



# The Franchise Valuations Reporter



## Our Expertise

Within the franchise, distribution and dealership context, we are experts in:

- Damages, Valuations & Expert Testimony
- Finance, Accounting and Tax
- Cyber Security and E-discovery of Electronically Stored Information

We offer a free initial consultation. If any readers have questions, you are welcome to email or phone us and we will provide our best answer as quickly as possible.

Bruce S. Schaeffer, Editor  
[Bruce@FranchiseValuations.com](mailto:Bruce@FranchiseValuations.com)  
 212.689.0400



## Damages: Dunkin' Donuts Cites Our White Paper on Appeal

*Dunkin' Seeks Review in Bertico*

As our readers may know, Ned Levitt and I prepared a [white paper for CCH](#) on the recent *Bertico* decision in Quebec.[1] Dunkin's appeal quoted our paper, *inter alia*:

192. A "White Paper" written by the authors Edward (Ned) Levitt and Bruce S. Schaeffer for the Business Franchise Guide shortly after the Judgment was announced analyzed the case for the Commerce Clearing House. It found that the method used by the Trial Judge to calculate damages was extraordinary. Specifically, *"The method adopted used comparable sales to calculate lost profit, which is far from orthodoxy"*. *"We are not aware of case law, other than Dunkin' Donuts, that predicates a plaintiff's lost profits on a competitor's operating results"*. *"In fact, Tingley, J.C.S. acceptance and stamp of approval of the franchisees' expert's use of the alleged results of Tim Hortons to calculate the lost profits of the Franchisees is highly unusual and quite remarkable"*.

[1] Ned Levitt and Bruce S. Schaeffer, "The Second Battle of the Canadian Donut Wars - Bertico v. Dunkin' Donuts: Lessons Learned About Franchisors' Duties, Lost Profits Calculations and the Credibility of Expert Testimony", in CCH Business Franchise Guide, September 24, 2012, at para 7413.

## Tax Outlook for 2013

*Ways and Means Alums Doubtful There Will Be Reform*

Because I write the Bloomberg/BNA Tax Management Portfolio on the Tax Aspects of Franchising, I was invited to a recent presentation sponsored by Bloomberg Law, where three well-informed panelists expressed skepticism about the possibility of achieving comprehensive tax reform any time soon.

On the subject of "loopholes," Jon Traub, former staff director for the House Ways and Means Committee, said the biggest current targets are LIFO, R&D, Accelerated Depreciation and Bonus Depreciation. He predicted "sector on sector violence" among lobbyists because financial institutions don't care if all those loopholes are dropped while manufacturing and drug companies will fight to the death to maintain them.

Melissa Mueller, also a former tax director for the Ways and Means Committee and tax counsel to the Senate Finance Committee, believes the upcoming "clifflets" - sequester at the end of this month, a possible government shut-down in March, and the postponed debt ceiling decision in May - will prevent Congress from addressing tax reform in the first half of 2013.

Traub compared Congress to a seventh grade dance with all the boys lined up on one wall on one side of the room and all the girls lined up on another wall on the other side of the room and nobody is willing to be the first one to cross and ask someone to dance.

The only way to accomplish individual tax reform and corporate tax reform

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at the same time is what Traub called the BLT solution, i.e., keeping them separate as long as possible. He said, "It's like making a bacon, lettuce and tomato sandwich. To do it right one must keep the bacon and the hot part of the sandwich on one side so it doesn't get cold, while at the same time keeping the lettuce and tomato away from the bacon to prevent it from getting soggy. The only way to do it is to prepare two separate half sandwiches and then at the very last minute slam them together."

Also covered was the need to change the foreign tax rules, the "carried interest" rules and the closing of "loopholes" - all considered highly unlikely to be adopted.

## Covenant Not to Compete Discharged in Bankruptcy

### *Court Holds It Can Be Reduced to Money Damages*

In a recent issue of this Reporter we discussed [valuing covenants not to compete in franchising](#) and concluded there was little authority on the issue. So franchise practitioners should be aware of the recent case of *Allegra Network, LLC v. Ruth*,<sup>[1]</sup> where a bankruptcy court held that a covenant not to compete (in an Insty-Prints franchise agreement) was dischargeable in bankruptcy because it could be reduced to a judgment for money damages. The court offered no method to compute such value but did cite several Michigan cases as its authority<sup>[2]</sup> including the following:

In *Grigg Box Co. v. Michigan Box Co.*,<sup>[3]</sup> which concerned a salesman who was coerced by his new employer to breach his covenant not to compete, the statute analyzed was MCL 445.774a which applied only and specifically to employer-employee situations. The case was analyzed as a breach of contract case and the measure of damages was lost profits. But that statute does not appear to apply to franchisor-franchisee relationships and does not show how damages would be quantified in that situation.

