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The Franchise Valuations Reporter

Featured Expert: Peter R. Silverman

This issue's lead article was inspired by Peter R. Silverman, a Partner in Shumaker, Loop & Kendrick, LLP, in Toledo, Ohio. A member of the firm's Franchise and Distribution practice group, Peter has been an active arbitrator since 1986 and a mediator since 1990. He is a member of the AAA's Large, Complex Case Arbitration Panel. He teaches seminars nationwide and writes widely on alternative dispute resolution.

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Three Ways to Lower the Costs of Dispute Resolution - Maybe

Peter Silverman - a Well Respected Neutral

In our lead article this month we feature a letter on Planned Early Dispute Resolution ("PEDR") by Peter R. Silverman, of Shumaker, Loop & Kendrick in Toledo, Ohio. Peter, a member of Shumaker's Franchise and Distribution practice group, describes PEDR as a way to use all tools available to resolve franchise disputes "quicker, cheaper, and better." With almost 25 years' experience acting as a neutral and writing about the mediation process, Peter believes the use of PEDR in mediation will enhance outcomes for all parties.

Peter recently outlined nine steps in the process of applying PEDR principles including the following:

> "At the earliest possible point in a dispute that won't resolve quickly and cooperatively, the parties would retain a PEDR neutral. Ideally, this would occur before either files suit or arbitration so that the dispute wouldn't need to be disclosed . . . and it can be resolved confidentially. . .
>
> "The PEDR neutral would sound out the parties by phone to determine whether both are at a point where they stand a reasonable chance to promptly and successfully negotiate resolution. This generally can happen if each side has investigated sufficient facts from its own client; has sufficient facts from the other side; has thought through the legal, equitable, and leverage issues in the case; and has a realistic handle on the time, cost, and risks of litigation. I'll call this the *essential information*. . . "

Throughout, the role of the neutral is to try to facilitate a settlement using "methods ranging from suggesting direct negotiation with recommended guidelines; phone discussions coupled with exchange of offers; traditional mediation; or a hybrid approach."

If the parties are unable to reach resolution, there is still a role for the PEDR neutral by helping to "structure further information exchanges and discussions before either party files suit or arbitration," or helping to "structure the lawsuit or arbitration to allow for it to be handled as quickly and economically as possible."

In the current litigious atmosphere where it seems time and costs are sometimes in excess of the original dispute, Peter's approach is worth considering. His letter includes a link to the ABA's PEDR booklet as well references to his extensive writings on the subject of mediation.

Pre-Litigation Damages Assessments

Conflicts occur in the course of all business relationships and in franchise, dealership, and distributorship disputes damages are an essential element which must be proven. Reviewing this issue should be one of the first steps in any dispute - preferably before issue is joined - yet litigators often share a common pitfall of paying substantial attention to liability issues but failing to

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Franchise Regulation and Damages, the only treatise that covers valuations of franchises, is updated 3 times a year.

For more details, to see a Table of

address damages adequately.[1]

Identification of all damages issues is absolutely necessary in determining the direction, the risks, and the costs of litigation. The question of whether or not a party has "substantial evidence" to prove damages is often an issue as well. This early exercise should dictate the course of discovery, motion practice and the trial and prove of maximum benefit to the client.[2] Franchise Valuations has years of experience in providing such assessments.

Judge Laro's Hot Tub Suggestion

U.S. Tax Court Judge David Laro recently suggested a possible time-saving and cost-saving method to deal with conflicting expert opinions - go "hot tubbing". This was not a respected jurist proposing a sixties redux activity for time warped hippies; rather he was talking about an alternative method of giving expert testimony more formally known as "concurrent witness testimony". Apparently it works in other countries. In Judge Laro's example, he sits at a table with the experts at his sides. The judge opens a conversation, asks questions of the experts, and invites them to pursue their own dialogue without the lawyers interrupting. The theory is that without being attacked over their credibility, they are able to have a collegial discussion about their work on the case. He believes this technique can lead to a more equitable outcome. In effect, he seeks to take the adversarial nature out of the adversarial process. I, for one, am skeptical of such kumbaya outcomes.

