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The Franchise Valuations Reporter

Franchise Technology Risk Management

Donut Wars, Part II

Noted Canadian franchise lawyer, Ned Levitt, and I recently reviewed the case of *Bertico v. Dunkin' Donuts* - what we're calling "The Second Battle of the Canadian Donut Wars" - for CCH's Business Franchise Guide. You can read the entire article here.

Our Expertise

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

- Damages, Valuations & Expert Testimony
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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

Estate Planning and Exit Strategies for Baby Boomers in Franchising

Tools and Strategies for Implementing the End Game

A baby boomer who is an owner of a franchise, dealership or distributorship will either die owning the business or sell it before death. As we noted in our last issue there are about 40 million baby boomers in the US, many of whom are franchise owners approaching retirement age; and the wealth of many of them - indeed often far more than 50% of their net worth - is tied up in their franchise. What are some of the options for preserving these valuable assets?

At a minimum, they must consider, devise and implement: (i) a **succession plan** as discussed in part in our last newsletter; (ii) an **estate plan** with appropriate documents; (iii) **estate tax planning**, if needed; and (iv) a **valuation** to determine how much money the business is worth. The value is particularly important information whether a franchise owner is considering selling the business or leaving it by will or trust.

An **Estate Plan** is made up of legal documents that are a blueprint for the disposition of assets upon the death of the franchise owner. The most often used documents, particularly for owners of franchises, dealerships or distributorships who will be subject to estate taxes, are:

1. Pour-Over will
2. Revocable Trust
3. Durable Power of Attorney (Financial)
4. Durable Power of Attorney (Health Care) - a/k/a "living will" or "health care proxy"
5. HIPAA Form
6. Irrevocable Life Insurance Trust
7. Grandchildren's Trust
8. GRIT, GRAT or GRUT
9. Charitable Lead Trust or Charitable Remainder Trust

These and other key terms used in estate planning are explained in our Glossary of Financial and Estate Planning Terms.

Exit Planning - Sale or Other Pre-Death Disposition Options
According to Richard Jackim, JD, MBA, CEPA, an attorney and investment banker on the Board of Governors of the Exit Planning Institute, when planning a disposition a business owner has only nine options to consider:

1. Sell or give your company to a family member;
2. Sell your business to one or more key employees;
3. Sell to your employees (ESOP);
4. Sell your business to other shareholders;
5. Sell to an outside third party;
6. Bring in an outside investor and keep a minority interest;
7. Go public;
8. Hire a management team to take over and become a passive owner; or

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9. Liquidate your business.

And according to Venture Resources there are "12 Fatal Mistakes to Avoid When Selling Your Business":

1. Lack of deal structure expertise
2. Failure to adjust the net owner benefit
3. Failure to maintain confidentiality
4. Failure to secure qualified buyers
5. Failure to continue to run your business
6. Failure to properly adjust for economic conditions and owner's ability
7. Failure to provide credible information
8. Poor negotiating techniques
9. Failure to place the proper value on your business
10. Failure to consider alternative investments
11. Failure to prepare for proper due diligence
12. Failure to seek professional assistance and consultation

Owners of franchises, dealerships and distributorships must be aware that there are legal, financial, marketing, and other vital considerations that must be addressed in the selling process, most of which should not be made without the advice of the right professionals.

Expert Witness Testimony

5 Ways to Reduce the Costs of Financial Experts

In conjunction with the Institute for the Advancement of the American Legal System (University of Denver), the AICPA's Financial Valuation Services (FVS) executive committee has just released its new study, "Another Voice: Financial Experts on Reducing Costs in Civil Litigation." The FVS study proposes five basic reforms to maximize the effectiveness and efficiency of financial experts in the pretrial process:

1. ***Judges should manage cases early, actively, and consistently.*** Specifically, court continuances can drive up an expert's case preparation costs by 11% to 25%, the majority of FVS survey respondents indicate.
2. ***Clients and attorneys should involve experts early.*** One of the "major themes" to emerge from the FVS survey focuses on engaging the expert as early as possible in the litigation to reduce overall costs.
3. ***Attorneys should streamline expert depositions and discovery.*** For example, although expert depositions are a "valuable tool" in litigation, say FVS respondents, just about half (44%) of their testimony and time are wasted on nonsubstantive questions.
4. **Daubert *challenges should be timely and targeted.*** The use of *Daubert*-like challenges by attorneys can potentially reduce the time and total costs of cases involving financial experts, says the FVS study, but significant savings will only come with the implementation of all the recommended reforms.
5. ***Attorneys and the court should encourage opposing experts to cooperate.*** The vast majority (71%) of FVS survey respondents believes that by allowing experts to talk with one another before the trial - and without attorneys - would decrease case preparation costs. A formalized system of expert collaboration is "vastly underutilized," one respondent said.

