

MEMORANDUM

SUPREME COURT - STATE OF NEW YORK
COUNTY OF NASSAU

PRESENT:

HON. IRA B. WARSHAWSKY,

Justice.

TRIAL/IAS PART 10

In the Matter of the Application of
EDWARD MURPHY, et al.,

Petitioners,

INDEX NO.: 002640/2006

Shareholders in United States Dredging Corporation,

-against-

UNITED STATES DREDGING CORPORATION,
et al.,

Respondents.

DECISION AFTER TRIAL

This matter was tried before the court over a three day period, November 27-29, 2007. The court was familiar with the parties having presided over a derivative action brought by these same movants against the officers and directors who are also the majority shareholders.

FINDINGS OF FACT

This is a special proceeding for judicial dissolution of a Corporation commenced by Regina M. Adams, Joan Murphy, Eileen Gallagher Poczatek, Maraline Murphy, Maureen Gibbons, Nannette Meyers, and Edward Murphy ("Petitioners" and/or "Petitioner" and/or "Minority Shareholders"), against certain Shareholders of United States Dredging Corporation ("Respondent" and/or "USD" and/or "Corporation"), by Petition filed on February 14, 2006 (the "Commencement Date") (see Petitioners' Exhibit "1") and Amended Petition (see Petitioners' Exhibit "2"), brought pursuant to Business Corporation Law ("BCL") § 1104-a on the grounds that the Directors or those in control of the Corporation have been guilty of oppressive actions

toward the Petitioners as minority shareholders.

USD is a corporation, incorporated in New York State on October 24, 1934. As of February 13, 2006, the Valuation Date as fixed by this court in its ruling on December 14, 2007, the Corporation had 4,333.333 shares issued and outstanding.

The Petitioners collectively represent a 36.77% interest in the Corporation (see Petitioners' Exhibit "4").

USD and the Corporation's shareholder Directors, James F. Murphy, John J. Murphy (now deceased) and Michael J. Gallagher ("Directors"), as well as non-petitioning shareholders Jayne Gallagher and Rosemarie Codus contested the allegations of oppression, but after Respondent USD's motion for dismissal of the Petition was denied by Order of this court dated October 25, 2006, an answer was filed which did not contest Petitioners' 36.77% ownership of the shares in USD.

Respondent, USD, with leave of the court, elected, pursuant to BCL § 1118, to purchase Petitioners' shares of USD, thus, consenting to the dissolution, but not to a buyout price.

Despite attempts at settlement, the parties were unable to agree upon a price of those shares (see Petitioners' Exhibit "3"), thus necessitating this valuation proceeding and a hearing which provided the court with dueling experts.

All of the shares of USD are subject to an agreement dated April 16, 1956, between the original shareholders (the "Agreement"), requiring that any shareholder wishing to sell his or her shares in the Corporation must first offer their shares to the existing shareholders of the Corporation. Said agreement plays no role in the matter currently before the court.

In 2005, USD sold its main asset, real property located in Red Hook, Brooklyn, New York, to IKEA for \$31.25 million.

At the time of this closing on June 2, 2005, USD held two substantial assets: the \$29.1 million net proceeds from the IKEA sale and real estate located in Avon, Connecticut that was net leased to CVS and had been acquired as part of a tax exempt exchange upon the disposition of other real property owned by USD in New Jersey.

The purchase price of the Avon, Connecticut property was \$3.9 million, and USD twice mortgaged this property for a total of \$3.5 million (see Petitioners' Exhibit 4).

In June 2005, USD held cash assets in excess of \$33 million as well as an interest in the

real property located in Avon, Connecticut that had been acquired in 2001.

The Directors, who have controlled the Corporation for in excess of twenty (20) years, decided to have USD reinvest \$25.8 million of the proceeds via tax-free exchanges pursuant to Section 1031 of the Internal Revenue Code (26 U.S.C. § 1031), by acquiring properties in Toledo, Ohio, Vernon, Connecticut and Sun City, Florida.

The Toledo property is held in the name of a wholly owned subsidiary of USD, Dredging Toledo, LLC.

In conjunction with the Toledo property acquisition, USD received \$16 million in mortgage financing proceeds (see Petitioners' Exhibit "4"), which sum is apparently held by USD in an account at Alliance Bernstein.

The Corporation's revenues are essentially fixed and subject to long-term leases (see Petitioner's Exhibit 4).

The Avon, Connecticut property is "triple net leased" to CVS Caremark through January 31, 2023.

According to trial testimony, a triple net lease means that the lessees pay all expenses for the property (see Fielstein testimony, page 315, lines 8-10).

The lease is renewable, at CVS's option, in five-year increments, through 2073. Rent for the first three renewal periods is fixed at \$306,900 per year. Thereafter, rent is to be at fair market value (see Petitioners' Exhibit 10 and Respondent's Exhibit BBB).

The Toledo, Ohio, property is triple net leased to Wal-Mart through January 15, 2024. The lease is renewable, at Wal-Mart's option, in five-year increments, through 2099, at a fixed rent of \$1.4 million per year (see Petitioners' Exhibit 13 and Respondent's Exhibit FFF).

The Vernon, Connecticut property is triple net leased to Walgreen's through September 1, 2075. Walgreen's has the option to terminate the lease at the end of every five years after September 1, 2030. The minimum annual rent, through the term of the Walgreen's lease, is \$403,000.

Rent due under the lease could exceed the minimum based on a pre-agreed formula of 2% of gross sales, excluding the sale of food items, plus 0.5% of gross sales of food items and non-third party prescription items (see Petitioners' Exhibit 14 and Respondent's Exhibit GGG).

The Sun City, Florida, property is a single-family residence. It is triple net leased to a

non-petitioning shareholder of the Corporation, who in a previous proceeding, testified in support of USD's management and who has received health insurance benefits from the Corporation although not an employee.

This Sun City, Florida, lease is for four (4) year terms through August 31, 2025, at a fixed rent of \$16,800 per year. The terms of the Sun City, Florida, lease specify that the tenant has the option, at any time during the lease, to purchase the property.

The Sun City, Florida, purchase price is fixed at \$280,000 through August 2008. Thereafter, the purchase price will be adjusted annually to reflect increases in the Consumer Price Index. Alternatively, the landlord has the right, at any time after August 2007, to require the tenant to purchase the property. In this case the purchase price would be fixed at \$280,000 and the Corporation has the right to redeem the shareholder's shares as consideration if the shareholder defaults in its obligation to purchase the property (see Petitioners' Exhibit 17 and Respondent's Exhibit YY).

Trial testimony characterized this real estate portfolio as low return but low risk (see Fielstein testimony, page 316, lines 18-19) and proffered that, based on the fact that three of the four rentals are significant and substantial retailers (CVS, Wal-Mart and Walgreen's), the Corporation has a very stable operation from the perspective of cash flow (see Fielstein testimony, page 315, lines 12-15).

By exchanging the properties, previously owned by USD, for other properties in what is known as a 1031 exchange, the corporation was able to avoid paying over \$11 million in capital gains taxes on said sales. When one or more of the properties is sold the built in gains tax would then have to be paid on that property or properties. The built-in gains tax is commonly referred to as the B.I.G. or the B.I.G. tax.

