The Franchise Valuations Reporter

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Our Expertise

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

- Valuations
- Damages
- Expert Testimony
- Finance, Accounting & Tax

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 valuations and damages in franchise disputes, 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

Additional Damages Not Allowed For Post-Judgment Appreciation of Property

The Court of Appeals of Washington affirmed a trial court's dismissal of a complaint seeking additional damages following a judgment in favor of the former property owner and full satisfaction of that judgment. Pacific 5000, L.L.C. (Pacific) asserted claims for violation of the Consumer Protection Act (CPA), and conspiracy in restraint of trade. Pacific alleged that Fife Commercial Bank and others conspired to force Pacific to sell commercial property Pacific owned for below its market value. Pacific had been awarded compensatory damages in the amount of its equity in the subject property, and those damages were trebled. **But the property's market value had nearly doubled when it was resold three years later, and Pacific sought to recover the property's appreciation.** By this time, though, the court-ordered damages award had been fully paid to Pacific. Thus, the complaint sought an impermissible double recovery and was rejected. Nice try! (*Pacific 5000, L.L.C. v. Kitsap Bank*, June 7, 2022, Maxa, B.).

Award of $2.75 Billion in Damages to Centripetal for Cisco's Willful Infringement Vacated Because Judge's Spouse Owned Cisco Stock

A judge presiding over a patent infringement case should have recused himself when he learned that his wife owned stock in one of the companies involved, the U.S. Court of Appeals for the Federal Circuit held. Because the judge already had drafted part of his opinion before he learned of the conflicting financial interest, he decided to place the stock in a blind trust rather than sell it and create an appearance of insider trading. However, 28 U.S.C. § 455 requires a judge in this situation to either recuse himself from the case or divest himself of the conflicting financial interest. The judge's placement of the stock in a blind trust did not comply with the divestiture requirement because it only eliminated control, not ownership. The opinion and

order on infringement and damages and the post-trial motions were vacated and the case was remanded further proceedings before a newly appointed judge (*Centripetal Networks, Inc. v. Cisco Systems, Inc.*, June 23, 2022, Cunningham, T).

Punitive Damages Award Reduced By $100,000 for Indie Film Production Company

Following a jury trial that found a record company executive and his production company must pay more than $800,000 in damages for copyright infringement and defamation over an independent movie, the federal district court in Manhattan reduced the punitive damages award because even though the punitive damage award of $250,000 for defamation to the film's director was reasonable, the court concluded the jury award of $125,000 in punitive damages to the movie production company was excessive when there was no award of compensatory damages for defamation. Accordingly, the court held that the movie production company can either accept a reduction of its punitive damages award from $125,000 to $25,000, or a new trial on punitive damages (*Webber v. Dash*, June 14, 2022, Lehrburger, R.).

Valuations and Discounts

Appraising Real Estate Centered Business Enterprises

In an interesting discussion from Bruce E. Jones, MAI, ASA-GC, BCA, CMEA, he reviews Real Estate Centered Business Enterprises (RECEs), which commonly sell as real property going concerns with elements of real estate, personal property and a business enterprise component such as funeral homes. He shows that business appraisers face several challenges with these assignments due to the interdependence of the business with the other assets. Another key challenge with these types of assignments is relying on separately completed real estate appraisals that are frequently incorrectly developed based on an inappropriate premise of value. The article provides readers a conceptual framework for valuing these types of businesses.

"Tax Affecting" – In Flux Again

In the case *In Re Cellular Tel. P'ship Litig.*; 2022 Del. Ch. LEXIS 56 (*Cellular)*, a "fair value" freeze out dispute, the court found there should be no tax affecting. It was a big messy dispute. At issue was a 1.881% interest in a partnership that owned AT&T Mobility Wireless Operations Holding LLC which owned cellular rights in New Salem, Oregon. AT&T hired PwC as their expert to value the interest in a situation where the court found that the expert was hired based on A&T's assumption the expert would be a good witness in the litigation they expected and turned in what the Court found was really AT&T's work product. The defendant determined the value of the frozen out interest to be about $4.1 million of a total $219 million. The Court ultimately found the interest's value to be $13.4 million of a total $714 million.

