



## O Canada!

I will be speaking on franchise valuations at two upcoming franchise law events in Canada along with Attorney Ned Levitt.

On February 2nd we will be at the Canadian Franchise Association Legal Day in Toronto at The Old Mill.

We are also speaking at the CFA National Convention scheduled for April 1-3, 2012, in Niagara Falls at the Sheraton on the Falls Hotel.

## 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



## Terminated Hotel Franchises: Liquidated Damages or Lost Future Royalties?

### *In Days Inn, Court Confirms Strict Limits on Damages Claims*

The case of *Days Inn Worldwide vs. Investment Properties of Brooklyn\** has again raised the issue of hotel franchisors' rights to lost future royalties - in this case in the context of a default judgment. In *Days Inn*, the franchisee defaulted three years into a 15 year term by selling the property after failing quality inspections and not paying royalties for the last several months of his hotel operation.

The franchisor sued, won a default and then claimed the remaining twelve years of royalties, discounted to present value, as damages. The judge objected to the number of years claimed, specifically referencing other case law holding that hotel franchisors were only allowed to collect an amount equal to the royalties forsaken during the period it would take them to re-franchise the area. Based on evidence provided by the franchisors, these cases generally limited franchisors to damages equal to 2 years of royalties.

In *Days Inn*, the Court held, inter alia:

*This Court disagrees with DIW's method of calculating lost future profits, and finds that these damages are too remote, uncertain, and speculative to be recoverable. . .*

There is no support underlying DIW's contention that it can estimate, with any reasonable degree of certainty, what these revenues would be over the remaining twelve years of the term of the License Agreement. . .

Here, DIW has done no more than have its "Director of Contracts Compliance" do the arithmetic involved in projecting out \$279 per day for 4,505 days and then present valuing the result. It *has provided this Court with no proof regarding: competitive market conditions in the relevant market, its own expansion or contraction in the relevant market since 2007, its historical accuracy in forecasting future revenue streams from franchised hotels, or its ability to forecast economic trends. . .*

In other contexts, courts have concluded that a two-year time period is a reasonable measure of a franchisor's damages for breach of a hotel franchise agreement because that is the average time it takes a franchisor to find a replacement franchisee. . .

*By allowing DIW to obtain a judgment for the twelve-plus-year-stream-of-income - the judgment sought by DIW - the Court would be encouraging DIW to commit economic waste by putting forth no efforts to mitigate its damages.*

[Emphasis in the original.]

As I have made clear in an [earlier newsletter](#) and in my treatise (Section 8.02C.6 discussing the difference between liquidated damages and lost future royalties as shown by the *Radisson* and *Sealy* cases) the allowed two years of losses are actually more akin to liquidated damages although measured by lost future royalties.

\*(DC MN) August 26, 2011, CCH Business Franchise Guide ¶14,756.

## An Uptick in New York State Franchise Registrations

## 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](mailto:Henry@FTRM.biz) or call (212) 689-0400

## Links to Recent Articles on Cyber Crime



[Hacking Seen as Rising Risk With Car Electronics](#)

[Hackers-for-Hire Are Easy to Find](#)

### DISCLAIMER

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.

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Assistant Attorney General Joseph Puntoro, speaking to the New York Bar Association, reported that his office received 253 new franchise registrations in 2011 and 1,144 renewals.

Mr. Puntoro also advised that unregistered franchisors may be allowed to exhibit at the June 2012 International Franchise Expo provided they obtain an exemption by submitting a [form](#) which is available on the NYAG website.