Judge Laro is the author of the seminal *Mandelbaum*[3] decision, where he made clear that he is really not impressed by the opinions of experts. For example:

> d. Court's View on Experts[4]
>
> We are unpersuaded by Mallarkey's ***[can you imagine an expert named Mallarkey?]*** analysis and conclusions. . .We are further troubled by the fact that Mallarkey relied primarily (if not entirely) on the restricted stock studies to support his conclusion of a 30-percent discount rate. Because the restricted stock studies analyzed only "restricted stock", the holding period of the securities studied was approximately 2 years. Mallarkey has not supported such a short holding period . . .
>
> We are no more persuaded by Grabowski's analysis or conclusions. First, Grabowski's determination of fair market value focuses only on a hypothetical willing buyer and does not reflect the view of a hypothetical willing seller. . . He also did not consider whether such a seller would sell his or her Big M stock for at least 70 percent less than its freely traded value. We find incredible the proposition that any shareholder of Big M would be willing to sell his or her stock at such a large discount. . . Second, we give the Shareholders' Agreements less weight than Grabowski . . . Third, we are troubled by the fact that Grabowski failed to consider hypothetical willing buyers who are genuine representatives of prospective investors in Big M . . . Fourth, we have problems with many of the assumptions that Grabowski relied on to determine the marketability discount.

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[1]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") cited by Rose, Fredrick W., Substantive and Procedural Aspects of Assessing Damages in Commercial Litigation (self published 2004).
[2]Manual for Complex Litigation, Op cit. §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

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small to justify the cost of pursuing the litigation") cited by Rose, Fredrick W., Substantive and Procedural Aspects of Assessing Damages in Commercial Litigation (self published 2004).
[3] 69 T.C.M. 2852 (1995)
[4]Ibid at p. 2866

Attorney-Client Privilege: Be Careful

Tax Court Finds Good-Faith/State-Of-Mind Penalty Defense Waives Attorney-Client Privilege

In a recent Tax Court case[1] which focused on Code Sec. 6662 accuracy-related penalties, the IRS determined that the adjustments of partnership items were attributable to a tax shelter (Son of BOSS) and the underpayments of tax resulting from the adjustments of partnership items were attributable to a substantial understatement of income tax, a gross valuation misstatement, or negligence or disregard of rules and regulations. Taxpayers' arguments in support of their affirmative defenses of good faith and state of mind as to the penalties put their legal knowledge, understanding and belief at issue. As a result, the Tax Court held that the taxpayers would sacrifice the attorney-client privilege to withhold the contents of opinion letters if they persisted in that defense. Mark Allison, member, Caplin & Drysdale, Chartered, New York, told CCH. "The Tax Court has now made it clear, if it was at all ambiguous previously, that once the door is opened by the taxpayer the court will open it all the way."

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[1] *Ad Investment 2000 Fund LLC*, 142 TC No. 13

Nexus: No Use Tax Due for Cloud Computing

Michigan

According to CCH, on April 29, 2014, the Michigan Court of Claims held that cloud computing, or software as a service (SaaS), is a nontaxable service rather than a taxable use of prewritten software. The court reasoned that the software was not "delivered" - a pre-requisite of taxability - because the third-party providers did not surrender possession or control of the software to the taxpayer, nor did the third parties actually transfer to the taxpayer the software needed to process and produce the outcomes. The court's decision acknowledged the "complexity associated with the computer environment" and the "changing nature of computer-based technology and business models." There are currently two bills pending in Michigan, Senate Bill 142 and Senate Bill 143, which would codify the decision in this case. These bills would make it clear that for both sales and use tax purposes, the right to access prewritten computer software on another person's server is a nontaxable sale of service.[1]

Virginia

Also, on April 29, 2014, the Virginia Tax Commissioner issued a taxpayer-favorable ruling addressing Virginia sales and use tax. The Commissioner determined that cloud computing services were exempt from sales and use tax because they do not involve tangible medium and qualify as a nontaxable service under Virginia's exemption for electronic transfers of software.[2]

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[1]Va. Pub. Doc. Rul. No. 14-42 (Mar. 20, 2014).
[2]*Auto-Owners Insurance Company v. Department of Treasury*, Case No. 12-000082-MT (Mich. Ct. Cl. 2014).

Baby Boomer Exit and Succession Planning Seminars

Presentations for Franchise Systems and Franchisee Associations Available from Franchise Valuations Ltd.

With 40 million people in the US aged 65+ (projected to be 55 million by 2020); with 10,000 people a day turning 65; and with 28% of franchisees now over the age of 55, baby boomer exit and succession planning is a demographic imperative. There will be a tremendous turnover in units in the coming years with franchisees and franchisors benefiting from well-planned seamless transfers. But they will be punished for failing to plan with distress sales and transfer disputes.

Bruce Schaeffer and Michael Seid recently spoke about the issue at the International Franchise Association Annual Convention. Franchise Valuations offers half-day seminars to review and discuss what must be done to accomplish franchise exit and succession planning that will serve both the franchisees and the franchisors.

We invite you to contact us to discuss how we can custom design a presentation for your system. This is not an issue that can be avoided. It is a certainty, for it is death and taxes.

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