SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF QUEENS

- X

IN THE MATTER OF THE APPLICATION OF LAWRENCE R. BLAKE, HOLDER of Twenty-Five (25%) Percent of all outstanding shares entitled to vote in an election of shareholders of BLAKE AGENCY, INC.

Petitioner,

-against-

FOR THE DISSOLUTION OF THE BLAKE AGENCY, INC.,

Respondent.

- X

REPORT OF
SAMUEL S. TRIPP,
REFEREE

Index No.
11002/81

HEARING IN QUEENS COUNTY BAR ASSOCIATION BUILDING

Wednesday, July 28, 1982, 9:30 A.M. until 5:00 P.M.
Friday, July 30, 1982, 9:30 A.M. until 5:00 P.M.

HEARING IN COURTROOM 66, GENERAL COURTHOUSE

Monday, August 2, 1982, 9:30 A.M. until 5:50 P.M.
Transcript herewith together with Exhibits to be returned to the parties.

Reporter: Jack E. Solomons, OCR, Supreme Court, Nassau County, Supreme Court Drive, Mineola, N.Y. 11501

APPEARANCES

HONOROF & HONOROF
by Daniel M. Honorof, Esq.
Attorneys for Petitioner
5 Mineola Boulevard
Mineola, New York 11501
(516) 746-7676

BRODERICK, BRODERICK & REDMOND
by Peter M. Redmond, Esq.
Attorneys for Respondent
38-08 Bell Boulevard
Bayside, New York 11361
(212) 229-6070

FINAL SUBMISSION

Petitioner's post-hearing memorandum was received on September 28, 1982 and Respondent's on October 27, 1982. Petitioner's Reply was received on November 22, 1982. All are submitted herewith for the Court's consideration upon any motion addressed to this Report (CPLR 4320, 4403).

A. NATURE OF THE PROCEEDING AND THE ISSUE TO BE DETERMINED

In this proceeding by the owner of a 25 percent stock interest in respondent Blake Agency, Inc. (hereinafter "Agency"), for its judicial dissolution pursuant to section 1104(a) subdivisions 1 and 2 of the Business Corporation Law, initiated by order to show cause dated August 4, 1981, Justice Angelo Graci handed down a memorandum, dated April 8, 1982 deemed by the parties a "short form order" of reference (Stevenson v. News Syndicate Co., 302 NY 81, 87; see Court's Exhibit 2). Therein I was appointed "Referee to hear and determine" the fair value of the petitioner's shares in the Agency on August 3, 1981, the day prior to August 4, 1981 when the petition dated July 24, 1981 and verified on August 4, 1981, was filed (BCL 1118(b), see Court's Exhibit 2). I qualified as Referee by Oath sworn to on May 6, 1982 duly filed in the office of the County Clerk of Queens County.

The transcript of the first hearing on July 28, 1982 reflects agreement by counsel that this reference be to hear and

"report" (CPLR 4212), rather than to "determine" solely the "fair value" of petitioner's shares (SM 2-4).*

B. THE PLEADINGS AND RESPONDENT'S ELECTION TO PAY FAIR VALUE FOR PETITIONER'S SHARES

The pleadings in this matter (Exhibit E), consist of the petition attached to the order to show cause dated August 4, 1981; respondent's answer verified September 14, 1981; and the opposing affidavits referred to in the affirmation, dated September 21, 1981, of Peter M. Redmond, Esq., one of the attorneys for the respondent. Allegations in the pleadings do not define or formulate any issues for disposition inasmuch as respondent has elected to purchase petitioner's minority stock interest as shown below.

Petitioner's Exhibit 2 consists of the "Notice of Election Pursuant to BCL, 1118", dated October 30, 1981, filed by the Agency, to purchase the shares owned by the petitioner, Lawrence Blake, at their "fair value" as of August 3, 1981, and the affidavit of William Blake, respondent's president, attesting to the fact that such election and filing was made pursuant to the authorization of the Board of Directors of Respondent who "have approved and adopted a plan to acquire the outstanding shares owned by the Petitioner".

* Unless otherwise indicated, numbers in parenthesis refer to pages of the transcript of testimony at the hearing. The Court's and petitioner's Exhibits are numbered; those of the respondent are lettered.

In finding that a reference was required the memorandum-order of Justice Graci, dated April 8, 1982, mentions an order dated November 19, 1981 with respect to a motion which was before the court on November 18, 1981 and a letter from one of petitioner's attorneys, Daniel M. Honorof, Esq., dated April 5, 1982, "in which there is included a stipulation between the parties * * * (which) indicates that the parties have been unable to reach a mutual agreement on the value of the petitioner's share and request a hearing with respect to same * * *". A copy of this stipulation, signed by the respective attorneys, is marked Court's Exhibit 3. The memorandum-order of Justice Graci also provides:

> "The parties shall be equally liable for the payment of the aforesaid Referee's fees".

In fact, pursuant to agreement on the record (SM-7) each party shared equally in the cost of the transcript of testimony of the hearing, one copy to each and the original to the Court. Each party paid, through me, the sum of $1,811.25 to Jack E. Solomons, the Official Supreme Court Reporter who took the testimony of the three-day hearing in a transcript of more than 803 pages in view of the fact that several pages were lettered.

C. THE FINDINGS REGARDING AGENCY, ITS INCORPORATION AND SHAREHOLDERS

The Agency was duly organized by William R. Blake, Sr., the father of its present owners (SM 426) on July 1, 1954 pursuant to Article 2 of the Stock Corporation Law (Ex. 1). Upon his death in 1968 he bequeathed an equal 25 percent stock interest in the corporation to each of four (4) of his sons, Lawrence, Richard, Robert and William R. Blake (SM 426-7). Richard became the president and chief operating officer of the corporation which position he held until April 27, 1971 when he transferred his stock interest to his brother William for $4,200 at a time when only they participated actively in the Agency (SM 478) whose business then had a commission income of approximately one hundred or one hundred ten thousand dollars per year (SM 428, see financial statement for year ended June 30, 1971, Ex. B).

Since that sale to date, William R. Blake, Jr. has been president and the only person operating the Agency. It is engaged in "a general insurance business primarily dealing in property and casualty insurance with a small degree of ancillary business being life, accident and health and consulting" to which William Blake has devoted probably 100 percent of his daily time, averaging 60 hours during a typical week (SM 425-6, 519).

Thus, from April 1971, William has been the owner of 50 percent or 100 shares out of the 200 issued and outstanding and Robert and the petitioner of the remaining interest, each owning 50 shares (SM 532). William, alone, has personally been active in

the business, obtaining, keeping and servicing all its customers (SM 454), including subproducers whose custom was said to produce 20 percent of the commission income (SM 463). The Agency is concededly well managed and stable, enjoying a good reputation in the community (SM 262, 375, 675). For his efforts, William receives salary and perquisites. His compensation package, extant on August 3, 1981, was approved by the Board of Directors on January 1, 1979 (SM 579-80). The total of $84,092 (SM 63, 92) was not found unreasonable upon the audit of the respondent's 1979 income tax return by Internal Revenue Service (SM 570-71, 617-18). Robert, although a 25 percent shareholder and vice-president of the Agency, has not engaged in its activities, been employed by it nor has he been paid any salary or other benefits as officer (SM 451). Neither has the petitioner, the remaining 25 percent shareholder. He has not been active in the business for some 10-12 years, nor has he received compensation or benefits of any kind (SM 445). No dividends were ever declared or paid by the Agency since its incorporation in 1954 (SM 452). No one, including the president, has an employment contract, nor are there any piracy or noncompetitive covenants or shareholders' agreements (SM 459).

The Agency has five (5) full time salaried employees. It rents some 800 square feet of space for a net-net rental of $535 per month (SM 482-85) in a building at 196-20 Northern Boulevard,

Flushing, Queens County, owned by Marian L. Blake, the mother of the Blake brothers (SM 445, 446, 448). She is 71 years of age (SM 481). Another tenant in this building is W. R. Blake & Sons, Inc., a real estate corporation organized by and named after their late father. Joanne M. Blake, William's wife (SM 481), is a shareholder as is petitioner Lawrence and Robert W. Blake, both of whom, until about 1971 or 1972 were employed by this real estate corporation (SM 447), only Robert continuing to date as its "principal operating officer" (see footnote on page 3 of respondent's brief). This family corporation is engaged in the real estate brokerage commissions business (SM 438).

