To be Argued by:
PHILIP H. KALBAN

New York County Clerk's Index Nos. 110474/07 and 110445/07

New York Supreme Court

Appellate Division—First Department

Application of ROBERT T. GIAIMO, Individually and as Co-Executor of the Will of EDWARD P. GIAIMO, JR., Deceased, for the Judicial Dissolution of EGA ASSOCIATES, INC.,

Petitioner-Respondent/Cross-Appellant,

– against –

JANET GIAIMO VITALE,

Respondent-Appellant/Cross-Respondent.

Index No. 110474/07

Application of ROBERT T. GIAIMO, Individually and as Co-Executor of the Will of EDWARD P. GIAIMO, JR., Deceased, for the Judicial Dissolution of FIRST AVENUE VILLAGE CORP.,

Petitioner-Respondent/Cross-Appellant,

– against –

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Respondent-Appellant/Cross-Respondent.

Index No. 110445/07

BRIEF FOR PETITIONER-RESPONDENT/ CROSS-APPELLANT ROBERT T. GIAIMO

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TABLE OF CONTENTS

Page(s)

TABLE OF AUTHORITIES....................iii

PRELIMINARY STATEMENT....................1

COUNTER-STATEMENT OF ISSUES PRESENTED....................4

ARGUMENT....................6

I. THERE SHOULD BE NO DISCOUNT FOR SPECULATIVE FUTURE CAPITAL GAINS TAXES....................6

A. Fair Value Presumes An Ongoing Business, Not One In Liquidation, And The Court Below Erred In Applying A BIG Discount....................6

B. *Wechsler* Has No Bearing On The Instant Proceedings....................18

C. Appellant's Arguments Are Without Merit....................22

D. If There Is To Be A Discount For BIG, Projected Costs Of Sale Should Be Deducted From The Projected Sale Proceeds....................27

II. THE COURT BELOW CORRECTLY FOUND THAT THERE SHOULD BE NO FURTHER DEDUCTION FOR MARKETABILITY....................29

A. The Shares Are Readily Marketable....................32

B. Past Accounting Irregularities Are Irrelevant Under The Asset-Based Approach....................33

C. The First Department Does Not Permit A DLOM For A Real Estate Holding Company....................34

D. A Marketability Discount Is Incorporated Into The Asset Valuation....................42

E. Baliban's DLOM Is Not Supported By The Studies He Cites....................45

III. THE REFEREE MISREAD LEVY'S TESTIMONY AND ERRED IN REDUCING THE APPRECIATION RATES USED BY LEITNER,THE JOINTLY RETAINED REAL ESTATE APPRAISER....................51

IV. THE EGA AND FAV CHOSES-IN-ACTION WERE ASSETS ON THE VALUATION DATE AND MAY NOT BE CONDITIONED ON FUTURE ACTIONS BY THOSE CORPORATIONS....................56

TABLE OF CONTENTS
cont'd

Page(s)

V. PREJUDGMENT INTEREST SHOULD BE AWARDED AT 9% 60

A. Limited Scope Of Reference...61

B. Respondent's Bad Faith And Oppressive Behavior 62

VI. RESPONDENT SHOULD BE HELD IN CONTEMPT FOR MAKING FALSE REPRESENTATIONS TO THE COURT AND THE JUDGMENTS SHOULD BE INCREASED BY THE PROPORTIONATE AMOUNT OF THE UNDISCLOSED ASSETS 64

CONCLUSION 67

TABLE OF AUTHORITIES

Page(s)

CASES

317 W. 87 Associates v. Dannenberg,
159 A.D.2d 245 (1st Dep't 1990) 64

Arnaud v. Stockgrowers State Bank,
992 P.2d 216 (Kan. 1999) 39

Borenstein v. Rochel Properties, Inc.,
216 A.D.2d 34 (1st Dep't 1995) 24

Brown v. Arp & Hammond Hardware Co.,
141 P.3d 673 (Wyo. 2005) 13, 14, 15, 38

Cawley v. SCM Corp.,
72 N.Y.2d 465 (1988) 21

Cohen v. Akabas & Cohen,
71 A.D.3d 419 (1st Dep't 2010) 30, 31

Cohen v. Cohen,
279 A.D.2d 599 (2d Dep't 2001) 36

Conway v. Carpenter,
43 Conn.L.Rptr. 422, 2007 WL 1600004 (Super. Ct. 2007) 15, 16

Estate of Jelke v. Commissioner of Internal Revenue,
507 F.3d 1317 (11th Cir. 2007) 20

Estate of Rothko,
84 Misc.2d 830 (Sur. Ct. N.Y. Co. 1975) 64

Frater v. Lavine,
229 A.D.2d 564 (2d Dep't 1996) 25

Friedman v. Beway Realty Corp.,
87 N.Y.2d 161 (1995) .... passim

Greek Peak Inc. v. Armstrong,
265 A.D.2d 760 (3d Dep't 1999) 41

Page(s)

CASES

Hall v. King,
177 Misc.2d 126 (Sup. Ct. N.Y. Co. 1998), *aff'd*, 265 A.D.2d 244 (1st Dep't 1999) 36, 37

Herman v. Gill,
61 A.D. 3d 433 (1st Dep't 2009) 25

In re 75,629 Shares of Common Stock of Trapp Family Lodge, Inc.,
725 A.2d 927 (Vt. 1999) 20, 26

In re McLoon Oil Co.,
565 A.2d 997 (Me. 1989) 39

Kim v. Kim,
170 Misc.2d 968 (Suffolk Co. 1996) 65

Lawson Mardon Wheaton, Inc. v. Smith,
734 A.2d 738 (N.J. 1999) 39

Lehman v. Piontkowski,
203 A.D.2d 257 (2d Dep't 1994) 41

Matter of Blake v. Blake Agency,
107 A.D.2d 139 (2d 1985) 34, 35, 36

Matter of Cinque v. Largo Enterprises of Suffolk County, Inc.,
212 A.D.2d 608 (2d Dep't 1995) 34, 35, 36, 37, 40, 41

Matter of F.P.D. Realty Corp.,
267 A.D.2d 111 (1st Dep't 1999) 56

Matter of LaSala,
Feb. 6, 2003 N.Y.L.J. (col. 1) (Sup. Ct. West. Co., Rudolph, J.S.C., Jan. 16, 2003) 17, 23

Matter of Murphy v. United States Dredging Corp.,
2008 WL 2401230 (Sup. Ct. Nassau Co., Warshawsky. J.S.C., May 19, 2008) 8, 23

Page(s)

CASES

Matter of Pace Photographers, Ltd.,
163 A.D.2d 316 (2d Dep't 1990)..62

Matter of Pace Photographers, Ltd.,
71 N.Y.2d 737 (1988)..61

Matter of Penepent Corp., Inc.,
96 N.Y.2d 186 (2001)..28

Matter of Rateau v. DAPA Communications, Inc.,
59 A.D.3d 1037 (4th Dep't 2009)...25, 41

Matter of Smith v. Russo,
230 A.D.2d 863 (2d Dep't 1996)..62

Matter of Town of Brookhaven v. New York State Board of Equalization and Assessment,
88 N.Y.2d 354 (1996)..22

Matter of Walt's Submarine Sandwiches, Inc.,
173 A.D.2d 980 (3rd Dep't 1991)..32

Matter of Whalen v. Whalen's Moving & Storage Co.,
204 A.D.2d 468 (2d Dep't 1994)..34, 35, 36, 37, 40, 41

Matter of Whalen v. Whalen's Moving & Storage Co.,
234 A.D.2d 552 (2d Dep't 1996)..35

Matthew G. Norton Co. v. Smyth,
51 P.3d 159 (Ct. of Appeals, Wash. 2002)..16, 21

Murphy v. United States Dredging Corp.,
74 A.D.3d 815 (2d Dep't 2010)...passim

O'Rourke v. Long,
41 N.Y.2d 219 (1976)..22

Paskill Corp. v. Alcoma Corp.,
747 A.2d 549 (Del. 2000)..11, 12, 38

Page(s)

CASES

Pueblo Bancorporation v. Lindoe, Inc.,
63 P.3d 353 (Col. 2003)....................22, 38

Quill v. Cathedral Corp.,
215 A.D.2d 960 (3d Dep't 1995)....................32

Raskin v. Walter Karl, Inc.,
129 A.D.2d 642 (2d Dep't 1987)....................41

Rigel Corp. v. Cutchall,
511 N.W.2d 519 (Neb. 1994)....................38

Seagroatt Floral Co. v. Riccardi,
167 A.D.2d 586 (3d Dep't 1990), *aff'd in part, modified in part, rev'd in part*, 78 N.Y.2d 439 (1991)....................43, 44

Seagroatt Floral Co. v. Riccardi,
78 N.Y.2d 439 (1991).................... 29, 30, 31, 44, 49, 61

Security State Bank v. Ziegeldorf,
554 N.W.2d 884 (Iowa 1996)....................39

U.S. Inspect, Inc. v. McGreevy,
2000 WL 33232337 (Cir. Ct. Va. 2000)....................39

Vick v. Albert,
47 A.D.3d 482 (1st Dep't 2008),
lv. to app. denied, 10 N.Y.3d 707 (2008)....................36, 37, 38

Wagner v. Dunetz,
299 A.D.2d 347, 349 N.Y.S.2d (2d Dep't 2002)....................37

Wechsler v. Wechsler,
58 A.D.3d 62 (1st Dep't 2008)....................passim

Page(s)

STATUTES

Business Corporation Law §623 .... 12, 18

Business Corporation Law §1118 .... passim

CPLR 4404(b) 66

CPLR 5004 62

CPLR 5015(a)(2) and (3) 66

I.R.C. §1374 8

Judiciary Law §753(a)(2) 64

OTHER AUTHORITIES

Cecile C. Edwards*, Dissenters' Rights: The Effect of Tax Liabilities on the Fair Value of Stock*, 6 DePaul Bus.L.J. 77, 98-99 (1993) 15

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PRELIMINARY STATEMENT

Petitioner-Respondent-Cross-Appellant, Robert T. Giaimo ("Petitioner" or "Robert") respectfully submits this brief in opposition to the appeal of Respondent-Appellant, Janet Giaimo Vitale ("Respondent" or "Vitale") and in support of Robert's cross-appeal from parts of the two judgments (A10-15, A60-64) ("Judgments") of the Supreme Court, New York County, that among other things determined the "fair value," pursuant to Business Corporation Law §1118(b), 6 McKinney's §1118(b), of Robert's shares[1] in EGA Associates, Inc. ("EGA") and First Ave. Village Corp. ("FAV") as of July 31, 2007 ("Valuation Date"). The appeals from the two judgments have been consolidated because (a) the two judgments were based on a single decision/order ("Decision") of the Honorable Marcy S. Friedman, J.S.C., dated April 25, 2011, and entered in the New York County Clerk's Office on April 26, 2011 (A16-43), deciding the two proceedings below; (b) the Decision was based on the single Report (A137-320) ("Report") of the Special Referee, Louis Crespo ("Referee"); (c) the two fair value hearings were tried jointly before the Referee; and (d) the issues on appeal are identical in the two proceedings.

1 Robert owned shares individually and as the beneficial owner of shares bequeathed to him by his deceased brother, Edward P. Giaimo, Jr.

Although the Decision below is well-researched and well-reasoned, the court below (a) misread the expert testimony of real estate appraiser James Levy in determining to ascribe a uniform 30% appreciation rate to recalculate the real estate valuations of Joel Leitner, the appraiser jointly retained by Respondent and Petitioner on behalf of EGA and FAV (A4421-30); (b) wrongly included an impermissible discount for built-in capital gains taxes ("BIG"), that it otherwise believed inappropriate (A27), in determining the fair value of the corporations as on-going businesses; (c) misunderstood the concept of "valuation date" in requiring an escrow of those portions of the value of Robert's shares attributable to the choses-in-action and making their release dependent on the outcome of a post-Valuation Date determination of a claim by the corporations against the estate of Edward P. Giaimo, Jr. (the "Estate"); (d) misunderstood the thrust of Robert's contempt motion and the availability of information in discovery in that the hidden management fee receivables owing to EGA and FAV could not have been "discovered" because Vitale controlled EGA and FAV and failed to disclose them; (e) misinterpreted its own prior order (A783) which limited the reference to establishing the fair value of the stock of the corporations, and not the determination of an interest rate; and (f) abused its discretion in refusing to hold Vitale in contempt for affirmatively representing to the Referee what Vitale falsely

claimed constituted all the assets of the corporations at a time when she knew of the hidden receivables.

Were "discounts" permissible in determining "fair value," the court below correctly concluded that there cannot be a discount for lack of marketability ("DLOM") on the facts proved at trial. Although the court below erroneously felt constrained to include (A27) a BIG discount, its use of a present day value of the BIG discount was appropriate if such a discount is to be allowed.

As demonstrated by the reasoning in the Decision and the Report, with the exception of the issues raised by Robert's Cross-Appeal, the Judgments should be affirmed.

