To Be Argued By:
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Time Requested: 15 Minutes

New York Supreme Court

APPELLATE DIVISION — SECOND DEPARTMENT

Docket Nos.
2020-04299
2020-04302
2020-04303

In the Matter of

SERGIO MAGARIK, individually and derivatively on behalf of KRAUS USA, INC.,

Petitioner-Appellant,

against

KRAUS USA, INC., MICHAEL RUKHLIN and RUSSELL LEVI,

Respondents-Respondents.

BRIEF FOR RESPONDENTS-RESPONDENTS

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I. COUNTERSTATEMENT OF QUESTIONS PRESENTED

1. Should this Court affirm the reasoned Judgment entered by the Honorable Vito M. DeStefano, J.S.C. ("IAS Court") concerning the value of Kraus USA, Inc. ("Kraus"), which was based on a careful weighing of all evidence, involved credibility determinations of the parties' expert witnesses, and was ultimately within the range of testimony and documentary evidence presented?

Answer: Yes.

2. Did the IAS Court "use the wrong legal standard", "look beyond the Valuation Date" or abuse its discretion by rejecting Appellant Sergio Magarik's ("Appellant") expert's inflated valuation model that was built around revenue projections that, while well-meaning, were proven to be unrealistic and unachievable *as of the Valuation Date*?

Answer: No.

II. PRELIMINARY STATEMENT

Simply stated, the IAS Court did not abuse its discretion by determining that the fair value of Kraus was $6,050,000 as of September 20, 2015 (the "Valuation Date"). The case now on appeal was a contentious business "divorce" that involved a classic battle of the experts. The IAS Court, which presided over this heavily litigated case from its inception all the way through trial, found that one expert's valuation was unrealistic while the other expert's valuation was more reliable and accurate. It is axiomatic that expert credibility determinations in a valuation case are overwhelmingly the province of the trial court and cannot be disturbed on appeal. Further, the IAS Court's decision was well-reasoned, supported by evidence, and – most importantly – *within the range* of expert testimony. As such, pursuant to applicable law – including, but not limited to, cases from this Court – deference to the IAS Court's determination is required on appeal.

The IAS Court did not apply the "wrong standard" or "look beyond the Valuation Date" by rejecting an expert opinion whose outrageously high valuations were built around internal projections that, while well-meaning, were shown to be unreliable and unachieved as of and before the Valuation Date. No statute, case, or rule of law mandates that a trial court in a New York Business Corporation Law ("B.C.L.") § 1118 proceeding embrace one expert's position over another or blindly adopt a valuation model built on assumptions proven to be demonstrably wrong. To

the contrary, the law clearly recognizes that there is no one way to value a company, and gives the trial court broad leeway to weigh evidence and exercise reasoned judgment on items such as value.

At trial, there was ample evidence that Appellant's valuation model was built around company-generated, aspirational sales and earnings forecasts, which he blindly accepted and not hard facts that were known or were knowable as of the Valuation Date. The company first began to generate these monthly forecasts in February 2014, and had *never* met them as of the Valuation Date. The forecasts also assumed substantial profits from sales of products that were not even developed, let alone launched or sold, as of the Valuation Date. Put simply, Appellant's expert "arrived" at stratospheric valuation numbers through fiction, not fact. No conceivable error flows from the IAS Court's refusal to play along with the charade.

Appellant's obsession over Respondents' banking relationship and preoccupation with what information Respondents may have shared with a lender has nothing to do with Kraus' valuation or the issues on appeal. There is no rule of law requiring any court to embrace a valuation built on unrealistic projections simply because those projections were, at some point in time, shared with a bank. Nor was the IAS Court required to credit valuation guestimates, either in a loan application or on anywhere else for that matter. There is no such thing as "valuation by estoppel." Fair value for purposes of a BCL §1118 proceeding is not established by

projections shared with a bank; certainly not where the projections were proven wrong and unreliable as of the Valuation Date. Rather, fair value is established by considering evidence, including, but not limited to, expert testimony, and making credibility determinations – precisely the process that the IAS Court employed.

