THE USE AND MISUSE OF EXPERTS IN FRANCHISE LITIGATION

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THE USE AND MISUSE OF EXPERTS IN FRANCHISE LITIGATION

I. INTRODUCTION

In recent years, expert witnesses serve an ever more critical role in franchise disputes. Franchise litigators have expanded their use of experts beyond damages issues and now commonly use experts to opine on liability issues as well. Today, parties frequently retain experts early on to provide guidance and support for development of the factual issues underpinning a party's claims or defenses, and to provide testimony that will assist in persuading the trier of fact to decide the ultimate issues in the case in the proponent's favor. For these reasons, it is critical that franchise practitioners familiarize themselves with the many ways in which experts have been used, and misused, in franchise cases. This paper discusses cases demonstrating the various ways in which franchise litigators have used experts in support of their cases and presents practice pointers for selecting and managing expert witnesses.

We begin by providing a brief overview of the legal standards governing the use of expert witnesses and the typical factors that courts consider in deciding whether an expert's proffered testimony will withstand challenge. Is the witness proposing to offer expert testimony requiring specialized knowledge or lay testimony based on personal knowledge? Is the expert qualified to opine on the subject matter of his or her testimony? Will the testimony help the trier of fact to understand the evidence? Is the expert's methodology reliable, and has the expert reliably applied his or her methodology to the issues in the case? Where an expert's proffered testimony can meet these tests, courts will allow the testimony, but where one or more of these factors is lacking, the expert will not be permitted to testify.

We then explore best practices for selecting and managing expert witnesses. We offer guidelines on how to identify and vet appropriate experts and discuss the use of testifying versus non-testifying experts. We also consider the benefits of using an expert to help litigators develop their cases and provide caveats on how much direction to give an expert and what information and documents to provide or withhold. We also make suggestions regarding how to prepare a testifying expert for direct examination and cross-examination at trial.

Finally, we close with a review of recent cases where expert testimony was offered, successfully and un成功fully, to establish or refute liability and damages claims. The cases surveyed include various franchise and dealer disputes where experts were retained to opine on liability issues, such as industry standards, the nature of the franchise relationship, the impact of enforcement of franchise agreement provisions, the duties of franchisors and franchisees, the impact of a change in the franchise relationship, and the value of the franchise brand. We also explore cases examining the methods that experts use to calculate damages in franchise cases, including future lost profits and fair market value. We also present cases addressing issues that experts have faced in discounting future lost profits to present value, projecting damages into the future, valuing nascent businesses, and using a competitor's profits to measure damages.

We believe that the legal principles, best practices, and case discussions set forth in this paper will assist franchise litigators to use expert witnesses to prove the critical elements of their cases efficiently and effectively.
II. LEGAL OVERVIEW

A. Federal Court Standards

1. Federal Rules of Evidence

Rule 702 of the Federal Rules of Evidence establishes the threshold for the introduction of expert testimony, providing that:

A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if:

(a) the expert’s scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue;
(b) the testimony is based on sufficient facts or data;
(c) the testimony is the product of reliable principles and methods; and
(d) the expert has reliably applied the principles and methods to the facts of the case.

2. The Daubert Standard

Rule 702 was amended in response to the Supreme Court’s decision in Daubert v. Merrell Dow Pharmaceuticals, and its progeny, including Kumho Tire Co. v. Carmichael. In Daubert, the Court charged trial judges with the responsibility of acting as gatekeepers to exclude unreliable expert testimony and provided a non-exclusive list for trial judges to use in evaluating whether to admit scientific testimony. The list included: (1) whether the expert's theory can be or has been tested objectively, as opposed to being a subjective, conclusory approach that cannot be verified; (2) whether the expert's theory has been subjected to peer review or publication; (3) whether the expert's theory is subject to known or potential rates of error; (4) whether the expert's theory comports with applicable standards and controls; and (5) whether the expert's theory has acquired general acceptance in the relevant academic community. Courts have described the Daubert standard as containing three discrete inquiries: qualifications, relevance, and reliability. The burden of establishing these elements is on the proponent. In Kumho Tire, the Court clarified that the trial judge’s role as gatekeeper applies to all expert testimony, not only testimony based upon scientific principles, as in Daubert.

\[1 \text{ 509 U.S. 579 (1993).} \]
\[2 \text{ 119 S. Ct. 1167 (1999).} \]
\[4 \text{ Id. at *2.} \]
B. State Courts’ Standards

Prior to Daubert, the prevailing standard used to determine the admissibility of an expert’s scientific testimony was found in Frye v. United States.\(^5\) There, the Court of Appeals for the District of Columbia noted:

> Just when a scientific principle or discovery crosses the line between the experimental and demonstrable stages is difficult to define. Somewhere in this twilight zone the evidential force of the principle must be recognized, and while courts will go a long way in admitting expert testimony deduced from a well-recognized scientific principle or discovery, the thing from which the deduction is made must be sufficiently established to have gained general acceptance in the particular field in which it belongs.\(^6\)

Thus, a court applying the Frye standard must determine whether the expert’s method is generally accepted by experts in the particular field. The Frye standard has been abandoned by many states and by the federal courts in favor of the Daubert standard, but remains the law in some states, including California, the District of Columbia, Illinois, Kansas, Minnesota, Pennsylvania and Washington.\(^7\)

Finally, in arbitration, with its relaxed evidentiary standards, the parties generally are free to decide their own standard of admissibility for expert testimony, although Daubert, the majority rule, is often the fallback position of the parties.

C. Typical Issues Addressed In Daubert Challenges

1. Is The Witness Testifying As An Expert Or Providing Lay Testimony Based On Personal Knowledge?

Before asserting a Daubert challenge, one must determine whether the witness is testifying as an expert or providing lay testimony based on personal knowledge. In Lift Truck Lease and Serv., Inc. v. Nissan Forklift Corp., N.A.,\(^8\) the plaintiff offered the testimony of its controller to prove its damages. Nissan moved to exclude the controller’s testimony under Daubert, arguing that the plaintiff had not designated its controller as an expert witness even though his opinions required specialized knowledge not within the ordinary experience of lay persons.\(^9\) The plaintiff countered that the controller was not designated as an expert because his testimony concerned the plaintiff’s books and records with which the controller was

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5 293 Fed. 1013 (D.C. Cir. 1923).

6 Id. at 1014.

7 Daubert, or a variation thereof, has been widely followed in state courts, including Arizona, Arkansas, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Idaho, Indiana, Iowa, Kentucky, Louisiana, Maine, Massachusetts, Michigan, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Mexico, North Carolina, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, West Virginia, Wisconsin, and Wyoming. Alabama, Maryland, New Jersey, and New York use elements of both Frye and Daubert. Alaska, North Dakota, and South Carolina have adopted their own standards for admissibility. See https://jurilytics.com/50-state-overview.


9 Id. at *1.
personally familiar. The court sided with the plaintiff, finding that because the witness would be testifying based on his personal knowledge acquired in the ordinary course of his employment as the plaintiff’s controller, the plaintiff was not required to disclose him as an expert witness, and his testimony was not subject to a *Daubert challenge*.

2. **Is The Expert Competent And Qualified To Testify Regarding The Matters That He Intends To Address?**

A proponent of expert testimony frequently faces a challenge to the expert’s qualifications. The expert’s experience is often a key factor that will enable the expert to survive a *Daubert* challenge regarding his qualifications. For example, in **Jordan v. City of Chi.,** the court noted that “[a]n expert may be qualified to render opinions based on experience alone.” It based this decision on the commentary regarding Rule 702 that “[i]n certain fields, experience is the predominant, if not the sole basis for a great deal of reliable expert testimony.”