At trial, the expert witnesses for both Petitioners and Respondents opined that the valuation of a real estate investment company such as USD could be best valued utilizing either the Adjusted Book Value Method (Cost Approach) or the Income Approach (see Fielstein testimony, page 319, page 330; see McAteer testimony, pages 26-27) or both. Both experts utilized the same valuation methodologies in their respective reports, the net asset (cost) approach and the income (discounted future cash flow (or "DFCF")) approach. However, as one would expect in a case of this nature, each expert weighted the two approaches differently and

reached different values as to each area.

Respondents expert, Mr. McAteer, testified that in the event that the court did not accept the entire built in capital gains tax [B.I.G.] as a liability of the company (which he chose to do), in the net asset approach, then he would weight the DFCF method 85% and Mr. Feilstein did not disagree with that approach, but did not opine on the number. It was also suggested that the DFCF method could be used as the sole method in determining the fair value of the Corporation (see TR. 582-88). It would appear that the parties agree that the court has the discretion to choose the method or methods to be used in valuing the company. See In Re Seagroatt, 78 N.Y. 2d 439, 445 (1991). In Matter of LaSala, 2/6/2003, NYLJ, p. 24, col. 1, the court found the “cost” or book value approach was best for a real estate investment company.

The Petitioners’ expert, Howard Fielstein of Margolin, Winer & Evens LLP, testified that based on the Adjusted Book Value Method (Cost Approach), the fair value of the Corporation’s equity as of the Valuation Date was equal to \$24,758,500 (see Exhibit 3 of Petitioners’ Exhibit 4).

Mr. Fielstein further testified that based on the Income Approach, the fair value of the USD’s equity as of the Valuation Date is approximately \$20,007,000 (see Exhibit 9 of Petitioners’ Exhibit 4).

Thus, in the opinion of Mr. Fielstein, the Petitioners’ combined ownership interest of 36.77% has an indicated value of \$9,103,700 under the Cost Approach and \$7,356,000 under the Income Approach (see Petitioners’ Exhibit 4), both as of the Valuation Date.

Respondents argue that the court must reject Mr. Feilstein’s conclusions, in that he disregarded New York law in not using a willing buyer test, and he omitted both liabilities of USD as well as including certain assets improperly.

To reconcile these aforesaid values, Petitioners’ expert, Margolin, Winer & Evens, applied a weighting of 55% to the Income Approach method and a weighting of 45% to the Cost Approach method, under the belief that the long-term nature of the real estate and mortgage financing transactions which the Corporation has entered into argues for giving slightly greater weighting to its expected long-term cash flow than to an estimate of the current values of its discrete, and highly encumbered assets (see Petitioners’ Exhibit 4).

Applying a weight of 55% to the value determined under the Income Approach and a

weight of 45% to the fair value determined under the Cost Approach, he concluded value of the Petitioners' shares as of the Valuation Date was equal to \$8,143,000 (see Petitioners' Exhibit 4 at Exhibit 9).

In reaching his conclusion, Petitioners expert made no deduction nor discounted the value of the Corporation based upon the illiquidity of the shares, sometimes known as an illiquidity discount or lack of marketability discount; and he only deducted a discounted value of the B.I.G. tax rather subtract the entire amount in determining the fair value of USD.

Conversely, Respondent's expert Mr. McAteer, of Holtz Rubenstein Reminick LLP determined the fair value of Petitioners' shares to be \$3,761,000 (see Petitioners' Exhibit 25) as of July 13, 2006, five months after the Valuation Date of February 13, 2006. He used a 15% illiquidity discount and subtracted the entire B.I.G. tax in reaching his conclusion (the court fixed February 13, 2006 as the Valuation Date after Mr. McAteer filed his report).

The Respondent's expert, in determining Petitioners' interest in the Corporation to be \$3,761,000.00 valued the Corporation before adjustments using a Cost (Asset) Approach at \$15,015,000 and Income Approach at \$11,403,000 (see Petitioners' Exhibit 25), weighing the Income Approach at 50% and Cost (Asset) Approach at 50% as of the Valuation Date (see McAteer testimony, page 29, line 8).

Numerous factors provide for the difference in the valuations that were reached by the two experts. One was the fact that on March 29, 2006 the board of directors voted to adopt a pension plan, obviously benefitting only the directors and their estates (Exhibit RR). The respondents' expert reduced the value of the Corporation by the value of the pension plan and considered the pension plan a liability of the Corporation though the pension plan did not exist as of February 13, 2006.

Another is the fact that the directors continued to compensate themselves at a rate which this court had found improper in its decision dated July 6, 2005. However, it must be recalled that the court's decision of July 2005 has no prospective impact, and the court has never ruled as to the propriety or impropriety of the salary that was being given to the directors at any time after the court's decision nor at any time that postdated the period of time that was covered by the court's decision. This does not in any way mean that this Court believes that the salaries taken by the directors were appropriate or fair compensation for the work that they did.

However, there is no decision that can be used by the Petitioners which would allow them to reduce the salaries of the directors for the purposes of the fair value computation. Another factor that was considered by the respondents expert in reaching his fair value computation was the fact that the court granted a motion that allowed the directors to be reimbursed for their legal fees relating to the prior action which this Court has previously referred. The court will rule separately on the status of the deductibility of the attorney's fees for the directors and that of the value of the pension plan as a liability. The court's only concern at this point is that what it had ruled were overpayments of salary to the officers and directors, have been refunded to the Corporation. If they have not yet been refunded to the Corporation, either by reducing compensation that was to have been paid to them or they having actually repaid set amounts, then those amounts are to be included in the value of the Corporation. However, the difference in valuation is not only attributable to the above recited factors which occurred after the valuation date.

In December of 2005, in a letter to all shareholders (Exhibit JJ), the President of USD offered to repurchase the shares of Petitioners based on a liquidated value of \$12,300,000 (see Petitioners' Exhibit 6, 62, and 62A), without considering a \$1 million dividend which was declared in January, 2006. Petitioners' 36.77% of the \$11.3 million would be \$4.155 million, slightly less than McAteer's (unweighted) net asset value of \$4.325 million (Exhibit A at Exhibit 2A and Exhibit 5 of Exhibit A), which was discounted. After discounting, the McAteer fair value computation was slightly over \$3.5 million.

The Respondents choose to differentiate the December 2005 offer from President James F. Murphy, which was considered a liquidation value offer, from the fair value computation of Mr. McAteer. They point out that there were numerous costs that would have to be deducted from the December 2005 buyout offer before anything would actually be paid (lawyers' fees, accountants' fees, etc.). All though it is not essentially relevant to the courts final decision in this case, the Court believes that only attorneys and accountants could have come up with these deductions and that if an agreement had been reached, much of the proposed "deductions" would have been avoided. It is regretful that the animosity that existed and still exists amongst these family members prevented them from considering the December 2005 offer. Now, we do have attorneys fees and experts fees that will reduce what ever award is made by the court.

