

## BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF: )  
 )  
ACFN FRANCHISED, INC., ) OTA NO. 18124128  
 )  
APPELLANT. )  
 )

**CERTIFIED COPY**

TRANSCRIPT OF PROCEEDINGS

Sacramento, California

Wednesday, July 20, 2022

Reported by:

SARAH M. TUMAN, RPR  
Hearing Reporter

Job No. :  
37123OTA(A)

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15               TRANSCRIPT OF PROCEEDINGS, taken at  
16               400 R Street, Sacramento, California,  
17               commencing at 9:35 a.m. and concluding  
18               at 10:47 a.m. on Wednesday, July 20, 2022,  
19               reported by Sarah M. Tuman, RPR, Hearing  
20               Reporter in and for the State of California.  
21  
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23  
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25

1 APPEARANCES:

2  
3 Panel Lead: ALJ ANDREW KWEE

4  
5 Panel Members: ALJ JOSH LAMBERT  
6 ALJ SUZANNE BROWN

7  
8 For the Appellant: EDWARD DAVIS  
9 J. KERR

10 For the Respondent: STATE OF CALIFORNIA  
11 DEPARTMENT OF TAX AND FEE  
12 ADMINISTRATION  
13 SCOTT CLAREMON  
14 CHAD BACCHUS  
15 JASON PARKER  
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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-11 were received at page 8)

(Department's Exhibits A-C were received at page 8)

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By Mr. Bacchus 14

A P P E L L A N T ' S

WITNESSES:	DIRECT	CROSS	REDIRECT	RECROSS
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Jeffery Kerr	20			
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(Further)	47			
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C L O S I N G   A R G U M E N T

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By Mr. Bacchus 57

1 Sacramento, California; Wednesday, July 20, 2022

2 9:35 a.m.

3  
4 JUDGE KWEE: All right. Thank you. We're ready  
5 to go on the record.

6 We're opening the record in the Appeal of ACFN  
7 Franchised, Inc. This matter is being held before the  
8 Office of Tax Appeals. The OTA Case Number is 18124128.  
9 And today's date is Wednesday, July 20th, 2022. The time  
10 is approximately 9:35 a.m., and this hearing is being  
11 conducted in Sacramento, California. And it's also being  
12 livestreamed on OTA's YouTube channel.

13 Today's panel -- today's hearing is being heard  
14 by a panel of three Administrative Law Judges. That's  
15 myself, Andrew Kwee, I will be the law -- the lead  
16 Administrative Law Judge. And to my right is Suzanne  
17 Brown, and to my left is Josh Lambert. And they're the  
18 three -- we are the three members of this panel.

19 All three of us will meet after the hearing and  
20 produce a written opinion as equal participants. Although  
21 I will be conducting the hearing today, any Judge on this  
22 panel may ask questions or otherwise participate to ensure  
23 that we have all the information needed to decide this  
24 appeal.

25 Just for the record, would the parties please

1 state their names and who they represent? And I'll start  
2 with representatives for the tax agency, CDTFA.

3 MR. BACCHUS: Chad Bacchus.

4 MR. CLAREMON: Scott Claremon. And we also have  
5 Jason Parker in attendance.

6 JUDGE KWEE: Okay.

7 And for Appellant, would you please state your  
8 name and who you represent? Would the people please state  
9 your name and who you represent?

10 MR. DAVIS: I'm Edward Davis. I represent ACFN  
11 and its CEO, Jeff Kerr.

12 MR. KERR: I'm Jeffrey Kerr, founder and CEO of  
13 ACFN.

14 JUDGE KWEE: Okay. Thank you.

15 And, Mr. Kerr, is your microphone on?

16 MR. KERR: It doesn't look like the light's on.

17 JUDGE KWEE: Oh. So you can push -- there's a  
18 little button. If you push that, the light should come  
19 on.

20 MR. KERR: Better now?

21 JUDGE KWEE: Perfect. Thank you.

22 Okay. So with that said, there was just one  
23 preliminary matter.

24 I noticed that I had -- during the prehearing  
25 conference, I believe, for Appellant's representative, you

1 indicated that you were going with an April 10, 2019,  
2 exhibit list consisting of 11 exhibits. I did note that  
3 there was a subsequent submission after our first hearing  
4 conference on January 9th, 2020 -- so about nine months  
5 later.

6 That one contained the 19 exhibits. And I just  
7 wanted to confirm with you that you wanted to roll it back  
8 to the 11 exhibits.

9 MR. DAVIS: The -- the 11 exhibits -- I believe  
10 the errata sheet was to actually coordinate those. And  
11 then there -- it says it brings it down to the 11th. So  
12 there were two sets. What we did was coordinating saying  
13 it was only the 11.

14 JUDGE KWEE: Okay.

15 MR. DAVIS: That was the purpose. So if those  
16 dates were mixed up, my apologies, your Honor.

17 JUDGE KWEE: Okay. Perfect. Yes. So I did have  
18 that. And I did distribute the 11 exhibits; so I think we  
19 are good there.

20 I would ask, could you also double check that you  
21 have your microphone on? Because they aren't picking up  
22 your voice on the livestream. It should be a green light  
23 that comes on.

24 MR. DAVIS: It's a green light. And I am  
25 speaking directly into the microphones.

1 JUDGE KWEE: Okay. Cool. Thank you.

2 So for the exhibits for this Appeal, then,  
3 consist of CDTFA's three Exhibits, A through C. And these  
4 were discussed at the prehearing conference and  
5 distributed to the parties via email after the prehearing  
6 conference.

7 And for Appellant, I have Exhibits 1 through 11.  
8 Those were also discussed and distributed following the  
9 prehearing conference. My understanding is that neither  
10 party has objections to any of the exhibits offered for  
11 the admission.

12 Is the summary I provided correct for CDTFA?

13 MR. BACCHUS: Yes, it is.

14 JUDGE KWEE: Okay.

15 And for Appellant; is that correct?

16 MR. DAVIS: Yes, your Honor.

17 JUDGE KWEE: Okay. Then Exhibits 1 through 11  
18 for Appellant and A through C for CDTFA are admitted into  
19 the record -- evidentiary record.

20 (Appellant's Exhibit Nos. 1-11 were received in  
21 evidence by the Administrative Law Judge.)

22 (Department's Exhibit Nos. A-C were received in  
23 evidence by the Administrative Law Judge.)

24 JUDGE KWEE: And for the witnesses, we just have  
25 one witness for Appellant, Jeffrey D. Kerr, the president



1 and CEO of Appellant and its holding companies. He is  
2 present today, and there are no objections to hearing  
3 testimony from Mr. Kerr today.

4 Is that summary correct, CDTFA?

5 MR. BACCHUS: Yes, it is.

6 JUDGE KWEE: Okay.

7 And for Appellant, is that summary accurate?

8 MR. DAVIS: Yes.

9 JUDGE KWEE: Okay. Great.

10 So just a reminder, there is only one issue in  
11 this -- this appeal. That issue is whether the ATM  
12 franchise fees -- the initial franchise fees are taxable  
13 as a part of the sale of ATMs.

14 The parties agree to the calculation of the ATM  
15 franchise fees. And there were other items included in  
16 the audit, which are not at issue in Appeal today. The  
17 only issue is the ATM franchise fees and whether they are  
18 taxable or nontaxable.

19 And as far as the time estimates, we have  
20 allocated 10 minutes for Appellant's opening presentation.  
21 Following that will be 15 minutes allocated for CDTFA's  
22 opening presentation. And then we'll have testimony from  
23 the witness allocated at 25 minutes. Following that,  
24 we'll have ten minutes per party for closing remarks.

25 Is there any -- is that an accurate summary of

1 the time estimates? Or are there any concerns with the  
2 time estimates provided?