On the other hand, in **Armstrong v. HRB Royalty, Inc.,** the court found that experts who admitted that they were unfamiliar with the term “fair and equitable price,” as related to payment to the franchisee in the event of termination by the franchisor, were not qualified to render an expert opinion as to the meaning of that term, stating that “[s]uch a person by definition possesses no ‘knowledge, skill experience, training or education’ sufficient to testify as an expert.”

Similarly, in **Chang Young Lee ex rel. Bo Hyun Lee v. Choice Hotels Int’l, Inc.,** the court granted summary judgment in favor of the defendant because the plaintiff’s expert failed to establish the standard of care in Indonesia governing the installation, maintenance and use of a pool at a hotel. Specifically, the court found that the expert was not qualified as an “authority on foreign law” and had failed to provide a sufficient basis for his testimony that a Regulation for health requirements for swimming pools and public baths provided the standard of care for “commercially managed resort swimming pools” in Indonesia. The court noted that the expert lacked supporting information regarding the Indonesian law upon which he was relying.

Likewise, in **Braucher ex rel. Braucher v. Swagat Group, L.L.C., et al.,** a hotel guest and the estate of a deceased guest brought negligence, wrongful death, and apparent agency

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10 *Id.*

11 *Id.*


13 *Id.* (citing Fed. R. Evid.—adv. comm. notes).


15 *Id.* at *2.


17 *Id.* at *10.

18 702 F. Supp. 2d 1032 (C.D. Ill. 2010).
claims against a hotel franchisee and its franchisor, alleging that the guests contracted Legionnaires’ disease as the result of the hotel’s failure to maintain the hotel pool and spa properly.19 Plaintiffs’ expert, who was a retired Coast Guard Commander with extensive experience in water safety, opined, among other things, that all of the defendants, including the franchisor, had a duty to maintain the pool and spa properly.20 The franchisor moved to bar the expert’s testimony that it had a duty to maintain the pool and spa at the franchisee’s hotel.21 The court found that the plaintiffs’ expert had no experience in either franchise relationships or hotel industry practices. Therefore, the court concluded that although the expert may have had the expertise to opine on whether the pool and spa were maintained properly, he was not qualified to render an expert opinion about which parties had a legal duty to maintain the pool and spa.22

3. Will The Expert’s Testimony Assist The Trier Of Fact To Understand The Evidence Or Determine A Fact In Issue?

In Hetrick v. Ideal Image Development Corp.,23 the court found that the expert’s testimony would assist the trier of fact to understand the evidence or to determine a fact issue, stating that “[a]n expert’s testimony will assist the trier of fact when it offers something beyond a reasonable understanding and experience of the average citizen.”24 The court noted that the franchise industry is an appropriate subject for expert testimony, and concluded that the expert’s testimony would assist the trier of fact in determining facts in issue, “particularly regarding the cause of the Hetricks’ financial loss.”25

Likewise, in Goldberg v. 401 North Wabash Venture, LLC,26 the court held that an expert’s testimony as to the industry practice and custom for condominium development might assist the trier of fact in, among other things, evaluating the plaintiff’s argument that the defendants concealed their development plans, made material misrepresentations, and offered only pretextual reasons in their defense.27

In contrast, in Interim Healthcare of Northeast Ohio, Inc. v. Interim Servs., Inc.,28 the court found that the testimony of the plaintiffs’ expert would not help the trier of fact because the unambiguous language of the franchise agreement resolved the issue. The franchisee plaintiffs, who were providers of home health care services, claimed that after Medicare changed its reimbursement policies, their franchisor failed to disclose that its other franchisees

19 Id. at 1034-1035.
20 Id. at 1041.
21 Id.
22 Id. at 1042.
24 Id. at *4.
25 Id.
27 Id. at *4.
were experiencing disallowances of royalty payment reimbursements. The franchisees alleged that if they had known the risks of the Medicare royalty disallowance, they would not have expanded their Medicare business and would have been able to avoid the significant damages that they had incurred.\textsuperscript{29} The court refused to consider an affidavit from the plaintiffs’ “franchise operations expert” stating what the franchisor’s duties and responsibilities in securing Medicare royalty reimbursement should be.\textsuperscript{30} The court held that because the franchisor’s duties under the franchise agreement were not ambiguous, and there was no provision requiring the franchisor to advise the franchisee regarding Medicare reimbursements, the expert’s testimony would invade the province of the court, which alone has the power to determine whether contract terms are ambiguous.\textsuperscript{31}

4. **Is The Methodology By Which The Expert Reached His Conclusions Sufficiently Reliable?**

In *Matrix Grp. Ltd., Inc. v. Rawlings Sporting Goods Co.*\textsuperscript{32}, the Eighth Circuit assessed the licensee’s expert’s methodology related to the valuation of a terminated license agreement after the district court reduced the plaintiff’s damages award by eliminating “terminal value” damages. The expert made two damages calculations: first, she assessed the “present value” of the license agreement over the first ten years after termination;\textsuperscript{33} next, she assessed the “terminal value” or market value of the license agreement after ten years, which she described as “what somebody would be willing to pay for the right to have this contract,” assuming a constant growth of the license agreement and then discounting this value to arrive at the present “terminal value.”\textsuperscript{34} The court found that the expert’s calculation of the value of an asset at liquidation was a necessary part of discounted cash flow analysis, and was recognized under the law, especially because the license agreement was to generate income for an “indefinite period.”\textsuperscript{35} The court concluded that the expert provided an estimate as to the cash value available from the disposition of an asset, approved her methodology, and overruled the district court’s decision eliminating the award of “terminal value” damages.\textsuperscript{36}

5. **Is The Methodology Adopted By The Expert Reliably Applied To The Principles In The Case?**

Courts often decline to exclude expert testimony because the party’s objections to expert testimony are deemed to go to the weight of the opinion, not its admissibility. For example, in *Hetrick v. Ideal Image Development Corp.*,\textsuperscript{37} the Hetricks objected to the introduction of Ideal

\textsuperscript{29} Id. at 708.
\textsuperscript{30} Id. at 770.
\textsuperscript{31} Id.
\textsuperscript{32} 477 F.3d 583 (8th Cir. 2007).
\textsuperscript{33} Id. at 593-594.
\textsuperscript{34} Id.
\textsuperscript{35} Id. at 594.
\textsuperscript{36} Id.
\textsuperscript{37} Supra, note 22.
Image’s expert testimony in part because the Hetricks’ contended that the expert’s methodology was not reliable, and that the expert failed to consider relevant factors. The court rejected the Hetricks’ argument, holding that the expert’s methodology met the reliability test because although the expert “[did] not consider all the ‘relevant factors’ in his report . . . . an expert’s conclusions should not be excluded because he or she has failed to rule out every possible alternative cause.” In fact, the expert’s testimony was based upon Ideal Image’s financial records and sales revenues automatically generated by its electronic point-of-sale system and information that the expert typically reviewed in his work as a franchise consultant, and his report disclosed all of the information that he used to form his opinion. Therefore, the court concluded that the Hetricks’ objections “to the reliability of [the expert’s] opinion go to the weight of his testimony, rather than its admissibility.”

In Goldberg v. 401 North Wabash Venture, LLC, the defendants argued that the expert did not provide enough detail about his experiences to render him qualified, but, as in Hetrick, the court concluded that that issue went to the weight, not the admissibility, of the expert’s testimony.