The valuation for this proceeding is to be at "fair value" of a going concern. BCL § 1118. Respondent's expert valued both the Corporation and Petitioners' interest in the Corporation at less than the Corporation's own calculation of value based on liquidation. Though the respondents expert denies that his calculations resemble a liquidation value, and points out that none of the costs of liquidation were included in his calculations, he chose to treat the built in gains tax (B.I.G.) as though it was being paid in one lump sum at the time of the purchase of the Petitioners shares and deducted it in its entirety.

Petitioners continuously harp back to the value of the Corporation as of June 2005. It is at that time that the majority of the assets of the Corporation were held in cash, shortly after the IKEA sale had culminated. They then proceed to raise an argument that the reason that the cash does not exist today is because the directors have chosen to invest a large portion of that amount in real estate. All that is a matter of fact. It has no relevance to the courts decision. There is no action before this Court that the directors were derelict in their duties or acted improperly in any way as to the investment of the IKEA sales proceeds. No part of that argument will be considered by the court. However, when an expert comments on lack of marketability or instant liquidity due to the type of asset as had Mr. McAteer, the court will consider that it was the investment decisions of the directors, who have controlled the company for twenty years, that has resulted in this non-marketability. The creators of the cause of the non-marketability should not gain from their handiwork.

It is agreed that the cash dividend paid to the Petitioners in January 2007, paid after the valuation date, will be considered a credit to the purchase price.

EQUIPMENT - There were differences in assets and liabilities of each report . As per the August 2007 deposition of James F. Murphy (see Petitioners' Exhibit 23), the crane and tug were valued at \$40,000. Petitioners' expert took half as a conservative number, of \$20,000. Petitioners' expert added \$28,000 for five cars that were not on the books, for a total of \$48,000 (see Fielstein testimony, page 381, lines 16-21). Respondents argue that only three cars were shown on the books and records of USD as of the 2005 tax return (exhibit W.). They further argue that the crane is owned by an entity other than USD. Furthermore there is no evidence that the tug or a second crane referred to in the Petitioners appraisal are of any marketable value. Petitioner Relies on the testimony of James Murphy to support these miscellaneous claims of

asset value. They have chosen to ignore the erratta sheet that Mr. James Murphy filed when his deposition was returned to petitioner. Let's understand we are not dealing with an erratta sheet which corrects a typo. This is a wholesale change of testimony. However, it was not considered by Petitioner and it cannot be ignored.

The court accepts the value for a crane and tug at \$20,000. The court rejects the value of the cars as set by Mr. Feilstein at \$28,000. The fact that the cars were not shown in the 2005 tax return does not prove they were not still assets of the Corporation. However, there is no evidence that the cars were still registered to the Corporation or its subsidiary corporation and, therefore, the court rejects them as assets of USD for the purpose of the valuation.

There is currently a claim pending against an insurance carrier for \$150,000, concerning property damage for a crane. This claim has been disputed, and there is no indication at this time that the carrier is or is not going to pay on that claim. Petitioners' expert discounted that figure by 20% to give it a present value of \$120,000 (see Fielstein testimony, page 381, lines 22-25) and included it with the Corporation's assets. The court agrees with Respondent that there was no basis to include such a large amount for this contingent claim in the net asset approach. However, this is a corporation, as the parties are well aware, that survived by collecting on insurance claims and liquidated damages from breached options to buy the Red Hook property. It is not unreasonable to conclude there will be a partial recovery. The court directs that a \$50,000 value be placed on the insurance claim.

It is generally agreed that in the area of Fair Value calculation, what was known or reasonably knowable on the valuation date should be taken into consideration by the court. The issues of the pension and the legal fees compensation fall into this category.

Indemnification to officers for legal fees was disclosed as a contingency, which means it was in the footnotes. There was no accruing amount in the 2005 financial statements, but there was a claim for reimbursement reflected in the December 31, 2005 financials (R.Ex.L at p.11) and was reflected in the June 30, 2006 general ledger, after the Valuation Date (see Fielstein testimony, page 382, lines 9-16).

The officers and employees have been and are in a separate SEP pension plan. The new pension plan was instituted (April,2006) after the Valuation Date and would reward three of the officers over the next ten years at the rate of \$100,000 per annum, for a total payment of

approximately \$3 million, present value today of approximately \$2 million (see Fielstein testimony, page 383, lines 3-7).

In sum, the calculations that account for the difference in valuation are: (1) reduction of value by all \$11.6 million versus part of built-in gains tax; (2) discount for lack of marketability; (3) net difference in assets and liabilities; (4) differences in discounted cash flow methodology; (5) the treatment of cash held by the Corporation as operating assets to be excluded from value or non-operating assets to be included in valuation (the Respondents' expert put all \$16 million of current cash holdings into operating assets, while Petitioners' expert put only \$2.1 million into operating assets); and (6) other miscellaneous adjustments.

PENSION PLAN

It cannot be denied that the issue of the proposed pension plan had been discussed for at least a year prior to the Board of Directors voting to approve it on March 29, 2006. Though the new pension plan postdates the valuation date the court finds that it is to be included in the Fair Value calculation. More specifically, the pension plan, present valued and tax adjusted, as a liability shall be included in the Net Assets-Fair Value calculation.

DIRECTORS LEGAL FEES FROM PRIOR ACTION

It also cannot be denied that the possibility of the directors requesting to have their legal fees reimbursed by the Corporation was known to both the Petitioners and respondents in this matter. However, unlike the pension plan, where the Petitioners were helpless to prevent its enactment, and thus it was a *fait accompli*, the reimbursement of legal fees to the respondents from the prior action that was tried before this Court was not such a certainty. It could not be considered to be known or knowable. Rather it would be considered out right speculation on the part of the parties to assume that over a year after the valuation date had been set legal fees would be awarded. Therefore the court finds that the legal fees awarded to the respondent officers and directors are not to be deducted from the assets of the Corporation in the Fair Value calculation.

Toward the end of the trial both sides agreed that the court could make specific finding and the respective experts will then recalculate their valuations pursuant to the court's findings. The court accepts that offer and will make specific request at the end of the decision.

CONCLUSIONS OF LAW

In 1979, Business Corporation Law section 1104-a and section 1118 were enacted for the specific purpose of enabling minority shareholders of closely held corporations to obtain relief, when they found themselves in a situation of being denied participation in or being frozen out of corporate management. See In the Matter of Lawrence R. Blake, as Holder of 25% of All Outstanding Shares Entitled to Vote in an Election of Shareholders of Blake Agency, Inc. v. Blake Agency, Inc., 107 A.D. 2d 139 (2d Dept. 1985) (statutes were impacted to afford a minority shareholder the right to bring a proceeding to dissolve the corporation and to distribute its assets among the shareholders.) To counterbalance this forced purchase format, BCL § 1118 was created, allowing the corporation the option of electing to purchase the minority's shares, thereby avoiding dissolution.

