



# The Franchise Valuations Reporter



## Our Expertise

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

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



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## 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.

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## We Write the Book

**Franchise Regulation and Damages**, the only treatise that covers damages in franchise disputes and valuations of franchises, 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](#).

## Valuations

### *Fair Value - E&Y Updated Study*

A study by E&Y was recently updated in October 2017. According to the report, Accounting Standards Codification (ASC) 820, which is the authority on "Fair Value Measurement," has a principles-based framework for measuring fair value in US GAAP which is based on a number of key concepts including unit of account, exit price, valuation premise, highest and best use, principal market, market participant assumptions and the fair value hierarchy. ASC 820 includes a single definition of fair value that should be used for financial reporting purposes, provides a framework for applying this definition, and requires numerous disclosures about the use of fair value measurements in financial statements. [The excellent study can be found here.](#)

### *Weinstein Scandal Sparks Valuation Questions*

Because of the egregious behavior of Harvey Weinstein, the Weinstein Co. may be forced into bankruptcy - a stunning and sudden collapse of a once-powerful firm. To what extent was a valuator supposed to take into account the fact that there were rumors about him for years? In the past, the probability of this leading to liability was far less than it is now, in the wake of similar scandals such as those surrounding Roger Ailes and Bill O'Reilly at Fox News. How is this sort of potential liability quantified? Is a valuator subject to liability for exposing the problem?

### *Damodaran on the Effects of Corporate Scandal*

From a valuation standpoint, there are many consequences, according to Professor Aswath Damodaran (New York University Stern School of Business). If the "corporate narrative changes as a consequence of the misconduct," a company can have serious long-term damage. Damodaran writes, "This is due to several reasons. The first is that the scandal can unalterably change the reputation of the company especially to the extent that its narrative was built on that reputation". Thus, the news in 2015 that Volkswagen, a company known for German efficiency and reliability, had cheated on emissions controls for its diesel cars could have altered the story line and it had large consequences for value. The second is that a key component or components of the company's business model may have been built on questionable business practices, which, once exposed, can no longer be continued. The third is that large scandals often result in management turnover, with the new management perhaps bringing a different perspective to the company.

### *Duff & Phelps Rate Changes*

Equity Risk Premium ("ERP"), one of the components of the discount rate used in valuations, changes over time depending on fluctuations in global economic and financial conditions. Based upon current market conditions, Duff & Phelps has decreased its U.S. Equity Risk Premium recommendation from 5.5% to 5.0%. The 5.0% ERP guidance is to be used in conjunction with a normalized risk-free rate of 3.5% when developing discount rates as of September 5, 2017, and thereafter, until further guidance is issued.

## DISCLAIMER

The information provided in this newsletter is for informational purposes only and should not be construed as legal or expert advice which can only be obtained from appropriate professionals. Franchise Valuations, Ltd. and Franchise Technology Risk Management provide such expert advice on the topics addressed herein.

Please visit our websites at [www.FranchiseValuations.com](http://www.FranchiseValuations.com) and [www.ftm.biz](http://www.ftm.biz)

To summarize their recommendations:

- \* Equity Risk Premium: Decreased from 5.5% to 5.0%
- \* Risk-Free Rate: Reaffirmed at 3.5% (normalized)
- \* Base U.S. Cost of Equity Capital: 8.5% (5.0% + 3.5%)

## Tax Nexus: Sales Tax

### *Physical Presence Requirement Under Attack*

There is a new and informative article in the ABA publication *Tax Times* on the "physical presence" requirement for state's asserting sales tax nexus.[1] The current controlling precedent from SCOTUS is *Quill v. North Dakota*[2] which established the "physical presence" requirement. *Quill* relied on the 1967 case of *National Bellas Hess*[3] which in the days before computers were prevalent held that keeping track of the various state and local rules and rates was beyond mere taxpayers. In *Quill*, SCOTUS held that requiring out-of-state sellers with no "physical presence" to collect and pay over sales tax did NOT violate the Due Process clause but did violate the Commerce clause. That means that a change can be made by simple Congressional legislation which would not require the Supreme Court to overturn *Quill*.

Since the advent of simple computer programs which keep track of sales tax regulations and rates, many have argued that the "physical presence" standard is obtuse and that it has become the death knell of bricks and mortar retailers (Cf. Amazon results vs Walmart results). More recently Justice Kennedy in *Direct Marketing Ass'n v. Brohl*[4] stated (in effect) that the *Quill* rule is stupid and his dissent basically begged for an opportunity to overturn it or for Congress to pass legislation rather than relying on *Quill*. [5]

Additionally, many states have passed or introduced legislation to either overturn or modify the result in an attempt to protect their tax revenues and their local retailers.[6] We shall keep our readers advised of further events.

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[1] [Cody J. Edwards, "Let's \(Not\) Get Physical: States Challenge Physical Presence Sales Tax Nexus Law," \(Vol. 37 No. 1 November 2017\)](#)

[2] 504 U.S. 298 (1992)

[3] 386 U.S. 753 (1967)

[4] 135 S. Ct. 1124 (2015)

[5] In response, two opposing bills have been introduced in Congress, one favoring the "physical presence" requirement and the other removing it but no action has been taken.