3 MR. DAVIS: No. We're -- we're fine with that.

4 JUDGE KWEE: Okay. Great.

5 Then we are ready to start. If there's no  
6 questions of the Office of Tax Appeals before we get  
7 started, then I will turn it over to Appellant's  
8 representative to begin their opening presentation.

9 You have ten minutes -- until 9:50.

10 Thank you.

11 MR. DAVIS: Thank you.

12  
13 OPENING STATEMENT

14  
15 MR. DAVIS: Good morning, members of the panel.

16 The evidence will show that ACFN is a registered  
17 California franchise or -- of a proprietary business  
18 model, which provides private ATM services.

19 The ATM services, which are the business of ACFN,  
20 are consumer ATM credit/debit transaction for individual  
21 checking and savings account records, which were all  
22 regulated directly by the FDIC. That is the core of their  
23 business.

24 JUDGE KWEE: Oh. Mr. Davis, I'm sorry to  
25 interrupt. I'm getting feedback that I -- they can't hear

1 you on the livestream. Is it possible that you could move  
2 your microphone just a little bit closer to you so that  
3 we're able to have a record on our livestream of what  
4 you're saying?

5 MR. DAVIS: Can you hear me now?

6 JUDGE KWEE: Oh. That is -- I believe that's  
7 perfect.

8 MR. DAVIS: Oh. You're not kidding. It's a very  
9 limited directional mic.

10 JUDGE KWEE: It is very picky. We have a lot of  
11 people mention that, and I apologize. But what you just  
12 did -- that helped a lot. Thank you.

13 MR. DAVIS: Based on the audit reports, as -- as  
14 well as the decisions that have been handed out so far,  
15 there is a fundamental misunderstanding of what ACFN's  
16 business is. They are a financial services business.  
17 They are regulated by the FDIC. That means they're in the  
18 banking business, they don't sell ATM's.

19 An ATM is merely a tool. It's for  
20 telecommunications only. It's actually a dumb circuit.  
21 So the evidence today -- and we'll go through it -- will  
22 show that all of the services that are provided here are  
23 actually provided -- provided in the network beyond the  
24 ATM -- beyond the ATM. The ATM -- no services happen  
25 inside of that ATM.

1           So ACFN's not in the retail business of selling  
2     ATMs. Any ATMs that come as part of, if they happen to  
3     take them as part of the franchise, are fully consumed by  
4     those parties. ACFN doesn't make them, they don't install  
5     them, they don't supply them in any fashion.

6           They do make them available, and the franchisees  
7     can decide to use them or not. We'll get into more detail  
8     about that.

9           ACFN charges a franchise fee for the legal right  
10    to conduct and act and be part of that business. A  
11    franchise is a legal right. It's actually a series of  
12    licenses. The predominance of what the franchise covers  
13    based on its historical -- how it was put together  
14    historically is that it is intangible.

15          All of the licenses that come -- all of the  
16    services that come off of those licenses that are  
17    allowed -- are intangible. So in exchange for that fee, a  
18    license is granted that allows the franchisee the legal  
19    right to offer federally regulated consumer credit and  
20    debit financial services. That is the core of the  
21    business, not ATMs.

22          And franchise was statutorily created. And it  
23    started out merely as being part of the securities  
24    regulation in the state because they were offered as  
25    private placements. Then the Attorney General, in 1969 --

1 there were so many issues with how those presented and  
2 sold. There was an Attorney General's opinion.

3 After the Attorney General's opinion, California  
4 took the lead and both was the first state to create an  
5 entire section in its code dealing with franchises. And  
6 that -- those franchises are regulated as similar to any  
7 security. That's very similar to what happens under the  
8 FCC.

9 As a matter of fact, the United States Government  
10 adopted California's model in 1972. So that model  
11 requires two things: It requires, obviously, an  
12 agreement -- an SPA, a purchase and sale agreement --  
13 which is called a "Franchise Agreement," that details in  
14 detail what those licenses entail. And those licenses  
15 entail a series of pieces of intellectual property and  
16 rights to intellectual property.

17 Once again, the ATM is merely a tool. It does  
18 only one thing. It's no different than a telephone  
19 switch. It does one thing. It opens a channel so that  
20 whoever the card member is at the other end of that can  
21 communicate securely with its own bank -- that bank has a  
22 different system. It has to be inside of that system.

23 The ATM has no smarts in it for that purpose. It  
24 does one thing. It opens a channel for you to be able to  
25 communicate with your own bank. According to all of the

1 FDIC regulations, once again, it's only a tool. And we'll  
2 step through that piece by piece.

3 And that system is secure. Meaning, all banks  
4 communicate in mainframe language. Some of them still are  
5 not digitized. They go through digital to analog  
6 translation. And that's way beyond this.

7 The point there is an ATM has no ability to  
8 interact other than to open a channel -- period -- for the  
9 card holder to communicate with its own bank through the  
10 internet or through two-twist wire -- obviously, a  
11 telephone line -- most, now, it's internet. And  
12 everything else happens at the bank in a secure location.

13 So with that, that's what the evidence at the  
14 appropriate point -- we're ready to begin testimony.

15 JUDGE KWEE: Okay. I will let CDTFA have their  
16 opening presentation, and then I'll turn it back to you  
17 for testimony from the witness.

18 Okay. So when you're ready to begin, CDTFA.

19  
20 OPENING STATEMENT

21  
22 MR. BACCHUS: Good morning.

23 The only issue in this Appeal is whether  
24 automated teller machine, or ATM, franchise fees are  
25 taxable as part of the sale of ATMs.

1 Appellant is a California corporation that  
2 operates an ATM franchise, selling ATM franchise licenses  
3 to franchisees. According to Appellant's Exhibit 5, which  
4 is their Franchise Agreement, for a total contract amount  
5 of \$\$29,500 Appellant provides the following: A license  
6 to operate under its franchise, one ATM, one extra cash  
7 cassette, operational software, financial forms, financial  
8 and banking transaction processing services, and training.

9 Of the \$\$29,500 contract amount, \$\$4,995  
10 represents the cost of the ATM. The Franchise Agreement  
11 requires franchisees to purchase additional ATMs, cash  
12 cassettes, and other related equipment and supplies  
13 exclusively from Appellant.

14 In the audit found in the Department's Exhibit C,  
15 the Department concluded that the franchise fees were part  
16 of the sale of ATMs and that the entire contract amount  
17 was taxable. Appellant's Disclosure Document, found in  
18 Appellant's Exhibit 6, lists Appellant's new franchisees  
19 during the liability period. The Department used this  
20 list to calculate unreported taxable franchise tax fees of  
21 just over \$196,000.

22 Revenue and Taxation Code Section 6051 imposes  
23 sales tax on a retailer for its retail sales of tangible  
24 personal property in this state. Section 6091 states that  
25 all other retailer's gross receipts are presumed subject

1 to tax. Section 6012 defines "gross receipts" as the  
2 total amount of the sale price without any deduction for  
3 the cost of the property sold, the cost of the materials  
4 used, labor or service cost, or any other expense.

5 Sections 6011 and 6012 state that the total  
6 amount of the sale price includes any services that are a  
7 part of the sale of tangible personal property.

8 Regulation 1501 provides that services that are not part  
9 of the sale of tangible personal property are not subject  
10 to sales tax.

11 In these cases, the person rendering the service  
12 is the consumer of any tangible personal property that  
13 person uses incidentally in rendering the service. The  
14 true object of the contract, whether the purchaser's real  
15 purpose is to acquire the service per se, or the tangible  
16 personal property, is the test used in determining whether  
17 a particular transaction involves the sale of tangible  
18 personal property or the performance of a service with an  
19 incidental transfer of tangible personal property.

20 To be clear, anything other than the incidental  
21 transfer of tangible personal property would constitute a  
22 taxable sale of tangible personal property. Here, there  
23 is no dispute that the transactions at issue included the  
24 transfer of an ATM and other tangible personal property.  
25 Moreover, the ATM cannot be said to be incidental to the



1 provision of a service. The ATM is the mechanism used to  
2 conduct the banking business.

