



## The Franchise Valuations Reporter

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# Ask the “FAT” Man (Finance Accounting and Tax) Franchise Questions (Also Damages, Valuations, Expert Testimony and Cyber-Security)

**A New Feature:** Because our areas of expertise are virtually unique within the franchise community, we are offering a free consultation service. If any readers have short questions in our selected areas of knowledge, you are welcome to email or phone us and we will provide our best answer as quickly as possible.

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*We have published a very substantial number of articles and White Papers on the selected areas in which we have expertise. Most are available here in pdf on the [franchisevaluations.com](http://franchisevaluations.com) website.*

## Damages Decisions

### ***Lost Profits on Breach of Covenant Not To Compete***

In a recent case addressing Oklahoma law, *Southwest Stainless v. Sappington*, 2009 WL 2989149 (CA 10 Filed Sept. 21, 2009) a metals business was granted damages against an employee that took specific

business to a competitor in violation of a non-compete but was denied general “lost profits” in the entire territory resulting from the defection. The district court found the employer did not prove it would have won all of the competitor's business but for the breach, and it was not contradictory to find

it would have won just some. The 10<sup>th</sup> Circuit affirmed.

### ***“New Business Rule” for Lost Profits in California***

In deciding whether lost profits are capable of proof with reasonable certainty, courts often distinguish between established businesses and new or “fledgling” enterprises. Although the standard of reasonable certainty when proving lost profits applies to both, new businesses must generally meet a higher evidentiary burden for the obvious reason that often there does not exist sufficient experience upon which to make an estimate with reasonable certainty.

Thus a “new business” owner trying to establish damages generally has a harder burden of proof. In most states they are not precluded from claiming lost profits; but the evidence presented must be certain enough to support an award.

Although a minority of states follows the *per se* “new business” rule - an automatic exclusion of any claim for lost profits by a new business - that is not the case in California where the rule is:

Lost profits of unestablished businesses, without a track record, are typically more “uncertain, contingent and speculative” than those of established businesses, but

such new or prospective operations may also receive lost profit damages where these can be shown by “evidence of reasonable reliability.” (*Kids' Universe v. In2Labs, supra*, at p. 883, 116 Cal.Rptr.2d 158.)

In the recent California case of *Gullwing International v. Ostermeier*, 2009 WL 2961939 (Cal. App. 2 Dist. Filed Sept. 17, 2009) the argument was that Gullwing was not entitled to lost profits damages because its business was unestablished. The appellate court reviewed the issue *de novo* and ruled that Gullwing was an “existing business, which had been in operation for at least six years-far more than a very short period of time” and concluded that the fact that the defendant sought to expand it did not transform the established business into an “essentially ... new business.”

Furthermore, the court noted that defendant’s counsel had the opportunity to cross examine plaintiff’s expert and failed to do so on his lost profits calculation.

Finally the court held that CA’s limitation (under Civil Code section 3343) on damages recoverable in fraud and conversion causes of action to out-of-pocket losses did not apply because in this case the fraud took place after the business transfer and involved breach of fiduciary duty.

## **Nexus Notes**

### ***“Physical Presence” Not a Requirement for Income Tax Nexus – New Jersey***

In a unanimous decision by the Supreme Court of New Jersey handed down Dec. 15, 2009, (*Praxair Technology, Inc. v. Director, Division of Taxation*, New Jersey

Supreme Court, No. A-91/92-08) the state's highest court upheld a New Jersey Tax Court decision affirming the taxation of a Delaware intellectual property holding company and denying that “physical presence” was essential for income tax nexus as follows:

The Tax Court reasoned that, in this instance, form would not trump substance, concluding that the use of intangible property for income-producing purposes in New Jersey renders that property's owner subject to taxation either as one who is 'doing business, [or] employing or owning capital or property ... in this State.' N.J.S.A. 54:10A-2. From a straightforward plain language standpoint, no other conclusion is sensible.

The taxpayer was assessed almost \$3 million with interest and penalties.

Thus, we continue to warn as strongly as possible that trying to make the argument any longer that "physical presence" is

## CyberCrime

MORE REASONS TO BE FRIGHTENED!  
Links to Recent Articles on Cyber-Crime

BEWARE SOCIAL NETWORKING!

Viruses That Leave Victims Red in the Facebook

<http://www.nytimes.com/2009/12/14/technology/internet/14virus.html>

Web Attack on Twitter Is Third Assault This Year

[http://www.nytimes.com/2009/12/19/technology/internet/19twitter.html?\\_r=1&hp](http://www.nytimes.com/2009/12/19/technology/internet/19twitter.html?_r=1&hp)

(An online attack on Twitter was the result of the simplest of security breaches: someone got the password to enter the master directory of Twitter's Internet addresses and then redirected users to an alternate site instead. The security

required for income tax nexus or that franchisors can avoid paying the recently announced requirements of the CA income tax under a case from 1949 (*Rainier Brewing*) is a very, very weak hand to play. You've got to know when to fold 'em.

### ***"Physical Presence" Not a Requirement for Income Tax Nexus - Wisconsin***

On Dec. 29, 2009, the Wisconsin Department of Revenue adopted an order that amends a number of corporation franchise and income tax rules relating to apportionment and nexus, and in particular it provides rules relating to sourcing for intangibles for taxable years beginning on or after January 1, 2009 (*Emergency Rule Order*, Wisconsin Department of Revenue, effective December 31, 2009).

breach — the third major one at Twitter in 2009 — underscores the continuing weakness of the company's systems as its micro-blogging service is becoming more important to business and even global politics.)

LAW FIRMS BE PARTICULARLY ALERT!

As Phones Do More, They Become Targets of Hacking

<http://www.nytimes.com/2009/12/21/technology/21cell.html?hpw>

Law Firm Abandons iPhone After Experts Warn of Security Issues

<http://tax.cchgroup.com/network&JA=LK&fNoSpIash=Y&U=gsfk10&LKQ=NON%3A%20FTD01%2020091222-M.1&KT=L&fNoLFN=TRUE&>

# A Free Test of Your Website Security

As we have previously reported, Payment Card Industry Data Security Standards, apply to any business that swipes VISA, MasterCard, Discover or American Express as payment, and stipulates that a company must take special steps to secure its web applications. Sensitive financial data must be safeguarded or companies face fines, penalties and possibly yearly mandated government audits.

PCI DSS also requires that companies install an application layer firewall in front of Web

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applications, or have all custom application code viewed for vulnerabilities by an organization that specializes in application security, such as our FTRM division. The recent PCI DSS update, 1.2, recommends taking both steps simultaneously.

Get in touch with us today to arrange a free test of your system which will include a review of your web traffic logs. Call us at 212.689.0400 or e-mail [Henry@FTRM.biz](mailto:Henry@FTRM.biz) or [Henfree@FTRM.biz](mailto:Henfree@FTRM.biz).

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