



The Franchise Valuations Reporter



See You In New Orleans

International Franchise Association Annual Convention

On February 24, 2014, Michael Seid, Managing Director, MSA Worldwide, and I will be speaking on the topic of "**Exit, Succession and Estate Planning for Baby Boomer Franchise Owners**". The session will be moderated by Carlton Curtis, VP of Industry Affairs, The Coca Cola Company.

For more information on the program and to register, go to the [IFA website](#).

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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We Write the Book

Franchise Regulation and

Best Practices: Attorney-Expert Relationship

A Common Interest Alone Doesn't Guarantee Success

According to a professional publication for valuers, "Business Valuations Wire," attorneys at the recent AICPA Forensic & Valuation Services Conference in Las Vegas offered the following tips for experts:

Read the documents. At deposition, an expert's apparent unfamiliarity with a document he or she received, and should know, embarrasses expert and attorney alike.

Know Fed. R. Evidence 26. The rule limits disclosure and prevents the opposing attorney from requesting draft reports or other disclosures made in preparation for trial, with the exception of information related to the expert's compensation or to data that the attorney provided to the expert. And importantly, the various states have their own discovery rules, making it critical that the expert know the regimen he or she is operating under.

Disclose the information. An expert's timely disclosure to the attorney of all prior expert testimony and all prior publications enables the attorney to ensure that the expert did not previously testify in a manner that contradicts the theories underlying the current case.

Know what to do in a deposition.

The way an expert performs at a deposition may make or break the attorney's case. Knowing that a convincing performance may assist in reaching a settlement, to help the expert succeed, and strengthen the case, the attorney would do well to prepare -- not coach -- the expert for deposition.

Mention causation.

A plaintiff's damages expert is often called upon to tie the defendant's wrongdoing to the loss the plaintiff sustained, even if the attorney will present the legal theory of causation.

Editor's Comment: Causation is a tricky area for most experts to testify about because experts are not allowed to opine as to matters of law. My two law degrees and extensive experience in the practice of law are helpful in the preparation of reports, depositions and testimony.

Valuations

Why Small Business Owners Need Valuations

An article at Forbes.com answers the most frequent question valuation specialists get from small-business owners: "Why should I bother valuing my business?" Here's a good rundown of the reasons why:

1. **Someone else will value the business anyway.** For bank loans, the bank will value the business, but the owner will want to demonstrate a higher valuation.
2. **A potential buyer shows up.** The business owner needs a firm grip on value in case a potential buyer makes a lowball offer.
3. **Retirement needs.** For many small business owners, their

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 [CCH web page here](#).

Legal Eagles Noms

It's Award Season But Not Just for Oscars

Justin Klein, Esq., of Marks and Klein, reminds us that the deadline to nominate your candidates for outstanding franchise lawyers is coming up soon. Go to the [Franchise Times site here](#) to fill out your ballot.

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.

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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.

Please visit our websites at www.FranchiseValuations.com and

business is the main asset in their retirement plan. You can't plan retirement income without knowing the value of the plan's main asset.

4. **Estate planning.** Business owners who have various assets and want to leave equal amounts to heirs need to monitor the value of the family business to make sure none of the heirs get shortchanged.
5. **Key person planning.** A business valuation can serve as a baseline value when designing growth incentives to reward key persons in the business.
6. **Court challenges.** Business valuation issues do end up in court, so a business owner needs all information available to fend off legal challenges.

DE Chancery Declares Actual Merger Price More Reliable Than DCF Analysis

Over the years, the Delaware Court of Chancery has repeatedly expressed its strong liking for the discounted cash flow (DCF) analysis in fair value determinations (used in oppressed shareholder disputes to compute enterprise value without discounts). But in a recent decision the court expressly rejected the DCF method in favor of the actual merger price. In a case involving the company that owned and managed "iconic" entertainment assets such as "American Idol" and "So You Think You Can Dance," a major issue was how to handle "the maturation" of the "American Idol" franchise because after 2006, the show's revenues began to decline for five seasons.

After the company put itself up for sale and potential buyers expressed an interest, management created five-year projections which posited that revenues for "American Idol" would increase by some \$20 million each year. Whether the additional \$20 million per year was a "genuine prediction" of future revenue or merely a "marketing ploy" with which to generate a high bid became a pivotal question for the valuation experts both sides retained. The eventual buyer paid \$5.50 per share.

But the petitioners' expert, using a DCF analysis as well as "guideline" analyses, concluded the company was worth \$11.02 per share. In contrast, the company's expert relied solely on the DCF method and ended up with a \$4.41 value per share -- \$1.09 below the sales price. The petitioners' expert wholly adopted the revenues appearing in the management projections, whereas the company's expert ignored the projected \$20 million annual increase and instead assumed fees would grow at 4% per year for five years. Neither treatment was reliable, the court found.

