

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

Come See Our New Website

We invite you to visit our recently updated website at www.franchisevaluations.com. We thought it was time for a fresh-but-not-flashy look and hope you find it functional and easy to navigate.

We have a new page featuring a glossary of selected valuation and damages terms as well as a glossary of financial and estate planning terms. You will also be able to see back issues of *The Franchise Valuations Reporter* going back to 2009.

We Write the Book

Franchise Regulation and Damages, the only treatise that

Valuations

Discount Rate - Inflation, Volatility Trigger Increase in ERP, Per Kroll

Kroll has increased its recommended U.S. equity risk premium (ERP) component from 5.5% to 6.0% when developing dollar-denominated discount rates as of Oct. 18, 2022. This is matched with the higher normalized risk-free rate of 3.5% or the spot 20-year U.S. Treasury yield as of the valuation date if it is higher than 3.5%. Kroll says, "Investors have tried to ascertain the magnitude and speed at which central banks will raise interest rates, leading to a potential decrease in the value of companies in various industries due to an increase in discount rates."

MARKABLES Study Says Customer Relations Is the Top Intangible

Customer relations is the most important of all intangible assets, accounting for 25% of enterprise value, according to a [new study from the Swiss firm, MARKABLES](#). Next in line are software and technology, at 18% of enterprise value each, and last comes trademarks, at 8%. "Looking at the development during the last 15 years, customer relations showed the highest growth, while trademarks suffered badly, from a once leading position to last place," says the study.

Kroll Reports Goodwill Impairments YTD 2022 Are Up

So far in 2022, the amount and frequency of goodwill impairments recorded by U.S.-based companies have increased. An analysis by Kroll finds that, compared to 2021, the top 10 impairments recognized thus far are triple the size of the top 10 for overall 2021. The data were compiled on Aug. 15, 2022.

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.](#)

Damages

Rescission

In our treatise “Franchise Regulation and Damages” Section 7.02B2 we write, “Rescission is equity’s attempt to unwind a transaction the law finds unjust or unfair. The objective of rescission is to put the parties in the same position they would have been in had there been no transaction. Frequently, however, this cannot be accomplished so the law attempts to do the next best thing and award money damages deemed to be the *equivalent* of unwinding the transaction.” In a commendable recent article in the *Franchise Law Journal*, Vol. 42, Number 1 (Summer 2022) “Claiming Rescission: The Battle for Equity”, the authors Filemon Carillo and Jazlyn Cabula offer a 22-page article on the various theories and statutes providing liability. The section covering Damages, however, is only 1 page long. But they cannot be blamed for the calculation often involves unwinding 10 years of transactions – a task both daunting and difficult to articulate. Nonetheless, we recommend the article for its sweeping analysis of the liability component for any practitioner daring enough to bring such a claim.

Maximum Statutory Damages Awarded For Defunct Service Provider’s Online Movie Piracy

In *Millennium Funding, Inc. v. Micfo LLC*, (October 31, 2022, Jackson, R). the maximum statutory damages (\$4.2 million plus attorney’s fees and costs) were awarded against a web services company because it took no action in response to thousands of copyright notices, preferring to preserve its subscriber revenue. Micfo LLC, a defunct Infrastructure as a Service (IaaS) business that rented IP addresses to virtual private networks and other internet users was liable for the maximum statutory damages rather than lost profits for copyright infringement, held a federal District Court. It should be noted that the lost profits to the copyright holders far exceeded the statutory damages.

Encroachment/Fraud

Claim Against Franchisor Fails By At Least Two Miles

In *Prometheus Innovation Corp. v. Huntington Learning Centers Inc.*, (November 2, 2022, Wilson, R)[¹] the New Jersey Superior Court granted summary judgment to a learning center franchisor on claims brought by one of its franchisees that filed suit after the franchisor announced plans to open another learning center that would compete with the franchisee for customers and was located approximately five miles away. The court concluded that the franchisee’s fraud claim failed because the announced new learning center located five miles from the purchased learning center was well outside three-mile

exclusive zone granted under the franchise agreement. The court also concluded that statements made by the franchisor that it would not open a competing location near the learning center were puffery and did not constitute misrepresentations or tortious interference.