3 Appellant is in the business of selling. The  
4 license or franchise Appellant sells is for the rights to  
5 place an ATM in a specific location to conduct those  
6 banking services. Without the ATM, the franchisees have  
7 no way to benefit from the purchase of a franchise.

8 Given the facts, there can be no reasonable  
9 argument that the ATMs are incidental to the performance  
10 of a service. Because the contracts at issue involve a  
11 transfer of tangible personal property that was not  
12 incidental to the provision of a service the transaction  
13 is subject to sales tax including any services that were a  
14 mandatory services part of the sale of tangible personal  
15 property.

16 There is no dispute that Appellant provided the  
17 ATMs, or sold the ATMs, only to those that entered into a  
18 Franchise Agreement and paid the required contract amount.  
19 Appellant has not provided any evidence that the franchise  
20 fees were optional or that acquiring the ATMs were  
21 optional. And in fact, the Franchise Agreement indicates  
22 that the franchise fees and the ATMs are integrated and  
23 not separable.

24 Accordingly, the franchise fees are mandatory to  
25 obtain the transfer of the ATMs, and the entire contract

1 amount is subject to sales tax. This result is consistent  
2 with how the Department has historically handled  
3 transactions involving franchise fees and the transfer of  
4 tangible personal property.

5 Annotation 330.3330 states that the initial  
6 franchise fee and the additional payment fee for the use  
7 of machines which are leased by a corporation to its  
8 franchisees are taxable. The backup letter to this  
9 annotation, which was written in 1969, indicates that the  
10 franchisee was required to pay a franchise fee of \$350 to  
11 become a franchisee and to gain use of equipment necessary  
12 to run the franchise.

13 Similarly, in the appeal at issue here, the  
14 franchisee must pay the franchise fee to obtain an ATM,  
15 which is necessary to run the franchise.

16 In its briefing, Appellant relies on the court  
17 case of Dell v. The Superior Court County of the -- of the  
18 City and County of San Francisco, but Appellant's reliance  
19 on Dell is misplaced. Dell merely holds that, with  
20 respect to a mixed transaction -- and in Dell that  
21 involved charges for an optional warranty contract -- the  
22 application of tax to charges for optional nontaxable  
23 service is not dependent upon whether the charges are  
24 separately stated unless a statute or regulation expressly  
25 requires that such charges be separately stated.

1           Dell simply does not apply to bundle  
2 transactions, which are at issue here, where a mandatory  
3 service is part of the sale of tangible personal property.  
4 And Dell certainly does not stand for the proposition  
5 that, in a bundled transaction, services that are part of  
6 the sale can be rendered nontaxable because a portion of  
7 the lump sum price can be readily allocated to the  
8 services.

9           Here, there's no dispute that the franchisees  
10 could not get the ATMs without -- without also paying the  
11 franchise fee. The fee was mandatory, and these  
12 constitute bundled transactions. Thus Dell is  
13 inapplicable to this appeal. The franchise fees are part  
14 of the sale of the ATMs and are subject to sales tax.

15           Based on the foregoing, the Department requests  
16 that the Appeal be denied. Thank you.

17           JUDGE KWEE: Okay.

18           So then I will turn it back to Appellant's  
19 representative for the witness testimony.

20           MR. DAVIS: Thank you.

21           JUDGE KWEE: Oh. And before we get started, I  
22 would swear in the witness.

23           Mr. Kerr, if you would, raise your hand.

24       ///

25       ///

1                               JEFFERY KERR,  
2   called as a witness on behalf of the Appellant, having  
3   first been duly sworn by the Administrative Law Judge, was  
4   examined and testified as follows:

5  
6               THE WITNESS:   I do.

7               JUDGE KWEE:   All right.   Thank you.

8  
9                               DIRECT EXAMINATION

10  
11   BY MR. DAVIS:

12       Q     Mr. Kerr, what is your position at ACFN?

13       A     Owner and CEO.

14       Q     How long have you been in that position?

15       A     Since 2003.

16       Q     Are you also considered a pioneer in the field?

17       A     Yeah.   For what we do, yes.

18       Q     What is an ISO?

19       A     Independent Sales Organization.

20               (Reporter interrupted)

21               ISO is an Independent Sale Organization.   So it's  
22               a company that aggregates services for small  
23               operators.

24               (Reporter interrupted)

25               What's an ISO?

1 Q What is an ISO?

2 So ACFN is an ISO?

3 A Correct.

4 Q And being an ISO, did you have to register with  
5 the FDIC?

6 A Yes. With all the national networks, Cirrus plus  
7 STAR, all those get a sponsorship -- sponsoring bank and  
8 comply with a whole bunch of the regulations in the  
9 banking industry, yes.

10 Q So -- so all of those licenses actually came with  
11 the franchise?

12 A They obtained them by becoming a franchisee.  
13 Correct.

14 Q Okay. When -- let's start from the beginning.  
15 What is a franchise? And what do you have to do  
16 in order to get one of those?

17 A Right. So obviously, it's a way of operating a  
18 business. It's business "know-how." It's clearly  
19 intangible property. And we teach people how to -- what  
20 we do, mostly, is marketing services. We do some  
21 accounting, and, of course, we do some compliance work.

22 Franchisees don't come to us -- even 1 percent of  
23 the decision is not based on the type of equipment we use.  
24 That's not even a question in our conversations.

25 It's where do we operate? How much revenue is

1 generated? What kind of income can they expect to earn by  
2 joining our business? And the machine is definitely  
3 ancillary. It's -- it's a side thing.

4 Do we use a Triton? Do we use a Nautilus  
5 Hyosung? Do we use Genmega? Do we use this -- this  
6 configuration? That configuration?

7 We have our preferences, but it's not at all what  
8 the business -- it's not about the ATM. It's about the  
9 income it generates, which relates to the location where  
10 it's placed, and of course, operating in a compliant way,  
11 the safe way. And that's what we teach people to do.

12 Q In registering and becoming a franchise owner,  
13 did the State require you to do certain things in order to  
14 get the -- the B license tax write-off?

15 A Absolutely. So we have to have a Franchise  
16 Disclosure Document; we have to have a Franchise  
17 Agreement; we have to file paperwork every year with the  
18 State; we have to pay fees to be a licensed franchisor;  
19 and, yeah, we have to do a lot of things every year.

20 Compliance -- we have counsel for that. That's a  
21 separate issue from here.

22 When a person calls us -- I think it's an  
23 important point to make -- when a person wants to buy an  
24 ATM, they don't come to ACFN. That's a ridiculous  
25 assumption, or -- or -- or understanding, of what we do.

1           If you want to buy an ATM, you Google "buy an  
2 ATM," you'll never find ACFN. If you call me to say, "I  
3 want to buy an ATM," I'm going to say I can't sell you one  
4 because you're not one of my franchisees.

5           If you want to buy an ATM from someone else, you  
6 can conclude the transaction in 5 minutes, you pay your  
7 sales tax, you're done.

8           You want to buy one from me, you got to go  
9 through the disclosure process, you got to read the FDD,  
10 you got to have the 14-day wait period, you got to pay a  
11 franchise fee, you got to complete training, and then --  
12 then you can buy an ATM machine.

13           But we don't -- we facilitate the purchase of ATM  
14 machines through Triton so that franchisees can get good  
15 pricing. We're not in the business of selling ATM  
16 machines. It's something we do, but you want to buy an  
17 ATM machine, you're not going to buy it from ACFN. You  
18 have to buy a franchise.