D. FINANCIAL DATA CONSIDERED IN EVALUATING PETITIONER'S 50 SHARES AS OF AUGUST 3, 1981

At the request of the attorneys, a pre-trial conference was held in my office on May 27, 1982 of which Court's Exhibit 2 is a Resume. It was agreed, in paragraph 1, that the fair value of petitioner's 50 shares would be determined as of August 3, 1981 - the day prior to the filing of the petition for corporate dissolution.

It was further agreed (par. 2) that by a certain date petitioner would serve "a plain and concise statement in consecutively numbered paragraphs concerning his position or claim with respect to each and every line set forth in each of the three (3) financial statements heretofore furnished by the respondent

for the period ending on June 30, 1981". These financial statements were for fiscal years ending on June 30th, 1979 (Ex. 3), June 30th, 1980 (Ex. 4), and June 30th, 1981 (Ex. 5). Other requirements of paragraph 2 of the Resume permitted the respondent to file "a statement of its position with respect to the matters affirmatively claimed by petitioner to have been omitted or as to which there is any discrepancy * * *".

Such a statement, dated June 22, 1982 (Ex. A), was served in respect to petitioner's clarified compliance (Ex. 7) with paragraph 2 of my Resume (Court's Ex. 2) after I had found fault for lack of clarity with the first attempt to comply, by my letter to petitioner's attorney, dated May 28, 1982 in response to his letter dated May 27, 1982 enclosing "a statement from Arthur R. Venezia, the accountant who will testify at the trial hereof". Attached to this "clarified" statement of Mr. Venezia, a Certified Public Accountant and his cover letter to petitioner's attorney dated June 7, 1982 (Ex. 7), are copies of the last three (3) fiscal financial statements, prepared by Burns & Co., Certified Public Accountants, Exhibits 3, 4 and 5.

Early in Mr. Venezia's direct testimony, I admitted in evidence over objection, Exhibit 6, consisting of a five-page typewritten statement summarizing his report (SM 31) sent to me by letter dated May 21, 1982 as well as to the respondent's attorneys (SM 30-33). This was characterized "as evidentiary material"

which I admitted in evidence "for whatever its worth, subject to a motion to strike" (SM 34) which was never made, probably because testimony concerning its contents was adduced.

In the course of the testimony by Mr. Herbert Lapidus, petitioner's expert insurance agency witness concerning the value of his 50 shares of stock (SM 163-169) there was admitted in evidence as Exhibit 8 a two page letter from him dated April 19, 1982, containing 21 questions to "give him a clear picture of the operation and allow me to refine the appraisal". The three-page typewritten response (with these questions repeated) was admitted in evidence as Exhibit 9 (SM 183-4). The ten-page Lapidus appraisal report of the entire Blake Agency, with changes of only the "Median" figures, not those called "low" and "high" on page 10 thereof, made by him in the course of his testimony, was admitted in evidence as Exhibit 10 (SM 185-8). That report, dated April 20, 1982, did not reflect the data contained in Exhibit 9, since Mr. Lapidus did not then have that information (SM 189).

Respondent's expert insurance agency witness, Kenneth D. Pollock (SM 655-63), made an appraisal report specifically of petitioner's 50-shares of stock in the Agency (Exhibit B, SM 668-9). There is some confusion about the designation of this Exhibit as "B" inasmuch as among the seven (7) documents of the Appendix listed on page ii of the Table of Contents of this appraisal, is the fiscal June 30, 1971 Financial Statement of the

Agency, initially offered for identification (SM 432-35) and subsequently admitted in evidence as part of Mr. Pollock's appraisal report, Exhibit B (SM 665-69).

Reference to the above exhibits has been made here to clarify this record for the reviewing court; also to aid me in reaching a conclusion of the quite complicated issue of the fair value of petitioner's 50 shares of stock in this close family corporation with 200 shares issued and outstanding, which he sought to dissolve but has been stopped from doing so by that corporation's invoking the provisions of the comparatively recent statute under which it duly elected to purchase petitioner's shares at fair value as of August 3, 1981. The respective valuations made by Messrs. Venezia and Lapidus for the petitioner and Mr. Pollock for the respondent, are widely disparate although made largely upon the basis of the same three unaudited financial statements (SM 85-88) and particularly, the one ending with fiscal June 30, 1981, without reference to the period from that date until August 3, 1981, since as conceded by everybody, there was no substantial or material change during that short interval (SM 143, 194, 643).

E. THE STATUTE INVOLVED

According to the copy of the legislative "jacket" supplied by petitioner's attorneys as an Appendix to their brief received on September 28, 1982, Chapter 217 Laws of 1979 became effective on June 11, 1979. The bill amended the Business Corporation Law

by adding a new section 1104(a) to permit corporate stockholders owning 20% or more shares in a "close" corporation whose shares are not traded on any securities exchange or on the over-the-counter market, to petition for judicial dissolution of the corporation with buy-out features embodied in new section 1118 of which subdivision (b), applicable to the case at bar, reads as follows:

> "(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 and determine the fair value of the petitioner's 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."

The legislative "jacket" discloses no memorandum or message by the Governor nor specific objections to the proposed enactment except by the Committee on State Legislation of the Association of the Bar of the City of New York. Commenting, inter alia, upon the bill's silence as to how the "fair value" of the shares of a petitioner may be determined under the buy-out provisions, the Association's letter to the Governor's Counsel, dated June 6, 1979, states:

> "Nor does the bill indicate how the court is to determine the 'fair value' of the petitioners' shares (except to exclude

> any element arising from the filing of the petition); if the standards of an appraisal proceeding under BCL Sec. 623 are intended, this should be specified."

Whether the new statute incorporated some portions of BCL 623 was the subject of the decision in 1980 by the Appellate Division of the Second Department in Matter of Fleischer, [Gift Pax, Inc.], 79 AD2d 636, 637. There, the petitioner owning one-third of the shares in each of two corporate respondents, after complying with the requirements of BCL 1118, sought to incorporate selected provisions of BCL 623 governing proceedings for the valuation of shares belonging to a dissenting shareholder exercising his statutory right of appraisal. The Appellate Division held that absent express legislative incorporation in the new statute by reference to section 623, the Court would not do so judicially, observing that there was:

> "* * * no legislative design that selected provisions of section 623 of the Business Corporation Law were intended to govern a court's determination of value under section 1118 * * * (and) that it is the better practice to refrain from judicial legislation and await further legislative action. Importantly, such a course will not, in our view, defeat the remedial purpose behind sections 1104-a and 1118 * * * nor prevent the court, in appropriate cases, from making such order as justice requires".

While this holding has been questioned by Professor Fogelman in Section 11.19 at pages 266-7, of the 1981-82 Cumulative Annual

Pocket Part to Volume 8 of West's McKinneys Forms, Business Corporation Law, the Fleischer decision appears to have been harmonized in Matter of Delinko (Misc 2d , NYLJ, October 7, 1982, page 6, col. 5) cited in respondent's post-trial brief. That case involved motions by petitioner Delinko and respondent Allison, equal shareholders of two respondent corporations, to confirm, with adjustments and modifications, the report of the appraiser appointed pursuant to BCL 623(h)(4). This appraiser was appointed on May 28, 1980 notwithstanding that Delinko had sought the dissolution of both corporations pursuant to BCL 1104-a because of alleged internal problems among stockholders etc., and Allison had served on Delinko a BCL 1118 notice of election to purchase for fair value all of the latter's shares in each respondent corporation, and the new statute contained no alternative provisions for the appointment of an appraiser similar to that in BCL 623.

Both BCL 623 and 1118 provide the method for the determination of the fair value of shares, the first section being addressed to the problem of dissenting stockholders of corporations being merged, purchased or restructured and the second, to the problem of buying out for fair value the shares of a minority stockholder thereby assuring survival of a close corporation notwithstanding the commencement of proceedings by the minority stockholder to dissolve it. The Court in Delinko

rejected Allison's objection to invoking BCL 623(h)(4) observing that reliance on Fleischer, supra, was misplaced and that:

> "The appraiser appropriately observed that because of the similarity in purpose between section 623(h)(4) and section 1118(b) of BCL, 'the cases interpreting 'fair value' under section 623 are highly relevant in forming the basis fordetermination of 'fair value' under section 1118(b) * * *'
>
> Moreover, it is a general rule of statutory construction that where a word has been used in a particular sense in one part of a statute, it is to receive the same meaning when used in other parts of the statute unless a different meaning is indicated (56 NY Jurisprudence, Statute, sec. 141). Thus the appraiser's utilization of the valuation criteria and standards articulated by our courts in respect to proceedings under BCL 623(h) was proper. It is clear from a reading of his report that he correctly took into account and gave consideration to market value, investment value and net asset value in determining the 'fair market' value of the shares of Sunshine and Holdee (see Matter of Behrens, 61 NYS2d 179, aff'd 271 App Div 1007; Matter of Marcus (Macy & Co.), 273 App Div 722, aff'd 303 NY 711)."

