



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 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.

Bruce S. Schaeffer, Editor
Bruce@FranchiseValuations.com
 212.689.0400

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

Damages

Failure To Show Initial Harm From Misappropriation Did Not Require Dismissal of Trade Secret Claims

The Utah Supreme Court, reversing a district court, held that companies should be given a presumption of harm when their trade secrets are disclosed. Therefore, defense industry technology company InnoSys, Inc. was entitled to reversal of an award of summary judgment to a former employee on the basis that InnoSys failed to show harm stemming from alleged misappropriation of trade secrets.

The former employee disclosed the misappropriation herself when she filed a claim for unemployment benefits after being fired by InnoSys, and submitted a number of protected documents -- protected emails and a confidential business plan -- into the administrative record. InnoSys alleged that proved that the former employee violated a nondisclosure agreement and misappropriated company trade secrets by, *inter alia*, copying a confidential business plan to a thumb drive, and placing protected information on the record in an administrative (unemployment) proceeding. The misappropriation was not in dispute. The former employee admitted that she copied the business plan on the day of her termination.

And catch this: The district court had granted the former employee summary judgment, finding that InnoSys failed to make an adequate showing of harm AND the court had also entered Rule 11 sanctions against InnoSys and awarded attorney fees to the former employee. (*InnoSys, Inc. v. Mercer*, August 28, 2015, Lee, T.)

Tax Free Exchange

IRS Greenlights the Exchange of Rights To Manufacture or Distribute Products As Of "Like-Kind"

In a Private Letter Ruling (LTR 201531009) the IRS has determined that an exchange of product manufacturing and/or distribution rights in one territory for the same rights in another territory qualified for like-kind treatment. Under Code Sec. 1031, no gain or loss would be recognized by the taxpayer on the exchange.

Lost Future Royalties: Same Franchisor, Opposite Conclusions

One Finds Franchisor Must Mitigate Damages; the Other Doesn't

PuroSystems Inc. (PSI), a franchisor of disaster recovery and remediation businesses, has had issues with its franchisees over the past few years with some franchisees leaving the system before their terms were up. As a result, the franchisor has brought claims against certain departing franchisees seeking Lost Future Royalties (LFR). It must be understood that LFR is not a damages claim in and of itself, but is a

Henry@FTRM.biz
or call (212) 689-0400

Just Published

Be sure to check out this article - "[Identify What's Missing From Your Cyber-Security Posture](#)" - by Bruce Schaeffer and Henry Chan published in the June 2015 issue of *Franchising World*.

We Write the Book

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 Contents or to place an order, go to the Wolters Kluwer Law & Business web page [here](#).

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 and www.ftm.biz

subset of lost future profits. Thus the full amount of claimed LFR, as a matter of law, must be reduced by at least the "saved costs" as a result of no longer having to provide anything to the departed franchisee from whom future royalties are sought. Two arbitration panels -- apparently on very similar facts with much the same counsel -- came to opposite results.

On the one hand . . .

In *PuroSystems, Inc. v. Scott DeMalteris*, AAA Arb. No. 32 114 00505 12, a decision handed down July 31, 2013, the panel sided with the departing franchisee finding that "PuroSystem's future lost profits are contingent on whether a new franchisee will be placed in DeMalteris' former territory, and whether the franchisee will be successful."

While PSI's expert's damages model was based on the assumption that it would take four years to establish a new franchisee in DeMalteris' former territory, "PuroSystems offered no credible evidence to support such a finding." The panel heard evidence that PSI "had placed another franchisee in DeMalteris' former [territory] within two months of DeMalteris' termination."

As to the element of whether the franchisee will be successful, ". . . the Panel finds that the future lost profit analysis PuroSystems is relying upon is contingent and/or conjectural, and its future lost profit damages are not reasonably certain."

But on the other hand . . .

More recently, on November 14, 2014, another arbitration panel came to a completely opposite result in *PuroSystems, Inc. v. John Woods*[1]. In that case PSI was awarded lost future profits, in the nature of LFR, for a franchisee's breach which was occasioned by the franchisee's terminating the agreement before the expiration of the 20-year term. The franchisee's defense that the franchisor constructively terminated the agreement was rejected by the arbitrators as merely a pretext.

Unlike in *DeMalteris*, the *Woods* panel found that the franchisor was entitled to damages for LFR stemming from the termination under Florida law which allowed for the recovery of lost future profits if (1) the lost future profits were within the reasonable contemplation of the parties at the time of contracting and (2) they were proven with reasonable certainty.

