International Franchise Association
54th Annual Legal Symposium
May 15-17, 2022

Maximizing Recovery in a Franchise Case

Panelists:

Marisa Rauchway Sverdlov
Rauchway Law
West Caldwell, New Jersey

Joe Lesovitz, CFE
Citrin Cooperman
Philadelphia, Pennsylvania

Moderator:

Mackenzie Dimitri
Einbinder & Dunn, LLP
New York, New York

I. Introduction

The franchising industry, though rife with opportunity, holds potential for a myriad of legal and economic complications. As many franchisors and franchisees have learned firsthand, disputes can arise from many facets of the franchisor/franchisee relationship. Franchisees and franchisors must often weigh whether it makes good business sense to pursue a legal remedy against a wrongdoer.

The decision to litigate a dispute should never be taken lightly, as running into court (or arbitration, as the case may be) is often a time consuming and expensive ordeal. Accordingly, before engaging in this process, attorneys must consider the threshold question: What can my client reasonably expect to recover from litigation?

For both franchisors and franchisees, maximizing recovery in a franchise case implicates several considerations and factors. Not only do franchise agreements themselves often contain several key provisions affecting a party's potential recovery, laws outside of the four corners of the franchise agreement may affect the types of damages possible in any given dispute.

This paper seeks to provide the reader common types of damage claims in a franchise case, as well as strategies to maximize recovery in such cases. Additionally, this paper will explain the role an expert can play in the valuation of damages in franchise litigation.

II. The Franchise Agreement – Common Clauses and Ancillary Agreements That Impact Damages

A. Liquidated Damages Clauses

Franchise agreements often contain "liquidated damages" clauses, which generally provide a formula for how a franchisor can calculate lost profit damages after the early termination of a franchise agreement. The rationale for the enforcement of liquidated damages clauses is to compensate the franchisor for fees it reasonably expected to earn during the term of the contract. When a franchisee in a ten year franchise term is terminated in year five, for example, the franchisor loses five years of fees it expected to receive from the franchisee over the life of the agreement. Without a liquidated damages clause, and depending on how the recurring fees are structured in the agreement (whether, for example, on a percentage of sales basis or an absolute dollar figure), it can be exceedingly difficult for a franchisor to establish exactly the amount of fees lost due to the early termination. The franchisor can also run up against arguments that a franchisor should be able to immediately mitigate damages by bringing in another franchisee to replace the terminated franchisee. Attorneys representing franchisors should always analyze whether such damages might be imposed in a dispute. Attorneys representing franchisees should advise clients of the potential for liquidated damages – whether the franchisor has alluded to them or not.

A liquidated damages clause takes the guesswork out of this calculation, and can provide an effective response to a defense that the franchisor's damages claim is "speculative." Liquidated damages clauses typically provide that, should a franchisee be terminated before the end of the term, the franchisor can use the average monthly fees paid over a certain time period, multiplied by either a set period of time (typically 24-36 months), or the number of months remaining in the term, whichever is less. This way, a franchisor has a reliable method of calculating damages – already agreed to by the franchisee – for an early exit from the franchise agreement. Additionally, it can be argued, depending on jurisdiction, that this 24 -36 month period represents a reasonable amount of time for a franchisor to mitigate damages by finding a replacement franchisee.

Critically, these liquidated damages clauses can sometimes be found to be unenforceable, depending on the jurisdiction. For example, under Maryland law, a liquidated damages clause is enforceable only where three factors exist: "(1) the clause must provide in clear and unambiguous terms for a sum certain; (2) it must reasonably compensate for damages anticipated by the breach; and (3) it may not be altered to correspond to actual damages determined after the fact."[1] Similarly, under Ohio law, courts will not enforce a liquidated damages clause where "the legitimate objective of the clause" is not to reasonably compensate a party, but rather is merely a "penalty" for violating the franchise agreement.[2] Texas courts will also refuse to enforce liquidated damages clauses where the clause fixes an "unreasonably large" damages amount under the circumstances, amounting to an impermissible "penalty."[3]

The Texas case of Dickey's Barbecue Pit, Inc. v. Neighbors, Docket No. No. 4:14-cv-484, 2015 U.S. Dist. LEXIS 179917 (E.D. Tex. Sept. 18, 2015) is instructive on this point. In that case, a franchisor terminated a franchisee's franchise agreement, at which time the franchisee owed $5,463.00 in past royalty fees. The liquidated damages clause, however, required the terminated franchisee to pay $676,122.55 in damages. The Court held this amount to "clearly" be a penalty, and would not enforce the clause, awarding only $5,463.00 in "actual" damages.[4]

---

[1] Choice Hotels Int'l, Inc. v. Smith Hotel Props., LLC, Docket No. 5:09-CV-00285-80, 2011 U.S. Dist. LEXIS 48928 (E.D.N.C. May 6, 2011) (quoting Bd. of Education of Talbot County v. Heister, 392 Md. 140, 896 A.2d 342, 352 (2006)).

[2] See e.g., Leisure Sys. v. Roundup LLC, Docket No. 1:11-cv-384, 2012 U.S. Dist. LEXIS 155948, *43 (S.D. Ohio Oct. 31, 2012) (holding liquidated damages clause unenforceable because the "stipulated damages provision is . . . so disproportionate in amount such that it operates as an unenforceable penalty").

[3] See e.g., Phillips v. Phillips, 820 S.W.2d 785, 788 (Tex. 1991) (affirming holding that a liquidated damages clause requiring ten times the amount of actual damages is an unenforceable penalty).

[4] 2015 U.S. Dist. LEXIS at *13-14.

It is therefore critical to check the governing law before relying on a liquidated damages clause when assessing the possible value of a claim or potential counterclaim.

B. Limitation on Damages Clauses

Franchise agreements also often provide clauses that limit damages, such as clauses that provide no punitive or incidental damages will be permitted on any claim brought by either party arising out of the franchise relationship. These clauses often also provide carve outs, such as the example clause below:

> The parties hereto and each of them EXPRESSLY WAIVE(S) ANY CLAIM FOR PUNITIVE, MULTIPLE AND/OR EXEMPLARY DAMAGES, except that this waiver and limitation shall not apply with respect to (a) Franchisee's obligation to indemnify Franchisor pursuant to any provision of this Agreement, and/or (b) any claims Franchisor brings against Franchisee and/or Franchisee's guarantors for unauthorized use of the Marks, unauthorized use or disclosure of any Confidential Information, unfair competition, breach of the non-competition covenant and any other cause of action under the Lanham Act and Franchisor shall be entitled to receive an award of multiple damages, attorneys' fees and all damages as provided by law.

In the above sample clause, the parties expressly waive claims for certain types of damages, but exempt a franchisee's indemnity obligation from this damages limitation clause. This type of exclusion aims to protect the Franchisor from the situation where the Franchisor must pay, for example, punitive damages as a result of an occurrence at a franchisee's location, and the franchisee claims there is no indemnity obligation because of this damages limitation clause (assuming the franchise agreement requires the franchisee to provide such indemnification). Similarly, the above-cited sample also removes limitations on damages for certain particularly harmful actions by the franchisee in connection with the Franchisor's intellectual property and confidential information, namely "unauthorized use of the Marks, unauthorized use or disclosure of any Confidential Information, unfair competition, breach of the non-competition covenant and any other cause of action under the Lanham Act."

For conduct these limitations cover, these provisions can dramatically limit the amount of damages that can be sought by either party, and often have the practical effect of limiting damages to the actual amount of losses that are a direct, foreseeable consequence of the violation of the franchise agreement in question. As with liquidated damages provisions, however, practitioners must check the governing jurisdiction to determine the enforceability of these clauses.

