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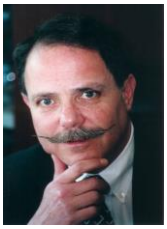
The Franchise Valuations Reporter

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

NASAA Cover Sheets and ASC 606

Change in Revenue Recognition Rules Causing Renewal Problems for Franchisors

On March 11, 2020, Dale Cantone of the Maryland AG's office emailed the ABA Franchise Forum to say:

While we may see challenges this renewal season incorporating the new NASAA state cover sheets, perhaps the more challenging issue this renewal season may involve the impact of ASC 606.

State franchise regulators have already noticed a number of franchise disclosure documents this year with audit reports that do not correctly apply the new standards for recognizing revenue under ASC 606.

Applicants who file a franchise registration with state franchise agencies should confirm that audit reports included with financial statements correctly describe and apply the standards for recognizing revenue after the effective date of ASC 606. If they do not, the franchise registration will not be made effective until the audit report and audit complies with ASC 606.

ASC 606 is an accounting rule that focuses on the proper revenue recognition for up-front franchise fees. We have repeatedly addressed this issue in our newsletters (See May 2017, November 2017 and January 2018 and this article from Bob Gilbert, tax partner in Citrin Cooperman's New Jersey office.)

Valuations

EBITDA Multiples Decline in the Second Half of 2019

Business Valuation Resources (BVR) reported that EBITDA multiples declined for the second consecutive quarter, reporting at 3.5x in the fourth quarter 2019. This marked the fourth decline over the past five quarters. EBITDA, as a percentage of revenue, remained at 11% in the fourth quarter of 2019. Since 2014, EBITDA margins have ranged from 9% to 15%. In private transactions BVR reports that the Selling Price/EBITDA Median is 4.4X. EBITDA multiples remain the highest for the information sector (11.1x). Meanwhile, the lowest EBITDA multiples are in the accommodation and food services (2.6x) and the other services sectors (3.1x). For more details, see the DealStats Value Index Digest for 4Q2019 here.

Asset-Based Appraisal Unsuitable For Fair Value Determination, Court Says

In a bitter fight between siblings over the buyout of the minority shareholder's interest in a successful construction business, the trial court found the asset-based valuation the majority shareholder's expert proposed was fatally flawed for at least two reasons. Scott Linde and his sister, Barbara, formed LindeCo in 2006. He held 75% of the issued shares and she the remaining 25%. The relationship broke down. Scott proposed a buyout of Barbara's stake at book value. She rejected the offer, finding book value significantly undervalued the company. As a remedy, the court ordered Scott

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to buy out Barbara's interest at fair value which the Court determined by adopting Barbra's expert's valuation based on the income and market approaches.

New Guide to Canadian Business Valuations

Canada's valuation professional organization (VPO) whose members have the Chartered Business Valuator designation adhere to the CBV Institute Practice Standards, which do not contradict the International Valuation Standards (IVS). The CBV Institute has published *A Bridge From CBV Institute Practice Standards to IVS* to highlight areas of differences between the two sets of standards.

Damages

Lanham Act Disgorgement Damages Split Amongst All Competitors in False Advertising Case

In *Boltex Mfg. Co. v. Ulma Piping U.S. Corp.*,[1] the Court ruled that while disgorgement was appropriate, the amount was reduced as the profits from misconduct were gained at the expense of all competitors. A finding that the Defendant committed false advertising under the Lanham Act was affirmed, but the damages awarded by a jury to the two plaintiffs were reduced. The court scaled back the amount of damages, noting that Plaintiffs were merely two of the players in the marketplace harmed by the false advertising.

Proximate Cause of Damages Must Be Shown for Legal Malpractice

The New York Appellate Divisions, in both the First and Second Departments, recently reaffirmed that a party's failure to demonstrate that an attorney's actions proximately caused their alleged damages is fatal to a legal malpractice action.[2]

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[1]USDC SD TX Case 4:17-CV-01400, February 7, 2020, Hanen, A.

[2]*Marder's Antique Jewelry, Inc. v. Bolton*, 2020 NY Slip Op 00674 (1st Dept. 2020) and *Hilario Dominguez v. Mirman*, M*arkovits & Landau, P.C., et al.* 2020 NY Slip Op 00845 (2nd Dept. 2020).

Joint Employer, Independent Contractor, Vicarious Liability

New NLRB Joint Employer Rule

The new rule, which will go into effect April 27, 2020, specifies that to be a joint employer, a business must possess and exercise **substantial direct and immediate control over one or more essential terms and conditions of employment.** The final rule defines key terms, including what are considered "essential terms and conditions of employment," and what does, and what does not, constitute "direct and immediate control." The final rule also defines what factors constitute "substantial" direct and immediate control and makes clear that control exercised on a sporadic, isolated, or *de minimus* basis is not to be considered "substantial." The rule also **"preserves franchisees' ability to run the day-to-day operations of their businesses without compromising the brand standards required of the franchise model."**

States Challenge Labor Department's Joint Employer Rule

On February 26, a coalition of Democratic state attorneys general filed a lawsuit in New York federal court to overturn the Department of Labor's finalized rule on joint employment. The lawsuit, filed by 17 states and the District of Columbia, argues that the rule would "impermissibly narrow" the scope of the Fair Labor Standards Act and leave workers "even more vulnerable to underpayment and wage theft."

Congressional Democrats Vow to Challenge NLRB Final Joint Employer Rule Via Appropriations Process

When the National Labor Relations Board (NLRB) released its final rule on joint employer status, House Democrats vowed to challenge the rule via the appropriations process, which could undermine the agency's ability to enforce the new rule.

Claim That Convenience Store Franchisee Owners Were Employees of Franchisor Survives

In a suit by a franchise-owning married couple alleging numerous claims arising out of their terminated franchise agreement, against the franchisor Family Fare, which franchises gas station-connected convenience stores, the federal district court in Winston-Salem, North Carolina, has ruled that the married couple can pursue a claim for violation of the federal Fair Labor Standards Act's overtime provisions because (1) they have sufficiently pleaded that the franchisor and the couple's franchise entity were the couple's joint employers and (2) that the couple were employees and not independent contractors. (*Elsayed v. Family Fare LLC*, February 18, 2020, Biggs, L.).

7-Eleven Won't Face Franchisees' Overtime Suit, But Failed To Escape Their Expense-Reimbursement Claims Under California Law

A district court in California declined to hold that franchisees were undisputedly misclassified as independent contractors; even if the California Supreme Court's recently adopted "ABC test" applied. Thus, triable issues existed as to their employment status. The case involved four 7-Eleven franchise owners who brought a putative class action alleging they were improperly classified as independent contractors (which was denied) but the Court left alive their California law claims for unreimbursed expenses. Ruling on the parties' cross-motions for summary judgment, the court also rejected the franchisees' contention that they were undisputedly employees of 7-Eleven under California law since questions remained as to whether they performed work that was "outside the usual course" of 7-Eleven's business (*Haitayan v. 7-Eleven, Inc.*, February 19, 2020, Fischer, D.).

Quotations

In Sir Winston Churchill's six volume history "The Second World War," the Moral of the Work was:

In War: Resolution

In Defeat: Defiance

In Victory: Magnanimity

In Peace: Good Will