Section 1118. Purchase of petitioner's shares; valuation:

(a) in any proceeding brought pursuant to section 1104-a of this chapter, any other shareholder or shareholders or the corporation may, at any time within 90 days after the filing of such petition or at such later time as the court in its discretion may allow, elect to purchase the shares owned by the petitioners at their fair value and upon such terms and conditions as may be approved by the court.

(b) if one or more shareholders or the corporation elect to purchase the shares owned by the petitioner but are unable to agree with the petitioner upon the fair value of such shares the court, upon the application of such prospective purchaser or purchasers, shall stay the proceedings brought pursuant to section 1104-a of this chapter to determine the fair value of the petitioners shares as of the day prior to the date on which such petition was filed, exclusive of any element of value arising from such filing.

Determining "fair value" of the Petitioners shares in a closely held corporation presents a difficult problem. In "Valuation: New York Business Divorce", an on line newsletter, posted on May 5, 2008, Peter Mahler, Esq. wrote:

A federal appeals court once remarked that 'the valuation of a closely held company is an inexact science', adding, 'some might say an art' (*Okerlund v. U.S.*, 365 F3d 1044 [Fed. Cir. 2004]). Looking at the gallery of New York valuation law, the artist must be Jackson Pollack.

In Amodio v. Amodio, 70 NY 2d 5, 7 (1987) the court noted that what was required was "a discriminating consideration of all information bearing upon an enlightened prediction of the

future”. In other words, what the Court of Appeals is asking is that the trial term court be a soothsayer. This court will do its best to comply.

As may be noted by the casual reader the statute does not define the term “fair value.” The Blake court noted, that in making the necessary determination on what is “fair value” courts should generally look for guidance to the criteria set forth by the cases interpreting the BCL § 623 and appraisal rights statute: “the factors to be considered are, inter alia, market value, investment value, and net asset value. See Matter of Endicott Johnson Corp. v. Bade, 37 N.Y.2d 585 (1975).

As pointed out in Blake, supra, when dealing with a closely held corporation, market value is usually of little or no significance because the shares of stock are not traded on any public market. In fact, a sale of the stock of a closely held corporation usually does not qualify as an arms length transaction because the sale usually involves officers, employees or other family members. Rather, net asset value is generally the standard applicable in evaluating manufacturing corporations or real estate and investment holding companies.

Investment value is usually a function of the earning power of the corporation. Thus, acceptable methods of determining investment value include (1) a ‘discounted income approach’, by which either average earnings of the corporation measured over a number of years, or a weighted average of corporate earnings (giving greater weight to corporate earnings of the most recent years) is capitalized at a predetermined percentage, and using the capitalization rate, a multiplier is developed and that multiplier is then applied to earnings; (2) capitalization of dividends, if the corporation has a history of payment of dividends; or (3) a ‘comparative appraisal’ approach, which utilizes a comparison with the price-to-earnings ratios of publicly traded stocks in similar industries and financial situations of the closely held corporation (*see generally*, Haynsworth, *Valuation of Business Interests*, 33 Mercer L Rev 457; Schreier and Joy, *Judicial Valuation of ‘Close’ Corporation Stock: Alice in Wonderland Revisited*, 31 Okla L Rev 853; 12B [rev vol] Fletcher, *Cyclopedia of Private Corporations* §§ 5906.12-5906.15, at 386-404 [permanent ed]). Blake, supra at 147

More recently, “Fair Value” has been defined by the Courts as the minority shareholder’s proportionate interest in the going concern value of the corporation as a whole, that is, what “a willing purchaser, in an arm’s length transaction, would offer for the corporation as an operating business.” Matter of Pace Photographers [Rosen], 71 N.Y.2d 748 (1988), quoting Matter of Blake v. Blake Agency, 107 A.D.2d 146, (2d Dept. 1985). See also Matter of Penepent Corp.,

96 N.Y.2d 186, 193 (2001) citing to Seagroatt, supra, 78 N.Y.2d at 445.

Under the facts of this case, Petitioners' expert Margolin, Winer & Evens LLP determined that it would be inappropriate to impose a discount for lack of marketability to its fair value calculation and further determined that "the willing purchaser" test was inappropriate under our facts. The purchasers he envisioned were the respondent stockholders or the corporation. He points out that there is nothing hypothetical about this sale. The Buyer, USD, exists and has exercised the right to acquire the Petitioners' equity interest. USD has sufficient liquid assets to pay the Fair Value of Petitioners' shares as fixed by the Court. Thus, a "marketability" discount is inappropriate in this case.

Petitioners' expert also relies on the USD shareholder's agreement. The agreement states (a) existing shareholders have the first option to purchase shares that a shareholder may wish to sell; (b) the purchase price of any stock of the corporation offered for sale thereunder is to be determined based on the fair value of the corporation's assets less its liabilities.

In that the agreement does not mention any discounts that were to be applied to the purchase, Mr. Fielstein concluded a lack of marketability discount was inappropriate. He further concluded that since the corporation had previously repurchased stock from shareholders and that there was cash available for the purchase in non-operating assets, there was a "ready market" for the Petitioners' shares - the corporation and the other shareholders.

To call the corporation in BCL §§ 1104 and 1118 a "ready market" for the purchase of the minorities' stock and, thus, the basis to deny a lack of marketability discount, is disingenuous. The only reason the market exists is pursuant to statute. It is not a voluntary sale as contemplated by a buy-sell agreement or as seen in the shareholder's agreement of USD. See Matter of Friedman v Beeway Realty, 87 N.Y.2d 161,170 (1995). Though the shareholders' agreement provides for a "right of first refusal" to other shareholders if a shareholder decides to sell, there is no obligation under said agreement for a shareholder to purchase the tendered shares. Therefore, it also does not create a "ready market" for the purchase of Petitioners' shares.

Therefore, though the Petitioners' expert has not misstated the facts of this case, the Court believes it is powerless to reject case law which has taken up the cudgel of the hypothetical "willing purchaser" and has used it repeatedly, perhaps at times without any real

true meaning. Thus this court will continue to use the “willing purchaser” test, for what it is worth, and will also consider the Lack of Marketability discount. But the court feels compelled to point out that there practically never is a “willing purchaser” in a BCL 1118 buyout and it is pure fiction when an expert uses the terminology.

LACK OF MARKETABILITY DISCOUNT

The Blake court also made it clear that though a lack of marketability discount is appropriate in a closely held corporation said discount cannot be simply applied because the interest to be valued represents a minority interest in the corporation.

The court stated that BCL § 1104-a was enacted for the protection of the minority shareholder and therefore the corporation should not receive a windfall in the form of a discount because it elected to purchase the minority interest pursuant to BCL § 1118. Blake is often cited for its ruling that a minority discount is not to be applied in a section 1118 valuation, but it must also be noted that in making such decision it inferentially approved of the lack of a marketability discount in the shares of a closely held corporation. It specifically stated: “A discount for lack of marketability is properly factored into the equation because the shares of a closely held corporation can not be readily sold on a public market. Such a discount bears no relation to the fact that the Petitioners’ shares in the corporation represent a minority interest (citations omitted).” See also Matter of Friedman v. Beway Realty, 87 N.Y.2d 161 (1995); Matter of Seagroatt Floral Co., 78 NY2d 439 (1991). Thus, it is quite clear that a discount for lack of marketability is appropriate in determining Fair Value. The only issue is what is the appropriate amount. Though this court has great respect for stare decisis, in most cases such as ours, the lack of marketability discount serves to cloak what is really a minority discount.