For example, in Sanchez v. CleanNet USA, Inc., 78 F. Supp. 3d 747 (N.D. Ill. 2015), the United States District Court for the Northern District of Illinois held a a damages limitations clause to be unenforceable under the Illinois Franchise Disclosure Act (the "IFDA"). In that case, the court recognized that the IFDA provides that "[a]ny condition, stipulation, or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this Act or any other law of this State is void."[5] The clause at issue in that case provided that the parties to the franchise agreement waived claims for punitive damages and recovery of attorneys' fees and costs.[6] The court held that "[b]ecause the Illinois Franchise Disclosure Act, 815 ILCS 705/22, makes franchisors liable to franchisees for damages and attorneys' fees, the remedial limitations in the Franchise Agreement—which includes [a] waiver of punitive damages and recovery of attorneys' fees and costs—are unenforceable."[7] Other state franchise laws have similar prohibitions.[8]

C. Prevailing Party Clauses

Franchise agreements also routinely include "prevailing party" clauses. These clauses typically provide that if any claim is brought by either the franchisor or franchisee, the "winner" of the claim will also receive their attorneys' fees and/or costs in prosecuting/defending against the claim. Notably, these clauses often are either vague or silent as to what actually constitutes a "prevailing" claim. For example, if a franchisee files several claims against a franchisor, and only wins one, who is the prevailing party? What if both parties win some of their claims? What if the case settles? In all of these circumstance, the governing case law may need to be consulted to determine who actually "prevail[ed]" in any given case.

For example, in Discovery Point Franchising v. Miller, 234 Ga. App. 68 (Ga. Ct. App. 1998), the Georgia Court of Appeals was presented with a franchise agreement that contained a "prevailing party" clause that provided "the prevailing party shall be entitled to recover reasonable attorneys' fees and court costs [from] the other party." Both the franchisor and franchisee convinced the jury in the trial court that the other party had breached the agreement, though the jury only awarded damages to the franchisor. Critically, even though both parties had

---

5 78 F. Supp. 3d at 757.

6 Id.

7 Id.

8 See, e.g., New Jersey Franchise Practices Act, N.J.S.A. 56:10-7 (prohibiting "require[ing] a franchisee at time of entering into a franchise arrangement to assent to a release, assignment, novation, waiver or estoppel which would relieve any person from liability imposed by this act); N.J.S.A. 56:10-10 ("Any franchisee may bring an action against its franchisor for violation of this act in the Superior Court of the State of New Jersey to recover damages sustained by reason of any violation of this act . . . Such franchisee, if successful, shall also be entitled to the costs of the action including but not limited to reasonable attorney's fees;" and see, e.g., New York Franchise Sales Act, N.Y. Gen. Bus. §687 ("Any condition, stipulation, or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this law, or rule promulgated hereunder, shall be void.")

"prevailed" by showing the other party had breached the franchise agreement, the court determined that only the party that had been awarded damages constituted the prevailing party under the franchise agreement, and therefore only awarded attorneys' fees to the franchisor.

As another example, the Indiana case of Jessup v. Chi. Franchise Sys., Docket No. 29A02-1302-PL-160 (Ct. App. Ind. Nov. 26, 2013) is instructive: In that case, the court held that in order to be a "prevailing party," a party must win "a trial on the merits" and obtain "entry of a favorable judgment." Accordingly, following this court's rationale, winning, for example, a preliminary injunction would not entitle a party to attorneys' fees – which could be quite considerable – for winning such temporary relief.

D. Personal Guarantees

The personal guaranty – required by the vast majority of franchise agreements – is often a critical document to maximizing damages (or at least the collectability of damages) for claims brought by the franchisor. Generally, a personal guaranty in a franchise agreement requires anyone with an ownership interest (sometimes a minimum percentage is required), to individually guaranty the obligations of the franchisee company entity. This way, the owners of the franchisee entity cannot hide behind the corporate entity they have created to, for example, stop paying fees under the agreement. Franchisors often require owners' spouses to also sign personal guarantees, so as to avoid potential collection issues with jointly held assets. For example, where a franchise is sold in a state subject to "community property" laws, and both spouses do not sign personal guaranties, the franchisor may find it impossible to collect on a debt against the franchisee because all assets are not subject to collection unless a judgment is obtained against both spouses.

To the extent a franchisor has claims against a franchisee entity, and the franchisee entity has no assets, the personal guarantees may be critical to recover any monetary damages at all, as a result of a breach of the franchise agreement.

Franchisors should take care to ensure that personal guarantees are executed by all parties against whom it would seek to enforce a judgement. In the Georgia case of Groth v. Ace Cash Express, Inc., 623 S.E.2d 208, 209, 276 Ga. App. 350, 351 (Ga. App. 2005), the franchisees of a check cashing franchise assigned their business to new operators. The assignment stated as follows:

> Assignee hereby assumes the obligations and liabilities of Assignor in and under the Franchise Agreement, including to personally guarantee the obligations of the Assignee as set forth in the Franchise Agreement under **Exhibit F—Guaranty** which is attached hereto as Exhibit A.[9]

[9] 623 S.E.2d at 209.

The partners of the entity-assignee signed as "partners" of the entity-assignee.[10] The Court of Appeals of Georgia reversed the trial court and held that "a single signature generally denotes that the person is signing in either an individual or representative capacity, but not both."[11] Because of the format of the signature block and the fact that the contract did not "unequivocally state" that the individuals were guaranteeing the entity-assignee's debt.[12]

III. Statutory Claims – Common Statutory Claims That Can Impact Damages

State statutes and federal regulations can have a significant impact on a franchisor or franchisee's potential recovery in litigation.

A. State Disclosure and "Little FTC" Laws

The federal FTC Rule provides a litany of requirements that franchisors must follow. However, there is no private right of action for violating this federal regulatory framework. Nevertheless, several states have enacted state statutes – including, without limitation, "Little FTC" laws - which often provide a private right of actions for franchisees against franchisors. In addition to monetary damages, including punitive damages and costs, the statutes also often provide for rescission as an express remedy for a franchisor's violation of state disclosure laws.

States that have franchise disclosure laws that specifically provide for private rights of actions include: California, Hawaii, Indiana, Illinois, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington and Wisconsin. Other states afford franchisees private rights under consumer protection/unfair trade practices laws,[13] though not all states provide private rights to franchisees under such statutes.[14]

Critically, even where franchisees are entitled to a private right of action under these statutes, the specific unlawful conduct that gives rise to claims varies considerably. For example, in New York, a litigant can bring a private cause of action against a franchisor who does not timely provide a franchise disclosure document, while the same failure in Maryland does not give rise to a private right of action.[15] In Indiana, a private right of action exists "only for acts which constitute

---

[10] Id.
[11] Id.
[12] Id.
[13] See e.g., Aurigemma v. Arco Petroleum Products Co., 734 F. Supp. 1025, 1027 (D. Conn. 1990) (Franchisee has private right of action against Franchisor for violation of federal disclosure laws under Connecticut Unfair Trade Practices Act (CUTPA), Conn. Gen. Stat. § 42-110b).
[14] See e.g., IOWA CODE 714.16; TENN. CODE ANN. 47-18-104 (b)(27).
[15] See A Love of Food I, LLC v. Maoz Vegetarian USA, Inc., 70 F. Supp. 3d 376, 410 (D.D.C. 2014 ("The [New York "Little FTC"] differs from the [Maryland "Little FTC"] insofar as New York law provides a cause of action for the selling of a franchise without timely disclosure of the offering prospectus. See N.Y. Gen. Bus.

fraud, deceit or misrepresentation," and not for otherwise technical violations of Indiana's statute.[16]