One of the main issues was “tax affecting” (spelled “effecting” in the opinion). AT&T claimed the cash flow should be discounted at the 36% rate AT&T paid. The plaintiffs said that because they were a partnership and paid no income taxes the cash flow should not be discounted at all for taxes which they did not pay. The Court reviewed the issue under Delaware law referring first to the case of *Radiology Associates* 611 A.2d 485, 1991 Del. Ch. LEXIS 234 (1991) which ruled there should be no tax affecting. Then 15 years later in *Delaware MRI*, 898 A2d 290, 2006 Del. Ch. LEXIS 84, 2006 WL 4764042, the Court valued the entity based on what an acquirer would pay for the business and did tax affect at a contrived 29.4% rate. However, in *In Re Cellular* the Court found that the issue was primarily “damages” – as opposed to “valuation” – and held that AT&T breached its fiduciary duty and therefore, there should be no tax affecting to reduce the payout to the aggrieved parties. The Court wrote, “the fact that the court applied a valuation principle previously does not create a rule of law.”

Fair Value – New Jersey – No Discounts

New Jersey is one of several states that allow (but do not mandate) discounts for lack of control and marketability in fair value (oppressed shareholder) situations if it is proven that the discounts are fair and equitable. But, in a recent case, the trial court disallowed the discounts—and an appellate court agreed. The defendants argued that the discounts should be allowed based on the premise that the dissenting partners’ dissociation was wrongful (and damages were owed to the partnership), so the discounts were fair and equitable. But the trial court did not find that the dissociation was wrongful, and the appellate court came to the same conclusion. Therefore, there was no justification to apply either discount. *Robertson v. Hyde Park*, 2022 N.J. Super. Unpub. LEXIS 848..

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[1] Which in earlier newsletters we promised we would review.

Attorneys' Fees

Lanham Act Attorney Fees of More Than $1.6M Held Reasonable

In a design patent infringement, copyright infringement, and trade dress infringement suit, brought by Lanard Toys Limited—the creator of a chalk holder toy designed to look like a no. 2 pencil—against Toys “R” Us-Delaware, Inc., and other defendants, the federal district court in Jacksonville has found that a magistrate judge’s recommended award of attorney fees and costs of over $1.6 million under the Lanham Act and the Florida Deceptive and Unfair Trade Practices Act was proper and should be adopted. The court held that the magistrate judge properly found that the claims were intertwined and shared a common core of facts and related legal theories, making the fee reasonable for all hours expended on the Lanham Act claims (*Lanard Toys Limited v. Toys "R" US-Delaware, Inc.*, June 22, 2022, Howard, M.).

Rule 37 Sanctions Against Individual Attorneys Stand in Softball League Franchise Dispute

The Sixth Circuit affirmed an award of sanctions against individual attorneys who represented the National Pro Fastpitch League franchisor, NPF Franchising, LLC (NPF), for discovery violations, but vacated and remanded the award of sanctions against their law firm. The franchisor filed the lawsuit against a terminated franchisee alleging breach of the franchise agreement. (*NPF Franchising, LLC v. SY Dawgs, LLC*, June 15, 2022, Bush, J.).

The franchisor eventually voluntarily dismissed the lawsuit, and prior to the voluntary dismissal by the franchisor, the franchisee moved for attorney fees and costs on three grounds. These were "the fee-shifting provision of the non-competition agreement, the Federal Rules of Civil Procedure, and the court's inherent authority." The franchisee claimed that the franchisor and its counsel "abused the judicial and discovery process to harass and defame [the franchisee], their friends, family, and employers extrajudicially." The motion also requested that the court "issue monetary sanctions against [the franchisor] and its counsel for 'repeated discovery intransigence' and other conduct in this case pursuant to the court's inherent authority to do so." A magistrate judge recommended that the franchisee's motion for fees and costs be granted, and the district court granted the motion.