Neither section 623 nor section 1118 of the Business Corporation Law, each designed to remedy different problems, sets forth any factors, criteria or standards by which the fair value of the subject corporate shares is to be determined. (See Matter of Endicott Johnson v. Bade, 37 NY2d 585, 587). In the situations to which each section is addressed, both require the court to make the ultimate determination of fair value, in the case of section 623, "as of the close of business on the day prior to the

shareholders' authorization date, excluding any appreciation or depreciation directly or indirectly induced by such corporate action or its proposal", and in the case of Section 1118, "as of the day prior to the date on which such petition was filed, exclusive of any element of value arising from such filing."

One of the procedural differences between the two sections is that section 623 provides for the following alternative:

> "The court may, if it so elects, appoint an appraiser to receive evidence and recommend a decision on the question of fair value. Such appraiser shall have the power, authority and duties specified in the order appointing him, or any amendment thereof." (Emph. added.)

Whether the Court iself hears the legal evidence on the question of fair value of the shares involved or whether it judicially reviews the evidence adduced before an appraiser (Amella v. Cons. Edison Co., 73 NYS2d 263, 266, affd 273 App. Div. 755) upon a motion to confirm, modify, or reject his recommendation, the ultimate determination of the issue of fair value rests solely with the Court (Matter of Endicott Johnson v. Bade, supra, at page 588; Matter of Kaufmann, Alsberg & Co. v. Green Co., 30 Misc 2d 1025, 1031, affd 15 AD2d 468). This duty of

ultimate determination is analogous, where, as here, the Court chose a referee pursuant to CPLR 4212 (See Matter of State Farm Mutual Ins. Co. (Meneses) AD2d , NYLJ., Dec. 10, 1982, p. 12, Col. 5) to hear the legal evidence on the issue (as was done in Matter of Fleischer, supra), whose report recommending a determination of fair value, likewise, is subject to a motion to "confirm or reject, in whole or in part" (CPLR 4403; Matter of Galiber v. Previte, 40 NY2d 822, 824; Bannon v. Bannon, 270 NY 484, 492) upon the transcript of testimony taken by the referee (CPLR 4320).

Examination of the record on appeal and briefs in Matter of Fleischer, supra, reveals that only the narrow question of incorporation by reference of selected procedural portions of BCL 623 was decided. The Court was not asked nor did it address itself to criteria for determining fair value under that statute or BCL 1118 both of which are silent on that subject. Nor was the Court called upon to decide whether any criteria established by case law for determining fair value in proceedings under Section 623 may or may not be used for determining fair value in proceedings under Section 1118 of the Business Corporation Law.

The fair value of petitioner's 25 percent minority interest in the close family service agency here involved is a question of fact in light of relevant elements which enter into evaluating such interest fairly in relation to the particular activity in which it is engaged as a continuing going concern business and in

context of a hypothetical sale between a willing seller and buyer (See 33 Mercer Law Review 457 (1982), "Valuation of Business Interests" by Harry J. Haynsworth IV; and "The Valuation of a Closely-Held Business" by David W. Hardee, ALI-ABA Course Materials Journal, Part 1, June 1981, Vol. 5, No. 6 at p. 38; Part 2, August 1981, Vol. 6 No. 1, at p. 91; and Part 3, October 1981, Vol. 6 No. 2 pp 83 et seq). Absent statutory criteria, judicial and academic authority articulating factors for determining fair value, if appropriate, are in my opinion, relevant whatever the purpose of the valuation, at least, to aid the trier of the facts in determining whether erroneous theories or criteria of valuation were used by the parties' experts and certified public accountants or the record does not support their methods or results.

Petitioner's attorney concludes in his post-hearing brief that $172,542.47 was the fair value on August 3, 1981 of his client's 50 shares of stock in the Agency by a "cash payment". This is one quarter of the Agency's "gross" valuation of $690,169.88 arrived at on the basis of the summary on page 10 of the report of Herbert Lapidus, his insurance expert (Exhibit 10) as adjusted by testimony (SM 287-300). In a prior part of his brief, however, the conclusion reached, apparently upon the calculations by Mr. Lapidus (Ex. 10), is that $648,274.21 was the "gross value" of the Agency, and $162,068.55 the fair value of petitioner's 25 per cent interest using a multiplier of 2 in

respect to the Agency's fiscal 1981 commission income of $254,210.26.

In still another part of his brief, petitioner's attorney reached the figure of $604,654.35 as the "gross value" of the entire Agency based upon the testimony of accountant Venezia, who rounded out that figure to "approximately $600,000" or $150,000 for the petitioner's 25 per cent minority interest. Mr. Venezia applied "a general formula that's used by the IRS when an item of good will in a business is questioned" regardless of the nature of the business (SM 75-77). He practically developed his own formula since only three (3) years of unaudited financial statements were available as against the five (5) years required by the Internal Revenue Service ruling (SM 110-12) which also recognizes "discounts" (SM 144,153).

Petitioner's reply brief, received on November 22, 1982, concludes, however, that the Court should "set the fair value of his stock interest at one-fourth of the high fair value determined by Mr. Lapidus, to wit, the sum of $195,535.88 or in no event less than the median value of $172,542.47". These figures are based on tables at pages 9-10 of that reply brief which vary from petitioner's expert's (Lapidus) typewritten tables at page 10 of his appraisal report (Ex. 10), even with respect to the "median" table as revised at the hearing by Mr. Lapidus in his own

handwriting. No reference was made to the testimony and conclusions for lesser amounts reached by Mr. Venezia.

Respondent's attorney, in his post-hearing brief, urges a recommendation of $25,000 as the fair value of petitioner's specific 50 shares of stock as of August 3, 1981 payable in cash. After attempting to reconcile the results of the methods employed by petitioner's two expert witnesses and outlining in Appendix 2 respondent's insurance expert's (Pollock) capitalization of earnings as shown in the financial statement for fiscal year ending June 30, 1981, it is concluded that:

> "The evidence available to establish market value is too remote. Accordingly, Petitioner's shares have no market value. The net asset value of Petitioner's share should be established at $23,829, which is discounted book value. The investment value of Petitioner's shares should be established at $25,808, which is the discounted capitalized earnings value. Respondent's valuation of $25,000 would represent a 60% weight being given to investment value, a 40% weight being given to net book value and a zero weight being given to market value."

So wide apart are the respective valuations of the parties, that the trenchant comment by Justice Brandeis on the subject of experts' reports is pertinent to the instant case (Missouri ex rel S.W. Bell Tel. Co. v. Pub. Service Comm., 262 U.S. 276, 299). Referring to calculations made by an engineer, Justice Brandeis stated:

> "But gradually it came to be realized that the definiteness of the engineer's calculations was delusive; that they rested upon shifting theories; and that their estimates varied so widely as to intensify, rather than to allay doubts." (Emph. added.)

Since the statute is silent as to how fair value of a minority interest may be determined, I shall resolve the dilemma in the manner of a common-law trier of fact, adapting such elements of fair value established by rulings of the Internal Revenue Service (Exs. C & D) and analogous New York case law in proceedings under BCL 623, likewise without criteria, as I believe appropriate in achieving a realistic and just result upon the particular facts and circumstances of this case.

Arthur R. Venezia, the certified public accountant for the petitioner, based his valuation largely upon the eight factors delineated in Internal Revenue Ruling 59-60, C.B. 1959-1 page237 in evidence as Exhibit "C" with adjustments due to the availability of only three years financial data. Professor Harry J. Haynsworth, in his article on "Valuation of Business Interests" (1982), 33 Mercer Law Review 457, 466-467, states:

> "The most complete statement of the relevant factors to consider in valuing a closely held business is contained in Revenue Ruling 59-60. This ruling, which has been influential in nontax as well as tax valuation cases, lists eight non-inclusive fundamental factors that should be considered in each case * * *. Of these factors, the two that are generally

> given the greatest weight are net asset value and earnings. Nevertheless, all the factors must be considered in making the valuation." (Emph. added.)