For the broader "Little FTC" statutes – which encompass conduct outside of franchising as well – the types of claims that give rise to private rights also vary. For example, under the Florida Deceptive and Unfair Trade Practices Act, a franchisee may sue a franchisor where the franchisee can show (1) a deceptive act or unfair practice; (2) causation; and (3) actual damages.[17] Under the Colorado Consumer Protection Act, a franchisee must make a more robust showing, namely (1) the defendant engaged in an unfair or deceptive trade practice; (2) the deceptive trade practice occurred in the course of the defendant's business; (3) the deceptive trade practice significantly impacted the public as actual or potential customers of the defendant's business; (4) the plaintiff suffered an injury to a legally protected interest; and (5) the deceptive trade practice caused the plaintiff's injury.[18]

Once a litigant establishes that a claim gives rise to liability under any given statute, the next step is to determine the types of damages available. Once again, damages remedies vary. For example, in New York, a franchisee can recover damages from a franchisor who violated the state's disclosure laws when selling the franchise in question to the franchisee. If the franchisee can establish that such violation was willful and material, then the franchisee may also be entitled to rescission (discussed in further detail below) of the franchise agreement, including recovery of all money paid by the franchisee to the franchisor, with interest, attorney's fees and costs.[19] Both California and Illinois' franchise disclosure statutes provides for similar remedies, though notably Illinois law does not impose a willful or material requirement to be entitled to rescission.[20] Furthermore, in

L. § 691(1) (noting that selling a franchise in violation of section 683 leads to civil liability); id. § 683 (setting forth the disclosure requirements)).

[16] Continental Basketball Ass'n v. Ellenstein Enters., 669 N.E.2d 134, 137 (Ind. 1996).

[17] FLA. STAT. 501.203.

[18] Rhino Linings USA, Inc. v. Rocky Mountain Rhino Lining, Inc., 62 P.3d 142, 146-147 (Colo. 2003).

[19] See e.g. N.Y. Gen. Bus. § 691 ("A person who offers or sells a franchise in violation of section six hundred eighty-three, six hundred eighty-four or six hundred eighty-seven of this article is liable to the person purchasing the franchise for damages and, if such violation is willful and material, for rescission, with interest at six percent per year from the date of purchase, and reasonable attorney fees and court costs.")

[20] See e.g. Cal. Corp. Code 31300 ("Any person who offers or sells a franchise in violation of Section 31101, 31110, 31119, 31200, or 31202, or in violation of any provision of this division that provides an exemption from the provisions of Chapter 2 (commencing with Section 31110) of Part 2 or any portions of Part 2, shall be liable to the franchisee or subfranchisor, who may sue for damages caused

some states, such as New York and Illinois, a franchise can obtain damages not only from the franchisor entity itself, but potentially also from a franchisor's officers or directors.[21]

States' broader "Little FTC" laws also provide for a range of remedies. For example, under Connecticut's unfair trade practices statute, a franchisee can seek both compensatory damages and punitive damages from a franchisor.[22]

---

thereby, and if the violation is willful, the franchisee may also sue for rescission, unless, in the case of a violation of Section 31200 or 31202, the defendant proves that the plaintiff knew the facts concerning the untruth or omission, or that the defendant exercised reasonable care and did not know, or, if he or she had exercised reasonable care, would not have known, of the untruth or omission."); see also, Illinois Franchise Disclosure Act of 1987, 815 ILCS 705/26 ("Any person who offers, sells, terminates, or fails to renew a franchise in violation of this Act shall be liable to the franchisee who may sue for damages caused thereby . . . [and with certain exceptions] [i[n the case of a violation of Section 5, 6, 10, 11, or 15 of the Act [815 ILCS 705/5, 815 ILCS 705/6, 815 ILCS 705/10, 815 ILCS 705/11, or 815 ILCS 705/15], the franchisee may also sue for rescission.")

[21] See id. ("A person who directly or indirectly controls a person liable under this article, a partner in a firm so liable, a principal executive officer or director of a corporation so liable, a person occupying a similar status or performing similar functions, and an employee of a person so liable, who materially aids in the act of transaction constituting the violation, is also liable jointly and severally with and to the same extent as the controlled person, partnership, corporation or employer. It shall be a defense to any action based upon such liability that the defendant did not know or could not have known by the exercise of due diligence the facts upon which the action is predicated."); see also, Illinois Franchise Disclosure Act of 1987, 815 ILCS 705/26 ("Every person who directly or indirectly controls a person liable under this Section 26, every partner in a firm so liable, every principal executive officer or director of a corporation so liable, every manager of a limited liability company so liable, every person occupying a similar status or performing similar functions, and every employee of a person so liable, who materially aids in the act or transaction constituting the violation, is also liable jointly and severally with and to the same extent as such person, unless said person who otherwise is liable had no knowledge or reasonable basis to have knowledge of the facts, acts or transactions constituting the alleged violation.")

[22] See Conn. Gen. Stat. § 42-110g ("Any person who suffers any ascertainable loss of money or property, real or personal, as a result of the use or employment of a method, act or practice prohibited by section 42-110b, may bring an action in the judicial district in which the plaintiff or defendant resides or has his principal place of business or is doing business, to recover actual damages. Proof of public interest or public injury shall not be required in any action brought under this section. The court may, in its discretion, award punitive damages and may provide such equitable relief as it deems necessary or proper.")

In sum, as each state's disclosure and/or "Little FTC" laws contain nuances specific to each jurisdiction, practitioners must review each statutory/regulatory framework carefully to assess the full scope of the remedy afforded franchisees for franchisor disclosure violations.

B. Rescission

Fourteen states have franchise-specific statues that set forth various grounds for a franchisee to rescind a franchise agreement and describe the types of restitutionary relief available to the franchisee upon rescission. While certain states allocate restitutionary damages in the case of contract rescission[23], others do not.[24]

In addition to statutory claims, franchisees may seek rescission when suing for fraud based on a material misrepresentation.[25] According to the Restatement, a plaintiff may seek rescission when his or her "manifestation of assent" is "induced by either a fraudulent or a material misrepresentation by the other party upon which the recipient is justified in relying" and thus may seek to void the contract.[26] Some states, like California, will bar a claim for rescission in certain cases where either the franchisee knew of the misrepresentation or the Franchisor could not have reasonably known of the misrepresentation.[27]

---

[23] See Cal. Civ. Code § 1692, providing as follows:

> When a contract has been rescinded in whole or in part, any party to the contract may seek relief based upon such rescission by (a) bringing an action to recover any money or thing owing to him by any other party to the contract as a consequence of such rescission or for any other relief to which he may be entitled under the circumstances or (b) asserting such rescission by way of defense or cross-complaint.
> . . .
> A claim for damages is not inconsistent with … rescission. The aggrieved party shall be awarded complete relief, including restitution of benefits, if any, conferred by him as a result of the transaction and any consequential damages to which he is entitled; but such relief shall not include duplicate or inconsistent items of recovery.

