malec, Ph.D., Partner and Managing Director

Our litigation support practice has seen an increasing docket of intellectual property ("IP") infringement matters. This is not a surprise to us since companies are becoming more sophisticated in understanding the value of their IP, as well as protecting and monetizing it. We have also noticed that we are being retained on litigation assignments earlier on in the case and being asked to perform pre-litigation consulting services for counsel with more frequency. We anticipate both of these trends to continue throughout the year.

IP infringement matters continue to increase. Sound economic analysis is needed in IP litigation since the assets themselves (i.e., patents, trademarks, trade secrets, copyrights, etc.) are, by their very nature, complex. For example, economic damage quantification on patent infringement matters requires an understanding of the demand for the infringed product, acceptable non-infringing substitutes, and the ability of the patent holder to produce and market the product. In a trademark infringement matter with a diminution in value claim, the economic expert needs to conduct economic analysis to determine the strength of the mark and the impact of the diminution in value; perhaps corrective advertising is needed to remedy the situation. As such, sound and logical economic analysis is required along with well-thought out economic damage quantification that can be clearly and concisely conveyed to the trier of fact.

Being brought in on litigation support assignments earlier in the process is advantageous because we can assist counsel with litigation strategy, discovery, and damage theory. This often leads to a well-thought out litigation strategy that works in tandem with economic damage quantification. Of course, there is a balancing act of case management and anticipated economic damages. Nevertheless, it is not helpful when needed documents or information cannot be requested because discovery has ended, which can "hand-cuff" the economic damages expert and litigator unnecessarily. It goes without saying that winning liability with an award of zero economic damages is generally not a good outcome for your client. Consequently, it only makes sense to understand the magnitude of anticipated economic damages before the case is filed.

As we look at the year ahead, we anticipate an increase in IP engagements, as well as continuing to be retained early in the litigation process so as to assist counsel with litigation strategy and the resulting commensurate economic damages.

Enhancing the Value of Your Real Estate

by Michael Deighan, Managing Director

Whether you own a manufacturing facility, office building or are a seasoned real estate developer, the O'Keefe Real Estate Group can help you improve your bottom line. We have assembled a team that is unparalleled in the industry with real hands-on experience in all facets and classes of real estate. We can effectively address all aspects of the real estate life cycle including acquiring, developing, managing, financing (debt and equity), providing valuations, restructuring, selling, leasing, and construction completion. We have acted as a court appointed receiver on hundreds of parcels of improved and unimproved commercial and residential properties. Our unflinching goal is to help all stakeholders protect and improve their interest in and to maximize their value in the property.

The values in virtually all classes of real estate are now at prerecession levels, but refinancing and restarting projects are still difficult tasks. Many properties that were financed prior to 2007 are reaching their maturity dates and must be refinanced, oftentimes requiring additional equity. Lease absorption rates continue to rise, but not all properties are sharing in the upside. The O'Keefe Real Estate Group has helped to refinance hundreds of millions of dollars of mortgage loans (conforming and non-conforming). We are a leader in handling troubled real estate across the country. Our team provides a comprehensive approach designed to ensure all elements of a project receive the finest management and financial support. O'Keefe has the deepest bench in the industry and the track record to complete the toughest of projects in a timely and cost effective manner.

Our team of professionals has an average of 30 years of individual real estate experience with Fortune 500 companies, regional and local developers, lenders and single-tenant developers and owners. We have the knowledge and perseverance needed to protect the value, integrity and potential in your real estate matters.

We can help you and your organization when you are considering how best to:

- Determine the highest and best use for your portfolio
- Refinance your expiring debt with a reluctant lender
- Negotiate and settle disputes with lien holders or equity partners
- Complete development and construction projects with limited budgets
- Provide turnkey asset and property management services

Armed with our deep experience and subject matter expertise, the O'Keefe Real Estate Group stands ready to assist you with creative, collaborative and cost effective solutions to your real estate needs.

O'Keefe Wins Turnaround of the Year Award

The Turnaround Management Association (TMA) honored O'Keefe with the prestigious 2014 Not for Profit Turnaround of the Year Award on September 30. The winners were honored during a special awards ceremony at The TMA Annual, which took place September 29 – October 1 at the Westin Harbour Castle in Toronto, Ontario.

O'Keefe's client is a non-profit organization and recognized leader in the field of special education, providing assistance to students and adults with severe disabilities, including autism. O'Keefe's turnaround expertise saved over 450 jobs and made it possible for the Organization to continue services for nearly 500 students and adults attending the program. Once the restructuring was complete, O'Keefe, with the legal expertise of Fox, Swibel, Levin, and Carroll, LLP, was able to refinance the Organization's complex credit structure. The Organization now has a financial road map to complement its mission for many years to come.

Since 1993, TMA has honored excellence through its annual awards program, which recognizes the most successful turnarounds and impactful transactions. This year's winners saved countless jobs and made a significant economic impact, both locally and globally.

TMA
2014 Award Winner
Turnaround of the Year

With offices in Atlanta, Bloomfield Hills, Chicago, and Grand Rapids, O'Keefe is a leading firm providing transactional financial consulting to middle market companies.

