



# The Franchise Valuations Reporter

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Welcome to our newsletter focusing on issues unique to our practice that we don't think are addressed anywhere else: valuation and damages, cyber crime, expert testimony and tax nexus – the issues we know best, that matter to our clients - franchise executives and the consultants, attorneys and other professionals who advise them. We hope you find information that warns, informs and benefits you.

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## **WARNING: GOODWILL WRITE-DOWNS; IMPAIRMENT OF INTANGIBLE PROPERTY**

Franchise companies (Zors and Zees) are required to measure the value of IP on their books, at least annually, to see if it has been impaired under FASB 141 and 142. If it has – as has the “goodwill” booked on practically every franchise company balance sheet in the world in light of the current financial meltdown – then the company will have to do an IP valuation and write down the intangible assets that have lost value on both their balance sheets and income statements. This will particularly affect companies that have acquired franchisors; and all franchisees and dealerships that have acquired others. Auto and other dealerships

that expanded since the 1990s will be most heavily impacted. For example Bloomberg News recently reported that European companies may be forced to write down \$214 billion of goodwill after overpaying for takeovers this decade and noted that Alcatel-Lucent and Telecom Italia SpA were among 28 companies in the Dow Jones Stoxx 600 Index whose market value dropped below the so-called goodwill, listed on their balance sheet. Similar situations are extant in the U.S. See:

[http://www.bloomberg.com/apps/news?pid=20601109&sid=a\\_0VJI.Co.iA&refer=home](http://www.bloomberg.com/apps/news?pid=20601109&sid=a_0VJI.Co.iA&refer=home)

## Valuation Decisions

### Valuation in Divorce

In the ironically captioned divorce case of *Fickle v. Fickle*, 2008 WL 3843846 (Tenn. App. Aug. 19, 2008) the Tennessee Court of Appeals affirmed the valuation of a business

based solely on the value of its underlying real estate - without enhancement for potential development - as Mr. Fickle was deemed unable to capitalize such development; and without any discounts for

built-in capital gains or lack of marketability. This is further proof of the notion that valuing businesses in divorce proceedings differs substantially from arriving at “fair market value” in other contexts. See also *Bertuca v. Bertuca*, (November 14, 2007) [CCH Business Franchise Guide ¶13,876](#) (and Franchise Regulation and Damages Section 20.02K Valuations in Divorce) also holding that “fair market value” was not the standard to be applied in valuing several McDonald’s franchises in a divorce proceeding. However, this area is far from consistent. In the case of *In re Marriage of Thornhill*, 2008 WL 3877223 (Colo. App. Aug. 21, 2008) the Colorado Court of Appeals held that a discount for lack of marketability should be applied in a divorce situation rejecting the wife’s contention that the discount was inappropriate as a matter of law in divorce situations as it is in dissenting shareholder situations. The Court said that the term “fair value” (the dissenting shareholder standard) was not used in the divorce statute and the failure to apply the discount could penalize the spouse that owned the business.

### No Opposing Expert

As we’ve pointed out in the past (CCH Treatise “Franchise Regulation and Damages”) it is very risky for one side to allow an opposing expert to go un-rebutted. In the case of *Ebner v. Ebner*, 2008 WL 4562516 (Ohio App. 5 Dist. October 6, 2008) the court accepted a business valuation, notwithstanding a recognized difficulty in obtaining data, when it was the only valuation in evidence. And in a situation where both sides fail to present evidence, the court may just punt. In *Smialek v. Smialek*, 2008 WL 3161859 (Ky. App. Aug. 8, 2008) the Kentucky Court of Appeals affirmed a lower court decision to simply put no value at all on a marital business where neither party engaged an expert to offer an appraisal.

### “Fair Value” in Dissenting Shareholder Action

In *Holiday Medical Center, Inc. v. Weisman*, 2008 WL 2677504 (N.J. Super. A.D. July 10, 2008) the appellate court affirmed the right of a lower court to consider valuing the enterprise as a going concern but reversed in part to determine why the actual liquidation value of the business was not the controlling factor.

## Damages Decisions

### Lost Profits

In *High Performance Learning Inc. v. Aspen Technology*, 2008 WL 3861993 (Mass. Ct. App. Aug. 21, 2008), the Massachusetts Court of Appeals affirmed a lower court’s calculation of lost profits denying defendant’s claim that the plaintiff’s profit margin was excessive, holding that a damage award was not required to be reduced because a business enjoys a healthy profit margin.

### Consequential Damages

In *Llamas Group v. Huron Valley Schools*, 2008 WL 3349076 (Mich. App. Aug. 2, 2008), the Michigan Court of Appeals found that where one party’s breach of contract results in the other’s loss of a certification, in this case a contractor’s bond, the breaching party is liable for such resulting consequential damages.

# CyberCrime

## Hard Times Drive Geeks to Crimes: Data Breaches in the US Are Up More Than 50% Affecting the Records of More Than 35.7 Million People

As reported in the *Washington Post*, Identity Theft Resource Center of San Diego announced that 656 breaches were reported in 2008, up from 446 in the previous year. Nearly 37 percent of the breaches occurred at businesses. "This may be reflective of the economy, or the fact that there are more organized crime rings going after company information using insiders," said Linda Foley, the center's co-founder. "As companies become more stringent with protecting against hackers, insider theft is becoming more prevalent."