Just as Revenue Ruling 59-60, as amended, "has been influential in nontax as well as tax valuation cases", so should the elements developed by case law in relation to determining "fair value" of dissenting stockholders' shares under BCL 623, be influential in the determination of the "fair value" of the shares of minority stockholders under BCL 1118. Professor Haynsworth, in his article - "Valuation of Business Interests" 33 Mercer Law Review 457 (1982) states at page 509:

> "Aside from the necessity of complying with the requirements in the statutes, the determination of value in a dissenters' rights valuation case is essentially the same as in other valuation cases. Thus, most courts give primary weight to net assets, earnings, and, in situations involving publicly traded companies, market value of the stock." (Emph. added.)

In any event, Mr. Lapidus, petitioner's expert, stated (SM 189):

> "Subjective judgment is always involved in determining the value of an agency because so much of it is intangible, and because of that arguments can be made for using multiples other than the median one which I felt was the fair multiple, and as a result, I used a higher and low multiple for the intangible assets. The current assets can vary based upon the fact that we didn't, at the time this was made up, we didn't have the figures for

> the date, we had it for the end of the fiscal year rather than the working date."

The Court of Appeals, in an analogous valuation proceeding under BCL 623, held that the determination of fair value requires the consideration of market value, investment value and net asset value (Matter of Endicott Johnson Corp. v. Bade, 37 NY2d 585, 587-8), with "all three factors * * * to be considered" to provide "the elasticity deemed necessary to reach a just result * * * (and that) the weight to be accorded to each varies with the facts and circumstances is a particular case * * *" citing Matter of Fulton, 257 NY 487, 494. The Court then concluded:

> "It follows that all three elements do not have to influence the result in every valuation proceeding. It suffices if they are all considered. Compelling the consideration of all of them, including those which may turn out to be unreliable in a particular case, has the salutary effect of assuring more complete justification by the appraiser of the conclusion he reaches. It also provides a more concrete basis for court review." (Emph. added.)

Exhibit "D" in evidence, outlines at page 328 thereof subsequent modifications of IRS 59-60 upon which Mr. Venezia relied. In "The Valuation of a Closely-Held Business" (Part 1) by David W. Hardee (ALI-ABA Course Materials Journal, June 1981, Volume 5, No. 6, at pages 40 et seq), it is stated at page 40 that the last three sentences of Section 4.02(f) of IRS 59-60 were deleted by IRS 65-193 and that:

"b. Revenue Ruling 59-60 admits that a determination of fair market value is a question of fact which depends upon the circumstances of each case; that valuation is not an exact science; and that common sense, informed judgment, and reasonableness are required."

F. FACTORS FOR THE VALUATION OF PETITIONER'S 50 SHARES

Before applying, separately, the factors established by Internal Revenue Service rulings and by New York case law as outlined in Matter of Endicott Johnson, supra, I shall add to the general findings already made, findings upon specific issues peculiar to the situation involved in this case and the radically different conclusions reached by the opposing insurance agency experts and the certified public accountants, professing to have utilized the same financial and background data of the Agency.

1. Richard's April 1971 "Sale" of His Quarter Interest:

The Agency is not listed nor has its stock ever been traded on any exchange or on an over-the-counter market. Except for Richard's sale of his 50 shares to his brother William, in April 1971, ownership of the stock of the corporation has continued in the brothers as bequeathed by their father in 1968. That transaction in 1971 I find, was not an arm's length "sale" reflective of the then value of the 50 shares transferred to William. It was an internal transaction triggered by Richard leaving and setting up his own business in Suffolk County since

"there was a lot of friction * * * under a stock relationship * * * with tremendous stress" (SM 791-2) - "mostly due to family atmosphere * * * between brothers operating a business" (SM 474). The consideration was the payment by William of the $4,200 that Richard owed the corporation. Richard did not execute any noncompetitive covenants or anything else except an hold-harmless agreement (SM 468-9).

The payment of his debt to the corporation, testified Richard, "had nothing to do with the value of the stock", which he presumed "would have a fairly decent value" in 1971 taking into consideration "the common multiple factors that are utilized in the insurance industry" (SM 792-8). James M. Burns, the certified public accountant for the Agency thought, however, that it had operated at a loss of almost $6,400 based on its financial statement ending June 30, 1970, last preceding the April 1971 sale (SM 556-60). At that time neither the petitioner nor Robert was active in the business except that the latter was, as now, vice-president without compensation (SM 444-5).

Yet, Mr. Pollock, respondent's insurance agency expert relied upon the $4,200 "sale" in 1971 of Richard's one quarter minority interest to William, developing comparable current valuations by the application of the 1971 price/earning ratio to the earnings shown in the unaudited financial report for fiscal year ending June 30, 1981 (Ex. 5). He also adjusted the 1971

consideration of $4,200 for Richard's 50 shares in proportion to the increase in adjusted net revenues between 1971 and 1981 (SM 677-84). I am unable to accept these calculations based as they are upon the 1971 transaction above described which I do not find to be appropriate nor realistic for the use made by Mr. Pollock. Where the expert testimony is manifestly unreasonable on its face", it need not be accepted (Matter of Gilbert, 176 App Div 850, 854).

2. POLLOCK'S COMPARATIVE LISTED AGENCIES

For comparison, respondent's insurance agency expert, Pollock, at page 24 of his Report (Ex. B), relied upon price/earnings ratios of three large, listed publicly traded, nationwide, even international, insurance brokerage agencies. This he did, apparently, because of factor .01(h) in Section 4, page 239 of IRS 59-60 (Ex. C). Attached to this Report are the Standard & Poor's Reports on these agencies for 1981 (Appendix 5, 6 and 7). A mere perusal of these reports demonstrates the utter lack of resemblance to Blake Agency - a one-man personal service operation as compared to these huge agencies with tremendous books of business, subsidiaries, and acquisitions, two actively traded in volume on the free and open market of the New York Stock Exchange, and one, Alexander and Alexander, traded freely on the over-the-counter market (NASDAQ). Speaking generally concerning such large agencies, not necessarily the three named by Mr.

Pollock, even respondent's accountant, Burns, attested to their difference from the one-man personal service Agency herein. He testified on cross-examination (SM 638) as follows:

"Q. Wouldn't you characterize most insurance agencies as a personal service business where customers are sold on personal contact?

A. No.

Q. Where do you place the distinction?

A. There are certann types of insurance agencies, such as the ones advertised on the television and radio, you know, if you have 400 tickets, you'll only pay $22.00 for minimum liability, I don't believe they are personal service businesses. The larger type of insurance agencies tend not to become so much of a personal service business, they have a large tremendous book of business that came about as a result of advertising or as the result of saturation campaigns by salesmen." (Emph. added.)

In Righter v. The United States, 439 F 2d 1204, the United States Court of Claims (1971), speaking of comparisons with listed stock of corporations engaged in the same or a similar line of business, as a factor for the appraisal of closely held corporate stock, for estate tax purposes, observed at page 1207:

"The comparative appraisal method produces, nevertheless, no magic formula which rigidly gives the exact valuation answer. Companies are rarely identical in size, operation or product, and allowances must be made, as the statute says, for 'all other factors.' This would necessarily include the very fact of unmarketability of the stock of the closely held corporation. In the last analysis, much

necessarily depends on the informed judgment of the knowledgeable investor concerning the refinements and adjustments to be made in arriving at the ultimate valuation figure."

In context with the valuation problem at bar, I find that the three large, listed, actively and freely traded agencies upon which Mr. Pollock relied, unacceptable for purposes of comparison with Blake Agency, having no market and personally serviced solely by one man - William - with no one else keeping, replenishing or otherwise obtaining new customers or other corporate opportunities.

3. WILLIAM'S COMPENSATION

The Agency's book of premium business is 1.8 million dollars from approximately 1400-1500 customers (SM 370, 525, 533). The acquisition of petitoner's 50 shares by the Agency will not change the concomitant commission revenue and service expense (SM 531-3).

