



## The Franchise Valuations Reporter

404 Park Avenue South, 16th Floor, NY, NY 10016  
O: 212.689.0400 / [Bruce@FranchiseValuations.com](mailto:Bruce@FranchiseValuations.com)

Volume 2, Issue 8 – September 2010

Our areas of expertise in the franchise, distribution and dealership context are:

Finance, accounting and tax;

Damages, valuations and expert testimony; and

Cyber-security and E-discovery of ESI (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.

Bruce S. Schaeffer, Editor

[Bruce@FTRM.biz](mailto:Bruce@FTRM.biz)

If you do not want to receive this email reporter you may unsubscribe below.

## Valuations in Divorce

### ***What is the Standard? Fair Market Value, Fair Value or Other?***

Valuing assets in divorce situations is not the same as the normal “fair market value” appraisal.

A review of three recent cases illustrates that value in divorce proceedings is not formulaic as much as it is a matter of the discretion of the court. Courts may or may not deem themselves bound by accepted definitions of “fair value for appraisal rights” (allowing no discount factors and generally providing for a control premium) or “fair market value” which provides for discounts such as lack of marketability and supposes a transaction between a hypothetical willing buyer and willing seller rather than the actual parties and their

specific facts and circumstances. The amounts at issue are substantial as courts have accepted discounts for minority interests and lack of marketability in a range from 15% to more than 50% of the total enterprise value.

In *Alexander v. Alexander* [79A02-0906-CV-528 (Ind. App. 5-20-2010) Court of Appeals of Indiana (May 20, 2010)] one of the marital assets in dispute was a Century 21 franchise. The competing valuations were described by the court as follows:

The business appraisals disagreed in several areas, best summarized as follows: (1) Strauch eliminated all of the interest expenses incurred by the corporation, and Stover found the expenses to be legitimate expenses

(2) Strauch increased the cash flow of the business, and Stover used the actual Federal Income Tax Returns filed by the parties to reflect the expenses and income of the business.

One expert ascribed a value of \$288,600 to the franchise while the other came in at \$35,800. Not surprisingly, the Court effectively cut the baby in half and arrived at a value of \$119,475. More importantly, the court discussed and accepted (although modified) certain discounts to the valuation – basically adopting the mechanics of a “fair market value” analysis even though an appraisal rights theory was argued.

In another case, *In re Marriage of Thornhill* [08SC777 Supreme Court of Colorado (June 1, 2010)] the court was called upon to adopt “fair value for appraisal rights” as the standard for valuation of closely held businesses for divorce proceedings and expressly declined to do so. Experts for both Wife and Husband provided valuations which initially were within \$18,000 of each other, for total enterprise values of approximately \$2.5 million.

However, significant disparity resulted from the application of a thirty-three percent marketability discount by Husband's expert while the wife's expert applied no marketability discount, citing a decision with respect to appraisal rights [*Pueblo Bankcorporation v. Lindoe, Inc.*, 63 P.3d 353 (Colo. 2003)]. But the appellate court declined to accept that there was any required definition as a matter of law saying

that by statute the proper method was within the “discretion” of the trial court.

In a third case, *Brown v. Brown* [792 A.2d 463 (N.J. Super. Ct. App. Div. 2002)], by contrast, a New Jersey appellate court did extend a rule prohibiting the use of marketability discounts in shareholder dispute cases to divorce proceedings – effectively adopting “fair value for appraisal rights” as the appropriate valuation standard for New Jersey divorces. It should be noted that this case was expressly rejected by the Colorado court in *In re Marriage of Thornhill*. Most courts have left the applicability of marketability discounts to the trial court's discretion.

***Valuations: Expert Report, Regardless of Expert's Qualifications, Will Be Rejected if Not a “Qualified Appraisal”***

In the recent case of *Scheidelman v. CIR*, T.C. Memo. 2010-151, No. 15171-08 (July 14, 2010) the United States Tax Court, in a memorandum decision, gave notice that the Service and its appraisers will use the case as justification to inquire deeply into, and analyze critically, appraiser qualifications and appraisal quality. In *Scheidelman*, the IRS successfully argued that the taxpayer's appraisal did not satisfy the requirements of Regulation Section 1.170A-13(c), which specifies the elements required to be contained in a qualified appraisal of scenic easements, the type of property at issue.

Lesson: taxpayers and litigators should be careful in vetting their experts and their expert's reports.

## Nexus Notes

***“Physical Presence” Is Not a Requirement for Income Tax Nexus in Ohio***

The Ohio Department of Taxation recently held that L.L. Bean, Inc. was subject to the

commercial activity tax (CAT) due to the vendor's substantial economic nexus with Ohio by selling and shipping goods into the State. [*In re L.L. Bean, Inc.*, Ohio Department of Taxation, August 10, 2010.]

