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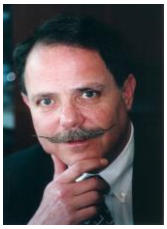
The Franchise Valuations Reporter

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

DISCLAIMER

New Tax Law

Tax Affecting - Impact on Valuations

We have discussed the issue of "tax affecting" in several issues: it is the contrived discount asserted by many valuation specialists, to calculate the value of S Corporations (and LLCs) on an after tax basis as if they were C corporations and paid the corporate tax - which they do not. The IRS and the Tax Court have generally refused to entertain this discount and according to the eminent tax authority, John A. Bogdanski, author of the treatise, *Federal Tax Valuation,*[1] in light of the enormous reduction in C corporation tax rates in the new tax law, this argument for "tax affecting" should be even weaker than before. We agree.

Transfers of Intangible Property Between Related Parties

In the franchise world, there are often transfers of intangible property from a US franchisor to a foreign entity for purposes of licensing and franchising overseas. Under the new tax law Sections 367(d) and 482 grant the IRS specific authority to provide Regulations outlining specific approaches to the valuation of such IP transfers. The major difference from prior law is the authorization to value such transferred intangible property on an "aggregate basis" rather than viewing each intangible asset in isolation. This will probably result in higher valuations of the transferred IP.

IRS Issues Proposed Regulations on Business Interest Limits

The IRS proposed new rules to govern the business interest expense deduction limit under the new tax law, the Tax Cuts and Jobs Act (TCJA). Under these rules a taxpayer may only deduct business interest up to the sum of its business interest income, plus 30% of its adjusted taxable income, and its floor plan financing interest. This is bad news for highly leveraged firms but smaller companies, defined as those with revenues under $25 million, are exempt from the rules.

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[1]2018 Cumulative Supplement No. 2, ¶6.03[6][d][vi], published by Warren, Gorham & Lamont.

Valuations

Private Firm Multiples

A white paper which derived median price-to-revenue prices that private firm buyers paid for private firms from 2003 to 2017 based on data from *Pratt's Stats* (now *DealStats*) showed:

- Price-to-revenue range: 45% to 49%;
- Midrange: 47%; and
- Low to high percent change: 9%.

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. provides such expert advice on the topics addressed herein.

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"Surprisingly to many, the variation from low to high for average price to revenue multiples paid for all private firms is a meager 4% in absolute terms and only 9% in relative terms," says the white paper. Compared to data from the public markets, "private firm multiples do not rise and fall as widely (erratically) as those of the public firm cohort."

Private Equity Valuations

According to another report, venture capital and private equity firms paid a median valuation multiple of 11.9x EBITDA for new investments during the first nine months of 2018. While valuations remain near historic highs, multiples have come down slightly in all but the small market, the report says. Private equity investors have continued to pay a considerable premium over strategic acquirers as of the end of the third quarter.

Valuation Impairment - Down $4.6 billion

Ouch!! Verizon will take a $4.6 billion write-down on its media brand, Oath, which includes Yahoo and AOL that was formed in 2017, says an article on CNN Business. Intangible asset valuations can fluctuate wildly. When the company last did its goodwill valuation, the brand was valued at $4.8 billion. This may be one of the biggest impairment write-downs ever.

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[1]"2018 Q3 Private Equity Valuations Report" from Murray Devine Valuation Advisors.

Wrongful Termination Claim Denied

A Distributorship With Mandatory Purchase Requirements Was Not a Franchise

In a breach of contract and trademark infringement suit, a frozen yogurt equipment manufacturer was entitled to partial summary judgment against equipment distributors, as well as their owner, on the following issues: (1) the distributorship agreement was not subject to either the California or the Washington franchise laws; (2) as a result, the manufacturer was free to terminate the distributorship agreement under the terms of the agreement; and (3) the distributorship agreement was properly terminated. The court ruled that the agreement was not subject to either state franchise law because mandatory purchase requirements at wholesale in a distribution agreement do not constitute a "franchise fee," which, if paid, would have subjected the agreement to the franchise laws.

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[1]*PW Stoelting LLC v. Levine*, December 17, 2018, Griesbach, W.

