



The Franchise Valuations Reporter



We're Moving!

In early August, Franchise Valuations Ltd. will move 5 blocks north to new offices at:

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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



Lost Profits in Franchise Disputes: The Discounted Cash Flow Method

Proving Claims and Measuring Damages

When we are brought in to provide consulting or testifying expertise involving money damages in a dispute between a franchisor and franchisee, our first order of business is to determine what claims are made and how damages are measured. In my book, *Franchise Regulation and Damages*, I devote several chapters to these topics. Last month I offered a [primer](#) on the various types of disputes and how damages are measured.

In this issue, we focus on how to make and prove a case for lost profits.

Evidence must be introduced sufficient to estimate lost profits with some reasonable degree of certainty. Anticipated profits that are remote, uncertain, or speculative are not recoverable. Nonetheless, any claim for lost profits is, by definition, based on a prediction of future events and is necessarily an estimate. But a plaintiff's proof must provide at a minimum the following data: (1) the quantity of product or services on which lost profits are alleged; (2) the price at which such product or services would be sold; (3) the amount of time it would take to consummate the sales; (4) the expenses that would be incurred in accomplishing the sales over time; and (5) the means to discount (that is, reduce to present value) the profits that would have been realized from the sales in future years.

The plaintiff carries the double burden of proving the amount of damages with reasonable certainty and the cause of the damages. And in some jurisdictions the plaintiff must not only show the actual losses suffered but also eliminate possible external causes of its business failure, such as a nationwide economic recession.

Discounted Cash Flow Method

Many methods of proving lost profits have received court approval such as calculations of damages based on the amount of sales made by a competitor and the amount of plaintiff's own prior sales. But the most common method of proving lost profits uses the Discounted Cash Flow (DCF) method - a concept taken from business valuations. Generally the DCF method follows three steps:

1. an estimation of net cash flows that the firm will generate over a projected period;
2. computation of a terminal or residual value equal to the future value of the firm's cash flows beyond the projection period; and
3. the application of a discount rate (estimated cost of capital) to reduce to present value the projected net cash flows and the estimated terminal or residual value.

[Click here for more on lost profits and the discounted cash flow method.](#)

Franchise Valuations Ltd. provides consulting and testifying expertise for money damages. Readers are invited to contact us at (212) 689.0400 or Bruce@FranchiseValuations.com to see if a damages or valuation report

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.

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

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.

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

is appropriate for your situation.

To see a description, table of contents, and ordering information for *Franchise Regulations and Damages*, [follow this link](#).

SBA Loan Failure Data

BlueMauMau Posts Fascinating SBA Study

The SBA released data on 584 franchise systems. Contrary to all the happy talk about franchises being "idiot proof," it shows astonishingly high failure rates, including:

- 58 systems with loan failure rates of 50% or more (as high as 94.12% for Wings-N-Things);
- 159 systems with loan failure rates of one-third or more, including many well known brands;
- 28 systems with average loan disbursements of more than \$100,000;
- An average charge-off percentage of just over 8% (and many much worse) which means a lot of franchisees who went under lost far more than their business investment.

To see spreadsheets with the [100 worst-performing](#) and [100 best-performing brands](#), click here. Special thanks to BlueMauMau.org for providing the very useful information to the on-line population.

Expert Witness Excluded for Offering Legal Opinion

Trying to Get a Grammarian Admitted as an Expert on the Meaning of Contractual Term: Were They Serious?

The testimony of an **expert grammarian** retained by a franchisor of portable storage businesses to address the grammatical nuances of a sentence in a franchise agreement at issue in the franchisor's dispute with three franchisees was ruled inadmissible under Florida law because it was the court's job alone to interpret and give meaning to the terms of a contract. Thus, the franchisees' motion to bar the introduction of the expert's testimony was granted.

The expert offered his opinion on the legal effect of the contractual provision at issue: whether the term "Net Sales" included "monies received as part of the cross country move program" for purposes of calculating the royalties owed by the franchisees to the franchisor. In addition to analyzing the term "Net Sales" based on punctuation and syntax, the expert construed the language of the agreements by applying the cannon of contract construction known as *noscitur a sociis* (i.e., "It is known from its associates. . . The meaning of a word is or may be known from the accompanying words." Black's Law Dictionary).

The expert proffered was Ross Guberman, the founder and president of *Legal Writing Pro*, an advanced legal-writing training and consulting firm. He claimed to have conducted more than a thousand programs on three continents for many of the largest and most prestigious law firms and for dozens of state and federal agencies and bar associations. Mr. Guberman is also a Professorial Lecturer in Law at The George Washington University Law School, where he teaches an advanced seminar on drafting and writing strategy. Some of his eminent writings are listed as:

- How Summer Associates Can Write Better, *Legal Times*
- Helping Associates Improve Their Writing Skills, *Law Practice*
- Not the Time for an Opus, *Legal Times*
- Why Johnny, Esq., Can't Write: Ten Causes and Ten Solutions, *PDQ*
- Home Is Where the Heart Is, *Legal Affairs*

Nonetheless, he was rejected.

