To be Argued by:
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New York Supreme Court
Appellate Division – Second Department

Docket No.: 2013-02792

MAN CHOI CHIU and 42-52 NORTHERN BLVD, LLC,

Plaintiffs-Respondents-Cross-Appellants,

– against –

WINSTON CHIU,

Defendant-Appellant-Cross-Respondent.

WINSTON CHIU,

Counterclaim Plaintiff/ Third-Party Plaintiff-Appellant,

– against –

MAN CHOI CHIU,

Counterclaim Defendant/ Third-Party Defendant-Respondent,

– and –

HELEN CHIU, TERESA CHIU and 42-52 NORTHERN BOULEVARD, LLC,

Nominal Counterclaim Defendants-Respondents.

(For Continuation of Caption See Reverse Side of Cover)

BRIEF FOR PLAINTIFFS-RESPONDENTS-CROSS-APPELLANTS

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PRELIMINARY STATEMENT

This Brief is respectfully submitted on behalf of Man Choi Chiu and 42-52 Northern Blvd., LLC, Helen Chiu and Teresa Chiu, in response to the appeal filed by Winston Chiu from the Judgment entered February 6, 2013,[1] following a trial in the Supreme Court, Queens County (Weiss, J.).

Winston, Man Choi's older brother, is appealing from the Judgment to the extent that the court determined that, as of February 9, 2008 (the valuation date) he had a 10% interest in the limited liability company, rather than a claimed interest of 25% or more. Significantly, Winston incredulously testified that he was still the sole, 100% owner of the company (R. 689-690, 698) (notwithstanding prior court rulings, including by this Court, that Winston was deemed to have "withdrawn" from the company as of February 9, 2008) (R. 722), while his counsel inconsistently argued that Winston had a purported interest of 25% or 32%.[2]

Winston failed to prove that he had an interest of 25% or 32% in the company, whose sole asset is a commercial building located in Long Island City (purchased in 1999 for $5.45 million and valued at $13.5 million as of early 2008),

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[1] The Judgment appears at pages 15-17 of the Joint Record. References "R.__" are to the Joint Record.

[2] Conspicuously absent from Winston's Brief is any mention that, in the opening statement at trial, his attorney claimed that Winston had a 32% interest based upon an alleged mathematical "mistake" in the way the parties' initial capital accounts were calculated (R. 62), but never proved, or pursued, such claim during trial.

based upon his minor "capital contribution" of $193,854 (only 3.5% of the purchase price) and a paper "guaranty" of a $3.5 million mortgage to Eastbank, N.A. (which was also guaranteed by two of Man Choi's companies and Henry Chiu, his late son).

Winston is also appealing from the court's Judgment, awarding him the sum of $1,514,954.63 (with pre-judgment interest from the Valuation Date) (R. 17) as the "buy out" value of his supposed 10% interest in the company. Winston claims, however, that based upon his initial and only "capital contribution" of $193,854, he is entitled to a "buy out" payment in excess of $2.6 million (or over $4 million with interest to date), giving him annual "windfall" returns of 33% to 37% in a real estate holding company that never generated any actual income. Moreover, Winston never had any management responsibility, liabilities or actual risk with respect to the operation of the company.

Finally, Winston is appealing from the court's dismissal of his claims for alleged breach of "fiduciary duty." Not only did Winston fail to prove that he was "frozen out" of the affairs of a company in which he had had no involvement in the first instance, but he also failed to demonstrate that he suffered any "damages." Moreover, the court properly dismissed Winston's purported derivative claims, as he lacked standing to assert such claims in the first instance, having "withdrawn" as a member 4 months prior to the time he asserted such claims.

In an attempt to obtain an unjust award of attorneys' fees, Winston claims that the court should have, at the very least, awarded him "nominal damages" and even "punitive damages," whereas the record demonstrates that Winston failed to prove any damages, or any malicious or willful conduct, by Man Choi, warranting punitive damages.

This Brief is also submitted in support of Man Choi's cross-appeal from the same Judgment (R. 39-40), to the extent that the court incorrectly determined that Winston had a 10% interest in the company as of the valuation date. In fact, had the court properly credited Man Choi for all of his "capital contributions," totaling nearly $2 million, toward the initial purchase of the property, it would have found that Winston had an interest of 5.74%, worth $440,471, and not a 10% interest worth in excess of $1 million.

Thus, Man Choi proved that he and his wholly-owned companies contributed nearly $2 million out of the $5,693,618 in total closing costs for the LLC's initial purchase of the property in 1999, including the sum of $1,149,920 from the refinancing of a mortgage by 1-9 Bondst Realty Inc. (wholly-owned by Man Choi) on a separate property, which funds the court incorrectly determined were a "loan" rather than a "capital contribution." However, such funds should have been properly classified as Man Choi's "capital contribution," based upon the classic characteristics of a "capital contribution," as there was no promissory note

executed, no repayment schedule, no stated interest rate, and no security or collateral given for such contribution. In fact these were the very same Roth Steel factors that the court correctly applied in determining that $1,233,014 contributed by Man Choi (after the purchase of the property), for "capital improvements," constituted a "capital contribution" and not a "loan."

Indeed, the $581,562 for which the court credited Man Choi as his initial "capital contribution" (which included the $535,000 contract deposit) represented only a relatively small portion—i.e., only the cash portion—of his total "capital contributions" toward the purchase of the property.

Properly viewed, Winston's "contribution" toward the purchase of the property was only $193,854, which represented proceeds from the sale of a California property that he wanted to shelter from payment of capital gains taxes by performing a "1031 tax-free exchange," using Man Choi's company as his "conduit." Thus, the initial "split" in interest of 75%-25% between Man Choi and Winston, as reflected in the company's tax returns for the first two (2) years and its unaudited financial statements, was merely the mathematical product of the parties' relative cash contributions toward the purchase of the property and not, as the court incorrectly found, the result of any "agreement" between Man Choi and Winston.

However, even if there were such "agreement," the court, mindful of this Court's March 2007 decision on Winston's appeal in the first action, was correct in determining that the initial 75%-25% "split" was merely the "starting point" and "not an ending point" (R. 1166-1167). Thus, the court correctly adjusted the parties' respective interests based upon Man Choi's additional "capital contributions," totaling $1,233,014, made toward "capital improvements" of the property.

Contrary to Winston's assertions, the members' relative interests are not static and not fixed forever based merely upon the information that was (incorrectly) reported in the company's tax returns. Winston argues that this Court should not permit Man Choi and the company to "disavow" the information in the tax returns simply by not having filed any returns after 2000, while omitting that he himself admitted to filing false personal income tax returns for nearly a decade, claiming to be the 100% owner of the company, in order to take, on his personal tax returns, deductions for 100% of the company's expenses that he never paid. Thus, based upon his own fraudulent conduct, Winston himself should be "estopped" from relying upon the company's tax returns, purportedly showing that he had a 25% interest, that he himself had "disavowed" by filing false personal returns claiming to be the 100% owner of the company.

The court correctly rejected Winston's assertion that Man Choi's additional "capital contributions" unilaterally "diluted" his interest, because he himself could have made, but elected not to make, further contributions. Likewise, the court correctly rejected Winston's self-serving assertion that such capital improvements were made solely for the benefit of Man Choi's businesses operating from the property, finding that such improvements, including a second floor and upgraded building's systems, constituted "major structural alterations" as opposed to ordinary maintenance that a tenant would make under a standard "triple net" lease. Moreover, Man Choi proved at trial that these improvements increased the overall value of the property far beyond the cost of the improvements and, in turn (along with a rapidly rising real estate market), increased the actual value of Winston's slightly lesser interest.

Man Choi and the company are also appealing to the extent that the court improperly determined that the "fair value" of Winston Chiu's 10% interest in the company was $1,044,974 (as of the valuation date). Even if the 10% interest (and not 5.74%) were correct, the court nonetheless miscalculated the "net asset value" of the company (used to determine the value of the respective interests) by failing to include, on the company's balance sheet, "liabilities" totaling $1,366,780, based upon the court's own findings. Thus, the $1,149,920[3] contributed by Man Choi to

[3] The court erroneously listed such amount as $1,142,000 (R. 25).

the company (from the proceeds of the mortgage refinancing by 1-9 Bondst Realty), which funds the court (albeit incorrectly) determined were a "loan," should have been included as a "liability" on the company's balance sheet in calculating its "net asset value." In addition, the court neglected to account for, and also include as a "liability" on the balance sheet, 2 other "loans" made by Man Choi's other companies toward the purchase of the property. Indeed, Winston's own valuation expert admitted that such sums were "debts" on the company's balance sheet (R. 6369).

The net effect of the court's mathematical errors was to overstate the "net asset value" of the company (the correct amount is $9,082,959, not $10,449,739), thereby incorrectly determining that the "fair value" of Winston's 10% interest was $1,044,974, and not the mathematically correct amount of $908,296.

In addition, Man Choi and the company are appealing to the extent that the court failed to adhere to established New York precedent, particularly in this Department, by failing to apply <u>any</u> discount to the "fair value" of Winston's interest, to account for the lack of marketability of his illiquid interest in the privately-held, real estate holding company. The court erred in equating the value of Winston's membership interest in the company, whose sole asset is the commercial building, with the sale of the realty itself, which the court incorrectly found was "easily marketable" (R. 36). Thus, the court erred in treating Winston's

interest as the equivalent of cash or a marketable security that can be easily liquidated and converted to cash.

The court also overlooked credible testimony by Man Choi's valuation expert that, based upon restricted stock studies and prevailing case law, there is a range of between 15% to 25% for such discount. Thus, this Court should search the record and make its own determination as to the proper amount of such discount, which cannot be "zero," as the court incorrectly found.

Finally, Man Choi and the company are appealing to the extent that the court awarded any *pre*-judgment interest on the "buy out" amount of Winston's interest, and at the statutory rate of 9%, commencing as of the valuation date. In effect, the court improperly rewarded Winston for his inequitable and unlawful conduct, including and especially his adjudicated "fraudulent conveyance" of the company's property in April 2001, the subject of the first action that is nowhere mentioned in Winston's Brief. Nor should Winston have been rewarded for deliberately overstating his interest in the company to force a "buy out" of his interest under the threat of a "dissolution." Indeed, for the past decade Winston sought only to extort funds from his brother and his family.

Winston's appeal should be denied in all respects, as there is no support in the record for his outlandish claim that, as of the valuation date, he had a 25% interest in the company, worth in excess of $2.6 million. Rather, this Court should,

on the cross-appeal, determine that, as of the valuation date, Winston had a 5.74% interest in the company, with a "fair value" of $440,471.

However, even if it were to affirm the finding of a 10% interest, this Court should nonetheless search the record and find that, based upon the company's correct "net asset value" of $9,082,959, Winston's 10% in interest was worth $908,295. Moreover, this Court should modify the Judgment by deleting, or substantially modifying, the award of pre-judgment interest.

COUNTERSTATEMENT OF QUESTIONS PRESENTED

Question No. 1: Did the court err in determining Winston had a 10% interest as of the February 9, 2008 valuation date, the "fair value" of which was $1,044,974?

Answer: Yes.

Question No. 2: Did the court err in determining the sum of $1,149,920 (erroneously listed as $1,142,000), contributed by Man Choi (from the mortgage refinancing of a separate property) toward the initial purchase of the property in 1999, constituted a "loan" and not "capital contribution," where there was no promissory note, no repayment schedule, no stated interest rate, and no security or collateral given for the repayment?

Answer: Yes.

