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The Franchise Valuations Reporter

Our Expertise

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

- Valuations, Damages & Expert Testimony
- Finance, Accounting and Tax

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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.

DISCLAIMER

Tax Policy Advice: Fund the IRS

Andrew Ross Sorkin Says "Nobody Wants to Be a Patsy"

As we have advocated repeatedly in this newsletter, the IRS needs the resources and personnel to do its basic job: collect income taxes from those who owe. According to Andrew Ross Sorkin, *New York Times* reporter and DealBook editor, "The agency is so underfunded that the chance an individual gets audited is minuscule - one person in 161 was audited in 2017, according to the I.R.S. And individuals with more than $1 million in income, the people with the most complicated tax situations, were audited just 4.4 percent of the time. It was more than 12 percent in 2011, the Center on Budget and Policy Priorities reported. The laws in place hardly matter: Those willing to take a chance can gamble that they won't get caught. That wouldn't be the case if the agency weren't having its budget cut and losing personnel."

He goes on to quote Mary Kay Foss, a C.P.A. in Walnut Creek, Calif., who told the trade magazine *Accounting Today* what we all know but is inexplicably never said aloud: "No business would cut the budget of the people who collect what's owed. It encourages people to cheat. We need a well-trained, well-paid I.R.S. staff so that those of us who pay our taxes aren't being made fools of."

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[1]Andrew Ross Sorkin is a columnist and the founder and editor-at-large of the New York Times' DealBook. He is a co-anchor of CNBC's Squawk Box and the author of "Too Big to Fail." He is also the co-creator of the Showtime drama series Billions. The full article can be found here: "Tax the Rich? Here's How To Do It (Sensibly)"

Joint Employer

Cottman Transmission May Be Joint Employer

An employee who alleged workplace discrimination, retaliation and the creation of a hostile work environment under the Civil Rights Act of 1964 adequately pleaded a joint employer relationship to survive a motion to dismiss. *Ward v Cottman Transmission*, 2019 WL 643605 (D NJ Feb. 14, 2019)

Valuations

Contentious Lund Fair Value Rulings Affirmed on Appeal

The Minnesota district court's "fair value" determination of a grocery store chain, was upheld after a decades-long fight among the grandchildren of the business's founder, Russell T. Lund Sr. The trial featured veteran appraisers, Robert Reilly of Willamette and Roger Grabowski of Duff & Phelps but the district court decided neither expert's valuation was wholly credible.[1] The court approved of the use of the discounted cash flow analysis to value the grocery-related businesses. But it said the experts' disagreements over every input and assumption showed "their valuations are tailored to suit the

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party who is paying them." The Court did its own DCF and came up with a value between the two experts who had disagreed on business risks and the appropriate Discount Rate to use in the valuation.

Report on EBITDA and Multiples

EBITDA multiples rose across all industries in the second half of 2018. They were highest over a six-year period in the third quarter of 2017, at 5.0x. But by the second quarter of 2018 fell to 3.5x -- the lowest levels since the fourth quarter of 2013. They rebounded and increased to 4.5x and 4.2x in the third and fourth quarter of 2018. EBITDA as a percentage of revenue, which had peaked in the first half of 2018, subsequently declined in the two quarters following. After reporting at the lowest level (3.1x) in the second quarter of 2018, the selling price-to-EBITDA multiple rebounded in the third quarter, to 4.3x, before settling at 4.1x in the fourth quarter of 2018. EBITDA multiples are highest for the information sector (11.1x) and the mining, quarrying, and oil and gas extraction sector (8.5x). Meanwhile, the lowest EBITDA multiples are in the accommodation and food services (2.6x) and the other services sectors (3.0x). The median across all industry sectors is 4.4x. Finally, the pace of private-company acquisitions slowed in 12 of the 15 industry sectors from 2017 to 2018. The number of acquisitions in the information sector had the biggest decline, 65.2%, while acquisitions in the educational services sector saw the largest increase, 63.2%.[2]

Goodwill Impairment

Late last month Kraft Heinz Co. wrote down the value of its Kraft and Oscar Mayer brands by $15.4 billion, disclosed an investigation by federal securities regulators and slashed its dividend, sending its stock down more than 20% in after-hours trading.[3] That is the largest impairment write-down we are familiar with. It caused Kraft Heinz to swing to a fourth-quarter loss, marking a striking reversal after several years of higher profit margins that were seen as a model for the packaged-food industry. "We were overly optimistic on delivering savings that did not materialize," Chief Executive Bernardo Hees said on a conference call. The firm said its brands like Oscar Mayer hot dogs and Kraft Mac & Cheese returned to sales growth after several years of declines. But profit margins suffered as a result, making the brands less valuable.