The IAS Court most certainly did *not* abuse its discretion when it refused to compare Kraus to the *Tesla Corporation*, as suggested by Appellant's expert. So that there is no doubt before this Court, at trial, Appellant's expert tried to justify an exaggerated valuation figure by urging the IAS Court to compare Kraus, a closely held sink and faucet *wholesaler*, to the Tesla Corporation, a publicly traded electronic vehicle manufacturer with a significantly higher market value and price to revenue multiple. Given the outrageousness of Appellant's position, a finding that the comparison was "not reasonably relatable to Kraus either in terms of size, ownership or marketability" should come as no surprise to anyone and cannot be faulted, let alone, reversed under any standard.

In short, contrary to what Appellant may think, the IAS Court was neither "illogical" nor "absurd" and these uncivil criticisms on the IAS Court are completely unjustified. The IAS Court was presented with two very different valuations from two experts who disagreed with one another. The learned trial judge carefully considered each expert's methodology, the evidence underlying each expert's premises and assumptions, and then made a decision within the range of testimony.

Consistent with prevailing law, which holds that valuing a closely held corporation is not an exact science, IAS Court dutifully considered a variety of evidence and methods, not just the one forecast around which Appellant's entire case was built. Furthermore, the IAS Court properly "got into the weeds" to determine what was reliable and what was "known and knowable" as of the Valuation Date instead of proceeding blindly like Appellant. This is a textbook exercise of discretion case. There is absolutely no basis for any claim of error and the IAS Court's determination should be affirmed in its entirety.

III. FACTS AND PROCEDURAL HISTORY

A. Background and Initiation of IAS Court Proceedings

Kraus is a closely held New York corporation formed on February 23, 2007 by Russell Levi and Michael Rukhlin ("Majority Shareholders"). Kraus is a sink and faucet wholesaler that operates out of a facility in Port Washington, New York. R. 22. Kraus sources products from foreign manufacturers and sells these products to retailers in the United States. Kraus does not sell to the general public. *Id.* Kraus' success depends on the margin between the cost of goods purchased abroad and the cost of goods sold. In many ways, Kraus is the proverbial middleman.

Appellant first joined Kraus as a shareholder in 2009, with a small stake in Kraus that grew over time to 24%. R. 20. Appellant was fired from Kraus on September 10, 2015 for various acts of disloyalty, including, but not limited to, attempting to secretly create a competing business. R. 2646-48. By Verified Petition, dated September 21, 2015, Appellant sued Kraus and the Majority Shareholders alleging shareholder oppression claims, including fraud, misconduct and other malfeasance claims (the "Fault Claims"). R. 2624. By way of relief, Appellant sought, *inter alia,* judicial dissolution of Kraus pursuant to BCL § 1104-a. *Id.* Appellant's invocation of BCL §1104-a triggered certain statutory buy-out rights.

On May 6, 2016, Kraus and the Majority Shareholders exercised these rights pursuant to BCL §1118(c) and elected to purchase Appellant's 24% interest in Kraus at fair value. R. 2651. This prompted approximately two years of arduous litigation over Appellant's Fault Claims and the valuation claims *in tandem* and *in front of the same judge*. Through heavily litigated pre-trial proceedings, the IAS Court, who presided over this case from inception, grew very well acquainted with the parties, their contentions, their evidence and their experts. On several occasions, the IAS Court denied various orders to show cause filed by Appellant seeking various forms of bonds, receivership, injunctions and other relief. By the time of trial, the IAS Court understood and knew the issues well. Pre-trial opinions, including one of March 18, 2018, crystallized the main issue in the case – a disagreement over fair value – and noted a "wide disparity between the opposing experts' valuation of Kraus", setting the stage for a trial involving a classic battle of the experts. (NYSCEF No. 237 at p. 4, fn. 2).

On July 26, 2018, Appellant simply abandoned all of his Fault Claims with prejudice. (NYSCEF No. 246). Once they were withdrawn, the sole remaining issue before the IAS Court – and now on appeal – was the fair value of Kraus and Appellant's respective 24% minority interest. Thus, the IAS Court's sole task was

to determine Kraus' value, and Appellant's interest, as of September 20, 2015, i.e., the Valuation Date.[1]

B. The Experts' Valuations

Appellant relied on the valuation report of Randall Paulikens ("Paulikens" or "Appellant's Expert") (R. 1078-1136) and Respondents relied on the valuation report of Paul Marquez ("Marquez" or "Respondents' Expert"). R. 1137-1250. Both experts valued Kraus utilizing two methodologies – an "income approach" and a "market-based approach."