Question No. 3: Did the court err in failing to find, based upon all of Man Choi's "capital contributions," including all funds contributed toward the initial purchase of the property and for major capital improvements thereafter, Winston's interest as of the February 9, 2008 valuation date was at most 5.74%, and not 10%?

Answer: Yes.

Question No. 4: Did the court correctly determine the amount of $1,233,014 contributed by Man Choi and his entities (after the purchase) toward capital improvements, including a second floor and upgrades of major systems, constituted a "capital contribution" to the company and not a "loan"?

Answer: Yes.

Question No. 5: Assuming Winston had a 10% interest as of the valuation date, did the court err in determining the "fair value" of Winston's interest was $1,044,974, by (mis)calculating the "net asset value" of the company in failing to include, on the company's balance sheet, "liabilities" totaling $1,366,780, including $1,149,920 advanced by Man Choi that the court itself determined was a "loan" and which Winston's valuation expert admitted was a "debt" due to the company?

Answer: Yes.

Question No. 6: Did the court err by failing to apply any discount to the "fair value" of Winston's interest, to account for the lack of marketability of his illiquid interest in the privately-held company?

Answer: Yes.

Question No. 7: Did the court err in not crediting the testimony of Man Choi's valuation expert, based upon his review of restricted stock studies and prevailing case law, that such discount ranges from 15% to 25%?

Answer: Yes.

Question No. 8: Did the court err in rewarding Winston for his fraudulent conduct by awarding him pre-judgment interest on the "buy-out" value of his interest, at the statutory rate of 9%, commencing as of the valuation date?

Answer: Yes.

Question No. 9: Did the court properly dismiss all of Winston's claims for breach of "fiduciary duty," as Winston failed to prove any damages and lacked standing to assert such derivative claims, having "withdrawn" as a member of the company 4 months prior to their assertion?

Answer: Yes.

COUNTERSTATEMENT OF FACTS

Regrettably, for the past decade, Man Choi Chiu ("Man Choi") has been forced to litigate with Winston Chiu ("Winston"), his older brother. In a prior action between them, Man Choi successfully fought to regain title to a valuable commercial property located at 42-52 Northern Boulevard, in Long Island City ("Property") that Winston literally "stole" from him, by fraudulently conveying title to his own entity. Indeed, Winston took advantage of the death of Henry Chiu ("Henry"), Man Choi's only son, who acted as his father's "right hand" (as Henry, unlike his father, was fluent in, and could read, English) (R. 1005), to convert the Property and attempt to exclude Man Choi's wife and daughters from the family business (R. 235-236, 400-403).

The second round of litigation, on appeal here, was brought to determine the extent, and "fair value," of Winston's interest in 42-52 Northern Blvd., LLC (the "LLC"), the fee owner of the Property (R. 19-22).

At trial, Man Choi, his two (2) daughters Helen Chiu and Teresa Chiu (whom Winston, their uncle, sued as "nominal defendants" in the Man Choi/LLC action), and the LLC (collectively, the "MCC Parties") proved by a preponderance of evidence, and credible testimony, that Winston was seeking to obtain an unjust "windfall," based upon his sole $193,854 "investment" in the LLC. Such "investment" was made to complete Winston's own tax free-exchange under

Section 1031 of the Internal Revenue Code. Significantly, the MCC Parties proved that Winston was never the 100% owner of the LLC that he (still) claimed to be (R. 689-690). They also proved that Winston did not have an interest of 25% or 32%. Rather, the MCC Parties proved that at most, as of February 9, 2008 ("Valuation Date"), Winston had an interest of 5.74%, the "fair value" of which was $440,471.

A. The LLC's Formation and Its Purchase of the Property in 1999

In 1999, Man Choi decided to purchase the Property for use by his restaurant supply and equipment businesses (R. 24, 205). Ronald Fishman, a real estate attorney, testified that he was retained by Man Choi and Henry, on behalf of the LLC, for the purpose of acquiring the Property. Notably, Fishman testified that Winston was not involved in negotiating or drafting the contract of sale (R. 1006).

Fishman also testified that he formed the LLC on May 13, 1999, after the execution of the contract of sale (R. 1015-1016, 5662-5564). Contrary to the court's finding (R. 24), there was no evidence or testimony presented at trial that Man Choi and Winston both formed the LLC, as Fishman was retained by Man Choi and Henry, and not by Winston. Notably, the court found that no "operating agreement" was ever executed (R. 25).

Winston's entire "contribution" toward the purchase of the Property, for a $5,450,000 price (R. 25), was a mere $193,854, or 3.5% of the purchase price (R. 24-25, 1062, 5242). As the court found, Man Choi permitted his older brother to

"invest" the sum of $193,854 in the LLC, which was formed to hold title to the Property, "so that the latter could obtain section 1031 tax advantage pertaining to the sale of property he owned in California" (R. 24). Indeed, Winston admitted that he needed to have some indicia of ownership and it was for this reason that title to the Property was temporarily conveyed to Winston (and his wife) and the very same day (September 8, 1999) title was rightfully re-conveyed to the LLC (R. 1009, 5363-5365, 5368-5370).

Winston admitted that he sought to save approximately $20,000 in deferred capital gains taxes through a 1031 exchange, using Man Choi's LLC as his "conduit" (R. 25, 731, 1023-1024). In fact, Fred Samuel, a real estate attorney, testified that he was retained by Man Choi and his son specifically to "facilitate" Winston's 1031 exchange (R. 656-657).

Man Choi did not need Winston's $193,854 to purchase the Property (R. 214, 400). Indeed, nearly all funds used to acquire the Property in 1999, totaling $5,693,618 with closing costs, except for the $3.5 million mortgage provided by Eastbank, N.A. ("Eastbank"), came from Man Choi or his entities, including 1-9 Bondst Realty Inc. ("Bondst Realty") (R. 5243). Thus, Man Choi contributed nearly $2 million ($1,948,343) toward the purchase, consisting of: (i) $1,272,566 paid at closing by Bondst Realty, including $1,149,920 from its mortgage refinancing of a separate property ("Bondst Refi") (R. 234, 1849-1881, 5242,

5243), and by Win Restaurant Supply; (ii) the $535,000 deposit (R. 25), mostly funded by Bondst Realty (R. 5677); (iii) $145,145 in closing costs from Win Restaurant Supplies, Inc., and (iv) $47,052 in building costs from Man Choi's entities (R. 5243).

Contrary to Winston's assertion that his contributions to the LLC were "substantial," including his "guaranty" of the mortgage, the court found that such "guaranty" was not a "contribution" to the LLC, and did not "factor into the [initial] ownership split" (R. 29). Indeed, the LLC's $3.5 million mortgage was based upon the credit of Man Choi and his companies (R. 5878-5884, 5932-5966), including a $500,000 collateral mortgage and an assignment of leases for billboards at 318 Lafayette Street, in Manhattan (R. 5330-5336, 5530-5535, 5967-5976). In addition, Betty Chiu, Man Choi's wife, deposited $150,000 into a cash collateral account at Eastbank as further security for the mortgage (R. 1340-1342, 1348, 5869-5874).

By contrast, Winston, who had been retired for over a decade, submitted a mere one-page "Personal Financial Statement," listing his "net worth" as $1,767,690, including $600,000 in alleged "promissory notes" as "assets" (R. 780-781, 3905). Moreover, belying Winston's attempt to bolster his "guaranty," the record shows that 2 of Man Choi's businesses, as well as Henry, also guaranteed the mortgage (R. 26, 227, 5516-5517, 5520-5521, 5522-5523). At closing,

Winston executed a "guaranty" only because he was signing the other loan documents on behalf of the LLC (R. 1009),[4] which Man Choi permitted him to do to effectuate his 1031 exchange and out of respect for his older brother.

In fact, it is undisputed that Eastbank never sought to enforce Winston's "paper" guaranty, as the LLC timely made all payments (from funds provided solely by Man Choi's companies), that by early 2008, the LLC had paid down the mortgage to $916,866 (R. 78, 5204), and that in the LLC's 2009 refinancing of its mortgage, Eastbank willingly released Winston from his guaranty (R. 1831-1835).

Contrary to the court's finding, there never was any "agreement" between Man Choi and Winston to divide the ownership of the LLC solely according to their respective cash contributions toward the purchase of the Property (R. 25). Thus, while the court found that Man Choi had made a "cash contribution" of $581,562.93, and Winston of $193,854.31 (R. 25),[5] no document expressly set

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[4] Winston asserts that the opinion letter given at closing by the LLC's counsel opined that the closing documents signed by Winston, as a member of the LLC, were "duly authorized" (R. 5665-5668). However, Fishman testified that the letter was merely the "bank's form" letter that was required as a condition of the loan, and nothing set forth in the letter should be read to infer that Winston was a member of the LLC with any actual interest (R. 1013-1014). Indeed, Fishman testified that at the time he understood that Man Choi was the "sole" member of the LLC (R. 1016).

[5] The court found that the $60,000 deposited by Winston at Eastbank, in the name of Bondst Realty, was neither a "contribution" by Winston to the LLC (R. 25-26), nor a "loan" to the LLC, as Winston claims at page 10 of his Brief. Rather, such funds were transferred from Bondst Realty's account to Man Choi, were then used for the LLC's purposes, and properly credited as part of Man Choi's initial "capital contribution" to the LLC (R. 25).

forth the terms of, or evidenced, any such "agreement" to divide their interests 75%-25%. Indeed, such "split" was merely the mathematical ratio of the parties' cash contributions toward the purchase of the property (R. 989-991), and notably failed to include the $1,149,920 advanced by Man Choi to the LLC from the Bondst Refi. Significantly, there was no note or other documentation concerning the $1,149,920 contributed by Man Choi and found to be a "loan" (R. 25).

The court found that the LLC had filed tax returns only for the years 1999 and 2000, together with K-1 Statements (R. 1778-1803),[6] reflecting 75% "ownership of capital" for Man Choi, and 25% "ownership of capital" for Winston (R. 26). Again, such 75%-25% "split" was based solely upon the parties' initial cash contributions toward the purchase of the Property (R. 25, 5339) and not pursuant to any "agreement."

B. Winston Seized Upon Henry's Death to Convey Title to the LLC's Property to Himself and Attempt to Exclude Man Choi's Wife and Daughters From the Family Business

Winston seized upon the death of Henry, Man Choi's son, to literally "steal" the Property from Man Choi and attempt to exclude his wife and daughters from the family business (R. 235-236, 400-403).

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[6] The LLC filed its 2000 return in July 2001 (R. 1792). The LLC did not file any returns thereafter due to the ongoing litigation with Winston, which commenced in 2002, concerning his purported ownership interest in the LLC. As the issue of Winston's interest remains unresolved, the LLC did not file, and could not have filed, any returns after 2000.

Winston, who had no involvement in any of Man Choi's businesses, did not want Man Choi's wife or daughters to have any role in the LLC or Man Choi's other businesses (R. 236).[7] Thus, after Henry's sudden death in May 2000 (R. 739), Winston preyed upon his younger brother,[8] first by converting the Property and, as a *post hoc* "justification" for his unlawful conduct, claiming that he owned a 100% interest in the LLC, merely because, at the closing, he had signed a single document, prepared by Eastbank, erroneously listing him as the LLC's "sole member" (R. 750-751, 5543).

As adjudicated in the parties' first action, by the April 26, 2001 deed (R. 3698-3699) (and while falsely asserting to be the "sole member" of the LLC), Winston fraudulently conveyed title to the Property from the LLC to his so-called "Godbless WMSC Living Trust," whose beneficiaries were his own family (R. 3683-3696). Winston admitted that he did so without the knowledge or consent of the LLC or his brother, and without paying any consideration for the Property or

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[7] Winston testified that he did not want Man Choi's wife and daughters to be involved in the LLC, because they were allegedly conducting improper "cash sales" (R. 885-886), which was yet another convenient fabrication at trial to "justify" his own outrageous and indefensible conduct.

