SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

In the Matter of the Application of: GURNEY'S INN RESORT & SPA, LTD., a New York corporation, Petitioner, and NANCY ARZANIPOUR, et al., Respondents, To Determine the Fair Value of the Common Shares of Gurney's Inn Resort & Spa, Ltd. Held By Respondents Pursuant to Section 623 of the New York Business Corporation Law.	INDEX NO.: 154466/2018 (Hon. Barry R. Ostrager)

RESPONDENTS' POST-HEARING MEMORANDUM OF LAW

Respondents Nancy Arzanipour, Paul Arzanipour, Lorraine Ferretti, Patricia Frank-Janewicz, George Rosenfeld Inc., Michael Giordano, Janice Katz, Christine Lauria, Marcia Ruskin, Jay Scansaroli, Janice Scansaroli, Joseph Scognamiglo, Alan Sparks, and Vito Vitrano, representing 2,350 dissenting Class A shares, submit this post-hearing Memorandum of Law.

I. Introduction

Respondents dissent from Gurney's offer of $118.80[1] per share offered in the Merger. A hearing was held on Monday, December 3, 2018 and Wednesday, December 5th. The trial exposed several critical facts: (1) Gurney's appraiser used a discount rate that was almost 100 basis points higher than the "typical" rate noted by the Gurney's appraisers themselves. This had

[1] "This payment operates as a floor on valuation." *Rand v. 610 Smith St. Corp.*, 992 NYS 2d 609, 44 Misc. 3d 783 (New York City Supreme Court, 2014) (J. Sherwood) (holding further that there is no support for contention that value can be reduced below amount already paid). *Id.* at *612.

the effect of suppressing valuation; (2) Gurney's appraiser failed to properly include the increased economic value to Gurney's of owning all units "free and clear" as of the March 28th valuation date which suppressed the valuation; and (3) Gurney's appraiser failed to include two valuable balance sheet assets, namely the brand value and value of net operating loss carry forwards, which meant that dissenters' were not paid their fair share for those valuable assets.[2]

The evidence clearly demonstrates that a fair value award should be based upon dissenters' appraiser's valuation of $115 million for the land and operations of Gurney's Trial Exhibit H, page 11, plus the $8.5 million midpoint valuation of Gurney's brand.[3] Trial Exhibit H, pages 162-165, plus $2.8 million for value of tax carry forward benefits Trial Exhibit G at pg. GURN0414, for a maximum grand total of $126.3 million. To ensure equal treatment of all Class A shareholders, the amount per share to be awarded to dissenters should be calculated in the same way as non-dissenters' share amounts were calculated for purposes of determining the merger consideration (and in the same way that the offer to dissenters post-merger as calculated). *See* Verified Petition, Exhibit E, attachment 2. Finally, the amount of the difference between Gurney's $84 million valuation and the fair value award in this case should be increased by an award of interest from March 28, 2018 to date of judgment (and by the 9% CPLR rate post judgment).

II. The Appraisal Statute: BCL 623

New York's Business Corporation Law 623 gives shareholders who are subject to corporate action such as cash out merger (BCL 907), the right to dissent and demand "payment

[2] Nor does Gurney's alleged fair value offer estimate any value for the occupancy rights embedded in the Class A shares. Petitioners are only identifying the issue here to preserve it for appeal, if such were to occur. The issues were articulated in Respondents' Verified Answer to Petition and in Petitioners' Pre-Hearing Memorandum and were the subject of a proffer at trial, on the record.

[3] At Exhibit I, page GURN 0418, Gurney's auditors valued the brand, "Service Mark" at $5 million as of December 31, 2017.

of the fair value of his shares." BCL 623(a). In 1982[4], the statute at 623(h)(7) was amended to give courts discretion to consider value arising from post-merger events and factors. Section 623(h)(7) requires the Court to consider post-valuation date effects on the corporation and its shareholders. *Cawley v. SCM Corp.*, 72 NY 2d 465 (1988); *Alpert v. 28 Williams St. Corp.*, 63 NY 2d 558 (1984). Gurney's argues that elimination of the time shares should not be considered because that occurred before the merger and this was not part of ". . . the transaction giving rise to shareholders' right to receive payment. . ." But the evidence shows otherwise. The proxy attached to the Verified Petition as Exhibit E, describes a unitary transaction. In any event, the Court must consider the status of Gurney's as of the valuation date of March 28, 2018 at which time Gurney's had no timeshares.