Appellant's Expert opined that Kraus was worth approximately $30 million on the Valuation Date and, thus, the fair value of Appellant's 24% interest was $7,011,000.00, without applying any discount for lack of marketability for Appelant's 24% minority interest. R. 1085. Paulikens' income-based approach disregarded Kraus' historical earnings opting, instead, to borrow figures from certain internal forecasts predicting hopeful, but never realized, future revenues and profits made by Kraus' management, dated June 8, 2015 ("Management Forecasts"), when applying for a bank loan. R. 1873-1878. In fact, Paulikens did not use Kraus' sales and income figures up to the Valuation Date as required by statute, but in fact, by his own admission, used the entire period through December 31, 2015 (which

[1] Under BCL § 1118(b), shares are to be valued as of the day prior to the date on which such petition was filed. Here, the Verified Petition was filed on September 21, 2015, making September 20, 2015 the Valuation Date by operation of law.

included the most important quarter of the business year with more than $5 million dollars in additional sales generated post the Valuation Date, for his "administrative convenience"). R. 169-170.

By using the Management Forecasts (instead of historical earnings) as a foundation for his assumptions as to Kraus' future performance, Paulikens then created his own forecasts and arrived at a much higher valuation figure than Marquez. Paulikens then "confirmed" the higher value via a market-based approach that likened Kraus to Tesla, a publicly traded electric vehicle manufacturer whose stock traded at a significantly higher market value and price-to-revenue ratio, and who is a unique and innovative market setter. R. 1093. Kraus, on the other hand, is a marketer of commonly used products that competes in a dense marketplace with hundreds of other companies selling similar wares.

Respondents' Expert, on the contrary, reasonably determined that Appellant's fair value share in Kraus was $1,100,000.00. R. 1140. Marquez valued Kraus to be worth approximately $6 million as of the Valuation Date. R. 1166. Marquez considered the Management Forecasts, but appropriately rejected them as ambitious, unreliable and demonstrably never realized. R. 1268. Marquez opined that Kraus had, as a matter of historical course, never met any of its income or sales projections; the Management Forecasts were based on overly ambitious assumptions; certain facts *known as of the Valuation Date* rendered the Management Forecasts unreliable

and unrealistic, and the Management Forecasts could not – and should not – be relied upon. R. 795.

C. The Trial and Post-Trial Submissions

The IAS Court below held a non-jury trial over the course of 7 days between November 14, 2018 and May 16, 2019. R. 7. The IAS Court heard testimony from six witnesses, including Paulikens and Marquez, who expressed differing opinions supported by different justifications. The Management Forecasts were extensively explored during the trial. Evidence as to the question of their accuracy and reliability, including the assumptions on which they were based, and the experience of those who created those forecasts, was presented and considered. Witnesses who created the Management Forecasts testified and were subjected to direct and cross-examination. What was known, what was knowable and what was assumed as of the Valuation Date was parsed out, isolated and questioned before the IAS Court. The economic assumptions underpinning both experts' models, including those dealing with future performance, were presented, challenged and argued *ad nauseum* by fact and expert witnesses and counsel zealously advocating for vastly different positions. The IAS Court admitted and considered dozens of exhibits. The IAS Court asked questions of various witnesses and even discovered errors in Appellant's Expert's income approach model, which he was forced to acknowledge. R. 146.

Post-trial and at the Court's invitation, on September 26, 2019, Appellant and Respondents submitted extensive Post-Trial Memorandums, Proposed Findings of Facts and Conclusions of Law. (NYSCEF Nos. 248, 249, 250, 251). By the end of the case, the IAS Court had presided over the case for nearly five years and had before it a well-developed record.

D. The IAS Court's Decision

On April 26, 2020, the IAS Court issued a Decision and Order ("Decision") finding that the value of Kraus was $6,050,000, and that the value of Appellant's 24%, after applying a modest 5% discount for lack of marketability, to be $1,379,400 – well within the parameters laid out by the experts, and far closer to Respondents' position. R. 11. The IAS Court also awarded Appellant 9% statutory interest from the Petition Date notwithstanding the long delay caused by Appellant's litigation maneuvers related to his Fault Claims, which he ended up withdrawing with prejudice prior to trial. Significantly, the IAS Court provided the Respondents with a two-year period within which to satisfy the Judgment, and explained that "the two-year period is intended to balance the cash flow issues experienced by Kraus with the fact that [Appellant] has not received the value of his interest during the pendency of the proceedings. R. 10. In other words, having heard, read and considered all of the evidence, the IAS Court recognized and made provisions for

the fact that Kraus was cash-strapped and was not the Tesla-like juggernaut the Appellant claimed.