COUNTER-STATEMENT OF ISSUES PRESENTED

1. Should there be any discounts in determining "fair value" under BCL 1118(b)?

The court below reluctantly and erroneously found that there should be a discount.

2. Under the facts of this case, should there be a discount for built-in capital gains taxes?

The court below erroneously answered in the affirmative.

3. If a deduction for BIG is determined to be appropriate, should the discount be (a) reduced to present day value and (b) be determined after deduction of projected expenses of a sale that would incur capital gains taxes?

The court below answered (a) correctly in the affirmative and (b) erroneously in the negative.

4. Should there be a further discount for lack of marketability under the facts of this case?

The court below correctly answered in the negative.

5. Should the appraised value of the corporate real estate have been reduced from the values determined by the jointly retained expert?

The court below erroneously answered in the affirmative.

6. Can an asset of a corporation being valued under BCL 1118(b) at the valuation date be conditioned on the future collection of that asset?

The court below erroneously answered in the affirmative.

7. Should the court below have considered Respondent Vitale's improper activities in determining the rate of pre-judgment interest?

The court below abused its discretion in answering in the negative.

8. Should the court below have held Respondent Vitale in contempt for falsely representing the assets of the corporations by failing to disclose accounts receivable?

The court below erroneously answered in the negative.

9. Should the undisclosed assets that came to light after trial but prior to the determination of the court below on the cross-motions to confirm/reject/modify the Report have been included in the fair value of Petitioner's shares?

The court below erroneously answered in the negative.

ARGUMENT

I. THERE SHOULD BE NO DISCOUNT FOR SPECULATIVE FUTURE CAPITAL GAINS TAXES

A. Fair Value Presumes An Ongoing Business, Not One In Liquidation, And The Court Below Erred In Applying A BIG Discount

Respondent contends that the only difference between fair value and fair *market* value is a discount for minority interest in fair market value. Respondent is incorrect. As shown hereafter, the two key theoretical differences are (1): (a) fair *market* value appraises a petitioner's interest as a *minority* interest versus (b) *fair value* appraising a petitioner's interest as a percentage of the *controlling* interest; and (2): (a) fair *market* value uses a *liquidation* scenario versus (b) *fair value* using an *ongoing business* scenario.

In determining fair value, a court is attempting to place all shareholders on equal footing and is seeking to assure that the dissenting or minority shareholder being bought out is being treated fairly, *i.e.,* receiving the fair value of his/her shares. The court below recognized that virtually every state in the Union that has analyzed this issue has concluded that in order to give "fair value" it would "decline to consider the tax consequences of the sale of any assets unless there is evidence that the corporation was actually undergoing liquidation on the valuation date." (A27, citations omitted.)

> These cases treat an assumed liquidation as inconsistent with the valuation of the corporation as an ongoing concern. *While the reasoning of the cases has much to recommend it*, New York follows the contrary view that it is irrelevant whether the corporation will actually liquidate its assets, and that the court, in valuing a close corporation, should assume that a liquidation will occur. (*See Wechsler,* 58 AD3d at 73.)

(A27, emphasis added).

The court below, however, failed to recognize that *Wechsler v. Wechsler*, 58 A.D.3d 62 (1st Dep't 2008), is a fair *market* value case, not a fair value case. Further, *Wechsler* involved a securities trading account that contained stocks and bonds that were constantly being bought and sold, *i.e.*, "liquidated". As the court below did recognize, the contrary is true here:

> EGA and FAV are both corporations with a history of *never having sold* any of their real properties. There is no evidence in the record that they have any financial reason to sell properties in the foreseeable future.

(A26, emphasis added.)

Unfortunately, because of its misreading of *Wechsler*, the court below believed its hands were tied and it had to assess a BIG discount. New York, however, with respect to *fair value*, does *not* hold the view that "the court, in valuing a close corporation, should assume that a liquidation will occur." (A27.) In fact, just three pages earlier the court below recognized that the Court of Appeals in *Friedman v. Beway Realty Corp.*, 87 N.Y.2d 161 (1995) ("*Beway*"), requires "that fair value is to be determined based on the worth of a dissenting

shareholder's shares in a 'going concern.' (87 NY2d at 167.)" (A24.) Thus, the Decision is internally inconsistent. While the court recognized that fair value is determined on a "going concern" basis, it then applied a liquidation concept of a discount for BIG taxes. Yet, the two corporations being valued had never in their history sold a single property, and the law allows a purchaser to simply convert the "C" corporation to an "S" corporation or "LLC" ownership, as Respondent here did, and the new owner can hold the property for 10 years and never pay a capital gains tax. I.R.C. §1374, 26 U.S.C. §1374.

Both the court below and the Referee adopted the approach in *Murphy v. United States Dredging Corp.*, 74 A.D.3d 815 (2d Dep't 2010), applying a "present value" discount for BIG. (A26.)

The court in *Murphy* was wrong in permitting a deduction for BIG. But, in addition to the theoretical and legal reasonings that prohibit a deduction for BIG, the proceeding at bar is factually distinct from that in *Murphy*.

In *Murphy*, the corporation had previously sold its real properties, acquired others, and engaged in 1031 exchanges. *Matter of Murphy v. United States Dredging Corp.*, 2008 WL 2401230 at *3, *10 (Sup. Ct. Nassau Co., Warshawsky, J.S.C., May 19, 2008). EGA and FAV have never sold and have no intention of selling a single property. (A796, ¶4.) Respondent simply converts the corporations to LLCs or S corporations, holds these properties for 10 years, and

never has to pay any capital gains tax.[2] Whether Respondent will ever pay capital gains taxes is wholly speculative and cannot constitute a deduction in determining fair value. No deduction may be taken from Petitioner's interest when no comparable deduction is taken from Respondent's interest.[3] Discounting the corporations' net asset value for projected BIG taxes "would result in minority shares being valued below that of majority shares, thus violating our mandate of equal treatment of all shares of the same class in minority stockholder buyouts." *Beway*, 87 N.Y.2d at 169. Indeed, because of the appreciation of the shares of EGA and FAV, Petitioner, unlike Respondent, has to pay capital gains taxes on most of the judgment amount. Thus, by deducting the BIG, Robert is penalized twice, solely for the benefit of Respondent. The BIG deduction must be reversed.

Moreover, the question of whether to deduct BIG taxes in determining fair value is in the first instance a legal issue, not a fact or expert opinion issue. Although, in order to protect his rights, Petitioner presented at trial the testimony

2 Courts and experts using the "willing purchaser" fiction to analyze fair value, have held that the seller, knowing that the buyer can defer or avoid ever paying capital gains taxes, would never agree to a reduction in the sales price by reason of BIG. Even Respondent recognizes the distinction between fair *market* value and fair value in that the former presumes a "willing seller" and the latter an "unwilling seller." Appellant's Brief at 20-21. Knowing that the buyer controls the incidence of the tax, the *unwilling* seller would not agree to reduce the purchase price based on such a purely speculative tax burden. Further, when the actual facts adduced at trial do not suggest that the shareholders intend to liquidate the corporation, the court may not assume that a hypothetical buyer would do so.

and reports of his stock valuation expert on the BIG issue, no deduction for BIG taxes is permissible in a BCL §1118(b) proceeding.[4]

The law of this State, and, indeed, virtually every state, is that with regard to an election to purchase stock there may be *no* deduction whatsoever for BIG.

> [T]he statutory objective here [is] achieving a *fair* appraisal remedy for dissenting minority shareholders. Mandating the imposition of a "minority discount" in fixing the fair value of the stockholdings of dissenting minority shareholders in a close corporation is inconsistent with the equitable principles developed in New York decisional law on dissenting stockholder statutory appraisal rights (a position shared by the courts in most other jurisdictions) and the policies underlying the statutory reforms giving minority stockholders the right to withdraw from a corporation and be compensated for the value of their interests when the corporate majority takes significant action deemed inimical to the position of the minority.... The fair value of a dissenter's shares is to be determined on their worth in a <u>going concern, not in liquidation</u>....

Beway, 87 N.Y.2d at 167 (italics in original, underlining added).

There is no capital gains tax payable on the BIG while EGA and FAV are going concerns especially here where the corporations have never sold a property in their more than half-century of existence and no evidence was presented of an intention to sell any properties. The value of Petitioner's interests in the two corporations is his percentage of the value of the assets net of the actual, known,

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4 *See* Report (A233, ¶328): "Mercer rejects the opinion that a deduction based on DLOM and B.I.G. must be factored in the valuation of EGA and FAV, whereas here the shares are valued under the concept that the corporations continue as two separate ongoing concerns at the 'financial control level of value.' Mercer opines that fair value with respect to EGA and FAV should be determined as a whole and no discounts should be applied for B.I.G. or DLOM (T,1803-1824) [A 2653-2674]."

non-speculative, existing liabilities as of the Valuation Date, not after deduction of an unknown liability that will never be incurred. No tax was payable on the Valuation Date and the court erred in speculating that one may become payable in the future. A deduction for a BIG tax that will almost certainly never be paid is the antithesis of the requirement to achieve a "*fair* appraisal remedy."

Imposition of a BIG discount on the value of the petitioning shareholder's shares would significantly undermine one of the major policies behind BCL §1118(b), the remedial goal of protecting minority shareholders from being forced out at unfair values imposed by those dominating the corporation. *Id.* at 169.

> This protective purpose of the statute prevents the shifting of proportionate economic value of the corporation as a going concern from minority to majority stockholders. As stated by the Delaware Supreme Court, "to fail to accord to a minority shareholder the full proportionate value of his (or her) shares imposes a penalty for lack of control and unfairly enriches the majority stockholders who may reap a windfall from the appraisal process by cashing out a dissenting shareholder" (*Cavalier Oil Corp. v. Harnett*, 564 A2d 1137, 1145 [Del. 1989]).

Id.

The Delaware Supreme Court, on which the New York Court of Appeals relied in *Beway*, addressed the BIG issue here in *Paskill Corp. v. Alcoma Corp.*, 747 A.2d 549 (Del. 2000).

> [T]he Court of Chancery erroneously valued [the corporation] on a liquidation basis and exacerbated that problem when it calculated [the corporation's] net asset value by deducting speculative future tax liabilities.

Id. at 550. In *Paskill*, the petitioner's buy-out rights accrued by reason of a merger. At the time of the merger, the corporation's "investment assets were not for sale."

> The record reflects that a sale of its appreciated investment assets was not part of [the corporation's] operative reality on the date of the merger. Therefore, the Court of Chancery should have excluded any deduction for the speculative future tax liabilities that were attributed by [respondent] to those uncontemplated sales.

Id. at 552 (footnotes omitted).

In both Delaware and New York the law is the same with respect to dissenters' rights in mergers and the rights of minority shareholders when the corporation or another stockholder has elected to purchase the minority stockholders' interest. *Beway*, 87 N.Y.2d at 168 ("there is no difference in analysis between stock fair value determinations under Business Corporation Law §623, and fair value determinations under Business Corporation Law §1118"). The "principles [that] have emerged from our cases involving appraisal rights of dissenting shareholders under Business Corporation Law §623..." apply to the determination of "fair value" under BCL §1118. 87 N.Y.2d at 167. In both *Paskill* and *Beway*, the Courts determined that the "fair value of a dissenter's shares is to be determined on their worth in a going concern, not in liquidation...." 87 N.Y.2d at 167.

The record here also reflects that a sale of their appreciated investment assets was not part of EGA's and FAV's operative reality on the Valuation Date, and no speculative future tax liabilities may be attributed to those uncontemplated sales.

Wyoming's Supreme Court in *Brown v. Arp & Hammond Hardware Co.*, 141 P.3d 673 (Wyo. 2005), also addressed the issue of a BIG discount in determining fair value. After an extensive analysis of the case law from sister states and a review of law review articles, the court concluded: "While the ultimate determination of fair value is a question of fact, the determination of whether a given fact or circumstance is relevant to fair value is a question of law...." *Id*. at 686, n.22. The lower court had imposed a "5% discount...to account for potential future tax consequences." *Id.* at 687. The petitioner-appellant claimed "that the discount was not supported by the evidence and is based upon a theory that conflicts with the meaning of fair value." *Id*. at 687. The Supreme Court responded: "We agree." *Id.*

As here, in *Brown* there was a valuation date pursuant to statute, and, "[a]s of that date, no sale of assets was contemplated." *Id*. at 688. The respondent in *Brown* claimed that liquidation was anticipated as the only way to pay for petitioner's shares, and therefore a BIG discount should be applied. *Id.* The Wyoming Supreme Court disagreed:

> This justification for applying a tax discount has been rejected as inconsistent with the remedy provided by the dissenting shareholder's right to appraisal:
>
>> Under the dissenter's rights statute, the court is required to value the corporation as a "going concern." Accordingly, courts have generally rejected any tax discount "unless the corporation is undergoing an actual liquidation." Here, there was no evidence that [the corporation] was undergoing liquidation on the valuation date. Indeed, the evidence indicated that [the corporation] was a going concern. Thus, the trial court correctly declined to consider the tax consequences of the sale of any assets.
>>
>> [The corporation] maintains that it will have to sell assets in order to pay the dissenters for their shares, and that therefore the tax consequences of the sale should be considered in the valuation. … [T]he dissenters are entitled to a pro rata share of the fair value of the corporation immediately before the merger. "Thus, if costs are incurred after effectuation of the exchange, those costs should not be assessed against the dissenting shareholders." Accordingly, it would be inappropriate to consider a future sale of assets to determine the fair value prior to merger.
>
> *In re 75,629 Shares of Common Stock of Trapp Family Lodge, Inc.*, 725 A.2d [927] at 934 [Vt. 1999] (citations omitted).
>
> Courts generally find that "unless the corporation is undergoing an actual liquidation, the liquidation method is not an appropriate method of valuing shares of a dissenting shareholder." *Hansen* [*v. 75 Ranch Co.*, 957 P.2d 32 (Mont. 1998)] at 42.

