

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

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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,

Damages

Deb Coldwell Administers a Texas Ass-Kicking

In *Pizza Hut v. Ronak and Pandya*, (US DC E.D. Texas, Texarkana Division 2022) a federal district court granted just about everything the franchisor asked for through its battalion of attorneys (9 for franchisor against 11 for franchisees) led by Deborah Coldwell of Haynes & Boone.

The Court concluded that: "(1) Ronak Foods breached its Franchise Agreement with Pizza Hut; (2) Pandya Restaurants breached its Franchise Agreement with Pizza Hut; (3) JNP Foods breached its Franchise Agreement with Pizza Hut; (4) Pandya individually breached the Guaranties with Pizza Hut; (5) Franchisee Defendants breached the Forbearance Agreement with Pizza Hut; (6) Franchisee Defendants, including Intervenor Ronak Capital, breached the Transfer Agreement with Pizza Hut; (7) Franchisee Defendants failed to de-identify certain restaurants and Pizza Hut is entitled to injunctive relief; (8) Franchisee Defendants violated the Lanham Act and Pizza Hut is entitled to injunctive relief; (9) Franchisee Defendants' counterclaims for fraud/fraudulent inducement, tortious interference with prospective business relations and one count of defamation are barred by the parties' General Release; (10) Franchisee Defendants' counterclaim for breach of the Transfer Agreement fails; (11) Franchisee Defendants' counterclaim for defamation on one count while the Transfer Agreement was in effect fails; (12) Pizza Hut's request for an accounting is moot; (13) Pizza Hut is entitled to recover damages, fees for indemnified matters and attorneys' fees as damages in part; (14) Pizza Hut is not entitled to lost future royalties on this record; (15) Pizza Hut is entitled to recover reasonable attorneys' fees and expenses; (16) Pizza Hut is entitled to recover pre-and post-judgment interest and costs."

go to the [Wolters Kluwer Law & Business web page here.](#)

The only blemish on this victory is (14) Pizza Hut is not entitled to lost future royalties on this record. An appeal has been filed with the Fifth Circuit

Texas Ass-Kicking, cont'd.

Franchisor Not Entitled To Lost Future Royalties

Pizza Hut requested substantial lost future royalties (LFR) — in the amount of \$16,948,956.00 which they arrived at by calculating total lost future royalties at \$42,512,991.26, subtracting out \$24,076,017.00 in mitigation and \$2,375,102 in incentives that Pizza Hut paid to the new restaurant franchisee, then discounting all future amounts to net present value utilizing an 8-percent discount rate. As a threshold issue the Court got the parties to acknowledge that state and federal courts in Texas have not explicitly determined—utilizing Texas law—whether a franchisor is able to receive lost future royalties from a franchisee when the franchisor is the party responsible for terminating the agreement. The parties also agreed that Pizza Hut, acting as franchisor, was the party here that terminated the agreements.

The Court went on to do its own research and analysis on LFR and concluded: "Having surveyed the landscape on this discrete legal issue, the Court finds the reasoning presented in *Progressive Child Care* compelling. See *Progressive Child Care Sys., Inc. v. Kids 'R' Kids Intl, Inc.*, No. 2-07-127-CV, 2008 WL 4831339 (Tex. App.—Fort Worth [2d Dist.] Nov. 6, 2008) (pet. denied) (permitting lost future royalties). Akin to the principles underlying lost profits, parties should be entitled to the benefit of their bargain. A franchisor has a certain expectation of a benefit that it would reasonably have been expected to receive absent breach—under fundamental contractual principles."

But the court heard testimony about the dismal performance of the franchisee. To quote one witness, "Mr. Pandya had been at the bottom of the rack and stack for quite some time. . . .not only in my 15 years at Pizza Hut but in my experience in the restaurant business, I've never seen anything this poorly run operationally." In denying LFR, the Court noted, "It is incongruous for Pizza Hut to ask for lost future royalties based on its expected benefit of the bargain when the record is replete with testimony that Franchisee Defendants' business was lackluster and its performance was 'dead last.'"

I have provided expert testimony in many lost future royalties cases. Never have I seen the judge or arbitrator consider the business's dismal performance a bar or authority for a reduction on the LFR amount. In arguing against awards of LFR, I have often stated that a franchise agreement is not a suicide pact but the forums routinely ignore me. Nonetheless, I think the court's reasoning makes eminently good sense.