As part of its Decision, the IAS Court expressly addressed the Management Forecasts that Appellant focuses its appeal on, deeming them unreliable and declining to adopt them:

> Much of the petitioner's valuation depended upon projected earnings prepared by Kraus Controller Daniel Lusby in connection with a loan application to Bank Hapoalim B.B. ("BHI"). These projections were, put mildly, ambitious, and, in fact, were overstated. In the loan application to BHI, the parties valued Kraus at more than $30 million. In reality, the value of the business was never $30 million and the projections contained in the loan application were never realized. The court need not comment further on representations made by the parties to BHI in order to secure a loan, or what reliance may have been placed on such representations by BHI, except to note that, ultimately, the representations were not accurate.

R. 8-9.

The IAS Court also detailed other reasons why it rejected Appellant's Expert's valuation. The IAS Court pointed out that the "two valuations provided were *vastly disparate* from each other, underscoring *mistaken premises and assumptions*," R. 2 (emphasis added), and rejected the "incorrect comparables" advanced by Appellant's Expert (such as comparing Kraus to Tesla and other public corporations). R. 1270 (Respondents' Expert's Rebuttal Report). The IAS Court further noted that Appellant's Expert afforded both valuation approaches (market based and income based) *equal weight*. R. 9. By contrast, Respondents' Expert

accorded *greater weight* to the income approach, urging that such an approach was a more reliable method. R. 9. The IAS Court concluded that Respondents' methodology was more "sound and provides a realistic assessment of Kraus' fair value consistent with the *credible* evidence presented regarding Kraus' successful business model as well as its debt and cash flow issues." R. 9 (emphasis added).

Further, the IAS Court also noted a very substantial discrepancy in *how* each Expert's numbers were arrived at. Both Experts "plugged" their underlying assumptions into an income and market approach to arrive at a final valuation. R. 9. Appellant's Expert opined that, under an income-based scenario, Kraus was worth $21,900,000 while under a market-based scenario, the value jumped to a $38,780,000, a difference of approximately 77%. R. 9. Appellant's Expert then simply averaged the two without attempting to account for or explain the incredibly broad discrepancy between the two methods used. By contrast, under Respondents' methodology, the difference between results generated by the income versus market approach was far more narrow. The income based approach resulted in value of $6.16 million whereas the market based approach resulted in a "range from 5.26 million to 6.1 million," a difference of less than 9%. R. 9. The internal *consistency* between Respondents' figures stood in stark contrast to the internal *inconsistency* with the Appellant's figures, calling the latter into doubt. R. 9 (emphasis added).

This appeal ensued.

IV. STANDARD OF REVIEW

Appellant flips the standard of review on appeal in a BCL § 1118 proceeding on its head, and would have this Court believe that it *must* ignore the IAS Court's Decision below. Nothing could be further from the truth.

Pursuant to BCL § 1118, the trial court undertaking a valuation proceeding is broadly empowered to "determine the fair value of the petitioner's shares as of the day prior to the date on which such petition was filed[.]." N.Y. B.C.L. § 1118(b). It is axiomatic and incontrovertible that "[f]air value, being a question of fact, will depend upon the circumstances of each case, and there is no single formula for mechanical application." *DeAngelis v. AVC Servs., Inc.,* 57 A.D.3d 989, 991 (2d Dep't 2008). To that end, "[t]he determination of a fact-finder as to the value of a business, if it is within the range of testimony presented, *will not be disturbed on appeal where the valuation rests primarily on the credibility of the expert witnesses and their valuation techniques.*" *Adelstein v. Finest Food Distrib. Co., N.Y.,* 116 A.D.3d 850, 850–51 (2d Dep't 2014) (emphasis added).

V. LEGAL ARGUMENTS

A. The IAS Court's Valuation Determination Was Within The Range Of Testimony Presented And Cannot Be Disturbed On Appeal

A valuation "*will* not" be disturbed on appeal if it is "within the range of testimony presented" and "rests primarily on the credibility of the expert witnesses and their valuation techniques." *Adelstein*, 116 A.D.3d at 850–51 (emphasis added).