[24] See e.g. Va. Code § 13.1-557 et seq. Virginia's code does not allocate restitutionary damages in the case of contract rescission.
[25] See Restatement (Second) of Contracts § 164.
[26] Id.
[27] See Cal. Corp. Code 31300 ("Any person who offers or sells a franchise in violation of Section 31101, 31110, 31119, 31200, or 31202, or in violation of any

Rescission is an equitable remedy and it is within a trial court's discretion to adjust the equities "to do justice between the parties." Lumsden v. Lawing, 107 N.C. App. 493, 504, 421 S.E.2d 594, 601 (1992). A crucial element in contract rescission is the return to the status quo, but courts differ on how to restore the franchisee to its pre-contractual position. In the pro-franchisee case of Young v. T-Shirts Plus, Inc., 349 N.W.2d 109 (Wis. App. 1984) (unpublished opinion), the Court of Appeals of Wisconsin held that the franchisee was entitled to not only recover operating losses, but also lost wages (subject to offsets for any income or profit received as a result of the franchise). Contrary to the approach taken in Young, some courts approach restitution damages as awarding the plaintiff only the benefits conferred upon the other party (and not reliance damages due to monies expended and paid to third parties). See DeRosa v. Boston Bakery & Italian Food Specialty, Inc., 98 B.R. 644 (D.R.I. 1989) (distinguishing between restitution and reliance damages).

C. Franchise Relationship Laws

Franchisees in several states may also find themselves entitled to damages – and non-monetary relief – pursuant to state franchise relationship laws. While these laws also vary widely, each generally governs a franchisor's conduct during the franchise relationship, and often override the express language of the franchise agreement. Nearly half the states in the country have some form of franchise relationship law in place.

For example, the New Jersey Franchise Practices Act, N.J.S.A. 56:10-1 et seq. (the "NJFPA"), is a particularly powerful franchise relationship law. If a franchisee can establish a violation of the NJFPA, the franchisee can seek damages, attorneys' fees and, in appropriate cases, injunctive relief from the franchisor.[28] The NJFPA prohibits franchisors from, in most circumstances, terminating or failing to renew a franchisee without providing at least sixty (60) days' notice and a showing of "good cause." The NJFPA also prohibits franchisors from imposing "unreasonable standards" on a franchisee, a vague standard that

provision of this division that provides an exemption from the provisions of Chapter 2 (commencing with Section 31110) of Part 2 or any portions of Part 2, shall be liable to the franchisee or subfranchisor, who may sue for damages caused thereby, and if the violation is willful, the franchisee may also sue for rescission, unless, in the case of a violation of Section 31200 or 31202, the defendant proves that the plaintiff knew the facts concerning the untruth or omission, or that the defendant exercised reasonable care and did not know, or, if he or she had exercised reasonable care, would not have known, of the untruth or omission").

[28] N.J.S.A. 56:10-10 ("Any franchisee may bring an action against its franchisor for violation of this act in the Superior Court of the State of New Jersey to recover damages sustained by reason of any violation of this act and, where appropriate, shall be entitled to injunctive relief. Such franchisee, if successful, shall also be entitled to the costs of the action including but not limited to reasonable attorney's fees.")

can potentially be used by franchisees to push back on onerous franchise agreement provisions. Franchisors are also prohibited from requiring a franchisee from signing away a franchisee's rights under the NJFPA as a condition of entering into a franchise agreement. Notably, these requirements will override any language in a franchise agreement that purports to override the requirements of the NJFPA.

Other examples of states with franchise relationship laws include, without limitation, Nebraska, Wisconsin, Minnesota and California. Nebraska's statutory framework includes nearly identical language to the NJFPA regarding entitlement to damages, neither of which spell out how to exactly calculate damages.[29] California's relationship statute, on the other hand, provides somewhat more guidance for how to calculate damages from the loss of a franchise, providing "[i]n the event a franchisor terminates or fails to renew a franchisee, in violation of this chapter, the franchisee shall be entitled to receive from the franchisor the fair market value of the franchised business and franchise assets and any other damages caused by the violation of this chapter."[30]

Critically, not all franchise relationships are protected by state franchise relationship laws, and practitioners, once again, must review the applicable state's specific regulatory/statutory framework to determine if a franchisee can take advantage of any remedies the statute in question provides. Once again, the NJFPA is instructive. This statute requires, in part, that the franchise agreement in question contemplate or require that the franchisee have a "place of business" in New Jersey, a phrase that is narrowly defined. Specifically, for businesses that make a majority of sales directly to consumers, a "place of business" must be a brick-and-mortar location "at which the franchisee displays for sale and sells the franchisor's goods or offers for sale and sells the franchisor's services," and cannot be merely "an office, a warehouse, a place of storage, a residence or a vehicle." This definition often results in franchise businesses where services are performed solely at consumers homes – such as home cleaning or home health aide services – from not being afforded the protections of the NJFPA.

D. Antitrust/Robinson-Patman Act

[29] Cf. R.R.S. Neb. § 87-409 ("Any franchisee may bring an action against its franchisor for violation of sections 87-401 to 87-410 to recover damages sustained by reason of any violation of sections 87-401 to 87-410 and, when appropriate, shall be entitled to injunctive relief. The prevailing party in any action brought pursuant to this section shall be entitled to the costs of the action including but not limited to reasonable attorney's fees"); N.J.S.A. 56:10-10 ("Any franchisee may bring an action against its franchisor for violation of this act in the Superior Court of the State of New Jersey to recover damages sustained by reason of any violation of this act and, where appropriate, shall be entitled to injunctive relief. Such franchisee, if successful, shall also be entitled to the costs of the action including but not limited to reasonable attorney's fees.")

[30] Cal. Bus. & Prof. Code § 20035.

Franchisees may also have antitrust claims – under federal antitrust law and/or state law counterparts – against franchisors that can result in significant damages for franchisees who can establish a franchisor has committed an antitrust violation. Critically, federal antitrust claims provide for not only attorney's fees to a prevailing party, but also triple damages.[31] These violations include a host of potential claims revolving around a franchisor's unlawful "restraint of trade."

For example, the Robinson-Patman Act, 15 U.S.C. 13, generally prohibits (subject to certain defenses) a franchisor from selling products/services at different prices to franchisees who compete against each other, as well as discrimination in the provision of promotional and/or marketing benefits where such promotional benefits are not administered based on some objective, "'proportionally equal' criteria."[32] Moreover, courts have recognized discrimination in credit terms as a violation of the Robinson-Patman Act.[33]

In Schwartz v. Sun Co., 276 F.3d 900 (11th Cir. 2002), a multi-unit gas station franchisee filed suit against the Sun Company franchisor, alleging that the franchisor was selling its Sunoco-branded gas to competing stations at prices lower than what plaintiff was receiving. Plaintiff specifically alleged that such conduct was a violation of, inter alia, the Robinson-Patman Act, 15. U.S.C. 13(a). Although the trial court granted the franchisor's motion for summary judgment on plaintiff's Robinson-Patman Act claim, the 11th Circuit Court of Appeals reversed, holding that a jury award of $ 2,486,138 should be reinstated (which included trebling of damages). The Court explained that Plaintiff franchisee had established a Robinson-Patman Act claim for price discrimination by showing: "(1) the defendant discriminated in price between different purchasers of commodities of like grade and quality, and (2) the effect of that discrimination was to substantially lessen competition or tend to create a monopoly." Regarding the second prong, the Court expressed that plaintiff franchisee's burden was not particularly onerous, providing, in part: "If nothing else, [plaintiff] showed that the volume of gasoline sold at his stations decreased when [competitors] opened Sun stations nearby that

[31] See 15 U.S.C. 15(a) ("any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.")

[32] See Alan's of Atlanta, Inc. v. Minolta Corp., 903 F.2d 1414 (11th Cir. 1990) (Robinson-Patman Act "requires that purchasers be given an equal opportunity to participate in certain types of seller programs relating to the resale of products, such as advertising and promotional programs, and that the benefits under those programs be disbursed on equal terms to purchasers in proportion to some objective value of their participation.")