The appellate court reviewed the district court's granting of sanctions against the attorneys for an abuse of discretion. The court found that the district court was clear "about both the discovery misconduct and the prejudice it imposed on [the franchisee]" and found that it did not abuse its discretion in "the award and amount of sanctions imposed on the individual attorneys." The court found that there was no requirement that the "district court needs to match up every dollar of sanctions to every individual party sanctioned." The attorneys and the law firm contended that their conduct was justified. The court disagreed, agreeing with the magistrate and district court that the "individual attorney's conduct was not zealous advocacy, but an abuse of the judicial process and a waste of resources." It found that the sanction under Rule 37(d) against the individual attorneys was not an abuse of discretion.

Rule 11 Sanctions After Medical Device Manufacturer's Affirmative Defenses Against Distributors Fail

The affirmative defenses raised by sports medicine and trauma products manufacturer Biomet and its affiliate Zimmer Biomet Holdings (together, Biomet) regarding their failure to pay lifetime commissions to independent distributors that had filed suit against Biomet were without merit, the federal district court in South Bend has decided. The distributors were also entitled to an award of prejudgment interest from Biomet, on the earlier finding by a jury that Biomet breached the parties' distributorship agreements. Further, Biomet's counsel's (Quarles & Brady) baseless and frivolous arguments warranted Rule 11 sanctions and was ordered to show cause, within two weeks of the entry of the order, as to why sanctions should not be imposed (*Hess v. Biomet, Inc.*, June 28, 2022, DeGuilio, J.) On its own accord, the court determined that the defendants were subject to Rule 11 sanctions for "deliberately misstat[ing] case law," raising "frivolous" and "baseless" arguments, "wasting the time of the Court," and "burdening the opposing party." Citing multiple examples, the court found that the defendants had failed "to do even basic legal research before filing papers with [the] court" and "deliberately misconstrued or ignored" relevant case law.

Expert Testimony

Purchaser of Consulting Business Franchisor Succeeds in Excluding One of Two Untimely Expert Reports

A company, Rekor Systems, that alleged that it was the victim of a fraud in connection with its purchase of a franchisor of crisis-management and emergency-response consulting businesses, was entitled to strike one of two expert reports that were untimely proffered by the defendants after the court-ordered deadline to complete discovery expired. The defendants' expert report of Michael H. Seid ("Seid Report") was excluded because the failure to timely produce the report was not substantially justified and would not be harmless under the factors

of *Softel, Inc. v. Dragon Med. & Scientific Commc'ns, Inc.* Further, within the time permitted under the Case Management Plan, the defendants chose not to take depositions of the plaintiff's experts, not to ask for further time for expert testimony, and not to timely produce expert reports. Although the defendants' expert report of Lawrence R. Chodor ("Chodor Report") was also untimely, the court did not exclude it because if it had done so the defendants would have been prejudiced by not having expert testimony to challenge the plaintiff's damages expert (*Rekor Systems, Inc. v. Loughlin*, June 8, 2022, LIMAN, L).

Joint Employer/Independent Contractor

Employees' Sherman Act Claims Against McDonald's Over Anti-Poaching Policy Fail

A federal district court in Chicago granted restaurant franchisor McDonald's' motion for judgment on the pleadings dismissing a suit brought by former McDonald's restaurant employees alleging McDonald's violated the Sherman Act by restricting employee poaching between its franchises. The court found the complaints did not plausibly suggest the restraints contained in the franchise agreements would be unlawful under rule-of-reason analysis because the employees failed to allege the relevant market in which they sold their labor or that McDonald's had market power in that relevant market (*Deslandes v. McDonald's US, LLC*, June 28, 2022, Alonso, J.).