[8] Regrettably, this was not the first time that Winston had preyed upon his own family members. At trial, the court admitted in evidence a prior California decision in Kim Fai Leung Chiu v. Tsong Jin Leung, wherein the court found that Winston was "both a sophisticated and educated man," who was "unable to distinguish between his own property and the property of others" (R. 206-209, 1837-1848).

transfer taxes (R. 697-698). It was no coincidence that Winston had formed his trust on the very same day as he recorded the fraudulent deed (R. 692-693).

Winston failed to present any credible evidence to support his "pseudo-psychological" theory that after Henry's death, Man Choi "felt slighted by Winston and started to pretend that Winston was never a member of the LLC." See Winston's Brief, at p. 5. Indeed, Man Choi would have been justified in feeling more than merely "slighted," based upon Winston's outright fraudulent and unlawful conduct.

C. This Court's March 2007 Decision on Winston's Appeal From the Judgment in the First Action

In the first action, the lower court set aside Winston's fraudulent deed to the Property and awarded legal fees in favor of Man Choi and the LLC as a result of Winston's conduct.

On Winston's appeal from the lower court's decision in the first action, this Court, in Chiu v. Chiu, 38 A.D.3d 619, 832 N.Y.S.2d 89 (2d Dep't 2007), judgment aff'd, as modified, 67 A.D.3d 975, 890 N.Y.S.2d 78 (2d Dep't 2009), leave to appeal denied, 2010 N.Y. LEXIS 3764 (2010), affirmed the judgment setting aside Winston's fraudulent conveyance and awarding legal fees to Man Choi and the LLC. This Court modified the judgment to the extent that the court had granted Man Choi's and the LLC's procedural motion (made after close of evidence) for leave to amend the complaint (to conform the pleadings to the proof)

to include a new cause of action to declare that Winston was merely a "nominal member" of the LLC.

Contrary to Winston's repeated assertions, this Court never held, in its March 2007 decision in the first action, that Winston had any particular membership interest in the LLC, and certainly not an interest of *at least* 25%. Indeed, on Winston's most recent appeal, this Court affirmed the denial of summary judgment and rejected Winston's assertion that this Court's March 2007 decision had previously determined that he had *at least* a 25% interest in the LLC.[9]

Seeking to minimize the impact of that decision, Winston claims the "sole reason" that this Court affirmed the denial of summary judgment was that the relief sought, a declaration that he had *at least* a 25% interest, "would not conclusively dispose of the merits of the first cause of action, or any part of that cause of action . . ." Man Choi Chiu v. Winston Chiu, 92 A.D.3d 922, 938 N.Y.S.2d 899. However, had this Court found Winston's arguments to be compelling (based upon Man Choi's purported "admissions" and "documentary evidence" including the LLC's tax returns), this Court could have granted summary judgment in his favor.

In affirming the denial of summary judgment, this Court also implicitly rejected the very same argument that Winston advances on his present appeal, i.e.,

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[9] See Chiu v. Man Choi Chiu, 92 A.D.3d 914, 938 N.Y.S.2d 900 (2d Dep't 2012); Man Choi Chiu v. Winston Chiu, 92 A.D.3d 922, 938 N.Y.S.2d 899 (2012).

that the March 2007 decision compelled a determination that the extent of Winston's interest must be based upon the "LLC's own records," which Winston self-servingly limits to the LLC's filed tax returns (R. 1778-1803), unaudited financial statements (R. 297, 5350-5355), and a one-page purported "list" that supposedly names the "shareholders" [sic] of the LLC and their respective percentage interests (R. 5347-5349).

However, there was no evidence that Helen Chiu, who is not an accountant (R. 89), actually prepared and sent all three (3) pages of such document (the purported "list") to the LLC's accountant. Nor did Helen recall having sent such document to the LLC's accountant (R. 128). Moreover, contrary to Winston's assertion, at that time Helen was not the "Vice-President in charge of finances and recordkeeping" for the LLC. See Winston's Brief, at p. 9. In fact, at that time Helen held no title and was merely helping her father, following her brother's untimely death, to send the LLC's accountant documents needed by Winston to effectuate his 1031 exchange (R. 72, 128).

Further, the purported "list" was not introduced at the trial of the first action, because it was not then available to either party. In fact, Winston had obtained such document, before the trial in the second round of actions via a non-party subpoena upon the LLC's accountant, in whose files such document was located (R. 468).

Notably, the court found that "neither side submitted evidence of a list [of members] current as of February 9, 2009 which complied with LLCL §1102(a)" (R. 30), in accordance with this Court's March 2007 Order.

D. The Litigations to Determine the Extent, and "Fair Value," of Winston's Membership Interest in the LLC

After the appeal in the first action, in late August 2007 Man Choi and the LLC commenced an action against Winston to determine the extent, and "fair value," of Winston's membership interest in the LLC, to "oust" him from the LLC based upon his adjudicated fraudulent conduct, and for an "accounting" (R 19-20).

By March 11, 2008 Order, the court dismissed the First Cause of Action, seeking a judgment declaring that Winston, *at best*, was only a "nominal" member of the LLC, and dismissed the Second Cause of Action, seeking Winston's "ouster." The court granted reargument on the "ouster" claim, but by July 7, 2008 Order, adhered to its prior determination (R. 20). On appeal, this Court affirmed the dismissal of the "ouster" claim (R. 23), finding that, in the absence of an "operating agreement," there was no statutory authorization for such relief.[10]

Winston asserted counterclaims and commenced a third-party action, alleging that Man Choi breached his "fiduciary duty" by depriving Winston of his right to participate in the LLC's affairs, caused the LLC to incur unnecessary legal

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[10] See Chiu v. Chiu, 71 A.D.3d 646, 647, 896 N.Y.S.2d 131, 132 (2d Dep't 2010).

fees (in successfully suing Winston to set aside his fraudulent conveyance), and permitting Man Choi's companies to occupy the Property without payment of rent. Winston also asserted a third-party claim against Helen and Teresa Chiu for "aiding and abetting" Man Choi's breach of "fiduciary duty" (R. 20).

Several months after Man Choi and the LLC commenced their action, Winston commenced his own action, asserting a total of 8 causes of action (R. 21). Most of Winston's causes of action (seeking a "set off," for breach of an alleged "agreement" between himself and Henry Chiu, "tortious interference," and "misappropriation" of the LLC's assets) were dismissed by the motion court's March 31, 2008 Order (R. 23).

Only the following claims in Winston's separate action survived dismissal: (i) a declaration that Winston had *at least* a 25% interest; (ii) permission to "withdraw" from the LLC; (iii) a "dissolution" of the LLC based upon, *inter alia*, a "deadlock" fabricated by Winston himself; and (iv) breach of "fiduciary duty" by Man Choi (R. 21-22).

On appeal, by March 2, 2010 Order, this Court determined that Winston had "withdrawn" as a member as of February 9, 2008. This Court also barred Winston from recovering any alleged damages for breach of fiduciary duty against Man Choi occurring prior to October 10, 2004 (R. 22).[11]

[11] See Chiu v. Chiu, 71 A.D.3d 621, 896 N.Y.S.2d 132 (2d Dep't 2010).

As previously mentioned, the motion court, by two January 26, 2011 Orders (one in each action), denied Winston partial summary judgment, declaring that he was *at least* a 25% member of the LLC (R. 23-24). This Court, in two separate decisions in February 2012, affirmed the lower court (R. 24).

E. The Valuation of the LLC and Establishing the Members' Respective Capital Accounts

At trial, Joseph Nelson, a valuation expert at the accounting firm of Berdon LLP and a CPA, testified for the MCC Parties with respect to the valuation of the LLC.

Nelson testified that, in accordance with LLCL § 509,[12] he utilized the "net asset value" approach to value a 100% interest in the LLC (R. 938, 1095-1096). Nelson further testified that such approach was the appropriate method for valuing a real estate holding company such as the LLC (R. 1096).

Eric Haims, a real estate appraiser with the highest MAI designation (R. 360-361), testified for the MCC Parties as to, among other things, the value of the Property as of the Valuation Date. The Property's valuation in its renovated condition, which Haims testified was $13.7 million as of the Valuation Date (R.

[12] Pursuant to that statute, in the absence of an operating agreement (as here), a member is entitled to receive the "fair value of his or her membership interest in the [LLC] as of the date of withdrawal based upon his or her right to share in distributions from the [LLC]."

372),[13] was one component (i.e., a "fixed asset") in a complex calculation performed by Nelson.

In contrast to the methods of Winston's valuation expert, Nelson calculated the "net asset value" of the LLC by analyzing the LLC's actual books and records, including its general ledger, financial statements, filed tax returns (for 1999 and 2000), and accountant's work papers. Because the LLC's books and records were incomplete, Nelson and his staff had to meticulously reconstruct the books in order to accurately reflect activity in the LLC's accounts (R. 945-946). Nelson also had to "roll forward" the LLC's financial statements in order to calculate the "net asset value" as of February 9, 2008 (R. 973-975). Over objection, the court admitted in evidence 5 binders upon which Nelson's testimony and calculations were based (R. 946-970, 3918-5240).

Significantly, Nelson also had to adjust the members' capital accounts (which were incorrectly established by the LLC's accountant), because the initial 75%-25% "split" in interest, as reflected in the LLC's tax returns and financial statements, was "absolutely" incorrect, as it reflected only the relative "cash"

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[13] Although the valuations for the Property in its renovated condition offered by both sides' experts were very close (within $200,000), Henry Salomon, Winston's appraiser, used inappropriate "comparable" properties that were far smaller and, thus, had a higher per square foot value than the Property.

contributions toward the purchase of the Property (R. 941-942, 988-989).[14] Thus, the $581,562 allocated to Man Choi's capital account represented only a small portion of his actual $2 million contribution for the purchase of the Property (R. 982, 5242, 5243, 5245).

Nelson testified that all of Man Choi's contributions toward the purchase (as with Winston's $193,854 "investment") should have been properly classified as "equity" and not "debt," particularly because there was no executed promissory note, no stated interest rate, no repayment schedule and no collateral given for the repayment of the funds (R. 1058). Nelson's conclusion was based not only upon Generally Accepted Accounting Principles (GAAP), but also upon statutes and case law, including Tax Court decisions and Roth Steel Tube Co. v. Commission of Internal Revenue, 800 F.2d 625 (6th Cir. 1986) (R. 985, 1057-1058).[15]

Based upon his analysis of all factors, Nelson concluded that advances made for the initial purchase, as well as for improvements of the Property, by either party, should be properly classified as "equity" and not "debt" (R. 976-977).

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[14] Indeed, Nelson testified that, because the LLC's tax returns reflected an incorrect 75%-25% "split" in interest, he did not "put any credence to the tax returns" (R. 1183).

[15] In Roth Steel, a case cited over 100 times by federal and state courts, the Sixth Circuit set forth 11 separate factors to consider in making the determination whether an advance of funds should be classified as "debt" or "equity," including whether any debt instrument or note was executed, the absence of which is a strong indication that such advance is "equity."

Regarding improvements to the Property, Helen and Teresa testified (and the court found) that a total of $1,233,014—funds contributed by Man Choi and his companies—was expended to improve the Property after its purchase (R. 27, 96-98, 261, 1829-1830).[16] Once again, over objection, the court admitted in evidence 4 binders containing receipts and invoices for such improvements (R. 1882-3674).