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[1]*Lund v. Lund (Lund II)*, 2019 Minn. App. LEXIS 16

[2] Business Valuation Resources DealStats Valuation Index Digest 1Q 2019

[3] "Kraft Heinz Divulges SEC Investigation, Swings To Loss"

New Tax Law

Final Regs Issued on PTE QBI Deduction

The Treasury published final regulations explaining which taxpayers qualify for the 20% "qualified business income" (QBI) deduction for pass-through entities (PTEs). The final rules provide details on the type of service businesses that are excluded including healthcare, law, accounting, and consulting as opposed to the types of businesses which do qualify such as the real estate industry, architects, and engineers.

New Law's Big Tax Breaks Focus on Distressed Main Streets

As noted by the *New York Times* and many other publications, hedge funds, investment banks and money managers are trying to raise tens of billions of dollars this year for so-called opportunity funds, a creation of the 2017 tax law meant to steer money to poor areas by offering potentially large tax breaks.[1] It has jacked up prices in bad neighborhoods and commenced a flurry of investment activity into projects ostensibly meant to help struggling Americans. The ranks of those starting such funds include Anthony Scaramucci, the New York hedge fund executive who served briefly as Mr. Trump's communications director.

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[1] See: "Wall Street, Seeking Big Tax Breaks, Sets sights o Distressed Main Streets"

Damages

Prevailing Plaintiff In Copyright Infringement Denied Attorneys' Fees and Costs

The Copyright Act's reference to "full costs" did not authorize an award of litigation expenses beyond those specified in the general costs statute. Therefore, the U.S. Supreme Court reversed a $12.8 million award to Oracle USA for expert witnesses, e-discovery, and jury consultant costs, which went beyond those categories. The decision of the U.S. Court of Appeals for the Ninth Circuit affirming the award for litigation expenses such as expert witnesses and other fees to Oracle USA Inc. -- the prevailing party in copyright infringement action against Rimini Street, Inc. -- was reversed in a unanimous decision by the U.S. Supreme Court because the term "full costs" in Section 505 of the Copyright Act was limited to the six cost categories specified in the general costs statute codified at 28 U.S.C. §§1821 and 1920.

The Ninth Circuit had held that although the award included expenses that went beyond those categories, the award was appropriate because the Copyright Act gave federal district courts the discretion to award full costs to the prevailing party in copyright litigation. However, Supreme Court precedent has consistently adhered to the approach that awards for litigation expenses were limited to those costs specified in Sections 1821 and 1920 (*Rimini Street, Inc. v. Oracle USA, Inc.,* March 4, 2019, Kavanaugh, B.).

Prevailing Defendants in Copyright Action Denied Attorney Fees and Sanctions

Despite prevailing against all claims of copyright infringement, unfair competition, and violation of the Digital Millennium Copyright Act, the prevailing defendants were not entitled to the award of attorney fees and sanction awards against the party bringing the unfounded infringement action. After analyzing numerous factors the federal district court in Phoenix in its discretion declined to make such awards against SellPoolSuppliesOnline.com LLC (SPSO), a licensor of pre-made websites of swimming pool supplies that had brought a copyright action.

In a separate order, the court declined to sanction SPSO's attorney for conduct that allegedly led to excess costs, expenses and fees caused by unreasonably multiplying the proceedings in violation of 28 U.S.C. §1927 The court in Phoenix previously had dismissed the copyright infringement suit brought by SPSO against a pool builder and remodeler Ugly Pools Arizona Incorporated, based on SPSO's knowingly having submitted inaccurate information on its registration application to the Copyright Office, and the fact that the core requirements for liability under DMCA were not present (*SellPoolSuppliesOnline.com LLC v. Ugly Pools Arizona Inc.,* March 11, 2019, Bade, B.).

More Wisdom from John Wooden

Success is never final, failure is never fatal. It's courage that counts.

I worry that business leaders are more interested in material gain than they are in having the patience to build up a strong organization, and a strong organization starts with caring for their people.

Adversity is the state in which man most easily becomes acquainted with himself, being especially free of admirers then.