When the merger took place, the future revenue streams related to "American Idol," the company's primary asset, were "in a state of flux." Therefore, the court could have "little confidence in the reliability of using or excluding the estimated \$20 million increase in revenues." For this reason, it found the DCF analysis was not the appropriate technique in this case. Instead, it adopted the actual merger price, which resulted from a sales process that was "thorough, effective, and free from any spectre of self-interest or disloyalty." [1]

[1] *Huff Fund Investment Partnership v. CKx, Inc.*, 2013 Del. Ch. LEXIS 262 (Oct. 31, 2013)

Valuations High For Private Firms, Says Pepperdine Report

The value of privately held businesses is very high right now, according to the 2014 Capital Markets Report from Pepperdine but it notes the effect of the economy continues to be a problem. "Current low interest rates means affordable capital for small-business expansion, but access to the funds remains a challenge for small firms even though there appears to be an abundance of private equity capital currently on the sidelines looking for

quality deals," says Dr. Craig Everett, director of the project. "Valuations are very high right now, making it a seller's market for owners of businesses with strong financials and healthy growth trends."

Other interesting findings:

- According to investment bankers surveyed, the top three reasons for deals not closing were valuation gap (26%), unreasonable seller or buyer demand (21%), economic uncertainty (12%), and insufficient cash flow (12%).
- Approximately 41% of angel investors surveyed based valuations on gut feelings when valuing privately held businesses.

A Quiet Year for the US Tax Court: Bogdanski says BV Cases Took 'Back Seat' This Year

According to the Business Valuations Wire, **Prof. Jack Bogdanski** (Lewis & Clark Law School) in his seventh annual symposium on developments in federal tax valuation, said that there were hardly any new business entity valuation cases. Unlike last year, when there were many cases involving family limited partnerships (FLPs), this year the Service devoted its resources to challenging taxpayer claims for charitable contribution deductions related to conservation and facade easements. The latter, in particular, have become a mass-marketing tax shelter tool in areas such as New York City and have triggered a vigorous response from the IRS. Litigation typically focuses on whether the appraisal is qualified, whether the expert testimony was admissible under *Daubert*, and finally -- assuming the case is still alive -- what the value of the restriction is.

Nexus Roundup

Intellectual Property Holding Company and Licensor Deemed Unitary and Required to File Combined Return in Arizona

In another nail in the coffin for the argument that "economic presence" is not enough to yield income tax nexus, the Arizona Department of Revenue recently required taxpayer Home Depot to include its trademark-licensing subsidiary in its combined Arizona income tax return as part of its unitary business because the operations of the taxpayer and the subsidiary were substantially interrelated. The subsidiary's sole business was the management of the taxpayer's trademarks - same facts as *Geoffrey* in 1993.

Without the taxpayer's continuing efforts to promote its brand, the trademarks that constituted the subsidiary's only assets would have been worthless. More fundamentally, the trademarks at issue had value to the subsidiary only to the extent that customers valued the taxpayer's brand. It did not matter that most of the products the taxpayer sold bore trademarks of other manufacturers. The taxpayer's argument that substantially interdependent businesses could escape unitary treatment if they could prove they dealt with each other at arm's length flew in the face of the court's previous desire to adopt a "quantifiable, objective" test for unitary treatment.[1]

[1] *Home Depot U.S.A., Inc. and Affiliates v. Arizona Department of Revenue*, Court of Appeals of Arizona, Division One, No. 1 CA-TX 12-0005, December 5, 2013

New Jersey-Income Tax: Ownership Interest in Limited Partnership Created Nexus for Corporation

A corporation was deemed to have nexus with New Jersey and required to

file corporate business tax returns where the corporation owned 99% of a limited partnership that operated 25 supermarkets in New Jersey. The court noted that the corporation and the limited partnership were in the same line of business, were dependent upon each other, and almost all of the corporation's officers worked out of an office located in the state that was listed as the headquarters of the limited partnership.[2]

[2]*Village Super Market of PA v. Director, Division of Taxation*, New Jersey Tax Court, No. 021002-2010, October 23, 2013

Occupational Tax on Attorneys Not Unconstitutional in Georgia

A city ordinance that imposed an occupational tax on attorneys who maintained an office and practiced law in the city was not an unconstitutional precondition or license for engaging in the practice of law and did not violate the equal protection requirements of the Georgia and federal constitutions, the Georgia Supreme Court has ruled, because the tax was merely a means to generate revenue.

The taxpayers argued that the ordinance's registration requirement was itself a precondition to their ability to practice law, and that the ordinance violated the Equal Protection Clauses both by not applying uniformly to all attorneys practicing law in Georgia and by charging the attorneys to whom it applied the highest percentage rate of their gross revenues. The court decided that it was reasonable for the city to require attorneys with offices inside city limits to help pay for city services from which they benefited. Further, because all attorneys subject to the ordinance were taxed uniformly under its provisions, the court found that the rate charged was valid.[3]

[3]*Moss v. City of Dunwoody*, Georgia Supreme Court, No. S13A1105, October 21, 2013

Cybersecurity

More Reasons To Harden Your Network

[Bots now account for 61% of web traffic](#)

[Who is Selling Target's Data?](#)

[Britain's BBC television network hacked](#)

[16.6 Million People Experienced Identity Theft in 2012](#)

[A Snapchat security breach affects 4.6 million users. Did Snapchat drag its feet on a fix?](#)