Expert Witnesses

No Protection of Draft Expert Reports in Tax Court

Amendments to the Federal Rules of Civil Procedure Rule 26, which became effective in late 2010 generally prevent the discovery of experts' draft reports. But a recent case, *U.S. v. Richey*, may cloud the protection in Tax court proceedings against the IRS which has broad power to subpoena an appraiser's work files (presumably including draft reports) during the investigation of a claim, even after the taxpayer has paid the deficiency - and especially if the taxpayer is still considering litigation.

A question has arisen as to whether *Richey* effectively opened a "back door" for the IRS to procure an appraiser's draft reports during claims investigations. The issue came up at a recent ASA National IRS Symposium in Los Angeles, and IRS representatives have promised to research the issue and respond. It should be noted that the U.S. Tax Court has not adopted FRCP 26. So for now, attorneys and appraisers should assume that all of their work on tax engagements may be subject to disclosure. In those cases it may be better to go back to the good old ways and consider forum-sharing software such as Cisco's Webex that allows meeting participants to view and discuss draft documents on a computer/video screen.

PwC Updates Study on Daubert Challenges to Financial Experts

As reported by BVWire, PricewaterhouseCoopers has just released its study, "*Daubert* Challenges to Financial Experts: An 11-year Study of Trends and Outcomes," covering federal cases since the U.S. Supreme Court's 1999 *Kumho Tire* decision expanded *Daubert's* reach to financial experts. Highlights of this year's report include:

- This past year (2010) saw the most challenges and the second highest exclusion rate for all expert witnesses during the past 11 years (2000-2010).
- During that time, plaintiffs' financial experts were challenged more frequently than defense experts, but courts ultimately excluded only 45% of plaintiffs' experts vs. 48% of defense experts.
- Challenges to economists, accountants, and appraisers accounted for 55% of all challenges to financial experts (perhaps because they are the most frequently engaged group). Although attacked more often, this group was less likely to succumb to a *Daubert* review (42%, 40%, and 34%, respectively) than other financial experts (53% excluded).
- For the 11th consecutive year, lack of reliability was the top reason that courts excluded financial experts (7 out of 10 cases), most often due to the lack of valid data or the lack of a valid analytical framework for the data.
- For the first time since 2001, the number of challenges to

financial experts fell (by 11%); however, the success rate rose to its highest level in six years: in 2010, courts excluded 50% of all financial experts, compared to the 11-year average of 45%.

The PwC study highlights the continuing trend of using *Daubert* as a pre-trial weapon to attack economic experts and evidence in damages and other cases, often leading to dismissal.

ESI and E-Discovery: Mynix, Micron Raise Rambus Shredding Claim

Lawsuit on Shredding As a Litigation Strategy Under Way

In a suit claiming \$4.3 billion in damages, Plaintiffs Hynix and Micron want jurors to know Micron shredded documents as a "litigation strategy" based on a federal appeals court's ruling in May 2011 that Rambus destroyed documents relevant to patent cases against Hynix and Micron. The case has taken more than seven years to reach trial. The plaintiffs claim the "raison d'etre for Rambus's document retention policy was to further Rambus's litigation strategy by frustrating the fact-finding efforts of parties adverse to Rambus," as the plaintiffs wrote in court filings.

For more on this case, go to "[Hynix, Micron Raise Rambus Shredding Claims as Trial Begins](#)," by Joel Rosenblatt.

For technical and computer issues related to ESI and E-Discovery, talk to Henry Chan at (212) 689-0400 or e-mail him at Henry@FTRM.biz.

CyberCrime

Malware Stats: As Many As One of Every 10 Downloads From the Web Includes Harmful programs.

Last year, the computer security experts at Symantec discovered 286 million new and unique threats from malicious software, or about nine per second, up from 240 million in 2009. The company said that the amount of harmful software in the world passed the amount of beneficial software in 2007, and as many as one of every 10 downloads from the Web includes harmful programs.

Unlike past blitzes of spam with clunky sales pitches, today's attacks often rely on a familiar face and are extremely difficult to stop. In a practice known as spear phishing, hackers send e-mails that seem to come from co-workers or friends and include attachments that can release malware to steal passwords and other sensitive data. In other cases, malware can be activated when a Weblink is clicked.

For a review of your security procedures and the security policies provided in your Operating Manuals, contact Henry Chan at (212) 689-0400 or Henry@FTRM.biz.

Here are some links to recent articles on cybercrime:

[Hackers Attack Another Sony Network](#)

[Stolen Data Is Tracked To Hacking at Lockheed](#)

[Hackers Attack Nintendo](#)

[Cyber Cops Stymied By Anonymous Hackers](#)

[Citi Takes Heat Over Hack Attack](#)

[Deploying New Tools to Stop the Hackers](#)

[Sega Says Hackers Stole Data of 1.29 Million Users](#)