The *Woods* panel cited as the leading Florida case, *Burger King Corp. v. Barnes*[2] in which Burger King was awarded damages to compensate it for fees that would have been paid over a future period of 210 months. That case was instructive, both as to the entitlement and to the amount of lost future profits the franchisor was entitled to, the arbitrators held.

The *Woods* panel said that lost future profits were within the contemplation of the franchisee when he signed the parties' agreement, and did not find credible testimony by the franchisee's expert that the FTC Franchise Rule required the franchisor to disclose potential liability for lost future profits.

Contrary to the *DeMalteris* decision, the *Woods* panel rejected the franchisee's argument that the franchisor was required to mitigate its damages.

So-Called "Confidential" Operating Manuals

Both franchisees claimed that PSI failed to provide trade secrets or

confidential or proprietary information through PSI's manuals or training. The DeMalteris panel heard testimony on the subject and concluded, "At best, the manuals are nothing more than a compilation of widely known information that is available to the public through numerous sources and/or are common knowledge in the remediation industry." Thus, PSI's restrictive covenants were ruled unenforceable against DeMalteris.

Although Woods made the same claim, his panel was silent on the issue.

[1]American Arbitration Association Case No. 32 114 Y 00002 14, filed in Broward County Florida appears at CCH Business Franchise Guide ¶15,539

[2]Business Franchise Guide ¶11,413

Attorneys' Fees

"Prevailing Party" Awarded Attorneys' Fees 5 Times the Amount Won in the Case

A franchisor of outdoor swing set businesses, Creative Playthings Franchising Corp., was entitled to recover attorney fees and expenses based upon an attorney fees provision in the franchise agreement between the franchisor and a terminated franchisee. In its original fee request the franchisor proposed a reduction of \$129,190 to account for potential inefficiencies, duplicative work, degree of success, and documentation issues.

The balance was further reduced by the Court by 25%. Nonetheless, the franchisor was awarded \$296,641.13 in fees and \$33,673.94 in expenses for a total award of \$330,315.07 while the total amount awarded in the litigation was less than \$62,000.[1] The law firm's original bill was \$524,711.50 in fees for 1,968.15 hours of work performed by three attorneys and an unspecified number of paralegals. The results are as shown below:

<u>Claim</u>	<u>Outcome</u>
Unpaid Fees	\$33,163.29
Misuse of Intellectual Property	\$3,217.00
Failure to pay for Inventory	\$16,465.75
Improper Inventory Order Procedures	\$9,000.00
Total	\$61,846.04
 <u>Attorneys Fees</u>	
Charged	\$524,711.50
Less: Franchisor's Reduction	\$129,190.00
Adjusted Fee Request	\$395,521.50

Less: Court reduction of 25%	\$98,880.38
Plus: Expenses	\$33,673.94
Net Fee Award	\$330,315.07
# of hours	1,968.15
Billing Rate per hour	\$167.83

[1]Creative Playthings Franchising Corp. v. Reiser, DC Mass., CCH Business Franchise Guide ¶15,565

Succession Planning: Franchisees and Franchisors Take Heed

Age Wave of Boomers Is Upon Us

In an [informative article on Baby Boomers](#), Stacy Cowley of *The New York Times* addresses the fact that more than 10,000 people per day are turning 65 and that many of them are planning for business successions -- or failing to do so.

Cybersecurity

LifeLock Subject of Contempt Motion

In August the Federal Trade Commission accused LifeLock Inc. of violating a 2010 settlement with the FTC and 35 state attorneys general concerning previous misrepresentations it had allegedly made regarding its identity theft services. It filed a motion for contempt against Lifelock in federal court and is seeking redress for consumers affected by the alleged violation of the settlement.

Connected Devices Offer Little Safety Long Term

Manufacturers and retailers are paying little heed to longer-term privacy and security as they pump intelligent consumer devices like smart TVs and wearable devices into the market, according to [guidelines issued by an industry group the Online Trust Alliance.](#)

[Forward email](#)



This email was sent to susan.ogulnick@gmail.com by bruce@franchisevaluations.com | [Update Profile/Email Address](#) | Rapid removal with [SafeUnsubscribe™](#) | [About our service provider.](#)



Try it FREE today.

Franchise Valuations Ltd | 3 Park Avenue | 31st Floor | New York | NY | 10016