19           So there's some distinctions here.

20           Q     Was there ever a situation where someone came to  
21 buy a franchise and didn't want the ATMs?

22           A     Yep. That does happen. Actually, happens a lot,  
23 now. It used to happen less, before; but it absolutely  
24 happens. And there's a few scenarios:

25           One is they're buying -- we do acquisitions; so

1 they're buying locations that already have the ATMs. So  
2 they're buying based on the multiple of the income  
3 generated by those locations, not which ATM is there or  
4 what the cost of the ATM is.

5 It's based on the revenue generated. That's how  
6 the value is determined. And the machines just come with  
7 the locations because we acquired them that way.  
8 Sometimes they're in the ATM business before they join us;  
9 so they may have equipment.

10 By the way, I want to correct one statement that  
11 was made in the opening and -- that they have to buy all  
12 the machines from ACFN -- that's factually incorrect. The  
13 agreement actually states they can buy from alternative  
14 services, but they have to be approved.

15 They have to be approved so they comply with our  
16 network and fit within our skill set so that we are able  
17 to support when there are disputes or what have you. So  
18 it has to be approved, but they can buy from alternative  
19 service. They don't have to buy from ACFN.

20 Q So further question, on the services that are  
21 there, the financial services, all those financial  
22 services, indeed, have separate individual licenses and  
23 contracts you have to -- to -- obtain in order to put this  
24 network together; is that correct?

25 A Correct.



1 Q Okay.

2 A Yes.

3 Q So this network actually happens where?

4 A At the network level.

5 Q Okay.

6 A The ATM just calls in.

7 Q So -- so -- so the -- the ATM is like a  
8 telephone; correct?

9 A Yep.

10 Q Okay. Nowadays have we moved further than just  
11 an ATM? Is -- are there other devices that are used?

12 A Yes. We -- we -- we have two other products that  
13 we are promoting now: Cell phone charging stations and  
14 vending machines that specifically vend over the counter  
15 pharmaceuticals.

16 Because they fit in the same skill set. They  
17 process the same transactions over the same networks. And  
18 franchisees have the skill set to operate them. And we  
19 have the skill set to secure contracts to place them that  
20 appeal to the same customers we work with.

21 So we have other products, yeah.

22 Q What's actually inside an ATM?

23 A Cash, obviously. And very specific computer  
24 boards that can't do anything other than the intended call  
25 the network -- so they ask if this transaction can be

1 approved -- specific purpose components. That's it.

2 Q So specifically, the only thing in there is a  
3 switch? Actually, a connection to either the internet or  
4 a telephone; is that correct?

5 A Yeah. Wireless device.

6 Q Okay. And that device merely opens a circuit;  
7 correct?

8 A Yeah.

9 Q And that circuit goes to the internet; correct?

10 A Yeah. Mostly.

11 Q It's a portal?

12 A Yeah.

13 Q So that ATM does nothing else? There are no  
14 other services provided there?

15 A No, that's correct.

16 Q Okay.

17 A Just makes a phone call.

18 Q It only makes a phone call. So it is actually  
19 incidental.

20 A It's a communication device, yeah.

21 Q That's it.

22 Now, the other services that are there and the  
23 software that's actually provided and, ad nauseam, in the  
24 disclosure document as required -- does it actually do  
25 the -- the software there? Does -- is it actually loaded

1 onto that ATM?

2 A By a manufacturer before it's shipped. And  
3 it's -- there's nothing there that is specific to ACFN.  
4 It's totally standard.

5 And, yeah. There's different ATM manufacturers,  
6 different models. They all have the same software. It  
7 just does one simple function. So it's not --

8 Q That's just for the --

9 A We don't write the software. We don't develop  
10 it. We don't produce it.

11 Q And you don't -- and you don't load any software  
12 on?

13 A No. No.

14 Q The software -- the software I'm discussing or  
15 asking about is lead?

16 A Oh.

17 Q That comes out on the -- the audit report is lead  
18 generation, et cetera. What is that software?

19 A Right. So that has nothing to do with the ATM.  
20 That's the way we track our leads and do our marketing to  
21 secure locations for our franchisees to install our  
22 machines.

23 And that's also nonproprietary. It's all -- it's  
24 like Sales Force but different -- that you use we just put  
25 our leads --

1 Q Where does it reside?

2 A The cloud -- just somewhere.

3 Q It's -- it's -- it's for a laptop?

4 A Yeah. You can access from anywhere.

5 Q Yeah. But -- but you don't get there from the

6 ATM?

7 A No. No.

8 Q And it's not loaded on the ATM?

9 A No. It has nothing to do with the ATM.

10 Q So ACFN doesn't manufacture?

11 A No.

12 Q You don't install?

13 A No.

14 Q You don't service in any way?

15 A No.

16 Q Okay. And try to -- do they actually drop-ship

17 these?

18 A Correct.

19 Q Okay.

20 A It's shipped direct to the franchisee.

21 Q So hence, the issue we had early on with sales

22 tax versus use tax that took two years to settle; is that

23 correct?

24 A I'm sorry. I didn't follow the question.

25 Q Your franchisees, from the very beginning, had

1    been instructed, when they purchase something, they have  
2    to pay a sales tax on it; correct?

3           A     Correct. They're required to open an account  
4    with what used to be with the Board of Equalization and  
5    pay sales tax directly in their retails.

6           Q     Okay.

7           A     We don't do that.

8           Q     But there is a dispute whether it was sales tax  
9    or use tax; is that correct?

10          A     I don't know.

11          Q     Okay.

12          A     Sorry.

13          Q     Anyway, the -- the issue is ACFN's not in the ATM  
14    business. Was the ATM only offered as convenience?

15          A     Only as part of the franchise to generate the  
16    income. There are hundreds of companies in the ATM  
17    business that just sell ATMs, and we're not one of them.  
18    It's not what we do. It's not our business model.

19                And by the way, I don't think there's any dispute  
20    the franchise fee as an intangible property is not  
21    taxable. And if we charge 299 -- \$29,500, and the  
22    agreement clearly identifies the ATM as \$4,995, seems to  
23    me that a reasonable conclusion, that is -- that the rest  
24    of that is the franchise fee, the business know-how, and  
25    intangible.

1           Seems reasonable to me. Layman's terms  
2 understanding -- obviously, I'm not an attorney -- but if  
3 it's \$29,500, and the agreement clearly states the ATM is  
4 \$4,995, then the rest is the franchise fee -- the rest is  
5 intangible property. That's a reasonable conclusion in my  
6 opinion. And the fact that we're licensed as a  
7 franchisor.

8           So I don't know how to make the leap that the  
9 whole thing is taxable.

10          But, anyway, I just want to --

11          Q     Does ACFN even include an ACFN in anything it  
12 does, now, in terms of franchise?

13          A     You mean ATM? No.

14          After the audit, we changed that to make sure  
15 there's no possible misunderstanding moving forward. We  
16 just took it out, yeah.

17          Q     And that -- that did not change the price of  
18 the -- of the franchise?

19          A     No. No.

20          Q     So once again, just to be clear, ACFN does not  
21 install any software either?

22          A     No. No.

23          Q     So what's included -- excuse me -- what's  
24 included in the initial training?

25          A     So the heart of the training is generating leads

1 and our marketing services.

2 Like I said, nobody comes to ACFN to buy an ATM.  
3 You can buy an ATM from hundreds of companies. All of  
4 them would sell them for less than we do. We sell them at  
5 higher prices because we do all the marketing to find the  
6 locations.

7 The ATM has no value unless it's at a location  
8 producing revenue; right? So we charge more. That's why  
9 you wouldn't come to us to simply buy an ATM. But with  
10 that, in training, we focus on marketing services: Where  
11 do we want to put them?

12 In our case, mostly in hospitality. We have ATMs  
13 in more than 2,000 hotels. It's a safe environment,  
14 it's -- we can charge higher fees, we get more --  
15 conversion rate is higher. So we train franchisees to  
16 scout for these locations. We train them to collaborate  
17 with us to help us secure these agreements.