[33] See e.g., Carlo C. Gelardi Corp. v. Miller Brewing Co., 502 F. Supp. 637, 647 (D.N.J. 1980) ("discrimination in credit terms can amount to price discrimination in violation of [the Robinson-Patman Act]").

sold the same gas at a lower retail price. It was reasonable for the jury to infer from this that [plaintiff's] customers became customers of [competitors] who were offering lower prices because of the lower price at which they were receiving the gas from Sun."

Another instructive case – though not a traditional franchise case – is the Third Circuit Court of Appeals case of Orologio of Short Hills Inc. v. Swatch Group, 653 Fed. Appx. 134 (3d Cir. June 24, 2016). In that case, a watch distributor filed a Robinson-Patman claim against one of its suppliers, Swatch Group (U.S.) Inc., alleging, in part, that the supplier unlawfully provided promotional benefits to other authorized Swatch dealers who competed with plaintiff for customers, such as co-operative advertising opportunities. Although the trial court granted summary judgment to Swatch, the Third Circuit Court of Appeals reversed, holding that claimant had produced evidence that a reasonable jury could find established a Robinson-Patman violation.[34]

In sum, to the extent a franchisee can establish that a franchisor has been offering price breaks to other franchisees, and/or offering specific advertising benefits to a franchisee that is driving business away from another franchisee in the same market (and no proportionally equal benefit is offered to the harmed franchisee), a Robinson-Patman Act claim against the franchisor may result.

E. Federal and State Intellectual Property Statutes

Franchisors also can seek damages – as well as injunctive relief – from a series of federal and state laws aimed at providing relief for unlawful use/misappropriation of intellectual property. For example, not only do most states have laws prohibiting misappropriation of a franchisor's trade secrets, the Defend Trade Secrets Act of 2016 ("DTSA") also provides a federal private right of action to franchisors (and access to federal courts) to pursue claims for misappropriation of trade secrets.[35] Under the DTSA, protected intellectual property can broadly include "'all forms and types of financial, business, scientific, technical, economic, or engineering information,' regardless of whether it is tangible or intangible, or how the information is stored, memorialized, or maintained."[36] Notably, under the

[34] See also 16 C.F.R. 240.10(b) (""The seller has an obligation to take steps reasonably designed to provide notice to competing customers of the availability of promotional services and allowances"); 16 C.F.R. § 240.8 ("A seller who makes payments or furnishes services that come under the Act should do so according to a plan. . . . The seller should inform competing customers of the plans available to them, in time for them to decide whether to participate.")
[35] See 18 U.S.C.S. § 1836 ("An owner of a trade secret that is misappropriated may bring a civil action under this subsection if the trade secret is related to a product or service used in, or intended for use in, interstate or foreign commerce.")
[36] Brightview Grp., LP v. Teeters, 441 F. Supp. 3d 115, 129 (D.C. Md. 2020).

DTSA, a franchisor that can establish that misappropriation was willful/malicious can seek, without limitation, double damages and attorney's fees.[37]

Additionally, for franchisees who use a franchisor's trademark without permission after the relationship has ended, the Lanham Act provides for monetary damages (in addition to injunctive relief). Specifically, the Lanham Act can provide franchisors with potentially three times the amount of a franchisor's actual damages as a result of unauthorized use of its trademark, as well as any profits the unauthorized franchisee obtained (so long as recovery is not duplicative).[38]

---

[37] See 18 U.S.C.S. § 1836 ("if the trade secret is willfully and maliciously misappropriated, award exemplary damages in an amount not more than 2 times the amount of the damages awarded.")

[38] 15 U.S.C.S. § 1117 provides, in part, for the following damages:

> **(a) Profits; damages and costs; attorney fees.** When a violation of any right of the registrant of a mark registered in the Patent and Trademark Office, a violation under section 43(a) or (d) [15 USCS § 1125(a) or (d)], or a willful violation under section 43(c) [15 USCS § 1125(c)], shall have been established in any civil action arising under this Act, the plaintiff shall be entitled, subject to the provisions of sections 29 and 32 [15 USCS §§ 1111, 1114], and subject to the principles of equity, to recover (1) defendant's profits, (2) any damages sustained by the plaintiff, and (3) the costs of the action. The court shall assess such profits and damages or cause the same to be assessed under its direction. In assessing profits the plaintiff shall be required to prove defendant's sales only; defendant must prove all elements of cost or deduction claimed. In assessing damages the court may enter judgment, according to the circumstances of the case, for any sum above the amount found as actual damages, not exceeding three times such amount. If the court shall find that the amount of the recovery based on profits is either inadequate or excessive the court may in its discretion enter judgment for such sum as the court shall find to be just, according to the circumstances of the case. Such sum in either of the above circumstances shall constitute compensation and not a penalty. The court in exceptional cases may award reasonable attorney fees to the prevailing party.
>
> **(b) Treble damages for use of counterfeit mark**. In assessing damages under subsection (a) for any violation of section 32(1)(a) of this Act [15 U.S.C.S. § 1114(1)(a)] or section 220506 of title 36, United States Code, in a case involving use of a counterfeit mark or designation (as defined in section 34(d) of this Act [15 USCS § 1116(d)]), the court shall, unless the court finds extenuating circumstances, enter judgment for three times such profits or

Franchisors have considerable latitude to establish the scope of damages under the Lanham Act, rendering the statute particularly appealing where the facts and circumstances warrant.[39]

IV. The Role of the Expert- Valuing Damages

> damages, whichever amount is greater, together with a reasonable attorney's fee, if the violation consists of—
>
> > (1) intentionally using a mark or designation, knowing such mark or designation is a counterfeit mark (as defined in section 34(d) of this Act [15 USCS § 1116(d)]), in connection with the sale, offering for sale, or distribution of goods or services; or
> > (2) providing goods or services necessary to the commission of a violation specified in paragraph (1), with the intent that the recipient of the goods or services would put the goods or services to use in committing the violation.
>
> In such a case, the court may award prejudgment interest on such amount at an annual interest rate established under section 6621(a)(2) of the Internal Revenue Code of 1986 [26 USCS § 6621(a)(2)], beginning on the date of the service of the claimant's pleadings setting forth the claim for such entry of judgment and ending on the date such entry is made, or for such shorter time as the court considers appropriate…

[39] See Ramada Inns, Inc. v. Gadsden Motel Co., 804 F.2d 1562, 1565 (11th Cir. 1986) ("In making a damage assessment, the district court may allow recovery for all elements of injury to the business of the trademark owner proximately resulting from the infringer's wrongful acts."). The Court went on to explain as follows:

> Where the wrong is of such a nature as to preclude exact ascertainment of the amount of damages, plaintiff may recover upon a showing of the extent of damages as a matter of just and reasonable inference, although the result may be only an approximation. Story Parchment Company v. Paterson Parchment Paper Company, 282 U.S. 555, 563, 51 S. Ct. 248, at 250, 75 L. Ed. 544 (1931). The wrongdoer may not complain of inexactness where his actions preclude precise computation of the extent of the injury. Eastman Kodak Company v. Southern Photo Company, 273 U.S. 359, 379, 47 S. Ct. 400 [405], 71 L. Ed. 684 (1927).

Id. (citing Bangor Punta Operations v. Universal Marine Company, 543 F.2d 1107, 1110-11 (5th Cir.1976); Borg-Warner Corporation v. York-Shipley, Inc., 293 F.2d 88, 95 (7th Cir.1961)).

Industry participants may find themselves thousands of dollars into an economic damages case almost without warning. A forensic accountant or an economic damages expert, engaged to calculate damages, is integral in such a case. This section aims to provide this paper's readers with a helpful and informative guide to identifying, conceptualizing, and calculating economic damages within the franchise industry through the diversified lens of the expert.

A. Overview of Expert Valuation of Damages

Prior to any damage calculation, regardless of the approach or methodology utilized to quantify damages, an expert should perform certain steps to evaluate the matter.