[1] [No. BER-L-2025-20](#).

Tax Changes

IRS Provides Relief Procedures For S Corporation Elections

Making and maintaining a valid S Corporation election is subject to intricate and arcane rules. However, the IRS recently issued guidance under Revenue Procedure 2022-19, providing a series of “taxpayer assistance procedures” to resolve certain issues involving S Corporations and their shareholders, to maintain S Corporation status without running afoul of the requirements. For example, some of the easing centers on:

- The one class of stock requirement and governing provisions, including “principal purpose” conditions. The IRS will not treat an S Corporation as violating the one class of stock requirement as a result of an agreement that does not have a principal purpose to circumvent the one class of stock requirement.
- Disproportionate distributions when normally all S Corporation shareholder distributions must be pro-rata.
- Some inadvertent errors or omissions on the S Corporation election, Form 2553.

Inflation Fuels Sharp Rise in Estate Tax Exemption

As [reported by Politico](#), couples will be able to shelter an additional \$1.72 million from estate tax next year. The estate tax, like many other federal taxes, is indexed to consumer costs — and, because of soaring prices, the IRS says the estate tax exemption (after which people have to begin paying the 40 percent levy) next year rises to \$25.8 million per couple. The hike is coming as a major reduction in the estate tax pushed through by the Trump administration is slated to expire in the next few years. Unless lawmakers act, the amount people can exempt from the levy will suddenly fall by more than half beginning in 2026.

Expert Testimony

Appraisers Have Highest Exclusion Rate Under Daubert, Per PwC Study

Under *Daubert*, appraisers were excluded more often in 2021 than any other type of financial expert witness, according to the PwC survey, “*Daubert Challenges to Financial Experts (2000-2021)*.” In 2021, there were 272 reported challenges to financial expert witnesses - an increase of 19% from 2020. Of the 272 challenges against financial expert witnesses in 2021, 89 challenges (33%) resulted in partial or full exclusion of the expert. Of the three most common financial experts (economists, accountants, and appraisers), appraisers had a 38% exclusion rate in 2021, followed by accountants (32%) and economists (27%). Indeed, over the entire 22 years of the study, appraisers have the highest exclusion rate (44%) of the three.

The annual study analyzes challenges to financial expert witnesses (appraisers, accountants, economists, and others) under the *Daubert* standards from 2000 to 2021 - the years following the U.S. Supreme Court's *Kumho Tire* decision, which expanded *Daubert's* reach to include financial expert witnesses.

Prior Transaction Used to Yield Current Value of a Dental Practice

In *Logue v. Logue*,^[1] a North Carolina divorce case, the wife's stake in a dental practice was valued based on what she paid for it two years before she and her husband separated. She had purchased a 50% share of a father-son practice from the father, who continued to work at the practice and was paid as an associate. She paid \$1.2 million, which was based on an appraisal that included \$1 million of goodwill. At the date of her divorce separation, she was still carrying the \$1 million of goodwill on the books and the elder dentist was still working at the practice.

At trial, neither the husband nor wife offered up a current valuation of the practice, so the court examined the price paid for the wife's stake two years before, concluding that it was an arm's-length transaction. The court also investigated what happened to the practice in those intervening two years. "Persons looking at the practice would not see any change that might impact the goodwill," the court wrote. Therefore, the court valued the business at essentially what was on the balance sheet (the \$1.2 million purchase price less some small accounting adjustments). On appeal by the wife, the holding was affirmed because although the original and trial court valuation approach was "rudimentary," it was "sufficiently reliable" considering both parties chose not to retain experts to prove otherwise.

[1] 022-NCCOA-625; 2022 N.C. App. LEXIS 644; 2022 WL 4350119

Quotations

Advice to Benedict Arnold From His Mother

"Be dutiful to superiors, obliging to equals, and affable to inferiors, if any such there be."

"Don't neglect your precious soul, which once lost can never be regained."