I find that for personally servicing this volume of business on a full time basis, William Blake has received some $84,000 annually, as set forth below (SM 616), ever since the January 1, 1979 resolution of the Board of Directors changed (SM 92) his compensation for fiscal year ending June 30, 1979 which was audited by Internal Revenue Service (SM 579-80):

Base compensation - - - - - - - - - - - - - - -	$ 55,000
Commission for new business of 30 percent -	$ 16,358
Pension contribution - - - - - - - - - - - - -	$ 9,350
Automobile and entertainment expense - - -	$ 1,800

Health insurance	$ 752
Life insurance	$ 832
Total	$ 84,092

When respondent's accountant's (Burn's) attention was drawn to the view that this compensation was excessive as claimed by Mr. Venezia (SM 23-28) and Mr. Lapidus (SM 238, p. 7, Ex. 10), and that William could be replaced by an account executive for a yearly base salary of $25,000 plus 60 percent of new business generated by him the first year (SM 238-24)), Mr. Burns stated that it was impossible for a volume of 1.8 million dollars in premiums from 1400-1500 customers to be serviced by one account executive and that at least two would be required.

Based upon the claim of Mr. Lapidus that a base salary of $25,000 for an account executive plus 60 percent of new business generated by him, the industry standard (SM 245), then two executives, the minimum required for servicing an 1.8 volume of business, according to Mr. Burns, would cost $50,000 a year in salary with $32,000 more for commissions on new business at 60 percent on the basis of the $16,000 received by William on only 30 percent of new business. When perquisites are added, including 15 percent for profit sharing, the overall compensation for two replacements for William would exceed the $84,000 he has received since 1979 (649-651).

I am persuaded by the practicality and logic of the above views of Mr. Burns. I cannot conceive that a large book of business as personal as that of the Blake Agency could operate without loss of customers, at least for some time, even with two replacements. I find that William Blake's compensation was reasonable considering the time and effort he has devoted to the business as its one-man operator since April 1971.

Accordingly, the $84,000 package of compensation added by Mr. Venezia to the Agency's net income, cannot be accepted. In the first place, he had no experience with insurance agencies (SM 66) and claimed familiarity only with Internal Revenue Service values of any business having good will (SM 69). He reached the value of $465,000 for the Agency's good will by adding to the president's compensation of $84,000 a year, the average corporate earnings of $9,000 per year during the last three years, making a total of $93,000 which, when multiplied by five (5), resulted in the $465,000 which he said should be the Revenue Service's interpretation of the Agency's good will value, alone, without considering retained earnings, depreciated physical assets and stockholders' equity - totalling $139,654 (SM 70-75).

4. Agency's Purchases of Other Agencies

Some six years ago (SM 505) respondent purchased two small agencies, Damon and Schaeffer, whose principals were approximately in their late fifties and sixties, respectively.

Each participated without remuneration during at least six months visiting their former accounts with William Blake (SM 514). The consideration for one of these agencies, Damon, was 50 percent of the average local retained agency commission without adjustments, over a period of four years - at that time, in effect, a two times multiple (SM 505-6) which "worked out * * * between one-and-a half and two times" over the four year period (SM 509-510). The Schaeffer Agency was purchased within a month or two thereafter on the basis of similar terms, as Damon, but for a period of only three years with respect to the 50 percent of retained commissions without adjustments, computed into the area of "one-and-a half times max * * *" (SM 511-12).

With regard to Damon there was a noncompetitive agreement without a piracy clause and as to Schaeffer, a covenant of noncompetition from the principal (SM 528). The purchase price was based on actual retainage of commissions; in the event of a mid-term cancellation, that was debited back against the seller's account, the respondent not paying for business it did not retain. No payment was made for policies not subsequently renewed (SM 529-30). On new business generated from an existing account, commissions were paid to the sellers neither of whom produced either a gain or loss because they were paid on a 50 percent basis (SM 532-534). I find that these two small agencies were

purchased for a multiple of no more than about one and one-half times commissions actually earned during future years (SM 530).

5. Negative Factors in The Industry Since 1979

At least from 1979 during the three-year period of the financial statements in evidence, the insurance market has been "soft" (SM 490-2) creating problems for insurance agencies in the metropolitan area (SM 454). William Blake testified without contradiction that insurance companies have reduced premiums basically across the board on risk thereby reducing commissions to get cash flow for investment purposes. Changes in premium-billing procedures were also made placing agencies on an "on an account current" basis requiring them to remit premiums to the insurers by September 15th whether or not collected. Losses for earned premiums resulted when an account was subsequently cancelled without paying the Agency when it had already paid the insurance company; the difference between the premium earned for that given period of time until cancellation thus became the obligation of the Agency, "which is a big difference in the last three or four years as it was previously." (SM 455-6). This testimony was supported by respondent's witness, Mr. Pollock (SM 688-91).

Before direct billing was started there was a span of about 45 days between billing and remittance of premiums thereby enabling the Agency to use the premiums paid to it as working capital which was kept separately and the money invested in

certificates of deposit with the interest therefrom retained by the Agency (SM 457). On cross-examination, however, Mr. Blake conceded that the respondent's accounts receivable remained in the same area during the last three years ending with fiscal 1981; that although overhead expense was not lowered, direct billing has caused him "more headaches and loss of time and money" due to loss of interest on the premiums theretofore invested in certificates of deposit for which the Agency did not have to account to the insurers. In fact, its separate premium account is audited both by the insurance companies and the Superintendent of Insurance (SM 493-8).

6. SUB-PRODUCERS

The Agency is a direct contact business (SM 488). The commission income from 10 of its largest customers is about 40-45 percent of the total and some 20 percent thereof (SM 463) from five subproducers (SM 516). Mr. Blake further testified that there is no and never has there been any contractual relationship with the Agency's subproducers all of whom are independent insurance brokers on a cordial relationship with him (SM 463). They simply present business to the Agency which either writes it for half the commissions (SM 205) or declines it (SM 450). Of the five subproducers, two have been serviced by the Agency over five years and three during the last three. Four of them operate in the greater Flushing area and one in Farmingdale, Suffolk County.

William Blake has no financial interest in any of them (SM 489-90).

Mr. Lapidus testifying for petitioner, stated that subproducers may or may not be discounted by a substantial or small amount depending upon the nature of the suproduction. If they are employees of the Agency and their business is owned by it, the subproduction has value. If the subproducers continue to own their accounts and merely make the Agency a vehicle for servicing them, subproduction has little or no value except as a small income producer for the Agency itself (SM 177 178) which should be deducted for the full 20 percent (SM 282). He also stated that subproducers - outside brokers - have nothing to sell when they retain title to their expirations or customer lists and are not contractually bound to the Agency (SM 195-206).

On the basis of all of the foregoing, I find that the subproducers using the Agency to write their books of business for 50 percent of the commissions derived, retain title to their customers so serviced and are not employees or otherwise contractually bound to continue using the Agency. The arrangement is simply at the will of either. Accordingly, the Agency's commission revenue produced by subproducers must be deducted from the commission income reported in the financial statement for fiscal year ending June 30, 1981 (Ex. 5) upon which both sides relied.

G. FAIR VALUE ACCORDING TO IRS RULINGS

Professor Haynsworth in his article on "Valuation of Business Interests", supra, quoted at pages 476-7 of 33 Mercer Law Review (1982), from Professor Dewing's Work on "Financial Policy of Corporations" (5th Ed. 1953) as did also, Justice Alexander in Matter of Delinko, supra, wherein are set forth three of Professor Dewing's seven categories of business with various multiples appropriate to each type. The appraiser in that case adopted a 2.5 multiplier as the appropriate factor in capitalizing the net earnings of Sunshine Temporary Office Personnel, Inc., one of the corporations there involved. The court found this multiple unsupported by the evidence, noting that "Sunshine is more nearly a '7. Personal Service Business'" described by Professor Dewing as follows:

> "7. Personal service business. They require no capital, or at the most a desk, some envelopes and a few sheets of paper. The manager must have a special skill coupled with an intensive and thorough knowledge of his subjects. The earnings of the enterprise are the objective reflection of this skill; and he is not likely to be able to create 'an organization' which can successfully 'carry on' after he is gone. He can sell the business, including the reputation and the 'plan of business', but he cannot sell himself, the only truly valuable part of the enterprise - 100%, a value equal, approximately, to the earnings of a single year." (Emph. added.)

Inasmuch as analysis showed that Sunshine had some of the characteristics of the "6. Industrial Business" category to

which Professior Deming gave "a value approximately twice the net earnings", Justice Alexander applied an 1.5 factor to Sunshine's earnings in determining its value. This factor was applied because both Delinko and Allison were "the key to its operation" as revealed by the record, its history, its prospects, and all the facts and circumstances; and that "they are the primary moving forces behind Sunshine because they are responsible for and control all of Sunshine's clients."

