



## The Franchise Valuations Reporter

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Our areas of expertise in the franchise, distribution and dealership context are:

Finance, accounting and tax;

Damages, valuations and expert testimony; and

Cyber-security and E-discovery of ESI (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.

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## Damages and Valuations

### ***Rescission: Damages Theories and the Survival of Contract Terms***

Rescission is a remedy under the franchise laws of many states. However, it has become a very broad term which describes a variety of situations based on several different theories:

- “Rescission by agreement” is contractual in nature and theoretically seeks to enforce the contract and allow damages.
- “Rescission for failure of consideration” is usually a plea for rescission (or restitutionary damages) as an alternative to compensatory damages.
- “Rescission for mistake, duress, menace, or undue influence” is a plea by a party:

1) to be relieved of a contract which was defective at its inception because consent was not freely or knowingly given, and 2) obtain restitution.

- “Rescission for illegality” is a remedy which provides restitution with respect to a contract which, at law, was never enforceable.

Thus a claim simply sounding in “rescission” can be very difficult to put through a mathematical damages analysis at least until the underlying theory of the claim is determined.

Also of great import in the rescission context are questions about the survivability

of the other terms of the franchise agreement such as:

- 1) whether an arbitration clause in a franchise agreement sought to be rescinded applies;
- 2) whether post-term covenants not to compete in a franchise agreement sought to be rescinded can be enforced; and
- 3) whether special or consequential damages are available in a rescission action.

A review of the case law reveals that the answer to all of the above is, “It depends.”

### **Valuations: “Discount Rate” Cases**

To prove lost profits and many other types of future oriented damages, a calculation must be made determining lost revenues and expenses. Then the annual “profit” must be reduced to its net present value by applying a “discount rate” to such anticipated future earnings.

*Business Valuation Update*, a professional journal, has identified what they consider to be the most important cases on the issue as follows:

1. *Energy Capital Corp. v. United States*, 302 F.2d 1314 (Fed. Cir. 2002)
2. *Franconia Associates. v. United States*, 61 Fed. Cl. 718 (2004)

## **Nexus Notes**

### **Washington’s Tax Authority Notifies Businesses that “Physical Presence” Is Not a Requirement for Taxability - the B&O Tax is Triggered by Economic Nexus**

On May 28, 2010, the Washington State Department of Revenue issued a notice that pursuant to a law change effective June 1, 2010:

“Washington State’s new economic nexus test goes into effect. The economic nexus test may be met without a physical presence

3. *AlphaMed Pharmaceuticals, Inc. v. Arriva Pharmaceuticals, Inc.*, 432 F. Supp. 2d 1319 (S.D. Fla. 2006)
4. *In re Magna Cum Latte, Inc.*, 2008 WL 2047937 (Bankr. 2008)
5. *Miller Bros. Coal v. Consol of Kentucky, Inc.*, 2009 WL 4904032 (Bkrcty. E.D. Ky.)
6. *Purina Mills, L.L.C. v. Less*, 295 F. Supp. 2d 1017 (N.D. Iowa 2003)
7. *Munters Corp. v. Swissco-Young Industries, Inc.*, 100 S.W.3d 292 (Tex. App. 2003)
8. *Kool, Mann, Coffee & Co. v. Coffey*, 300 F.3d 340 (3d Cir. 2002)
9. *Diesel Machinery, Inc. v. B.R. Lee Industries, Inc.*, 418 F.3d 820 (8th Cir. 2005)
10. *Fairmont Supply Co. v. Hooks Industrial, Inc.*, 177 S.W.3d 629 (Tex. App. 2005)
11. *Olson v. Nieman's, Ltd.*, 579 N.W.2d 299 (Iowa 1998)
12. *Knox v. Taylor*, 992 S.W.2d 40 (Tex. App. 1999)
13. *Burger King Corp. v. Barnes*, 1 F. Supp.2d 1367 (S.D. Fla. 1998)
14. *American List Corp. v. U.S. News and World Report*, 75 N.Y.2d 38 (Court of Appeals 1989)

in Washington. Under the new economic nexus standard franchise fees, royalty income and other income from Washington could become subject to Washington’s business and occupation tax on an apportioned basis.”

The Notice went on to warn:

“Under this new standard, a franchisor has nexus with Washington State if in a tax year it has at least one of the following in Washington State:

- It is commercially domiciled in Washington;
- Property – average value exceeding \$50,000,
- Payroll exceeding \$50,000 (including certain third party costs),
- Sales exceeding \$250,000, or
- At least 25% of its worldwide property, payroll or sales.”