Id.

A deduction for BIG taxes might be permissible "if the business of the company is such that appreciated property is scheduled to be sold, in the

foreseeable future, in the normal course of business." *Id.*, n.23. Here, no property is "scheduled to be sold," or has ever been sold "in the normal course of business."

> [T]ax consequence should be considered only when a sale of those assets is imminent and unrelated to the transaction which triggered the shareholders' right to dissent.

Cecile C. Edwards*, Dissenters' Rights: The Effect of Tax Liabilities on the Fair Value of Stock*, 6 DePaul Bus.L.J. 77, 98-99 (1993). "In the absence of specific facts about a prospective sale, 'it would be the basest form of speculation to attempt to determine tax consequences of a voluntary liquidation of assets at an unknown future time.'" *Brown*, 141 P.3d at 689.

A Connecticut appellate court found the reasoning in *Brown* to be persuasive. In *Conway v. Carpenter*, 43 Conn.L.Rptr. 422, 2007 WL 1600004 (Super. Ct. 2007), there had been considerable appreciation of real estate assets owned by the corporations. *Id.* at *3. The court queried why the respondents should "be left with the entire, future liability for capital gains tax?" *Id.*

> The answer lies in the uncertainty surrounding this potential tax liability. There is no evidence before the court which indicates when any corporate asset is going to be sold. No tax consequences related to the appreciation of the properties will be incurred so long as the properties are not sold. Even if the property is sold, the tax consequences of that sale can sometimes be deferred. To make things even less certain, no one can predict what price each property will sell for at some entirely unknown date in the future, nor can the tax rate at that time be known. Applying a discount in anticipation of future capital gains tax would, under these circumstances, be nothing more than speculation.

Id. *See also*, *Matthew G. Norton Co. v. Smyth*, 51 P.3d 159, 168-69 (Ct. of Appeals, Wash. 2002) (no BIG discount in fair value appraisal "based on hypothetical liquidation at some indefinite time in the future...." BIG may only be considered "if the business of the company is such that appreciated property is scheduled to be sold in the foreseeable future in the ordinary course of business").

If an EGA or FAV property is ever sold, no one can predict what the purchase price will be or what the tax rate will be. Thus, taking a BIG deduction as of the Valuation Date for all 19 properties is speculative, improper and unfair. Yet, "fair" is the operative word in "fair value".

A BIG discount is a liquidation concept forbidden by the Court of Appeals in a fair value proceeding. EGA and FAV at the Valuation Date were going concerns, each deriving its revenue through leases of apartments and stores in their buildings. Appraisal techniques and discounts that may be valid in *liquidation* contexts, such as fair *market* valuations for estate and gift tax purposes, are not valid in the context of a fair value appraisal under BCL §1118.

The BIG deduction in the Judgments reduced the value of Petitioner's interest by a total of more than $10 million;[5] yet, Respondent suffers no

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5 EGA BIG = 13,934,287
FAV BIG = 6,313,462

20,247,749
÷ 2

$10,123,875 (A332, ¶16, A335.)

corresponding reduction in the value of her interest. Reducing net asset values by recognizing unrealized (and never to be realized) hypothetical trapped-in capital gains enriches the Respondent at the expense of the Petitioner.

To date, only two New York cases have discussed the issue of the BIG deduction in the context of a buyout under BCL §1118: *Murphy* and *Matter of LaSala*, Feb. 6, 2003 N.Y.L.J. 24 (col. 1) (Sup. Ct., West. Co., Rudolph, J.S.C., Jan. 16, 2003) ("*LaSala*").

In *LaSala*, the court stated:

> At the outset, it is important to briefly review the legislative intent of BCL §1104-a and BCL 1118 (L. 1979; as amended L. 1986; L. 1990). The statutes are designed and intended to protect minority stockholders in closely held corporations from abuses of those in control of the corporation while at the same time affording the corporate entity, or its other stockholders, a right election to purchase the petitioner's shares and avoid dissolution.

After quoting the language of BCL §1118, the *LaSala* court went on to quote *Beway*, 87 N.Y.2d at 167: "Fair value requires that the dissenting stockholder be paid for his or her proportionate interest in a going concern...."

In *LaSala*, like here, the respondent contended that the net asset value of the corporation must be reduced by the amount of the BIG. The court disagreed:

> The Court has considered and rejects respondents' claim for a further discount based upon a potential future capital gains tax liability. 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 petitioner's shares of stock.

> This conclusion is based upon the principle that the corporation is valued as an operating business rather than a business in the process of liquidation ([*Beway*]). Capital gains tax triggers on liquidation which is not a factor to be considered by this court in determining fair value.

Capital gains taxes are not triggered until the property is sold, *i.e.,* on liquidation. Fair value is not computed under a liquidation format, and the court below erred in discounting the values of EGA and FAV by any amount for speculative, future (never to be incurred) capital gains taxes. That part of the Judgments must be reversed.

B. ***Wechsler* Has No Bearing On The Instant Proceedings**

The court below (A25) and the Referee (A300, ¶145 and n.29) each correctly distinguished *Wechsler*, a fair *market* value case in a matrimonial action involving equitable distribution principles. No fair value case in New York or any place in the country has applied the 100% BIG deduction in *Wechsler* or in either of the two tax cases on which *Wechsler* relied.

Wechsler was not a proceeding under either BCL §1118 or §623, and there is no statutory compulsion to apply a "fair value" standard with respect to a matrimonial action. The property owned by the holding company in *Wechsler* was not real estate but registered securities: "[The corporation] bought and sold securities solely for its own account." 58 A.D.3d at 66. The assets in *Wechsler*

were actively traded in the ordinary course of business. Thus, on its facts, *Wechsler* is wholly distinguishable from the case at bar.

The *Wechsler* court was not bound by Court of Appeals *fair value* decisions requiring that it use "going concern" values only. Quoting *Estate of Jelke v. Commissioner of Internal Revenue*, 507 F.3d 1317, 1332 (11th Cir. 2007), the *Wechsler* court stated: "It is more logical and appropriate to value the shares of the investment holding company...based upon an *assumption* that a liquidation has occurred, without resort to present value or prophecies." (Emphasis in original, internal brackets omitted.) Unquestionably, the *Wechsler* court applied a liquidation valuation, a method explicitly prohibited here by *Beway*. 87 N.Y.2d at 168, 167 ("under Section 1118..., in fixing fair value, courts should determine the minority shareholder's proportionate interest in the going concern value of the corporation as a whole, that is,...as an operating business...", "fair value of a dissenter's shares is to be determined on their worth in a going concern, not in liquidation...").

> A dissenting shareholder is not in the position of a willing seller, however, and thus, courts have held that fair value cannot be equated with "fair market value." See, e.g., *McLoon Oil*, 565 A.2d at 1005; *Hansen*, 957 P.2d at 41. Accordingly, methods of stock valuation used in tax, probate or divorce cases to determine fair market value are inapposite to the determination of "fair value" under the dissenters' rights statute. See *McLoon Oil*, 565 A.2d at 1004 (stock valuation method used in tax and probate cases not applicable); *Hansen*, 957 P.2d at 40 (fair market valuation for purposes of property distribution in marriage distinguishable from fair value for purposes

> of dissenters' rights). A shareholder who disapproves of a proposed merger gives up the right of veto in exchange for the right to be bought out at "fair value," not at market value. See *Hansen*, 957 P.2d at 41.

In re 75,629 Shares of Common Stock of Trapp Family Lodge, Inc., 725 A.2d 927, 931 (Vt. 1999).

Respondent and her appraisers have tried to confuse the issues by inserting fair *market* value concepts where they do not belong. Respondent disproves her own arguments, however, conceding that *Wechsler* held that 100% of the BIG should be deducted "to arrive at the fair *market* value of the stock of the close corporation...." Appellant's Brief at 44 (emphasis added). Thus, Respondent concedes that *Wechsler* is not a *fair value* case, uses a liquidation concept, and is inapposite. Although *Wechsler* is the law in the First Department with respect to fair *market* valuations, it has absolutely no bearing on a *fair value* determination.

Respondent tries to support her misguided argument by asserting that the determination of the *Wechsler* court "was based on the holdings and rationale of *Dunn* and *Jelke*." Appellant's Brief at 45. *Dunn* and *Jelke* were tax cases, the ultimate fair *market* value cases. Indeed, the *Jelke* court stated that "prophesying as to when the assets will be sold...requires a crystal ball." 507 F.3d at 1332. This is precisely the type of speculation prohibited in fair value cases. By statute, Petitioner here is guaranteed the real value of his stock, unaffected by speculative liquidation scenarios used in tax or matrimonial cases. The court below

erroneously imported theory developed in tax cases into a valuation seeking to protect a minority shareholder.

Further, in *Wechsler* the court recognized that the corporation would have to sell assets annually to meet the husband's "distributive award obligations. Doing so, of course, will result in annual tax liabilities greater than those [the corporation] historically had incurred." 58 A.D.3d at 70. Thus, in *Wechsler* a liquidation valuation was appropriate, while here, a liquidation valuation is forbidden.[6] *See Norton, supra*, 51 P.3d at 168.

Significantly, *Respondent concedes*:

> In valuing Petitioner's stock in EGA and FAV, the court cannot consider post valuation events, but can consider "elements of future value...which are *known or susceptible of proof* as of the [Valuation Date] and not the product of *speculation*." *Cawley v. SCM Corp.*, 72 N.Y.2d 465, 472 (1988).

Appellant's Brief at 23 (emphasis added). But as shown above, a BIG discount *is* the product of "speculation", and a future sale that would impose a BIG tax was *not* "known or susceptible of proof" at the Valuation Date.

Respondent wants this Court to do, and the court below in fact did, exactly what is prohibited by *Cawley*. The possible future sale of any of the properties is a post-valuation event that "the court cannot consider," neither "known [n]or

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6 Wechsler/EGA-FAV distinctions: (a) Matrimonial/BCL ¶1118; (b) fair market value/fair value; (c) registered securities/real estate; (d) liquidation value/going concern value; (e) history of regularly selling assets/history of never selling assets; and (f) projected future liquidations of securities/absence of any evidence of future intent to sell the real estate.

susceptible of proof" as of the Valuation Date, and purely a "product of speculation." Vitale defeats her own arguments for *any* discount for BIG.

C. **Appellant's Arguments Are Without Merit**

Determination of the meaning of "fair value" as used in BCL §§623 and 1118 is a question of law to be determined by the court, as is every interpretation of statutory language. *Matter of Town of Brookhaven v. New York State Board of Equalization and Assessment*, 88 N.Y.2d 354, 360 (1996) ("matters of statutory construction and interpretation are particularly within the competence of the judiciary…and present pure questions of law"). *See also, O'Rourke v. Long*, 41 N.Y.2d 219, 224 (1976).

Because the meaning of "fair value" is a question of law, it is not a fact issue to be opined on by appraisers or to be determined on a case-by-case basis. A potential future capital gains tax liability is not an existing liability for a going concern and, as a matter of law, may not be considered. *Accord*, *Pueblo Bancorporation v. Lindoe, Inc*., 63 P.3d 353, 361 (Col. 2003) ("[T]he meaning of 'fair value' is a question of law, not a question of fact to be opined on by appraisers and decided by the trial court").

In *Murphy*, a parcel of real property, constituting the bulk of the corporation's assets, was sold in 2005 for $31.25 million, and the court knew what the BIG on that sale would be when the properties obtained in the 1031 exchange

would be sold. The *Murphy* court did not have to speculate as to that number. *Murphy,* 2008 WL 2401230 at *2, *10.

Here, nothing has occurred to fix the BIG on any of the corporate properties, and any future sale or sale price is pure speculation. Additionally, it is further speculation to apply a tax rate 10 years from now when no one knows what the corporate or capital gains tax rates will be. Thus, applying the rationales of the only two New York cases on point, *LaSala* and *Murphy*, to the facts here, there is no basis whatsoever for applying a BIG deduction of any kind or magnitude.