Courts will refuse to admit expert testimony where the expert’s conclusions rest on nothing more than the expert’s ipse dixit. For example, in Echo, Inc. v. Timberland Machs. & Irrigation, Inc., at the summary judgment stage the parties disputed whether more than 50% of TMI’s business was with Echo. In its summary judgment motion, Echo relied upon sales and gross profit figures demonstrating that less than 50% of TMI’s business was with Echo, and TMI offered expert testimony of its Secretary and President, Mark Zeytoonijan, to discredit Echo’s figures. Zeytoonijan testified that because TMI’s Sprinkler House division had not been profitable, its sales and gross profits figures should not be considered in determining TMI’s sales and gross profits. The Seventh Circuit held, however, that the district court properly excluded Zeytoonijan’s opinion on this point because it “rests on nothing more than Zeytoonijan’s say-so rather than a statistical analysis . . . nothing but his ipse dixit.”

38 Id. at *3.
39 Id. (citations omitted).
40 Id.
41 Id.
42 2012 WL 3686644.
43 Id. at *4.
44 See General Elec. Co. v. Joiner, 522 U.S. 136, 146 (1997) (“[N]othing in either Daubert or the Federal Rules of Evidence requires a district court to admit opinion evidence that is connected to existing data only by the ipse dixit of the expert.”).
45 661 F.3d 959 (7th Cir. 2011).
46 Id. at 964-965.
47 Id. at 965.
48 Id.
49 Id.
6. Prohibited Testimony

Rule 704 of the Federal Rules of Evidence provides that “[a]n opinion is not objectionable just because it embraces an ultimate issue.”50 Prior to the enactment of Rule 704, courts regularly excluded opinions on “ultimate issues.” Rule 704 was adopted because the basic purpose of opinion testimony, both lay and expert, is to assist the trier of fact.51 Because the old “rule was unduly restrictive, difficult of application, and generally served only to deprive the trier of fact of useful information,” Rule 704 was enacted to abolish this judicial practice.52

However, there is good case law precluding expert testimony as to outcome-determinative legal conclusions. For example, in RJW Mgmt. Co., Inc., et al. v. BP Prods. North Am., Inc.,53 although an expert was qualified to testify as to franchise industry standards, the court excluded his testimony regarding his legal conclusions that BP had breached its contractual duties and its duty of good faith and fair dealing, noting that an expert ordinarily is not permitted to offer outcome-determinative legal conclusions.54

III. SELECTING AND MANAGING TESTIFYING AND NON-TESTIFYING EXPERTS

Finding an expert who is collaborative, engaging, and responsive is essential. Potential experts can be identified in a number of ways. Contacting a well-regarded research center or a major university may be useful. Or, if a claim involves a specific industry, the industry trade association may be able to suggest possible candidates. Counsel can also seek recommendations from other lawyers, or from experts who are not able to work on the matter. Online research can identify candidates who wrote or spoke on a particular topic. Lawyers who have tried similar cases may provide information about the strengths and weaknesses of particular candidates.

Best practice is to interview and compare several candidates, in person if possible. Although a face-to-face meeting may be more expensive than a telephonic interview, it is very helpful in providing better understanding of a candidate—someone with whom the lawyer will be working closely for a long time. People have subtle characteristics that can best be learned by meeting in person; some personalities click more easily than others, and it is important that the lawyer and expert work well together. A candidate who looks perfect on paper may be disappointing in person. If an in-person meeting is not possible, a video call should be arranged, because that can illuminate much more of a candidate’s personality than a phone call. When interviewing candidates, counsel should gauge each candidate’s interest level and availability. Compensation should be mutually agreed upon when the expert is retained, and the expert’s compensation should not depend on the results of the case—because that would compromise the expert’s objectivity.

50 Fed. R. Evid. 704.
51 See Fed. R. Evid. 704—adv. comm. notes.
52 See Fed. R. Evid. 704—adv. comm. notes.
54 Id. (citing United States v. Sinclair, 74 F.3d 753 (7th Cir. 1996)).
It is essential that the expert be objective, and analyze the relevant facts carefully. Counsel should confirm that the expert selected is not inclined to provide conclusory testimony without conducting a detailed analysis of all relevant facts. Also, experts who derive a large portion of their compensation from providing expert testimony may be less persuasive to the trier of fact. The best expert will be—and will appear to be—objective, unbiased, and impartial.

A. Testifying vs. Non-Testifying Experts

Before selecting a testifying expert, counsel should evaluate each candidate's appearance, demeanor, and likeability. The demeanor and behavior of some candidates may make them seem trustworthy, which is very important for a testifying expert. Also, a testifying expert must be able to explain his or her opinions in a thoughtful and comprehensive manner. An expert witness who uses esoteric and hard-to-comprehend language will be much less effective. Likeability also is important. The ideal expert is one who can make a complex subject interesting and understandable.

Federal Rule of Civil Procedure 26(a)(2) requires that each testifying expert witness prepare an expert report for submission to the other side. The report must include (a) a complete statement of all opinions that the witness will express and the reasons for those opinions; (b) the facts or data considered by the witness in forming the opinions; (c) any exhibits that will be used to summarize or support the opinions; (d) the witness's qualifications, including a list of all publications authored in the previous ten years; (e) a list of all other cases in which, during the previous four years, the witness testified as an expert at trial or by deposition; and (f) a statement of the compensation to be paid for the study and testimony in the case.

Non-testifying experts are used as consultants and do not need to provide a written report. Moreover, their identities do not have to be disclosed, and they will not be deposed or cross-examined by opposing counsel. Non-testifying experts should be selected entirely on the basis of their relevant qualifications and their ability to help in analysis, cross-examination of opposing experts, strategy, and assisting the testifying expert.

B. Due Diligence In Selecting An Expert

In evaluating candidates, counsel should independently confirm the information in each candidate’s curriculum vitae, and review all articles and speeches that the candidate authored. Counsel should also review a candidate’s prior testimony. If prior testimony is covered by a protective order, even a redacted transcript will be useful. It is important to see how the candidate held up on cross-examination and whether the trial judge was critical of the expert. Prior transcripts also will show how the expert handled aggressive cross-examination and efforts to impeach.

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56 Id.
57 See id.; see also 1 DOUGLAS DANNER & LARRY L. VARN, EXPERT WITNESS CHECKLISTS § 1:32 (3d ed. 2015).
58 FED. R. CIV. P. Rule 26(a)(2).
During the initial interview with a candidate, counsel should ask about the candidate’s criminal record, prior testimony and presentations (both oral and written), and anything else that might be fodder for the adversary’s cross-examination. Counsel should determine whether the candidate has ever been subject to a Daubert challenge, and if so, whether his or her testimony was excluded by the court. It is also important to confirm that the expert did not previously give any testimony (or write anything) that is inconsistent with the anticipated expert testimony in the pending case.

Each expert candidate should explain what discovery is necessary to support the contemplated expert testimony. Each candidate also should explain his or her approach in an understandable way. The candidates should provide references, and counsel should speak to other lawyers for whom the candidate has provided expert testimony.

C. Working with the Expert Through Various Phases of Litigation

In some situations, it may be helpful to work with an expert even before filing suit, because an expert’s suggestions can be valuable in shaping counsel’s approach to drafting the complaint. The expert should be urged to think creatively in helping to develop counsel’s arguments. Counsel should think carefully about providing information and documents to a testifying expert, because all such information and documents are subject to discovery. Counsel should only give the expert information and documents that are both relevant and necessary for the expert’s role in this case. Counsel should be judicious in selecting information and documents for transmittal to the expert, while making sure that nothing important is withheld. If relevant information and documents are withheld from the expert, cross-examination will be devastating.

