

# 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,

## Expert Testimony *Daubert Challenges to Financial Experts*

PwC's report on federal courts gatekeeping role with respect to expert testimony from 2000 to 2019 has been released. They identified 2,842 *Daubert* challenges to financial experts between 2000 and 2019. They found that of the 224 challenges against financial expert witnesses in 2019, 83 challenges (37%) resulted in partial or full exclusion of the expert.

They also found that lack of reliability, either on its own or in combination with other factors, was the main reason for financial expert exclusions and that excluding testimony due to a lack of reliability, was the most frequent reason (with courts most frequently citing a lack of sufficient data or the use of methods that are not generally accepted as reasons for exclusion). Securities litigation, fraud, and intellectual property cases had the highest rates of exclusion for financial experts and during 2019, cases involving intellectual property resulted in the most challenges to financial expert witnesses.

The Tenth, Second, and Fourth Circuits, on average, had the highest exclusion rates, and of the three most common financial expert types, accountants and economists were the most frequently challenged. By expertise the exclusion rates were economist 41%, accountant 45%, appraiser 45% and "other financial" 48%. The full study is available [here](#).

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

## Valuations

### ***Indiana Supreme Court Issues Key Ruling on Discounts in Compelled Buybacks***

Last year, in a compelled buyout case, the Court of Appeals sided with the departing minority shareholder when it found discounts did not apply in a closed-market sale. But the Indiana Supreme Court just reversed the Court of Appeals, finding there was no blanket rule disallowing discounts in a compelled buyback, especially where the parties exercised a shareholder agreement whose terms suggested the use of fair market value.[1]

### ***Charting Goodwill Jurisprudence (as of January 2021)***

Business Valuation Resources has updated its handy reference guide (formerly known as “Goodwill Hunting in Divorce”)—a state-by-state breakdown of goodwill jurisprudence. Goodwill is a fundamental concept in divorce and in franchise valuations but one of the things that makes it challenging is that divorce is a state matter and that different states adhere to different rules as to how to treat business goodwill, personal goodwill, enterprise and professional goodwill. The study is available [here](#).

### ***Delaware Court Weighs in on Goodwill in Sole Proprietorships***

A recent divorce case out of Delaware is significant for addressing the treatment of goodwill where the business is a sole proprietorship.[2] The business was a sole proprietorship through which the husband had worked for decades as an independent contractor for a larger financial services and investment firm. The husband earned income from selling clients policies that met their financial and strategic needs and maintaining the plans throughout their lifetime.

The parties’ valuation experts reached very different conclusions. The husband’s expert found the business was worth \$255,000. The wife’s expert arrived at a value of nearly \$3.5 million. Goodwill—specifically whether there was enterprise goodwill— was a major area of disagreement. The husband’s expert premised his valuation on the understanding that, under the controlling Delaware case law, there could be no goodwill in a sole proprietorship under any circumstances. This proposition was based on a 1983 decision from the Delaware Supreme Court, *E.E.C. v. E.J.C.*, that dealt with goodwill in the context of valuing a law firm owned by a sole practitioner. In *E.E.C.*, the high court noted the parties conceded that “goodwill should be disregarded.”

But the court noted that the husband’s business was not a law firm “and the practice and means of generating income are different” and said that, “The Court does not read *EEC* as stating that every sole proprietorship in every case has no professional good will.” Therefore, the court found that the valuation of the husband’s expert was based on the wrong premise and went with the analysis of the wife’s expert, who assigned 5% of goodwill to the husband (value of a noncompete) and the remainder to the business. The court noted that both experts agreed that, if the husband could transfer goodwill to a buyer his client base and stream of income (95% of the income), he could obtain about \$3.5 million for the business.

### ***How Did the COVID-19 Pandemic Impact EBITDA Multiples in 2020?***

*DealStats Value Index Digest* for the first quarter of 2021 studied the effect of the COVID-19 pandemic on the U.S. economy for most of 2020 which caused an unprecedented economic impact on small businesses showing how EBITDA multiples have trended. They say that taking into consideration the uncertainty the onset of the spread of the virus caused early in the second quarter of 2020, sellers appeared to have initially forecasted a worst-case scenario, with EBITDA multiples falling to 3.7x, their lowest level since the second quarter of 2018. The decline came after the median EBITDA multiple in the first quarter of 2020 came in at its highest first-quarter level, 4.3x, in six years. However, by the second half of 2020, EBITDA multiples returned to levels near historical norms, at 4.7x in the third quarter and 4.4x in the fourth quarter of 2020. The report is available [here](#).

### ***Trump's Most Enduring Legacy Could Be the Historic Rise in the National Debt***

According to [this Washington Post story](#), the growth in the annual deficit under Trump ranks as the third-biggest increase, relative to the size of the economy, of any U.S. presidential administration. They say that one of the former President's lesser known but profoundly damaging legacies will be the explosive rise in the national debt that occurred on his watch. "The financial burden that he's inflicted on the government will wreak havoc for decades, saddling our kids and grandkids with debt." The national debt rose by almost \$7.8 trillion during his time in office. That's nearly twice as much as what Americans owe on student loans, car loans, credit cards and every other type of debt other than mortgages, combined, according to data from the Federal Reserve Bank of New York. It amounts to about \$23,500 in new federal debt for every person in the country.

