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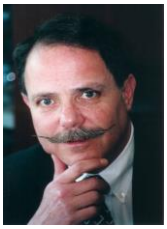
The Franchise Valuations Reporter

Our Expertise



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

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

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We Write the Book

Franchise Regulation and Damages, the only treatise that covers valuations and damages in franchise disputes, is updated 3 times a year.

For more details, to see a Table of Contents or to place an order, go to the Wolters Kluwer Law & Business web page here.

DISCLAIMER

Joint Employer

Department of Labor Proposes 4-Factor Test: Hiring and Firing, Supervision and Control, Payment, and Record-Keeping

As reviewed in the excellent Daily Antitrust Reporter from CCH/WoltersKluwer, on April 1, the DOL announced a proposed rule to "revise and clarify the responsibilities of employers and joint employers to employees in joint employer arrangements." The Fair Labor Standards Act as interpreted by the DOL proposes a four-factor test to consider whether there is a joint employer relationship which turns on the power to:

- Hire or fire the employee;
- Supervise and control the employee's work schedules or conditions of employment;
- Determine the employee's rate and method of payment; and
- Maintain the employee's employment records.

The proposal also includes a set of joint employment examples for comment that would further assist in clarifying joint employer status, notably in the franchise industry. The DOL's examples can be seen here.

CA 9 Overrules District Court's Grant of Judgment for 7-Eleven on Franchisee Labor Law Claims

It was error for the federal district court in Los Angeles to grant franchisor 7-Eleven judgment on the pleadings on the claims of plaintiff franchisees that the franchisor misclassified them as independent contractors rather than employees. The court also erred in denying the franchisee's motion for injunctive relief. Claims brought by plaintiff franchisees that the franchisor violated the Fair Labor Standards Act and the California Labor Code by misclassifying them as independent contractors rather than employees, were reinstated by the U.S. Court of Appeals in San Francisco, vacating and remanding the case[1] In addition, the lower court erred in denying the franchisees' motion for a preliminary injunction and corrective notice in another case[2] (regarding 7-Eleven's distribution of a franchise renewal agreement requiring franchisees to release their wage-and-hour claims in *Haitayan I (Haitayan v. 7-Eleven, Inc.*, February 27, 2019, *per curiam*).

The appellate court also provided guidance to the district court on several other issues raised on appeal. First, the court's reliance on *Ahussain v. GNC Franchising, LLC,* 2008 WL 11336812 (C.D. Cal. Mar. 19, 2008) in addressing the likelihood of success on the merits was unwarranted. The appellate Court ruled that *Ahussain* applies to general releases in franchise renewal agreements, but it does not address California's prohibition on the contractual waiver of the plaintiffs' claims. The franchisor's contention that the waiver was a permissible settlement was rejected by the appellate court, as labor claims may only be settled by release and payment.

The court also rejected the franchisor's contention that the plaintiffs are contractually obligated to sign the general release because the franchise agreements they signed in 2004 said a general release would be required for renewal. 7-Eleven did not show that this provision negates California's prohibition on contractual waiver of wage-and-hour claims. Finally, the

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district court was encouraged to consolidate these two cases in the interest of judicial efficiency and for the convenience of the parties, the Ninth Circuit said.

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[1] (No. 18-55462, *Haitayan I*).
[2](Nos. 18-55910 and 18-56346, *Haitayan II*)

Vicarious Liability

Midas and Parent Entities Not Liable for Store Manager's Alleged Harassment of Employee

In *Harris v. Midas*,[1] a federal district court found that the franchisee's degree of control over its shops precluded finding the franchisor vicariously liable; and that the conduct complained of did not rise to the level of actionable intentional infliction of emotional distress. The franchisor could not be held liable for the alleged sexual and physical misconduct of a manager at a Midas shop against an employee because the defending entities (TBC) were not in control of the management of the shop.

The evidence of record showed "that the TBC defendants simply did not exert control, authority, or otherwise manage the day-to-day operations and employee relationships at the store to the degree required to impose liability," in the court's view. They were not joint employers based on their authority to promulgate workplace policies or their setting of a sexual harassment policy covering employees such as the plaintiff. "[W]hile the Franchise Agreement required franchisees' compliance with 'reasonable policies, regulations and procedures, including those related to supervision and training of personnel' in some areas, there was no genuine dispute that the TBC defendants did not subject the store to any relevant policies." They had no role in the creation of the franchisee's employment manual, which governed employee conduct at that store.

