



# The Franchise Valuations Reporter



## Our Expertise

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

- Damages, Valuations & Expert Testimony
- Finance, Accounting and Tax
- Cyber Security and E-discovery of Electronically Stored Information

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

Our franchise law and computer forensics experts provide consulting and implementation of all aspects of cyber security, ESI management and e-discovery for franchise systems - from preparation of cyber security and ESI-related policies and procedures manuals through collection, preservation, processing, production and presentation.

To inquire about our services, please e-mail  
[Henry@FTRM.biz](mailto:Henry@FTRM.biz)  
 or call (212) 689-0400



## Damages: "And it's One, Two, Three - What Are We Fighting For?"

### **Court Tells Government It Was Wrong To Seize AIG; Awards ZERO DAMAGES**

In what *The Washington Post* described as a Solomonic ruling, a federal court has ruled that the Federal Reserve exceeded its powers in temporarily nationalizing insurance giant American International Group during the financial crisis of 2008, but by doing so caused no harm to AIG shareholders who had demanded as much as \$38 billion dollars in compensation. Thus the estimated tens of millions of dollars in attorney's fees Maurice Greenberg paid to David Boies were all for a Pyrrhic victory.

### **Plaintiff's Damages Award Takes a Big Hit On Appeal; \$1.5 Billion Award Reduced To \$278 Million**

The U.S. Court of Appeals for the Federal Circuit has affirmed a district court's finding that Marvell Technology Group, Ltd. infringed Carnegie Mellon University's (CMU) patents, that the patents were not invalid, and that CMU was entitled to damages and royalties. However, an enhanced damages award was rejected. Also, the court vacated and remanded the district court's damage award and royalty rate calculations based on chips not made or used in, or imported into, the United States to determine whether those chips were sold in the United States (*Carnegie Mellon University v. Marvell Technology Group, Ltd.*, August 4, 2015, Taranto, R.).

## Using 401-k Roll-Overs to Fund Start-Ups: Uh Oh

### **Eighth Circuit Affirms Payment Of Wages From IRA-Owned LLC Funded With Rollover Proceeds Was A Prohibited Transaction**

Affirming the Tax Court, the Court of Appeals for the Eighth Circuit has found that by directing an LLC that was owned by his IRA (that was funded with proceeds from a 401-k that were rolled over into the IRA), and engaged in the used vehicle business, to pay him a salary, the taxpayer had engaged in a prohibited transaction. The Eighth Circuit found that the taxpayer had caused his IRA to invest most of its value in the LLC with the understanding that he would receive compensation and that constituted the indirect transfer of the income and assets of the IRA for his own benefit. *Ellis, CA-8, June 5, 2015; 2015-1 USTC ¶150,328; TRC IRS: 66,454.*

The Court held that the IRA's investment in the LLC, where the IRA obtained a 98-percent ownership interest in the LLC, was not a prohibited transaction *per se*. However, the payment of compensation to the husband by the LLC, where the husband acted as the LLC's general manager and was the beneficial owner of 98 percent of the outstanding membership interests of the LLC, did constitute a prohibited transaction, which caused a deemed distribution of the IRA's assets that was includible in the taxpayer's income. Consequently, taxpayers were liable for a 10-percent additional tax for the early distribution since the husband had not attained the age of 59-1/2. In addition, the taxpayers were subject to an accuracy-related penalty as they



## Just Published

Be sure to check out this article - "[Identify What's Missing From Your Cyber-Security Posture](#)" - by Bruce Schaeffer and Henry Chan published in the June 2015 issue of *Franchising World*.

## We Write the Book

**Franchise Regulation and Damages**, the only treatise that covers valuations of franchises, 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

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. and Franchise Technology Risk Management provide such expert advice on the topics addressed herein.

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did not present evidence of reasonable cause.

## Nexus: State and Local Taxes

### ***Washington State's Notorious Business and Occupancy Tax: Special Notice Issued on Rate Increase on Royalty Income***

The Washington Department of Revenue has issued a special notice regarding the business and occupation (B&O) tax rate increase on royalty income. Effective August 1, 2015, the rate increases from 0.484% to 1.5%. Special Notice, Washington Department of Revenue, July 24, 2015

## Valuation

### ***Control Premiums Around the World***

Business Valuation Resources has published a chart and graph showing the premia paid for company control in various countries. The chart may be found [here](#).