Respondent’s expert used 15%, an amount that is less than that used in some cases but an amount that Petitioner’s expert would also use but for the fact that he has concluded that no discount of this nature is appropriate under our facts (see pp. 2-4).

TAX ON BUILT-IN GAINS

In reaching its conclusion on Fair Value, respondents expert deducted as a current liability the entire tax (\$11.6 million) that would be imposed on the corporation due to its gain from the sale of various parcels of real property. In actuality said tax was avoided at the time of

the sale of the properties through a 1031 exchange. Those properties purchased via the 1031 exchange have previously been delineated under the findings of fact.

The Petitioners' expert argues that to deduct the entire B.I.G. tax in reaching a fair value determination, would be to treat the valuation as though the corporation was being liquidated. Under no other circumstance would the tax be paid as contemplated by the respondents expert. If USD remains a "C" corporation, it would eventually have to pay the B.I.G. tax and the shareholders would be taxed on distribution made to them. The Petitioners expert determined the "present value" of the B.I.G. tax at \$3 million and proceeded to deduct it as a liability.

The court believes that when one considers the ongoing drive by the respondents to convert this "C" corporation to an "S" corporation, that possibility and its tax impact would be considered by our "willing purchaser." If the corporation became an "S" corporation (which could only happen by unanimity of the shareholders), and the property was held for 10 years, there would be no B.I.G. tax due by the corporation; and the "S" corporation shareholders would only pay a tax upon the sale of the replacement property.

In a U.S. Tax Court case from 1998, Davis v. C.I.R. (110 T.C. No. 35, 110 T.C. 530, Tax Ct. Rep. (CCH) 52, 764, Tax Ct. Rep. Dec. (R.I.A.) 110.35) the court wrote:

In an established line of cases, this Court has held that projected capital gains taxes do not reduce the value of closely held stock when liquidation is speculative. [Citations Omitted].

First, prior to 1986, former I.R.C. 336 and 337 allowed the tax-free liquidation of a corporation; the corporation could thereby completely avoid capital gains taxes upon a subsequent sale of all its assets. Courts reasoned that the corporation's ability to avoid taxes upon liquidation rendered the projected liability so speculative as to be irrelevant. Estate of Piper, 72 T.C. at 1087.

The repeal of those provisions, in the Tax Reform Act of 1986, P.L. 99-514, 631-633, 100 Stat. 2269-2282, *as reprinted in* 1986-3 C.B. (Vol. 1) 186-199, did not foreclose the possibility of avoiding capital gains taxes at the corporate level upon sale of all assets. A subchapter C corporation can convert to an S corporation described in subchapter (I.R.C. 1361, *et seq.*) and avoid recognition of any gain, if the corporation retains the assets for a period of ten years from the date of conversion to an S corporation. See I.R.C. 1374(d)(7). One of petitioner's experts recognized this possible alternative. Since Artemus D. Davis was a long term investor in Winn-Dixie stock, electing subchapter S appears to be a reasonable method to avoid the corporate level capital gains tax.

Although the willing buyer might incorporate a reduction in his price for costs of a subsequent liquidation, the willing seller has no incentive to accommodate that reduction. Why would the willing seller, knowing that the capital gains taxes can be deferred or avoided, agree to that reduction? Why would the willing seller, knowing further that the buyer controls the incidence of tax, agree to any reduction based on the buyer's purely speculative tax burden? See **Mandelbaum v. Commissioner, T.C. Memo. 1995-254, 69 T.C.M. (CCH) 2852, 2866 (1995), aff'd, 91 F.3d 124 (3d Cir. 1996).**

Second, and more importantly, when the actual facts do not suggest that the shareholders intended to liquidate the corporation, this Court has refused to assume that the hypothetical buyer would do so. **Estate of Ford v. Commissioner, T.C. Memo. 1993-580, 66 T.C.M. (CCH) 1507, 1517 (1993), aff'd, 53 F.3d 924 (8th Cir. 1995); Estate of Bennett v. Commissioner, T.C. Memo. 1993-34, 65 T.C.M. (CCH) 1816, 1825 (1993).**

Though we are not in Tax Court, and a Fair Value calculation (willing buyer - operating business) is not identical to the procedure of Tax Court as described above, it is clear from the evidence that no liquidation was or is contemplated by the Respondents in our case and thus a "liquidation" or semi-liquidation scenario is not appropriate when dealing with the B.I.G. tax.

If the properties are not sold for 19 years, does the B.I.G. remain the same or is the tax recalculated? It appears that the \$11.6 million, being based on the gain on the IKEA property, would remain the same; of course, the possible gain on the property for which it was exchanged would then have to be determined.

Respondents' expert believes Petitioners' expert was wrong to conclude in his analysis that USD would hold the properties for a lengthy period of time (19 years). However, the minimal history that exists for the corporation shows USD does not quickly sell property. For example, the Red Hook property was bought in 1985 and sold in 2005 (it would have been sold sooner if a viable buyer had arisen). The Jersey City property was purchased in 1965 and sold in 2001. Of course, it must be remembered that USD was not in a real estate investment company in that period, but rather a company involved in various aspects of waterfront work. As that world "dried up" they shifted focus to survive. However, the intent of the directors, who are also the sole officers, is reflected in the President's Report of James Murphy on November 15, 2005 (Exhibit II) where he speaks of holding the property so that their children will benefit in the future. It is clear to the court that the underlying intent of the Murphys and the Gallaghers that

control USD is to hold property for a lengthy period of time. It is also reflected in the type of investments that have been made with the proceeds from the Jersey City and Red Hook sales.

Finally, in reference to the B.I.G. tax, a “willing buyer” would not expect the entire B.I.G. to be deducted from value. Rationally the deduction of the entire B.I.G. would mean the payment of the B.I.G. at that time. The B.I.G. is not payable until property is sold. The willing buyer would not expect the assets of the corporation to be sold when he/she buys in. Why would such buyer buy into this type of Real Estate Investment Corporation if the corporation is going to sell their assets as soon as you buy? There is nothing about the assets of this corporation that would lend the buyer to believe that these long term leases had suddenly become worthless and therefore the corporation was selling everything off, causing the payment of the B.I.G. tax, with possible plans to reinvest in new real estate. It would be unreasonable to make the deduction made by the Respondents’ expert. Furthermore, if the Respondents convert the C corporation to an S corporation, as they have tried to do for many years, they will at least hold the property for ten more years after conversion. The court rejects the “alternative investment” position taken by McAteer under the facts of this case. The court directs that the “present value” of the B.I.G. as determined by Mr. Fielstein is to be deducted in the valuation process.

