



The Franchise Valuations Reporter



See You in Baltimore

We're looking forward to seeing many of our readers at the ABA Forum on Franchising, October 19th-21st.

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We've Moved!

Franchise Valuations Ltd. and Franchise Technology Risk Management have moved 5 blocks north to new offices at:

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When to Hire a Damages Expert

Litigators Pay Too Much Attention To Liability Issues But Rarely Address Damages Early Enough

Three Easy Questions:

1. What are franchise litigation disputes about almost all the time? Answer: Money!
2. What is one of the first questions that should be asked when litigation is contemplated or initiated? Answer: What are the damages?
3. When should a consulting and/or testifying damages expert be retained? Answer: As soon as possible!

In all franchise, dealership and distributorship disputes, damages are an essential element which must be proved; and reviewing the amount and the method of calculating the possible damages should be one of the first steps in prosecuting or defending any lawsuit.

But a common pitfall of litigators is that they often pay substantial attention to liability issues from the beginning of the case but rarely address damages until much later. This has been recognized as a professional infirmity. See e.g. Federal Judicial Center, Manual for Complex Litigation, §33.1 at 303 (speaking of antitrust but applicable to other areas, "the attention given to liability issues . . . may lead to neglect of injury and damages issues.")* Early attention to damages issues will often dictate the course of discovery, motion practice and even the trial.

According to a recent article in an insurance litigation journal:**

Expert guidance and testimony play a central role in the late stages of legal proceedings, when experts provide reports and serve as witnesses concerning the substance of the case and the appropriate damages. In the hope of minimizing fees, many [parties] often wait until the late stages to engage them.

But that's false economy. Early retention of experts is critical to helping [parties] decide if a case is worth pursuing or disputing; or if it makes more sense to settle, based on forensic evaluation of specific evidence and economic evaluation of likely damages. (Emphasis added.)

If the case is worth pursuing, these experts can increase the odds of winning by helping improve strategy, guiding discovery and depositions, and enhancing the quality of Daubert challenges, both to exclude the opposition's experts and to achieve summary judgments.

The sooner [parties] add this expert knowledge to the case preparation team, the greater the benefit they will be able to realize. The overall impact of early-stage expert contributions is an improvement in efficiency and win rate.

As another example, the "Initial Pleadings" chapter*** in the ABA's Franchise Litigation Handbook - an excellent compendium of potential liability issues in the franchise context - lacks any review of one of the

Our Expertise

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

- Finance, Accounting and Tax
- Damages, Valuations & Expert Testimony
- 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.

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Franchise Technology Risk Management

Our franchise law and computer forensics experts provide consulting and implementation of all aspects of cyber security, ESI management and e-discovery for franchise systems - from preparation of cyber security and ESI-related policies and procedures manuals through collection, preservation, processing, production and presentation.

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first questions that should be asked, i.e. "What are the damages?"

From the very beginning, there should be discussion of what elements of damages can be proven with testimony of lay witnesses and what elements may require experts; also part of the very first considerations should be a review of the financial documents that may be necessary to establish and prove (or disprove) damages.

[*] See also, Manual for Complex Litigation, §33.1 at 303 ("[e]arly scrutiny of the claimed damages can facilitate settlement, either because of the magnitude of the potential exposure or because provable damages are too small to justify the cost of pursuing the litigation").

[**] Donald M. May, Ph.D., "Factors to Consider When Hiring an Expert," May 26, 2011.

[***] This chapter, by Deborah S. Coldwell, is available as a free download on the ABA website.

Economic Nexus - Income Tax

"Physical Presence" Argument Ignored as Usual: U.S. Supreme Court Denies Cert

On October 5, the SCOTUS refused KFC's petition for certiorari to overturn the highest court of Iowa's holding that "economic nexus" was sufficient to yield income tax liability for an out-of-state franchisor collecting royalties. This should not be a surprise and I have to say, "I told you so". The conclusion of Chapter 6A of CCH's treatise *Franchise Regulation and Damages* (which I write) reads:

It seems clear that the requirement of "presence" for tax nexus applies only in the sales tax context. With respect to income taxes, New York, New Mexico, South Carolina, New Jersey, and Missouri all represent different parts of the spectrum of "nexus." The tests and the requisite elements differ substantially in many other taxing jurisdictions and must be reviewed carefully based on the facts and circumstances of each individual situation. Franchisors that ignore this issue do so at their peril.

We have cautioned readers of this newsletter about this position more than a dozen times going back to 2009 and in the BNA Tax Management Portfolio I write since 1999. In the January 2011 issue of this newsletter, I wrote:

The truth is that nothing about this Iowa case is really news. The case is 40 pages long and for 31 pages discusses and then rejects the "dormant Commerce Clause" argument. The results are the same as the results in a long string of cases since the original Geoffrey case in 1993. Losing counsel was the same counsel who argued several *Geoffrey* and *Lanco* cases. The judgment was unanimous. And the penalties were upheld because counsel failed to preserve the issue for appeal. In the opinion of this tax lawyer, who has been writing and lecturing on this issue for more than 25 years, franchisors that still believe that "physical presence" is a pre-requisite for income taxation are pursuing folly and there is no statute of limitations to protect them if they have not filed returns. The result is generally a tripling of the liability.