New York appellate courts routinely and unequivocally affirm the valuations of lower courts in BCL § 1118 valuation proceedings as long as such valuations were within the range of testimony presented and rested on credibility determinations. For example, in *Adelstein* this Court rejected appellant's appeal of a trial court's BCL § 1118 determination as to the fair value of a closely held corporation, finding that the appellant was not entitled to have certain additional sums considered as part of the valuation. 116 A.D.3d 850, 850–51 (2d Dep't 2014). This Court rejected the attempt to overturn the trial court's valuation, holding that "the Supreme Court's determination as to the fair value of the petitioner's shares in the subject corporation is supported by the evidence . . . These salaries and disbursements were accounted for in the petitioner's expert's valuation of the petitioner's shares in the corporation, which was adopted by the Supreme Court." *Id.*

Similarly, in *Collision Depot, Inc. v. Zigman*, the appellant sought to reverse the trial court's determination of fair value in a B.C.L. § 1118 proceeding, and, again, it was rejected. 294 A.D.2d 497, 498 (2d Dep't 2002). This Court, once again,

stated it was a futile effort, holding that "[t]he determination of a fact-finder as to the value of a business, if it is within the range of testimony presented, will not be disturbed on appeal where the valuation rests primarily on the credibility of the expert witnesses and their valuation techniques . . . The Supreme Court's determination of the fair value of the shares of stock of the petitioner's decedent in the three closely-held corporations is supported by the record. The petitioner's contrary interpretation of the facts and credibility of the witnesses does not warrant disturbing the Supreme Court's determination." Here, too, Appellant's challenge to the IAS Court's determination is nothing more than a contrary interpretation of facts and mere opinion regarding witness credibility.

In *In re Burnham*, this Court yet again rejected another attempt by a minority shareholder appellant to overturn a trial court's BCL § 1118 valuation, when the IAS Court made a credibility determination and adopted one expert's valuation over the other – just like the IAS Court did here. 261 A.D.2d 863, 863–64 (2d Dep't 1999). In rejecting this misguided appeal, this Court determined:

> At the conclusion of the trial, Supreme Court rejected the valuation of petitioner's expert as based upon an erroneous assumption concerning the gross management fees received by the corporation in 1990, and accepted the valuation of respondents' expert.
>
> Because Business Corporation Law § 1118 'offers no definition of fair value and no criteria by which a court is to determine price or other terms of the purchase, fair market value, being a question of fact, will depend upon the circumstances of each case; there is no single formula for mechanical application' . . . . 'The determination

> of a fact-finder as to the value of a business, if it is within the range of testimony presented, will not be disturbed on appeal where valuation of the business rested primarily on the credibility of expert witnesses and their valuation techniques' . . . Petitioner's 'contrary interpretations of fact and credibility do not warrant disturbing the court's determinations.'

Id. (internal citations omitted).

After 7 days of trial, hearing all of the witnesses and weighing all of the evidence, the IAS Court valued Kraus at $6,050,000. While this valuation was much closer to Respondents' Expert's valuation, it was expressly and undeniably within the range of testimony presented by both Experts. That makes this Court's determination of the appeal a simple one.

In fact, Appellant's real complaint is not with the IAS Court – but with Respondents' Expert. As Appellant repeats at length throughout his appeal, he takes offense that – unlike his own expert – Respondents' Expert was unwilling to simply and blindly adopt the Management Forecasts. *See* Appellant's Brief ("App. Br.") 23 ("Mr. Marquez did not use those projections . . ."); App. Br. 24 ("Mr. Marquez did not use the Company's earnings projections supplied to BHI."); App. Br. 27 ("Mr. Marquez's approach was fatally flawed. The main problem in his approach was using historical figures and not the projections that the Company itself prepared, approved and submitted to BHI[.]").

As demonstrated by Appellant's own words, the gripe on appeal is not over the application of the correct legal standard, but over how experts arrived at a

determination of value. Appellant transparently seeks a "second bite of the apple" because he is disappointed that the IAS Court rightfully rejected his expert's valuation. However, this Court need not – and should not – revisit the IAS Court's Decision, as its valuation was expressly within the range of testimony presented. It is hornbook law that a valuation "*will* not" be disturbed on appeal if it is "within the range of testimony presented" and "rests primarily on the credibility of the expert witnesses and their valuation techniques." *Adelstein*, 116 A.D.3d at 850–51 (emphasis added).