Discount Rate

How the Changes to the Government's Credit Rating Impacts Discount Rates

In calculating the proper discount rate for use in computations involving corporate finance, or damages for lost profits or business valuations, courts, academics and practitioners have long used government security (U.S. Treasury Bills and Bonds) rates as the benchmark for a risk-free rate of return when beginning a computation using the "build-up" method. But now that there have been credit downgrades of US debt, should that affect the risk-free rate for damages and valuation computations?

According to Anthony Banks, Senior Manager at Marcum LLP, the short answer is No. No matter what adjustments have been made to the US credit rating, it is still the safest haven for assets. Mr. Banks recently wrote, "In short, recent ratings downgrades do not mean that the risk-free rate has changed markedly. Instead, it means that valuation professionals need to continue to utilize reason and apply rigorous analysis when developing their cost of cost of capital estimate."

Franchise Success Rate: Does the IFA Fib?

SBA Warns Again: Franchises Do Not Succeed More than Small Businesses

Readers should be aware of a recent article by Don Sniegowski of Bluemaumau.org, a pro-franchisee website, in which he notes:

> The Small Business Administration has declared yet again to the public that franchises have the same success rates as independent small businesses. "Survival among independent businesses and franchises appears to be similar," declares economist Brian Headd in the SBA's Office of Advocacy newsletter this month. It is one of a number of similar announcements the Administration has made over the last decade, with several private scholarly studies as well that have reached similar conclusions. But studies showing equivalent success rates for franchises and independent small businesses go against industry lore and have largely failed to catch the attention of sellers and buyers.
>
> What is the survival rate of franchises?
> It's about the same as small business establishments of 500 employees or fewer... "About half of all new establishments survive five years or more and about one-third survives 10 years or more," declares the September announcement of the SBA. "As one would expect, the probability of survival increases with a firm's age. Survival rates have changed little over time."

Sniegowski then goes on to hammer the IFA saying:

"The IFA has consistently misrepresented that investing in a franchise means improved odds of success. The renewal rate claim is yet another example because it implies that 90% of franchise buyers are successful..."

Tax Nexus: Flaws In IFA's Advice

IFA's Positions on the Issue Should Not Be Relied On

As many of our readers know, I regularly take issue with the position of the IFA and some others about the applicability of the economic nexus doctrine with respect to the income tax liability of out-of-state franchisors who collect monies from in-state franchisees. Recently I had an e-mail correspondence with Dean Heyl, the IFA's point man on this issue.

On August 22 I wrote:
Hi
I just read your column in Franchising World August 2012 where you write, "The Supreme Court has made plain that a physical presence, not an economic presence, is needed for a state to impose corporate income taxes on companies."
That is not my understanding. Do you have any authority for the statement?

On August 23 Mr. Heyl wrote back :

> Bruce,
> Quick answer is that you're 100% correct.

Mr. Heyl then went on to give the standard litany of purported reasons why franchisors should not be subject to tax without physical presence. After presenting the position of "the folks on the BATSA Coalition," a group that previously failed to achieve passage of the Business Activity Tax Simplification Act, Heyl wrote, "I plan to issue a correction in a future issue of Franchising World."

I disagree with the IFA's position on this - and have for decades. Really, it is not a new issue. I think the IFA is doing its members a disservice by belittling the probability of being liable for income taxes under the theory of economic nexus. For example, with interest and penalties KFC just ended up paying about 400% of the underlying tax liability because they did not file although they received royalties from Iowa.

Absent a change by Congress there is no legitimate basis for the IFA to continue leading its members on in thinking that they will prevail on the argument that economic nexus is not enough for income tax liability.