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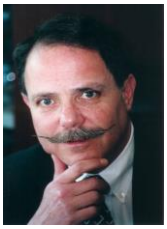
The Franchise Valuations Reporter

Our Expertise



Within the franchise, distribution and dealership context, we are experts in:

- Damages, Valuations & Expert Testimony
- Finance, Accounting and Tax
- Cyber Security

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Have a Question About Succession Planning for Franchise Owners?

Call us for a free, confidential consultation. And we're always interested in your comments about the newsletter.

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We Write the Book

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

For more details, to see a Table of Contents or to place an order, go to the Wolters Kluwer Law & Business web page here.

Damages

Defendant's 'Avoided Costs' Are an Improper Measure of Damages in Trade Secret Misappropriation Cases

In response to a certified question from the Second Circuit asking New York's highest court whether under New York law claims of misappropriation of a trade secret, unfair competition, and unjust enrichment can be measured by how much money the defendant saved by its unlawful activity, the New York Court of Appeals has ruled that "avoided costs" is not a proper measure of damages under any of the three theories.[1] Under New York law, the court said, compensatory damages should return a plaintiff to the position that it would have been in had the wrongdoing not occurred. "Avoided costs" is an improper measure because it focuses on the defendant's gain rather than on the plaintiff's loss. Three of the seven judges, however, vigorously dissented.

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[1] *E.J. Brooks Co. v Cambridge Sec. Seals* 2018 NY Slip Op 03171, (May 3, 2018, Court of Appeals Feinman, J.)

Attorneys' Fees

Dismissal Because of Arbitration Clause Did Not Warrant Award of Copyright Act Attorney Fees

In a case that may be precedent for franchise litigation, the First Circuit Court of Appeals in Boston upheld the dismissal of a copyright infringement plaintiff's claims against music publisher Sony Corporation of America and other related defendants pursuant to a mandatory arbitration provision in the agreement and ruled that the decision did not warrant an award of attorney fees to Sony as a prevailing party under the Copyright Act. An award of attorney fees under the Copyright Act required a material alteration of the parties' relationship, and the mere sending of the plaintiff's claims to arbitration did not suffice.[1]

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[1] *Cortes-Ramos v. Sony Corp. of America,* (USCA 1, No. 16-2441, May 4, 2018, Barron, D.).

Valuations

Recent Important Cases in the Opinion of Business Valuation Resources

- *Jensen v. Jensen*: Michigan divorce case on appreciation and retained earnings
- *Dell v. Magnetar*: statutory fair value case, Delaware Supreme Court reviews Chancery's preference for DCF
- *DFC Global*: statutory fair value case, Delaware Supreme Court reviews Chancery's fusion valuation method
- *Hornberger v. Dave Gutelius Excavating*: shareholder agreement dispute centering on use of discounts
- *Radiologix v. Radiology & Nuclear Medicine*: contract dispute,

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Daubert challenge to expert's damages calculation
- *Humane Soc'y of the United States v. Perdue*: how to value intellectual property that's functionally obsolescent

Tennessee Appeals Court Allows Slight DLOM in Divorce Case

In general, valuations in divorce cases do not take into account discounts for lack of marketability or DLOMs. But a recent Tennessee appeals court opinion seemed to allow such discount with respect to two pass-through entities left to a wife by her father.[1]

Other Divorce Cases Addressing DLOMs

In *Tate v. Tate* [2] the Ohio Court of Appeals upheld the valuation of a minority interest in farm entities based on the fair value standard. The court noted that the prevailing expert specifically referenced buy-sell agreements that did not contemplate the use of discounts in valuing an exiting member's partial interest.

In *Cobane v. Cobane*, the Kentucky Court of Appeals said that, in valuing the owner-spouse's minority interest in an LLC, it was not error for the trial court to reject a discount based on certain questionable actions related to the owner's interest.

No Tax Affecting According to Internal IRS Memo For S Corp Valuations

It is no secret that the IRS is opposed to "tax affecting" the valuation of pass thru entities, that is, taking a discount for fictional taxes that the pass thru entity does not really pay. The issue has been frequently discussed in this newsletter. Pursuant to a Freedom of Information Act request, Michael Gregory of Michael Gregory Consulting LLC obtained an internal IRS memo which declared the IRS position was against tax affecting a non-controlling interest in an S Corp.

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[1] *Telfer v. Telfer*, 2018 Tenn. App. LEXIS 120 (March 5, 2018).
[2] 2018 Ohio App. LEXIS 1340 (March 29, 2018)
[3] 2018 Ky. App. LEXIS 107 (March 23, 2018)

Joint Employer and Vicarious Liability

No Vicarious Liability

In *Gress v. Lakhani Hospitality, Inc.*[1], a hotel franchisor was held to not owe a duty to protect a guest staying at one of its franchisee's hotels from being raped, allegedly by the hotel security guard. Although the franchisee innkeeper had a special relationship with the guest and owed her a duty to protect against the general character of the harm she suffered, there was no special relationship between the guest and the franchisor, which, unlike the franchisee, could not be held liable for the alleged criminal acts of the franchisee's employee.

The appellate court also affirmed the trial court's conclusion that the franchisor could not be held liable for negligently hiring and retaining the security guard, since it was not alleged that the franchisor employed the security guard or communicated with the franchisee about the hotel's management or its employees. The guest did not develop any argument that the trial court improperly dismissed the guest's claim that the franchisor was negligent in training and supervising the franchisee's employees, and so the dismissal of that claim was affirmed on appeal as well.

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[1] 2018 IL App (1st) 170380, No. 1-17-0380, (Filed May 2, 2018, Flanagan, K.)

Expert Testimony

Daubert Attack in ESOP Case Over Trustee Qualifications

In *Acosta v. Vinoskey*,[1] a case focused on an ESOP valuation, the court recently excluded a part of a government expert's damages testimony. The trustee challenged the damages expert's qualifications under *Daubert* because he did not have business valuation experience, was not a CPA or CFA, and claimed he did not know the standard applicable to ERISA transactions. The court disagreed, finding the expert had been qualified as a witness in many other ESOP cases and that he had significant experience in the private equity industry, a background that "provides guidance on the sort of diligence required in this transaction."

However, the court agreed with the trustee that there were some insurmountable problems with the way the expert applied a valid methodology. In terms of an overpayment claim, the court found the expert incorrectly applied the guideline public company method and precluded him from using it for his valuation. Further, the expert's approach to determining damages that existing shareholders allegedly incurred due to the transaction "does not provide any basis to figure out what those damages would be." Because there was no damages testimony to sustain this count, it collapsed.

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[1]2018 U.S. Dist. LEXIS 64094 (April 17, 2018)

Quotations

God created war so that Americans would learn geography. *Mark Twain*

The really frightening thing about middle age is the knowledge that you'll grow out of it. *Doris Day*