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

Valuation

Gift and Estate Planning at Low Valuations

The disruption brought about by COVID-19 created certain industry “winners” and “losers.” Many of those that emerged as losers are small and medium-sized privately held businesses such as restaurants, bakeries, gyms, hair salons and spas, and the corresponding real estate holding entities that leased to such businesses, held retail and office space, and even apartment buildings. While being on the losing side, it may be a good time for business owners to view this as an opportunity to take advantage of low business valuations to minimize estate and gift taxes and think about succession planning.

Damodaran’s Strong feelings About Socially Conscious ESG Investing – Valueless Crap

A year ago, Professor Aswath Damodaran (New York University Stern School of Business) called it “the most overhyped, oversold concept in the history of business.” He was talking about environmental, social, and governance (ESG) factors. He got some pushback but has not changed his mind. “I am more convinced than ever that ESG is not just overhyped and oversold, but it’s become a gravy train for all the people who make money on ESG, and none of those people are in the groups that ESG is supposed to help.”[1]

Missing Intangible Assets Distorts Return on Capital

As a general rule, self-created intangible assets (the most prevalent being the rubric “good will”) do not appear on the balance sheet. This is particularly true in the franchising context. The inconsistent and incomplete recognition of intangible assets in financial statements distorts performance metrics. Invested capital and profit are understated. The combined effect is generally to overstate return on capital.

The inconsistencies in intangible asset accounting under both IFRS and US GAAP are essentially this: intangibles that are acquired separately, or together with other assets in a business combination, are recognized as assets in the balance sheet and amortized over their useful life. However, the expenditure that produces most (although not all) internally generated intangibles is immediately expensed especially in the franchise context.[1] This is very different from tangible asset accounting, where both acquired and internally constructed assets are recognized in the balance sheet.[2]

Insurer Not Required to Defend Valuation Firm in ESOP Lawsuit

In *Great Am. Fid. Ins. Co. v. Stout Risius Ross, Inc.*, 2021 U.S. Dist. LEXIS 158553; 2021 WL 377 (Aug. 23, 2021) the Court held that a valuation firm can no longer force its professional liability insurer to defend a lawsuit challenging the firm's ESOP valuation because the case's surviving claim falls under a policy exclusion, which excludes coverage for securities violations. While the policy covered valuation services, it also featured an exclusion for claims against the insured for securities violations. The insurer's duty to defend the firm ended when the ESOP participants suing the firm filed an amended complaint that included only one claim for federal securities fraud. This sounds like the suit against *Gawker* which was designed to bankrupt the defendant.

[1] BVWireIssue #228-3
[2] https://www.footnotesanalyst.com/missing-intangible-assets-distorts-return-on-capital/

Valuation Discounts and Premiums

Expelled Partner Should Get FMV—No DLOM and No DMIN

In *Dipak Patel v. Siddhi Hospitality, LLC et al.,* 312 Or. App. 347 (June 16, 2021), an Oregon appellate court addressed a buy-out deal with compensation for a partner's 25% interest in a business after he was expelled from the firm. The trial court allowed for discounts for lack of control and marketability from the fair market value of the partner's 25% interest. But the appellate court noted that the firm's operating agreement called for compensation at 25% of the FMV of the *assets* of the business—not the *interest* in the business. So the case was remanded back to the trial court for recalculation, without discounts.

Joint Employer/Independent Contractor

Judge Rules California's Gig Worker Law Is Unconstitutional

A federal court in California has recently ruled that a group of former 7-Eleven franchisees were not employees of 7-Eleven.[1] In this second Haitayan case, four former franchisees brought wage and hour claims against 7-Eleven claiming that the franchisor owed them millions of dollars in unreimbursed expenses because they were employees and not independent contractors. 7-Eleven denied the claims on the basis of the franchise relationship and a two-day bench trial was held.

Following trial, the court concluded that the former franchisees were independent contractors and not employees. Under applicable California law, the key factor was the level of control 7-Eleven retained over the franchisees. The court found the evidence at trial established that the former franchisees exercised their own judgment in determining, among other things: what products they would carry and their pricing; how to organize the store; what promotions to take part in; the scheduling, hiring, and firing of employees; and their own schedules and pay at their stores. The court further observed that the former franchisees held themselves out as business owners; they were not subject to the control of a 7-Eleven field consultant; their success was directly tied to their business savvy in operating their franchises; their income was entirely dependent on the profits they generated in operating their franchises; and 7-Eleven's core business is franchising, not operating convenience stores.

Based on the foregoing, the court concluded that the circumstances weighed in favor of finding the former franchisees were independent contractors and not employees of 7-Eleven, and the court ruled in favor of 7-Eleven on all claims.

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[1] *Haitayan v. 7-Eleven, Inc*., 2021 WL 4078727 (C.D. Cal. Sept. 8, 2021).

Damages

Recoverable Hack Damages re PII

Many have heard stories about the impact on franchise systems when there is a major cyber-security problem: a breach and a hack. In an interesting and broad article available here the authors give a history of the hacks of several enterprises. They discuss what happens when credit card data is stolen and personal identifiable information is stolen. They recount how this information is used and sold on the dark web and the issues that arise when damages are claimed. They discuss the cases of Target Corporation Data Security Breach Litigation, *Attias et al. v. Carefirst, Inc*., and Wawa to provide context and insight on what must be proven and how damages are calculated.

Franchisor's Claim for Liquidated Damages Survives Motion to Dismiss

In *Holiday Hosp. Franchising, LLC v. N. Riverfront Marina & Hotel, LLLP*, 2021 WL 3798561 (N.D. Ga. Aug. 26, 2021) the court denied a franchisee's motion to dismiss a franchisor's claim for liquidated damages. Holiday Hospitality had a license with Northern Riverfront to develop and operate a hotel under its brand but, in spite of numerous extensions, Northern Riverfront failed to commence construction on the hotel. Holiday Hospitality terminated the agreement and sued Northern Riverfront, seeking nearly $5 million in liquidated damages.

Northern Riverfront moved to dismiss the lawsuit for two reasons: First, Holiday Hospitality waived its rights under the agreement by waiting nearly four years to file the lawsuit. The district court disagreed, holding that waiver was a fact issue to be decided by a jury. Second, Northern Riverfront argued that the liquidated damages provision was unenforceable under Georgia law because (1) it included damages incurred over an excessive time period and (2) the calculation was based on the average daily revenue of other hotel locations within the brand, which amounted to an unreasonable estimate of potential losses. The court rejected this argument as well, concluding that a determination of the reasonableness of the liquidated damages sought is based upon facts alleged in the complaint, which alleged sufficient facts to satisfy the elements of the enforceability of a liquidated damages provision. In addition, the court noted that the Eleventh Circuit and Georgia Court of Appeals had already determined that the exact liquidated damages provision at issue was reasonable under Georgia law.

Quotations

Murphy's Law Corollaries

Never Eat Prunes When You Are Famished

Friends Come And Go – But Enemies Accumulate