Counsel for the petitioner argues at page 6 of his reply brief that Matter of Delinko is distinguishable since it involved an employment agency and that none of the other, including tax cases cited by respondent, pertain to an insurance agency and that since this is "a case of first impression * * * the referee is free to use any method or combination of methods * * * in arriving at the fair value." This is reasonable.

I point, however, to Donehoo, Executrix etc. v. United States of America, U.S. District Court, West. Dist. Pa., Civil No. 66-572, 3/27/68, Sorg, District Judge (U.S. Tax Cases, Vol. 68-1, Commerce Clearing House, Inc.). That decision of which a copy is attached for convenience, involved the valuing of a decedent's 92 percent interest in "a fire, casualty and automobile insurance agency" for purposes of taxing the right to succeed thereto. The only item contested was "the assignment of a value in the amount of $40,500 to insurance policy 'expirations' (i.e.

good will)" of that agency not included in the estate tax return filed by the plaintiff executrix. In his conclusions of law, Judge Sorg stated:

> "2. The value of the expirations in decedent's insurance business represents an intangible asset of his estate subject to the federal estate tax laws (citations).
>
> 3. The fair market value of the expirations * * * at the time of decedent's death was $38,936.98.
>
> 4. At the time of his death decedent owned 92% of this asset, in the amount of $39,822.02."

The above conclusions were based upon a stipulation at trial that:

> "17. In the insurance industry one and one-half times the total commissions of an insurance agency received during the year preceding a proposed sale is generally regarded as a fair market price for the good will or expirations of such business * * *. (Emph. added.)
>
> 18. The gross commissions of the Donehoo Agency for the year preceding decedent's death amounted to $25,957.99."

While Judge Sorg applied to the $25,957.99 gross commissions of the Donehoo Agency for the year preceding the decedent's death, a multiplier of one and one-half, he did so, not as an independent judicial finding based on disputed evidence before him, but solely upon a stipulation at trial that such factor "is generally regarded as a fair market price for the good

will or expirations of such business", in Pittsburgh Pennsylvania where decedent had resided in 1962.

While Professors Haynsworth and Dewing and Justice Alexander in Delinko each speak about a multiple applied to the net earnings of a business to determine good will, the Donehoo case applies the multiple to the insurance agency's gross commissions. In the case at bar, both sides' experts also based their calculations on a multiple applied to gross commissions in 1981. I find that in the insurance agency business, an agency's value is calculated by reference to its gross commissions and not the agency's earnings or its "bottom line." I therefore find that an appropriate multiple should be applied to the Agency's 1981 gross commissions (less adjustments for subproducer and contingent income as previously discussed) to determine the value of the Agency's good will.

After consideration of the various multiples proposed, which range from under 1 to 2.5, I find that a multiple of one (1) times gross commissions is appropriate for the determination of the value of the good will of Blake Agency in Flushing, New York, as of August 3, 1981.

Indubitably, William Blake, alone, "is the key" to the Agency's operation, and its "primary moving force" because he is responsible for and controls all its clients. He is not bound by any employment or shareholder's agreements nor any non competative

or piracy covenants preventing him from setting up his own agency. At least some of the 1400-1500 customers of the respondent, in such event, are likely to flow to him even without his solicitation, because of his past direct personal service to them. Therefore, multiple of one times the commission earnings reported in the Agency's fiscal year ending June 30, 1981 as hereinafter adjusted may properly be applied here. In Commissioner v. Killian, 314 F2d 852, 855, (1963), the Fifth Circuit stated: that "information concerning fire and casualty policies written * * * over a period of many years * * * did indeed have intrinsic economic value in the nature of good will, which being made accessible to the purchasers gave reasonable expectation that the 'old customers will resort to the old place' * * *" and that "it is settled that good will, as a distinct property right, is a capital asset * * *".

The Agency's fiscal financial statement (Ex. 5) preceding August 3, 1981, reports a gross commission income of $254,210.26, the parties having conceded that there was no material variance during the short interval between June 30, 1981 when its fiscal year ended, and August 3, 1981. In the above total rounded out to $254,210, there was included, however, an item of $9,872 as "Contingency Income". Since this aspect was not addressed in the briefs I sent a letter to both attorneys dated November 29, 1982 of which a copy is marked Court's Exhibit 4. I

sought enlightment and hopefully, agreement whether the "Contingency Income" was properly includable in the gross amount reported. The responses from the respective attorneys marked, respectively, Court's Exhibits 5 and 6 indicate disagreement, albeit, reference to the record was made to aid the determination of the question upon the proof adduced.

Petitioner's expert witness, Mr. Lapidus, was rather equivocal on the subject of "contingency income" (SM 397-99). When asked whether it is "common to purchase contingency income", he answered - "It's done - sometimes its done and other times it is not" (SM 397). At page 8 of his appraisal report (Ex. 10), however, Mr. Lapidus stated that the Agency's "performance in 1981 was better, showing an increase to $244,338". This amount is precisely the arithmatical balance left after deducting the "Contingency Income" of $9,872 from the entire commission income of $254,210 shown for fiscal year 1981 (Ex. 5). Respondents' expert witness, Mr. Pollock, testified that he "reduced all three years the subproducer revenues * * * (and) the contingency revenues and I came down to an adjusted revenue" (SM 687). At page 20 of his appraisal report (Ex. B), Mr. Pollock deducted from the "gross revenues" of the Agency the precise amount for "Subproducer Revenues" and "Contingent Income", which for 1981 were $32,744 and $9,872, respectively, leaving "Adjusted Revenues" for that year of $211,594.

In light of the above, the $9,872 in contingency income during 1981, is deducted from the gross commissions reported for that year, totaling $254,210 leaving the balance of $244,338, also found by Mr. Lapidus. This sum is subject to deduction therefrom of the amount of commission revenue stemming from the five independent subproducers during fiscal 1981.

Nowhere in the testimony do I find evidence of the precise amount of commissions that subproducers generated during fiscal 1981. Mr. William Blake merely stated that "as far as commission income to the office", the subproducers produce "20 percent of our business" (SM 463). Inasmuch as the Agency's expert insurance witness, Mr. Pollock, stated on page 20 of his appraisal Report (Ex. B), that in addition to deducting from the 1981 gross revenue of $254,210, the sum of $9,872 for "Contingent Income" he also deducted the sum of $32,744 for "Subproducer Revenues", leaving $211,594 as the "Adjusted Revenues". I adopt these figures and find them accordingly, absent other or different proof of actual amounts.

This "adjusted revenue" of $211,594, the adjusted commission earnings for the year 1981, represents the good will of the entire Agency having 200 shares of issued capital stock. This amounts to $52,898 of good will, specifically for petitioner's one quarter interest subject, however, to deductions of "discounts" therefrom.

Professor Haynsworth states in his article at page 488 of 33 Emery Law Review, supra, that "After the value of the entire interest has been determined * * * the final step in valuing a particular interest in the business is to take into account any allowable discounts. The four discounts that are most often recognized in closely held business valuations are the following: (1) lack of marketability; (2) restrictions on resale imposed by securities laws; (3) minority interest; and (4) loss of key men. These discounts are not mutually exclusive. Therefore, they may be cumulative, if the facts justify the existence of more than one" (Emph.added).

I am of opinion that a discount for "lack of marketability" is here warranted since petitioner's interest, in the language of Professor Haynsworth (p. 489), is in "a closely held business * * * (which) interest cannot readily be sold * * *, (is) less marketable and, therefore, less valuable than equivalent interests in companies whose securities are regularly traded in a recognized market * * *".

There should also be a discount because of petitioner's minority (25 percent) interest in the Agency. As also pointed out by Professor Haynsworth in his article, supra (at pp 492-493): "A potential investor in a closely held corporation is willing to pay more for a majority interest in the business than for a minority interest because of the ability to maintain voting control and to

elect a majority of the directors * * *". At page 494 it is stated" Many cases, however, give an overall figure for both lack marketability and minority interest * * *".

Here, I believe there should be an overall percentage discount for both "lack of marketability" and "minority interest" which I find to be 40 percent.* There should be no other discount, i.e., for "loss of key man" inasmuch as that factor, I believe, applies to succession tax cases where the executive (here William Blake), is "the driving force behind the success of the business" whose demise "will usually have a more adverse impact on a small closely held business than it will in a large company" (Haynsworth at page 496 of 33 Mercer Law Review).