Counsel should collaborate with the expert in determining what subjects and issues to emphasize in the expert report. However, counsel should not write the expert’s report or otherwise take control of the drafting process. Counsel and the expert should allow time for the exchange of several drafts of the report before it must be filed. The report should be broad enough to encompass all relevant issues, and it should be focused so that it does not provide superfluous information that might provide topics for the adversary’s cross-examination of the expert. Moreover, the report should avoid expressing extreme positions that are not absolutely necessary, in order to limit the scope of cross-examination.

It may be desirable to have the expert attend some depositions—both fact depositions and depositions of opposing experts—in order to suggest lines of inquiry to counsel during the depositions. In preparing the expert for his or her own deposition, counsel should explain that opposing counsel may take an aggressive approach in trying to get helpful admissions, or may be ingratiating in an effort to get the expert to talk too much. Taking the time to practice with the expert and work through possible questions is essential. Moreover, most expert depositions are videotaped. The expert must understand that facial expressions and language on video may be viewed by the trier of fact. Also, it may be helpful to have a different lawyer from counsel’s firm conduct a mock deposition and cross-examination of the expert.

Counsel should practice the direct testimony with the expert. The goal at trial is to demonstrate that the expert is qualified to opine on the issues. To that end, counsel should present the qualifications of the expert in a way that persuades the judge and jury that the expert is credible. Counsel must establish the foundation regarding the expert’s preparation and opinions, and try to elicit the expert’s key opinions in compelling language. After establishing the relevant background, counsel should put in the capstone—the most effective
and persuasive part of the argument that the lawyer wants to embed in the mind of the trier of fact. It is like the climactic scene in a dramatic play or movie.

Throughout the preparation process, counsel should be thinking about cross-examination of the expert. Any vulnerabilities, inconsistencies, and weaknesses that become apparent should be discussed with the expert to determine how to handle them effectively during cross-examination. Opposing counsel will try to minimize the expert’s qualifications and credentials and demonstrate that they are not relevant to the issues in the lawsuit. Moreover, opposing counsel probably will try to show that the expert is biased. Accordingly, the expert must be prepared carefully for cross-examination, particularly for aggressive and leading questions. If the expert has weaknesses or hot button issues, counsel must discuss possible answers to questions on those topics. In addition, the expert should be counseled on habits and appearance that may be modified in order to make the best possible impression on the trier of fact.

The expert’s key on cross-examination is to appear calm and confident. The expert must keep control over his or her answers. For example, if a yes or no answer is requested, the expert should try to clarify the background or the question before answering. The ultimate factor is how the trier of fact perceives the expert. Counsel can emphasize the expert’s qualifications and credentials, but all may be lost if the expert becomes argumentative and arrogant on cross-examination.

IV. AREAS WHERE EXPERTS ARE USED IN FRANCHISE LITIGATION

Franchise litigators customarily use experts to support or contest damages arguments. In recent years, franchise litigators also increasingly use experts to support claims or defenses on the ultimate issues to be decided by the fact-finder. Following is a sampling of recent franchise cases in which expert witnesses were used to establish or rebut claims of liability and damages.

A. Liability – Case Studies

Both franchisors and franchisees use experts in franchise cases to opine on factual matters that affect the heart of the claims at issue, such as industry standards, the nature of the franchise relationship, the duties of franchisors and franchisees, the meaning of provisions in franchise agreements, the impact of a change to the existing franchise relationship, the value of the franchise brand, and other specific issues that will help the trier of fact decide the ultimate issue.

1. Franchise Industry Standards

Experts are commonly used to opine on franchise industry standards. For example, in Wilbern v. Culver Franchising Sys., Inc., the franchisee retained an expert to provide testimony in support of his claim that his franchisor had discriminated against him based on race. The plaintiff, an African-American, alleged, among other things, that by deviating from standard industry practice with regard to site selection, menu pricing, and territorial protection, Culver’s
had engaged in a pattern and practice of racial discrimination in violation of Section 1981 of the Civil Rights Act of 1866. The plaintiff’s expert was prepared to testify that the plaintiff would have been successful in developing a Culver’s franchise in a majority African-American neighborhood on Chicago’s South Side; that the reasons Culver’s gave for not approving a franchise at that location did not make sense from a business standpoint; that the South Side location was a better franchise location than the suburban Franklin Park location that Culver’s approved for the plaintiff; that the plaintiff was treated differently than other Culver’s franchisees and not in accordance with customary industry practices regarding restaurant site selection, menu pricing, and same-brand competition; that sales at the Franklin Park location were detrimentally affected by Culver’s decision to allow a competing Culver’s franchisee to open nearby; and, that the plaintiff suffered economic losses as a result of Culver’s failure to approve the South Side location. Culver’s argued that the expert’s testimony relating to Culver’s failure to exercise best practices or conform to industry standards was off the mark because the case involved whether Culver’s applied its policies uniformly among all franchisees, not whether Culver’s practices conformed to franchise industry standards. The court rejected Culver’s reasoning on the grounds that the expert’s testimony was relevant to the issue of pretext and that his testimony might lead a reasonable jury to conclude that Culver’s expressed reasons for the conduct complained of were not the real motivating factors for that conduct.

Similarly, in RJW Mgmt. Co., Inc., et al. v. BP Prods. North Am., Inc., the plaintiffs overcame a challenge to their expert’s proffered testimony regarding franchise industry standards. The defendants moved to exclude the testimony of the plaintiffs’ expert witness, who was prepared to testify that BP failed to meet accepted franchise industry standards in three areas: (1) disclosures to its franchisees; (2) development, sale, and supply practices; and (3) ongoing operation of the franchises. The court determined that the expert was qualified to testify based on his “lengthy and substantial experience in the franchise industry and familiarity with franchise industry practices,” and that, if the plaintiffs’ fraud and misrepresentation claims survived summary judgment, the expert’s testimony regarding franchise industry standards might assist the fact-finder on those claims.

Likewise, in TCBY Systems, Inc. v. RSP Co., Inc., the district court admitted the testimony of the franchisee’s liability expert, who opined that the franchisor had not met the minimum custom and practice observed by franchisors with regard to site selection. The franchisor representative who evaluated the proposed site had no experience in evaluating proposed sites, failed to follow the franchisor’s minimum guidelines for site selection, and

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62 Id. at **7-8.
63 Id. at *10.
65 Id. at *1.
66 Id. at *2.
67 33 F.3d 925 (8th Cir. 1994).
68 Id. at 929.
testified that he based his approval on simply “eyeballing” the site. 69 On appeal, the Eighth Circuit upheld the district court’s admission of the expert’s testimony, finding that it helped the jury understand what constituted “reasonable assistance” with site selection in the franchise industry. 70

2. Other Industry Specific Standards

Experts also are used to testify with regard to industry-specific standards. For example, in *Atmosphere Hospitality Mgmt., LLC v. Shiba Investments, Inc., et al.*, 71 a hotel management company brought an action to resolve issues related to hotel licensing and management agreements between the parties. 72 The expert analyzed the parties’ proffered and actual license and management agreements and opined on whether the terms and conditions used in these documents were consistent with the terms and conditions typically found in similar contracts in the hotel industry. The expert compared the four agreements to hotel license agreements used by six national hotel brands and relied on his 35 years of experience reading and negotiating hotel franchise and license agreements. He concluded that the terms and conditions of the two proffered agreements were generally consistent with hotel industry standards, but that the two agreements ultimately signed by the parties were not. 73 The court found that the expert’s testimony would be relevant to determining the meaning of undefined terms in the agreements, based on his knowledge regarding the general meaning of those terms in the hotel industry. 74

