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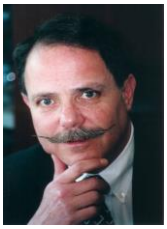
The Franchise Valuations Reporter

Our Expertise



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

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

Bruce S. Schaeffer, Editor
Bruce@FranchiseValuations.com
212.689.0400

Have a Question About Succession Planning for Franchise Owners?

Call us for a free, confidential consultation. And we're always interested in your comments about the newsletter.

Bruce S. Schaeffer, Editor
Bruce@FranchiseValuations.com
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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

Valuations

Assumed Events Should Not Be Considered in a Valuation

In *Grieve v. Commissioner*, T.C. Memo 2020-28 (March 2, 2020), the tax court was confronted with the admissibility of expert testimony and two major issues: 1) the appropriate discounts for lack of marketability (DLOM) and for lack of control (DLOC) in interests in two LLCs which were basically incorporated pocketbooks holding primarily publicly traded securities; and 2) whether or not "subsequent events" (in this case hypothetical) should be considered in a valuation.

In the first part of the opinion the Tax Court ruled on a *Daubert* challenge finding:

> Rule 702 of the Federal Rules of Evidence is viewed as a rule of admissibility rather than exclusion. *Arcoren v. United States*, 929 F.2d 1235, 1239 (8th Cir. 1991). When an expert's methodology, not qualifications, is in dispute, exclusion of the expert [*17] report is not warranted. See *Synergetics, Inc. v. Hurst*, 477 F.3d 949, 956 (8th Cir. 2007).

Next the Court was confronted with accepting or rejecting the IRS' trial expert's assertion that substantially lower DLOMs and DLOCs should be applied (rather than the approximately 15% DLOC and 25% DLOM argued by the taxpayer) because the IRS' expert argued that a reasonable buyer would buy out the .02% Class A Partner and remove the restrictions on Class B shares in the LLC. In effect, the IRS' expert was arguing that not only should subsequent events be considered but that even fictional subsequent events should control. But the Tax Court rejected the proposal holding:

> We are looking at the value of the class B units on the date of the gifts and not the value of the class B units on the basis of subsequent events that, while within the realm of possibilities, are not reasonably probable, nor the value of the class A units. In *Succession of McCord v. Commissioner*, 461 F.3d 614, 629 (5th Cir. 2006), rev'g and remanding *McCord v. Commissioner*, 120 T.C. 358 (2003), the Court of Appeals for the Fifth Circuit reasoned that there are three types of conditions along the "speculative" continuum: (1) a future event that is absolutely certain to occur; (2) a future event "that is not absolutely certain to occur, but nevertheless may be a 'more . . . certain prophec[y]'"; and (3) "a [*34] possible, but low-odds, future event" which is "undeniably a 'less . . . certain prophec[y]'".
>
> Mr. Mitchell's valuations [the IRS' expert] relied on an additional action. He concluded that to determine the value of what a willing buyer would pay and what a willing seller would seek for the class B units, a premium to purchase the class A units has to be taken into account. Elements affecting the value that depend upon events within the realm of possibility should not be considered if the events are not shown to be reasonably probable. Olson, 292 U.S. at 257. The facts do not show that it is reasonably probable that a willing seller or a willing buyer of the class B units would also buy the class A units and that the class A units would be available to purchase. To determine the fair market values of the class B units we look at the willing buyer and willing seller of the class B units, and not the

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willing buyer and willing seller of the class A units.

Valuing Wealth Management Businesses

Wealth management businesses are often franchises - Ameriprise comes to mind. They typically manage their clients' investable assets and retirement plans. Wealth management is different from pure investment management in that it involves both relationship management and wealth planning. In a very informative article the authors, Edward Mendlowitz and Elena Ladygina, offer some metrics and guidelines for valuing such firms:

- Revenue multiple: This can generally vary between one to three times trailing 12-month revenue
- Cash flow multiple: This can vary from three to eight times EBITDA
- Asset multiple: 1 percent to 2 percent times AUM (Assets Under Management)
- Market approach: What similar public companies are selling for, if similar companies can be identified

Delaware Fair Value Decision

In a statutory appraisal action involving the sale of a public company, the Delaware Court of Chancery found the deal price to be the proper determinant of fair value.[1] Although the court concluded that a synergy deduction was appropriate, the court noted that the deduction ultimately had no practical consequences.