In contrast, Winston never made any contributions toward improvements (R. 27, 783). Nor did Winston pay for any of the Property's operating expenses, except for a token water and elevator bill in 2005, totaling $2,000 (R. 27, 714).

As found by the court, the improvements, made between 2000 and 2002, included "building a second floor, installing escalators, installing a freight elevator, changing the electrical system, and doing HVAC work" (R. 27). Nelson testified that it was particularly significant that Man Choi had invested money in the LLC to make capital improvements at a time when, because of the renovations, the Property could not have generated any income, and when the LLC could not have obtained further financing because, based on the outstanding $3.5 million mortgage, the "loan-to-value" ratio was already at 65% (R. 1065).

Thus, Nelson concluded that had the LLC's capital accounts been properly established as of "Day 1," i.e., immediately after the acquisition of the Property,

[16] Photographs of the construction work were admitted in evidence (R. 1804-1817).

the correct "split" in ownership should have been 91% for Man Choi and 9% for Winston (R. 982, 1063, 5242).

F. Valuation of Winston's Interest as of February 9, 2008

Nelson performed an analysis and calculation of Winston's interest as of 2 distinct points in time: (i) May 21, 2001, when Winston had purportedly "withdrawn" all of his initial capital from the LLC; and (ii) February 9, 2008, the judicially-set valuation date (R. 938). The court did not find that Winston had "withdrawn" his initial cash contribution as of May 21, 2001 (R. 26-27),[17] and the MCC Parties' cross-appeal does not challenge such determination.

Nelson used the "net asset value" approach for the valuation of the LLC as of the Valuation Date (R. 1080-1081). Specifically, Nelson "rolled forward" the LLC's financial statements to February 9, 2008 (R. 1081, 1101-1102). For both Man Choi and Winston, Nelson recorded funds advanced for capital improvements (totaling $1,233,014) as "capital" or "equity," and for operating expenses (paid entirely by Man Choi and his companies) as "loans" (R. 940-941, 1081-1082, 5137). Indeed, Man Choi and his companies funded over $4.8 million in operating expenses of the LLC, while Winston paid almost zero (R. 1089, 5204).

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[17] The court found that the only funds that Winston returned to himself were the $290,623 in proceeds from his alleged second, unilateral "1031 exchange" (R. 26-27). However, Winston admitted that, in May 2001, he wrote a check to himself, from a purported LLC account, in the amount of $193,854.41 (R. 5683), which was within 10 cents of his initial cash contribution at closing of $193,854.51 (R. 798-799).

From June 2002 (after the renovations) through 2005, Nelson calculated the "rent" (payable for the use of the Property by Man Choi's various companies) as being equal to the total operating expenses (e.g., mortgage, real estate taxes, insurance, etc.). Notably, neither side presented any evidence concerning the "fair market rent" for this period. However, based upon Haims' testimony and appraisal report, for 2006 through February 9, 2008, Nelson calculated the "rent" for the Property as the difference between the "fair market rent" and the total operating expenses paid by Man Choi and his entities. The difference became a "receivable" due from Man Choi, in the amount of $928,000, which was factored into Nelson's calculation of the LLC's "net asset value" (R. 972-973, 1090-1092).

Nelson testified that although Winston's interest in the LLC had decreased from 7.84% to 5.74% due to Man Choi's additional "capital contributions" (R. 1288-1289, 5245), his interest was worth substantially more, because the value of the Property had increased to $13.7 million, according to Haims's appraisal (R. 372, 1149-1150, 1288-1291).

Nelson testified the "net asset value" of the LLC, as of February 9, 2008, was $10,449,739 (R. 5247). Nelson also testified that under applicable law in New York, including In re Seagroatt Floral Co., Inc., 78 N.Y.2d 439, 445-46, 576 N.Y.S.2d 831, 834 (1991), he applied a lack of marketability discount for Winston's illiquid interest in the LLC. Based upon restricted stock studies,

including the Pepperdine studies, and prevailing New York case law, including from this Department, Nelson testified that a 25% discount should be applied. (R. 1096-1100). Thus, as of the Valuation Date, Nelson concluded that the "fair value" of Winston's 5.74% interest was $440,471 (R. 1116-1119, 5248).

In stark contrast, Winston's expert, Z. Christopher Mercer, was directed by counsel to assume that Winston already had a 25% interest, and calculated its "fair value," as of the Valuation Date, between $2.2 million and $2.6 million, depending upon whether $1.6 million of fictitious "foregone rent" [sic] were included (R. 1617, 1643).[18] Mercer's testimony, however, had little probative value, as it was not based upon the LLC's actual books and records. Mercer, unlike Nelson, did not "roll forward" to the Valuation Date, the LLC's books, which were incomplete and failed to accurately reflect activity beyond 2000.

Indeed, the MCC Parties demonstrated that Mercer sought to mimic Nelson's "net asset value" approach and, not surprisingly, came up with nearly the same $10.4 million "net asset value" for the LLC, but only because he likely tailored his valuation to Nelson's testimony to match Nelson's valuation (R. 1697-1698). Notably, in calculating the LLC's "net asset value," Mercer classified all of

[18] Mercer's calculations of fictitious "rent" failed to account for approximately $1.8 million in operating expenses paid by Man Choi from 1999 to 2000, a period during which Mercer testified, without basis, that the LLC "broke even." In contrast, Nelson testified that he included $928,000 as a "receivable" due for "rent" in calculating the "net asset value" of the LLC (R. 1090-1092).

Man Choi's advances of funds to the LLC for the purchase of the Property (other than the $581,562.93), as a "debt" on the LLC's balance sheet, including $1,142,040 due to Bondst Realty (funds advanced from the Bondst Refi), $49,000 to Win Restaurant Equipment, and $111,566 to "Chius" (R. 6369).

Moreover, Mercer employed "short-cuts" and made far too many unfounded assumptions for his testimony, and for his valuation, to have credibility (R. 1659, 1664-1665). Indeed, Mercer admitted that he did not make an "independent evaluation of [Winston's] specific ownership interest," but simply "assumed," as dictated by Winston's counsel, that Winston had a 25% interest as of the Valuation Date (R. 1615, 1645-1647).

Mercer also testified that he applied a "zero" discount based upon his "Three Levels of Value" theory (that no New York court has ever recognized), claiming that any discount is inconsistent with valuing a "controlling interest" in a company (R. 1551-1560). In contrast, Nelson testified that under a New York "fair value" valuation, he had to determine a member's proportionate interest in the going concern value of the private company as a whole (R. 938), and then apply an appropriate discount for the lack of marketability of such interest.

Mercer also egregiously erred in testifying that there is no difference between the sale of realty and the sale of an interest in a private company, a mistake repeated by the court in its own findings (R. 36, 1700). Thus, Mercer's

analysis, based more upon "alchemy" than accepted valuation practice, assumed that a *hypothetical* sale of the Property occurred on the Valuation Date, such that Winston's interest would have been instantaneously converted to cash on that date and distributed to "buy out" Winston's interest (R. 1698-1703).

However, in valuing a property as of a certain date it cannot be assumed that it would have been sold as of such date. In fact, real estate appraisers must consider both the "exposure time," which occurs *prior to* the valuation date, and the *subsequent* "marketing time" for selling the property. Thus, as Haims testified, there was no guaranty that the Property would have been sold as of the Valuation Date for that price, and it could have taken as long as 18 months to actually sell (R. 371, 551, 1304-1305). Indeed, even according to Salmon (Winston's own real estate appraiser), it could have taken 6-12 months to actually sell the Property (after the Valuation Date) (R. 1371, 1704).

Most significant is that Mercer's inflated valuation of Winston's purported 25% interest as being between $2.2 and $2.6 million (depending on whether "foregone rent" is included), does not pass a "sanity check" (R. 1639). Mercer himself admitted that based upon Winston's $193,854 "investment" and his own valuation, Winston would receive a capital return of ten times (based on annual returns of 33%-36.7%) (R. 1640-1642). That would value the LLC, an entity that never earned any actual income, in the same stratosphere as internet companies

such as *Google* (R. 1648), and would give Winston an unjust "windfall" for an "investment" in which he had no management responsibility, no liabilities and no actual risk.

In sum, Winston utterly failed to prove that he had an interest of 25%, 32% or otherwise in the LLC, which interest was supposedly worth $2.2 million to $2.6 million (without pre-judgment interest).

G. The Memorandum Decision After Bench Trial

In its Memorandum Decision, the court determined that Man Choi was entitled to judgment declaring that Winston had a 10% interest as of February 9, 2008 (R. 38). The court also dismissed Winston's counterclaims and third-party action commenced against Man Choi and, nominally, Helen and Teresa Chiu (R. 38).

The court also determined that the "fair value" of Winston's 10% interest, as of February 9, 2008, the date of his "withdrawal" from the LLC, and based upon the LLC having a "net asset value" of $10,449,739, was $1,044,974 (R. 36, 38).

The court reached that conclusion by using the initial 75%-25% "split" as a "starting point," and crediting Man Choi with having made a "capital contribution" in the amount of $1,233,024, for improvements to the Property, which altered the "split" to 90%-10% for Man Choi and Winston, respectively (R. 22, 27, 35). In doing so, the court determined that "$1,142,000," obtained by Man Choi from the

Bondst Refi, was a "loan" to the LLC, and did not factor such amount into the members' capital accounts (R. 25, 33). The court, however, made a mathematical error by failing to include the $1,142,000 "loan" as a "liability" on the LLC's balance sheet (or two other "loans" totaling $216,860) and correspondingly reducing the "net asset value" of the LLC.

Rather than order the "dissolution" of the LLC, the decade-long threat used by Winston to attempt to extort a "buy out" from Man Choi, the court exercised its discretion by granting Man Choi the right to "buy out" Winston's interest in compliance with a judgment to be entered, or the LLC would be dissolved (R. 37).[19] Finally, the court dismissed Winston's remaining claims, including his Eighth Cause of Action for alleged breach of "fiduciary duty" (R. 37-38).

The Judgment, entered on February 6, 2013, awarded Winston $1,514,954.63, with pre-judgment interest at 9% per annum, commencing from the valuation date, but granted Man Choi ninety (90) days in which to "buy out" Winston's interest (R. 15-17).

On April 3, 2013, the MCC Parties filed an Undertaking on Appeal for the amount of the Judgment, together with interest thereon and costs, thereby staying the "buy out" provision and "dissolution" of the LLC pursuant to the Judgment.

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[19] See Matter of 1545 Ocean Ave., LLC, 72 A.D.3d 121, 893 N.Y.S.2d 590 (2d Dep't 2012).

ARGUMENT

POINT I

THE COURT ERRED IN DETERMINING THAT WINSTON HAD A 10% INTEREST AS OF THE VALUATION DATE

The court erred in finding that Winston had a 10% interest in the LLC as of the Valuation Date (R. 38). Had it properly given credit for all of Man Choi's "capital contributions" toward the LLC's purchase of the Property in September 1999 (totaling nearly $2 million), and not merely his cash contributions of $581,562.93, the court would have determined that Winston had a 5.74% interest, the "fair value" of which was $440,471.

A. The Court Erred in Not Crediting Man Choi for All of His "Capital Contributions" Toward the LLC's Purchase

The court was correct in determining that the "fair value" of Winston's interest should be determined according to the parties' relative contributions to the LLC, in accordance with LLCL § 504 (R. 28-29, 31-35).