Attorneys' Fees

Attorney Fees Awarded in Frivolous Lanham Act Suit Over "Patented" Process

A nutritional supplement company won a summary judgment ruling and then moved for $168,835 in attorney fees.[1] They were originally sued by a competitor, Certified Nutraceuticals, Inc., that claimed that Avicenna Nutraceutical, LLC, falsely advertised its collagen products as "patented." The court granted summary judgment to defendant on the Lanham Act claims and the state law claims, finding the plaintiff's claims to be frivolous because they failed to research the assignment of the patent at issue. The district court in San Diego, California awarded the requested attorney fees in full finding that the case was "exceptional", and therefore warranted fees under the Lanham Act and that the amount was reasonable.

Voluntarily Dismissed DTSA Claims Not Subject to Award of Defendant's Attorney Fees

According to the Eleventh Circuit, a district court properly determined that the Defend Trade Secrets Act (DTSA) does not allow a defendant to recover attorney fees for defending against a plaintiff's claims that were voluntarily dismissed without prejudice. The ruling held that the defendant in such a case does not qualify as a "prevailing party" under the statute's fee shifting provision. Because the interpretation of "prevailing party" status in a federal statute is a question of federal law, the defendants' reliance on judicial interpretation of state statutes modeled on the Uniform Trade Secret Act was misplaced. Under federal statutes, such as the Copyright Act and the Patent Act, a dismissal without prejudice does not grant prevailing party status because it does not result in a "material alteration of the legal relationship of the parties".

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[1]*Certified Nutraceuticals, Inc. v. Avicenna Nutraceutical LL*C, November 7, 2018, Benitez, R.

[2]*Dunster Live, LLC v. LoneStar Logos Management Co. LLC*, November 13, 2018, Costa, G.

Joint Employer and Vicarious Liability

Debate Over "No Hire Agreements" Grows as Two More Are Sued

As "no-poach" agreements continue to be the subject of national news, two more franchise companies have been sued by their employees for violations of the Sherman Act. Nationwide pizza chain Papa John's and automobile repair shop Jiffy Lube were sued for violations of the Sherman Act and Clayton Act for instituting anti-competitive agreements into its franchise agreements in an effort to lower its labor costs and thereby unfairly restricting its employees.

Papa John's: In the first complaint, an employee of Papa John's International, Inc., a nationwide pizza restaurant with more than 700 locations and 22,400 employees, alleged that starting in 2008, the restaurant and its franchisees sought to reduce its labor costs by entering into an agreement not to compete for individuals employed by other Papa John's restaurants. An investigation initiated by the Washington Attorney General's Office determined that the agreement restrained competition in the labor market. In July 2018, the Washington AG concluded that the No Hire Agreement constitutes an agreement in restraint of trade that "restricts worker mobility and decrease[s] competition for labor by preventing workers from moving among the chain[]'s franchise locations" and that the agreement artificially reduced employee compensation by putting a downward pressure on wages. As a result of these findings, the Washington AG and Papa John's entered into a consent order that requires the pizza restaurant to remove the No Hire Agreements from its franchise agreements.

Jiffy Lube: In the second complaint, an employee of Jiffy Lube, a nationwide chain of light automobile repair services with more than 2,000 shops, alleged that as part of its standard franchise agreement, Jiffy Lube franchisees are prevented from hiring anyone that has worked at another Jiffy Lube location within the past six months in an anticompetitive manner in an attempt to reduce worker wages. The class action suit alleges that Jiffy Lube engaged in predatory and anti-competitive behavior by orchestrating an agreement to restrict competition among Jiffy Lube shop owners, which unfairly suppressed employee wages, unreasonably restrained trade, and restrained employees' ability to secure better compensation, advancement, benefits, and working conditions in violation of the Sherman Act. The complaint seeks monetary damages as well as injunctive relief.

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[1] *Greer v. Papa John's*, S.D.N.Y., Case No. 1:18-cv-11312, December 4, 2018

[2] *Fuentes v. Royal Dutch Shell PLC*, E.D. Pa., Case No. 2:18-cv-05174-AB, November 29, 2018

Quotations

Be sincere, be brief, be seated.

Franklin Delano Roosevelt on how to deliver a report.

Foolhardiness is boldness without an object.

Carl von Clausewitz on military mistakes.