Additionally, Midas could not be held vicariously liable under an agency theory because there was no aspect of the relationship between the franchisee's company, Auto Systems Center, Inc. and its employees at the Lower Burrell store meaningfully controlled by the TBC, the court found. The franchise agreement did not create an agency relationship by virtue of clauses indicating that the TBC defendants would provide resources or assistance to the franchisee and that the franchisee had to report sales to them and to comply with the law or risk termination. According to the court, an offer to assist does not equate to an ability to control.

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[1](DC PA WD March 29, 2019, Bissoon, C) Civil Action No. 17-95

Valuations

Some Pluses and Minuses of EBITDA

The well-recognized valuation expert Chris Mercer has recently posted two interesting pieces on EBITDA covering some things it does not do well and then some things it does. His ultimate conclusion is that EBITDA itself is not a cure-all. Actual analysis and adjustment by a thinking human is required to accurately use it as a measure of cash flow. First he lists some shortcomings:

Does EBITDA Adequately Provide For

A GAAP defined measure?	No
Asset intensity?	No
Liquidity of a company's balance sheet?	No
Debt Level of a company's balance sheet?	No
Working capital needs?	No
Replacement capital expenditures?	No
CAPEX needs for future growth?	No
Owner perquisites?	No, unless adjusted
Non-cash items other than amortization and	No, unless adjusted
Non-recurring items of revenue or expense?	No, unless adjusted
Can the measure be manipulated by the unscrupulous?	Yes

On the other hand, Mercer says, there are some good things about EBITDA:

EBITDA is a source to pay interest on debt to lenders.

EBITDA is the source to pay applicable taxes.

EBITDA is the source to repay principal on debt owed to lenders when it is due.

EBITDA is the source of needed working capital requirements.

EBITDA is the source of replacement capital expenditures.

EBITDA is a source for capital expenditures to finance growth.

EBITDA is also the source for current dividends to

shareholders or economic distributions after flow-through taxes for pass-through entities.

Damages

Defendants Entitled to Attorneys' Fees as Prevailing Party for Obtaining Dismissal of Claims on Collateral Estoppel Grounds

A defendant need not obtain a favorable judgment on the merits in order to be a "prevailing party" under the fee-shifting provisions of the Copyright Act and Lanham Act. A test preparation business that had been found by a state court to lack standing to sue due to its "cancelled status" was properly ordered by a federal district court to pay the attorney fees incurred by a former principal of the business and a competing company in defending against the business's copyright and trademark infringement claims, according to the Second Circuit Court of Appeals. Although the defendants had obtained dismissal of the complaint on the ground that the prior state court orders on the complaining business's lack of standing collaterally estopped it from pursuing the infringement action, and not on the merits of the claims, the defendants qualified as a "prevailing party" for purposes of both the Copyright Act and the Lanham Act, the court said[1].

Lost Future Royalties - Advertising Fees

We have frequently argued that lost advertising fees claims are really a sub-set of lost future profits. As such, we have asserted that advertising fees are not a profit center because the franchisor is obligated to spend them all and therefore, lost advertising fees should not be an allowable claim in a lost future royalties case. But the Courts have not always agreed with us.

In the recent case of *Legacy Academy, Inc. v. Pacu Enterprises, Inc.*,[2] an appellate court held that daycare center franchisor Legacy Academy should have been awarded lost advertising/ marketing fees from a breaching franchisee and that a Georgia state trial court erred by not granting Legacy Academy's motion for a directed verdict on its claim for lost marketing/advertising fees from a franchisee that breached its franchise agreement by repudiating it before the end of its 25-year term. The franchisee's obligation to pay advertising fees to the franchisor under the agreement was fixed and absolute and, under Georgia law, the rule requiring a party to mitigate damages did not apply where there is an absolute promise to pay. Thus, the trial court was reversed.

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[1] *Manhattan Review LLC v. Yun*, March 25, 2019, *per curiam*

[2] March 13, 2019, Brown III,

Napoleon's Maxims of War

Also Applicable to Litigation

All wars should be systematic, for every war should have an aim and be conducted in conformity with the principles and rules of the art. War should be undertaken with forces corresponding to the magnitude of the obstacles that are to be anticipated.

When you have it in contemplation to give battle, it is a general rule to collect all your strength and to leave none unemployed.