First, before a case is accepted, the expert should consider his or her professional standards within the context of the case. For example, does this case require the expert to a take a position he or she knows is unsupportable or contrary to his or her professional standards? Will involvement in the matter jeopardize the expert's credibility by providing an opinion that may be excluded by a Court? What type of exposure (positive or negative) will the expert and his/her firm get if information becomes publicly available?

Second, he or she must confirm or expand upon their understanding of the legal matters involved, including when federal or state law could potentially affect the expert's calculation.[40] For example, certain jurisdictions have different applications of pre-judgment interest to a damages award including methodology (simple vs. compounded) and interest rate.

Third, the expert must analyze the following items to prepare a reasonably certain calculation of economic damages:

- Factual basis for the claim;
- Cause of loss by establishing a link between the alleged wrongful act and the damages sustained;
- Determination of evidence supporting the financial claims; and
- Financial documentation including financial statements, projections, budgets, market and industry data

This third step is of vital importance. "The practitioner is responsible for gathering enough sufficient relevant data to provide a reasonable basis for the opinions offered. It is up to the individual practitioner to decide the type, nature, and quantity of data that will satisfy this requirement."[41]

---

[40] AICPA Calculating Lost Profits, 11.
[41] Id., 7.

Once professional ethics requirements are satisfied, a damages expert will proceed to give appropriate consideration of factors such as sales and expenses, contracts or agreements, accounting books and records, historical sales trends, and any prospective financial data where supportable assumptions are made. As such, once the "basics" are covered and after careful consideration of the facts pertinent to the matter, the expert is able to proceed in choosing a methodology upon which to build his or her expert testimony.

There are several different methodologies a damages expert may use when calculating damages, though the scope of this paper will limit to the following in the franchise industry: (1) rescission, (2) breach of contract, (3) lost profits or revenues, (4) disgorgement, (5) calculations for royalties lost, and (6) business valuation

B. Rescission and Damages

As previously detailed, rescission is a remedy that, at a minimum, permits a franchisee to "undo" the franchise agreement and receive a refund of all of the moneys paid to the franchisor in connection with the investment. From a damages perspective, a remedy of rescission strives to place the injured party back into the position it was before entering the contract. On the contrary, expectation damage such as lost profits seeks to compensate the injured party for losses as if the contract had not been breached.

In the case of a franchise dispute, a party seeking a rescission of a contract may quantify losses that include, among others:

- Monetary amounts paid to the other party to the contract
- Expenses incurred during the due diligence process
- Operating expenses incurred for the business operations
- Capital expenses for assets contemplated to be used to operate the business

After quantifying the losses incurred by entering the contract, the injured party may need to reduce the losses by any gains realized during the contract.

C. Breach of Contract Damages

Breach of contract cases involve a party's general failure to fulfill its performance obligations as outlined in the contract or agreement, thus resulting in a either loss of potential revenues / profits or an unjust enrichment, also known as ill-gotten gains or disgorgement. Damages of these types are required to be "reasonably foreseeable [by both parties] at the time of contracting." [42]

Envision a franchisee has broken off from its 10-year partnership to join a competitor, thus violating a noncompete clause in the franchise agreement. The

[42] Id., 16.

contract has been breached and the competitor has wrongfully diverted customers from the franchise. The franchisor's attorney hires a damages expert to perform a damages calculation for the alleged wrongdoing and to ultimately testify as an expert witness in court or arbitration.

If the damages expert performed his or her professional ethical requirements and decided to accept the case, he or she would immediately identify the damage as an alleged breach of contract and loss of profits on behalf of the franchisor. As such, the damages expert is presented with several options in way of remedy calculation methods. Taking into account the particulars of the case, the practitioner has narrowed down his or her choices to the following two types of compensatory damages:

Types of Damages[43]	**Methodology**
Benefit-of-the-bargain	The difference between the amount the plaintiff could be expected to have received and the amount the plaintiff received
Reliance	The amount required to restore the injured party to the economic position occupied before the injured party acted in reasonable reliance on a promise.

The practitioner's next consideration is how to measure the duration in which the damages were incurred. Better known as the loss period, it generally begins on the date of the wrongful act and continues through the date operations resume as normal, or when the business may resume making profits at the same rate as before the wrongful act had occurred. However, the definition of this period is often largely more difficult than it may seem. The damages expert must consider numerous factors, such as, but not limited to[44]:

- The effective date of the contract
- Court filings, such as pleadings or rulings
- Court testimony
- Case law specific to the case's jurisdiction
- Discussions with the client and counsel
- Whether or not the business survived
- Historical operations of the business
- Relevant industry data such as average lifespan of the type of franchise
- The date of a termination provision in a contract

In the case of our franchise dispute example, information such as the length of the contact and the agreed timeframe of the noncompete clause must also be

[43] AICPA Calculating Lost Profits, 12
[44] Id., 26-28.

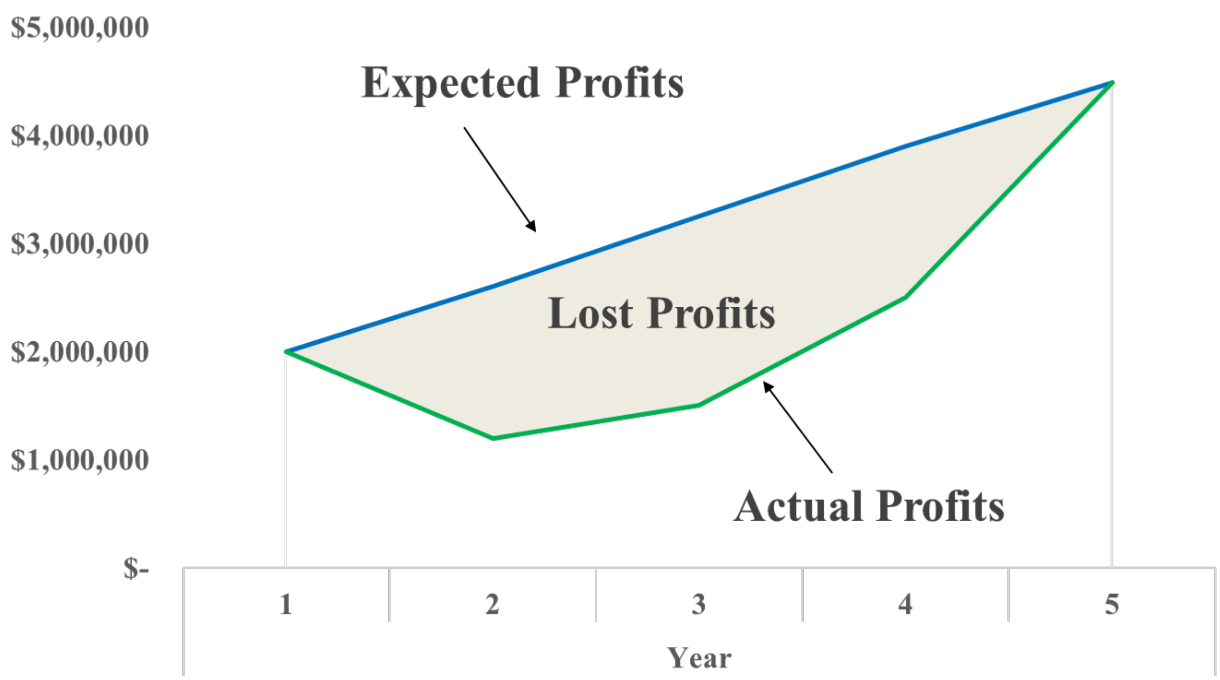
taken under consideration. Once the loss period has been determined, a practitioner will then move onto the next step of his or her calculation: the calculation of lost profits.