In *Faargsob, L.L.C. v. HTSTS, L.L.C.*,<sup>[4]</sup> the dispute arose out of a covenant not to compete given by the seller in connection with the purchase of a business - again a very different fact pattern from the franchisor-franchisee situation. The trial court threw out a jury finding of liability and damages of \$200,000 holding the amount was wholly "speculative". The award was reduced to zero. The appellate court affirmed the trial court decision treating the matter as a breach of contract action and wrote: "The proper measure of damages for a breach of contract is the pecuniary value of the benefits the aggrieved party would have received if the contract had not been breached."<sup>[5]</sup>

Query: if that rule were applied in the franchise context would the proper measure of damages be zero because the party subject to the covenant, if properly enforced, would not be in business and therefore would pay no royalties. Does that result make sense?

In *Brillhart v. Danneffel*,<sup>[6]</sup> the dispute also arose out of a covenant not to compete given by the seller in connection with the purchase of a restaurant business- still a very different fact pattern from the franchisor-franchisee situation. But the seller opened a competing restaurant 9.2 miles from the old site which was sold with a covenant against competition within a 10 mile radius. The trial court awarded damages but the appellate court found the computation vexing because the old site did not stay open as many hours as it had under the previous ownership and because the only evidence of damages was the owner's testimony that sales were off. Thus the appellate court held the lower court's damages computation to be "speculative" and remanded for further testimony on the issue of damages.

In another recent covenant-not-to-compete decision that was a franchise dispute, a Wisconsin court held that a two year covenant not to compete did

not start to run until the defendant stopped violating it. However, the court made no mention of damages due for the period during which the covenant was violated.[7]

[1] Bank DC Tex., CCH Business Franchise Guide ¶14,966

[2] See, e.g., *Grigg Box Co. v. Michigan Box Co.*, 2009 WL 3401111, at \*2 (Mich. Ct. App. 2009); *Faargsob, L.L.C. v. HTSTS, L.L.C.*, 2007 WL 2404516, at \*1 (Mich. Ct. App. 2007); *Schmitt*, 470 N.W.2d at 409; *Brillhart v. Danneffel*, 194 N.W.2d 63 (Mich. Ct. App. 1971); *Superior Consultant Co., Inc. v. Walling*, 48 F.3d 1219, 1995 WL 94746, at \*1 (6th Cir. 1995) [remanding case for calculation of money damages for breach of a non-compete covenant].

[3]2009 WL 3401111 (Mich. Ct. App. 2009) an Unpublished opinion

[4]2007 WL 2404516 (Mich. Ct. App. 2007),

[5]citing *Ferguson v Pioneer State Mut of Michigan*, 273 Mich App 47, 54; 731 NW2d 94 (2006)

[6]194 N.W.2d 63 (Mich. Ct. App. 1971)

[7]*Novus Franchising, Inc., v. Superior Entrance Systems, Inc., Superior Glass, Inc., and Knute Pedersen*, CCH Business Franchise Guide ¶14,974. (DC WD Wisconsin, Dated December 27, 2012)

## Valuations and Expert Testimony

### **What To Expect From an Expert**

Joe Epps, CPA/ABV, CFE, CVA, who works frequently as an expert witness, offers the following advice about what an attorney should expect from a testifying expert:

The first step is to confirm that the expert being considered has the proper qualifications regarding credentials and background. Once the qualification issues are confirmed, the next issue involves the critical skills of the expert witness, such as: (1) giving an independent opinion; (2) being able to support that opinion under a vigorous cross examination; and (3) the expert's ability to communicate with, and persuade, a jury.

Epps points out that just "telling the attorney what the expert thinks the attorney wants to hear is a prelude to disaster."

### **New Standards of Appraisal Practice**

At the end of January, 2013, two valuation societies (ASA and NACVA) announced they were pleased with the Appraisal Standards Board's third exposure draft of proposed changes to the 2014-2015 edition of the Uniform Standards of Professional Appraisal Practice (USPAP). The changes will be reviewed here if and when they are adopted.

### **Incomplete Appraisal Dooms Charitable Deduction**

In *Evanchik v. Commissioner*[1], the disallowance of a million dollar charitable donation of stock in a real estate holding company was upheld by the Tax Court because the appraisals that accompanied the tax return were egregiously inadequate. Some of the more serious problems:

- The appraisals did not appraise the correct asset. They valued the underlying real estate while the asset donated was the stock in the holding company.
- The appraisals failed to state the date or expected date of the contribution.
- The appraisals failed to provide a statement that the appraisal was prepared for income tax purposes.
- The appraisals failed to give the appraised fair market value on the

date (or expected date) of contribution.

To which my only comment is OMG! How many things can you get wrong?

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[1]T. C. Memo. 2013-34 (February 4, 2013)

## **More Reasons to Harden Your Network Security**

*Links to Recent Articles on Cyber-Crime*

[Hackers in China Attacked The Times for Last 4 Months](#)

[U.S. Said To Be Target of Massive Cyber-Espionage Campaign](#)