18 We go over, of course, compliance. That's a very  
19 important part of what we do. We have to do things in a  
20 certain way so if there's an audit, or Visa or MasterCard  
21 or one of the networks or a bank looks at you, you have  
22 all the right stickers, you have the correct parameters on  
23 your machine, you're keeping correct records, you could  
24 respond to journal dispute.

25 So we go over all the compliance stuff. We

1 explain, of course, to build the value, the network  
2 licenses that we bring to the table, what bookkeeping  
3 services we're going to provide. Because we pay the  
4 locations. We do all the computations for them. They're  
5 not, you know -- they don't have staff to do that kind of  
6 stuff.

7 And of course, we do train them how to program a  
8 terminal and -- when you receive it and install it.

9 But the heart of training is absolutely  
10 generating leads and marketing and compliance.

11 Q But after that training, they have to get  
12 somebody to install it; correct?

13 A Yeah. They can hire somebody or do it  
14 themselves. Depends on their skill set, you know?

15 Q What is the -- what is the "operations manual"  
16 that's included in there, also?

17 A It's a reference for them to -- how to operate  
18 their business and goes through all the things they need  
19 to know to operate their business properly.

20 Q Okay. In that reference manual, it is designed  
21 for ACFN; correct?

22 A Yeah. That's our program.

23 Q Is that considered a trade secret?

24 A Absolutely.

25 Q Okay. So that's also part of the intellectual



1 property?

2 A Absolutely.

3 Q Okay. In putting together the disclosure  
4 document and getting it through the State based on  
5 statutory requirements, all of the services, the network  
6 services, we're talking about have been separately  
7 delineated? I mean by that, they've been separately  
8 discussed in, or referenced to, in the disclosure  
9 document?

10 A Yes.

11 Q Okay. The Franchise Agreement is, really,  
12 designed as a purchase and sale agreement; is that  
13 correct?

14 A For a franchise, yes.

15 Q Okay. It's specifically designed and meets the  
16 State requirements?

17 A Oh, absolutely.

18 Q Per statute?

19 A Absolutely.

20 Q So the disclosure document is also based on  
21 excruciating detail both in the code and the regulations  
22 of the statute; is that not correct?

23 A It's prepared by counsel that specializes in that  
24 area, yes.

25 Q Okay.

1           A     Very costly.

2           Q     The services, the network service, and the  
3 financial banking services we've discussed -- can each one  
4 of those be separated and stand on their own?

5           A     They're each distinct. Absolutely.

6           Q     Can they all be subcontracted? If you didn't  
7 want to do portion?

8           A     Oh, no. No. No. No. No. It's not  
9 economically practical for an small operator to do any of  
10 that -- too much fees, too much compliance cost. Not  
11 really, no.

12          Q     But it could be done?

13          A     It could be done. Sure.

14          Q     Okay. And so they can stand on their own? They  
15 are distinct from each other?

16          A     Correct. Yes.

17          Q     So they're not actually bundled?

18          A     No, they're not.

19          Q     But in order to complete certain of your -- if  
20 you only did debits and not credits, or you limited your  
21 financial services, would you have to offer all of the  
22 services that you're doing?

23          A     We have to be members of all the national  
24 networks; otherwise, we'd have too many transactions  
25 declined. So we have to offer all of them, but each one

1 of them has a separate agreement and different pricing and  
2 different rules and, yes.

3 Q So they're pretty distinct from each other?

4 A They are. They are, but we need all of them to  
5 function properly, yeah.

6 Q So you -- okay. All right.

7 A Yep. We pay fees every year to each network and  
8 have to sign their agreement and compliance and all that.

9 Q Okay. We had one exhibit that we noted. And it  
10 is of significance because it details one of these  
11 transactions. As a matter of fact, that was one of the  
12 issues, but it speaks directly to the services.

13 And this would be Exhibit 9. And I would draw  
14 your attention to -- in Exhibit 9, there was a letter, and  
15 there were attachments. And the attachment we're  
16 directing you to is Attachment B.

17 I'm going to hand this -- for the record, I'm  
18 handing a paper copy of Appellant's Exhibit 9 and looking  
19 at Exhibit B to the letter N.

20 JUDGE KWEE: Okay. Exhibit 9, Attachment --

21 MR. DAVIS: Attachment B.

22 JUDGE KWEE: Okay.

23 MR. DAVIS: For the record, I'm handing it to the  
24 witness, Jeff.

25 ///

1 BY MR. DAVIS:

2 Q In looking at that, is a that a typical  
3 transaction?

4 A Yes.

5 Q As a typical transaction, does that clearly state  
6 and separate what those individual services are doing?

7 A Yes.

8 Q Okay. So those -- those services are distinct,  
9 they are separate, and they end up with separate cash  
10 flows; correct?

11 A Correct.

12 Q Okay. So they're not bundled, are they?

13 A No.

14 Q Okay. And your other services are all  
15 intangibles; correct?

16 A To my understanding, yes.

17 Q Okay.

18 A Absolutely.

19 Q And everything else that's licensed is  
20 intangible?

21 A Correct.

22 Q Okay. So as you said earlier, a logical reading  
23 of the Franchise Agreement and the fact that it has to be  
24 registered and its history is an intangible. Logically,  
25 they can be separated, and they do stand in operate

1 separately?

2 A Correct. Everything outside the \$4,995.

3 In fact, the position the State is taking, if I  
4 can say it -- that the whole thing is taxable -- means  
5 that we have no intangible property at all? Our franchise  
6 model, our business know-how has no value at all?

7 If they want to tax the whole thing, well, that's  
8 what it is. That's the sole reason people come to us.  
9 How would that have no value at all? I don't understand  
10 that at all.

11 Q So once again, in summary, question -- all  
12 network operations take places on the network; correct?

13 A Yes.

14 Q And that network lies beyond -- I'm using a  
15 term -- lies beyond the ATM?

16 A Correct.

17 Q So the ATM is no different than a telephone?

18 A Doesn't make any decisions. That is correct.

19 Q So decisions -- and ACFN loads no software there?

20 A Nope.

21 Q It does not install them?

22 A No.

23 Q So it takes no -- it takes no position with and,  
24 actually, is not part of in any way the OEM chain --  
25 Original Equipment Manufacturer?

1           A     No.   No.   No.

2           Q     So with Triton -- what is your actual position  
3 with Triton?

4           A     Officially, we're a distributor.  So we -- by  
5 aggregating the purchases of all our franchisees,  
6 facilitating all of them to buy from Triton, we get better  
7 pricing.  It's a volume thing.

8           Q     Once again, that goes to convenience?

9           A     Yes, of course.

10          Q     And it has never been an absolute requirement --

11          A     No.

12          Q     -- based on your disclosure document, that a  
13 franchisee has to buy your equipment?

14          A     No.  They can buy from an alternative source  
15 that's approved so that it fits within our network, and  
16 they can do what it needs to do.  But they don't have to  
17 buy it from us.

18          Q     And the requirement there is one so that they fit  
19 and operate with the network -- is the requirement?

20          A     Correct.

21          Q     Okay.  And the franchise statute and the  
22 franchise requirements for it to be a franchise -- do they  
23 require uniformity?

24          A     Franchise Agreement?

25          Q     Yes.

1           A     We're looking for uniformity, yes.

2           Q     Okay.

3           A     That's an operational thing just to make sure  
4 that we can operate the business.

5           MR. DAVIS: No further questions at this time,  
6 your Honor.

7           JUDGE KWEE: Okay.

8           I'll turn it over to CDTFA.

9           CDTFA, do you have any questions for the witness?

10          MR. BACCHUS: No questions.

11          JUDGE KWEE: Okay.

12          I did have a couple of questions. I just -- for  
13 the witness -- I'm hoping you could clarify.

14          In the agreement with the customer, is there  
15 any -- is there anywhere where it's specifically laid out  
16 in detail what is provided in exchange for the initial --  
17 initial franchise fee, \$29,500.