D. Lost Profits Damages

One consistent theme in calculating damages in a franchise case is the injured party's entitlement to recover lost profits due to the alleged misconduct. Lost profits in the case of a franchise dispute, are calculated based on the profits the injured party would have made pursuant to the franchise agreement "but for" the alleged actions of the defendant/respondent.[45] Simply put, lost profits are equal to lost revenues less avoided or incremental costs. However, despite a straightforward formula, the calculation and associated inputs are anything but simple. Specific to a franchise dispute, in some cases the economic harm suffered by a franchisor may result in lost royalty revenue pursuant to the franchise agreement, lost transfer fees or other fees pursuant to the franchise agreement and lost local and national marketing contributions.

If the franchisor's profits have been harmed from the alleged breach in contract, in addition to or outside of the examples cited above, the damages expert may perform a lost profits calculation to ascertain the economic harm. The chart below depicts a scenario where lost profits is represented by the gap between expected and actual profits for a growing business, similar to that of our franchise example. At the inception of the alleged wrongdoing, actual profits start to gradually decrease as expected profits increase as a steady pace. By year two, actual profits recover slightly, though the gap between expected and actual profits increases. Activity between years four to five represents mitigation of the alleged wrongdoing, as lost profits taper off where actual profits rise to meet expected profits once again.

[45] Lost profits calculations for franchise matters often address the royalty rate as agreed-upon in the franchising agreement. Note that the periodic royalty payment is typically based on revenues as opposed to profits.



Generally, lost profit damages are based one of the two following models:

Damages Models[46]	Description
Net Incremental Revenues Lost	Net incremental revenue that would have been realized but for the unlawful act, reduced by related by net incremental costs avoided
But-For Profits	Net profits that would have been achieved but for the unlawful act, reduced by actual or mitigating profits (or increased by actual losses) following the unlawful act.

In theory, application of either of the above models results in the same undiscounted lost profits amount, though depending on the circumstances surrounding the case, either one or both may be applicable.[47]

To apply to the facts of a given case, the practitioner will begin by calculating an estimation of the profits that would have been received by the plaintiff but for the alleged wrongful act during the loss period. "'But-for' profits are measured as but-for revenues less but-for expenses (also referred to as avoidable expenses)."[48]

[46] AICPA Calculating Lost Profits, 24.
[47] Id., 24.
[48] Id., 20.

Once but-for profits are calculated, the practitioner will subtract actual profits earned or anticipated to be earned from his or her total. Finally, the result is subject to discount or present value rates to arrive at a lost profits estimate at the time of judgment[49].

As you dive deeper into the specifics of each step, however, the qualitative assumptions may reveal a multitude of gray areas. Note the below non-exhaustive list of methods for quantifying but-for revenues:

But-For Revenue Estimation Methods[50]	**Description**
Before-and-After	Estimates revenue using the plaintiff's performance before the alleged wrongdoing compared to the plaintiff's actual impaired performance following the alleged wrongdoing
Yardstick/Benchmark	Uses a comparable "yardstick" to estimate what the revenues and profits of the business would have been. Examples of potential yardsticks include general economic trends, industry growth, or performance of other unaffected franchise locations.
Underlying Contract Terms	Utilizes underlying contract terms such as number of units to be sold, limitations on damages, or minimum or maximum amounts to be purchased or billed.

But-for expenses, also known as incremental or avoidable costs,[51] pose a similar problem. Incremental costs, central to any damages calculation, are defined as "those costs that are incurred with a change between two scenarios."[52] The purpose of the calculation is dependent on what that "increment" is in each specific case. The determination of this number will include certain tools such as:[53]

- Evaluation of cost line items in accounting records
- Statistical analysis, and
- Company-specific factual investigation.

E. <u>Disgorgement Calculations</u>

[49] Id.
[50] Id., 36-40.
[51] Id., 43.
[52] Id., 44.
[53] Id., 44-45.

Disgorgement, or unjust enrichment, aims to strip the wrongdoer of any gain or benefit realized from the alleged wrongful act.[54] Some examples of gains or benefits received by a wrongdoing within this context include[55]:

- Increased assets in the hands of the defendant;
- Market value of goods or services received by the defendant;
- The use value of any benefits received; and
- Collateral or secondary profits earned by the defendant by use of an asset received from the plaintiff.

If the practitioner determined that the franchisee in our example had wrongfully violated his or her contract through a non-compete clause and had revealed certain trade secrets to the franchise's competitor, the plaintiff may be entitled to the defendant's profits, or ill-gotten gains. According to the Copyright Act, "the [plaintiff] is entitled to recover the actual damages suffered by him or her as a result of the infringement, and any profits of the infringer that are attributable to the infringement and are not taken into account in computing the actual damages."[56]

In summary, the franchisor may be entitled to both a disgorgement of ill-gotten gains *and* an award of damages as a result of the breach of contract in our example. If the practitioner calculates these separate factors, he or she must be cognizant of where the two measures overlap.[57]

Once allocation has taken place between the two measures, the practitioner may proceed in estimating cost deductions from the calculated ill-gotten gains.

Below are several methods for measuring cost deductions in the context of a disgorgement remedies case:

Method[58]	**Description**
Differential Cost Rule	Only specific costs that would not otherwise have been incurred but to produce infringing goods [or services] are allowed as deductions. For example: fixed costs are included in the final disgorgement estimate, while variable costs are deducted.
Direct Assistance Rule	Costs that directly assisted in the production of the infringing goods [or services] are allowed as deductions. For example: some elements of overhead or general administrative expenses are permitted deductions.

54 AICPA Calculating Damages in Intellectual Property Disputes, 26.
55 Id.
56 Id., 104.
57 AICPA Calculating Lost Profits, 12.
58 AICPA Calculating Damages in Intellectual Property Disputes, 106-7.

Fully Allocated Cost Rule	All expense items properly allocated under [GAAP] to the production of the infringing goods [or services] are allowed as deductions.

F. Royalties Lost

There are some instances in which lost profits cases cannot be proven to a corrective extent, though a party may still be entitled to "damages adequate to compensate for the [alleged wrongful act], but in no event less than a reasonable royalty."[59] As a premise, cases such as this must involve a patent, license, trade secret, or other intellectual property. In the context of a franchise dispute, this may involve either an established royalty – likely derived from the franchise agreement – or a calculated royalty in way of negotiation between the parties.[60] Our scope limits our focus on the calculation of a royalty as part of a hypothetical negotiation between two parties.

Practitioners may maximize effectiveness of this sort of analysis using the Georgia-Pacific Corp v. U.S. Plywood Corp patent case as a guide.[61] The case provides 15 factors that have been widely accepted by the courts for the use of calculating a hypothetical royalty in a case such as the aforementioned.[62] The factors are as follows[63]:

> 1. The royalties received by the [plaintiff] for the license … in suit, proving or tending to prove an established royalty
>
> 2. The rates paid by the licensee for the use of other patents comparable to the patent in suit
>
> 3. The nature and scope of the license, as exclusive or nonexclusive, or as restricted or nonrestricted in terms of territory or with respect to whom the manufactured product may be sold
>
> 4. The licensor's established policy and marketing program to maintain its patent monopoly by not licensing others to use the invention or by granting licenses under special circumstances designed to preserve that monopoly
>
> 5. The commercial relationship between the licensor and licensee, such as whether they are competitors in the same territory in the same line of business or whether they are inventor and promoter

---

[59] Id. 62.
[60] Id.
[61] Georgia-Pacific Corp. v. United States Plywood Corp., 318 F. Supp. 1116 (S.D.N.Y. 1970).
[62] AICPA Calculating Damages in Intellectual Property Disputes, 66.
[63] Id., 66-67.