However, the court erred in failing to credit Man Choi for all of his "capital contributions" toward the company's purchase of the Property, totaling nearly $2 million, including the sum of $1,149,920 obtained from the Bondst Refi. Instead, the court improperly found that the "$1,142,000" contributed by Man Choi, indisputably for the acquisition of a "capital asset," was a "loan" (R. 25, 33).

The court's finding is contrary to the indisputable evidence that there was no promissory note executed, no repayment schedule, no stated interest rate, and no collateral given to secure the repayment of the funds.

As discussed in Point I(D) below, it was for these very reasons that the court correctly applied the Roth Steel factors to find that Man Choi's $1,233,014 contribution for capital improvements was a "capital contribution," including (and especially) the fact that there no instrument evidencing indebtedness (R. 33).

In the absence of an operating agreement,[20] the court correctly determined that it had to "consider the circumstances surrounding the infusion of money in classifying it as a loan or capital contribution," citing 38 Town Associates v. Barr, 225 A.D.2d 613, 639 N.Y.S.2d 442 (2d Dep't 1996), and Hynes v. Barr, 225 A.D.2d 588, 639 N.Y.S.2d 443 (2d Dep't 1996) (R. 33).

Moreover, as the court stated, the "primary factor" to consider, in evaluating whether such advance was an "equity contribution" or "loan," is whether "the transaction bears the earmarks of an arm's length negotiation," citing In re Cold Harbor Assocs. L.P., 204 B.R. 904 (Bankr. Ct. E.D. Va. 1997) (R. 32).

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[20] In this case, unlike Fazio v. Tracy, 39 Misc. 2d 172, 240 N.Y.S.2d 412 (Sup. Ct., Erie Co. 1963), cited in the court's Memorandum Decision (R. 32), where the court looked to the partnership agreement to determine whether the payment was a "capital contribution, there is no such agreement to guide the court's determination.

Indeed, in Cold Harbor, the Bankruptcy Court reclassified "loans," which were evidenced by promissory notes, as "equity" contributions, because the purported "loans" did not meet the characteristics of an "arm's length transaction." Among the factors considered by the court in determining that such infusion was, in fact, an equity contribution was the lack of formality of the alleged loan agreement, that the funds were used to acquire a "capital asset," and the lack of collateral to secure repayment.

Likewise, there was a complete and indisputable lack of formality here. No note was ever executed and no collateral was given for the funds contributed by Man Choi, and used by the LLC, to acquire a "capital asset," i.e., the Property.

Winston failed to present any evidence to support his assertion on appeal that, because the LLC was in an alleged "precarious" financial condition in 2001, "[i]t was at that point that Man Choi created LLC records showing that money he put in was loans" See Winston's Brief, at p. 18. Notably, Winston failed to provide any record citation for this self-serving statement.

Thus, had the court properly applied the authorities cited in its own decision, including Cold Harbor, *supra,* it would have reached the opposite conclusion—that Man Choi's $1,149,920 contribution was, in fact, part of his initial "capital contribution" to the LLC. Irrespective of the "form" of the transaction, i.e., that the sum appeared as "debt" on the LLC's accountant's work papers (the

Reconciliation of Initial Cash Through Building Acquisition" and Summary of Initial Property Acquisition (R. 5338-5339) and the LLC's financial statements (R. 5350-5355), Man Choi did not act as "lender" to his own company, expecting to be repaid with interest, but rather as "investor," expecting a return based upon the LLC's future. See Cohen v. KB Mezzanine Fund II, LP (In re SubMicron Sys. Corp.), 432 F.3d 448, 456 (3d Cir. 2006).

As this Court previously held in Chiu v. Chiu, 38 A.D.3d at 620, 832 N.Y.S.2d at 91:

> In reviewing a trial court's findings of fact following a nonjury trial, this Court's authority 'is as broad as that of the trial court' and includes the power to 'render the judgment it finds warranted by the facts, taking into account in a close case the fact that the trial judge had the advantage of seeing the witnesses' (Northern Westchester Professional Park Associates v. Town of Bedford, 60 NY2d 492, 499 [1983]) (other citations omitted).

Hence, this Court should determine that Man Choi's $1,149,920 was a "capital contribution" and not a "loan," and properly credit Man Choi for his $1,948,343 in total "capital contributions" toward the LLC's purchase of the Property (R. 5245). This Court should therefore find that, based upon Nelson's valuation, Winston's interest in the LLC was 5.74%, rather than the 10% found by the court.

B. The MCC Parties Should Not Have Been "Estopped" From Challenging the Erroneous Information in the LLC's Tax Returns

The court held that the MCC Parties were "estopped" from challenging the information in the LLC's tax returns, but only for the 2 years (1999 and 2000) that such returns were filed (R. 30-31).

The court erred in invoking "estoppel" and thereby limiting Man Choi's "capital contributions" to those amounts that were (incorrectly) reflected in the LLC's tax returns and unaudited financial statements.

In the first instance, the court improperly invoked "estoppel" to create an initial 25% interest in the LLC that Winston never had. Thus, in Heisler v. Gingras, 90 N.Y.2d 682, 665 N.Y.2d 59 (1997), reargument denied, 91 N.Y.2d 867, 668 N.Y.S.2d 563 (1997), the Court of Appeals expressly rejected the use of "estoppel" to resolve ownership disputes between shareholders. There, the Court of Appeals cautioned courts not to apply estoppel, because the "myriad of factual variations might otherwise lead to undesirable uncertainties and unevenness in connection with business and professional organizations of this kind." Id. at 687.

Moreover, the court should not have applied estoppel to information erroneously reported in the LLC's tax returns, as such information is not conclusive or dispositive evidence of ownership, particularly where, as here, the purported ownership percentages were contradicted by other evidence. See Chassier v. Brasseire Julien Corp., 2007 WL 2815085 (Sup. Ct., N.Y. Co. 2007)

(court found that there was conflicting "documentary evidence" for determining the parties' ownership interests in the company, including tax returns showing an individual having a 100% interest).

Here, the MCC Parties proved that Man Choi contributed nearly $2 million toward the purchase of the Property. Although the court correctly found that the initial 75%-25% "split" was based upon the parties' initial "cash" contributions toward the LLC's purchase of the Property, i.e., $581,562.93 by Man Choi and $193,854 by Winston (R. 26), it erred in improperly classifying Man Choi's contribution of $1,149,920 as a "loan." Compounding its error, the court improperly invoked estoppel to bar the MCC Parties from challenging the erroneous information reported in the filed tax returns.

The court's reliance upon Simon v. Safelite Glass Corp., 128 F.3d 68 (2d Cir. 1997) was misplaced, as Simon involved a dispute concerning social security benefits. There, the court invoked "judicial estoppel" to bar the claimant from asserting that he was not "disabled" under the Age Discrimination Act, whereas he had previously represented, in his application for benefits, that he was "disabled" and had been granted such benefits based upon the representation. Id. at 69. The Court held that "judicial estoppel" applied to such prior representation made in administrative or quasi-judicial proceedings.

Here, however, the doctrine of "judicial estoppel" is inapplicable, as there was no decision or judgment secured in any prior action (or administrative proceeding) between the same parties. See Angel v. Bank of Tokyo-Mitsubishi, Ltd., 39 A.D.3d 368, 835 N.Y.S.2d 57 (1st Dep't 2007), leave to appeal denied, 2007 N.Y. App. Div. LEXIS 8692 (1st Dep't 2007).

As the Court explained in Simon, 128 F.3d at 71, "judicial estoppel" is different from "equitable estoppel," in that the former seeks to "protect judicial integrity by avoiding the risk of inconsistent results in two proceedings." Here, in the absence of a prior favorable judgment, any prior inconsistent statements in the LLC's tax returns may only be used to impeach credibility, but they may not be leveraged to have preclusive effect. See Baje Realty Corp. v. Cutler, 32 A.D.3d 307, 310, 820 N.Y.S.2d 57, 59 (1st Dep't 2006).

Moreover, notwithstanding that the court discounted the testimony of the litigants and family members as having "extremely limited value" (R. 31), the MCC Parties proved, through expert testimony, that the $1,149,920 provided by Man Choi for the Property's purchase was, in fact, a "capital contribution."

Further, "equitable estoppel" should not be applied where neither Man Choi nor the LLC received or derived any benefit whatsoever from "holding out" Winston as a purported member of the LLC.

In Mahoney-Buntzman v. Bunztman, 12 N.Y.3d 415, 881 N.Y.S.2d 369 (2009), relied upon by the court and Winston, the Court of Appeals held that a husband was estopped from taking a position with respect to ownership of property that was inconsistent with the position previously taken on his federal income tax returns. There, the husband, against whom estoppel was applied, had derived a tangible tax benefit as a result of such filing.[21]

By contrast, not only did Man Choi and the LLC not derive any financial or tangible benefit as a result of the filing of the tax returns (R. 302), but Winston has improperly used such returns to assert in litigation—for the past decade—that he is entitled to *at least* a 25% interest (while, at the same time, filing personal tax returns claiming to be the 100% owner), which litigation has imposed severe financial and other burdens upon Man Choi and his family.

Accordingly, under these circumstances, the court erred in barring the MCC Parties from challenging the erroneous information in the LLC's tax returns for 1999 and 2000.

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[21] Likewise, in Stevenson-Misischia v. L'isola D'Oro SRL, 85 A.D.3d 551, 925 N.Y.S.2d 464 (1st Dep't 2011), and Peterson v. Neville, 58 A.D.3d 489, 870 N.Y.S.2d 348 (1st Dep't 2009), also relied upon by the court, the party against whom estoppel was applied derived a tangible benefit as a result of the tax filing. In Czernicki v. Lawniczak, 74 A.D.3d 1121, 904 N.Y.S.2d 127 (2d Dep't 2010), unlike the facts here, this Court found that there was "ample evidence" of the parties' agreement to purchase, own and operate a property as partners, including the filing of five (5) years of tax returns showing each party owned 50% of the partnership's capital.

C. *The Court Correctly Refused to Apply Estoppel to Preclude Evidence as to Additional Capital Contributions Made by Man Choi*

As the court should not have applied "estoppel" in the first instance, it was certainly proper for the court not to have applied it after 2000. Indeed, the court correctly found that, after 2000, estoppel "does not bar the admission of evidence showing that the relative interests of the parties changed in subsequent years" (R. 31), based upon additional capital contributions by Man Choi, totaling $1,233,014, for "capital improvements" to the Property.

Contrary to Winston's assertions, members' relative interests in the LLC are not static and cannot be fixed forever based merely upon the information that was (incorrectly) reported in the company's tax returns for two (2) years. Neither Capizola v. Vantage Int'l, Ltd., 2 A.D.3d 843, 770 N.Y.S.2d 395 (2d Dep't 2003), nor Romano v. Romano, 133 A.D.2d 680, 530 N.Y.S.2d 155 (2d Dep't 1987), relied upon by Winston, stand for the proposition that estoppel applies to the entire period, from 1999 to 2008.

Thus, in Romano, this Court held the lower court erred in finding that the husband was a 100% owner of the corporation, where the corporation's tax returns, for a period of 5 years, showed that the husband was only a 51% owner. Id. This Court's holding in Romano, however, did not involve any additional capital contributions made by a member, as here, that would have altered the parties' relative ownership interests.

Nor did this Court, in Capizola, hold that the parties' relative interests can never be adjusted based upon additional capital contributions, as here. Moreover, in Capizola, unlike here, the corporation's filed tax returns were not the only purported evidence of shareholder status. There, this Court found that claimant's status was bolstered by the delivery of stock certificates and a shareholder's agreement which, even though it was never consummated, recited that claimant was already a shareholder. Here, however, no "operating agreement" was ever executed (R. 25).