Appellant desperately complains that Respondents' Expert "substituted his own judgment for the judgment of both BHI and Kraus' own management." App. Br. 25. This argument lays bare the absurdity of Appellant's entire theory on appeal. He faults Respondents' Expert for using his own professional judgment, instead of sightlessly adopting the "judgment" of a third-party bank or Respondents' employees. That is exactly an expert's job – to exercise their own judgment, form their own opinion and present that opinion to the fact finder. It is then the fact finder's province to determine the amount of weight to be afforded to that opinion. No statute, case or procedural rule demands that the IAS Court must irresponsibly embrace a valuation figure based on Management Forecasts that were – *as of the Valuation Date* – demonstrably unreasonable, unreliable and wrong. In fact, the opposite is true.

This Court's longstanding cases discussed *supra*, and the numerous other cases that follow, compel summary denial of Appellant's appeal. *See, e.g.*, *Peritore v. Peritore*, 66 A.D.3d 750, 752 (2d Dep't 2009) ("defendant's contention that the Supreme Court erred in its calculation of the value of his dental practice is without merit. The determination of the value of business interests is a function properly within the fact-finding power of the court . . . Where that determination as to the value of a business is within the range of the testimony presented, it will be accorded deference on appeal if it rests primarily on the credibility of expert witnesses and their valuation techniques.") (internal citations omitted); *Ivani v. Ivani*, 303 A.D.2d 639, 640 (2d Dep't 2003) ("Valuation is an exercise properly within the fact-finding power of the trial courts, guided by expert testimony . . . The determination of the fact-finder as to the value of a business, if within the range of the testimony presented, will not be disturbed on appeal if it rests primarily on the credibility of expert witnesses and their valuation techniques.") (internal citations omitted); *In re USA Nutritionals, Inc.*, 306 A.D.2d 490, 491 (2d Dep't 2003) ("determination of a fact-finder as to the value of a business, if it is within the range of testimony presented, will not be disturbed on appeal where the valuation rests primarily on the credibility of the expert witnesses and their valuation techniques."); *Davis v. Alpha Packaging Indus. Inc.*, 267 A.D.2d 384, 385 (2d Dep't 1999) ("With regard to valuation, the determination of a fact-finder as to the value of a business, if it is

within the range of testimony presented, will not be disturbed on appeal where valuation of the business rested primarily on the credibility of the witnesses and their valuation techniques . . . The trial court's valuation of Alpha and of the petitioner's shares is supported by the evidence."); *In re Dissolution of F.P.D. Realty Corp.*, 267 A.D.2d 111, 112 (1st Dep't 1999) ("Nor should the JHO's valuation of the subject business be disturbed where, as here, the valuation was " 'within the range of the testimony presented' " and " 'rested primarily on the credibility of expert witnesses and their valuation techniques.' "); *In re Rateau*, 59 A.D.3d 1037, 1037 (4th Dep't 2009) ("We further conclude that the court's valuation of DAPACom falls 'within the range of testimony presented' and should not be disturbed.").

Appellant advances no compelling reason to ignore the overwhelming body of law – all conspicuously absent from Appellant's brief – prohibiting this Court from revisiting, second-guessing, and reversing the IAS Court's valuation that is expressly supported by the Record evidence and consistent with the testimony presented. Accordingly, on these grounds alone, the IAS Court's decision must be affirmed.

B. The IAS Court Was Not Required To Adopt the Management Forecasts), and Committed No Error of Law When It Declined To Do So

To swiftly affirm the IAS Court's Decision, this Court need not look further than the fact that the IAS Court's valuation was within the range of testimony

presented and rested on credibility determinations of the experts. However, should the Court choose to delve deeper into the "merits" of Appellant's appeal, affirmance of the Decision remains the only appropriate outcome.

The IAS Court was *not required* to accept or "adopt" a valuation based on the Management Forecasts, which the IAS Court determined were "put mildly, ambitious, and, in fact, were overstated[.]" R. 8. By suggesting otherwise, Appellant irresponsibly misrepresents the relevant law and record below. As set forth below: (1) the IAS Court aptly explained why it declined to adopt a valuation based largely on aspirational Management Forecasts; (2) the Record demonstrates that the Management Forecasts were ambitious and unrealized even as of the Valuation Date; and (3) the IAS Court did not "go beyond" the Valuation Date by rejecting an inflated valuation based on ambitious but unrealized Management Forecasts.