[6] Alabama, Indiana, Iowa, Maine, Massachusetts, North Dakota, Rhode Island, South Dakota, Tennessee, Vermont, Washington and Wyoming.

## Fairness of State Courts Survey

*The 2017 Lawsuit Climate Survey: Ranking the States*

Harris Poll recently conducted a survey for the U.S. Chamber Institute for Legal Reform to explore how fair and reasonable the states' liability systems are perceived to be by U.S. businesses. These perceptions matter because they can be influential in business decisions about where to conduct/expand/constrict business operations or sales. Most of the respondents in the survey (85%) reported that a state's litigation environment is likely to impact important business decisions at their companies, such as where to locate or to do business.

This is a significant increase from 75% in 2015 and 70% in 2012. The 2017 survey reveals that the overall average scores of the states are increasing, and senior attorneys and executives see the litigation environment improving generally; more than six in ten respondents (63%) view the fairness and reasonableness of state court liability systems in the United States as excellent or pretty good, up from 50% in 2015 and 49% in 2012. The remaining 36% view the system as only fair or poor, or declined to answer (1%).

However, several studies have documented very high litigation activity in certain county courts such as Madison County, Illinois, and Jefferson County, Texas, revealing that these counties have "magnet courts" that are extremely hospitable to plaintiffs.

## **Joint Employer and Vicarious Liability**

### ***Recent Activity***

On November 7, the House passed the Save Local Business Act, which would effectively kill the National Labor Relations Board's revised joint-employer standard that unleashed a firestorm when it was first announced in the Board's the 2015 3-2 *Browning-Ferris Industries* decision. The bill passed by a 242-181 vote with eight Democratic lawmakers crossing party lines to join the unified Republicans in favoring the legislation. It is important to remember that in *Browning-Ferris Industries*, the Labor Board returned to its pre-1984 standard for determining joint-employer status. The Board announced that it would no longer require that a joint employer not only possess the authority to control employees' terms and conditions of employment, but also exercise that authority.

The Board also dropped its requirement that to be relevant to the joint-employer inquiry, a statutory employer's control must be exercised directly and immediately. If otherwise sufficient, control exercised indirectly—such as through an intermediary—may establish joint-employer status under the Board's revised standard. The net effect of the Board's decision was to make finding joint-employer status easier, much to the alarm of many in the business community and, in particular, the franchise business.

### ***Recent Case Law - Harris v Midas***<sup>[1]</sup>

In a recent Pennsylvania case, an employee sufficiently alleged a joint theory of liability and vicarious liability where she used the franchise agreement to demonstrate that the franchisor had broad control to impose policies on the franchisee. The employee was able to show that the franchisor could (and did) implement some policies, such as training regarding discrimination.

The court analyzed the three factors. First, the court considered whether the franchisor had the authority to hire and fire employees, set work rules and assignments, and set conditions of employment finding that although the

franchisor did not have control over hiring and firing, it did have authority to set work policies. Second, the court considered whether the franchisor supervised employees on a day-to-day basis where the franchisor did not interact with the franchisee employees on a day-to-day basis, but the franchise agreement did state that the franchisor could require employees of the franchisee to attend training sessions. The court found this showing to be weak, but sufficient. Third, the court considered whether the franchisor controlled employer records, such as payroll, insurance, taxes, etc. where the franchise agreement allowed the franchisor to visit the franchisee store to examine and audit the franchisee's books and records. This gave the franchisor access to at least financial records and perhaps some employee records, which was a sufficient showing under this prong, according to the court.

#### **Recent Case Law - Parrott v Marriott [2]**

A federal district court in Michigan recently found that food service managers working at Marriott franchises had alleged enough facts to survive a motion to dismiss a lawsuit claiming that the franchisor exercises control over them and is their joint employer. Of note was the fact that Marriott gave employees discount room rates at Marriott hotels worldwide, which the court said could be viewed as the ability to affect compensation and benefits similar to an employment relationship. Talk about no good deed goes unpunished.

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[1] *Harris v. Midas (USDCWDPA) Civil Action No. 17-95, 11/8/17.*

[2] *Parrott v Marriott, 2017 WL 3891805, (US DC ED MI, 9/6/17)*

## **Errata**

In our last issue discussing the reliability of management representations for establishing value we gave an incorrect cite for the case of *Lund v. Lund*. The correct cite is Minnesota (Not North Carolina) District Court Fourth Judicial District Court File No. 27-CV-14-20058. The case focuses on the fair value in an appraisal case of the well-known Lunds & Byerlys grocery chain. The complaining shareholder (sister) was awarded \$45.2 million for her stake, less than the \$80 million she sought but more than double the \$21.3 million that the family-owned company offered her.

## **Quotes from Samuel Johnson**

***"Patriotism is the last refuge of a scoundrel."***

***"I never desire to converse with a man who has written more than he has read."***

***"Integrity without knowledge is weak and useless, and knowledge without integrity is dangerous and dreadful."***

***"You raise your voice when you should reinforce your argument."***

***"To keep your secret is wisdom, but to expect others to keep it is folly." (In a similar vein from Frederick the Great - Q. "Can you keep a secret?" A. "Yes." Reply: "Good, so can I.")***