In Matter of LaSala, (2/6/2003 NYLJ 24, (col.1) (Supreme Court, Westchester County) Justice Rudolph granted the respondents request for a discount to reflect lack of marketability of Petitioners shares in a real estate investment company. He rejected, however, a further request for a deduction based upon a potential future capital gains tax liability (B.I.G.). He pointed out “while potential future corporate tax liability may be a factor in evaluating an appropriate lack of marketability discount, it is not in and of itself a valid and independent discount or adjustment to be considered in arriving at the fair value of Petitioners shares of stock.” Justice Rudolph reached his conclusion based upon the principle “that the corporation is valued as an operating business rather than a business in the process of liquidation (Matter of Friedman, supra.)” Once again, it must be remembered that the capital gains tax is not triggered until the property is sold, or, in other words, upon liquidation. Fair value is not to be computed under a liquidation format. The court agrees with the logic expressed by Justice Rudolph. However, under these circumstances with the B.I.G. representing such a large portion of corporate assets it appears that a willing purchaser would expect to deduct the present value of the B.I.G. tax along with a

percentage for lack of marketability.

The court directs that a non-marketability discount of 15% be used in reaching a “fair value” valuation. It rejects the position that it should be increased. The court believes that such an increase would be equivalent to a minority discount under our facts, and rewarding the majority for investments which it solely controlled and which lack in liquidity (as per Mr. McAteer).

EXCESS WORKING CAPITAL - REAL OR A MIRAGE
OPERATING ASSETS V. NON-OPERATING ASSETS

Petitioners’ expert in determining the discounted future cash flow of the respondent, concluded the corporation had excess or non-working capital of over \$14,000,000. This is relevant in determining Fair Value when using the income approach.

Respondent argues that the income from United States Dredging’s cash and from United State Dredging’s security portfolio must be included in determining the income method, because these assets are needed for the corporation’s regular operations. This would include the paying of taxes, funding dividends (infrequent as they may be), avoiding the imposition of personal holding company taxes, and most obviously, to make further investments in real estate. However, president Murphy’s proposed buyout of the minority could not have been accomplished if the entire sum was placed in “working capital.”

Working capital is traditionally defined as current assets (such as cash, inventory, and accounts receivable) less current liabilities. Working capital measures liquidity and the ability to discharge short-term obligations. (Black’s Law Dictionary, Seventh Edition, 1999).

While respondents’ expert would hold over \$14 million as working capital as indicated above, Petitioners’ counsel chose to include only \$2.1 million in working capital in its calculations.

Much time and effort was dedicated to this complex issue at trial and in the submitted post-trial memoranda of law. Sixteen million dollars had remained in USD’s investment account so that it was available to pay a proposed buyout of stock and then remained after February 14, 2006 pursuant to a stipulation of the parties until a decision would be rendered by the court.

The income method of valuation, as compared to the net asset method, “is based upon the theory that the value of a business depends upon the future economic benefits it produces.

Future economic benefits are defined as the likely level of earnings and cash flow that a potential buyer would expect to realize.” Holtz Appraisal - Exhibit A at 32; see similarly MWE Appraisal, Exhibit 4 at 25.

Respondents’ expert has determined that the Income or Discounted Cash Flow Methodology gives a better picture of USD’s value to a “willing purchaser” than the Net Asset Value.

He bases his argument on the fact that property obtained in a 1031 Exchange receive no depreciation deduction and that this was a principle reason why the taxes payable by the corporation depressed the cash flow to an unusual extent (70% effective rate versus normal 40% corporate tax).

Both experts agreed that the Discounted Cash Flow Method was an appropriate method of valuing USD (not the only one, but appropriate). As noted, they differed dramatically in how this should be done on two significant areas. The first was in determining projected operating expenses for the corporation. The second was determining actual working capital that would have to be retained (and thus considered a subtraction in determining Discounted Cash Flow).

In Shannon Pratt’s Valuing Small Business & Professional Practices, at page 321, non-operating assets are defined as “assets that are not part of [the privately held company’s] operations.” The question for the court thus becomes whether the \$16.2 million shown in the corporation’s balance sheet of January 31, 2006 is used in “operating” the business. Starting with this amount and estimating the expected income from this amount and the expected expenses (including taxes) the corporation would only need \$2.1 million (Exhibit 6 to Exhibit 4) to run its business (as per Fielstein). This would ensure that by the year 2023 (last year of negative net cash flow), the corporation would have a positive ending working capital balance. Thus, Fielstein determined \$14.05 million of the corporation’s cash and cash equivalents should be considered a non-operating asset. He added this amount to \$5.95 million (determined to be the present value of the future benefit under the Discounted Cash Flow Method) (see Exhibit 8 to Exhibit 4). Result - the corporation’s equity under the income approach was \$20 million as of the valuation date (see Exhibit 9 to Exhibit 4).

Respondents argue against Petitioners’ findings. Initially, they argue against the projected expected income of 10% per annum as being far too high. Petitioners’ scenario would

result in no dividends being paid for 16 years. Respondent argues that a willing purchaser would never buy a minority interest in a corporation that would not pay a dividend for 16 years. Furthermore, a “willing purchaser” would expect a portion of the non-working capital to be applied to further real estate investments.

Petitioners’ expert also agreed that a “willing purchaser” who read USD’s management’s report to stockholders of November 15, 2005 (Exhibit II) would conclude that further real estate investments would be forthcoming in the near future.

Fielstein assumed that of the \$2.1 million in “working capital,” 90% would be invested in the stock market yielding 10%. This assumption (the 10%) was based on a re-investment of all dividends earned. If all dividends earned were re-invested, that would result in what is called a holding company tax. Furthermore, the 10% yield is contrary to a historic 6% rate of return.

Fielstein testified he relied on the fact that Holtz Rubenstein relied on the “passive” approach in computing earnings in its income method of valuation. Holtz actually prepared both an active and passive approach. McAteer choose the passive approach because he believed the company would use an outside investment advisor which would cut overhead. He, therefore, excluded pension expense, but included reduced overhead (i.e. salary, rent and prerequisites) in his model for income valuation.

The possibility of a holding company tax was not considered by Fielstein in his report. At trial he testified that to avoid a PHC tax on retained income (non-operating) the corporation would have to make distributions on an annual basis. Thus, the report that stated only \$2.1 million of working capital would be required by the corporation is in error.

Mr. Fielstein concluded if the \$14.05 million was paid out to shareholders, an additional \$320,000 would have to be held in working capital to avoid a PCH tax. However, if the \$14.05 million was invested in real estate, a securities account. or some other investment vehicle, his calculations for the PHC tax would be wrong.

In Exhibit UUUU, McAteer provides a schedule entitled Personal Holding Company Tax & Dividends. In the schedule Mr. McAteer shows the income that he believes would be produced under the Fielstein scenario. He then subtracts operating losses when applicable, a 40% corporate tax and after tax income. The corporation would then be required to distribute a dividend or be subject to a 15% penalty (tax) for failure to distribute the dividend. The

accumulated penalties would exceed \$4 million. He assumes the Murphys and the Gallaghers would not distribute a dividend (he might be right on that based on historical lack of dividends), however, if a small dividend would save large taxes, they might reconsider. Petitioners argue that the \$14 million was intended to be used to repurchase the minority shareholders' shares and, therefore, it was not working capital.