## Attorneys' Fees: A Question of Style

### *A Journey From Jonathan Swift to the Supreme Court*

Another interesting aspect of the *Days Inn* case was the discussion by Magistrate Judge Keyes of the proper nomenclature for the money that lawyers get paid. His footnote commentary included the following observations:

In reviewing Plaintiff's request for "attorneys' fees" . . . , this Court stumbled into a style and usage skirmish that is reminiscent of the egg-cracking dispute between Lilliput and Blefuscu. In *Gulliver's Travels*, the two nations warred over whether the big end or the little end of the egg should be uppermost when the egg was eaten. Likewise, in the federal reporters, numerous courts have struggled to resolve the "stylistic dilemma of whether to use 'attorney fees,' 'attorneys fees,' 'attorney's fees,' or 'attorneys' fees'...." ("The court must first decide a threshold issue of style. Is Lundy's petition best read as a request for: (1) an 'attorney fee;' or his (2) 'attorney fees;' (3) 'attorney's fee;' (4) 'attorney's fees;' (5) 'attorneys fee;' (6) 'attorneys fees;' (7) 'attorneys' fee;' (8) 'attorneys' fees;' ... ?"). [Citations omitted.]

After "survey[ing] the landscape," some courts have adopted "attorney fees" as an acceptable, albeit "inelegant" form. Others courts have opted for "attorney's fees," following the Supreme Court's Manual of Style. Numerous other courts have used the plural possessive "attorneys' fees" which. . . "is just as good, and some may even prefer that term in contexts in which there is clearly more than one attorney referred to." Notably, courts in the Eighth Circuit have used all these forms somewhat interchangeably. For uniformity's sake, this Court will adhere to the Supreme Court Style Manual's use of "attorney's fees." [Citations omitted.]

### *Prevailing Rates*

In another recent attorney's fees case, a court found rates in Sacramento, California, of \$75 per hour for paralegals, \$150 per hour for associates and \$250 per hour for partners in a law firm to be reasonable under a "prevailing party" provision in a franchise agreement and so were approved by the court.\*

\**Passport Health v TravelMed*, (DC ED CA) December 14, 2011, CCH Business Franchise Guide ¶14,750.

## Tax Planning: How Long will Dividends Be Taxed As Capital Gains?

### *A Rate Increase May Be Coming*

There is a sunset provision (currently) on taxing dividends at capital gains rates. Franchise companies with accumulated earnings and profits should consider making substantial distributions at the favorable rates if they don't think they will last past their current expiration of December 31, 2012.

## ***Valuations and Damages: Discount Rate***

### ***Revised Equity Risk Premium (ERP)***

As most practitioners know, in order to calculate damages in the nature of lost franchise fees, lost profits or loss of business value, the application of a discount rate is required to reduce the future cash flows to a net present value.

In computing a weighted average cost of capital (WACC) to use as the discount rate, many valuation specialists start with a risk-free rate and make adjustments for certain conditions. According to the BV Wire, Duff & Phelps, a major source of business valuation data, has revised its estimation for the Equity Risk Premium from 6% down to 5.5% as of January 15, 2012. Their reasons:

- The unemployment rate is down;
- Non-farm payrolls have been ticking up;
- Corporate credit spreads have diminished; and
- Consumer sentiment is rising by some standards.

## **IRS Alerts**

### ***Service Advises Taxpayers About Risk of Identity Theft***

The IRS has issued [fact sheets, forms and other information](#) to alert taxpayers to the risk of identity theft involving their tax records. According to the IRS, identity thieves use a legitimate taxpayer's identity to file a fraudulent tax return and claim a refund. Generally, this is done early in the filing season. A taxpayer may be unaware that his or her identity has been stolen until they file a return later in the filing season and discover that two returns have been filed using the same SSN.

Taxpayers who believe they may be at risk should contact the Service's Identity Protection Specialized Unit at (800) 908-4490 and should consider filing Form 14039, Identity Theft Affidavit, to indicate whether they are a victim of identity theft and whether their tax records or account may be at risk. The Service also reminded taxpayers that it does not initiate contact with taxpayers by email to request personal or financial information and asks that taxpayers report suspicious emails to them.

### ***Fifty Percent Bonus Depreciation Available in 2008 and 2009 for Certain Restaurant Properties***

According to CCH, the IRS Chief Counsel has concluded that qualified restaurant property and qualified retail improvement property are eligible for fifty percent bonus depreciation in both 2008 and 2009. Moreover, taxpayers are not required to take any special steps to claim bonus depreciation for these items. The key factor, the Chief Counsel determined, was that property that also is qualified leasehold improvement property qualifies for bonus depreciation, even if the restaurant or retail property would not qualify by itself.