III. A Valuation Of Operating And Non-Operating And Intangible Assets Is Required

"Valuation of closely held corporation is not an exact science, and it is the particular facts and circumstances of each case that will dictate the result." Giamo, supra at 524. Except for 623(h), the BCL "offers no definition of fair value and no criteria by which a court is to determine price on other terms. . ." *Matter of Seagroatt Floral Co., Inc.*, 78 NYS 2d 439 (1991). The three major elements of fair value are net asset value, investment value and market value" but "all three appraisal methods do not have to influence the result in every valuation proceeding. *Cawley . SCM Corp.*, 72 NY 2d 465 (1988). *Matter of Friedman v. Beway Realty Grp.*, 87 NY 2d 161 (1995).

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[4] New York Court of Appeals, in considering the 1982 amendment to BCL 623, explained that it was:

> ". . . intended to permit courts to supplement [the established valuation] approaches by also considering elements of future value arising from the accomplishment or expectation of the merger which are known or susceptible of proof as of the date of the merger and not the product of speculation."

Matter of Cawley, 72 N.Y. 2d 465 citing and quoting *Alpert v. 28 Williams St. Corp.*, 63 N.Y. 2d 85; *Weinberger v. VOP, Inc.*, 457 A. 2d 701, 713 (Del.).

A. The Evidence Adduced At The Hearing Demonstrates That Gurney's Land And Property Are Worth Materially More Than $118 Per Share ($84 Million Aggregate) Offered By Gurney's

The evidence at the hearing clearly demonstrated that HVS' appraisal of Gurney's properly appraised Gurney's as it existed on the date of valuation at March 28, 2018 by modeling all 109 of the resort's rooms as full revenue producers, free of timeshare owner units. Pre-2018 such time share units did not contribute to Gurney's revenue stream save for a relatively minor single, annual maintenance payment. Dissenters' appraiser explained the importance of "normalizing" Gurney's for the elimination of timeshares: "you are going to have this additional capacity at this property in 2018 that you didn't have in 2017, it's going to make a big impact." Tr. 163:11-13. The uncontradicted testimony of Respondents' expert Erich Baum also clearly shows that Gurney's appraisers' (CBRE) report does not include the full 109 rooms as free and clear revenue generators. Dissenters' appraiser testified (and was not contradicted on cross-examination) "CBRE did not do that." Tr. 154:19 – 165:5. The isolation of Gurney's "east" from the combined Gurney's – Panoramic operations was also a key distortion to the detriment of dissenters as dissenters' appraiser explained: CBRE allocation [of Gurney's east vs. Panoramic & Gurney's] "inflates Panoramic at expense of the main resort." Tr. 170:11-13. Dissenters' appraiser called Gurney's appraisers' methods and calculations "illogical." Tr. 170:2-6. As a result, CBRE calculated an average daily room rate that was artificially low and which was one of the factors which led to the low ball valuation. Both appraisers agreed that ADR is a critical number. Tr. 15:3-6; (Gurney's appraiser) and Tr. 146:23-25 (dissenters' appraiser).

Here, Gurney's appraiser, CBRE, failed improperly, to consider the additional value of timeshare owners units being returned to Gurney's inventory which allowed Gurney's to keep

100% of the rental income on these units for the first time. *See In re Jamaica Acquisition, Inc.*, 25 Misc. 3d 1212(A), 901 NYS 2d 907, 2009 NY Slip Op 52046(U) (Supreme Court Nassau County) (September 29, 2009), (applied 623(h)(7) to admonish an appraiser who failed to consider the economic and financial effects of conversion to a REIT). *Id*. at *15.

The testimony of Gurney's appraiser shows that its appraisal was too conservative. CBRE agreed that Gurney's was an exceptional property. CBRE appraiser said: Gurney's is a "unique property" (Tr. 48:18, 20) (*see also* Gurney's Exhibit 1 at GURN0002); that it was considered a Class A property in terms of asset and investment potential (Tr. 54:11-12) ; that Gurney's "outperformed competitors," by a wide margin (E1, GURN0126) and was the "best property out in the East End"; garnering the "highest rates" (Tr. 56) and that Gurney is at the "top of the market," Tr. 60:20-21; whose "positive attributes significantly out weight negative attributes." Tr. 78:15-18. CBRE appraiser agreed that positive attributes significantly out weight the negative attributes. Tr. 78:15-18. CBRE also estimated that occupancy will remain above long term averages. Tr. Ex. 1, GURN0054. Gurney's appraiser testified that Gurney's ADR was growing and occupancy was improving (Tr. 58:4-7) and that Gurney's will "outperform competitors by a wide margin." Trial Ex. 1 GURN0074. CBRE's assumption of minimal growth in early years artificially suppressed Gurney's appraisers' estimates.