Respondent wrongly asserts that Chris Mercer opined the BIG should be 40%. Mr. Mercer, after explaining the differences between fair value and fair market value, stated that there should be *no* BIG deduction in determing fair value, but if there is one, it must be limited per his testimony and the formulas in his report. (A233, ¶328.)

As Respondent concedes, the Referee's recommendation for calculation of the BIG, followed by the court below, "was based on his factual finding that 'there is proof of no readily available substitute or asset out of the corporate wrapper'...." Appellant's Brief at 42; (A302, ¶153). A referee's finding of fact is to be accorded great deference and, because it falls within the range of the testimony presented, should not be disturbed.

Referee Crespo's thorough and comprehensive findings of fact and conclusions of law contained in his 184-page Report interpret and resolve enormously complicated factual and legal disputes presented in hearings on 18 days spread over two months, including the often contradictory testimony of nine expert witnesses on diverse and complex issues. He had to review more than 2,500 pages of testimony and thousands of pages of exhibits, including more than 50 expert reports.

As Respondent concedes, "deference is given to the credibility findings of the Referee who heard the witnesses...." Appellant's Brief at 18.

In *Borenstein v. Rochel Properties, Inc.*, 216 A.D.2d 34 (1st Dep't 1995), one party's expert testimony was "uncontroverted". Here, each side presented its own experts, controverting for the most part the other side's testimony regarding the values of the real properties and the value of the stock. The Referee had the opportunity to judge which witnesses were worthy of belief. The Referee had serious questions about the credibility of Respondent's experts: Esposito "unconvincing," "not equal to that of Leitner" (A267-68, ¶30 and n.23); Gelbtuch opinion "of no real moment..." (A268, ¶32); "I have weighed the testimony of both Lipton and Baliban against that of Mercer and find that Mercer's opinion is more credible" (A290, ¶114); "Baliban's rebuttal testimony…without moment" (A294, ¶127). The Referee judged the testimony of the three experts presented by

Petitioner to be more worthy of belief: "Leitner was very credible..." (A267, ¶29, 271, ¶40); "Levy's rebuttal testimony was totally credible and convincing" (A271, ¶39); "Mercer was very credible..." (A300, ¶146).

> It is well settled that the determination of a Referee appointed to hear and report is entitled to great weight, particularly where conflicting testimony and matters of credibility are at issue, since the Referee, as the trier of fact had the opportunity to see and hear the witnesses and to observe them on the stand….

Frater v. Lavine, 229 A.D.2d 564 (2d Dep't 1996) (citations omitted).

As recently stated by the First Department:

> It is well settled that "where questions of fact are submitted to a referee, it is the function of the referee to determine the issues presented, as well as to resolve conflicting testimony and matters of credibility" [citations omitted]. The record does not demonstrate that the Special Referee exhibited partiality toward petitioners. Nor does it otherwise disclose any ground upon which the Referee's credibility determinations should be disturbed. The amount awarded is supported by the record.

Herman v. Gill, 61 A.D.3d 433 (1st Dep't 2009). Where the valuation "falls 'within the range of testimony presented' [it] should not be disturbed." *Matter of Rateau v. DAPA Communications, Inc.*, 59 A.D.3d 1037 (4th Dep't 2009).

Respondent here has set forth no basis for questioning the Referee's findings of fact, and the court below reviewed those findings of fact and found them amply supported by the evidence.

The Referee's factual finding that the "credible" proof established that real properties such as those here are not readily available in the market should not be

disturbed. A turnover of 178 buildings out of 17,000 is hardly a "robust" market as Respondent asserts. Appellant's Brief at 51. Respondent refers to an independent report in evidence, but that report demonstrates that the turnover for Manhattan walk-ups was an extremely low 1.8%. (A4379.) Respondent's claim that more properties were available for sale than were sold is pure speculation, unsupported by any evidence in the record. Respondent's "expert's" characterization of 178 sales in six months as being "very, very active" and a "large volume of transactions" is just one reason his testimony was rejected below. Appellant's Brief at 51.

The testimony of Respondent's stock valuation witnesses regarding the availability of substitute buildings (Appellant's Brief at 52) was outside their expertise. Neither witness was qualified as an expert on Manhattan real property, and the Referee properly rejected their baseless opinions, again finding Lipton and Baliban lacking in credibility.[7]

Clearly, on the facts and the law, there is no basis for a 100% BIG deduction or any BIG deduction.

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7 Mercer explained that Baliban's deduction of future corporate income tax is inappropriate in that a buyer of the naked assets would (a) have to pay income tax and (b) could easily avoid the C corporation level of taxation by immediately converting to an S corporation. Even Mr. Baliban's math is bad in that the additional C corporation tax would only be $775,000, not the $2,400,000 in income tax Mr. Baliban improperly deducts. As the Vermont Supreme Court explained in a fair value case, "the trial court correctly determined that no tax consequences of a sale of corporate assets should be considered where no such sale is contemplated." *Trapp*, 725 A.2d at 933.

D. If There Is To Be A Discount For BIG, Projected Costs Of Sale Should Be Deducted From The Projected Sale Proceeds

In determining the present value of the BIG tax, assuming a sale 10 years after the Valuation Date, the court below failed to deduct the expenses of that projected sale purportedly because Petitioner had failed to provide any factual basis for calculating such a deduction. (A27.) The court was incorrect.

The court below stated that it was "unable on this record to determine whether a reduction in value for non-tax liquidation costs should be allowed. Given the already protracted nature of the proceedings, the court declines to hold a supplemental hearing on this issue." *Id.* No supplemental hearing is required.

Petitioner referred the court below to the testimony and reports of Mr. Baliban, *Respondent's* stock appraisal witness, in particular to Respondent's exhibits 63 and 64 in which Mr. Baliban stated that in order to determine a BIG deduction (as would be applicable in fair *market* valuation cases), one must take the value of the properties on the Valuation Date, subtract the cost basis of those properties, and subtract the "[c]ost of hypothetical sale (est. at 4.5% of Property values)." (A4170, A4226.)

Respondent cannot dispute the need to deduct the projected costs of the hypothetical sale since her own expert propounded it and provided the formula for taking such a reduction.

Petitioner did the math for the court, deducting the 4.5% expense as proposed by Respondent. (A341, 342; A332, ¶16, last two columns.) The adjustment should not be necessary because the BIG discount should be rejected in its entirety, but if a BIG discount is sustained, the mathematical adjustment can be made with no difficulty.

Thus, the court below erred in finding that Petitioner did not provide the factual basis for deducting the non-tax selling costs.

But as Respondent concedes, a BIG discount cannot be applied under BCL §118(a) "because it 'would deprive minority shareholders of their proportionate interest in the corporation as a going concern' and 'would result in shares of the same class being treated unequally.' *Matter of Penepent Corp., Inc.*, 96 N.Y.2d 186, 194 (2001)...." Appellant's Brief at 20.

II. THE COURT BELOW CORRECTLY FOUND THAT THERE SHOULD BE NO FURTHER <u>DEDUCTION FOR MARKETABILITY</u>

The court below, citing *Seagroatt Floral Co. v. Riccardi*, 78 N.Y.2d 439, 447 (1991), stated the well-settled law that "a percentage discount against value is not the only way that illiquidity of the shares of a closely held corporation may be taken into account...." (A22.)

The court below then found as a matter of *fact* that the appraisers had already considered and applied a DLOM, and, in accord with *Seagroatt*, no further marketability discount was warranted: "the Referee specifically made a finding of fact, which is amply supported by the record, that the availability of similar properties on the open market is limited and that a buyer would accordingly buy the properties that EGA and FAV own through the corporations. ... This finding of the marketability of the corporations' shares is...relevant to the determination as to whether to apply a discount for lack of marketability...." (A24-25.)

As the court below correctly recognized, and the *credible* experts testified, Manhattan residential real estate in prime neighborhoods is rarely available for sale. There are many more buyers than sellers, and the buyers value the corporations based on the value of the real estate, not on an appraisal of the shares.

Moreover, as testified to by all of the real estate experts, their values of the real properties (subsequently used by the stock appraisers in valuing EGA and

FAV) had already factored in a marketability discount, thus fully conforming with the requirement set forth in *Seagroatt* that a court take into account in some part of its consideration the issue of marketability.

> *Mercer* is aware that realty assets of EGA and FAV were appraised at different values by Leitner and Esposito. He noted that both experts factored a holding period from valuation date to hypothetical sale (the exposure time for appraisals). Thus, he opines that a seller would not accept a further diminishment of value based on "some nebulous exposure of time to the market" that Lipton and Baliban coin as a DLOM, after the appraisal of the properties as it is in all likelihood an improper discount to the extent one is discounting for the same thing twice; it is doubling the discount. Thus, the valuation takes place on the hypothetical date of July 31, 2007, and there should be no further discount under any name for "marketing time after the sale"....

(A235-36, ¶336.)

Because the issue of marketability had already been considered and the values of the non-cash assets already reduced, a potential purchaser of all the shares of the corporations would not seek and the "unwilling seller" would not give any further reduction in the purchase price.

As recently set forth in *Cohen v. Akabas & Cohen*, 71 A.D.3d 419, 420 (1st Dep't 2010):

> The decision of a fact-finding court should not be disturbed upon appeal unless it is obvious that its conclusions could not have been reached under any fair interpretation of the evidence, particularly where the findings of fact largely rest upon considerations relating to the credibility of witnesses [citations omitted]. In that connection, the Special Referee as the trier of fact, considered the proof before him, as well as the credibility of the witnesses including the experts...,

> providing a detailed, well-reasoned explanation for his ruling. There is, thus, no basis for setting aside his decision, which is supported by the evidence presented at the hearing.

The Referee in his findings of fact concluded that the DLOM had already been deducted in valuing the real estate component of the share value. An additional DLOM would be a double discount. Respondent here, as in *Seagroatt*, "argue[s] that an identifiable discount must in all cases be applied against the value found -- that the factor of illiquidity cannot be 'buried' in the capitalization rate." 78 N.Y.2d at 446. The Court of Appeals disagreed: "Thus, to the extent Respondent corporations suggest that illiquidity can only be taken into account by the application of a percentage discount against the value...the argument fails as a matter of law." *Id.* at 447. The real estate appraisers here used the marketing time to determine their capitalization rates and values of the real properties. *See* Point II.D., *infra.*

The purpose of "fair value" is to ensure that a dissenting shareholder gets the true worth of his interest. Where there are two essentially equal shareholders, the court can accomplish the goal of the statute only by equally dividing the assets between the two shareholders. To do otherwise and apply a discount such as a DLOM is to favor the electing shareholder over the petitioning shareholder, precisely what BCL §1118 seeks to avoid.

A. **<u>The Shares Are Readily Marketable</u>**

Respondent failed to produce any evidence that the corporate shares are any less marketable than the portfolio of their assets. Indeed, to the contrary, it is quite evident from the testimony of and research done by Chris Mercer and from the Massey-Knakal reports in evidence and referred to by all the real estate appraisers that the corporate shares would be snapped up by the very eager buyers of Manhattan residential real estate. (A299, ¶¶141-44.) Walk-up tenements in these prime neighborhoods were "in great demand…" at the Valuation Date. (Levy, A3306.)

As the court below and Referee found, the shares of EGA and FAV were readily marketable, and no additional DLOM was required. *See, e.g., Matter of Walt's Submarine Sandwiches, Inc.*, 173 A.D.2d 980, 980-81 (3rd Dep't 1991) (where there is evidence of marketability, no DLOM); *Quill v. Cathedral Corp.*, 215 A.D.2d 960, 963 (3d Dep't 1995) (same). Further, where, as here, a prospective buyer would know each of the assets and its value, there is no reason for a buyer to seek or an unwilling (unmotivated) seller to give a discount simply because the buyer is purchasing the stock of a corporation owning the properties rather than the individual properties.

Respondent complains that the court below treated the shares of EGA and FAV the same as their underlying assets. Appellant's Brief at 31, n.12. If the

corporations had sold all their real estate and the corporations had only cash, there would be no DLOM. Here, real estate is more valuable than cash because it will appreciate faster than cash and earns income at a far greater rate. The court below and Referee were correct, and Respondent has failed to show any reason why a DLOM should be taken.

B. Past Accounting Irregularities Are Irrelevant Under The Asset-Based Approach

Respondent attempts to support her DLOM request by arguing that EGA and FAV had historically underreported their income. Appellant's Brief at 6-7, 40. Prior underreporting of income, which Respondent asserted was cured prior to the Valuation Date, has no impact on the value of the stock to a prospective buyer. There being no goodwill, the only concern is the value of the underlying assets. Further, all the stock valuation experts used the asset-based approach not the income approach or the market approach.[8]

Moreover, by this argument Respondent improperly seeks a double discount: Respondent sought and obtained a liability deduction for unpaid corporate income taxes for years prior to the Valuation Date, as reflected in amended tax returns, which Respondent's witness, Bryan Skarlatos, testified had been fully resolved

8 The Baliban report states: "EGA is a real estate holding company with no other operations . ... [W]e know that the income statements provided do not accurately reflect results of operations of EGA. Therefore, we...did not use the income approach in our valuation of EGA. ... [W]e used the asset approach in our valuation." (A4165, ¶¶20-21.)

with the taxing authorities. To seek a discount in the form of a DLOM because of the skimming and at the same time take a balance sheet deduction for the resultant tax liabilities is improper.

