The Franchise Valuations Reporter

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Our Expertise

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

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

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 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,

Valuations

Tennessee Appeals Court Finds Tax Affecting 'Relevant' to Fair Value Buyout

In *Raley v Brinkman* an appellate court in a Tennessee buyout dispute[1] involving a limited liability corporation which elected to be taxed as an S corporation, the parties disagreed over whether it was appropriate to tax affect in calculating the fair value of the terminated member's interest using the "income" method. The trial court was overruled with respect to its holding that 'no entity level tax should be applied in the valuation analysis for a non-controlling interest in an electing S corporation, absent a compelling demonstration that independent third parties dealing at arms-length would do so as part of a purchase price negotiation.'

The lower court, in declining to tax affect, followed the ***fair market value*** standard from *Gross v. Commissioner of Internal Revenue*.[2] In contrast, the Court of Appeals of Tennessee, by Ellen Hobbs Lyle, Chancellor,[3] after explaining the concept of ***fair value***, said that in such a case tax affecting was a consideration as it assisted the court "in determining the going concern value of the S corporation to the shareholder or member." Judge Lyle found the case of *Delaware Open MRI Radiology Associates, P.A. v. Kessler*,[4] which was an oppressed shareholder situation, more persuasive than *Gross* because the court's task in *Kessler* was to determine ***fair value*** of an S corporation while in *Gross* the task was to calculate the ***fair market value*** of the entity for gift tax purposes. But the Court closed with "Therefore, we vacate the trial court's judgment valuing Raley's membership interest in 4 Points and remand to allow the parties **to present evidence relative to tax-affecting**." (emphasis added)

Valuation Engagement vs. Calculation Engagement

go to the Wolters Kluwer Law & Business web page here.

In general, calculation and valuation engagements involve different scope of work assignments and different reporting requirements. There is also a substantial difference in the fees generally charged.

Valuation Engagement

- Provides an opinion or conclusion by the appraiser.
- Involves the "full" valuation process (i.e., incorporates all methods that will produce credible results).
- Results in a detailed or summary report (AICPA), or an appraisal or limited appraisal report (ASA). Both types of reports still require the full valuation process to be completed and documented.
- Valuations are most appropriate for reports for IRS compliance, financial reporting, litigation that will require testimony in court, and certain types of corporate planning.

Calculation Engagement

- Provides calculated values only. It can be helpful to express value as a range so as not to imply a level of assurance that does not exist.
- Involves a limited scope of work and does not include all the procedures required for an opinion/conclusion of value. Many times the appraiser and client agree on the valuation approaches and methods that will be applied.
- Allowed for by SSVS (AICPA), NACVA/IBA, and ASA.
- Most appropriate for internal company planning, preliminary M&A or transaction analysis, preliminary use for mediation or negotiations in litigation, and buy-sell agreements that specify the use of a formula.

String of Firms That Imploded Had Something in Common: Ernst & Young Audited Them

According to an article in The Wall Street Journal, EY reviewed the books of several companies where investors lost billions when scandals emerged. The article states, "The EY audit clients that faced financial issues were German payments processor Wirecard AG WDI ; China's Luckin Coffee Inc. LKNCY ; hospital operator NMC Health PLC; and NMC sister company Finablr PLC, which owned the Travelex currency service.

Positioning a Business for Sale

Steven M. Egna, of Valuation Resource Group, LLC, an Albany, NY, M&A Advisory Services, valuation, and litigation support firm, has recently authored an article stating that an exit plan must be fluid and flexible and offers an outline of six to-do headings and provides five rules of wisdom. The article, available here, is worthwhile reading for professionals working on business sales.

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[1] No. M2018-02022-COA-R3-CV (Tenn. Ct. App. Jul. 30, 2020)
[2] 78 T.C.M. (CCH) 21, 1999 WL 549463 (T.C. 1999), *aff'd Gross*, 272 F.3d 333 (6th Cir. 2001)
[3] You couldn't ask for a better judge, according to the eminent Joel Buckberg, Esq.
[4] 898 A.2d 290 (Del. Ch. 2006)

Joint Employer/Vicarious Liability

California's Gig Worker Law

According to this article in Wired, the recently passed California ballot measure known as Proposition 22 exempts Uber and Lyft from AB 5, the California statute which classifies many gig workers as employees. But millions of janitors, retail workers, and others are still covered by the law. On Election Day voters approved the ballot measure, which gave transportation and delivery companies permission to keep treating their drivers and delivery people as independent contractors, instead of employees.

