



The Franchise Valuations Reporter



Our Expertise

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

- Finance, Accounting and Tax
- Damages, Valuations & Expert Testimony
- Cyber Security and E-discovery of Electronically Stored Information

We offer a free initial consultation. If any readers have questions, you are welcome to email or phone us and we will provide our best answer as quickly as possible.

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Franchise Technology Risk Management

Our franchise law and computer forensics experts provide consulting and implementation of all aspects of cyber security, ESI management and e-discovery for franchise systems - from preparation of cyber security and ESI-related policies and procedures manuals through collection, preservation, processing, production and presentation.

To inquire about our services, please e-mail
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Damages in Franchise Disputes: A Primer

What Are the Most Common Types of Franchise Contests Claiming Money Damages? How Much Is a Claim Worth? A Nutshell Overview of Types of Disputes and Measures of Damages

When we are brought in to provide consulting or testifying expertise involving money damages in a dispute between a franchisor and franchisee, our first order of business is to determine what claims are allowed and how damages are measured. In my book, *Franchise Regulation and Damages*, I devote several chapters to these topics. At the risk of oversimplification, I have developed "talking points" to help the parties zero in on the issues.

The most common claims made by Franchisors focus on lost past royalties (and ad fund contributions) and lost future royalties (and ad fund contributions). Another type of claim may be brought under the Lanham Act for trademark infringement.

Franchisee claims tend to fall under one or more the following categories: Little FTC Acts, Fraud, Lost Profits, Encroachment, and Wrongful Termination.

Legal theories of how to measure Money Damages fall into four categories: Out-of-Pocket, Resale, Benefit-of-the-Bargain, and Special or Consequential.

[For the rest of our cheat sheet on Damages, see. . .](#)

Franchise Valuations Ltd. provides consulting and testifying expertise for money damages. Readers are invited to contact us at (212) 689.0400 or Bruce@FranchiseValuations.com to see if a damages or valuation report is appropriate for your situation.

To see a description, table of contents, and ordering information for *Franchise Regulations and Damages*, [follow this link](#).

Fair Value: New Accounting Guidelines Offered By FASB

Accounting Rule Makers Modify Guidelines for Valuing Assets Based on Market Prices Bringing U.S. and International Accounting Rules Closer Together and Forcing Companies to Disclose How They Value Their Most Exotic Assets.

Currently, the "mark to market" rules provide three levels of analysis of the "fair value" of assets: Level 1 assets, those valued strictly using market prices; Level 2 assets, those for which a blend of market prices and a company's own models are used; and Level 3 assets, which are the risky, illiquid securities valued using a company's own estimates and models rather than market prices. Companies will have to disclose more about the processes and assumptions they use in their Level 3 valuations. They will also have to discuss what might happen to the company's valuations if the factors they are using were to change. There has been a lot of criticism of the Level 3 "mark to market" analyses in the past with critics labeling the

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practice as "mark to make believe."

The adopted changes are part of the "convergence" project to bring U.S. and international rules on valuation closer together in an effort to standardize the accounting rules used world-wide. The Securities and Exchange Commission is expected to vote later this year on whether U.S. companies should switch to using international rules altogether. It is expected that most companies will adopt some form of the fair-value measurement changes in early 2012.

[For more on this topic, see the FASB website.](#)

Franchisee Status: Independent Contractor or Employee?

Franchisee Status for Employment Law Purposes May Differ from Status for Tax Law Purposes

The decision of Massachusetts' highest court in *Coverall North America, Inc. v. Com'r of Div. of Unemployment**, holding that a franchisee of a cleaning service franchisor was considered an employee for unemployment tax purposes, brought the issue of whether a franchisee is an employee or an independent contractor into the spotlight. But the status for income tax purposes may differ.

In a prior *Coverall* case it was held that the franchisees were misclassified as independent contractors - with the federal district court focusing on the second prong of the Massachusetts employment law's ABC test to determine whether the workers were independent contractors or employees, i.e., whether the franchisor and franchisee were in separate and distinct businesses. The franchisor argued that the franchisee was in the cleaning business and the franchisor was in the franchising business. However, the court said the franchisor did not establish or prove that the operations were "distinct." In colorful language the opinion referred to the arrangement as a Ponzi scheme.

Under the ABC test generally, if an individual performs services for an employer for remuneration, that individual is considered an "employee" unless it is shown that: (1) the individual is free from the direction and control of the employer; (2) the service is outside the usual course of the employer's business; and (3) the individual is engaged in an independently established trade or business.

For more on this topic, including a recent federal district court case involving a Mississippi franchisee, the Virginia Attorney General's position, and the IRS regulations, [click here](#).

*857 NE2d 1083 (Mass. 2006).

Valuations Cases

Valuing Franchises in Tax Proceedings: Minority Discounts Above 30% Will Be Scrutinized

In a presentation at the 3rd annual National IRS Symposium sponsored by the American Society of Appraisers' Los Angeles Chapter, IRS Engineer Tam manager neil Mills-Mazer said any fractional discount above 30% for minority interest would merit serious consideration and support, meaning it would invite more than usual scrutiny and would require extensive support. In another comment, Mr. Mills-Mazer also said there will be more Daubert challenges of valuation experts who stray from accepted methods.

Valuations: "Fair Value for Appraisal Rights" - Delaware Chancery Court Decisions

In *S. Muoio & Co., LLC v. Hallmark Entertainment Investments**, the plaintiff's expert relied on only one valuation method, rejecting comparable companies and comparable transactions analyses, and relying solely on a discounted cash flow analysis. In response, the court rejected his opinion entirely because it lacked credibility and because of his rejection of management projections and growth assumptions.

For a somewhat different result, see *In re Sunbelt Beverages***, a dealership case, where supposedly "comparable" transactions were rejected for use in an appraisal rights valuation because (a) there were differences in size, product and geography, and (b) the companies were privately held in a tightly controlled market.

[To continue reading about these and other recent Appraisal Rights decisions.](#)

*2011 WL 863007 (Del. Ch.) (March 9, 2011).

** 2010 Consol. C.A. No. 16089-CC (Del. Ch. Jan. 5, 2010).

CyberCrime

More Reasons to Secure Your Franchise System Network Against Hackers

Here are some links to recent articles on cybercrime:

[Sony Apologizes, Offers \\$1 Million Insurance After Hacking](#)

[Thieves Swipe Debit Card Data \(at Michael's Stores\)](#)

[Latest Scam Highlights Risks for Debit-Card Users \(Michael's Stores\)](#)

[Don't Let Hackers in the 24-by-7 Crime Window](#)