Respondent argues that a lack of audits or reliable financial records is another basis for a DLOM. *Id.* These are rental buildings, and as all the real estate experts testified, the only matters of interest to a prospective buyer are the conditions of the buildings and their rent rolls. Notwithstanding the testimony of Mr. Baliban, whom the Referee found to be less than credible, what the corporations had done with their rents in the past is of no import to a buyer.

C. The First Department Does Not Permit A DLOM For A Real Estate Holding Company

The law in New York regarding fair value has evolved to the point where a DLOM may only be applied to a corporation's "goodwill." Where, as here, "the value of the corporation is attributable solely to real property and cash," a discount for lack of marketability may not be taken. *Matter of Cinque v. Largo Enterprises of Suffolk County, Inc.*, 212 A.D.2d 608, 609-10 (2d Dep't 1995).

> The Judicial Hearing Officer properly refused to discount the value of the petitioner's shares of the corporation due to their lack of marketability. Such a discount should only be applied to the portion of the value of the corporation that is attributable to goodwill (see, *Matter of Whalen v Whalen Moving & Storage*, 204 AD 468, *Matter of Blake v. Blake Agency*, 107 AD 2d 139, 149). Here, the value of the corporation is attributable solely to real property and cash.

Id. Respondent presented no evidence of "goodwill" to be included in EGA's or FAV's assets. Thus, the Referee correctly concluded that the court may not apply a DLOM.[9]

In *Matter of Whalen v. Whalen's Moving & Storage Co.,* 204 A.D.2d 468, 469 (2d Dep't 1994), the court stated that "it was not improper for the Supreme Court...to direct the referee to discount the value of the shares in recognition of their lack of marketability, since the shares of a closely held corporation cannot be readily sold on a public market. However, the discount should only be applied to the portion of the value attributable to goodwill (*see, Matter of Blake v. Blake Agency*, 107 AD2d 139, 149)."

In a subsequent decision in the same case, *Matter of Whalen v. Whalen's Moving & Storage Co.*, 234 A.D.2d 552, 554 (2d Dep't 1996), the court stated that "the Supreme Court should not have discounted its operating value for lack of marketability. Such a discount should only be applied to the portion of the value of the corporation that is attributable to goodwill (*see*, *Matter of Cinque v. Largo Enters.*, 221 AD2d 608; *Matter of Whalen v. Whalen's Moving & Stor. Co.*, 204 AD2d 468; *Matter of Blake v. Blake Agency*, 107 AD2d 139, 149...). Here, the operating value of the corporation is attributable solely to tangible assets."

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9 Contrary to the reasoning of the court below (A23), the Court in *Beway* was not presented with and did not address this issue.

Accordingly, the court increased the value of the petitioner's shares by the amount of the DLOM erroneously attributed to the tangible assets.

In *Vick v. Albert*, 47 A.D.3d 482, 484 (1st Dep't 2008), *lv. to app. denied*, 10 N.Y.3d 707 (2008), a partnership dissolution case, the First Department agreed with the holding in *Cinque v. Largo, supra*, stating: "The unavailability of the discounts is particularly apt here, where the business consists of nothing more than ownership of real estate (*see Cohen v. Cohen*, 279 AD2d 599...(2001); *Matter of Cinque v. Largo Enters. of Suffolk County*, 212 AD2d 608...(1995)...."

Thus, although *Vick* was a partnership case, the First Department adopted the holding in *Cinque*, a BCL 1118 proceeding. As recognized by the Referee here, *Vick* is controlling precedent in this Department on the issue. (A293-94, ¶¶125-126.)

In *Hall v. King*, 177 Misc.2d 126, 132-33 (Sup. Ct. N.Y. Co. 1998), *aff'd*, 265 A.D.2d 244 (1st Dep't 1999), a decision rendered a decade before *Vick*, Justice Stephen Crane did express his disagreement at that time with the Second Department holdings in *Blake*, *Whalen,* and *Cinque*. *Hall*, however, involved an "antique reproduction business…" with goodwill and machinery, not a real estate holding company. Although this Department affirmed, it did so on different grounds, applying a "lack of marketability discount to all of the corporate assets in light of the *absence of a non-compete clause* between the parties...." 265 A.D.2d

at 245 (emphasis added). Thus, the Appellate Division decision in *Hall v. King* provides no authority for an application of a DLOM to the facts in this case.

Additionally, by 2002 Justice Crane, who had been elevated to the Appellate Division, Second Department, had changed his mind, conceding that his reasoning in *Hall v. King* was wrong, and *Whalen* is right. Justice Crane, joining in a unanimous decision, stated: "The Supreme Court also correctly declined to discount the value of the defendant's interest in her private medical practice based on lack of marketability since such a discount should only be applied to that portion of the value of the corporation that is attributable to goodwill...." *Wagner v. Dunetz*, 299 A.D.2d 347, 349 N.Y.S.2d (2d Dep't 2002).

Moreover, *Hall v. King* has no continuing authority on the issue in that the First Department has made clear in *Vick* that, *absent other considerations*, it is impermissible to take a DLOM in valuing a real estate holding company. As explained by the Referee and discussed hereafter, the courts deciding *Murphy v. U.S. Dredging* found other considerations that are not present here. (A292, ¶118.)

Plainly, the courts in *Vick, Whalen, Cinque, Cohen* and *Wagner* are correct.[10] Cash and real estate are fully "marketable", and it would be grossly inappropriate to take a DLOM against such assets, especially with respect to a commodity in

10 Neither Baliban nor Lipton, Respondent's stock appraisers, had any knowledge of these more recent decisions regarding DLOMs with respect to real estate holding companies, leading the Referee to question their qualifications to opine on this issue. (A218, ¶270, A291, ¶117.)

short supply like Manhattan real estate where the buyers outnumber the sellers. (Barely more than a 1% annual turnover per *Respondent's* expert: 17,000 tenements, 190 sales [A4125-26.]) Although this issue has never been directly presented to the Court of Appeals, it denied leave to appeal in *Vick*, thereby allowing to stand the First Department's holding that DLOM applies only to goodwill and not to marketable real estate.

Other states do not permit a DLOM at the control level, *i.e.*, on a fair value determination. In *Paskill Corp. v. Alcoma Corp.*, 747 A.2d at 557, the Delaware Supreme Court expressly directed the trial courts that no discount could be "applied to unmarketable shares not registered with the Securities and Exchange Commission or traded on any public market." The Supreme Court of Wyoming in *Brown v. Arp & Hammond Hardware Co.*, 141 P.3d at 677, confirmed the rejection of a marketability discount "because it would 'provide a windfall to [respondents]'." The Supreme Court of Colorado in *Pueblo Bancorp. v. Lindoe, Inc.*, 63 P.3d at 367-69, concluded that "the term 'fair value'...means the dissenting shareholder's proportionate interest in the corporation valued as a going concern. The trial court must determine the value of the corporate entity and allocate the dissenting shareholder his proportionate ownership interest of that value, without applying a marketability discount at the shareholder level." *See also Rigel Corp. v. Cutchall*, 511 N.W.2d 519 (Neb. 1994) (marketability discounts are inappropriate);

Security State Bank v. Ziegeldorf, 554 N.W.2d 884, 889-90 (Iowa 1996) (marketability discounts prevent minority shareholders from receiving fair value of their pro rata shares); *Arnaud v. Stockgrowers State Bank*, 992 P.2d 216, 220 (Kan. 1999) (discounts should not be applied); *Lawson Mardon Wheaton, Inc. v. Smith*, 734 A.2d 738, 749 (N.J. 1999) (shares should not be discounted absent extraordinary circumstances); *In re McLoon Oil Co.*, 565 A.2d 997 (Me. 1989) (rejecting marketability or "illiquidity" discounts); *U.S. Inspect, Inc. v. McGreevy*, 2000 WL 33232337 (Cir. Ct. Va. 2000) ("In this court's view, application of a marketability discount...would again be inconsistent with a determination of fair value based upon a dissenting shareholder's proportionate interest in an ongoing concern. ... Dissenting shareholders would receive less than their proportionate share of the entire firm's value, thereby transferring wealth from these shareholders to those in control. ... Controlling shareholders in non-publicly traded corporations would be given an added incentive to consider corporate actions that would lead to corporate buyouts. ... '[I]t is incongruous for the majority shareholder to oppress the minority shareholders, or to control the timing of a valuation by voting on a merger, and then obtain the benefit of a discount at the minority shareholders' expense'").

As the Referee correctly recognized, *Murphy v. United States Dredging* is distinguishable on its facts with regard to imposition of a DLOM. (A291-92,

¶118.) In *Murphy*, the petitioners owned in the aggregate 36.77 percent of United States Dredging Corporation. Here, Petitioner owned nearly 50% of each corporation. In *Murphy*, the corporation was not just a real estate holding company; it had operating assets and goodwill, not only cash and real estate. "The parties agreed that the Corporation should be valued using a weighted average of its net asset value and its *income value* determined by the discounted cash flow method." 74 A.D.3d at 816 (emphasis added). Here, to the contrary, only the net asset value was used because EGA and FAV are real estate holding companies.

As the Referee correctly determined, there is no risk associated with illiquidity of the shares of EGA and FAV to be considered, and, accordingly, no reason for a DLOM. Unlike here, United States Dredging had at least a dozen shareholders (7 petitioners and 5 individual respondents), more that 4 million shares, a shareholders' agreement with conditions and limitations, an active history of selling and trading its real properties, out-of-state properties, complex leases with major commercial tenants, past IRS 1031 exchanges to defer capital gain taxes, and mortgage and real estate financing. (R 291-92, ¶118.) The EGA and FAV properties had never been sold or swapped and were all owned free and clear with no mortgages. The Second Department in *Murphy* recognized that it had to distinguish the subject corporation from the corporations in *Cinque* and *Whelan.* It, therefore, stated that DLOM is not limited to goodwill "in all instances,"

thereby acknowledging that for corporations such as those described in *Cinque* and *Whelan*, for example EGA and FAV, DLOM *is* limited to good will, and without goodwill on the balance sheet, there can be no DLOM.

The cases cited by Respondent are not to the contrary. Appellant's Brief at 5. *Matter of Rateau v. DAPA Communications, Inc.*, 59 A.D.3d 1037 (4th Dep't 2009), does not set forth the nature of the business or of the assets, but the name, "DAPA Communications", certainly indicates that this was an operating corporation, not a real estate holding company. In *Lehman v. Piontkowski*, 203 A.D.2d 257, 258-59 (2d Dep't 1994), the court expressly discussed that the professional corporation's goodwill was properly taken into account in the valuation of the corporation. Likewise, *Greek Peak Inc. v. Armstrong*, 265 A.D.2d 760, 761 (3d Dep't 1999), valued a corporation operating a ski resort and the expert used the discounted cash flow approach. Finally, *Raskin v. Walter Karl, Inc.*, 129 A.D.2d 642 (2d Dep't 1987), involved "four connected corporations … which operate a mailing list brokerage business." The valuation was done on the going-concern investment-value approach. None of Respondent's authorities involved real estate holding companies and, accordingly, they were not governed by the holdings in *Vick, Cinque* and *Whalen*, as are the two proceedings at bar.

D. A Marketability Discount Is Incorporated Into The Asset Valuation

A discount for marketability is already included in the share valuations. All the stock appraisers relied on the real estate appraisals in valuing the shares on the asset-based approach. As stated in the real estate appraisals and confirmed in the testimony, the real estate valuations all include amounts of time for marketing the property and for a sale to be completed.[11]

As stated by Mr. Mercer:

> Each of the primary assets of the Companies has been valued assuming that exposure to the market has already occurred. It would therefore be double-dipping to apply a marketability discount to the stock of the Companies, when exposure to the market is presumed in the underlying appraisals. In addition, the fact that the Companies own fourteen properties and five properties, respectively, in a market where demand outpaces supply would likely lead to the ability to sell the stock of the Companies on a fairly rapid basis (per conversations with Leitner Group and Massey Knakal Realty).

(A4990; *see also* A235-36, ¶336, A4989-90, and A4994 (buyers aggressive because of limited supply).)