### ***Consideration of Synergies as a DCF Component***

According to Business Valuation Resources, the valuation practices of investment banks have changed recently with respect to how they account for synergies, according to a study published in the *Journal of Applied Finance*. Practically all of the 11 major investment banks interviewed said that now they specifically account for synergies rather than just folding them into the company's cash flows. Then they discount the various revenues at different rates depending on the presence or lack of synergies. In a similar study done in 1998, only half of the advisors said they made special adjustments to value synergies. The authors of the study believe that this trend is due to the increased recognition that planned synergies often don't pan out.

## Attorneys' Fees

### ***Franchisee's Spouse Must Pay Franchisor's Attorney Fees After Refusing To Arbitrate Termination***

A franchisee's spouse was liable to pay a franchisor's attorney fees and costs for refusing to submit her termination lawsuit to arbitration, as required by the franchise agreement, the federal district court in Green Bay, Wisconsin has ruled in *Everett v. Paul Davis Restoration, Inc.*, Griesbach, W. (DC ED WI Case No. 10-C-634, August 3, 2015).

In 2010, PDRI terminated the franchise agreement for cause for violation of the non-compete clause, and initiated arbitration. Mrs. Everett then sought a declaratory judgment, arguing that she was not bound by the arbitration clause, since she was not a signatory to the franchise agreement. PDRI countered that Mrs. Everett was estopped from avoiding arbitration under the direct benefits doctrine and won the arbitration, but when it sought confirmation of the arbitration award from the court, the district court ruled that Mrs. Everett's benefits from the agreement were indirect and she was therefore not bound by the arbitration clause. PDRI appealed.

In its November 3, 2014, decision, the Seventh Circuit U.S. Court of Appeals framed the issue before it as whether an owner-operator of a franchise was

obligated to arbitrate under a franchise agreement she did not sign, because she received direct benefits from the agreement. The court ruled that the doctrine of direct benefits estoppel did apply and reversed the ruling of the lower court, which then ruled in favor of PDRI. PDRI then moved for recovery of its attorney fees because the franchise agreement provided that any party that refused to arbitrate or abide by the decision of the arbitration panel was liable to the other party for all attorneys' fees and costs incurred in enforcing the arbitration provisions of the agreement.

## Cybersecurity

### ***Generally It's an Inside Job***

In its recently-released [2015 Data Breach Investigations Report](#), Verizon took a comprehensive look into what organizations should do to protect customers' personal information. Data breaches, which the report defines as any "incident that resulted in confirmed disclosure (not just exposure) to an unauthorized party," occurred across practically all industries, but were generally confined to a handful of common 'types' of breaches which fall into nine distinct categories: crimeware, cyber-espionage, denial of service, physical theft/loss, miscellaneous errors, payment card skimmers, point of sale, insider misuse, and webapp attacks.

Surprisingly, in the healthcare industry, where personally identifiable information (such as social security numbers, dates of birth and addresses) and highly confidential personal health information (such as medical records and health insurance information) are readily available, external intrusions such as cyber-espionage and webapp attacks account for *only* 13% of the data breaches combined. Far more prevalent threats are physical theft/loss (16%), miscellaneous errors (32%), and most importantly, insider misuse (26%). And these trends predominate across all industries. In fact, breaches caused by mistakes or purposeful misuse by an organization's employees account for 90.4% of all reported security incidents.

### ***IRS Focusing On Identity Theft***

Testifying before Congress recently, Acting Assistant Attorney General Caroline Ciraola, Tax Division, U.S. Department of Justice, said that the high potential for financial gain and low physical risk have made stolen identity refund fraud the new crime of choice for drug dealers and gangs. "For taxpayers whose identities are stolen, the economic and personal consequences can be severe and often long-term," she said.

A taxpayer generally becomes aware that he or she is a victim of tax-related identity theft when it is too late: only when the IRS rejects their tax return because someone has already filed a return using the taxpayer's name and/or Social Security number. A taxpayer may also receive correspondence directly from the IRS that informs them, prior to filing, that someone has filed a suspicious return under their information. In other cases, a taxpayer may have had his or her identity information compromised and wishes to alert the IRS as to the possibility that he or she may be targeted by an identity thief.

For all such cases, the IRS has created Form 14039, Identity Theft Affidavit. Taxpayers who are actual or potential victims of tax-related identity theft may complete and submit the Affidavit to ensure that the IRS flags the tax account for review of any suspicious activity. Taxpayers who have been victimized are asked to provide a short explanation of the problem and how they became aware of it.

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