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[1] *Hartman v. BigInch Fabricators & Construction Holding Co., Inc.*, Indiana Supreme Court, case no. 20S-PL-618 (Jan. 28, 2021) (*Hartman II*), and the Court of Appeals opinion in *Hartman v. BigInch Fabricators & Construction Holding Co., Inc.*, 2020 Ind. App. LEXIS 183 (May 5, 2020).

[2] *A.A. v. B.A.*, 2020 Del. Fam. Ct. LEXIS 33; 2020 WL 6379355 (Oct. 9, 2020).

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### ***Joint Employer/Independent Contractor After Gig Battle, Franchises Are Next Front in Worker Status War***

According to [this story in BloombergLaw.com](#), the franchise industry is mounting an attack on California's rigid worker classification standard, hoping to follow in the footsteps of app-based gig companies that managed to secure a carveout to save their business models. They are focusing their attack on the ABC test which the IFA claims could upend the franchise business model. The test clashes with franchising the IFA has said in an ongoing lawsuit challenging Assembly Bill 5, the law that makes it harder to classify workers as independent contractors instead of employees. The International Franchise Association, along with franchise groups that represent companies including Dunkin' and Supercuts, are banking on a different outcome in court, arguing that the state's "ABC test" shouldn't apply to franchises because federal law governs their businesses. It's an "open question" that the California Supreme Court punted earlier this month in a worker misclassification case against Jan-Pro Franchising International, and could come up again in the decades-old litigation.

### ***California Supreme Court Rules Dynamex Decision Applies Retroactively***

The California Supreme Court has followed up on its groundbreaking decision in *Dynamex Operations West Inc. v. Superior Court*, 4 Cal.5th 903 (2018), which imposed the so-called

“ABC Test” for determining whether a worker is an employee or an independent contractor. In *Vazquez v. Jan-Pro Franchising International*, S258191, the Court has ruled the ABC Test’s application applies retroactively to employee misclassification cases pending at the time of the *Dynamex* decision. Notably, *Vazquez* sidestepped how the ABC Test should apply in the context of a franchisor-franchisee relationship. In a footnote, the Court distinguished the issues decided in *Patterson v. Domino’s Pizza LLC*, 60 Cal. 4th 474 (2019) from *Vazquez* and noted that the question in *Patterson* was about the propriety of imposing vicarious liability on a franchisor for a franchisee’s wrongdoing, and not what standard should apply in determining the classification of workers as employees or independent contractors.

### ***Franchise Area Developer Unable To Rub Out Massage Client’s Vicarious Liability Claim***

An area development agreement between the franchisor of Hand and Stone massage salons and a developer, GWS Ventures, LLC (GWS), along with deposition evidence, raised an issue of fact as to whether a principal-agent relationship existed between the developer and the employee that could make the developer liable for an alleged sexual assault by the employee. Thus, the developer’s motion to dismiss the claim, which had been converted by the court into a motion for partial summary judgment, was denied. The suit was filed by a client at a Massage Envy salon, who asserted that the employee had sexually assaulted her. In addition to suing Massage Envy, the client sued the area developer and franchisor of Hand and Stone massage salons. The employee had previously worked at a Hand and Stone franchise in the developer’s territory. The evidence showed that the developer was given broad authority in handling violations. Thus, the evidence gave rise to a factual issue in need of further discovery in order to determine how much control GWS had over the former employee whether a principal-agency relationship existed between the developer and the masseur (*Doe v. Massage Envy Franchising, LLC*, January 22, 2021, Stokes, R.).

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## ***Attorneys’ Fees***

### ***Terminated Shell Franchisee Awarded Attorney Fees After Partially Prevailing in Suit Over Rent Spike***

In *Four S Shell LLC v. PMG LLC*,<sup>[1]</sup> (on which we previously reported) a franchisee’s successful Petroleum Marketing Practices Act suit warranted attorneys’ fees award despite failure of other claims. The former operator of a franchised Shell station was entitled to \$100,276.93 in legal fees and costs associated with its pursuit of PMPA and other claims against the franchisor because it prevailed on its claim under the Act. The requested amounts were for the most part reasonable, the court explained, and the defendants’ various arguments for reconsideration or reduction of the award lacked merit. The motion for attorney fees and costs was therefore granted, subject to certain deductions. Kudos to Evan Goldman.

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[1] January 22, 2021, Sheridan, P.

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## ***Three Cheers For. . .***

### ***Chuck Cooper - Constitutional Scholar***

Although I disagree with his politics almost completely, I am in awe of his honor, his grace and his acumen. [You can read his WSJ op-ed here.](#)

***Paige Bueckers – Point Guard***

Her back-to-back-to-back (3 in a row) 30-point games lifted the UConn women's basketball team to the number one ranking. [You can read about her exploits here.](#)