The taxpayer argued that these activities did not rise to taxable nexus, principally relying on *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). L.L. Bean argued that the

substantial nexus requirement under the Commerce Clause of the U.S. Constitution can only be satisfied through a physical presence in the taxing state. But as we have counseled repeatedly for 20 years, the physical presence argument was rejected because the department noted that the holding in *Quill* has practically never been extended to taxes other than sales tax.

## ESI and E-Discovery

### Best Practice

In the July issue of *The Franchise Valuations Reporter* we discussed the challenges of complying with the latest requirements for e-discovery and the need for franchisors to prepare for litigation or regulatory investigations by having a plan in place to preserve and collect Electronically Stored Information (ESI). In this issue we expand on that theme and examine the "litigation hold" process.

### Implementing an Archiving System

Because of the vast amounts of data created in the course of doing business and the courts' imposition of stricter discovery requirements, a system for managing ESI is critical. For franchisors these data collections and organizations should include, among others:

- FDDs (which could relate to suits for violation of a franchise law);
- Site selection (which could relate to a claim for breach of the covenant of good faith and fair dealing);
- Demographic analyses (which could relate to an encroachment claim);
- Pricing of mandated products (which could relate to an antitrust claim); and
- Calculations of the amounts specified as

liquidated damages in a franchise agreement (which could relate to whether it is fair compensation or a penalty).

To deal with what could easily amount to terabytes of ESI, all franchise companies are advised to implement an archiving system. E-mail and file archiving will allow the company's legal, IT and compliance teams to locate, preserve, and produce relevant ESI and will help with enforcement of the company's document retention policy.

But most importantly for litigation purposes, an archiving solution streamlines the administration of "legal holds." It facilitates efficient identification of potentially relevant ESI through enterprise-wide searching and enables "legal holds" to be immediately put into place, mitigating the risk of court-imposed sanctions related to preservation issues. And data that is not relevant to the matter or litigation can be easily released from the litigation hold, thereby reducing the amount that must be stored if the dispute progresses through the next phases of the e-discovery process.

### Duty to Preserve ESI

The exact moment the duty to preserve ESI arises remains a tricky issue. Franchisors

have to rely on case law, but that is confused too. For example, in one case a court found the duty to preserve arose no later than the lawsuit's filing; in another, the duty to preserve arose when a plaintiff sent a letter informing the defendant that he had consulted attorneys regarding the matter; and in yet another, a court held that the notice of litigation (requiring a "hold") was established after a phone call from the plaintiff and the filing of a complaint.

The best practice for franchisors is to implement a "legal hold" as soon as litigation appears to be on the horizon. Counsel and parties should maintain detailed notes of the preservation protocol followed, including when the hold was issued, what details were included in the hold, to whom the hold was issued and the efforts taken to monitor compliance.

#### Issuing Written "Legal Holds"

The case law makes clear that issuing written "legal holds" is essential to comply with the new e-discovery rules. And they must be communicated appropriately to all department heads, IT personnel and pertinent support staff. The instructions should include:

- the purpose for the hold;

## CyberCrime

### MORE REASONS TO BE FRIGHTENED!

#### Links to Recent Articles on Cyber-Crime

Could Your Cell Phone Be Hacked?

<http://smallbusiness.aol.com/2010/08/02/could-your-cell-phone-be-hacked/?icid=main|htmlw-sbn|dl2|link1|http%3A%2F%2Fsmallbusiness.aol.com%2F2010%2F08%2F02%2Fcould-your-cell-phone-be-hacked%2F>

- a description of the lawsuit or investigation;
- the guidelines for determining what data should be preserved; and
- who is responsible for preserving them.

Counsel should then work jointly with IT to notify opposing counsel and any relevant third parties of their corresponding duty to preserve potentially responsive information. Internal automatic destruction must also be suspended, which includes halting defragmentation software and other forms of automatic or routine drive "cleanup" activities.

*Franchise Technology Risk Management, consisting of franchise law and computer forensics experts, provides consulting and implementation of all aspects of ESI management and e-discovery for franchise systems— from preparation of ESI-related policies and procedures manuals through collection, preservation, processing, production and presentation of ESI. To inquire about our services, please e-mail [Henry@FTRM.biz](mailto:Henry@FTRM.biz) or call 212.689.0400.*

.

A Warning About a Weak Link in Secure Web Sites

<http://www.nytimes.com/2010/08/14/technology/14encrypt.html>

Defense official discloses cyberattack

<http://www.washingtonpost.com/wp-dyn/content/article/2010/08/24/AR2010082406154.html?hpid=topnews>

If you would like to unsubscribe, Click [HERE](#) to remove yourself from the mailing list.

If this is SPAM, please click [HERE](#) to report it to us.

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 and can be reached at 404 Park Avenue South, New York, NY 10016. 212.689-0400 or [www.franchisevaluations.com](http://www.franchisevaluations.com) and [www.ftm.biz](http://www.ftm.biz)