## ESI and E-Discovery

In the past few years, there have been tremendous changes with respect to litigants’ duties to preserve and collect Electronically Stored Information (ESI) and the fulfillment of discovery obligations. The most recent case law in this area should serve as a wake-up call: perfunctory practices based on claims of technical ignorance are no longer acceptable.

Every franchisor should have an updated policies and procedures manual and a plan for dealing with ESI and e-discovery proactively – before litigation or a regulatory investigation commences. Proper archiving, system mapping and preservation procedures for “legal hold” management must be established from the outset to ensure that discovery practices will withstand judicial scrutiny.

### Best Practices

In a paper entitled “E-Discovery: Rules and Best Practices,” presented by Robyn Fuller, Jeff Cowman and Leanna Anderson at the 2010 IFA Legal Symposium, the authors warned:

“Courts are increasingly expecting parties to retain experts, even if at substantial cost, to craft ‘search terms’ as part of a good faith effort to uncover all responsive information. The Court in *O’Keefe* [*United States v. O’Keefe*, 537 F. Supp. 2d 14, 24 (D.D.C. 2008)] made clear that only with great

caution should lawyers take on such tasks, unassisted by experts:

Given this complexity, for lawyers and judges to dare opine that a certain search term or terms would be more likely to produce information than the terms that were used is truly to go where angels fear to tread. This topic is clearly beyond the ken of a laymen and requires that any such conclusion be based on evidence that, for example, meets the criteria of Rule 702 of the Federal rules of Evidence.

No longer are the courts willing to excuse those of us struggling to master the new technologies.”

The authors went on to say:

“Parties and their counsel may wish to consider hiring experienced computer forensics vendors as consultants to assist with e-discovery rather than relying upon their own IT personnel, who may not have been exposed to the rules and requirements of litigation, such as chain-of-custody issues and preservation of metadata and who usually face competing pressures from their other responsibilities for the client’s business operations. E-discovery vendors can accomplish the copying and formatting required to produce in an appropriate form the results of an ESI search. While such costs may prove to be substantial, they often prove to be less than those associated with the time consumed by in-house personnel performing the work themselves and the vendors provide very effective, post-

production retrieval services as needs arise through the course of litigation.”

### The Role of Technical Experts

We cannot emphasize too strongly the wisdom of that advice. Parties must take the necessary steps to properly preserve relevant records for collection, review and production. The message is abundantly clear: courts will impose sanctions for failure to properly fulfill e-discovery obligations. All franchisors should establish written prophylactic policies and procedures, test them in advance, and be sure they are implemented in a timely manner if a legal dispute arises. Using outside experts familiar with ESI and the technical and legal requirements of e-discovery is a sensible place to start that will prove cost-effective in the long run.

As a first step in protecting themselves and their clients, counsel are urged to engage e-discovery experts – such as Franchise Technology Risk Management – to explain

## CyberCrime

### MORE REASONS TO BE FRIGHTENED!

#### Links to Recent Articles on Cyber-Crime

FBI Targets Cyber 'Mules'

[http://online.wsj.com/article/SB10001424052748703565804575238531980928488.html?mod=W\\_SJ\\_business\\_whatsNews](http://online.wsj.com/article/SB10001424052748703565804575238531980928488.html?mod=W_SJ_business_whatsNews)

AT&T Said to Expose iPad Users' Addresses

<http://www.nytimes.com/2010/06/10/technology/10apple.html?scp=1&sq=iphone%20hackers&st=cse>

the nuances of ESI, how it is stored, to what degree it can be recovered, what is metadata, and so forth.

Future issues of this newsletter will address the role of e-discovery experts in creating and testing ESI policies and procedures that will stand up in court, implementing a “litigation hold,” and other timely issues.

*Franchise Technology Risk Management, staffed by franchise law and computer forensics experts, provides consulting and implementation of all aspects of ESI management and e-discovery for franchise systems—from preparation of ESI-related policies and procedures manuals through collection, preservation, processing, production and presentation of ESI. To inquire about our services, please e-mail us at [Info@FTRM.biz](mailto:Info@FTRM.biz) or call 212.689.0400.*

FBI Opens Probe of iPad Breach

[http://online.wsj.com/article/SB10001424052748704312104575299111189853840.html?mod=W\\_SJ\\_hps\\_LEFTWhatsNews](http://online.wsj.com/article/SB10001424052748704312104575299111189853840.html?mod=W_SJ_hps_LEFTWhatsNews)

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