The appraisers having already taken into account the marketability issues in calculating their values, there is no basis for a second discount to be taken as a

11 Not only did the real estate appraisers (Leitner Group and All Island) allow for a reasonable time for exposure of the properties in the open market in determining their appraised values, the comparables used by each of the appraisers in determining those values were the final purchase prices paid at closing after (a) exposure to the market prior to contract, (b) negotiation of the contract, and (c) the time for inspection, financing, etc. after contract and before closing. Each real estate appraisal assumed that a hypothetical sale of the subject property (the closing) occurred on the Valuation Date and included a marketing discount for that sale. This is true for the All Island appraisals as well as the Leitner appraisals.

percentage of the final valuation. In *Seagroatt Floral Co. v. Riccardi*, 167 A.D.2d 586, 588 (3d Dep't 1990), *aff'd in part, modified in part, rev'd in part*, 78 N.Y.2d 439 (1991), the Appellate Division first found that the "Referee's decision to accept the opinion of petitioner's expert, based in part upon a valuation of the credibility of that witness and the evidence relied upon by him in forming his opinion, is amply supported by the record."[12] The court held that the referee erred in applying a 25% DLOM because, like here, "the record in this case establishes that the valuation method used by petitioners' expert included a marketability discount." The Court of Appeals agreed: "We agree with the Appellate Division as to the discount; its holding that illiquidity had indeed been considered by petitioners' expert more closely comports with the weight of the evidence...." 78 N.Y.2d at 444. The respondent in *Seagroatt* unsuccessfully argued that a DLOM "must in all cases be applied against the value found – that the factor of illiquidity cannot be 'buried' in the capitalization rate." The Court of Appeals disagreed: "[T]here is no single method for calculating" a DLOM. "Certainly, this Court has never mandated one. Thus, to the extent respondent corporations suggest that illiquidity can only be taken into account by the application of a percentage discount against value...the *argument fails as a matter of law*." 78 N.Y.2d at 446-

12 Likewise here, the Referee's decision to accept the opinion of Mercer, based on an evaluation of his credibility and the lack of credibility of Respondent's appraisers (A290, ¶114) and on the evidence relied on by Mercer in forming his opinion, is amply supported by the record.

47 (emphasis added). As in *Seagroatt*, Mr. Mercer explained that a DLOM was already factored into the value of the assets.

Here, Respondent's own witness testified that the DLOM is included in the capitalization rate:

> Q Marketing time here, you have nine to twelve months; correct?
>
> A That's correct....
>
> Q How does it play into your appraisal?
>
> A It plays into our appraisal from this. When we're considering a capitalization rate, we must consider the risk that the potential investor perceives in the market.

(Esposito, A1016, lines 8-25.)

By seeking a DLOM, Respondent is trying to get a double discount—one already incorporated into the capitalization rates. Mr. Baliban, was adept at double-dipping. He not only took improper deductions for BIG and DLOM, he twice deducted a 4½% selling expense for a hypothetical sale that will never occur.[13] (*E.g.,* A2610, lines 7-10; A4208.) He used it to increase his DLOM deduction and to directly reduce the corporations' net asset value. (A4208, A4268-69, n.(f); A4270-73, n.(d); A4274-75 n.(f).)

All the real estate appraisers valued the properties at the price for which they could be sold for cash on the Valuation Date, having incorporated in that price

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13 Here, obviously, there are no selling expenses because Respondent is purchasing the stock.

a reduction for the "marketing period." (*E.g.,* Esposito, A1017-18, marketing time considered in capitalization rates.) The share appraisers used the real estate values that incorporated this marketability discount in valuing the stock. (A293, ¶123.) Plainly, the shares of EGA and FAV could be readily liquidated for cash and were valued on that basis by both sides' appraisers. The court below properly rejected Respondent's attempt to impose a second DLOM.[14]

E. Baliban's DLOM Is Not Supported By The Studies He Cites

As the Referee found, even in his calculation of his proposed DLOM discount percentage, Respondent's stock appraiser was not credible. Mr. Baliban relied on a publication listing some 14 studies of restricted stock sales. (A4178.) All the studies, save one, used by Mr. Baliban involve DLOM's for minority interests, not for entire corporations or controlling interests. (A293, ¶121.) Thus, the specific DLOMs proposed by Respondent have imbedded in them prohibited minority shareholder discounts, and their use is inappropriate in a fair value case. Mr. Baliban relied heavily on restricted stock studies. His example is most telling: "A restricted stock is a stock issued by a publicly traded company (*e.g.*, General Motors) and is identical in all respects to the freely traded stock of the public company except that its trading on the open market is restricted for a certain period

[14] Respondent quotes excerpts from Mr. Mercer's testimony (Appellant's Brief at 29) to try to change the implications of his testimony. Mr. Mercer's full testimony shows his opinion that the shares of a controlling interest in EGA and FAV were liquid. (A2857-59.)

(usually 6-12 months)." (A4177, ¶46.) Although such restricted stock studies may have application in other circumstances, they cannot predict what discount, if any, a buyer might expect to realize in purchasing a controlling interest in a real estate holding company. While a restriction on publicly traded stock will almost certainly cause a buyer to seek a discount, a buyer of a controlling interest in a Manhattan real estate holding company will more likely pay a premium in order to obtain a portfolio of properties.

Mr. Baliban even acknowledged that the very studies he relied on are inapplicable to a fair value appraisal: "While a number of empirical studies such as the restricted stock studies have analyzed discounts for lack of marketability of *minority* ownership interests, there are *no* similar studies for businesses as a whole, which would include all of the benefits of control." (A4179, ¶49 emphasis added.) Baliban derived his DLOM from his "doubt as to whether a 49.75% interest in EGA could actually be sold." (A4179, ¶49.) Plainly, Mr. Baliban imputed an improper minority interest to his DLOM "computation."

Mr. Baliban then referred to a study done by one Micah Officer who calculated an "acquisition discount for 'stand-alone private firms and subsidiaries of other firms (unlisted targets) relative to acquisition multiples for comparable publicly traded targets.'" (A4180, ¶50.) As Mr. Baliban conceded under cross-examination, the Officer studies did not relate in any manner to real estate holding

companies. (A3564, lines 21-24, A3570, lines 5-8.) The Officer studies are inapplicable because they included motivated sellers, *i.e.*, subsidiaries of public companies that were being sold because the parent "selling firms require liquidity." (A3565, lines 18-19.)

On cross-examination, Mr. Baliban conceded that with respect to the subsidiaries, the seller was not an "unwilling seller," but rather a "motivated seller" in need of an immediate cash infusion (A3568), and the seller gave a "fire sale" discount. (A3571-72). The inclusion of fire sale-type statistics in a fair value analysis ignores the Court of Appeals mandate that the corporations be valued as "going concerns." Mr. Baliban conceded that the stand-alone closely held corporations in the Officer study sold at a premium over the publicly traded targets, not at a discount. (A3579, lines 8-19.) Thus, by Respondent's own authorities, with respect to non-subsidiary unlisted corporations, there is no DLOM for a controlling interest in a closely held corporation.[15] (A294, ¶127.)

Mr. Baliban went so far as to apply his DLOM not only to the value of the real estate, but to the cash and cash equivalents in the corporations, amounts which

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15 The one paper (DiMattia) Baliban addressed that did purport to study controlling interests, although not controlling interests in Manhattan real estate holding companies, "advocate[ed] a 4%-9% discount for lack of marketability...." (A4180, ¶51.) Baliban, dissatisfied with such a low DLOM, juggled those numbers by "[d]oubling the average selling time to 18-24 months [which] increases the DLOM similarly to range from 8%-18%." (A4181, ¶52.) Baliban thus doubled the time All Island said was required. Because All Island had already taken the selling period into account and Baliban took twice that period into account in "calculating" his DLOM, he has trebled the "selling period" to manipulate his DLOM up to 20%.

could simply be distributed to the shareholders at full value. Although Mr. Baliban may be an "economic and financial damages expert in a broad range of contract and tort damage claims..." (A4189-94), he is certainly not an expert in determining fair value or even fair market value of closely held corporations. An analysis of his publications (A4193-94) shows that he has never published in the area.[16]

Respondent's reasons for exacting a DLOM (time to sell, price risk[17], transaction costs, poor internal accounting) are fatally flawed.

As shown above, the concept of fair value in the context of BCL §1118 is to give the petitioner his or her actual share of the corporation as a going concern. Under the facts present here, fair value does not permit a deduction for either BIG or DLOM. Moreover, to take a deduction for both BIG and DLOM with respect to these two real estate holding corporations is on its face unfair. Per the statute, the hypothetical sale of the corporations is on the Valuation Date, the day prior to the filing of the dissolution petition. Each real estate appraisal assumed that a hypothetical sale of the subject properties occurred on the Valuation Date. Thus, the owner of a real estate holding company could never do worse than to sell all

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16 Respondent employed a second expert witness to opine on the exact same things as did Baliban. Dr. Lipton, whose experience relates primarily to tax issues in matrimonial cases and other divorce issues (A4142), not to valuing closely held corporations, also improperly applied discounts based on her "considerations [that] affect the fair *market* value...." (A4113, emphasis added.)

17 There is no price risk regarding a sale as the hypothetical transaction already occurred at the valuation price on the Valuation Date and assumes cash was received on the Valuation Date.

the real estate at the appraised values and pay the capital gains tax with respect to each property. An owner would never sell her stock for less than she would get for its assets. No rational seller of the corporate stock would allow for a further marketability discount. Respondent wants to take a 100% BIG deduction plus a 20% DLOM. No hypothetical willing buyer, knowing the seller can simply sell the properties and pay the BIG, would seek an additional DLOM discount. No seller would agree to it. The double discounts sought by Respondent not only violate New York law, they violate logic, reason, and all considerations of equity and fairness.

Further, Respondent failed to submit any valid support for a 20% or, indeed, any percent additional DLOM. (A291, ¶117, A293, ¶121, A294, ¶127.)

Quoting *Seagroatt*, Respondent asks that the court "include consideration of any risk associated with illiquidity of the shares." Appellant's Brief at 4. That is precisely what the court below and the Referee did. They discussed their consideration of such risk or lack thereof in great detail. They followed the law precisely and correctly. Respondent is just unhappy with the resulting valuation. No seller would accept a DLOM for shares of stock in a corporation with cash as its only asset. Likewise, no seller would accept a DLOM for the shares of a corporation that possessed Manhattan residential real estate and cash.

III. THE REFEREE MISREAD LEVY'S TESTIMONY AND ERRED IN REDUCING THE APPRECIATION RATES USED BY LEITNER, THE JOINTLY RETAINED REAL ESTATE APPRAISER

The court below in dealing with the multitude of issues raised on the motions to confirm/modify/reject the Report appears to have overlooked one issue: the appropriate appreciation rates to be used in determining the values of the real estate holdings.

The Referee rejected the testimony of Respondent's real estate appraiser witnesses, but found very credible and unbiased the testimony of Joel Leitner, the real estate appraiser whom Petitioner called to testify. (A267, ¶29, A271, ¶41.) Mr. Leitner was not retained initially by Petitioner but by EGA and FAV. (A4421-30.) Respondent Vitale, signing as President of FAV and EGA, retained Mr. Leitner's company to appraise and prepare reports on the properties owned by EGA and FAV. (A4422, 4426, 4429.) The original appraisals, prepared as of the date of death of Edward P. Giaimo, Jr., were sent to the attorneys for Vitale and Robert. (*E.g.*, A4431-33, 4437, 4592-93, 4598, 4677-78, 4683, 4704-05, 4710.) At Petitioner's request, the appraisals were thereafter updated by Leitner Group to the Valuation Date. (*E.g.*, A4586-91, 4602-05, 4687-90.)

Although Respondent retained Mr. Leitner, one of the most respected real estate appraisers in New York City, to prepare the appraisals, Respondent decided that she wanted lower valuations and found a Suffolk County appraiser, Karen

Esposito of All Island Valuation Services, to provide them. Joel Leitner is a Member of the Appraisal Institute, has the MAI designation, has a Master's Degree in real estate from New York University, chaired the Valuation Committee of the Real Estate Board of New York, is a member of the Counselors of Real Estate and the Mortgage Bankers Association of New York, and teaches at NYU in its real estate Master's Program. (A4413, A173, AP111.) Ms. Esposito has none of these qualifications. (A3855-56.)

In preparing his appraisals, Mr. Leitner used appreciation rates appropriate to each building. Those appreciation rates differed depending on the locations of the buildings, the condition of the buildings, and most importantly the types of tenants, whether rent controlled, rent stabilized or market rent. (A4431-4954.) Because Mr. Leitner was jointly retained, his appreciation rates and capitalization rates should be accepted without adjustment. (A271, ¶40.)

The appreciation rate is an important component of the capitalization rates that are ultimately used to determine the value of each property. Mr. Leitner and his reports attested to the appropriate appreciation and capitalization rates for each building. The Referee believed that Mr. Leitner's testimony and exhibits were far more credible than those of Respondent's appraisers. (A267, ¶30.)

Because Mr. Leitner had been jointly retained, Petitioner retained a different, but equally well qualified and respected, appraiser, Jim Levy, to review the All

Island appraisals and comment on the testimony of Ms. Esposito, Respondent's appraiser. (A4956-4961.) In his rebuttal testimony, which the Referee found very credible (A269, ¶34 - A271, ¶39), Mr. Levy stated that the appreciation rates used by Ms. Esposito were much too low and that the appreciation rates should be *no less than* 30%. (A2181-82; A270, ¶37 "at least approximately 30%...".) Nowhere did Mr. Levy testify that the appreciation rate should be 30% on all the buildings, as the Referee incorrectly inferred. (A166, ¶89, A169, ¶99, A276, ¶54.)