6. The effect of selling the patented specialty in promoting sales of other products of the licensee; the existing value of the invention to the licensor as a generator of sales of its non-patented item; and the extent of such derivative or convoyed sales

7. The duration of the patent and the term of the license

8. The established profitability of the product made under the patent, its commercial success, and its current popularity

9. The utility and advantages of the patent property over the old modes or devices, if any, which had been used for working out similar results

10. The nature of the patented invention, the character of the commercial embodiment of it as owned and produced by the licensor, and the benefits to those who have used the invention

11. The extent to which the infringer has made use of the invention and any evidence probative of the value of that use

12. The portion of the profit or of the selling price that may be customary in the particular business or in a comparable business to allow for the use of the invention or analogous inventions

13. The portion of the realizable profit that should be credited to the invention as distinguished from non-patented elements, the manufacturing process, business risks, or significant features or improvements added by the infringer

14. The opinion testimony of qualified experts

15. The amount that a licensor and a licensee would have agreed upon if both had reasonably and voluntarily tried to reach an agreement, that is, the amount that a prudent licensee — which desired, as a business proposition, to obtain a license to manufacture and sell a particular article embodying the patented invention — would have been willing to pay as a royalty and yet be able to make a reasonable profit, and the amount that would have been acceptable by a prudent patent holder that was willing to grant a license."

To help assist an expert in evaluating the hypothetical negotiation under the framework of the Georgia Pacific factors, an expert may undertake certain analyses and rely on information including, but not limited to, public filings, licenses involving the parties in the case (often produced in discovery), financial records of the parties, sales reports and invoices, technical expert reports, internal company correspondence, marketing plans, correspondence with customers, sales training materials, customer opinion surveys, customer list, industry research, correspondence and testimony of company management, and financial statements.[64]

Other items to consider when an expert evaluates the hypothetical negotiation under the Georgia Pacific framework include licensing history including prior agreements,[65] technical and economic comparability of other licensing agreements,[66] similarity to the intellectual property at issue including royalty structure,[67] and the use of industry / unrelated license agreements.[68]

The reasonable royalty methodology may not be as common of a damages remedy as other methodologies unless there are other factors present including infringement of intellectual property and no presence of a reasonable royalty rate among the franchisee and franchisor. A reasonable royalty methodology may be utilized when the franchisor has lost out on the payment of a royalty by the franchisee's unlawful use of the franchisor's intellectual property.

G. Business Valuation Considerations

In some instances, a dispute between a franchisee and a franchisor may result in economic harm to the current and future value of the franchisor's business. This economic harm may result in decreased cash flows thus reducing the value, in terms of revenue and/or profitability of the business. In these instances, a damages expert may perform a valuation of the business to ascertain the impairment of value to the business.

For example, envision a franchisor opening a new franchise business in direct competition with a current franchisee in violation of a franchise agreement. The franchisee may have a claim for not just lost profits over a definitive time period, but rather a permanent diminution of business value. One of the critical components of a business valuation is the concept that financial information, facts, and circumstances of the subject company may only be considered as of the date of the alleged bad act. If the information, facts, and circumstances are not known or knowable at the time of the alleged bad act, the expert may not be able to consider them in his or her calculations. This concept is in contrast to a lost profits calculation in which the damages expert generally is required to use information subsequent to the alleged bad act.

Typically, a damages expert quantifies the loss in business value by using valuation methodologies to assist in their measurement and would include an income approach, cost approach and/or a market approach.

---

[64] Id., 68-69.
[65] ResQNet.com, Inc. v. Lansa, 594 F.3d 860 (Fed. Cir. 2010).
[66] Uniloc USA, Inc. v. Microsoft Corporation, 632 F.3d 1292 (Fed. Cir. 2011).
[67] Lucent Techs., Inc. v. Gateway, Inc., 580 F.3d 1301 (Fed. Cir. 2009).
[68] IP Innovation LLC v. Red Hat, Inc., 705 F. Supp. 2d 687 (E.D. Tex. 2009).

An income approach is based upon the economic principal of expectation, the income approach requires the determination of the company's representative earning power. This future income or benefit stream is then discounted back to a present value. Alternatively, a representative earnings stream with constant growth into perpetuity is capitalized at a pre-determined percentage.[69]

A cost approach is based on the notion that the value of the enterprise business is approximated by the value of the tangible and intangible assets after recasting or normalizing the historical balance sheet to reflect all assets and liabilities at their fair market value. This method is most pertinent where a company's value is tied directly to the value of its underlying assets.[70]

A market approach is based upon the economic principal of substitution, the market approach arrives at an indication of value by using a comparison with multiples of publicly traded businesses or comparable private and public company

[69] Financial Valuation Applications and Models. Hitchner, James R. (2003), pgs. 85-125. "One of the two elements of any income approach method is a numerator, representing the future economic benefit accruing to the holder of the equity interest. This future economic benefit can take many forms. It can represent cash flow or net income. Net income may be on a pretax or after-tax basis. It also can represent a single payment or a series or stream of payments…The second element, the denominator, is the rate of return required for the particular interest represented by the cash flow in the numerator. The denominator reflects opportunity cost, or the "cost of capital." In other words, it is the rate of return that investors require to draw them to a particular investment rather than an alternative investment." Financial Valuation Applications and Models. Hitchner, James R. (2003), pg. 86.

[70] Financial Valuation Applications and Models. Hitchner, James R. (2003), pgs. 232-271. "A historically based accounting balance sheet will almost always bear little relationship to value. The balance sheet is useful only as a starting point and requires a series of adjustments to reach fair market value. And, as is discussed later in the chapter, depending on the interest being valued, the value indication thus derived may require further adjustments to properly reflect fair market value relative to the specific subject interest…The value of certain assets (on a GAAP basis), such as cash, accounts receivable, and to a lesser extent inventory, may closely approximate book value. Likewise, the value of other reported assets may not approximate book value. The value of other assets, such as property, plant, and equipment, seldom equals book value. Furthermore, unless purchased as part of a transaction, intangible assets are usually not recorded on the books. The asset approach is more commonly used in valuations for financial and tax reporting and for asset intensive businesses." Financial Valuation Applications and Models. Hitchner, James R. (2003), pg. 233.

transactions in similar industries and with similar financial metrics as the subject company.[71]

A business valuation considers all approaches and other external market and economic impacts to ascertain the economic harm due to the breach of the franchise agreement.

V. Conclusion

By nature, franchises are highly susceptible to complicated, costly, and otherwise destructive economic damages. Seasoned attorneys and litigation teams, coupled with a strong franchise agreement, can mitigate damages only to a certain extent. A general understanding of the damages claims available to both franchisors and franchisees, as well as the theories, requirements, limitations, and benefits of an economic damages calculation, can help prepare industry participants for the worst-case scenario, as well as to how to maximize recovery, depending on the party's goals. Our hope is that this paper may provide a helpful guide for those within the industry that become subject to this process.

[71] Financial Valuation Applications and Models. Hitchner, James R. (2003), pgs. 184-231. "As with other valuation approaches, the market approach does not exempt the valuation analyst from having to exercise professional judgment. The use of guideline companies is a starting point in that they provide analysts with some objective, quantitative guidance; these value indications must, however, be tempered with consideration of qualitative factors, such as product quality, depth and breadth of management, and employee turnover—factors that can be ascertained only from a solid understanding of the subject company and the experience of the business appraiser." Financial Valuation Applications and Models. Hitchner, James R. (2003), pg. 185.