THE M&A ADVISOR

O'Keefe Announced as Winner at the M&A Advisor Awards

O'Keefe was recently awarded the Restructuring Community Impact Award (under $50 million) by the M&A Advisor for the restructure of Youthville. Youthville is a non-profit organization that provides critically needed after school programming to under serviced teens in Detroit. Brad Coulter, Managing Director at O'Keefe, worked with the Skillman Foundation as well as other stakeholders to get this project to the finish line.

"The award winners represent the best of the distressed investing and reorganization industry in 2013 and earned these honors by standing out in a group of very impressive candidates," said David Fergusson, President of the M&A Advisor. "From lower middle market to multi-billion dollar deals, we have recognized the leading transactions, firms and individuals that represent the highest levels of performance."

On Tuesday, March 11th, The M&A Advisor will present the 2014 awards at the Awards Gala in Palm Beach, FL, in conjunction with the 2014 M&A Advisor Distressed Investing Summit. Since 1998, The M&A Advisor has been presenting, recognizing the achievement of and facilitating connections between the world's leading mergers and acquisitions, financing and turnaround professionals.

O'Keefe hires Stephen Hayduk, Matthew Kopmeyer and Carolyn Riegler

Stephen Hayduk has joined the firm as a Senior Associate in the Grand Rapids office. Prior to joining O'Keefe, Mr. Hayduk was responsible for the wind down and liquidation of international entities and developing solutions for more efficient quarterly close and reporting processes at Ally Financial. Prior, he was on the Assurance Team at Plante & Moran working primarily with manufacturing and distribution companies. Stephen is a Certified Public Accountant (CPA), earned his Master of Science in Finance from University of Michigan and has a Bachelor of Arts in Accounting from Michigan State University.

Matthew Kopmeyer has joined the firm as a Director in the Bloomfield Hills office. Prior to joining O'Keefe, Mr. Kopmeyer served as a Consulting Manager, and Director of I.T. for Bluewater Transaction Advisors, LLC. As Consulting Manager he specialized in transaction due diligence, forensic accounting and fraud investigation. As Director of I.T. he was tasked with designing, implementing, and maintaining a cloud based comprehensive workflow and project management system for the entire firm. He earned his Bachelor of Science in Accounting from Valparaiso University and is a Certified Fraud Examiner (CFE).

Carolyn Riegler has joined the organization as a Director in the Bloomfield Hills office. She utilizes her 30 years of professional experience in financial and operational capacities to provide clients with financial consulting services, litigation support services, real estate valuation, business turnaround and operational advisory services. Ms. Riegler is licensed by the State of Michigan as a Certified Public Accountant (CPA) and as a Real Estate Broker.

O'Keefe is glad to enhance our service offerings with our new staff members. To learn more about them and all of our staff please visit us at www.okeefellc.com/our-team/.

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O'Keefe Names Koss, Long and Malec Firm Partners

Susan Koss | Russell Long | Andrew Malec, Ph.D.

O'Keefe, a leading financial and strategic advisory firm specializing in turnaround and restructuring, strategic advisory, litigation support, and performance improvement, is pleased to announce the recent promotions of Susan Koss, Russell Long and Andrew Malec to Partners. Susan Koss is a recognized expert in the fields of litigation support, business valuation, forensic accounting, and turnaround management. She has significant experience in the areas of lost profits and economic damage quantification involving breach of contract and intellectual property infringement matters, among others. She has also performed numerous business valuations utilized in estate tax resolution, shareholder disputes, marital dissolutions, and merger and acquisition transactions. Ms. Koss is a Certified Public Accountant (CPA) and has been awarded the Accredited in Business Valuation (ABV) and the Certified in Financial Forensics (CFF) credentials by the American Institute of Certified Public Accountants (AICPA). She is also accredited by the National Association of Certified Valuators and Analysts (NACVA) as a Certified Valuation Analyst (CVA). Ms. Koss is a graduate of Oakland University.

Russell Long specializes in real estate consulting, receiverships, litigation support, business valuation and forensic accounting. He has acted as interim COO and receiver for numerous entities, negotiated creditor agreements, and prepared reorganization plans for informal workouts. Additionally, Mr. Long is responsible for leading forensic accounting teams in the investigation of "Ponzi" schemes and fraud cases. He is a Certified Public Accountant (CPA) and has been awarded the Accredited in Business Valuation (ABV) and Certified in Financial Forensics (CFF) credentials by the American Institute of Certified Public Accountants (AICPA). Mr. Long serves on the Board of Directors of the Turnaround Management Association (TMA) and is the past President of the Michigan Chapter of the TMA. Mr. Long is a graduate of Walsh College.

Andrew Malec, Ph.D. is a recognized expert in providing economic analysis and litigation advisory services to litigators in complex, commercial litigation matters, including, but not limited to, intellectual property infringement, securities litigation, and shareholder disputes. Dr. Malec also has significant experience in providing valuation opinions including derivative securities, enterprise value, equity, intangible asset/intellectual property valuation, and debt opinions for corporate planning, financial reporting, taxation, transaction litigation, and strategic planning purposes. Dr. Malec holds a Ph.D. in Economics from Wayne State University and is a faculty member for ICLE's Deposition Skills Workshop.

"Sue, Russ, and Andy are vital to the continued growth of our firm and have demonstrated leadership and success in our industry," said Pat O'Keefe, Founder and CEO of O'Keefe.