This Court should reject Winston's assertion that the MCC Parties attempted to avoid estoppel by not filing tax returns after 2000, as no evidence was presented for such argument, yet another convenient fabrication to bolster Winston's appeal.

Moreover, the LLC could not have filed any returns after 2000 due to the ongoing litigation with Winston concerning his purported interest in the LLC. Winston, on the other hand, unilaterally determined that he was the 100% owner of the LLC. In fact, Winston filed false personal tax returns for nearly a decade, claiming to be the 100% owner of the LLC, in order to improperly take, on his personal returns, deductions for 100% of the company's expenses that he himself never paid, so as to nullify his own tax liability (R. 705-718, 3700-3889).

Estoppel is an equitable principle that requires the invoking party to have "clean hands." See 55 N.Y. Jur.2d, Equity § 105 (2002). Having come to court

with "unclean hands," Winston is not entitled to receive any equitable relief. See Levy v. Braverman, 24 A.D.2d 430, 260 N.Y.S.2d 681 (1st Dep't 1965).

Based upon his own fraudulent and inequitable conduct, Winston should be "estopped" from relying upon information in the LLC's tax returns, purportedly showing that he had a 25% interest, information that he himself had "disavowed" by filing false tax returns claiming to be the 100% owner.

D. The Court Properly Determined That Funds Man Choi Contributed For "Major Structural Alterations" to the Property Were an Additional "Capital Contribution" to the LLC

The court also properly determined that funds Man Choi and his companies contributed, totaling $1,233,014, for "major structural alterations" to the Property, were an additional "capital contribution" to the LLC and not a "loan."

First, the court correctly found that there was no "agreement" between the parties concerning how these additional funds for improvement of the Property were to be characterized (R. 33).[22] The court also correctly excluded testimony concerning Winston's alleged "agreement" with Henry and found that such purported "agreement" did not constitute an "operating agreement" in accordance with LLCL § 417 (R. 29).

[22] Telstra Corp. v. Dynergy, 2003 WL 1016984 (Del. Ch., Mar. 4, 2003) is inapposite, as there the parties' dispute, concerning whether additional capital contributions by one partner "diluted" another's interest, was predicated upon a written limited partnership agreement.

Moreover, the court found that all 11 Roth Steel factors were satisfied, including lack of any instrument evidencing indebtedness, no prepayment schedule, no provision for the payment of interest, no source of repayment and the use of the funds directly for "capital improvements" (R. 33-34).

The court properly rejected Winston's argument that such "capital contribution" unilaterally "diluted" Winston's interest. Winston's Brief, at pages 22 and 37-40, disingenuously distorts and takes out of context the court's initial concern as to whether one member can unilaterally change the capital account of another by making additional "capital contributions" (R. 1148-1150). Only moments later, Justice Weiss posed a question to Nelson as to whether "an original ten percent interest that's down to one percent may be as valuable or more valuable by the increase of the value of the entity?"

Nelson replied:

> There's no question about that. In fact, under the analogy that you just pointed out, a five percent interest could be worth more than a 25 percent interest as long as you've got an increased value of the building (R. 1150).

Moreover, Nelson testified that, at most, Winston's interest was "diluted" by about 1%, from 9% to 7.84% (not from 25% to 7.84%) (R. 1288-1289). As such, this case is readily distinguishable from Dingle v. Xtenit, Inc., 20 Misc.3d 1123(A), 867 N.Y.S.2d 373 (Sup. Ct., N.Y. Co. 2008), another inapposite authority

relied upon by Winston, wherein plaintiff had presented a *prima facie* case that his interest in the company was "diluted" from 15% to less than 1%.

Nelson also testified that even if Winston's interest had been slightly "diluted," the value of his interest actually increased due to a rapidly rising real estate market and the added value of the improvements made to the Property (R. 1290-1291). Thus, the court correctly found that, based upon Haims's testimony, these capital improvements had "increased the value of the property" above and beyond their cost, and that Winston had shared in "that benefit" (R. 34).

The court also correctly found that Winston neither objected to the renovations nor offered to share in the expenses (R. 34). Winston's claim that he "did not oppose" the renovations because, he was allegedly "frozen out by 2000" (see Winston's Brief, at p. 39), is belied by the fact that Winston never had any involvement in the LLC's operations in the first instance, and certainly not after Man Choi, in early 2002, uncovered Winston's scheme to convert the Property by fraudulently transferring title to himself.

Contrary to Winston's assertion, such "major structural improvements," including adding a new second floor and upgrading the building's major systems, were not performed merely for the benefit (or convenience) of Man Choi's businesses operating from the Property. The court was correct in rejecting

Winston's assertion that Man Choi expended in excess of $1.2 million to "customize" the Property for his companies' businesses.

Moreover, the court correctly concluded that, contrary to Winston's assertion at trial (and also on appeal), these types of "major structural alterations" were not a substitute for the payment of "rent" by Man Choi's companies (R. 34). Indeed, no tenant under a typical "triple net" lease, where the tenant pays for all real estate taxes, insurance and maintenance (R. 34), would pay for adding a new level to the building, installing escalators and upgrading the major systems.[23]

Winston has cited no authority for, and certainly failed to prove, his assertion that "most new tenants pay for structural changes to the premises to accommodate their needs" (emphasis added). See Winston's Brief, fn. 14, at p. 36. The testimony of Salmon, Winston's real estate appraiser, that a tenant is responsible for "all alteration and maintenance expenses" was simply incredible, contrary to standard industry practice and, thus, properly rejected by the court. As such, the court correctly rejected Winston's argument that Man Choi, whom he demeaningly referred to as *his* "tenant," should have borne the costs of making such "major structural alterations" to the Property.

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[23] See Hepburn v. Getty Petroleum Corp., 258 A.D.2d 504, 505, 684 N.Y.S.2d 624, 624 (2d Dep't 1999) (this Court noting that under a "triple net lease," tenant was responsible for, *inter alia*, "repairs to and maintenance" of the premises). Indeed, the definition of a "triple net" lease that the trial court found online is consistent with this Court's decision in Getty Petroleum and also with standard industry practice.

The court correctly determined that funds contributed by Man Choi toward capital improvements constituted his additional "capital contribution" to the LLC.

E. The Court Correctly Excluded Winston's Testimony Concerning His Alleged "Agreement" with Henry

Contrary to Winston's attempt to fabricate an "operating agreement" out of whole cloth, the court correctly precluded Winston from testifying about his alleged "agreement" with Man Choi's late son, Henry (R. 834-835),[24] and correctly found that such "agreement" was not an "operating agreement" in accordance with LLCL § 417 (R. 29).

The alleged "agreement" between Winston and Henry referred to a yet to be formed, and unnamed, "Limited Liability Company" to purchase a property, and supposedly granted Winston the right to purchase up to 25% of the "Common Stock of said LLC" (R. 5645), even though LLC's do not issue stock. Such "agreement" also allegedly granted each of them the "Right of First Refusal" to purchase the other's "shares in the LLC" (id.). However, even a cursory reading of the single page document demonstrates that it does not come close to meeting the strict requirements, or definition, of an "operating agreement" under LLCL §§ 102 and 417, providing for how the business is to be conducted, and the "rights,

[24] Contrary to Winston's assertion, the court fully complied with this Court's prior March 2007 decision by admitting the closing binder containing such purported "agreement" (R. 5356-5661), but properly excluded Winston's testimony under the Dead Man's Statute (R. 834-835).

powers, preferences, limitations or responsibilities of its members, managers, employees or agents."

Notwithstanding that such "agreement" wound up in the closing binder,[25] the court correctly precluded testimony concerning the "agreement" pursuant to the Dead Man's Statute (CPLR § 4519) (R. 29), which precludes an "interested party" from testifying concerning transactions or communications with the deceased. See Estate of Wood, 52 N.Y.2d 139, 144, 436 N.Y.S.2d 850, 852 (1981); Friedman v. Sills, 112 A.D.2d 343, 491 N.Y.S.2d 794 (2d Dep't 1985).

Winston's reliance upon Acevedo v. Audubon Mgmt, Inc., 280 A.D.2d 91, 721 N.Y.S.2d 332 (1st Dep't 2001), in an attempt to evade the Statute, is misplaced, as there the First Department went no further than to hold that the Dead Man's Statute does not bar an "interested party" from expressing an opinion as to the "genuineness of the deceased handwriting," so long as the signature is authenticated by someone other than the interested party.

Here, however, unlike Acevedo, where the issue was whether the deceased had signed a document, Winston improperly attempted to testify about the substance of his alleged "agreement" with Henry and not to the genuineness of

[25] Indeed, Fishman testified that none of the purported "agreements" that were placed in the closing binder had played any role in the purchase of the Property, as he received such "agreements" from Henry after the closing and was instructed by Henry simply to "hold them in the file" (R. 1022, 1024-1025). Moreover, there was no evidence presented that any of these purported "agreements" were ever implemented.

Henry's signature on such document. Thus, Acevedo is clearly inapposite and distinguishable from these fact.

This Court should also reject Winston's assertion that Man Choi somehow "waived" any objection to Winston's testimony concerning the alleged "agreement" by merely testifying (as other witnesses did as well) that Henry was never a member of the LLC. By doing so, Man Choi in no way "opened the door" to Winston's improper testimony, in violation of the Statute, concerning the substance of an alleged "agreement" with his late son.

Moreover, unlike Estate of Mastrianni, 55 A.D.2d 784, 389 N.Y.S.2d 914 (3d Dep't 1976), also relied upon by Winston, counsel for the MCC Parties timely objected to Winston's testimony (R. 834-836).

Hence, the court properly excluded, under the Dead Man's Statute, any testimony concerning such purported "agreement."

F. The Court Correctly Rejected Winston's Attempt to Equate His "Guaranty" of the Mortgage to a "Capital Contribution"

The court properly rejected Winston's attempt to equate his paper "guaranty" of the mortgage to a "capital contribution" to the LLC (R. 29). Thus, the court properly found that the guaranties given by Winston, as well as by Man

Choi's two companies and his son, were "off-setting" and did not factor into the parties' initial ownership "split" (R. 29).[26]

Winston's argument also ignores that the MCC Parties presented overwhelming evidence that Eastbank made the loan based upon the credit of Man Choi and his companies, including a $500,000 collateral mortgage and assignment of lease on a separate property in Manhattan, and $150,000 deposited by his wife into a cash collateral account as further security. See discussion *infra* p. 15.

Contrary to Winston's assertion, he failed to present any evidence that Man Choi's companies could have easily avoided their guaranty obligations by rendering themselves "judgment-proof." Nor did Winston prove that Henry had "inadequate assets" according to his financial statement. Indeed, if any party's financial statement was thin, it was Winston's, whose single page "financial statement," listing assets of $1,767,690, included $600,000 in alleged "promissory notes" as "assets" (R. 780-781, 3905).

As such, the court correctly found that Winston's "guaranty" did not constitute a "capital contribution" to the LLC.

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[26] In contrast, in Sachs v. Adeli, 26 A.D.3d 52, 804 N.Y.S.2d 731 (1st Dep't 2005), relied upon by Winston, the court noted, *in dicta*, that plaintiff's ownership interest increased by giving a guaranty and by investing the additional sum of $315,000 in the company. By contrast, after Winston made an initial "investment" in the amount of $193,854 and gave a paper "guaranty," he never invested any additional funds and his "contributions" to the LLC were clearly not "substantial." Thus, Sachs, which involved a discovery motion, is inapposite.

