December 2011

The Franchise Valuations Reporter

Happy Holidays

We wish Good Health, Peace and Prosperity for you and yours in 2012.

Bruce S. Schaeffer, Editor
Bruce@FranchiseValuations.com
212.689.0400

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.

Bruce S. Schaeffer, Editor
Bruce@FranchiseValuations.com
212.689.0400

Damages Experts: A Billion Dollar Difference

Court Grants JMOL, Rejecting "Unduly Speculative" Expert Testimony

In the ongoing case of *Oracle USA, Inc. v. SAP, AG*,* a jury award of $1.3 billion was overturned by the trial judge granting defendants Judgment as a Matter of Law (JMOL). The court offered either a new trial or remittitur of $272 million - a damages award reduction of more than $1 billion! The entire trial was to determine damages since SAP had already admitted liability in the wrongful taking of certain software code in violation of the Copyright Act.

In overturning the jury award obtained at trial for Oracle by the renowned David Boies, the court repeatedly referred to counsel's usage of words like "theft" and "stealing" which SAP argued were prejudicial in proceedings under the Copyright Act which prohibits punitive damages and where liability had been conceded. And the court also noted "the invitation to speculate as to the value of the hypothetical license, made to the jury by Oracle's counsel during closing argument," and that SAP objected because Mr. Boies, "invited the jury in his closing argument to engage in guesswork and simply pick a number between $1.66 billion and $3 billion."

The jury had been instructed to choose between measuring damages by valuing a hypothetical license transaction at fair market value or a lost profits calculation. They chose to use the fair market value measure based on the testimony provided by Oracle's expert and returned with the $1.3 billion verdict.

But it was a short-lived victory. The court found that the damages award was "contrary to the weight of the evidence" and flew in the face of all the testimony that said no such "hypothetical" fair market value license would ever have taken place in the real world and that none ever had in the companies' combined histories.

*Slip Copy, 2011 WL 3862074 (N.D.Cal.), 2011 Copr.L.Dec. P 30,123, 100 U.S.P.Q.2d 1450 (Sept. 1, 2011)

Another Reason To Use an Expert

Using a Lay Witness May Backfire

Rule 701 of the Federal Rules of Evidence permits the admission of lay opinion testimony "only to help the jury or the court to understand the facts about which the witness is testifying and not to provide specialized explanations or interpretations that an untrained layman could not make if perceiving the same acts or events."*

And a recent case demonstrates the pitfalls of attempting to use a principal of a business as a lay witness in lieu of a financial expert. In *Echo v. Timberland*** the US Court of Appeals for the Seventh Circuit held that the president of a distributor was not allowed to offer testimony about seemingly mundane adjustments to his own financial statements. The court ruled that such testimony required an expert financial witness. The president had not been noticed as such, nor did the court below think he had the qualifications. Thus, his affidavit was excluded and all his causes of action were dismissed.

Buy-Sell Agreements: Check the Formula Price

Owners of closely held businesses should review their buy-sell agreements. Some of these may go back decades. In one recent New Jersey case, a formula buyout at "book value" from the 1980s was upheld even though it was conceded that such valuation was merely 2% of current "fair market value". [*Estate of Cohen v. Booth Computers*, 421 N.J. Super. 134, 22 A3rd 991, July 13, 2011]

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.

To inquire about our services, please e-mail Henry@FTRM.biz or call (212) 689-0400

Links to Recent Articles on Cyber Crime

China World's Biggest Cyber Thief: U.S. Intel (Cloud Computing Particularly Vulnerable)

Students Trade Hacking for U.S. Scholarships

For more on the facts of the case and the court's reasoning for throwing out the lay opinion testimony, continue reading here.

*United States v. Conn, 297 F.3d 548, 554 (7th Cir.2002)
**2011 WL 148396 (N.D.Ill.), 84 Fed. R. Evid. Serv. 692

Who Is a Franchisee in Connecticut? The Continuing Saga

Interpretations of the "Most or All" Formulation of the CFA

Echo v. Timberland is also the latest installment in the continuing saga of what constitutes a franchise under the Connecticut Franchise Act. In *Echo*, a U.S. District Court sitting in the Northern District of Illinois interpreted Connecticut law to hold that the CFA's protections only apply to business relationships that fall within the statute's definition of a franchise in Conn. Gen.Stat. § 42-133e(b). As the court explained:

> Courts examine two factors when assessing whether a plaintiff is substantially associated with defendant: (1) the plaintiff's use of the defendant's name, logo, and trademark; and (2) the percentage of the plaintiff's sales of defendant's products. [citation omitted] A plaintiff must derive at least one half of its total sales or gross profits from sales of the defendant's products in order for a court to find a substantial association between the parties.