In *AAMCO Transmissions, Inc. v. Baker*, 75 the expert’s reliance on automotive industry standards was a material factor in overcoming the franchisee’s Daubert challenge. The franchisor there sued a franchisee for trademark infringement, breach of contract and unfair competition, after terminating the franchise agreement on the ground that the franchisee was not operating its business in a fair and honest way. 76 The franchisee’s counsel objected, stating that the expert did not adequately demonstrate his methodology. The trial court overruled the objection, noting that the expert relied on “automotive industry standards”77 that provided a proper basis for the testimony. 78 The court concluded that the reliability of the testimony was enhanced by the expert’s curriculum vitae, certifications, training, and overall professional

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69 Id. at 927.
70 Id. at 929.
72 Id. at *1.
73 Id.
74 Id. at **3-4.
76 Id. at *4
77 Id.
78 Id.
The court also noted that the expert had provided sufficient methodology to support his opinion. The plaintiffs in Akshayraj, Inc., et al. v. Getty Petroleum Mktg., Inc., were operators of gasoline service stations that were being forced to convert from Mobil stations to Lukoil stations. They alleged that converting their stations from Mobil to Lukoil would result in a constructive termination of their franchise agreements in violation of the Petroleum Marketing Practices Act ("PMPA"), the New Jersey Franchise Practices Act and Pennsylvania franchise laws, as well as a breach of the franchisor's contractual obligations. The plaintiffs retained a petroleum marketing consultant with nearly 30 years' experience to opine on whether Lukoil was a branded gasoline versus an unbranded gasoline and whether the change from the Mobil brand to the Lukoil brand would have an adverse impact on their businesses. The expert testified that the petroleum industry recognizes several categories of gasoline—major brands, regional brands, sub-majors, independent brands, and unbranded. The price that consumers were willing to pay varied according to the brand category, with major brand gasoline drawing the highest retail price and unbranded gasoline having no brand value. He concluded that because Lukoil did not have a loyal customer base and was not a recognized brand, it fell into the category of an unbranded gasoline. He opined that Lukoil would take years to develop into a recognized brand with loyal customers. With regard to the economic impact on the plaintiffs' businesses, he explained that after the conversion, Lukoil maintained a price posture similar to Mobil and that, as a result, franchisees lost customers who were unwilling to pay a major brand price for unbranded gasoline. The court found that the expert's testimony was not relevant to whether the defendant had constructively terminated the plaintiffs' franchises in violation of the PMPA. A PMPA franchise requires three elements: (1) a contract to use the refiner's trademark; (2) a contract for the supply of motor fuel to be sold under the trademark; and (3) a lease of the premises at which the motor fuel is sold. Because the issue of constructive termination was whether the defendants provided the plaintiffs with a trademarked product, and not the strength of a particular brand in the marketplace, the court granted the defendant's motion for summary judgment on this issue.
3. The Nature of the Franchise Relationship

Experts also have been used to explain the nature of the franchise relationship. In International Franchise Association, Inc., et al. v. City of Seattle, the IFA, along with five franchise owners and managers, brought an action challenging the city’s classification of franchisees as large businesses for purposes of Seattle’s ordinance increasing the city’s minimum wage. The ordinance classified a franchise as a “large” business if its franchisor and/or its network of franchisees employed more than 500 employees in the aggregate in the United States. “Large” businesses were subjected to a more aggressive phase-in schedule and were required to pay the $15 per hour minimum wage within three years, rather than the seven years permitted for small employers. The plaintiffs sought a preliminary injunction to prevent the city from classifying franchisees as “large” employers and subjecting them to the more aggressive phase-in schedule. Among other arguments in support of their position, the plaintiffs alleged that the city’s classification of franchisees as large businesses violated the Dormant Commerce Clause and the Equal Protection Clause.

Office and Professional Employees International Union Local 8 submitted the expert declaration of a franchise business consultant in support of its amicus brief, and the city submitted the expert declaration of an economics professor. In his declaration, the city’s expert explained that the franchisee’s employees are not employees of the franchisor; rather, the franchisee makes decisions with regard to hiring, firing, pay, and benefits of its employees. He further explained that although franchisees and franchisors are separate legal entities, “franchisees are not free to do as they please” because the franchisor heavily regulates the franchisee’s business activities through its franchise agreements. The city’s expert opined that franchisees are willing to accept the restrictions placed upon them by their franchisors because being part of a franchise system provides significant benefits, including brand recognition; customer loyalty; access to advertising, trade secrets, and software; lower material costs; site selection assistance; financing; and extensive operational support and training. He also stated that being part of a franchise system often results in more profit for the business owner than would be the case if the business owner operated independently. In addition to these factors, and critical to the court’s decision, the union’s expert opined that franchisors have the ability to use their greater financial resources to support their franchisees during times of business stress, including responding to changed business conditions, such as regularly scheduled minimum wage increases. Based in part on the testimony of these two experts, the

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89 97 F. Supp. 3d 1256, aff'd, 803 F.3d 389 (9th Cir. 2015).
90 Id. at 1266.
91 Id. at 1265.
92 Id. at 1266.
93 Id. at 1264, nn.6-7.
94 Id. at 1264.
95 Id.
96 Id.
97 Id.
98 Id. at 1264-65; 1276.
court rejected the plaintiffs’ arguments that treating franchisees as “large” employers violated either the Dormant Commerce Clause or the Equal Protection Clause, and refused to grant a preliminary injunction to enjoin the city from treating franchisees as “large” employers.\(^9^9\) The district court’s determinations were affirmed on appeal.

4. **The Impact of Enforcement of Franchise Agreement Provisions**

Experts also have been retained to opine on the impact of the enforcement of specific provisions in a franchise agreement. For example, the franchisor plaintiff in Big O Tires, LLC v. Felix Bros, Inc.\(^1^0^0\) retained an expert to testify in support of its argument that enforcement of an in-term covenant not to compete would not impact competition in the relevant market in any discernible way.\(^1^0^1\) The franchisor alleged that the defendant franchisees, who owned two Big O franchised stores, as well as a former Big O franchise which the defendants were operating as an independent business, were violating the in-term restrictive covenants in their operating stores’ franchise agreements.\(^1^0^2\) The plaintiff’s expert testified regarding the geographic scope of the relevant market and opined that enforcing the restrictive covenant and closing the competing former franchised store would not adversely affect competition in that market.\(^1^0^3\) The court concluded that the reverse was also true—the expert’s testimony also supported the conclusion that not enforcing the in-term non-compete against the defendants would have no material impact on the competitive position of the two Big O stores still in operation,\(^1^0^4\) and noted the expert’s failure to address whether enforcing the covenant would prevent these two stores from engaging in trade in a substantial section of the relevant market.\(^1^0^5\) Based in part on the court’s analysis of the plaintiff’s expert’s testimony, the court found that the plaintiff had failed to establish imminent harm and denied the plaintiff’s motion for preliminary injunctive relief.\(^1^0^6\)

5. **The Duties of Franchisors and Franchisees**

In Mercedes-Benz USA, Inc. v. Coast Automotive Group, Ltd.,\(^1^0^7\) a former Mercedes-Benz auto dealership offered the testimony of two experts to support its counterclaim that, in light of the dealership’s past sales, Mercedes-Benz had unfairly allocated vehicles to the dealership and, as a result, the dealership had sustained economic injury.\(^1^0^8\) The litigation commenced after Mercedes-Benz terminated the dealership and filed suit seeking injunctive

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\(^{99}\) *Id.* at 1276-1280.