18          THE WITNESS: So you're talking about the  
19 franchise agreements?

20          JUDGE KWEE: Yes.

21          THE WITNESS: Yeah. It definitely spells out all  
22 the services that we provide to them.

23          JUDGE KWEE: Okay.

24          So I guess, when you were just testifying, you  
25 had talked about the intangible aspect -- the services

1 aspect.

2 THE WITNESS: Correct.

3 JUDGE KWEE: And you had also mentioned the ATM  
4 and -- and the training. And is the ATM and the  
5 training -- are those also provided as a part of the  
6 initial franchisees?

7 THE WITNESS: It is. And there's, now -- this is  
8 a long time ago -- now, we charge a separate \$995 fee for  
9 training. I mean, at the time it was included, if memory  
10 serves. Yeah. I think it was included.

11 MR. DAVIS: Your Honor, in the original  
12 documents, you had two things. It is -- it runs on the  
13 same securities. You have a purchase and sale agreement,  
14 which actually has some detail in it. That is the actual  
15 Franchise Agreement that has to take a certain format  
16 based on that statute.

17 However, the statute requires the equivalent of a  
18 private placement memorandum, and it has all the things in  
19 it. The disclosure document -- those go hand in hand, and  
20 they reference each other. And the greater detail is in  
21 the disclosure document.

22 THE WITNESS: That's correct. That's correct.

23 MR. DAVIS: That one goes down to -- if you need  
24 to find the licenses, you can find it in, or it's required  
25 to be in, the private placement memorandum.



1           That's the equivalent. That's where it touches,  
2 in the securities law. It's very, very strict how that  
3 has to be done. And it's done on a 50-state basis because  
4 the U.S. government follows that.

5           Also, that is -- if the state does not have a  
6 franchise law, the federal law is used. And that's based  
7 on California.

8           THE WITNESS: The FDD does have a table, your  
9 Honor, that breaks down all the services and all the fees  
10 that we charge for them. That's in the franchise  
11 disclosure document.

12           If I had a copy, I could tell you which one it  
13 is, but it's all in there.

14           JUDGE KWEE: Okay. Thank you.

15           I do have the Franchise Agreement and franchise  
16 disclosure document.

17           THE WITNESS: Of course.

18           JUDGE KWEE: So -- so I'm just understanding, for  
19 the \$\$29,500 initial franchise fee, they'll get the  
20 training for \$995 -- a \$995 value, the ATM, which I  
21 believe you said a \$\$4,995?

22           THE WITNESS: At the time. It's a lot less now.

23           JUDGE KWEE: Okay. And they'll also get the  
24 intangible aspects of the services that -- that you were  
25 discussing.

1           So is there anything else?

2           THE WITNESS: The lead generation, the marketing,  
3 the compliance. All right?

4           So the reason they joined our business, your  
5 Honor -- there's only one reason, and that's the  
6 marketing. Our ability to get their ATM in a Hilton  
7 hotel, for example.

8           If they buy it themselves, they could buy it from  
9 anywhere for less. The only reason they join us is  
10 because we can help them get that in a good location where  
11 they can charge a higher surcharge and get more  
12 transactions, i.e., make more money. That's the only  
13 reason they join us.

14           So we -- that's a big part of our services. They  
15 don't join us to buy ATMs. They don't need us for that.  
16 They could conclude that in five minutes over the internet  
17 for a lot less money.

18           So, yeah. Sorry.

19           JUDGE KWEE: Okay. I'll turn to the panel.

20           Does the panel have any other questions for this  
21 witness?

22           I'll start with Judge Brown.

23           JUDGE BROWN: Thank you.

24           I think I was just going to follow-up and say --  
25 ask either the witness or the Appellant's Representative,

1 do you want to point us to some specifics about where in  
2 the disclosure document does it show that it's never been  
3 required for a franchisee to buy the ATM from ACFN?

4 THE WITNESS: Yeah. I can find it. Says --  
5 search this thing.

6 Okay. So first of all, item 5, you can see where  
7 it clearly identifies the value of the ATM as \$4,995. So  
8 I just want to point that out it's page 4, item 5. That's  
9 right there. That's the value of the machine. The rest  
10 is all intangible property business know-how.

11 Item 6 lists all of the services that we provide  
12 and the fees we charge for them. So that goes back to the  
13 other question that I was asked.

14 Okay. Let's see. Items 5 and 7 -- let me see.  
15 Numbers 5 and 7 -- I think that's a little --

16 Do you have that one?

17 MR. DAVIS: Yeah. Franchise Agreement -- they  
18 cross reference each other. They cross reference.

19 And if you go through the footnotes of my opening  
20 brief, many of those cites are directly there. And they  
21 cross reference each other. And they -- they draw you  
22 back to the Exhibit so you can actually go into the  
23 Exhibit and find those.

24 Also, the --

25 THE WITNESS: Oh, okay. Sorry.

1           There's a page 19, item 2, here -- says that we  
2 provide you with buying advisory services. We provide you  
3 with a list of sources of approved suppliers for ancillary  
4 goods services and equipment.

5           So that's -- there's another place. I could keep  
6 looking, but that's just one place right there that tells  
7 you. We provide you with lists of sources. You don't  
8 have to buy from a particular source. You don't have to  
9 buy it from us. You have to buy something that's  
10 compliant with our systems. We have to approve it so we  
11 can support it.

12           But again, in some cases, they don't even need  
13 equipment because they're buying locations that already  
14 have them.

15           I don't know if you have -- is it possible to  
16 send that to the court later so we don't bore them  
17 flipping through the heart of pages here? Or is that --

18           MR. DAVIS: You want those exact cites?

19           JUDGE KWEE: I'll let Judge Brown respond.

20           JUDGE BROWN: If -- I guess I want to say that if  
21 the if Appellant finds additional citations that we  
22 haven't already pointed out, we can accept them after.  
23 But if that is -- if you've already pointed us to them,  
24 then that's sufficient.

25           THE WITNESS: That's one place. There's another

1 place that's more specific; but -- it's in the franchise  
2 agreements.

3 JUDGE BROWN: Yeah. Well, then it's -- I'm  
4 sorry. I think I found it, actually, in Appellant's  
5 additional brief.

6 Nope. That's not it. Sorry.

7 In Appellant's opening brief --

8 THE WITNESS: So under Equipment Section 2.2 of  
9 the Franchise Agreement, equipment and other accessories  
10 may purchase such equipment from us.

11 Oh, okay. Here. So same thing -- shall purchase  
12 or lease such equipment from us or our affiliate at our  
13 current prices or at our direction from sources and  
14 suppliers approved or designated in writing by us.

15 So you can buy from somebody else as long as we  
16 approve it. And the only approval is to make sure that  
17 it's going to work.

18 MR. DAVIS: Can you clearly cite that again?

19 THE WITNESS: 2.2 -- Section 2.2. It says,  
20 "Equipment of the Franchise Agreement." They can buy from  
21 other people as long as its compliant with what we do, and  
22 we can operate it.

23 JUDGE BROWN: I -- I found the page you were  
24 reading from. I think that answers my question.

25 Thank you. No further questions.

1 JUDGE KWEE: Judge Lambert, did you have any  
2 questions?

3 JUDGE LAMBERT: Hey.

4 I have a question about if the franchise  
5 terminates. And does the ATM not work for the franchisee  
6 anymore in that way? And they have to go somewhere else  
7 and purchase another franchise to make it work for them  
8 again?

9 THE WITNESS: Great question. So if the  
10 agreement expires and they don't renew, they have to  
11 either sell the locations with the ATMs or remove them.  
12 Because the ownership of the location rights is with ACFN.

