



# The Franchise Valuations Reporter



## Featured Expert: Keith J. Kanouse



This issue's lead article was suggested by attorney Keith J. Kanouse whose practice focuses on corporate, securities and real estate law with a primary focus on franchise, business opportunity and distribution law. Based in Boca Raton, Florida, he represents start-up franchisors and business opportunity sellers as well as franchisees. Kanouse can be reached at (561) 451-8090 or [Keith@Kanouse.com](mailto:Keith@Kanouse.com)

## 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.

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## Sub S Corps vs. LLCs: Pros and Cons

### *Consider Flexibility and Asset Protection As Well As Tax Consequences*

Last month's issue of our newsletter featured a [discussion of valuation issues](#) as they apply to pass-through entities such as S Corporations and LLCs. As a follow-up we would like to introduce readers to franchise attorney Keith Kanouse's answer to the question: Should my business be an S Corporation or a Limited Liability Company?

In his [recent article on the subject](#), Kanouse notes that both types of entities achieve the two basic objectives of (1) limiting an owner's personal liability for the business's debts and other obligations to the amount invested; and (2) avoiding federal income taxation at both the business entity level and the shareholder/member level such as is the case with C corporations where there is a tax at the corporate level on income and then at the individual level on dividends.

Kanouse reviews the relative advantages and disadvantages of S Corps and LLCs with respect to: personal liability; income taxes on the entity and its owners; state income tax considerations; limitations on ownership; management options; distributions of income, credits, losses and deductions; transferability of interests; self-employment tax issues; and creditor protection.

Due to the fact that there is a long-established body of statutory and case law involving corporations - which gives greater certainty - and due to the sometimes inconsistent tax treatment of LLCs (sometimes treated as partnerships and sometimes like corporations), and the complexity of LLC taxation, in his practice Kanouse generally finds the S Corp to be the preferable business entity assuming there are eligible shareholders and no need for special allocations. However, he notes that LLCs are becoming increasingly the business entity of choice where circumstances require more flexibility in ownership and/or profit and loss distributions.

## Baby Boomers: Exit and Succession Planning Seminars

### *Aging Franchise Owners Seek Franchisor Guidance*

Here at Franchise Valuations Ltd. we offer franchisors the opportunity to sponsor seminars for their franchisee owners on succession planning. Among the topics to be considered for discussion between franchise owners and their franchisees are:

1. What are you allowed to do (i.e. contractual restrictions in franchise agreements)?
2. Do you plan to dispose of your franchise assets during life or by will?
3. What are your franchise assets worth?
4. Do you have a gift or estate tax issue?

Proper planning not only benefits the franchisee/owners but by offering a

212.689.0400 seminar or workshop on these topics at an annual meeting, franchisors benefit by assuring a seamless transfer and an uninterrupted royalty stream.

## 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

### 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](http://www.FranchiseValuations.com) and [www.ftm.biz](http://www.ftm.biz)

## Wrongful Terminations: What is a Franchise?

### *Two Recent Cases in New Jersey and Hawaii Focus on the "License" Element*

Under most relationship statutes, a plaintiff must show the grant of "a license to use a trade name, trade mark, service mark, or related characteristic" to claim the necessary franchise relationship in wrongful termination cases. However, the New Jersey Supreme Court has declared that not every grant of permission to use a trademark in the sale of goods is a license within the meaning of the NJFPA. Rather, the hallmark of the franchise relationship was the use of another's trade name in such a manner as to create a reasonable belief, on the part of the consuming public, that there is a connection between the licensor and licensee.

In *McPeak v. S-L Distribution Co., Inc.*[1] the distributor alleged that: (1) the agreement granted an exclusive right to sell and distribute authorized products to authorized outlets within a defined territory; (2) the retailers believed that there was a connection between the manufacturer and the distributor; (3) the exclusive right to sell and distribute authorized products constituted a franchise within the NJFPA; (4) the relationship established a uniformity of product and control of placement, marketing, price, and other marketing and distribution methods that caused retailer customers to believe they were dealing with the manufacturer itself or a franchise; and (5) customers believed that the manufacturer vouched for his activities.