\(^{100}\) 724 F. Supp. 2d 1107 (D. Colo. 2010).

\(^{101}\) *Id.* at 1119.

\(^{102}\) *Id.* at 1110.

\(^{103}\) *Id.* at 1119-1120.

\(^{104}\) *Id.* at 1120.

\(^{105}\) *Id.* at 1119, n.8.

\(^{106}\) *Id.* at 1121.


\(^{108}\) *Id.* at 333-334.
relief and damages. \textsuperscript{109} The dealer countersued, alleging, among other things, that Mercedes-Benz had reduced the number of vehicles allocated to the dealer in retaliation for the dealer’s refusal to go along with a purported “price fixing” scheme put in place by Mercedes-Benz. \textsuperscript{110} The district court excluded the testimony of the dealer’s experts and the dealer appealed. \textsuperscript{111} The first expert had offered testimony to demonstrate that Mercedes-Benz’s allocation of vehicles to the dealer was unfair. He had not based his computations of automobile allocations on the dealer’s actual sales or examined the dealer’s operation to determine what constituted a reasonable allocation. Instead, he simply relied on the dealer’s assertion that the allocations were unfair. \textsuperscript{112} The court concluded that the expert’s testimony was unreliable. \textsuperscript{113} The second expert offered testimony on what the value of the dealership would have been at the time of its termination had a supposed fair number of vehicles been allocated to the dealership. However, the second expert based his opinion on projected profits in the first expert’s report. Because the second expert’s testimony was based on an unreliable report, his testimony was excluded as equally unreliable. \textsuperscript{114}

In \textit{Fransmart, LLC v. Freshii Development, LLC}, \textsuperscript{115} a franchise broker sued a franchisor of healthy fast-food restaurants to recover damages resulting from the franchisor’s failure to make payments required by the parties’ brokerage agreement. The court noted that in the opinion of the franchisor’s expert, the plaintiff franchise broker had not followed a rational growth and expansion plan in selling the franchisor’s franchises. The franchisor asserted affirmative defenses, including fraudulent inducement, claiming that, in order to induce the franchisor to use its services, the broker represented that it would use a model for franchise growth and expansion so that the franchisor’s business would grow in an organized manner, but that the broker never intended to use such a model and, instead, sold franchises wherever possible to maximize its short-term revenue. \textsuperscript{116} The franchisor further claimed that if the broker had such a model, it deviated from the model in selling franchisees on behalf of the franchisor. \textsuperscript{117} In a footnote, the court noted that the only evidence in the record to support the franchisor’s argument that the broker deviated from its model for franchise growth and development was a statement by the franchisor’s expert, who opined that the franchise sales made by the broker did not reflect a rational growth and expansion plan, but rather used a “scatter-shot approach” reflecting a “singular focus by [the broker] to maximize its short-terms [sic] revenues under the Consulting Agreement.” \textsuperscript{118} Two of the reasons, among others, that the court noted in rejecting the franchisor’s fraudulent inducement argument were that the franchisor had failed to establish

\textsuperscript{109} \textit{Id.}

\textsuperscript{110} \textit{Id.}

\textsuperscript{111} \textit{Id.}

\textsuperscript{112} \textit{Id.} at 334.

\textsuperscript{113} \textit{Id.}

\textsuperscript{114} \textit{Id.} at 335.

\textsuperscript{115} 768 F. Supp. 2d 851 (E.D. Va. 2001).

\textsuperscript{116} \textit{Id.} at 865.

\textsuperscript{117} \textit{Id.}

\textsuperscript{118} \textit{Id.} at 865, n.20 (quoting declaration of franchisor’s expert).
by clear and convincing evidence that the broker did not intend to use a franchise growth and expansion model at the time the representations were made, and also had failed to establish that the broker had deviated from such a model.\textsuperscript{119}

6. The Impact of a Change in the Franchise Relationship

The economic impact and effect on the public interest and welfare of adding two new GMC dealerships in the greater Chicago area was the subject of expert testimony in \textit{General Motors Corp. v. State Motor Vehicle Review Bd.}.\textsuperscript{120} Various GMC Chicagoland dealers protested the proposed dealerships to the Illinois Motor Vehicle Review Board (the “Board”), as permitted by the Illinois Motor Vehicle Franchise Act.\textsuperscript{121} The Board denied General Motors’ request to open the new dealerships. General Motors and the prospective owners of the two new dealerships appealed, and the case ultimately reached the Illinois Supreme Court.\textsuperscript{122} The court considered the conflicting testimony of GMC’s expert and the protesting dealerships’ expert before the Board. GMC’s expert had compared local GMC sales performance in the relevant market areas where the new dealerships were proposed to be located with adjusted national and statewide standards. The dealerships’ expert, on the other hand, compared sales performance in the relevant market areas with sales performance in all parts of the Chicago metropolitan area.\textsuperscript{123} The Board found that the dealerships’ expert’s approach was more appropriate, because it compared the two relevant market areas to marketing areas that were similar in most respects in that they were urban, dealers sold into one another’s territories, and the climate was generally the same.\textsuperscript{124} GMC’s expert’s adjusted national and state standards, however, included data from rural areas, which often had less competition and where customer preferences differed from those of customers in large urban areas such as Chicago.\textsuperscript{125} The dealerships’ expert also testified that the addition of the two new dealerships would exacerbate existing product supply problems and cause greater inconvenience to GMC customers in the relevant market areas.\textsuperscript{126} He further opined that it was not in the public interest to have multiple small dealers with small inventories requiring buyers to visit several GMC dealers to see all of the vehicles in which they were interested. Rather, the dealerships’ expert opined that Chicago area customers would be better served by having fewer and larger dealerships.\textsuperscript{127} The Illinois Supreme Court affirmed the lower courts, finding that it was reasonable for the Board to conclude that the method used by the expert for the protesting dealerships to measure economic impact in the relevant market areas for the two proposed dealerships was superior to

\textsuperscript{119} \textit{Id.} at 865-866.

\textsuperscript{120} 224 Ill. 2d 1, 862 N.E.2d 209 (2007).

\textsuperscript{121} \textit{Id.} at 6, 862 N.E.2d at 215.

\textsuperscript{122} \textit{Id.}

\textsuperscript{123} \textit{Id.} at 21, 862 N.E. at 223-224.

\textsuperscript{124} \textit{Id.} at 21-22, 862 N.E. at 223-224.

\textsuperscript{125} \textit{Id.} at 22, 862 N.E. at 224.

\textsuperscript{126} \textit{Id.} at 23, 862 N.E. at 224-225.