Previously, lawmakers had exempted about 100 kinds of independent contractors, including doctors, dentists, lawyers, songwriters, hair stylists, architects, youth sports coaches, and some freelance writers, producers, and cartographers. Ironically, Proposition 22 revokes the law for the exact companies which were its intended targets—ride-hail and delivery drivers. But AB 5 still exists, and this year's California state budget dedicated more than $20 million to enforcing it. However, as *The Washington Post* reported, Uber and Lyft used sneaky tactics to avoid making drivers employees in California and some voters say they regret casting their ballots for Prop 22.

Franchisors and AB-5

According to a post by the Mulcahy law firm "Unfortunately, recent developments surrounding AB-5 seem to leave just as many questions as they do answers. With the lack of clarity, AB-5 certainly still poses a potential

existential threat for the franchise model in California. For now, although not specific to AB-5, franchisors can at least be glad that some case law has held that franchisors in the restaurant industry did not exert the necessary control for a joint employer relationship for their franchisees' employees. *See Salazar et al. v. McDonald's Corp., et al.*, 944 F.3d 1024 (9th Cir. Oct. 1, 2019) (affirming that McDonald's was not an employer because it did not "retain 'a general right of control' over 'day-to-day aspects' of work at the franchises."). Maybe a similar line of reasoning will aid in arguing that franchisors similarly lack the requisite control of franchisees under AB-5. As AB-2257 has already carved out protection from AB-5 without an exemption for franchises though, franchisors may be left in limbo without additional clarification for the foreseeable future."

Attorneys' Fees

Court Declines to Award Attorneys' Fees

The same decision noted above, *Raley v Brinkman,* also held that an attorneys' fees provision in a buy sell agreement only applied in accordance with its terms which were limited to disputes brought in arbitration as opposed to the chancery court where the case was actually brought. Additionally, a claim was made that Brinkman was entitled to attorneys' fees by statute but that was also denied.

Dismissed Party in Trademark Dispute Not Entitled to Attorney Fees as "Prevailing" Party

In *Simon Property Group, L.P. v. Casino Travel, Inc.*,[1].the Court held that a party that was voluntarily dismissed from an ordinary trademark infringement case was not the "prevailing" party and was not entitled to attorney fees under the Lanham Act. A party that had been voluntarily dismissed from a trademark infringement case after the shopping mall plaintiff obtained the injunction it sought was not entitled to $90,000 in attorney fees because it was not the "prevailing party" in the litigation, as the Lanham Act and state law required. The shopping mall operator prevailed on every significant issue. Furthermore, even if the dismissed defendant, a bus service could somehow have been said to have prevailed, this run-of-the-mill trademark infringement case failed to satisfy the Lanham Act's requirement that the case be "exceptional" before fees could be awarded.

Franchisor Wins Attorneys' Fees and Costs in Termination Decision

As reported by Foley and Lardner's newsletter in *AFC Franchising, LLC, et al., v. Fairfax Family Practice, Inc., et al.*,[2] the U.S. District Court for the Eastern District of Virginia recently issued a decision awarding a franchisor attorneys' fees and costs following a drawn-out suit based on, among other things, alleged breach of a franchise agreement. Plaintiff AFC Franchising, LLC ("AFCF") operated a franchise system consisting of urgent care centers. In June 2014, AFCF entered into a franchise agreement with defendant Fairfax Family Practice, Inc. ("FFP"), subject to a weekly royalty fee that AFCF could electronically debit from FFP. The agreement provided that any default from FFP on royalty or other payments would constitute a basis for termination of the agreement unless FFP cured the default. Finally, the agreement specified that defendants would be liable for attorneys' fees if FFP breached the agreement. Foley and Lardner writes, "The case is instructive to in-house attorneys and outside counsel alike. Notably, the franchise agreement provided for attorneys' fees. Though the amount of fees was more than five times the amount of past-due royalties awarded to AFCF, this did not stop the court from awarding fees where they were due. This case underscores the simple—yet important—lesson to include a clear attorneys' fees provision in franchise agreements.

Direct Capacitor Buyers' Attorneys Awarded $70 Million

The federal district court in San Francisco has granted final approval of a settlement between certain direct purchasers of electrolytic and film capacitors and manufacturers, resolving allegations that mostly Japanese and other East Asian capacitor manufacturers engaged in an international conspiracy to fix prices.[3] Under the terms of the settlement, the manufacturers agreed to pay $232,050,000 to resolve the claims. The court approved the settlement, and awarded class counsel $70 million in attorney fees and $9 million in costs

[1] (October 20, 2020, Altman, R.)
[2] 1:18-cv-1356 (LMB/IDD)
[3] (*In re Capacitors Antitrust Litigation*, November 6, 2020, Donato, J.).

Quotations From Abraham Lincoln

"Most folks are about as happy as they make their minds up to be."

“No man has a good enough memory to be a successful liar.”

“There are no bad pictures; that’s just how your face looks sometimes.”