Gurney's appraisal adopted Gurney's management's 2018 budget[5] and hence the Gurney's appraisal assumed minimal growth in occupancy or ADR. Trial Ex. 1 at GURN0074.

The final distortion to dissenters' disadvantage was Gurney's appraisers' failure to set the cap rate "typically" at 25-50 basis points above the going cap rate, Tr. 111:1-12:8. Had that been done would have resulted in an $89 million valuation for Gurneys. Tr. 107:9-108:11.

B. Non-Operating Assets Must Be Valued In An Appraisal

[5] In fact 2018 actual results were above budget. Tr. 238:3-13.

Various assets not included in CBRE's appraisal must be added. New York's Appellate Division has approved the application of factors considered by the Internal Revenue Service in valuing stock, including: "the company's earning capacity" . . . "its goodwill and other intangible assets." Emphasis supplied. *See Matter of Blake v. Blake Agency*, 107 A.D. 2d 139, 146, 486 NYS 2d 341 (2nd Dept. 1985). Gurney's intangible asset is its brand, carried on its books at $5 million and valued by HVS at a midpoint of $8.5 million. (*See* Exhibit H).[6] (*See* Exhibit __ at pg. __. 2.80 million NOL value). Gurney's NOL benefits value were not included in CBRE's appraisal but should have been considered. *In Matter of Cawley*, 72 N.Y. 2d 465 at 473 the New York Court of Appeals held in a BCL 623 appraisal proceeding: "We hold dissenting shareholders are entitled to receive fair value for their securities as determined by a consideration of all relevant factors, including prospective, non-speculative tax benefits . . ." *Id.* at 467 (remanding case to trial court to consider the effect of tax benefits accruing to the corporation). *See also Matter of Endicott-Johnson*, 37 N.Y. 2d 585 (1985) (New York Court of Appeals leaving undisturbed on appeal the lower court's valuation of "investment tax credit and tax loss – carry forward" in appraisal). *Id.* at 590. In *In re Jamaica Acquisition, Inc.*, 25 Misc. 3d 1212(A), 901 NYS 2d 907, 2009 NY Slip Op 52046(U) (Supreme Court Nassau County) (September 29, 2009), the Court held the appraiser erred when it failed to consider the elimination of the 45% tax burden as a result of conversion to a REIT).

IV. BCL 501(c) Requires All Shares Be Treated Equally And Therefore In Determining The Allocation Of Aggregate Face Value To The Dissenters' Shares The Court Must Use the Same Forumual Used By Gurney's In Calculating Other Class A Shares Allocable Share

[6] Dissenters appraiser testified that including an appraisal of the brand was consistent with applicable standards (Tr. 175:14-17) and that the reason it was not done by CBRE was that Gurney's did not ask CBRE to appraise the asset. (Tr. 174:23-175).

BCL 501(c) states: "subject to the designations, relative rights, preferences and limitations applicable to separate series, each share shall be equal to every other share of the same class." The Court of Appeals has expressly held: "Determination of the fair value of a dissenter shares are governed by the statutory provisions of the business corporation law that require equal treatment of all shares of the same class of stock. *Matter to Friedman v. BeWay Realty Corp.*, 87 NY 2d 1161 (1995).

In arriving at the post-merger fair value offer to dissenters, Gurney's used the same formula that was used to cash out over 203,500 non-dissenting minority shares after the majority owner voted its shares to approve the sale of Gurney's to itself.[7] Since it used such formula for those shares, it is stuck using that formula for the Respondents shares because BCL 501(c) requires all shares of the same class to be treated equally. Such doctrine has been applied by the New York Court of Appeals in *FeBland v. Two Trees Mgt. Co.*, 66 NY 2d 556 (1985) to tenant shareholder corporations. Three years later in *Matter of Cawley*, the New York Court of Appeals held once again ". . . because each share of stock within a given class must be treated equally, the tax advantages . . . must be distributed proportionally among all shareholders in calculating fair value . . ." *Id.* at 467. *See also Katzowitz v. Sidler*, 24 NY 2d 512, 518.