\textsuperscript{127} \textit{Id.}, 862 N.E. at 225.
the method put forward by GMC’s expert,128 and that adding the two additional dealerships would not serve the public interest.129

7. The Value of the Franchise Brand

In *Equitable Life Assur. Soc. of U.S./Marriott Hotels, Inc. v. State Tax Comm’n of Missouri*,130 a hotel franchisee taxpayer and the county assessor sought review of the State Tax Commissioner’s valuation of the hotel’s real estate. The assessor challenged the gross annual income figure determined by the hotel’s expert, which the State Tax Commissioner adopted.131 The hotel’s expert testified that earnings that were currently being generated by the hotel were profoundly and positively influenced by its affiliation with the Marriott brand. Specifically, the management skill, brand name identification, and access to one of the largest reservation networks in the world contributed significantly to enhance the earnings of the hotel taxpayer.132 He further testified that because these factors are not part of the real property and are not part of the income stream that could reasonably be anticipated by a willing buyer for purposes of the income capitalization method to determine valuation for tax purposes, to the extent that they influence the income presently being derived from the hotel, they need to be removed.133 To quantify and remove the impact of these factors, the hotel’s expert studied average daily room and occupancy rates of competing hotels, in the immediate vicinity and nationally, based on reports recognized as authoritative in the appraisal field.134 To eliminate the impact of these non-assessable factors in his projection of “gross possible annual income,” the hotel’s expert based his calculations on market occupancy and room rates, rather than on the actual rates being realized by Marriott which, he opined, was the way that a prudent investor would project income.135 The court determined that any failure on the expert’s part to provide greater detail to support his mathematical calculations affected the weight of the testimony, not its admissibility,136 and that the expert’s evidence adequately supported the Commission’s decision to accept the hotel’s expert’s projection of “gross possible annual income,” even though the Commission did not accept other elements of the expert’s analysis.137

128 *Id.* at 22, 862 N.E. 2d at 224.

129 *Id.* at 23-24, 862 N.E. 2d at 225.

130 852 S.W.2d 376 (Mo. Ct. App. 1993).

131 *Id.* at 381.

132 *Id.*

133 *Id.*

134 *Id.*

135 *Id.*

136 *Id.* at 382.

137 *Id.* at 381-382.
8. Other Issues Specific to Particular Cases

In re SI Grand Traverse, LLC, involved a hotel franchisee who had filed a voluntary petition for relief under Chapter 11 of the U.S. Bankruptcy Code. The franchisee retained an expert to opine that its largest creditor would be adequately protected if the franchisee were allowed to use the hotel rents securing the first lien debt owed to the creditor. The creditor lacked confidence in the franchisee’s management abilities and was unwilling to consent to the franchisee’s use of its cash collateral. The principal issue in controversy was the franchisee’s proposed means of providing adequate protection to the first lien creditor. The franchisee had the burden of proof on the issue of whether its secured creditors were adequately protected by the franchisee’s proposed reorganization plan. At the hearing, the franchisee presented an appraisal report and testimony from its expert witness, a real estate appraiser, to establish that there was an equity cushion that would permit use of the rents. Although the court found that the appraiser testified credibly regarding his opinion of value, the appraiser’s conclusion that the property was worth $2.4 million (compared to total secured debt of $2.47 million) depended upon the franchisee maintaining the hotel as part of a national franchise brand and completing a Property Improvement Plan estimated to cost $499,000. The expert’s appraisal also relied on optimistic projections of occupancy and average daily rate indicators for the hotel that exceeded the projected increase in occupancy across the state. The court rejected the franchisee’s proposed plan on the ground that there was an insufficient “equity cushion” to provide adequate protection of the franchisee’s cash collateral.

B. Expert Testimony on Damages

1. Methods of Franchise Valuation

There are two traditional methods of valuing franchises: future lost profits and fair market value. Opinions on lost profits may be based on the before-and-after method, the yardstick method, or the sales projection method. The underlying difficulty in proving lost profits is that “the plaintiff must prove something that never came to be: the profits the plaintiff would have earned but for the defendant’s breach or wrongful conduct.”

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139 Id. at 704.
140 Id. at 705.
141 Id. at 705-706.
142 Id. at 706-708.
143 Id.
144 Id. at 708.
146 Stewart I. Edelstein, Daubert and Lost Profits Testimony, 41 Trial 31 (2005).
In calculating lost profits, the before-and-after method is a comparison of what was expected to occur against what did occur after the challenged conduct. An expert using this method looks at financial results projected to occur if the defendant had not committed the challenged conduct, based on results prior to that conduct, and then measuring the difference between these projections and what actually occurred.

When performing a before-and-after calculation, the expert must base projections of future performance on representative data. For example, in *Coca-Cola Co. v. Harmar Bottling Co.*[^149^], the reviewing court allowed use of the before-and-after method in calculating the alleged harm to a soft drink bottling company through Coca-Cola’s utilization of calendar marketing agreements, which allegedly restrained trade. Because there were no regional statistics on profits in the region, the expert used national statistics and extrapolated the bottler’s expected profits if the restraint on trade had not been imposed. However, the Texas Supreme Court reversed this decision because the expert had difficulty quantifying the extent to which Coca-Cola’s conduct restrained competition within the relevant geographic market.[^150^] It is essential that the expert’s before-and-after projection is tailored to the market in which the alleged harm occurred.

Similarly, in *David Otis v. Doctor's Associates, Inc.*[^151^], the court rejected an expert’s analysis of a sales agent’s lost profits claim because the expert did not perform any independent market analysis.[^152^] Instead, the expert simply relied on sales quotas in the contract. The expert failed to demonstrate that the contractual quotas were actually representative of expected sales in the market, based on the performance of similar businesses.

Experts also calculate lost profits of a franchisor when the franchisee breaches the franchise agreement. In *Progressive Child Care Systems, Inc. v. Kids ‘R’ Kids International, Inc.*[^153^], the franchisee was contractually obligated to pay the franchisor 5% of the franchisee’s enrollment-derived gross revenues.[^154^] The franchisee concluded that it was not receiving adequate operational support from the franchisor. Accordingly, it ceased operating its child-care facilities under the franchisor’s name and ceased paying royalties to the franchisor.[^155^] The trial court held that the franchisee had breached the contract, and the franchisor retained a forensic

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[^147^]: Micklich, supra note 145.

[^148^]: Id.


[^150^]: 218 S.W.3d at 677-78, discussed in Micklich, supra note 145, at 224.


[^152^]: Kennedy, supra note 151, at 169.


[^154^]: Id. at *1.

[^155^]: Id.
accountant to calculate both past and future royalties that the franchisee owed.\textsuperscript{156} The reviewing court affirmed that expert’s calculations of lost royalties.\textsuperscript{157}

Under the yardstick method, the expert compares the plaintiff’s performance against the performance of comparable businesses that were not impacted by the defendant’s wrongful conduct, and thereby gauges the adverse impact of that conduct on the plaintiff.\textsuperscript{158} The expert must ensure that “the benchmarks (or yardsticks) are sufficiently comparable that they may be used as accurate predictors of what the target would have done.”\textsuperscript{159} In \textit{CDW LLC v. NETech Corp.},\textsuperscript{160} the court rejected the expert’s methodology because he compared the performance of the plaintiff CDW franchisee with the average performance of other CDW franchisees in the same region without explaining why this average performance was a proper benchmark for the performance of the unit in question.\textsuperscript{161} The court stated that an expert who “uses the yardstick method of determining lost profits bears the burden to demonstrate the reasonable similarity of the business whose earning experience he would borrow.”\textsuperscript{162} That is, the expert using the yardstick method must explain why the performance of the comparable business or average performance of comparable businesses is analogous to the performance of the plaintiff’s business.

An expert using the sales projection method examines trends in the plaintiff’s sales before the challenged conduct occurred. The expert then uses those trends to project how the plaintiff’s business would have performed but for that conduct, and then subtracts the actual sales from the projected sales. The expert compares projected losses to the total value of the business immediately prior to the harm. The total damages are the lesser of the business’s total value before the harm and the loss projected based on sales trends.\textsuperscript{163} In order for this method to be effective, the data used for the projection must be reasonably related to the franchisee’s business. Otherwise, the sales decline may have been caused by extraneous factors.\textsuperscript{164}

2. **Discounting to Present Value**

Experts also must demonstrate the appropriate discount rate for determining the present value of lost profits.\textsuperscript{165} That includes determining what a reasonable discount rate would be.\textsuperscript{166}

\textsuperscript{156} \textit{id.} at *2.