Mr. Levy was commenting on the testimony of the All Island appraiser, not opining on what the particular appreciation rate should be on a particular building. That had already been done by Mr. Leitner. For example, the Leitner report for the building at 43-49 First Avenue owned by FAV (A4431-4591), states:

> Nearly all of the subject's rents are significantly below our market rent determination. The subject's actual annual gross income indicates the subject is below market, suggesting upside potential for many of the subject's units. The subject's current below-market rent roll will be applied in this analysis with this upside considered in determining an appropriate capitalization rate.

(A4538.)

Mr. Leitner's analysis also took into consideration "the subject property's location, age, and condition relative to competing properties." (A4554.)

> The subject property is occupied by rent stabilized [tenants] and therefore has high upside potential period. We project a 40% increase in value over the holding period.

(A4555.)

The Leitner report then proceeded to show the "Capitalization Rate Calculation." (A4555.) The Appendix contains the relevant entries for each building owned by FAV and EGA, except the building at 223 East 96th Street, which was appraised on a different basis. With respect to the value of the building at 223 East 96th Street, Petitioner accepts the value assigned by the Referee.

Each building differed, with some having exceedingly low rents and rent controlled as well as rent stabilized apartments (*e.g.*, 6 Spring Street [A4603]) and some having very few stabilized apartments (*e.g.*, 278 Mott Street [A4660]). For the Mott Street property, although the rents were below market rents in the area (A4657), the rents were much closer to market than in other buildings, and the Leitner report stated:

> The subject property is occupied by market rents and therefore has limited upside potential. We project a 25% increase in value over the holding period.

(A4658.)

With regard to the 6 Spring Street property, however, the Leitner report stated that the building's "rents are *significantly* below our market rent determination." (A4600, emphasis added.) Accordingly, the Leitner report projected a "50% increase in value over the holding period." (A4601.)

The capitalization rate calculations for these two buildings, accordingly, came out with 3.50% for 6 Spring Street and 5.00% for Mott Street. (A4601,

4658.) Although the appreciation rates ranged from 25% to 50%, most fell in the 35% to 40% range.

The Referee recognized:

> [Leitner's] cap rates for each building were different although the appraisals are all dated the same date. He testified the cap rates are influenced by upside potential in rent but, rent regulated, rent controlled, apartments have an upside potential that varies from building to building depending on the number of regulated/controlled apartments compared to market rent apartments. Buildings with potential future high rents impact the cap rate. Each building can be identical in all respects, but where apartments are regulated versus market, the upside potential will be different and, hence, the diversity in his cap rates (T, 608-612) [A1458-A62].

(A178, ¶128.)

Yet, the Referee erroneously overlooked his own finding of fact and assigned a constant 30% appreciation rate to all the buildings, a conclusion finding no support in the record.

Petitioner's Exhibit AH (A4955) sets forth the "'As Is' Value" for each building. The aggregate of these values for FAV ($28,600,000) should be substituted for the "Real Property Value of FAV" in the Report (A314, ¶202). With respect to EGA, after substituting the Referee's value for 223 East 96 Street, $6,884,540 (A286), in Exhibit AH (A4955), the resulting aggregate value for all the EGA real properties is $60,484,540, which number should then be substituted for the "Real Property Value of EGA" in the Referee's balance sheet (A310).

Although Petitioner's challenge to the Referee's adjustment of the appreciation and capitalization rates was part of Petitioner's motion to confirm in part, modify in part and reject in part the Report (A330, ¶8(b) and n.1), the court below did not address the issue in its Decision.

For the reasons set forth above, the Judgments should be modified to reflect the appropriate real property valuations.

IV. THE EGA AND FAV CHOSES-IN-ACTION WERE ASSETS ON THE VALUATION DATE AND MAY NOT BE CONDITIONED ON FUTURE ACTIONS BY THOSE CORPORATIONS

The Referee and the court below correctly found that the choses-in-action possessed by EGA and FAV against the Estate were assets to be included in the fair value of those corporations. It appears that Respondent does not question that these are legitimate assets, only that the court below purportedly erred in its determination of the values of those assets. Appellant's Brief at 54-57. Plainly, these values were based on the credible evidence, were correct, and should not be disturbed. *Matter of F.P.D. Realty Corp.*, 267 A.D.2d 111, 112 (1st Dep't 1999) (JHO's valuation should not "be disturbed where, as here, the valuation was within the range of testimony presented and rested on the credibility of expert witnesses and their valuation techniques" (internal quotes deleted).)

The court below and Referee erred, however, in their determination to require Petitioner to escrow the amounts of the two choses-in-action.

Each Judgment provides that a sum equaling the amount included in the fair value for Petitioner's share of the chose-in-action shall "be deposited in escrow...to be released...to Petitioner on entry of any final determination...by the Surrogate's Court, Westchester County of EGA's [FAV's] claim against Decedent's Estate for the chose-in-action as defined in the Report. Provided that: 1) if the Estate pays

less than the full value of the chose in action..., Petitioner shall receive from escrow his proportionate share of the amount paid...." (A13-14; A63-64.)

Fair value is determined at the valuation date. The choses-in-action were indisputably known and collectible assets at the Valuation Date. (A306, ¶170 - A307, ¶173.) The amounts of skimmed rents came from the corporations' two sets of books and were included in the amended tax returns signed by Respondent. (A2982.) There was no dispute at the Valuation Date that there were more than ample estate assets to pay the claims of the choses-in-action if and when EGA and FAV ever asserted those claims. (A307, ¶172-173, A311, A2982-83.) At the Valuation Date, no assets had been distributed from the estate. (A777, ¶30.)

The Petitions commencing these proceedings each asserted claims based on the skimming of rents from the properties of EGA and FAV. (A583, ¶50, A584, ¶54-55, A592.) Yet, as of the dates of the fair value hearings and the cross-motions on the Report, neither EGA nor FAV had made any claim against the Estate for the choses-in-action. (A779, ¶35.)

There is no basis in law or fact for requiring any part of the fair value of Petitioner's shares to be placed in escrow or to be made contingent upon collection of the corporate asset. A change in value of a corporate asset after the valuation date has no bearing on that asset's value on the valuation date. For example, if EGA owned gold bullion on the Valuation Date, its value could have tripled by the

time the Judgments were entered. That increase in value would belong to Respondent, and would not be includable in the value of Petitioner's shares at the Valuation Date. Conversely, if the value of the bonds in which EGA had invested its cash plummeted after the Valuation Date, Petitioner would still be entitled to his share of the fair value of the corporation with the bonds included at their Valuation Date prices. Anything that could happen regarding the potential collection of the choses-in-action after the Valuation Date is irrelevant, and Petitioner's receipt of that portion of the fair value of his shares cannot be made contingent on the collection post-Valuation Date of that asset. The issue to be determined with respect to fair value is the existence and value of the chose-in-action at the Valuation Date, not its collectability some three or more years later. This Court should order that the escrow be terminated and the sums contained in the escrow be released to Petitioner.

With respect to the amount of each chose-in-action, the Referee and the court below properly restricted the claim to the six years prior to the Valuation Date because of the Statute of Limitations, and also correctly reduced the amount of each chose-in-action by the amount of cash recovered that related to that same six-year period. In fact, the Referee was very liberal in determining how much cash was attributable to the six-year period in that he included all undated

envelopes as being within the six years and reduced the choses-in-action by the amounts in those undated envelopes. (A307-08, ¶¶174-175; A311, ¶188.)

Respondent wants to include as a set-off monies found in envelopes that had specific dates more than six years prior to the Valuation Date. That cash is identifiable to skimming of rents not included in the choses-in-action, and Respondent provides no legal authority by which it could be set off against the claims of EGA and FAV against the Estate. The Referee based his findings on the evidence he found credible. His determinations were well within the range of testimony presented and should not be disturbed.

V. PREJUDGMENT INTEREST <u>SHOULD BE AWARDED AT 9%</u>

The court below held that interest should be awarded at a reduced rate of 4% as recommended by the Referee:

> While Petitioner now claims that Respondent engaged in misconduct that supports the higher rate of interest, Petitioner acknowledges that he did not present evidence of misconduct to the Referee. Contrary to Petitioner's contention, the court finds that a recommendation by the Referee on interest was clearly within the scope of the reference, and that, having failed to present evidence bearing on the issue to the Referee, Petitioner has waived the right to do so.

(A33.)

The court below went on to find that the conduct of Respondent "does not rise to the level that would warrant the statutory rate of interest for the entire period." (A34.) This was error.

The Referee had determined that "there was no showing of bad faith by the Petitioner and, therefore, *statutory* interest is recommended." (A315, ¶205, emphasis added.)

The Referee then stated "there was no testimony or evidence that demonstrates oppressive conduct. There was no proof of being frozen out of the business or frivolous litigation...." (A315, ¶206.)

Such proof was spelled out in detail in the two verified dissolution petitions that commenced these proceedings. (A576, ¶14 - A586, ¶60; A5257-5282.) Indeed, Petitioner, after providing detailed facts supported by exhibits, explicitly asserted that Respondent was "guilty of oppressive, fraudulent and illegal actions...." (A585, ¶56.)

A. <u>Limited Scope Of Reference</u>

There was no opportunity at the trial before the Referee to present the evidence regarding Respondent's oppressive conduct, her having frozen Robert out of the business, and her frivolous litigation.

By identical orders dated December 20, 2007 (the "Referral Order"), the court below ordered "that the above-referenced matter is referred for an expedited hearing before a Special Referee to *establish the fair value of the shares* of stock of the corporations...." (A783, emphasis added.)

Thus, the purpose of the hearing before the Referee was solely to establish fair value. The Referral Order did not indicate that any other issues, including interest, were to be considered. Accordingly, Petitioner did not offer evidence before the Referee of the misconduct of Respondent. Indeed, under the case law, such evidence would have been inadmissible. *Matter of Pace Photographers, Ltd.,* 71 N.Y.2d 737, 748 (1988); *Seagroatt*, 78 N.Y.2d at 445 (on the issue of valuation, "the misconduct charges became irrelevant").

B. Respondent's Bad Faith And Oppressive Behavior

Respondent's oppressive and bad faith behavior towards Petitioner, including her seizing control of the corporations after Edward's death and denying Robert any role in management, is detailed in the record below. (A5285-5296, A5839-5846.)

Proof of these actions or patterns of behavior by Respondent was not submitted at the trial before the Referee because the sole issue was valuation. After the death of Edward, Respondent and Petitioner should have shared the management of EGA and FAV as the two surviving directors/shareholders. Instead, Respondent forced Petitioner out.

By reason of Respondent's oppressive and bad faith conduct and as a matter of equity and fairness, interest should be awarded at 9% per annum. (CPLR 5004.) At the very least, Respondent should be required to pay 9% interest for the period between when she served her frivolous and dilatory motion to revoke her election to purchase Robert's shares (April 22, 2008) and her notice of withdrawal of that motion (August 28, 2008). *See Matter of Pace Photographers, Ltd.,* 163 A.D.2d 316, 318 (2d Dep't 1990) (BCL §1118 "was amended in part to remedy the problems generated by delays…"); *Matter of Smith v. Russo,* 230 A.D.2d 863, 864 (2d Dep't 1996) (same).

If there is to be a reduction in the interest rate, it should be at most by 1/3 to 6%, not the drastic 55% reduction to 4% imposed by the court below.

VI. RESPONDENT SHOULD BE HELD IN CONTEMPT FOR MAKING FALSE REPRESENTATIONS TO THE COURT, AND THE JUDGMENTS SHOULD BE INCREASED BY THE PROPORTIONATE AMOUNT OF THE UNDISCLOSED ASSETS

Petitioner brought a motion below to hold Respondent in contempt for making misrepresentations at trial and concealing assets of FAV and EGA. (A5891-5926, A6026-6059.) Petitioner explicitly alleged that Respondent, her counsel and accountants knew months before the commencement of the fair value hearings of the existence of certain management fee receivables (A5895, ¶8, A5896, ¶14) that were not disclosed to or included in the reports of *any* of the share appraisers (A5895, ¶10 - 5896, ¶13, A5902-12).