The court finds that the assumption made by Mr. Fielstein in concluding that all \$14.05 million (after deducting \$2.1 million) were non-operating assets was incorrect. He incorrectly viewed these funds as not necessary or needed for the operation of the company. The operations of this Real Estate Investment Company is investing in real estate - not in the stock market. Assets are currently being held in a brokerage account pending the conclusion of this proceeding and the acquisition of real estate investment(s). The overwhelming majority of the funds in question were being held by USD pending the conclusion of the dissolution/valuation proceeding. Why would a willing purchaser invest nearly \$8 million in a Real Estate Investment Company that does not invest its available liquid assets in real estate? The cost to the corporation to follow Fielstein's assumption was at a minimum \$4 million in PHC taxes (or penalty) which Fielstein failed to take into consideration when he only put \$2.1 million into operating/working capital. Further, the income earned, on which McAteer imposed a tax, was "available for distribution", but is not distributed under the Petitioners' original scenario.

In response to the problem of the PHC tax Fielstein created Exhibit 77. It reflects the amount of distribution that would be necessary to avoid paying any Personal Holding Company (PHC) tax and still use the scenario presented by Margolin Winer Evens (\$2.1 million in operating/working capital). Exhibit 77 is not reflected in his report (Exhibit 4). The \$2.1 million would have to be modified. He determined that there would have to be approximately \$320,000 in addition to anything in his original report (Exhibit 4). He then present valued that amount to \$211,000. This assumes that \$14.05 million has been distributed/payed out.

On the other hand, if the \$14.05 million is invested at 6.7%, you would need to pay dividends of \$27 million over this period to avoid the \$4 million in PHC tax (McAteer's expert opinion). Essentially, according to McAteer, he would have to pay out the entire after tax income to avoid the PHC tax. Of course, Mr. McAteer has not any of the \$14.05 million being paid out in his scenario.

This does not occur under the Margolin Winer Evens scenario where there are distributions mathematically determined to prevent a PHC tax. Under the Margolin Winer Evens scenario the \$14.05 million is no longer part of the equation. Fielstein does his calculations and determines the appropriate distribution to avoid the PHC without in any way accounting for the \$14.05 million which Fielstein determines as being distributed to shareholders.

The hypothetical “willing purchaser” looks at all the investments held by the corporation, the nearly \$16 million sitting in the bank, its source and the reason for its presence, the letter from the president nine weeks prior to the valuation date setting forth the corporation’s intent to invest in more property for the benefit of the corporation, and the prior letter reflecting the intent to hold the property for their heirs. In the President’s Report of November 15, 2005, (Exhibit II), James Murphy wrote:

By the way, the acquisition of these properties will probably provide future payments to our heirs. When the loans are paid off in some 19 years, the income will go to the company for probably many years to come. If not, the buildings can be sold for a possible increase in value. The income at that time will probably be about \$2 million a year.

Thus, Mr. Fielstein had good reason to believe the corporation would hold onto their real estate investments for many years to come and he, unlike Respondents’ expert, did not spend hours discussing the case with the Respondents.

Mr. Fielstein also mentioned the possibility of a conversion by the corporation from a “C” corporation to an “S” corporation. The court is personally aware of the majority’s desire to convert to an “S” corporation for many years, due to this court having tried a prior matter between these same parties. The Petitioners in this action have continuously refused to consent to such a conversion unless there could be arranged a dividend or distribution to cover the “phantom income” that would be passed through to them via their K-1 forms. There is testimony if the corporation elected to be an “S” corporation and the property was not sold for ten years the corporation would not owe the B.I.G. Thus, the majority would have tremendous incentive not to dispose of the property for ten years.

Respondents’ counsel questioned whether a “willing buyer” would be concerned that once he owns a percentage of the corporation that any shareholder could stop the conversion by

objecting or holding the corporation hostage in exchange, for example, for a dividend. The Petitioners' witness believed any shareholder would be pleased with an "S" corporation conversion. The court agrees. The Respondents' counsel argued that the court should not consider the possibility of a conversion from a "C" to an "S" corporation. The court believes it is disingenuous for it not to, in some way, consider the possibility of the "S" corporation conversion considering it is as "known or knowable" as the pension plan and such conversion could eliminate the B.I.G. tax.

Thus, we have Exhibit UUUU of respondents showing a worst case scenario of the impact of a PHC tax on the corporation and Exhibit 77, Petitioners' methodology of how a small distribution could be used to avoid the PHC tax (of course, petitioner will have removed nearly all of the \$14 million that he has placed in non-operating assets from his hard number calculations). With all due respect to my dueling experts who prove you can put the same information in one end of the pipeline and produce different results at the other, I reject their conclusions. The court relies on their reports, logic and the facts as produced at the hearing as to the intent of the corporation.

The overwhelming majority of the money being held by the corporation has been held subject to the resolution of this dissolution action.

Exhibit SSSS, the deposition testimony of James Murphy, President of USD, makes for interesting reading. It reminds the court of the prior trial, the cavalier way in which the majority (officers and directors) ran the corporation and their desire to protect themselves and their progeny in futuro. It is regrettably clear that these men made investments, not needing the legal consent of the minority, into quality property, but that may not be the most attractive to a "willing purchaser." Thus, the acts of the majority resulted in a "Fair Value" valuation less than what may have been in a scenario with different investments.

It is clear from James Murphy's testimony that the approximately \$16 million (eventually reduced by the \$1 million dividend) was to be used for the purchase of more real estate, when the time was right and the proper investment property was found. It is also clear that part of the \$16 million was to be made available for the buyout of the minority's stock in a "liquidation" style of accounting. This amount was estimated by Mr. Murphy to be \$11.3 million in his letter of December 23, 2005 (Exhibit JJ). This would result in about \$4.15 million be used to buy out

minority shareholders.

This letter also notes that since the shareholders never elected a Sub. S status, previously predicted dividends would not be forthcoming. Further, that they would be looking to invest as a private equity company might do, to obtain control of a future investment. Obviously the S corporation issue was continuously kept alive by the corporation and thrown back into the face of the minority. It was almost as though the officers and directors in a form of "in loco parentis" were scolding the minority, "see what you've done, this is all your fault, now you'll suffer."

This court in its attempt to be the soothsayer required by the Court of Appeals in Amodio, and the "artist" of Okerlund v. U.S., 365 F.3d 1044, concludes, considering all of the above, and that working capital should be what is needed to discharge short-term obligations, that it is logical to believe that \$6.45 million should be considered working capital, thus producing breathing space for the payment of all types of taxes and debt service requirements. This would allow the retention in non-working capital as well as investing a significant amount of funds in realty. In that the definition of working capital speaks to the discharge of short-term obligations, any monies put aside for realty investment should be placed in the category of non-working capital. Therefore, the balance of these funds, \$9.7 million, shall be considered non-working capital. These amounts are to be used in recalculating the income approach in reaching a Fair Value determination.