\textsuperscript{157} \textit{id.} at *6.

\textsuperscript{158} Micklich, supra note 145, at 225.

\textsuperscript{159} \textit{id.} (discussing \textit{CDW LLC v. NETech Corp.}, 906 F. Supp. 2d 815 (S.D. Ind. 2012)).

\textsuperscript{160} 906 F. Supp. 2d 815 (S.D. Ind. 2012).

\textsuperscript{161} Micklich, supra note 145, at 225.

\textsuperscript{162} \textit{id.} (quoting \textit{CDW}, 906 F. Supp. 2d at 825).

\textsuperscript{163} \textit{id.} at 226.

\textsuperscript{164} \textit{id.}

\textsuperscript{165} \textit{id.} at 226-27.

\textsuperscript{166} \textit{id.}
As the Eighth Circuit emphasized in *Diesel Machinery, Inc. v. B.R. Lee Industries, Inc.*, an expert probably will have difficulty adding an additional layer of discounting to reflect the increased risk of re-investing a lump sum award into an ongoing business. In *Diesel Machinery*, defendants attempted to use a two-step analysis in discounting: first, determining the interest rate that the plaintiff could expect to receive on an investment of the lump-sum payment, and second, discounting further to reflect the risks inherent in the plaintiff’s cash flow. The court allowed the defendants to use only the first, more reliable method of discounting, based on the expected return on investment.

3. **Time Span for Measuring Damages**

Projecting damages too far into the future is perilous. In the *CDW* case discussed above, the court rejected the expert’s assumption that the plaintiff’s profits would not rebound for three to seven years, because the expert based this assumption entirely on the unsubstantiated opinion of two CDW executives. The court had previously enjoined the defendant from continuing to engage in the harmful conduct, thereby frustrating the expert’s assumption that damages would persist for many years.

In the *Kids ‘R’ Kids* case discussed above, the reviewing court affirmed the trial court’s reliance on a forensic accountant who calculated both the past-due royalties and the royalties that the franchisee owed over the entire unexpired term of the franchise agreement. The reviewing court did not examine the nuances of the forensic accountant’s analysis, but affirmed the analysis because it was “based on the two franchisees’ 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.” With more thorough analysis, opposing counsel might have been able to undermine the assumption that royalties would have continued throughout the duration of the agreement, and offered an expert whose testimony would support that challenge.

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167 328 F. Supp. 2d 1029, 1040 (8th Cir. 2000).

168 Micklich, supra note 145, at 226-27.

169 Id. at 227 (discussing *Diesel Machinery, Inc.*, 328 F. Supp. 2d at 1040).

170 Id.

171 See supra text accompanying notes 158-161.

172 Micklich, supra note 145, at 229 (discussing *CDW LLC v. NETech Corp.*, 906 F. Supp. 2d 815 (S.D. Ind. 2012)).

173 Id.

174 See supra text accompanying notes 152-156.


176 Id.
4. **Valuing Nascent Businesses**

Measuring lost profits of nascent businesses can be difficult. First, determining the appropriate time span can be challenging. In *Beverly Hills Concepts, Inc. v. Schatz and Schatz, Ribicoff and Kotkin*,¹⁷⁷ a start-up franchisor of fitness clubs sued its law firm, alleging that the firm’s malpractice caused the business to fail. The expert’s projections of lost profits, however, “assumed that the franchisor would have sold twenty franchises per year for the first five years and would have continued to expand until it was selling forty franchises per year by year twelve.”¹⁷⁸ The expert made these projections despite the fact the plaintiff had sold only one model unit, had never sold a franchise, and had never generated a profit.¹⁷⁹ The Connecticut Supreme Court concluded that there was no basis to award damages over such a long period, because the viability of the business was tenuous.¹⁸⁰

It can be difficult to project even short-run damages for a new venture that is not yet profitable at the time of the harm, or may be declining in value. In *Final Cut v. Sharkey*,¹⁸¹ a new hair salon franchisee sued the franchisor for blatant misrepresentations in the franchisor’s projections of operating costs and profitability.¹⁸² In awarding damages to the plaintiff, the court did not use any of the business valuation methods previously described. Instead, the court took a reliance damages approach and “ordered a full refund of the plaintiffs’ investment and all costs associated with the purchase of the franchises and the subsequent litigation.”¹⁸³ The plaintiff’s forensic accountant demonstrated how the franchisor had manipulated financial records to make other franchisees appear more profitable than they were.¹⁸⁴ It would have been impossible for the court to extrapolate damages with reasonable accuracy for such a new business, which might have failed on its own accord within a short amount of time. Accordingly, the court awarded the amount that the plaintiff spent in reliance on the franchisor’s misrepresentation.

5. **Using a Competitor’s Profits to Measure Damages**

Another approach to damage calculations is to consider the profits of a competitor, particularly when the defendant violated the plaintiff’s exclusivity or its promise to protect the plaintiff from outside competition.¹⁸⁵ In *Maintainco, Inc. v. Mitsubishi Caterpillar Forklift America, Inc.*,¹⁸⁶ the court found that when Mitsubishi granted a dealership to a company located near the

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¹⁷⁸ *Id.* note 151, at 171.

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*


¹⁸² *Id.* at *23, discussed in Micklich, *supra* note 145, at 234-35.


¹⁸⁴ 2012 WL 310752, at *25.

¹⁸⁵ *Id.* at 229.

plaintiff, Mitsubishi violated the plaintiff’s contractual right to exclusivity. The court allowed the expert to extrapolate damages based on the profits of the competitor that Mitsubishi wrongfully allowed to enter the market.187

Similarly, in Bertico Inc. v. Dunkin’ Brands Canada Ltd.,188 a Canadian court measured the harm that a franchisee suffered because the franchisor did not protect it from outside competition, by considering the competitor’s profits. The court held that “[l]ost profits flowing from lost sales in a growing market caused by a franchisor that had failed to protect its brand and the loss of investments made to participate in such market fall readily into the category of damages that is an immediate and direct consequence of the debtor’s default.”189 The plaintiffs’ expert “quantif[ied] the losses of ‘contribution margins’ each of the 32 stores sustained . . . with reference to the corresponding increases in sales of Tim Hortons, the principal beneficiary of Dunkin Donuts’ decline.”190

V. CONCLUSION

The outcome of litigation often depends on the testimony of the experts selected by the parties. Therefore, it is critical to consider the types of experts that will be needed at the inception of a case, and to vet potential experts early on to ensure that they are qualified and will be perceived by the trier of fact as authoritative and trustworthy. Before selecting an expert, it is also important for franchise litigators to have a thorough understanding of the standards that courts use to determine whether the expert’s proffered testimony will be admitted, as well as the factors that may lead the trier of fact to find an expert’s testimony more or less credible.

As detailed above, experts are being used to opine on an ever-expanding array of topics affecting franchise-related cases. Applying the legal principles and best practices set forth in this paper, and taking heed of the case studies demonstrating how experts have been effectively used, and how they have been misused, should assist the franchise litigator in avoiding pitfalls and successfully identifying the appropriate experts to assist them in proving their claims and defenses.

187 Micklich, supra note 145, at 230.
188 2012 QCCS 2809 (Can.).
189 Id. (internal quotations omitted).
190 Id.
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