We have been consistently correct on this issue and we are available to provide advice and representation for franchisors that fear they may not be in compliance with state and local tax nexus requirements.

construed as legal or expert advice which can only be obtained from appropriate professionals. Franchise Valuations, Ltd. and Franchise Technology Risk Management provide such expert advice on the topics addressed herein.

Please visit our websites at www.FranchiseValuations.com and www.ftm.biz

Nexus - Sales Tax: Amazon Concedes

"Physical Presence" Argument Forsaken; Will the IFA Give It Up Next?

Even as the International Franchise Association filed its amicus brief - for the second time - with the U.S. Supreme Court arguing "physical presence" was a requirement for taxability and that "economic nexus" was not sufficient to create income tax nexus, according to the Wall Street Journal, California Gov. Jerry Brown signed compromise legislation granting Amazon.com Inc. a reprieve from collecting state sales tax after the company offered the promise of thousands of jobs. The bill pushes back by a year the time when Amazon and other "no physical presence" Internet retailers would have to start collecting sales tax in California.

The compromise comes as Amazon fights efforts by California and other states to require it to collect sales taxes on purchases made via the site. Amazon has said it wants a federal law to cover the issue, rather than a state-by-state system. However, many investigative reports have shown that what Amazon really wants - which was Mr. Bezos' business plan from inception - is to continue its edge over in-state retailers by collecting no sales tax. Published analyses claim that not collecting and paying over sales taxes increases Amazon's revenues by about 15%.

Bill Dombrowski, chief executive of the California Retailers Association, said: "Amazon's concession to finally begin collecting sales tax in California is a groundbreaking moment that sends a strong message to Washington that it is time to stop giving special treatment to a select few." His organization includes such brick-and-mortar retailers as Wal-Mart, and strongly opposes giving Amazon special benefits.

On October 6, 2011, Governor Bill Haslam of Tennessee announced that Amazon had made a similar deal to collect sales taxes even though they have no "physical presence" in Tennessee.

Heads Up on the Taxman

IRS Announces New Voluntary Worker Classification Settlement Program

In light of the recent proceedings in Massachusetts and the enormous amount of literature devoted to the *Awwah v. Coverall North America* decision, people involved in franchising should be aware that the IRS issued Ann. 2011-64 informing taxpayers of a new Voluntary Classification Settlement Program (VCSP) that will enable many employers to resolve past worker classification issues by reclassifying people prospectively and making a minimal payment to cover all past payroll tax obligations. But only employers that have: (1) consistently treated the workers in the past as nonemployees; (2) filed all required Forms 1099 for the workers for the previous three years; and (3) are not currently under audit by the IRS, the Department of Labor or a state agency concerning the classification of these workers, are eligible.

As reported by CCH Wolters Kluwer, interested employers can apply for the program by filing Form 8952. The payment for all past years will be an amount effectively equaling just over one percent of the wages paid to the reclassified workers for the past year. No interest or penalties will be due, and the employers will not be audited on payroll taxes related to these workers for prior years. Participating employers will, for the first three years under the program, be subject to a special six-year statute of limitations, rather than the usual three years that generally applies to payroll taxes.

Franchisor's Tort Liability

A Footnote Compendium of a Much Litigated Area

In disputes between franchisors and franchisees, claims such as intentional infliction of emotional distress, tort claims based on injuries caused by defective or dangerous equipment, or assaults by third parties are frequently made. Issues that have been subject to litigation include:

- Direct liability against the franchisor;
- Direct negligence theories (in addition to vicarious liability) where plaintiffs were franchisee employees rather than customers;
- Vicarious liability claims

For all the relevant citations, taken from Fox & Schaeffer, *Franchise Regulation and Damages*, Section 15.04 (CCH Wolters Kluwer, 2005, updated 3 times annually), click [here](#).

Cybercrime: More Reasons to Harden Your Network Security

Here's an excerpt from a [recent news report](#) that franchise companies should be aware of.

New York Police Crack ID Theft Ring - Gang Ran Teams of "Shoppers" Using Stolen Cards From Luxury Hotel

"This is by far the largest and certainly amongst the most sophisticated identity theft credit card fraud cases any of us have ever seen," Queens District Attorney Richard Brown said.

Bank tellers, restaurant workers and other service employees working for the gangs stole card details from customers using a machine to "skim" personal data from credit cards. The data were then passed to criminal technicians who would make forged American Express, Visa and other branded credit cards. These would then be used by teams of "shoppers" who would buy high-end computer products across the US to resell to crime syndicates in China, Europe and the Middle East.

Police said they had seized tens of thousands of dollars in cash, \$650,000-worth of stolen computer equipment, a number of handguns and a truck full of electronics, computers, designer shoes, watches and ID theft equipment. Police Commissioner Kelly said the thieves had "an amazing knowledge of how to use technology."

"The schemes and the imagination that is developing these days are really mind-boggling," he said.

Links to Other Recent Articles on Cybercrime:

[For Hackers, the Next Lock to Pick](#)

[Targeted cyber attacks an 'epidemic'](#)

[Cyber-sabotage and espionage top 2011 security fears](#)

[HP Shows Hazard of Sharing LinkedIn Profiles](#)

[In China, business travelers take extreme precautions to avoid cyber-espionage](#)