**REVISED TABLE OF ESTIMATED FAIR VALUE AS OF
FEBRUARY 13, 2006 BASED UPON PETITIONERS' CHART
FROM PAGE 20 OF EXHIBIT 4 AND BASED UPON THE COST
OR ASSET APPROACH**

ASSETS

Cash and Market Securities	\$16,154,000	
Other Current Assets	<u>\$ 74,000</u>	
Current Assets		\$16,228,000
Land and Property	\$29,677,000	
Other Fixed Assets	\$ 285,000	
Less Accumulated Depreciation	<u>(\$ 120,000)</u>	
		\$29,842,000
Insurance Claims	\$ 50,000	

Due from Officers	\$ 178,000 ¹	
Other Assets	<u>\$ 206,000</u>	
Total		<u>\$ 434,000</u>
Total Assets		\$46,504,000

LIABILITIES

Current Liabilities	\$ 328,000	
Pension Plan	\$ 2,000,000	
Tax on Built-In Gains	\$ 3,037,000	
Long-term Debt	<u>\$18,671,000</u>	
Total Liabilities		\$24,036,000
Total Assets Less Liabilities		\$22,468,000
Less Discount for Lack of Marketability of 15%		<u>\$ 3,370,200</u>
		\$19,097,800
Less \$1 million for dividend paid January 2007		<u>\$ 1,000,000</u>
		\$18,097,000

The asset approach, be it calculated by the Petitioners' or Respondents' expert, yields a higher value than the income approach. The asset approach, after reducing the above by 15%, yields a net to the Petitioners of \$6,654,267 (.3677 x \$18,097,000).

In using the income approach, dramatic differences arose due to the manner in which the \$16.2 million cash was treated, be it as working capital or non-working capital, non-working capital being included in the equation in reaching a valuation amount when added to value as found from the DFCF method. As noted earlier, Mr. McAteer called it all working capital while Mr. Fielstein placed \$2.1 million in the working capital category. Mr. Fielstein's methodology did not account for a Personal Holding Company tax that would be applied to the retained earnings.

As can be seen from the two charts that follow, both experts used the same methodology and nearly the same factors in computing the income approach.

The first line on the chart "present value of cash flows" is impacted by "working capital." They both use 2% as "long term sustainable growth rate", and they both use a similar capitalization rate, 5.50% (Petitioner) and 6.05% (Respondent).

¹ If not previously repaid to the corporation by officers.

“After tax cash flow” differs by approximately \$440,000 (Petitioner being on the lower end) \$1,147,298 versus \$1,588,526. Again, this would appear to be largely due to how the working capital was handled by the respective experts. Both the present value factors (Petitioners’ = .24408) (Respondents’ = .22056) would appear to have been reasonably determined. Neither side attempted to convince the court why their capitalization rate or present value factor was more accurate than the other, but again are directly related to the valuation date used by the respective expert.

[Decision Continued on Next Page]

PETITIONERS' DFCF (EXHIBIT 8 TO EXHIBIT 4)

	<u>Source</u>	<u>Value</u>
I. Present value of cash flows to shareholders for 2006-2025 (a)	Exhibit 6	\$759,522
II. Terminal Value (b)		
After-Tax Cash Flow Year 2025	Exhibit 6 (page 6)	\$1,147,298
Estimated Long-term Sustainable Growth Rate		2.0%
Terminal Cash Flow (Cash Flow Year 2025 * (1 + growth rate))		\$1,170,244
Capitalization Rate	Discount rate less long-term growth rate	<u>5.50%</u>
		<u>\$21,277,164</u>
Present Value Factor (Exhibit 6, p. 6 of Exhibit 4) (mid-year convention)		<u>0.2440815</u> <u>\$5,193,362</u>
III. Income Approach Value based on present value of cash flows 2006-2025 plus terminal value (sum of I and II)		<u>\$5,952,884*</u>

(a) Assumes approximately \$14 million of cash & cash equivalents are non-operating asset

(b) Computed as the Present Value of the following: Terminal Cash Flow divided by the Capitalization Rate

* Does not include non-operating assets which Petitioner added in the amount of \$14.054 million (Exhibit 9 to Exhibit 4), nor does it account for the January 2007 dividend of \$1 million nor is there a lack of marketability discount applied. Upon adding in \$14.054 million, applying the 15% non-marketability discount, then deducting the \$1 million dividend, the Fair Value using the income method \$16,005,851. Petitioners' share of 36.77% equals \$5,885,351.

RESPONDENTS' DFCF (EXHIBIT 4 TO EXHIBIT A)

	<u>Ref.</u>	<u>Value</u>
I. Present Value Cash Flow to Equity Holders Years 2006-2025	Exhibit 4A	\$ 4,787,993
II. Terminal Value (a)		
After-Tax Cash Flow Year 2025	Exhibit 4A (page6)	\$ 1,781,921
Long-term Sustainable Growth Rate	Exhibit 4D	2.0%
Terminal Cash Flow (Cash Flow Year 2025 * (1 + growth rate))		\$ 1,817,560
Capitalization Rate	Exhibit 4D	<u>6.06%</u>
		<u>\$ 29,992,734</u>
Present Value Factor	Exhibit 4A (page 6)	<u>0.22056</u> \$ 6,615,296
III. DFCF Value (Sum of I and II)		<u>\$ 11,403,288*</u>

(a) Computed as the Present Value of the following: Terminal Cash Flow divided by the Capitalization Rate

* This amount is before the discount of lack of marketability (15%) and the adjustment for the \$1 million dividend paid in January 2007. After such adjustment the Income Method Value of USD is \$8,693,000. The net yield to Petitioners (36.77%) would be \$3,251,496.

The court directs that the Income Approach Value be re-computed using a capitalization rate of 5.50% and a present value factor of .2441% and, where appropriate, the nineteen year holding period. That the income approach be recalculated using these rates and factors using the aforementioned division of the \$16.154 million; \$6.45 million to be considered working capital and \$9.704 million as non-working capital. Further, that if the calculations involve retained earnings that would involve a PHC tax, then it should be accounted for. The experts are to use the aforementioned 15% lack of marketability discount.

DISCOUNT RATE

The discount rate used by Mr. McAteer was based upon the date he did his valuation in July 2006. When the experts do the re-evaluations, the discount rate as used by Fielstein as of February 13, 2006 of 7.5% is to be used by both sides, as needed, in any recalculation.

BALANCE BETWEEN NET ASSET COST APPROACH (ADJUSTED VALUATION) AND INCOME APPROACH (DFCF METHOD)

These two methods were chosen by both the experts as the best methods for valuing USD. Thus, what the court has examined up to this point are the factors which went into reaching the conclusions in each of the methods.

Each party shall submit to the court a new Income Approach Value within twenty (20) days of the date of this decision. In the alternative, the parties may choose to settle the matter considering the above decision of the court. It would be refreshing to see these families settle the case at this time, rather than continue their internecine battle.

The court will issue a final order giving appropriate weight to the two different methodologies after receipt of the requested Income Approach Value, and any modification of the aforementioned Asset Approach Value depending on whether the prior court ordered directors' fees have been reimbursed to the corporation..

Dated: May 19, 2008


J.S.C.

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