As stated by the court below: "'[F]raudulent and perjurious conduct during the course of judicial proceedings may [] warrant punishment by contempt.'" (A41, citation omitted.) *See, e.g., 317 W. 87 Associates v. Dannenberg,* 159 A.D.2d 245, 246 (1st Dep't 1990) ("Contributing to 'undisputed untruthfulness' on the record justifies the imposition of sanctions.... Such fraudulent and perjurious conduct during the course of judicial proceedings may also warrant punishment by contempt (Judiciary Law §753(a)(2))..."); *Estate of Rothko*, 84 Misc.2d 830, 870 (Sur. Ct. N.Y. Co. 1975), *mod'd on other grounds*, 56 A.D.2d 499 (1st Dep't 1977), *aff'd,* 43 N.Y.2d 305 (1977) ("The fact that the aggrieved parties possess another remedy to recover such damages does not prevent the institution of a proceeding to

punish for contempt...”); *Kim v. Kim*, 170 Misc.2d 968, 969 (Suffolk Co. 1996) (false statements in a net worth statement punished by contempt).

The court below stated that Respondent knew before November 2008 (at least two months before the commencement of the fair value hearings) that her “accountants determined that such receivables needed to be recognized, and that they filed amended tax returns...reflecting such receivables....” (A41.)

These receivables--owing from Respondent and from her mother’s estate of which she was the executor--were hidden from Petitioner and his professionals and were only discovered after the issuance of the Report. (A5896, ¶15.)

Discovery cannot disclose hidden receivables such as these that were not included in the corporation’s books and records. The issue, however, is not whether these assets were “discoverable”. The issue is whether Respondent falsely represented the assets of EGA and FAV by submitting balance sheets without these assets to the Referee and the share appraisers who relied on them.

The court below focused on discovery of work papers that were prepared in the fall of 2008 and not disclosed to Petitioner until 2010. The fall of 2008 was after completion of all discovery but before commencement of the fair value hearings.

The hidden receivables amount to more than $1.2 million. Petitioner’s portion is $281,187 with respect to his shares of FAV and $346,282 with respect to

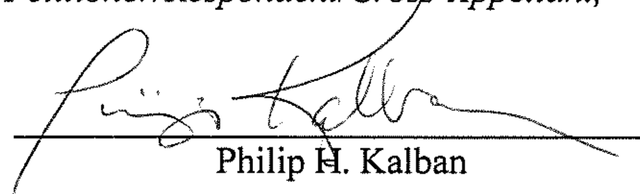
his shares of EGA. (A5897, ¶16, A5913-15.) This court should include the additional assets in the valuation of EGA and FAV pursuant to CPLR 5015(a)(2) and (3) or CPLR 4404(b).

CONCLUSION

Respondent's appeal should be denied is all respects. Petitioner's appeal should be granted and the Judgments and Decision modified to the extent of (a) restoring the Leitner valuations of the real estate holdings of the two corporations; (b) removing any discount for built-in capital gains taxes or, alternatively, deducting expenses of sale in calculating the BIG; (c) deleting the provision in each Judgment requiring an escrow of that part of Robert's share of the fair value of the corporations relating to the chose-in-action and ordering the release of said escrow to Robert; (d) including in the assets of EGA and FAV the value of the undisclosed assets ($1,258,373.72) that Vitale hid from Robert and the trier of fact; (e) increasing the rate of interest from the Valuation Date to the Judgment dates to 9% per annum; and (f) holding Vitale in contempt for her misrepresentations at the trial by submitting through her counsel and experts balance sheets that did not disclose and excluded accounts receivable for management fees owing to EGA and FAV.

Dated: New York, New York
July 6, 2012

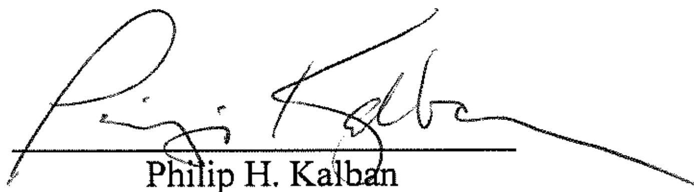
PUTNEY, TWOMBLY, HALL & HIRSON LLP
Attorneys for Robert T. Giaimo,
Petitioner/Respondent/Cross-Appellant,

By: 
Philip H. Kalban

APPELLATE DIVISION – FIRST DEPARTMENT
Printing Specifications Statement

This brief was prepared using Microsoft Word. The typeface is Times New Roman, 14 point. The word count including headings and footnotes, but excluding the Tables of Authorities and Contents, as calculated by the processing system is 15,490. By order dated July 6, 2012, the Appellate Division granted Petitioner-Respondent's request to file an over-length brief.

Dated: New York, New York
July 6, 2012



Philip H. Kalban

SUPREME COURT OF THE STATE OF NEW YORK
APPELLATE DIVISION - FIRST DEPARTMENT

Application of ROBERT T. GIAIMO, individually and as Co-Executor of the Will of EDWARD P. GIAIMO, JR., Deceased, for the Judicial Dissolution of EGA ASSOCIATES, INC., Petitioner – Respondent/Cross-Appellant, - against - JANET GIAIMO VITALE, Respondent – Appellant/Cross-Respondent.	**Supreme Court,** **New York County** **Index No. 110474/07** **CIVIL APPEAL** **PRE-ARGUMENT STATEMENT**

Pursuant to Section 600.17(a) and (b) of the Rules of the Appellate Division, First Department, Petitioner – Respondent/Cross-Appellant, Robert T. Giaimo, makes the following statements:

1. **Title of action:**

The title of the proceeding is as set forth in the caption above.

2. **Full names of original parties:**

Petitioner: Robert T. Giaimo, Petitioner – Respondent/Cross-Appellant ("Petitioner"), individually and as co-executor of the estate of Edward P. Giaimo, Jr.

Respondents: EGA Associates, Inc. ("EGA") and Janet Giaimo Vitale, Respondent – Appellant/Cross-Respondent ("Respondent")

Changes in parties: None

3. **Counsel for Appellant:**

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(212) 682-0020

4. **Counsel for Respondent:**

Mitchell J. Geller
Holland & Knight LLP
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5. **Court from which cross-appeal is taken:**

Cross-Appeal taken from a Judgment and from a Decision/Order of the Supreme Court of the State of New York, County of New York.

Judge: Hon. Marcy S. Friedman, J.S.C.

Date of Entry of the Judgment: August 26, 2011
Date of Entry of Decision/Order (the "Order"): April 26, 2011
Date of Entry of Report of Special Referee: July 15, 2010

6. **Nature and object of proceedings below:**

BCL 1118 election Fair Value Hearing before Special Referee Louis Crespo in BCL 1104-a dissolution proceeding to establish the fair value of all the shares of stock of EGA.

Cross-Motions to Justice Marcy S. Friedman to confirm in part, modify in part and reject in part the Report of Special Referee Louis Crespo.

Two motions by Petitioner, Robert Giaimo, to hold Respondent, Janet Giaimo Vitale, in contempt.

Description of Proceedings Below:

The proceeding below was commenced as a BCL 1104-a dissolution proceeding. The court (Marcy S. Friedman, J.S.C.) entered a temporary restraining order against Respondent Vitale. Pursuant to BCL 1118, Respondent Vitale elected to buy the shares in EGA of Robert T. Giaimo, Petitioner, as co-executor of the estate of Edward P. Giaimo, Jr., deceased. Pursuant to stipulation, Robert T. Giaimo in his individual capacity intervened as a Petitioner, and Respondent Vitale also elected to buy the shares in EGA owned individually by Robert T. Giaimo.

The parties could not agree on the fair value of the shares of EGA, and the court referred the determination of the fair value of the shares of EGA (and of a related corporation, First Ave. Village Corp. ["FAV"]) to a special referee to hear and report pursuant to a stipulation between the parties. The Special Referee, Hon. Louis Crespo, heard the joint trial of the issues regarding the fair value of each of EGA and FAV and rendered a single Report with findings of fact and conclusions of law regarding each of EGA and FAV (the "Report") on June 30, 2010.

By order to show cause dated June 7, 2010, Petitioner moved to hold Respondent in contempt for, *inter alia*, violation of a temporary restraining order. By notice of motion dated July 2, 2010, Petitioner moved to hold Respondent in contempt for, *inter alia*, her fraud on the court by concealing assets in connection with the Fair Value Hearings, and to direct that the undisclosed assets be included in the Fair Value of the corporate stock.

7. Result reached and method of disposition in the court below:

The court below (Marcy S. Friedman, J.S.C.) in the Judgment and Order erroneously (a) permitted a deduction from the Fair Value of the corporate stock for the built-in capital gains taxes ("BIG"), and further failed to deduct expenses of sale in calculating the BIG; (b) limited prejudgment interest to 4%; (c) required the escrow of and applied improper restrictions on that part of the fair value of the corporation relating to a certain chose-in-action; (d) reduced the appraised value of the corporate real estate as appraised by the jointly retained expert, Joel Leitner; (e) denied each of Petitioner's contempt motions against Respondent; and (f) failed to include the value of undisclosed assets in the fair value of the corporate stock.

8. Grounds for reversal or modification and issues proposed to be raised on appeal:

Petitioner/Cross-Appellant seeks reversal or modification of the order below on the following grounds:

The court below misinterpreted and misapplied the law and facts in permitting a deduction for BIG in determining Fair Value under BCL 1118 or, alternatively, in failing to deduct expenses of sale in calculating the BIG.

The court below failed to consider Respondent's improper activities and abused its discretion in limiting prejudgment interest to 4%.

The court below misinterpreted and misapplied the law and facts in applying conditions to inclusion of the chose-in-action in the Fair Value of EGA at the valuation date and in requiring an escrow of the value of the chose-in-action.

The court below and the Special Referee misinterpreted the evidence in reducing the value of the corporate real estate below the amount appraised by the jointly retained expert, Joel Leitner.

The court below misinterpreted and misapplied the law and facts and abused its discretion in denying Petitioner's contempt motions and in failing to include the value of the undisclosed assets in the fair value of the corporate stock.

9. Related Actions:

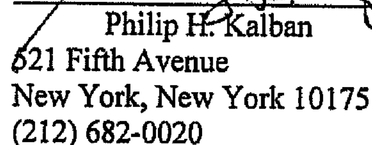
There are no related actions or proceedings now pending in this Court.

No other appeal is pending in this proceeding.

Copies of the Judgment and Order are annexed to the Notice of Appeal of Respondent.

Dated: New York, New York
October 6, 2011

Putney, Twombly, Hall & Hirson LLP
Attorneys for Petitioner – Respondent/ Cross-Appellant, Robert T. Giaimo

By: 
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SUPREME COURT OF THE STATE OF NEW YORK
APPELLATE DIVISION - FIRST DEPARTMENT

Application of ROBERT T. GIAIMO, individually and as Co-Executor of the Will of EDWARD P. GIAIMO, JR., Deceased, for the Judicial Dissolution of FIRST AVE. VILLAGE CORP., Petitioner – Respondent/Cross-Appellant, - against - JANET GIAIMO VITALE, Respondent – Appellant/Cross-Respondent.	**Supreme Court,** **New York County** **Index No. 110474/07** **CIVIL APPEAL** **PRE-ARGUMENT STATEMENT**

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Respondents: First Ave. Village Corp. ("FAV") and Janet Giaimo Vitale, Respondent – Appellant/Cross-Respondent ("Respondent")

Changes in parties: None

3. Counsel for Cross-Appellant:

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4. Counsel for Cross-Respondent:

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5. Court from which cross-appeal is taken:

Cross-Appeal taken from a Judgment and from a Decision/Order of the Supreme Court of the State of New York, County of New York.

Judge: Hon. Marcy S. Friedman, J.S.C.

Date of Entry of the Judgment: September 13, 2011
Date of Entry of Decision/Order (the "Order"): April 26, 2011
Date of Entry of Report of Special Referee: July 15, 2010

6. Nature and object of proceedings below:

BCL 1118 election Fair Value Hearing before Special Referee Louis Crespo in BCL 1104-a dissolution proceeding to establish the fair value of all the shares of stock of EGA.

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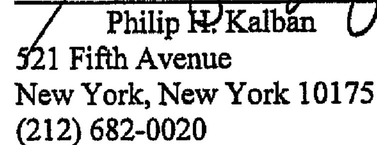
Copies of the Judgment and Order are annexed to the Notice of Appeal of Respondent.

Dated: New York, New York
October 31, 2011

Putney, Twombly, Hall & Hirson LLP
Attorneys for Petitioner – Respondent/ Cross-Appellant, Robert T. Giaimo

By: 

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STATE OF NEW YORK)
)   ss.:   **AFFIDAVIT OF PERSONAL SERVICE**
COUNTY OF NEW YORK)

I, , being duly sworn, depose and say that deponent is not a party to the action, is over 18 years of age and resides at the address shown above or at

On

deponent served the within: **Brief for Petitioner-Respondent/Cross-Appellant Robert T. Giaimo**

upon:

Joseph P. Sullivan, Esq.
Mitchell J. Geller, Esq.
Robert J. Burns, Esq.
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the attorney(s) in this action by delivering **2** true copy(ies) thereof to said individual personally. Deponent knew the person so served to be the person mentioned and described in said papers as the Attorney(s) herein.

Sworn to before me on

____

MARIA MAISONET
Notary Public State of New York
No. 01MA6204360
Qualified in Bronx County
Commission Expires Apr. 20, 2013

Job # 242653