The combined overall discount of 40 percent on petitioner's minority good will interest of $52,898 is $21,159. When this discount is deducted from the $52,898 a balance of $31,739 remains as the value of the good will of petitioners specific one quarter interest.

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*In Hardee's Article, ALI-ABA Course Materials Journal, above cited in Part 3, Vol. 6 No. 2 pages 83-84, discounts allowed for lack of marketability were stated to be in the range of 10%, 15%, 17.7%, 20%, 25%, 30%, 33 2/3%, and 35%. The author states (p. 85) that, "separate discounts should be allowed for lack of marketability and for a minority interest, since a majority interest may suffer from lack of marketability. But the cases usually merge these discounts and do not distinguish between them". Such are in the range of a "50% combined discount". See also, "C. Discounts" at pages 488 et seq. of 33 Mercer Law Review (1982), supra.

To this $31,739 must be added petitioner's share of tangible assets as reported in the financial statement for fiscal year ending June 30, 1981. Shown therein, are total assets of $321,443.03, comprised of $154,380.64 in cash; $48,105.29 in marketable securities (valued at cost); $111,686.19 in accounts receivable; and $7,270.91 of fixed assets, so valued after deducting accumulated depreciation. While some of these figures would be increased were fair market value used instead of cost such as the value of the fixed assets, which has been decreased by the accumulated depreciation of $11,027.35, other figures, such as the accounts receivable and the securities, are apparently less valuable at market value than the balance sheet indicates. I find that the total assets figure shown on the June 30, 1981 balance sheet, $321,443.03, is therefore appropriate for determining the petitioner's share of the Agency's net assets.

This balance sheet also discloses current liabilities of $189,060.25, the largest portion of which represents premiums payable. When the current liabilities are deducted from the total assets ($321,443.03 less $189,060.25), $132,382.78 remains. This figure is comprised of capital stock, $1,500; capital surplus, $2,076.44; and retained earnings of $128,806.34. The figure of $132,382.78 represents the net balance sheet value, or the net value of the tangilbe assets of the Agency. Petitioner's 25 percent share thereof, therefore, amounts to $33.095.

Petitioner's 25 percent share of the net tangible assets, composed primarily of retained earnings the corporation chose for whatever reason not to distribute through dividends, should not be discounted. The factors previously discussed regarding the petitioner's minority status in the Agency and the lack of marketability have no application in the context of tangible assets.

Based on the above and using the criteria set forth in the Internal Revenue Service rulings, as adapted to the facts in this case, I find that the "fair value" of petitioner's 50 shares was $64,834 on August 3, 1981, of which $33.095 represents his share of the tangible assets and $31.739, his share of the intangible asset of good will.

H. FAIR VALUE ACCORDING TO NEW YORK CASE LAW

The factors summarized by the Court of Appeals in Matter of Endicott Johnson Corp. v. Bade, supra, 37 NY2d 585, will next be considered insofar as each factor - market value, investment value and net asset value - is applicable to the particular facts and circumstances involved in this case.

For the reasons previously discussed, I find that neither the 1971 sale of Richard's 25 percent interest in the Agency to William nor the three large listed, actively traded agencies offered by the respondent as comparatives are realistic evidence to be considered upon the issue of the Agency's market

value on the relevant date. It is to be noted that no other evidence was adduced concerning the market value of the shares of this comparatively small, closely-held, local corporation whose stock is not freely traded on any public exchange and there have been no private sales for over ten years since April 1971. Accordingly, "market value" is of no assistance in this case in determining "fair value".

Turning to "investment value", I note that there is no precise definition given to this factor by New York Courts:

> "Investment value is not subject to a nice definition or determination, but takes into account factors such as the capitalization of the company, earnings and dividend record, position in the industry, prospects of the business and the industry, and the overall value of its securities in relation to general market conditions and the market values of comparable securities". (Emph. added; 11 NY Jur2d, Sec. 608 (footnote omitted.))

The elements considered in determining investment value are very similar to those stated in IRS Revenue ruling 59-60 discussed above. The weight to be accorded each indicia of a corporation's investment value varies depending upon the type of entity involved. "No rule can be laid down for determining the actual or true value of stock of a given class except one of a very general nature and which may, in a particular case, be inapplicable * * * because of the existence of a state of facts

peculiar to the situation involved in the particular case". (Matter of Fulton, supra, 257 NY 487, 494).

I find that the "investment value" of the Blake Agency on August 3, 1982 is represented by the value of the Agency's net tangible assets, comprised primarily of its retained earnings, plus its intangible good will. I further find that the discounts applied to the petitioner's 25 percent minority interest of the Agency's good will (discussed in relation to the Internal Revenue rulings) are fully applicable here, although the petitioner's share of the tangible assets should not be so discounted. Accordingly, I conclude that the Agency's "investment value" is equal to the value calculated pursuant to the criteria discussed with reference to the IRS revenue rulings - $64,834.

The final factor considered under state case law is the "net asset value". Again, I find that the Agency's value consists of the total of its tangible and intangible assets. However, were the Agency valued as though it would not be continued as a going concern business, I believe that some adjustments would be in order. Having found that the value of the Agency's good will was one times its annual commission revenue after deducting subproducer and contingent income from the 1981 income statement, there would be added to the resultant balance of $211,594, the net balance sheet asset figure of $132,382.78, for a total Agency value of $343,976.78. However, in the context of deriving a "net

asset value", I do not believe it appropriate to discount petitioner's 25 percent interest to any extent.

Were the Agency being liquidated, it would not matter whether the petitioner owned a majority or a minority interest -- all of its 200 issued shares would be of equal value. It is only when, as here, the Agency will continue as a going concern business, that petitioner's status, whether minority or majority, becomes relevant. Therefore, based solely upon the "net asset value" of the Agency, the value of petitioner's 50 shares would be 25 percent of the total Agency worth of $343,976.78, or $85,994 as compared with the $64,834 found to be the "fair value" under internal revenue rulings adapted to the facts in this case, which amount has also been found to be the "investment value", one of the three elements considered under New York case law, based upon the same salient financial data.

Here, however, the Blake Agency is not to be liquidated by dissolution. Consequently, its "net asset value" should play no part in or influence the determination of the "fair value" of petitioner's quarter interest therein. In Seaboard World Airlines, Inc. v. Tiger International, Inc., 600 F2d 355, the Second Circuit speaking through Judge Mulligan in context with New York shareholder appraisal suits, observed at page 362:

> "The remarks of one commentator respecting valuation of the shares of a dissenting stockholder under state appraisal statutes are

> ironically pertinent to the instant case. 'In most cases liquidation value of assets is not an appropriate consideration since 'liquidation' comprehends the termination of the business and disposal of the assets. Valuation on such a basis would be unrealistic except possibly when the firm is insolvent or when certain assets are idle and of no further use to the company. Most courts generally prefer to look to the 'going concern' value. Note, Valuation of Dissenters' Stock Under Appraisal Statutes, 79 Harv.L. Rev. 1453, 1457 (1966)(emphasis supplied)."

Should the Court, nevertheless, decide to permit "net asset value" to influence the result in this case, then, I perceive no rational basis for exclusive reliance upon one or the other valuation reached above; i.e., $64,834 or $85,994. As pointed out in Matter of Endicott Johnson, supra, at page 588: "The three elements are not discrete; defitionally, they may even flow into one another" (Emph. added). In other words, elements appropriate for determining value are not detached or separate from each other, but "may even flow into one antoher". With that concept in mind, the value of $64,834, I have reached pursuant to adapted Internal Revenue rulings, which also is the figure reached as the Agency's "investment value", one of the three elements articulated by New York case law, is blended or merged with the $85,994 calculated as the "net asset value", resulting in $75,414, as the value of petitioner's 50 shares on August 3, 1981.

The above approach applicable only if net asset value be cosidered, is a realistic and just method for determining the

"fair value" of petitioner's stock interest. It would not involve the impermissible averaging of the radically different claims of value reached by the parties; rather, it would be the "flow into one another" of the valuations I have reached giving consideration to various factors for determining value in this particular case. After all, as noted at page 23 of this Report by quotation from David W. Hardee's paper - The Valuation of a Closely-Held Business - "* * * valuation is not an exact science; and that common sense, informed judgment, and reasonableness is required". As noted by Judge Fuchsberg writing for the Court at page 588 of Matter of Endicott-Johnson, supra:

> "The ultimate valuation to the extent that it is confined to the issues of fact, rests largely within the discretion of the lower courts * * *" (Emph. added).