Amir Orad, chief marketing officer for Actimize, a fraud prevention company in New York, said "We recently had a mid-sized institution in the U.S. that wanted to do a test of technology to help them monitor employee activities, and that ended up with two employees being arrested. That's the type of outcome we did not see two years ago. I'm certain that some of the broad industry interest in this threat is the result of greater awareness of the problem and an active investment in catching bad guys, but I'm also sure that some of the incidents are the result of employees feeling the pinch from the recession."

## Scammers Replace Credit Card Readers

Late last year a scheme was uncovered in Ireland which has undoubtedly migrated to the US. Cyber crooks, posing as bank service personnel, replaced credit card

readers in retailers' stores with their own devices enabling them to steal data from over 100,000 debit and credit cards. However, ATMs that use the "chip and pin" system may be safe as those systems automatically reject a card that does not have the required chip and so far the criminals have not figured out how to duplicate those chips.

## YOU SHOULD BE FRIGHTENED! Links to Recent Articles on Cyber-Crime

Heartland Payment Systems Inc. said that cyber criminals compromised its computer network, gaining access to customer information associated with the 100 million card transactions it handles each month.  
<http://online.wsj.com/article/SB123249174099899837.html?mod=testMod>

Frequency and Severity of Data Breaches Have Led to Changes in How Companies Are Underwriting the Cyber Crime Risk for Insurance Purposes  
<https://plusweb.org/index.cfm/p/Journal.Article/articleID/100061.htm>

## Worm Infects Millions of Computers Worldwide

<http://www.nytimes.com/2009/01/23/technology/internet/23worm.html?hp>

## FTC May require new Identity Theft Programs

<http://www.franchise.org/Franchise-News-Detail.aspx?id=43488#two>

# Daubert Decisions

In *Taylor, Bean & Whitaker Mortgage Corp. v. GMAC Mortgage Corp.*, 2008 WL 3819752 (M.D. Fla. Aug. 12, 2008) a US District Court held that data provided by a third party (the Mortgage Industry Advisory Corp. in the form of MAIC indices) that the expert relied on and disclosed in his report was admissible under FRE 703 as the type of data customarily relied on by experts (and not deemed reliance on undisclosed experts). Thus a *Daubert* challenge was denied and the expert, a CPA, was allowed to testify with any disputed facts, data or reliability going to weight rather than admissibility.

CCH recently published a study prepared by Franchise Valuations Ltd. on expert testimony, focusing on *Daubert* and *Frye* challenges to the testimony of financial experts for the period 2004 through 2008. Copies of the study are available on request to 212.689-0400. Also the American Antitrust Institute has posted on its website a new working paper on *Daubert* challenges to antitrust experts at <http://www.antitrustinstitute.org/>. And PricewaterhouseCoopers also publishes a compendium of *Daubert* cases.

# Nexus Notes

## **Alabama --Corporate Income Tax: U.S. Supreme Court Asked to Hear Add-back Challenge**

A taxpayer, a wholly owned subsidiary of Wrangler Jeans, has asked the U.S. Supreme Court to overturn an Alabama statute requiring that certain royalty payments to related parties be added back to income and therefore, subject to the state's corporate income tax. At present, approximately 20 states have some version of an add-back statute. In its petition for certiorari, the taxpayer asked the U.S. Supreme Court to consider two questions: (1) whether Alabama's add-back statute discriminates against interstate commerce in violation of the Commerce Clause by denying a deduction for ordinary business expenses because they are paid to corporations located outside Alabama in a state that has chosen not to tax those payments, and (2) whether the statute violates the federal Due Process

and Commerce Clauses by denying a deduction for ordinary business expenses paid to corporations located outside Alabama based on the tax policy of the state in which those corporations are located.

## **New York --Sales and Use Tax: Amazon's Challenge to New Provision Taxing Internet Sales Dismissed**

A New York trial court, on January 15, 2009, dismissed a lawsuit filed by Amazon.com challenging a previously enacted New York statute that requires out-of-state Internet retailers with no physical presence in New York to collect New York sales and use taxes. Amazon sought a declaratory judgment that the new statutory provision was invalid, illegal, and unconstitutional (facially and as applied to Amazon) on the grounds that it violated the

Commerce Clause of the U.S. Constitution and the Due Process and Equal Protection Clauses of the U.S. and New York Constitutions. The court held that even accepting all the facts alleged by Amazon to be true, there was no basis upon which it could prevail and Amazon's complaint was dismissed in its entirety for failure to state a cause of action.

**Massachusetts --Corporate Income Tax: Economic Nexus Standard Upheld**

From the “When Will They Ever Learn?” files: the Massachusetts Supreme Judicial

Court has upheld the imposition of the financial institution excise tax and the corporate excise tax in two cases involving taxpayers that did not have a physical presence in Massachusetts. The cases were *Capital One Bank v. Commissioner of Revenue* and *Geoffrey, Inc. v. Commissioner of Revenue*, Massachusetts Supreme Judicial Court, Nos. SJC-10105 and SJC-10106, January 8, 2009. Do you believe they are still litigating *Geoffrey* more than 16 years after the original South Carolina decision (which has been followed by NC, NJ etc.)?

The information provided in this newsletter is for informational purposes only and should not be 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 and can be reached at 404 Park Avenue South, New York, NY 10016. 212.689-0400 or [www.franchisevaluations.com](http://www.franchisevaluations.com) and [www.ftm.biz](http://www.ftm.biz)