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[1] *In re Panera Bread Company*, 2020 Del. Ch. 42, 2020 WL 506684 (Jan. 31, 2020)

Revenue Recognition Rule

Implementation of ASC 606 Postponed For a Year

Nonetheless, it should be emphasized that regulators are rejecting annual filings that they feel don't comply with ASC 606, which focuses on the proper timing and amount of revenue recognition for up-front franchise fees -- even though it's been postponed!

Joint Employer, Independent Contractor, Vicarious Liability

Franchisor Found Not Liable As Joint Employer

A suit against McDonald's Corp. and McDonald's USA for race and color discrimination, based on the actions of the manager of a McDonald's operated by a franchisee, was dismissed by the federal district court in Denver. The suit failed to show that the the franchisor maintained the right to terminate the franchisee's employees such as the manager and failed to show that the franchisor maintained control of the franchisee's records. Because federal claims were dismissed, the court also dismissed state claims of assault and battery, intentional infliction of emotional distress, and negligence.[1]

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[1]*Chavez v. McDonald's Corp.*, March 20, 2020, Brimmer, P.

Attorneys' Fees

Attorney Fees Limited to Contingent One Third Fee

In *Royce v. Michael R. Needle, P.C.*,[1].a lump sum settlement made no mention of attorney fees and therefore, the Court ruled against the winning lawyer who had been sanctioned for frivolous behavior, holding that the fee should be based on the one-third percentage clause.

Game Developer Entitled To Partial Expenses Incurred Defending Overly Broad Subpoenas

A video game developer in a copyright infringement case was entitled to an award of a portion of the expenses it incurred in defending subpoena requests made by a computer graphics company to third parties that were broader than the limited scope ordered by the district court in order to evade the court's discovery limits. However, the court refused to award expenses related to a dispute over the scope of jurisdictional discovery because both parties were responsible for unnecessarily prolonging the proceedings.[2]

Request for Fees Denied Because Case Was Not "Exceptional"

In a patent action the winning party's request for an award of attorney fees under 35 U.S.C. § 285 and its request for expert witness fees were denied by the federal district court. Although the defendants' infringement was willful and the case was contentious, this did not make the case exceptional, warranting an award of attorney fees under Section 285.[3]

Attorney's Fees Denied Absent Showing of Bad Faith or the Filing of Frivolous or Unreasonable Claims

An award of attorney fees to a multi-level marketing company and its CEO -- the prevailing parties in a copyright infringement suit brought against them by an individual who participated in the development of the company -- was denied by a federal district court. A fee award under the Copyright Act requires a showing of bad faith or the filing of frivolous or unreasonable claims, and the U.S. Supreme Court had rejected the notion that courts may award attorney fees as a matter of course under the Copyright Act. Although the defendants prevailed on a motion for summary judgment, they failed to convince the court that the claims against them were frivolous or that an award of attorney fees would deter future unmeritorious suits.[4]

Use of Lodestar Method Alone and Reduction of Hours for Additional Class Counsel in Antitrust Class Action Was Not an Abuse of Discretion

In an antitrust class action brought by dairy farmers against Dairy Farmers of America, Inc., Dean Foods Company, and others, an Appellate Court ruled that a federal district court in Vermont did not abuse its discretion when it awarded attorney fees in the amount of $110,000 to Subclass Intervenor Counsel instead of the $249,016 that they had requested. The district court had every right to base its calculation on the lodestar method for calculating fees rather than the percentage-of-recovery method.[5]

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[1]February 20, 2020, St. Eve, A

[2]*Glass Egg Digital Media v. Gameloft, Inc.,* February 25, 2020, Illman, R..

[3] *Core Wireless Licensing S.A.R.L. v. LG Electronics, Inc.*, March 26, 2020, Gilstrap, R.

[4] *Windsor v. Olson*, March 27, 2020, Lindsay, S.

[5] *Allen v. Dairy Farmers of America, Inc.*, February 28, 2020, per curiam.

Quotations for the Pandemic

"Failure to plan is a plan for failure" - John Wooden (best basketball coach of all time)

"Mene, mene, tekhel upharsin" - *Thou hast been weighed in the scales and found wanting* - from the walls of a Chaldean Temple.