I. RECOMMENDATION

However, I recommend that the Court:

(a) Find and determine that the "fair value" of the petitioner's 50 shares of capital stock in respondent Blake Agency, Inc., was $64,834 as of August 3, 1981; and

(b) Direct the respondent Blake Agency, Inc., to pay to petitioner that sum in cash or by certified or bank cashier's check upon petitioner's delivery of his stock certificate for the 50 shares and such documents as may be necessary to effectuate its transfer to the Agency by a date

certain, fixed in the judgment to be made and entered (CPLR 411), as justice requires in the circumstances.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

Dated: December 20th, 1982

Samuel S. Tripp

SAMUEL S. TRIPP, Referee

of Elmer's estate subject to payment of claims (Section 474.160 V. A. M. S.), in addition to exempt property (Section 474.250 V. A. M. S.), and an allowance for a year's support (Section 474.260 V. A. M. S.). This she could not be deprived of unless she failed to timely elect to renounce the will (Section 474.160 V. A. M. S.). The statutory provision would have qualified for the marital deduction.

In view of the ambiguous language employed in Paragraph III it does not seem reasonable that plaintiff should have been put to an election to take the statutory one-half of Elmer's estate on the speculative possibility (which obviously did not occur either to her or to Edward) that a court would hold her interest was a life one only. Although the Probate Court in its order of distribution has in effect reached the same conclusion that we have, we do not rely to any extent on that fact or give any weight thereto (*Commissioner v. Estate of Bosch* [67-2 USTC ¶ 12,472], 387 U. S. 456), although it would appear significant that the only other major party in interest, Elmer's brother Edward, was the executor of the will and he petitioned for, or at the very least acquiesced in, the construction made by the Probate Court. No claim of collusion is made.

[Decision of Court]

We hold that the interest which passed to plaintiff under Elmer's will was a fee simple title and that the property so left to plaintiff qualifies for the marital deduction. Stated otherwise, such property is not disqualified for the marital deduction as a terminable interest.

We adopt the stipulated facts as our findings, and this opinion constitutes our conclusions of law. It follows that plaintiff is entitled to judgment. Pursuant to the stipulation, the parties are directed to compute the amount for which the judgment is to be entered, and in the event of their inability to so agree, a further hearing will be conducted to determine the amount of the judgment. The parties are directed to report to the Court within 30 days.

[¶ 12,519] Eleanor S. Donehoo, Executrix of the Estate of Robert S. Donehoo, Jr., Deceased v. United States of America.

U. S. District Court, West. Dist. Pa., Civil No. 66-572, 3/27/68.

[1954 Code Sec. 2031]

Estate tax—Valuation of other property—Insurance commissions.—In valuing insurance commissions (expirations) includible in a deceased insurance agent's estate, the court followed a method used for computing goodwill in the sale of an insurance agency. The court found that it is the practice of the insurance industry to value goodwill at one and one-half of the commissions received by the agency in the year preceding the year of sale. Using this formula, the court valued the commissions by multiplying the commissions received by the decedent's agency in the year before his death by 150%. The resulting amount was reduced to reflect a partner's interest in the commissions. See "Estate Tax" at ¶ 1215.459.

G. Kirby Herrington, 1230 Grant Bldg., Pittsburgh, Pa., for plaintiffs. Michael B. Arkin, Arthur A. Stern, Tax Division, Department of Justice, Washington, D. C. 20530, for defendant.

Findings of Fact

Sorg, District Judge: 1. The plaintiff, Eleanor S. Donehoo, widow of Robert S. Donehoo, Jr., and executrix of his estate, is a resident of Pittsburgh, Pennsylvania.

2. Robert S. Donehoo, Jr., hereinafter referred to as decedent, at the time of his death on August 13, 1962, operated a fire, casualty, and automobile insurance agency known as the Robert S. Donehoo, Jr., Insurance Agency.

3. Robert E. Donehoo, son of the decedent, was employed by his father to assist in the management and sales of the agency in 1958, and was employed there at the time of his father's death.

4. Robert E. Donehoo was to receive a salary of $400.00 per month plus the amount by which commissions on all new business produced by his own efforts exceeded his salary. It was also agreed that he was to have a proprietary interest in the business which he developed.

5. On November 13, 1963, plaintiff filed a federal estate tax return on behalf of the estate of Robert S. Donehoo, Jr. This re-

turn reported a total taxable estate of $24,511.27, and federal estate taxes due in the amount of $2,231.56, which amount was paid with the return.

6. After the death of decedent, plaintiff as executrix of his estate obtained a temporary license as an insurance agent from the Pennsylvania Insurance Commission in order to liquidate the business.

7. Plaintiff continued the employment of her son, Robert E. Donehoo, under this temporary license until October 1, 1962.

8. On October 1, 1962, Robert E. Donehoo entered into an agreement with plaintiff, the purpose of which was to carry on the business of the decedent.

9. According to the terms of this agreement, plaintiff and Robert E. Donehoo were to operate the insurance agency as a partnership. It was agreed that plaintiff owned 92% of the partnership capital and assets, and Robert E. Donehoo owned 8%. As to the division of profits, plaintiff was to receive 15% of the annual net commissions of the agency, in return for which her share in the capital and assets of the agency was to be reduced by 10% each year. Robert E. Donehoo, who was to manage the business, was to receive a salary of $725.00 per month, plus the increase of 10% of ownership of capital and assets relinquished by his mother each year.

10. On April 1, 1964, after plaintiff had received $5000.00, this agreement was terminated and a new agreement was entered into. According to the terms of the new agreement, Robert E. Donehoo gave a promissory note to plaintiff which obligated him to pay to her a total of $30,600.00 in monthly installments of $300.00 for 102 months. In return for this note plaintiff relinquished all of her interest in the partnership as of April 1, 1964.

11. On March 5, 1965, the District Director of Internal Revenue of Pittsburgh, Pa., assessed additional estate taxes in the amount of $4,033.90 and interest thereon in the amount of $300.28. These amounts were paid by plaintiff on February 9, and March 29, 1965.

12. This assessment was based upon adjustments increasing the amount of decedent's taxable estate to $46,661.29.

13. This increase consisted in part of the following adjustments, which are agreed to by plaintiff:

(a) Increase in gross estate (Schedule C) to include amount of savings account owned by decedent in Mt. Lebanon Savings & Loan Association	$2,601.00
(b) Increase in gross estate (Schedule E) by virtue of valuation of securities	118.53
(c) Decrease in deduction (Schedule J) for funeral and administration expenses	180.00
(d) Decrease in deduction (Schedule K) for non-deductible debts of decedent	900.51
Total Uncontested Increase (See Stipulation of Facts, p. 2)	$3,800.04

It was further stipulated at trial that the estate return over-represented liabilities by $700.00.

14. Only one item of adjustment is contested—namely, the assignment of a value in the amount of $40,500.00 to insurance policy "expirations" (i.e. good will) of the Robert S. Donehoo, Jr. Insurance Agency, which was not included in the estate tax return filed by plaintiff.

15. The Director also increased the marital deduction of plaintiff by $22,150.02, thus producing an increase in the net taxable estate of $22,150.02 upon which the above-mentioned additional tax and interest was assessed.

16. On August 9, 1963, plaintiff filed her claim under which she now seeks a refund of so much of the tax as is attributable to the value assigned to the aforesaid expirations.

17. In the insurance industry one and one-half times the total commissions of an insurance agency received during the year preceding a proposed sale is generally regarded as a fair market price for the good will or expirations of such business. This formula was also used by Robert E. Donehoo and the plaintiff in arriving at the terms of their two agreements.

18. The gross commissions of the Donehoo Agency for the year preceding decedent's death amounted to $25,957.99.

Conclusions of Law

1. This court has jurisdiction over the persons and subject matter of this action.

2. The value of the expirations in decedent's insurance business represents an intangible asset of his estate subject to the federal estate tax laws. *Commissioner v. Kelley* [63-1 USTC ¶ 9347], 314 F. 2d 852 (5 Cir. 1963); *Phillips v. Pa. Threshermen*, 199 F. 2d 244 (4 Cir. 1952); *Aitken v. Commissioner* [CCH Dec. 24,442], 35 T. C. 227 (1960); I. R. C. §§ 2031, 2032, 26 U. S. C. A. §§ 2031, 2032.