But the Court ruled that these allegations did not support a finding of a trademark license between the parties. The exclusive right to sell products within a defined territory did not confer a license. The fact that the manufacturer allowed the distributor to use its insignia in some circumstances did not in itself create a license. If it did, any business selling a name brand product would be considered as holding a license under New Jersey law. Moreover, the distributor failed to properly plead any facts demonstrating that he actually used the manufacturer's name.

Similarly, a District Court in Hawaii ruled that a distributor did not have a "franchise" relationship under the Hawaii Franchise Investment Law (HFIL) because the element of the grant of a license to use a trademark was lacking.[2] Under the statute, a franchise was an agreement "in which a person grants to another person, a license to use a trade name, service mark, trademark, logotype or related characteristic . . ."

The distributor's claim that it was entitled to use the manufacturer's name, trademarks, and proprietary software was at odds with the language of the agreement, the court found. The agreement did not suggest that the distributor was authorized to use the manufacturer's trademarks or software. The Court held that the agreement only authorized the distributor to purchase games and "fills" from the manufacturer and exercise its best efforts to develop markets for the games and distribute the games. A distributorship was different from a "franchise," the court observed. The very essence of a franchise relationship was that the franchisee represents the franchise to the public; a franchise was not created whenever one company purchased and distributed another company's products.

[1] CCH Business Franchise Guide ¶14,978. (DC New Jersey. Civil No. 12-00348 Dated December 19, 2012)

[2] *Prim Limited Liability Company v. Pace-O-Matic, Inc.*; CCH Business Franchise Guide ¶14,982. (DC Hawaii. Civil No. 10-617 Dated December 13, 2012)

## Damages: Mitigating Plaintiff Argues Himself Out of Court

### ***Unfortunately, Smart Planning Can Eliminate Damages and Basis for Suit***

In *FECO, Ltd., v. Highway Equipment Co., Inc.*,<sup>[1]</sup> the Iowa Court of Appeals affirmed that an Iowa trial court did not err in denying damages to a terminated farm implements dealer that fully mitigated any potential loss incurred by the manufacturer's improper termination because after the termination of its contract, the dealer began selling its own proprietary line of spreader boxes, which were extremely successful, taking over most of the spreader market.

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[1] CCH Business Franchise Guide ¶14,967 (Filed January 9, 2013)

## Valuations and Damages in Franchise Disputes

### ***Don't Forget We Provide Expert Services and We Write the Book***

CCH's [Franchise Regulation and Damages](#) is the only treatise that covers valuations of franchises and the law of damages for all franchise litigation and arbitration. We update it three times a year.

## For the Best Cyber-Security: Hire a Lawyer

### ***Protect Yourself With Attorney-Client Privilege***

As data breaches and cybercrime become everyday occurrences, best practices suggest hiring technical expertise under the umbrella of attorney-client privilege. According to *The Wall Street Journal*:

From 2008 through last year, hackers accessed 681 million records, and there has been a 40% increase in the number of publicly disclosed data breaches the last two years, according to a study by accounting firm KPMG. The typical data breach costs a company \$5.5 million in operating expenses and lost business, according to a 2011 report by the Ponemon Institute, a security research firm.

Companies on the losing-side of data-breach class-action litigation pay an average settlement award of \$2,500 per plaintiff, with attorney fees averaging around \$1.2 million, according to a survey released last year by Temple University Beasley School of Law.

So companies need to scour their cyber-world on an active and pro-active basis, and the best way to hire that expertise is through a knowledgeable lawyer. As further reported by the *Journal*:

Mike Dubose, the head of Kroll Advisory Solutions' cyberinvestigations practice, says Kroll advises its clients to hire a lawyer first and then have the lawyer hire Kroll. While a forensics firm such as Kroll can detect malware, scour network-access logs or understand the modus operandi of a foreign hacking group, if Kroll is contracted directly by the company rather than by an outside lawyer, that work is unlikely to be protected by attorney-client privilege, he says.

"Every network we have seen has substantial room for improvement," Mr. Dubose says. "What a company does not want is its investigation or due diligence, undertaken with the best of intentions, to be used

against it in litigation."

You can get this kind of protection under our attorney-client umbrella. Call (212) 689-0400 and our very own [Henry Chan](#) can get to work on protecting your systems!

MORE REASONS TO HARDEN YOUR NETWORK SECURITY!

*Links to Recent Articles on Cyber-Crime*

[Closing the Door on Hackers](#)