POINT II

EVEN IF IT PROPERLY DETERMINED THAT WINSTON HAD A 10% INTEREST AS OF THE VALUATION DATE, THE COURT NONETHELESS IMPROPERLY CALCULATED THE LLC'S "NET ASSET VALUE," THEREBY OVERVALUING WINSTON'S INTEREST

Even if it properly determined that Winston had a 10% interest in the LLC as of the valuation date, the court nonetheless erred in mathematically calculating the company's "net asset value," thereby overvaluing the "buy out" value of Winston's interest.

The court's error was failing to include, on the LLC's balance sheet, "liabilities" totaling $1,366,780, representing funds contributed by Man Choi and his companies toward the purchase of the Property, including the $1,149,920 (erroneously stated at $1,142,000) obtained from the Bondst Refi. Thus, when the court determined that the $1,142,000 was a "loan," it should have also made, but failed to make, an equivalent accounting adjustment. Indeed, Winston's valuation expert classified all such sums as "debts" in valuing the LLC (R. 6369).

Nelson explained that the "net asset value" of a company is calculated as the "amount of assets, if any, in excess of liabilities[.]" (R. 1057). The "basic accounting equation" is that "assets equals liabilities plus equity, so when you are looking at the liability and equity side of the balance sheet, if [an advance of funds] is not debt, it has to be equity" (R. 1057). The converse of Nelson's testimony is that if an advance of funds were found not to be "equity" (or capital), it must then

necessarily be classified as "debt" (or a liability) and reflected on the company's balance sheet as such.

Nelson further testified that he "made a determination that funds that were advanced by either individual, either Man Choi Chiu or Winston Chiu, specifically related to the purchase of the property or improvements to the property, should properly be classified as capital contributions" (emphasis added) (R. 940-941, 976-977, 1062).

The court admitted a chart prepared by Nelson (R. 5245), showing a "summary of the capital accounts of the respective ownership interests" of the parties (which assumed that Winston maintained his capital in the LLC until February 9, 2008). This chart demonstrated that Man Choi and/or his entities contributed a total of $1,948,343 toward the LLC's initial purchase of the Property, consisting of the $535,000 deposit (which was included in the $581,563 that the court found was Man Choi's initial "capital contribution"), together with the following amounts: (i) $1,149,920, advanced by Bondst Realty; (ii) $186,152, advanced by Win Restaurant Supplies, Inc.; and (iii) $30,708, advanced by Win Restaurant Equipment & Supply Corp.

Thus, Nelson testified that, as of the purchase of the Property, "Man Choi's capital account . . . should have been reflected of an amount of $1,948,343 and Winston's capital account which consisted of the 193,855" (R. 1062). The court,

however, found "that the $1,142,000 infusion was intentionally and correctly recorded as a loan on the company's books and records" (R. 33). Thus, the court found that such funds (stated as $1,142,000, although the correct amount is $1,149,920) constituted a "loan."

Thereafter, in calculating the "net asset value" of the LLC, the court, to be consistent with its finding that such funds to purchase the Property constituted a "loan" and not "capital," should have entered, as a "liability" on the balance sheet, the sum of $1,366,780, consisting of the $1,149,920 "loan" from Bondst Realty and $216,860 from Man Choi's other entities.

In support of their post-trial motion to correct this calculation error (denied by the court, together with Winston's cross-motion to increase the LLC's "net asset value"), the MCC Parties submitted Nelson's chart, illustrating how including the sum of $1,366,780 as a "liability" changed both the "net asset value" of the LLC and the "fair value" of Winston's 10% interest found by the court.[27]

This Court, upon review of the record (see Chiu, *supra*, Northern Westchester Professional, *supra*), should modify the Judgment to reduce the "net asset value" of the LLC from $10,449,739 to $9,082,959, and, accordingly, the "fair value" of Winston's 10% interest from $1,044,974 to $908,296.

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[27] Per Stipulation, this chart, which was inadvertently omitted from page 6321 of the Joint Record on Appeal, was inserted in the record.

POINT III

THE COURT ERRED IN FAILING TO APPLY ANY DISCOUNT TO THE "FAIR VALUE" OF WINSTON'S INTEREST TO ACCOUNT FOR THE LACK OF MARKETABILITY OF HIS ILLIQUID INTEREST IN THE PRIVATELY-HELD COMPANY

Separate and apart from the court's failure to properly calculate the "net asset value" of the LLC, the court committed an error of law by not applying any discount to the "fair value" of Winston's interest to account for the lack of marketability of Winston's illiquid interest in the privately-held company.[28] See Friedman v. Beway Realty Corp., 87 N.Y.2d 161, 171-172, 638 N.Y.S.2d 399, 405 (1995) (Court of Appeals holding that a court's failure to apply a marketability discount constitutes "reversible error").

Indeed, the court failed to follow well-established New York precedent, particularly from this Department, that the valuation of non-publicly traded shares must "include consideration of the fact that shareholders in closely held corporations, as contrasted with shareholders in public companies, are unlikely to find prospective buyers for their shares." In re Seagroatt Floral Co., Inc., 78 N.Y.2d 439, 445-46, 576 N.Y.S.2d 831, 834 (1991); Blake v. Blake Agency, Inc., 107 A.D.2d 139, 149, 486 N.Y.S.2d 341, 349 (2d Dep't 1985) (this Court noting

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[28] The MCC Parties never sought, nor did the court consider, a so-called "minority discount," which is not permitted under New York law, as opposed to a lack of marketability discount, which must be considered and applied.

that a discount is properly factored into the value of close corporation shares, because they "cannot be readily sold on a public market"), leave to appeal denied, 65 N.Y.2d 609, 494 N.Y.S.2d 1028 (1985).

As made abundantly clear in Seagroatt, "lack of a public market for the shares of a closely held corporation should certainly be considered in determining what a willing purchaser would pay for such shares." Id. at 446, 576 N.Y.S.2d at 835. Moreover, the Court of Appeals could not have been clearer in Beway Realty, *supra*, that in calculating the value of shares, due regard for their unmarketability must be made by applying a percentage discount and that the failure to do so constitutes "reversible error." See Raskin v. Walter Karl, Inc., 129 A.D.2d 642, 644, 514 N.Y.S.2d 120, 122 (2d Dep't 1987) (modifying a trial order that failed to apply lack of marketability discount).

Thus, in Beway Realty, *supra*, the Court of Appeals, holding that a lack of marketability discount should be applied, remanded the case to the trial court for further proceedings and upon remand (as subsequently reported in a different case[29]) the court applied a 26% lack of marketability discount.

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[29] See Matter of Jamaica Acquisition, Inc., Index No. 9278/2007, at p. 24 (Sup. Ct., Nassau Co.) (Sep't 29, 2009). There, the lower court noted that, "[t]he courts of this state have commonly applied [a lack of marketability discount] to net asset valuation," citing (among others) Beway Realty and Blake. The court also noted that such discount "is not designed to discount the value of the corporation or any particular asset (i.e. goodwill), but to reflect the lack of marketability of the shares of the corporation. The [discount] is, thus, applied to the aggregate net asset value or to whatever particular method was used to obtain fair value." Id. at p. 24.

Indeed, New York courts have consistently applied a lack of marketability discount, ranging from 15% to 25%, with most courts, including this Court, holding that a 25% discount (as found by Nelson) is appropriate. See, e.g., Cooper v. Cooper, 84 A.D.3d 854, 923 N.Y.S.2d 596 (2d Dep't 2011) (applying a 25% discount); Matter of Murphy v. United States Dredging Corp., 74 A.D.3d 815, 818, 903 N.Y.S.2d 434, 437 (2d Dep't 2010) (applying a 15% discount, as requested by both sides, and holding that such discount is not limited only to "goodwill"); Blake, *supra* (applying a 25% discount); Jamaica Acquisitions, *supra* (applying a 25% discount); Matter of Beattie v. Pandata Systems Corp., 2009 N.Y. Misc. LEXIS 3971 (Sup. Ct., Suffolk Co. 2009) (applying a 25% discount).

Notably, such discount has been applied in valuing interests in real estate holding companies, such as the LLC here. Thus, in Murphy, this Court affirmed the trial court's application of a 15% discount to an interest in a company whose assets consisted of cash from the sale of one property and ownership of a property net leased to a tenant. Likewise, in Jamaica Acquisitions the companies' assets consisted of income-producing properties.

Here, the court, while expressly acknowledging the Court of Appeals' precedents in Beway Realty and Seagroatt that, "in determining the fair value of a limited liability company, as with a close corporation, the illiquidity of the membership interests should be taken into account" (R. 36), nonetheless reached

the opposite and erroneous conclusion merely because the LLC is a real estate holding company.

The court's reliance upon Vick v. Albert, 47 A.D.3d 482, 849 N.Y.S.2d 250 (1st Dep't 2008), and Cohen v. Cohen, 279 A.D.2d 599, 719 N.Y.S.2d 700 (2d Dep't 2001) (R. 36), to support its finding of a "zero" discount, was misplaced. Vick, a First Department decision, incorrectly held that no lack of marketability discount should be applied where the business consists of nothing more than ownership of real estate. The rule of Vick, however should not be followed, because it not only conflicts with this Department's own precedents, but with Court of Appeals' precedents.

Thus, in Giaimo v. Vitale, 31 Misc.3d 1217(A), 930 N.Y.S.2d 174 (Sup. Ct., N.Y. Co. 2011), the court expressly refused to apply Vick, stating that it "may not be followed to the extent it is inconsistent with Beway." Moreover, there the court noted that Vick's reliance upon this Court's decision in Cohen for the proposition that such discount should only be applied to the portion of value attributable to "goodwill," was unwarranted because this Court, in a subsequent decision in Murphy (decided in 2010), applied the discount to all of the assets of a closely-held real estate holding company.

The First Department, in affirming the lower court in Giaimo left no doubt that Vick should not be read to preclude the application of the lack of marketability

discount to interests in real estate holding companies. 101 A.D.3d 523, 956 N.Y.S.2d 41 (1st Dep't 2012).

Thus, in Giaimo the First Department held that the:

> . . . motion court correctly held that the method of valuing a closely held corporation should include any risk associated with the illiquidity of the shares (*see* Matter of Seagroatt Floral Co. [Riccardi], 78 NY2d 439, 45-446 [1991]. It also properly rejected petitioner's contention that this Court's decision in Vick v. Albert (47 AD3d 482 [1st Dep't 2008], *lv denied* 10 NY3d 707 [2008] limits the application of marketability discounts only to goodwill, or precludes such discounts for real estate holding companies such as the corporations at issue here. The motion court erred, however, in assessing that the marketability of the corporations' real estate assets was exactly the same as the marketability of the corporations' shares (*see* Seagroatt Floral, 78 NY2d at 445-446). While there are certainly some shared factors affecting the liquidity of both the real estate and the corporate stock, they are not the same. There are increased costs and risks associated with corporation ownership of the real estate in this case that would not be present if the real estate was owned outright. These costs and risks have a negative impact on how quickly and with what degree of certainty the corporation can be liquidated, which should be accounted for by way of a discount (emphasis added).

101 A.D.3d at 524, 956 N.Y.S.2d at 43.

This is precisely the error of law made by the court, i.e., in equating the value of Winston's membership interest in the LLC, whose sole asset is real estate, with the sale of the realty itself, which the court incorrectly found was "easily marketable" (R. 36). Indeed, the testimony of both sides' real estate appraisers confirmed that there is an "exposure time" of at least six (6) months *prior to* any

hypothetical sale of the realty and thereafter a "marketing period" of at least another six (6) months or longer (18 months according to Haims) for a *hypothetical* sale of a property (R. 371, 551, 1304-1305, 1371). Thus, the court erred in treating Winston's interest in the LLC as the equivalent of cash or a marketable security that can be easily and quickly liquidated and converted to cash.