[7] That was the so-called MOU formula. The MOU's validity is the subject of litigation in *Frank v. Metrovest*, Index No. 653200/2018, pending before this Court and oral argument on Defendant's motions to dismiss is scheduled for January 15, 2019. The applicability in this case has no bearing in that case. Petitioners have asserted in the companion action that the MOU is not a valid, binding agreement in any way between Gurney's and majority owner and/or between majority owner and Class A shareholders. This position was asserted by Class A shareholders prior to the Gurney's vote on the merger and closing thereon. That position has been steadily asserted and never abandoned by any known Class A shareholder and certainly not by any of the Respondents. Nonetheless Gurney's (new 100% controlled by the malefactor former majority owner) persists in offering the MOU formula for "fair value" of Class A dissenters' shares. If Gurney's succeeds in convincing the Court that the MOU formula should be applied in lieu of BCL 623 "fair value" metric, then Gurney's will have paid such award under the MOU as a "voluntary payment." Under the "voluntary payment doctrine" (*Dubrow v. Herman & Beinin*, 157 A.D. 3d 629 (1st Dept. 2018), Gurney's would not then thereafter be able to claim in the class action that any dissenters are bound by the MOU.

Accordingly, to treat all Class A shareholders equally, the Court must use, or compel Gurney's to use, the same formula used for the minority holders and apply it to the grand total fair value determined by the Court after the Court's determination. That formula is as follows: start with the fair value, reduce it by 5% of that total, the first $50 million is divided by the total number of shares outstanding as of the merger date (*i.e.* 697,500) that amount is then added to the number yielded by the following formula (fair value in excess of $50 million is reduced by $20 million mortgages and divided by 203,550 minority shares as of the merger date. *See* Verified Petition Ex. E attachment 2.

V. Gurney's Has Waived And Failed To Offer Any Proof To Support A Discount For Lack Of Marketability ("DLOM")[8] Because It Has Not Pleaded Applicability thereof In Its Petition And Gurney's Appraiser Did Not Determine That A DLOM Was Appropriate

Lack of marketability discount is discretionary. In *Ruggiero v. Ruggiero,* No. 362 299-2013 (Sup. Ct. Suffolk Co. July 29, 2013) the court rejected a 20% DLOM discount because the proponent-expert "did not provide sufficient explanation." *Id*. Similarly in *Zelouf International Corp. v. Zelouf*, Justice Kornreich refused to apply a DLOM because the "liquidity risk" approved from the proof "more theoretical than real." 47 Misc. 2d 346, 999 NYS 2d 731 (Sup. Ct. New York County, December 22, 2014) and also noting that "no New York appellate court has ever held that a DLOM must be applied." *Id.* at 735 (emphasis in original).

Both appraisers opined on the marketability of the property. Gurney's appraisal report states: ". . . there are still plenty of national and international investors who are eager to place capital into well-established and emerging markets." Tr. Ex. 1 at GURN0054. "Market participants indicate that there is much continued interest in investment assets in Montauk." Tr. Ex. 1 at GURN0089. Dissenters' appraiser testified that Gurney's assets were "irreplaceable" (Tr. 151:21-152:5) and that he would expect "substantial interest" from investors (Tr. 150:1-11)

[8] The DLOM is not a "minority discount," the latter being forbidden in New York under BCL 623 because it would frustrate the remedial goal of the statute to protect minority shareholders from being forced to sell at unfair values imposed by the majority owner. *Matter to Friedman v. Beway Realty Corp.*, 87 N.Y. 2d 161, 169 (1995).

and as a consequence the price of Gurney's in a sale would get "bid up." Tr. 153:1-2. In *Matter of Dissolution of Walt's Submarine Sandwiches Inc.*, 173 AD 2d 980, 980-981, 569 NYS 2d 492 (3rd Dept. 1991), the Appellate Division upheld the trial Court's referral to apply a DLOM because the evidence showed the "respondents' marketability" via responses to a Wall Street Journal "for sale" ad.

VI. Interest Should Be Applied To The Award

BCL Rule 523(h)(6) states: The final Order shall include an allowance for interest at such rate as the Court finds to be equitable from the date the corporate action was consummated to the date of payment." A disserting shareholder will be awarded interest on any unpaid fair value unless there is a finding of behavior that is arbitrary, vexatious or otherwise not in good faith." In *Matter of Carolina Gardens, Inc.*, 238 AD 2d 189, 190, 655 NYS 2d 536 (1st Dept. 1997), *see also Miller Bros. Ind. Inc. v. Lazy River*, 272 AD 2d 166 (1st Dept. 2000); *Matter of Dimmock v. Reichold Chems.*, 75 AD 2d 870, 871. In determining the rate of interest, the Court shall consider all relevant factors, including the rate of interest which the corporation would have had to pay to borrow money during the pendency of the proceeding." Here interest should be awarded at the CPLR rate of 9% which is in the range of rates of interest paid by Gurney's as reflected in its financial statements. *See* Trial Exhibit I, pages GURN0419-0421, noting that Gurney's pays rates on debts from 4.5% to 13.76%. *Id.*

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