13 And the -- 99 percent of the time, they either  
14 renew or sell the business so they don't lose anything.

15 So again, the ATMs are not even part of the  
16 evaluation, it's what revenue is being generated. If you  
17 don't want to continue, we sell that revenue stream to  
18 somebody else, and you get your money and you get to go do  
19 something else.

20 MR. DAVIS: Better example than that --

21 THE WITNESS: If we were to remove our TIE's,  
22 what's called from the ATMs, they would some functioning,  
23 obviously. But we don't do that. We sell the account to  
24 somebody else, and they get the machine with it -- with  
25 the purchase; right?

1 FURTHER DIRECT EXAMINATION

2  
3 BY MR. DAVIS:

4 Q In a merger acquisition, what, if any, value is  
5 to the ATM and the MNA?

6 A It's the revenue stream. Everything is based on  
7 the revenue. But we -- we just reprogram the machine to  
8 work through our network as opposed to the seller's  
9 network.

10 Q But the machine itself, actually, doesn't even  
11 have scrap value at that point?

12 A No.

13 Q Okay. For accounting purposes --

14 A No.

15 Q Because they're -- they -- they're not carried at  
16 scrap value. Even in the accounting that's required for a  
17 franchise, there's special accounting rules for franchise.  
18 They carry things on-ledger, off-ledger. They use  
19 accounting that applies to banks also.

20 So their equipment is treated differently in a  
21 merger acquisition?

22 A Of course. We don't own the machines.

23 MR. DAVIS: Yeah. So -- but you're selling the  
24 territories.

25 JUDGE LAMBERT: Okay. Thanks.

1 I had one question. Is it, when someone buys a  
2 franchise, that equals one ATM? Or can they buy more than  
3 one ATM if they have a franchise?

4 THE WITNESS: Absolutely. You can buy as many as  
5 you want.

6 There's no reason to buy ten upfront when you  
7 don't have locations to put them in. You have to have one  
8 to get started. That's why the one was there.

9 But we did have, back when this audit was  
10 happening, exclusive territories. And if somebody wanted  
11 that, they'd buy five machines with the franchise thing  
12 just to demonstrate that they have the capital to justify  
13 an exclusive territory.

14 We don't do that anymore, but that was part of  
15 the agreement at the time. So they could buy one, they  
16 could buy five, or they could buy any number. It's based  
17 on how big they want to grow.

18 And we don't recommend buying more than one.  
19 When that goes in, you buy the next one. Because it's all  
20 about finding new locations and generating income.

21 Again, if you have ten machines, you're just  
22 taking up space in your garage. There's no value there.  
23 You buy one. When it goes in, get the next one. That  
24 goes in, get the next one. That's how we run the  
25 business.



1 JUDGE LAMBERT: Thank you.

2 THE WITNESS: Maybe I should -- perhaps I should  
3 note -- maybe it was part of your question -- the revenue  
4 we generate from ATM sales is -- I looked at 2019 before  
5 we came here because that's the last normal year, 2019 was  
6 -- 3.75 percent of our revenue was from ATM sales.

7 It's really not -- 90 percent was transaction  
8 revenue. There was some franchise fees in there.  
9 3.75 percent was equipment sales. That's really a tiny  
10 part of what we do. That's not what people come to us  
11 for.

12 JUDGE KWEE: This is Judge Kwee.

13 I did have a follow-up question on Judge Brown's  
14 line of questioning.

15 So did you -- during the audit period at issue,  
16 did you have franchisees who would come, prospective  
17 franchisees, and say that we'd want to sign up, but we  
18 want to use our own ATM machines, so we don't want to  
19 receive any ATM from you?

20 THE WITNESS: So that's rare. They would have to  
21 already be in the business to have their own equipment.  
22 So that was rare. I don't know if that happened during  
23 the audit period.

24 What did happen, definitely, during the audit  
25 period is we had acquisitions where we bought accounts

1 from competitors, and their ATMs that were originally  
2 purchased by the competitors -- not through ACFN, not by a  
3 franchisee, by the competitor -- transferred into our  
4 network to the franchisee that bought those locations.

5 That definitely happened during that period of  
6 time.

7 JUDGE KWEE: Okay. So I guess I was  
8 contemplating the initial scenario, when they first become  
9 a franchisee.

10 THE WITNESS: Sure.

11 JUDGE KWEE: And if someone did do that, is the  
12 fee still "nineteen-five"? Or do you reduce it? Would  
13 you have reduced it?

14 THE WITNESS: If they really did not need a  
15 machine, we would take that part off the price.

16 JUDGE KWEE: Okay.

17 THE WITNESS: But even if they're buying  
18 locations with existing machines, if they want to grow,  
19 they still need one to grow with.

20 But if they really didn't need one or want one,  
21 of course we take it off. They're not getting that value;  
22 so we take it off.

23 JUDGE KWEE: Okay. Thank you.

24 THE WITNESS: But it wouldn't be free it. Would  
25 be \$4,995 off.

1 JUDGE KWEE: Okay.

2 THE WITNESS: So the machines not \$29,500,  
3 anyway.

4 JUDGE KWEE: Thank you.

5 THE WITNESS: Yeah.

6 JUDGE KWEE: Are there any other questions from  
7 the Panel?

8 JUDGE BROWN: No further questions. Thank you.

9 JUDGE KWEE: Okay. And for Appellant's  
10 representative, did you have any follow-up questions for  
11 your witness? Before I move to --

12 MR. DAVIS: No redirect, your Honor. You allowed  
13 me redirect at the time; so I'm fine.

14 JUDGE KWEE: Okay. Great.

15 I did have one question for CDTFA.

16 I believe in -- in your opening presentation, you  
17 were referring to the, you know, the Dell case and  
18 Regulation 1501, which I believe has to do with the  
19 provision of services and the true object of the contract.

20 Can -- but I believe what they were saying is  
21 that there's also intangible aspects transferred. And I'm  
22 not sure that Regulation 1501 applies if you're having  
23 intangible aspects -- intangible aspects together.

24 I'm not sure if you have a response to that or if  
25 that would change, at all, the analysis that you have

1 talked about.

2 MR. BACCHUS: So 15 -- Regulation 1501 does apply  
3 to services.

4 Based on Mr. Kerr's testimony, it would appear  
5 that most of that fee is -- constitutes services. So we  
6 would -- the Department believes that the franchise fee  
7 constitutes services; so 1501 would apply.

8 JUDGE KWEE: Okay. Thank you.

9 And for the panel, just -- any questions for  
10 CDTFA before we move on to closing?

11 JUDGE BROWN: No questions. Thank you.

12 JUDGE KWEE: Okay.

13 And, Judge Lambert, do you have any questions?

14 JUDGE LAMBERT: Not at this time. Thanks.

15 JUDGE KWEE: Okay.

16 So then I will turn it over to Appellants for  
17 their final closings before -- you have ten minutes.

18  
19 CLOSING ARGUMENT

20  
21 MR. DAVIS: Thank you.

22 California's Franchise Investment Law defines a  
23 franchise as a contract. Okay? It's granted the right to  
24 engage in a business, offering, selling, and distributing  
25 services under a plan or a system substantial --

1 prescribed in substantial part by the franchisor  
2 associated with the franchisor's trademarks, commercial  
3 marks, symbols. And they're required by statute to pay a  
4 franchise fee.

5         The California Corporations Code requires  
6 registration of all franchise offerings. And key  
7 requirement that registration is that the franchise fee be  
8 paid directly to the franchisor by the franchisee in  
9 exchange for the right -- the right to engage in a  
10 proprietary business and to use certain intellectual  
11 property rights in a defined field of use.

12         It's designed -- the whole thing is about the  
13 license. It's a license. It's an intangible. That's  
14 what the entire statute is saying -- it's the purpose.

15         And if you look at the history of how the statute  
16 is put together, everything there is an intangible except  
17 for the ATM, which is a tool. And each individual  
18 franchisee pays tax on that.