The court also erred in finding that Nelson's testimony, as to a 25% discount, "lacked credibility" (R. 36). Nelson's testimony was based upon his extensive experience as a CPA and valuation expert, and his reliance upon restricted stock studies and prevailing New York law, including this Court's decision in Murphy. Likewise, the court erred in finding the record did not "permit the court to determine what lesser percentage might be appropriate" (R. 36). To the contrary, the record was replete with Nelson's credible testimony that such discount ranges between 15% and 25% (R. 1211-1218, 1301-1302).

As in Giaimo, this Court has the power to search the record and rather than remand for further proceedings below, it would be more "sensible and economical" for this Court to decide the issue based upon the full record. 110 A.D.3d at 524, 956 N.Y.S.2d at 43. See DeMatteo v. DeMatteo Salvage Co., 90 A.D.3d 981, 935 N.Y.S.2d 326 (2d Dep't 2011) (judgment modified to reflect proper valuation).

The MCC Parties submit that a lack of marketability discount of between 15% and 25% should be applied to reduce the "fair value" of Winston's interest in

the LLC, irrespective of whether such interest is found to be 5.74%, 10% or otherwise.

POINT IV

THE COURT IMPROPERLY AWARDED PRE-JUDGMENT INTEREST ON THE "BUY OUT" VALUE OF WINSTON'S INTEREST IN THE COMPANY

The court abused its discretion by awarding pre-judgment interest on the "buy out" value of Winston's interest, and at the statutory rate of 9%, thereby improperly rewarding Winston for his inequitable and unlawful conduct toward the company, Man Choi and his family.

It is well established that the allowance of interest in an accounting action between partners is a matter within the court's discretion based upon equitable principles. See, e.g., Susi Contracting Co. v. Orlando, 33 A.D.2d 548, 304 N.Y.S.2d 452 (1st Dep't 1969), leave to appeal denied, 26 N.Y.2d 610, 309 N.Y.S.2d 1027 (1970); John Hancock Life Ins. Co. of N.Y. v. Hirsch, 77 A.D.3d 710, 909 N.Y.S.2d 519 (2d Dep't) (holding that an award of pre-judgment interest in an equitable action rests within the court's discretion).

In the first instance, there is nothing in the LLCL that expressly provides for interest on a distribution upon the withdrawal of a member. See LLCL § 509.

Moreover, this Court's decision in Blake v. Blake, 107 A.D.2d 139 (2d Dep't 1985), relied upon by the court below, did not mandate an award of pre-

judgment interest. Rather, in Blake, *supra*, this Court simply held that "courts are not precluded from making such orders as justice requires" (emphasis added) as the statute in that case (the Business Corporation Law), as here, did not expressly authorize an award of pre-judgment interest.[30] While this Court held in Blake that the lower court erred in not awarding pre-judgment interest, the facts of this case do not justify any award of pre-judgment interest, and certainly not at the statutory rate of 9%, commencing as of the February 9, 2008 valuation date.

Here, Winston should not be awarded pre-judgment interest based upon his own, adjudicated inequitable and fraudulent conduct, including his theft of the LLC's valuable property. Nor should Winston have been rewarded for having deliberately overstated his purported interest in the LLC, falsely claiming to be the sole owner of the LLC (R. 689-690, 698), as part of his scheme to coerce, from his brother and his family, a "buy out" of his "interest."

Moreover, there was no evidence that any funds were wrongfully withheld from him by the MCC Parties to justify an award of interest. Rather, in August 2007, the MCC Parties properly commenced an action to determine the extent (and "fair value") of Winston's interest in the LLC, and the court's determination, after trial, that Winston only had a 10% interest was consistent with Man Choi's claim

[30] Likewise, in Matter of Superior Vending, LLC, 71 A.D.3d 1153, 898 N.Y.S.2d 191 (2d Dep't 2010), also relied upon by the court, this Court awarded pre-judgment of 9% on a "buy out" award, but did not expressly hold that an award of pre-judgment interest was mandatory.

that Winston, *at best*, had a minor interest in the LLC, and a complete rejection of Winston's false assertion that he was, and still is, the 100% owner of the LLC.

The court erred in granting pre-judgment interest and at the statutory rate of 9%, commencing as of the valuation date. If any interest is warranted, it should only run from the date of the entry of Judgment on February 6, 2013.

POINT V

THE COURT PROPERLY DISMISSED ALL OF WINSTON'S PURPORTED DIRECT AND DERIVATIVE CLAIMS FOR ALLEGED BREACH OF FIDUCIARY DUTY

Lastly, the court properly dismissed all of Winston's purported direct and derivative claims for breach of fiduciary duty.

Thus, the court correctly found that Winston's Eighth Cause of Action against Man Choi was "vaguely pleaded," and that he had failed to prove that Man Choi had breached any fiduciary duties owed to him by causing the LLC to take alleged "unauthorized actions" (R. 37-38), i.e., commencing the first action to undo Winston's fraudulent conveyance of the Property in April 2001.

Likewise, the court correctly dismissed Winston's alleged "freeze out" claim, in that Winston failed to prove any "damages" as a result of any alleged deprivation of an opportunity to participate in the LLC's business affairs (R. 37-38). Contrary to Winston's Brief (at p. 42), there was no express finding made by the court that any "freeze out" had actually occurred. Indeed, other than attending

the closing (and being permitted by Man Choi to effectuate his own 1031 exchange and out of respect for his older brother, to execute documents on behalf of the LLC) and filing a false deed to steal the LLC's Property, Winston, a retired California resident, had no involvement in the LLC or in any of Man Choi's other businesses.

Contrary to Winston's assertion, in Chiu v. Chiu, 71 A.D.3d 621, 623, 896 N.Y.S.2d 132 (2d Dep't 2010), this Court went no further than to state that the allegations set forth in the Eighth Cause of Action of Winston's complaint, "*if proven*" (emphasis added), may make out a claim for breach of fiduciary duty, but Winston failed to prove such claim at trial. Nor did this Court, in its March 2007 decision in the first action, ever hold that Winston was entitled to the disclosure of purported "material facts concerning the operation and management of the LLC," as Winston asserts.

The court also correctly determined that any claim for the alleged "underpayment" of rent by Man Choi's companies operating out of the Property rightfully belonged not to Winston, but to the LLC as a "derivative claim," citing Yudell v. Gilbert, 99 A.D.3d 108, 949 N.Y.S.2d 380 (1st Dep't 2012) (holding that where shareholders suffer solely through a depreciation in the value of their stock, the claim is "derivative," even if the diminution in value derives from a breach of "fiduciary duty") (R. 37-38).

Here, Winston's claim that he was allegedly not paid a share of what could have been the LLC's "profits" (from the alleged underpayment of rent) is a classic derivative (and not a direct) claim. See Yudell, *supra*.

Moreover, the court also correctly held that Winston lacked legal standing to assert a "derivative" claim, as he had first asserted such claim in his answer, dated May 30, 2008, which was 4 months after he was deemed to have "withdrawn" as a member of the LLC as of February 9, 2008 (R. 38).

While the Court of Appeals recognized in Tzolis v. Wolff, 10 N.Y.3d 100, 855 N.Y.S.2d 6 (2008) that a member of an LLC may sue derivatively, in order to have legal standing to bring the derivative action in the first instance, "a plaintiff must own portions of the LLC both at the beginning of and throughout litigation." Cohen PDC, LLC v. Cheslock-Bakker Opportunity Fund, LLP, 2010 N.Y. Misc. LEXIS 5382 (Sup. Ct., N.Y. Co.), aff'd, 94 A.D.3d 539, 942 N.Y.S.2d 81 (1st Dep't 2012). See Billings v. Bridgeport Partners, LLC, 21 Misc.3d 535, 540-541, 863 N.Y.S.2d 591, 594 (Sup. Ct., Erie Co. 2008) (holding that a non-member at the time derivative claims are asserted, lacks standing to bring those claims).

As Winston was indisputably not a member of the LLC at the time he first asserted his derivative claims, the court properly dismissed them. See Ciullo v. Orange & Rockland Utilities, Inc., 271 A.D.2d 369, 369, 706 N.Y.S.2d 428, 429 (1st Dep't 2000) (holding that a non-member at the time the derivative claims are

asserted lacks standing to bring those claims), leave to appeal denied, 200 N.Y LEXIS 3461 (2000).

Arfa v. Zamir, 63 A.D.3d 484, 880 N.Y.S.2d 635 (1st Dep't 2009), also relied upon by Winston, is readily distinguishable from the facts here, as there the right to exercise a "put" at any time after a manager's removal was pursuant to an express provision of the company's operating agreement, whereas here no such agreement ever existed (R. 25).

In an attempt to obtain an unjust award of attorneys' fees,[31] Winston argues that the court should have, at the very least, awarded him "nominal damages," and even "punitive damages." However, unlike in Brian E. Weiss, P.C. v. Miller, 166 A.D.2d 283, 284, 564 N.Y.S.2d 110, 111 (1st Dep't 1990), aff'd, 78 N.Y.2d 979, 574 N.Y.S.2d 932 (1991), relied upon by Winston, wherein the appellate court found that the trial court's award of nominal damages was "sufficiently supported by the evidence at trial," here, by contrast, Winston failed to make any such showing.

Nor does the Second Circuit's decision in Action House, Inc. v. Koolik, 54 F.3d 1009, 1013 (2d Cir. 1995), support Winston's assertion concerning an award of "punitive damages," because, as the Court there noted, under New York law a

[31] Evidently, Winston is complaining that he had to pay a substantial portion of Man Choi's attorneys' fees in the first action, which reference, in a footnote at page 45 of his Brief, is the only tacit admission by Winston of his wrongdoing that led to the parties' initial dispute.

finding of actual damages is required before any punitive damages may be awarded. Here, Winston failed to prove any actual or nominal damages.

If punitive damages should have been awarded against anyone for having "lied" during their testimony, it is Winston, who maintained that he was still the sole, 100% owner of the LLC (R. 689-690, 698), while his counsel argued, out of both sides of their mouths, that Winston had at least a 25% interest (if not more).

Thus, here, as in Reinah Dev. Corp. v. Kaaterskill Hotel Corp., 59 N.Y.2d 482, 465 N.Y.S.2d 910 (1983), yet another inapposite authority relied upon by Winston, there was absolutely nothing in the record to support an award of punitive damages.

This Court's decision in White Eagle Market, Inc. v. Lopez, 36 A.D.2d 864, 321 N.Y.S.2d 1019 (2d Dep't 1971), also relied upon by Winston, is readily distinguishable from the facts here, as this Court held that there was sufficient evidence to establish liability on defendants' part, but that the punitive damages award was "excessive."

Likewise, Local Union No. 38, Sheet Metal Workers' Int'l Assn. AFL-CIA, v. Pelella, 350 F.3d 73 (2d Cir. 2003), has no application here, as there the issue was an erroneous jury charge that punitive damages may be awarded even if the jury found that plaintiff failed to establish any actual damages, to which defendant failed to timely object.

For these reasons, the court's dismissal of Winston's breach of fiduciary claims should be affirmed, and in no event is Winston entitled to an award of attorneys' fees.

CONCLUSION

For all of the foregoing reasons, the Judgment should be modified to the extent cross-appealed from by the MCC Parties and, as modified, affirmed, and Winston Chiu's appeal denied in its entirety, and for such other and further relief as the Court deems just and proper under the circumstances.

Dated: New York, New York
November 26, 2013

Respectfully submitted,

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Dated: New York, New York
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