In another recent Connecticut case, a U.S. District Court held that an insurance agent's relationship with the insurance company was a "franchise" under the meaning of the CFA for purposes of the company's motion to dismiss. Thus, the agent's claims that the company violated the CFA by terminating the parties' agent agreement without adequate notice and "good cause" were allowed to proceed.*

A further discussion of the 50% test to prove "substantial association" and what elements of business activities will be taken into account by the courts in determining whether or not the relationship is a franchise under Connecticut law may be found here.

**Garbinski v. Nationwide Mutual Insurance Co*., DC Conn., Business Franchise Guide ¶14,655

Awuah Continued: Are Franchisees Independent Contractors or Employees?

Two Recent Decisions

The Ninth Circuit Court of Appeals recently reversed a federal district court decision holding it lacked jurisdiction to decide whether drivers for a franchisor of airport passenger shuttle businesses were employees or independent contractors under California law.* The District Court's ruling that such jurisdiction would hinder or interfere with the California Public Utilities Commission's exercise of regulatory authority over the relationship between the drivers and the franchisor was rejected and remanded.

Also, in *Jason Roberts v. Administrator Unemployment Compensation*,** after losing throughout the unemployment compensation administrative process on the issue of whether a concrete artisan who had been an employee and then became a licensed dealer was still an employee for purposes of unemployment insurance, the dealer filed a court proceeding. It

We've Moved!

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

3 Park Avenue
15th Floor
New York, NY 10016

Bruce S. Schaeffer, Editor
Bruce@FranchiseValuations.com
212.689.0400

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

lost again and then brought an appeal arguing that, in fact, the relationship was a "franchise" under the CFA and, therefore, it was exempt from the ABC test to determine whether or not the worker was an "employee."***

The court did not agree.

> The plaintiff contends, however, that had the board applied §42-133e (b) to the facts found, it would have determined that a franchise agreement existed and, furthermore, that the ABC test would have been inapplicable. Specifically, the plaintiff argues that a finding that a franchise agreement exists between the parties exempts the relationship from the purview of the act. The plaintiff neither cites, nor does our research reveal, any legal support for this argument. On the basis of our review of the act, we find nothing that elucidates the question of whether the existence of a franchise agreement precludes application of the ABC test. The act makes no express exemption for franchises, nor can we imply an exemption, particularly when, as is the case here, the legislature has created numerous exemptions from coverage under the act.

**Kairy v. SuperShuttle Int'l*, CA-9, CCH Business Franchise Guide ¶14,707
**127 ConnApp 780, 15 A3d 1145, CCH Business Franchise Guide ¶14,577 (April 12, 2011)
***The ABC test is conjunctive; failure to satisfy any one of the prongs will render the enterprise subject to the act... . Under the ABC test, an individual will not be considered an employee if: [A] such individual has been and will continue to be free from control and direction in connection with the performance of such service, both under his contract for the performance of service and in fact; and [B] such service is performed either outside the usual course of the business for which the service is performed or is performed outside of all the places of business of the enterprise for which the service is performed; and [C] such individual is customarily engaged in an independently established trade, occupation, profession or business of the same nature as that involved in the service performed... ." (Citation omitted; emphasis in original)

Cyber Security: Had a Good Steak Lately?

*Skimmers at the Best Steak Houses**

Do you like prime beef or creamed spinach? Do you have an American Express Gold Card or Black Card? Have you eaten at Smith & Wollensky's, the Capital Grille, JoJo and Wolfgang's Steakhouse in Manhattan, Morton's restaurant in Stamford, Conn., or the Bicycle Club in Englewood Cliffs, N.J., recently?

If so, you'd better check your credit card bills. According to the Manhattan District Attorney Cyrus Vance (it still seems strange to see a name other than Robert Morgenthau holding that office), a whole crew of waiters and crooks got access to primo credit cards using little three inch "skimmers" that some of them carried in their pockets to grab the electronic information from patrons' credit cards before they were swiped for payment by the restaurants. The data was then sent to some sophisticated criminals who made new (phony) credit cards and had mules quickly go to high end retailers to spend the hell out of them.

Most of the gang were arrested, but the one member of the criminal crew who is still on the loose is quite interesting. He is 51-year-old Gregory Portacio who served as a "jack of all trades" for the ring, distributing the forged credit cards, advising on store security and fencing the stolen goods for 10 cents on the dollar. Portacio's background: as a 20-year-old, he was convicted in the 1980 murder of a Queens housewife who was dragged to death alongside his vehicle when, authorities charge, he was trying to steal a necklace that wouldn't break. Mr. Portacio was also later convicted of a

sexual assault on a Brooklyn woman. "After several stints in prison," New York City Police Commissioner Raymond Kelly said, "Portacio turned to credit card fraud."

The moral of the story: Be careful out there. Use cyber security practices with your computers, your BlackBerrys and iPhones and with your credit cards. Portacio is still at large.

*As reported in *The Wall St. Journal*, "Steakhouse Staff Allegedly Took Cut."