

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

I.R.S. Says Prince's Estate Worth Twice What Administrators Reported

The federal government is seeking nearly \$39 million in taxes and fees based on a valuation of Prince's assets that his estate disputes. The I.R.S. says Prince's estate is worth \$163.2 million — about double the \$82.3 million claimed by the estate's administrator. [According to the New York Times](#), "For almost five years, the estate of Prince has been one of the music industry's most drawn-out and complex legal thickets, as the star's heirs aligned in two factions and business conflicts developed over Prince's storied "vault" of unreleased music. Now the estate also has a problem with the I.R.S. In filings with the U.S. Tax Court, it is clear that the estate and the federal government differ greatly on the value of many of Prince's assets, including real estate, music rights and the value of Prince's name and likeness. According to the Internal Revenue Service, the estate is worth \$163.2 million — about double the \$82.3 million claimed by Comerica Bank & Trust, the estate's administrator."

Discount Rate – the Company Specific Risk Premium

The most respected method for valuing companies, according to our research, is the DCF or Discounted Cash Flow Method. One of the keynote elements of this method is determining the "Discount Rate" (the anticipated return that an arm's length investor would demand). One of the most frequent methods used to estimate this rate is the "build up method" which generally considers the Risk-Free Rate, the Equity Risk Premium^[1], a Size Premium and a Company Specific Risk Premium. The Discount Rate is the sum of these components. The issue was covered extensively and well in a recent series of 4 articles written by the esteemed Robert Riley of Willamette Management and Connor Thurman of the same firm entitled. "Best Practices for Estimating the Company-Specific Risk Premium." It is very deep and not for the light-hearted.

go to the [Wolters Kluwer Law & Business web page here](#).

Valuing Passthrough Entities

Another recent scholarly article on the differences in valuing passthrough entities (Sub S Corps, partnerships and LLCs) from valuing C corporations was recently published by Empire Valuation Consultants entitled "Passthrough Entity Adjustment: Does One Still Exist". This and the issue of "tax affecting" for passthrough entities is currently in great flux.

Valuations in Tax Disputes

The granddaddy -- the original area of valuation disputes -- was always taxes starting with the original authorities under IRC Section 2031 and Rev. Rul. 59-60. In the recent scholarly article "Burden of Proof in Tax Cases: Valuation and Ranges - an Update" *The Tax Lawyer*, Vol. 73, No. 3 (Spring 2020) by John A Townsend, the author writes tellingly:

"It is one of the conceits of our law that we purport to declare something as elusive as *the* fair value of an entity on a given date . . . Valuation decisions are impossible to make with anything approaching complete confidence. Valuing an entity is a difficult intellectual exercise, especially when business and financial experts are able to organize data in support of wildly divergent valuations for the same entity."

Ah, how true!

Bankruptcy Court Highlights "Comparables" Selection in Assessing Experts' Valuations

In *In re Emerge Energy Services LP*, 2019 Bankr. LEXIS 3717 (Dec. 5, 2019), the court's opinion focused on disagreements related to the experts' comparable company analyses, specifically the **selection** of comparables. The debtor's expert considered five companies as possible comparables to the debtor, but, upon examination of their relative size, composition of assets, and the market they served, narrowed the set to two companies. The committee's expert considered the same five companies and only excluded one company. The court sided with the debtor's expert, noting he had provided materials and testimony that showed the contested companies were not true comparables with more diversification and were bigger in size and scope of operation than the debtor. The court noted that the committee expert's larger set of comparables increased the debtor's enterprise value by \$78 million.

Discounts Inappropriate in Valuing Minority Interest in Mandatory Buyback, Appeals Court Rules

In *Hartman v. BigInch Fabricators & Construction Holding Co., Inc.*, 2020 Ind. App. LEXIS 183 (May 5, 2020), the plaintiff was a founder as well as a director and officer of a company that fabricated and installed natural gas and pipeline equipment and owned a 17.77% interest in the business. When he was terminated (involuntarily), his departure from the company triggered a provision in the controlling shareholder agreement requiring a company buy back of his shares at the “appraised market value determined in accordance with generally accepted accounting principles”.

The appraiser found the plaintiff’s interest was worth about \$3.5 million but applied discounts for lack of control (DLOC) and marketability (DLOM) and concluded the final value was \$2.4 million. The lower court approved it but the appeals court rejected discounts in the context of a law firm’s purchase of a departing partner’s interest in the firm. The case was brought under the state’s professional corporation act. The court differentiated between fair value and fair market value and rejected the use of minority and marketability discounts in fair value cases where a controlling interest holder buys back the stock. Minority and marketability discounts were “open market concepts” that did not apply where a shareholder is compelled to sell to the majority, the court found. The use of discounts would mean a “windfall” to the buyer.

[1] Annual returns of U.S. stocks over the next decade are forecasted to be in the “modest 3.7%-5.7% range,” according to a recent market outlook report from Vanguard. This implies an equity risk premium (ERP) in the range of 2.2% to 4.2%, assuming a risk-free rate of 1.5% (the 20-year T-bond spot rate at the time of this writing). ***The forecast of stock returns “is quite different from the 10.6% annualized return generated over the last 30 years,” the report says.***

Joint Employer/Independent Contractor

New York Decision re Uber drivers

The Third Department of the Appellate Division of New York determined that Uber drivers are employees entitled to unemployment insurance benefits: “Uber controls the drivers’ access to their customers, calculates and collects the fares and sets the drivers’ rate of compensation. Drivers may choose the route to take in transporting customers, but Uber provides a navigation system, tracks

the drivers' location on the app throughout the trip and reserves the right to adjust the fare if the drivers take an inefficient route. Uber also controls the vehicle used, precludes certain driver behavior and uses its rating system to encourage and promote drivers to conduct themselves in a way that maintains 'a positive environment' and 'a fun atmosphere in the car.' Considering the foregoing, we find no reason to disturb the Board's finding of an employment relationship ...". *Matter of Lowry* (Uber Tech., Inc--Commissioner of Labor), 2020 N.Y. Slip Op. 07645, Third Dept 12-17-20

DOL Finalizes New Rule on Independent Contractor Classification

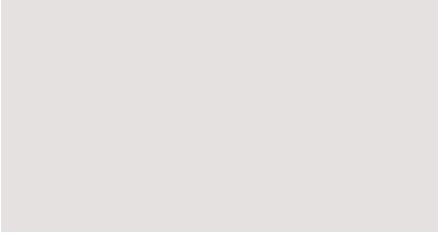
The Final Rule looks similar to the proposed rule published in September 2020. The Final Rule:

- Adopts an "economic realities" test to determine a worker's status and provides clarification on the concept of economic dependence, the "touchstone" of the economic reality test; and
- Describes the five factors involved in the "economic realities" test:
 - The nature and degree of the individual's control over the work;
 - The opportunity for profit or loss;
 - Skill required for the work;
 - Permanence of the working relationship; and
 - Whether the work is part of an integrated unit of production.
- Emphasizes that there are two "core" factors: the nature and degree of the worker's control over the work, and the worker's opportunity for profit or loss, which are given substantial weight in classifying workers.

Franchise Times Legal Eagles

If you were thinking of voting for yours truly to be a Legal Eagle, save your vote. *Franchise Times* has determined that I am not a lawyer for their purposes although I have two law degrees, a J.D. and an LL.M. (in Taxation), and have been practicing law for 40 years. The last time I received their award they rescinded it.

Quotations From Voltaire



Those who can make you believe absurdities can get you to commit atrocities.

The more often a stupidity is repeated, the more it gets the appearance of wisdom.