Valuations

Damodaran on Profitability Trends and Excess Returns

Professor Aswath Damodaran (New York University Stern School of Business) has once again offered his thoughts on trends in company profitability in 2022, including the impacts of inflation across global regions and industries. The gist of his findings: Sectors with the highest operating margins include energy (reflecting higher oil prices), a few technology groups (software and semiconductors) and, interestingly, tobacco (a declining, but high-profit business). On the downside, those sectors with the lowest operating margins include four industry groups from the retail space (not surprising, given this sector's history of low operating margins), the young online software sector, and two industries in "long-term trouble," namely, airlines and hotel/gaming.

Damodaran also noted that cost of capital in the U.S. saw its greatest increase last year, from 5.6% at the beginning of 2022 to 9.63% at the start of 2023. In terms of returns, almost 70% of all listed companies across the globe earned returns that were lower than their costs of equity or capital. U.S. companies have the highest percentage of companies that earn more than the cost of capital but still fall short of 50%, his analysis shows.

Expert Testimony

*Another Aspect of the Decision in *Pizza Hut v. Ronak* on Proving LFR*

In awarding no LFR in *Pizza Hut* the Court seemed displeased with the franchisor's estimate of LFR at least in part for two reasons: their estimated revenue forecasts were way too rosy, and Pizza Hut, the franchisor and plaintiff, did not use an expert. The Court specifically noted (in referencing the *Progressive* case which did allow LFR):

"In *Progressive Child Care*, franchisor's 'forensic accountant and damages expert testified to prospective losses of royalty payments' that were 'based on the two franchisee's business records, including enrollment records, cash receipts, account deposit records, check registers, income tax returns for the last five years, weekly revenue reports, sign-in sheets, tuition and income spreadsheets, and monthly royalty summaries.'. By contrast, Pizza Hut did not retain a formal expert, but offered the opinion of [their employee] Short as a lay witness."

Attorneys' Fees

*Another Aspect of *Pizza Hut v. Ronak* on Proving Attorney's Fees - The "Lodestar" Method*

There is a companion case to *Pizza Hut*. It has the same name; but the filing date is 12/22/22.^[1] It is basically a decision on the motion for attorneys' fees. The Lodestar amount found by the Court was \$4,332,504.24 for Haynes & Boone's 8,500 hours on the case after many reductions for other hours by other firms and by lawyers with minimum contact.^[2] Defendant complained that Haynes & Boone charged rates higher than those charged by local attorneys in Texarkana. The Court did not entertain that argument stating, "In this case, the Court finds that Pizza Hut reasonably sought an out-of-town firm with experience especially relevant to the case at bar. . . For example, Ms. Coldwell is a highly regarded attorney who is well known for her franchising expertise, and Haynes & Boone is highly ranked as a firm." [Are her ears burning?]

[1] Also, on appeal to CA 5

[2] “. . . the lodestar amount is calculated by determining the reasonable hours worked and multiplying those hours by a reasonable hourly rate.”

State and Local Tax Nexus

The Death and Aftermath of the “Physical Presence” Rule

In *South Dakota v Wayfair, Inc.* 138 S. Ct. 2080 (2018) Justice Anthony Kennedy wrote his final opinion and overturned *Quill v. North Dakota*[1] and all the tax jurisprudence that had evolved around the “bright line” test requiring “physical presence” to tax out of state operators. It had particular resonance in the sales tax area as it affected out of state franchisors. But in an exhaustive 63-page analysis of the issue and all that came before *Wayfair* and all that has come since, Eric S. Smith, Associate Dean and Professor of Taxation at the Goddard School of Business & Economics, suggests that, on balance, the harm of overruling *Quill* exceeded the benefit.[2]

[1] 504 US 298 (1992)

[2] Smith, Eric S., “A Requiem for the Physical Presence Rule: Deconstructing and Refuting *South Dakota v Wayfair, Inc*” *The Tax Lawyer Vol. 76 No. 1 (Fall 2022)*

Quotations from Vladimir Putin

One has to be insincere and promise something which you cannot fulfill. So, you either have to be a fool who does not understand what you are promising, or deliberately be lying.

I have always reacted negatively to those who with their snotty noses and erotic fantasies prowl into others' lives.

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