19         As we said, there are alternatives, and it's not  
20 required that you actually buy it. In both documents,  
21 whether it be the Franchise Agreement as expounded on by  
22 the Disclosure Document and Disclosure Document, is put  
23 together in the fashion and separates things out in the  
24 fashion that California's statute and regulations require.

25         You can see that the majority of what is -- what

1 is -- what is transferred to the franchisee under the  
2 statute -- the Franchise Statute is intangible. It is  
3 geared around intellectual property and rights. And each  
4 one of those intellectual property rights -- even the  
5 patent rights and other trade secret mark rights -- they  
6 have separate agreements that roll up.

7 Those are defined. And tell you which ones you  
8 have to participate in for the FDIC. So there's really no  
9 choice there. These licenses have to be separately stayed  
10 out.

11 Everything there, except for the ATM and the  
12 sub-equipment that goes with the ATM, which is a cash  
13 drawer. Everything's intangible, and all the services  
14 stand on their own. They're separately defined. They  
15 stand on their own.

16 So as logic looks at that Franchise Agreement and  
17 that license, that license predominantly -- other than if  
18 we're looking at it by value -- 3 percent of its total  
19 value is a value -- even in its -- its -- its -- its  
20 internal rate of return, et cetera, no matter how you look  
21 at it -- is less than 3 percent.

22 So is that 3 percent -- is the tail wagging the  
23 dog not logical? That's not a logical reading of that  
24 statute, and it's not handled that way in 50 states. And  
25 they're using our statute, California. We set the tone

1 for this nationwide. And this is -- this goes against  
2 logic.

3 We've been fighting this for eight years. We're  
4 trying to tell people we don't sell ATMs. There are  
5 alternatives. We cited them out, and you've even asked  
6 questions. It's the first time anybody's bothered to read  
7 this.

8 If you go through and read Exhibit 8, Exhibit 8  
9 has two letters in it. And it will tell you how badly  
10 misread these two documents were and how that's carried  
11 through as -- as -- as -- as the -- the mantra from the  
12 State all the way through this misreading of what's  
13 actually in these two documents -- those two letters back  
14 and forth between us documenting what happened with the  
15 auditors.

16 The auditors finally came around. They actually  
17 helped us file the claims for refund because they  
18 understood what was going on, finally. They sat down.  
19 The -- the -- the document that set out the example that  
20 we sat here and went through, Exhibit 9 -- the auditors --  
21 they got it finally.

22 But those were very badly misread. And those two  
23 letters that I quote from and the Exhibit that has the two  
24 letters with the back-and-forth documenting what we  
25 described with the State -- you'll see exactly where the

1 rails went off -- where the train went off the rails from  
2 the very beginning.

3 And it happened in the audit reports, which was  
4 just taking a company line, and followed all the way  
5 through the facts. And -- and -- and the distinction  
6 defies logic.

7 So those -- the -- the four exhibits -- the four  
8 exhibits that I would point you to that -- that speaks  
9 directly to these documents and your questions are as  
10 follows:

11 Exhibits 5 and 6 -- the -- the franchise -- the  
12 Franchise Agreement and the Disclosure Document.  
13 Franchise 9 -- I mean, article -- Exhibit 9, which --  
14 which is the exhibit that deals with the example. Exhibit  
15 B --

16 JUDGE LAMBERT: Could you -- could you please  
17 speak in the microphone.

18 MR. DAVIS: Excuse me.

19 JUDGE LAMBERT: I'm hearing we're not hearing you  
20 speak on the stream.

21 MR. DAVIS: Attachment B to Exhibit 9.

22 And the other one is Exhibit 8. And Exhibit 8  
23 has the two audit discussion letters right after the audit  
24 reports with the San Jose auditors.

25 So there's Exhibit 8, Exhibit 9, Exhibit 5,



1 Exhibit 6 -- that's where the heart of this testimony came  
2 from or was based upon.

3 And with that, I close.

4 JUDGE KWEE: Okay. Thank you.

5 So I will turn it over to CDTFA. You have ten  
6 minutes for your closing presentation. Thank you.

7 MR. BACCHUS: Thank you.

8  
9 CLOSING ARGUMENT

10  
11 MR. BACCHUS: The -- the Department just would  
12 like to reiterate that we are looking at specific  
13 transactions. The transactions are described in the  
14 Franchise Agreement and the Disclosure Document.

15 And it is clear in those documents that for a --  
16 for a contract amount, the franchise fee of \$\$29,500, that  
17 includes a transfer of an ATM and a cash cassette.  
18 Transfers of tangible personal property, like an ATM,  
19 constitute a sale of tangible personal property. That  
20 sale is subject to sales tax. And included in that amount  
21 are any services that are a part of the sale of the  
22 transfer of tangible personal property.

23 There had been no -- there is no evidence. And,  
24 in fact, Mr. Kerr's testimony supports the fact that these  
25 services are mandatory and not optional. Mandatory

1 services that are part of the sale of tangible personal  
2 property are subject to tax. And that is supported by the  
3 evidence that Appellant has submitted.

4 And there is no evidence that the -- that the  
5 services were somehow an optional part of the transfer of  
6 the ATM.

7 The testimony today was that you could not get  
8 the ATM without also paying for the services. So that  
9 constitutes a bundled transaction.

10 And as -- as the Department has said and  
11 continues to state, in those types of transactions,  
12 services that are part of that sale, or part of the  
13 transfer of the TPP, the tangible personal property, are  
14 taxable.

15 Thank you.

16 JUDGE KWEE: Thank you.

17 Just bear with me one moment.

18 Do the panel members have any questions? Before  
19 I --

20 Do you -- do you mind if I just get a quick  
21 clarification from the witness about a testimony that was  
22 provided today?

23 Okay. So was there testimony that it would not  
24 be possible to purchase an ATM without the franchise fee  
25 also? Just, I believe, CDTFA had mentioned that was

1     stated today. I just wanted to clarify whether or not  
2     that was stated.

3             THE WITNESS: We don't sell ATMs to anybody  
4     that's not a franchisee. You have to be a franchisee,  
5     first.

6             JUDGE KWEE: Okay. Thank you for that  
7     clarification.

8             I believe we're ready to conclude today.

9             So the panel -- are there any more questions from  
10    the panel?

11            Okay. Thank you. Thank you for coming in today.

12            We're ready to close the record for this Appeal.  
13    The record is now closed. This is submitted Wednesday  
14    July 20th, 2022.

15            We will have a decision issued within a hundred  
16    days. So after today, the Judges will meet and discuss  
17    this case. And we'll send you a written opinion of our  
18    decision in the mail.

19            So this concludes the oral hearing for this  
20    hearing, but there will another hearing shortly at  
21    approximately 11:00 a.m. or sooner.

22            Thank you.

23            MR. BACCHUS: Thank you.

24            (Proceedings concluded at 10:47 a.m.)  
25

1 REPORTER'S CERTIFICATION

2  
3 I, the undersigned, a Registered  
4 Professional Reporter of the State of California, do  
5 hereby certify:

6 That the foregoing proceedings were taken before  
7 me at the time and place herein set forth; that any  
8 witnesses in the foregoing proceedings, prior to  
9 testifying, were duly sworn; that a record of the  
10 proceedings was made by me using machine shorthand, which  
11 was thereafter transcribed under my direction; that the  
12 foregoing transcript is a true record of the testimony  
13 given.

14 Further, that if the foregoing pertains to the  
15 original transcript of a deposition in a federal case,  
16 before completion of the proceedings, review of the  
17 transcript [] was [x] was not requested.

18 I further certify I am neither financially  
19 interested in the action nor a relative or employee of any  
20 attorney or party to this action.

21 IN WITNESS WHEREOF, I have this date subscribed  
22 my name.

23 Dated: August 8, 2022

24 *Sarah Tuman*  
25

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