



The Franchise Valuations Reporter

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Volume 1, Issue 4 – May 2009

Damages, Valuations and Cyber Crime

Welcome to our newsletter focusing on issues unique to our practice that we don't think are addressed anywhere else: valuation and damages, cyber crime, expert testimony and tax nexus – the issues we know best, that matter to our clients – franchise executives and the consultants, attorneys and other professionals who advise them. We hope you find information that warns, informs and benefits you.

We are pleased to announce that Bruce Schaeffer has again been named as a “Legal Eagle” by *Franchise Times* magazine.

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Cyber Crime

In a Word, Worry: Beware Malware and Bots

“Malware,” short for “malicious software,” is the umbrella term for viruses and other evils that do their best to ruin our computers. “Bot,” short for robot, is a type of malware that, without the owner's knowledge, allows an attacker to gain total control over the owner's computer.

A March 15, 2009, article from the Boston Globe is worth quoting:

http://www.boston.com/news/local/massachusetts/articles/2009/03/15/in_a_word_worry/

“What are we talking about here?” In 2007, malware use equaled the combined total over the previous 20 years. Today, the take from global electronic fraud runs in the hundreds of billions of simoleons.

So what is the going rate for the guys who want to steal and sell your private information to other parties? Let's see, 10,000 compromised PCs will run you \$1,000. Bank account credentials start at \$50. Malware installation on PCs costs 30 cents apiece in the United States and 10 cents in the United Kingdom. You can rent a kit to create your own bot application for \$1 an hour, \$5 for five hours.

Bad guys will pay \$250,000 for access to a big server with gaping security holes in it. Access to Mozilla - my Mozilla - goes for a mere \$500. And the targets are damned near infinite: There were 230 million unique users from Facebook and MySpace from June 2007 to June 2008. If they were a country, they'd be the fourth-most populous in the world.”

And a recent article from the BBC site entitled, *US needs 'digital warfare force'* reported that, “During the past six months, the Pentagon spent more than £67m (\$100m) responding to and repairing damage from cyber attacks and other network problems.”

CYBER CRIME WHITE PAPER

We have just written a white paper on cyber security for Wolters Kluwer’s CCH, the publishers of the *Business Franchise Guide* and our treatise *Franchise Regulation and Damages*.

To download our PDF, please visit:

http://www.FranchiseValuations.com/press/cybercrime_whitepaper.pdf

Franchise Technology Risk Management, a unit of Franchise Valuations, provides cyber security analysis, penetration testing and consulting services for the franchise, distributorship and dealership community. If your company is interested in discussing how we can improve your security profile, please contact: Henfree@FTRM.biz

Nexus Notes

State and Local Governments Are Going Broke And Are In Desperate Need of Funds.

According to the *Wall Street Journal* of April 9, 2009

<http://online.wsj.com/article/SB123923448796803135.html>

Links to Recent Articles on Cyber-Crime

Identity theft nets some tax refunds, stimulus checks

<http://www.cnn.com/2009/CRIME/03/19/tax.sca.ms/index.html>

Senators blame China-based hackers for recent cyber attacks

<http://www.mcclatchydc.com/256/story/64546.html>

Vast Spy System Loots Computers in 103 Countries

http://www.nytimes.com/2009/03/29/technology/29spy.html?_r=1&hp

Web-Based Crime Jumps 33%, Group Finds

<http://online.wsj.com/article/SB123843998882670641.html>

U.S. Steps Up Effort on Digital Defenses

<http://www.nytimes.com/2009/04/28/us/28cyber.html>

“At least 10 states are considering some kind of major increase in sales or income taxes: Arizona, Connecticut, Delaware, Illinois, Massachusetts, Minnesota, New Jersey, Oregon, Washington and Wisconsin. California and New York lawmakers already have agreed on multibillion-dollar tax

increases that went into effect earlier this year.”

Accordingly, franchisors and licensors with units in several states should be particularly aware of becoming targets for the cash-strapped tax collectors.

Some recent decisions of note:

Massachusetts - Tjx Companies vs. Commissioner of Revenue, (Massachusetts Appeals Court, No. 07-P-1570, April 3, 2009)

In denying deductions for royalties paid to an Intangible Property Holding Company (an IPHC - basically the same structure disallowed in the 1993 *Geoffrey* case), the MA court held that the parent corporation that formed subsidiaries to hold certain trademarks was properly disallowed a deduction from Massachusetts corporate excise tax for the royalties paid to the subsidiaries because the transfer and license-back transactions constituted a sham.

MA held the same way less than a week earlier in, believe it or not, the MA *Geoffrey*

case and they have filed for certiorari to the U.S. Supreme Court.

Geoffrey, Inc. v. Massachusetts Commissioner of Revenue, (U.S. Supreme Court, Dkt. 08-1207, petition for certiorari filed March 30, 2009)

Maryland --Sales and Use Tax: Nexus Presumption for Online Sellers Introduced (S.B. 1071, as introduced in the Maryland Senate on March 28, 2009)

The state has introduced legislation which would create a rebuttable presumption that a seller is soliciting business in the state through an agent if the seller enters into an agreement with a state resident under which the resident, for a commission or other consideration, refers potential customers to the seller through a Web site link or otherwise.

This legislation is similar to New York's so-called Amazon law, which was upheld in January by a New York state court. Similar legislation has been introduced this year in California, Connecticut, Hawaii, Minnesota, North Carolina, and Tennessee.

Daubert and Valuations

Bankruptcy Practice: Expert Testimony on Valuations and Solvency in Light of *Daubert*

In light of the current economy more and more franchise, licensing and distributorship companies are faced with bankruptcies – either their own, their licensees’ or their suppliers’. In an excellent and highly recommended article of more than 100 pages, authors Bernstein, Seabury and Williams present a semi-treatise entitled,

“Squaring Bankruptcy Valuation Practice With *Daubert* Demands,” Vol. 16 *ABI Law Review* 161 (2008).

Since the US Supreme Court’s decision in *Daubert*, bankruptcy courts have been bound to enforce the same gatekeeper functions as other civil courts with respect to the relevance and reliability of financial or valuation experts’ proffered testimony. “In the past, issues of valuation in a bankruptcy case or adversary proceeding were regularly

negotiated, compromised, and stipulated to: rarely did the parties actually litigate the issue of valuation. Times have changed. Issues of valuation are now hotly contested.” And, as the authors emphasize, in bankruptcy time is money. Chapter 11 debtors in possession often file reorganization plans based on specific values at specific dates. Like food products on the grocer’s shelf, these opinions have expiration dates.

The article gives a brief analysis of the law under *Daubert* and *Kumho Tire* and then offers very detailed coverage of the valuation issues in three particular bankruptcy situations: (1) Solvency when trying to avoid “preferences”; (2) Solvency when trying to avoid “fraudulent transfers”;

and (3) Total Enterprise Value of “reorganized debtors”. Under each topic there are discussions in depth with cites to leading cases.

For a detailed analysis of the rules concerning admissibility of expert testimony under the federal trilogy of *Daubert*, *Joiner* and *Kumho Tire*, as well as the relevant authorities in the many states that still follow the *Frye* rule, see Schaeffer, *Franchise Regulation and Damages*, Chapter 21 “Expert Testimony on Valuations and Damages” which provides an extensive review of the federal authorities as well as the rules in the 50 states.

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 and can be reached at 404 Park Avenue South, New York, NY 10016. 212.689-0400 or www.franchisevaluations.com and www.ftm.biz.