1. The IAS Court Explained the Reasons for Declining to Adopt The Management Forecasts

In its Decision, the IAS Court clearly explained that, in valuing the company, it would not afford weight to the Management Forecasts that Appellant continues to raise and rely upon in his appeal:

> Much of the petitioner's valuation depended upon projected earnings prepared by Kraus Controller Daniel Lusby in connection with a loan application to Bank Hapoalim B.B. ("BHI"). These projections were, put mildly, ambitious, and, in fact, were overstated. In the loan

> application to BHI, the parties valued Kraus at more than $30 million. In reality, the value of the business was never $30 million and the projections contained in the loan application were never realized. The court need not comment further on representations made by the parties to BHI in order to secure a loan, or what reliance may have been placed on such representations by BHI, except to note that, ultimately, the representations were not accurate.

R. 8-9.

Appellant continues to seek a windfall by way of the Management Forecasts that were shown during the trial to never have been realized, and hopes that this Court will blindly rely on these prior unreliable "projections" and incorrectly value Kraus at $30 million, where the IAS Court was unwilling to do so after a lengthy trial. Appellant argues that his Expert's calculations miraculously matched values derived from unrealistic projections, which according to Appellant were not a mere coincidence, but an indicator of his Expert's reliability. However, these are all *credibility* issues and go to the weight afforded by the IAS Court to one fact over the other. The IAS Court, as finder of fact, was well within its province to choose not to summarily adopt this figure. Instead, the IAS Court's valuation was consistent with that of Respondents' Expert's valuation, as well as commonly accepted practice. The IAS Court stated:

> In view of all the testimony and evidence presented and other submissions, the court accepts the valuation of Respondents' expert Paul Marquez, which the court finds and determines to reflect a more accurate value of Kraus and the value of petitioner's interest therein. Marquez's valuation is supported by the credible evidence which

> demonstrated a successful and growing business that was not especially liquid. The court does not accept the valuations provided by petitioner's expert, Randall Paulikens, as they exceeded the true value of the business, were based on income projections that were unrealistic and overly optimistic and not based on appropriate comparable businesses. Moreover, the two valuations provided were vastly disparate from each other, underscoring mistaken premises and assumptions. The Petitioner's request that the court average the two incredibly disparate valuations is rejected . . .
>
> Reconciling the numbers according greater weight to the income approach, Marquez values Kraus at $6.05 million. The court concludes that this methodology is sound and provides a realistic assessment of Kraus' fair value consistent with the credible evidence presented regarding Kraus' successful business model as well as its debt and cash flow issues.

R. 7-8. The IAS Court, in no uncertain terms, explained the reasons associated with his decision to decline to adopt Appellant's Expert's valuation – which was nothing more than a mere regurgitation of the Management Forecasts, which he then boosted by creating his own multi-year projection and falsely referred to the entire exercise as "Management's Projections". R. 844.

2. The Management Forecasts Were Unreliable

A review of Appellant's Brief could lead this Court to believe that the Management Forecasts were unwaveringly sound, reliable and unchanging. However, Appellant conveniently ignores evidence presented to the IAS Court overwhelmingly demonstrating that the Management Forecasts, while well-meaning, were demonstrably unreliable, even as of the Valuation Date. For example:

- The Management Forecasts were prepared by a young and inexperienced management team. R. 975, 976.

- Lusby testified that he updated his projections, which he referred to as "rolling forecasts", monthly, as information became available, demonstrating that they were routinely subject to change. R. 975-976, 999.

- Lusby testified that the projections at issue were actually one of *four* slightly different versions of the rolling forecast that he gave to BHI in June 2015. R. 21, 978-979, 1014-1015.

- Although various versions of these Management Forecasts had been developed, monthly, since 2014, Kraus had *never* met any of the 2014 projections. R. 975, 976.

- During the first nine (9) months of 2015 (i.e. through the Valuation Date); Kraus never met *any* of the 2015 Management Forecasts. R. 976.

- Kraus' sales for the first nine (9) months of 2015 (i.e. through the Valuation Date") were 21.4 % less than what had been projected on the Management Forecasts. R. 967; R. 792-793.

- Kraus' net income (i.e. profits) for the first nine (9) months of 2015 (i.e. through the Valuation Date) were 98.3 percent less than what had been projected on the Management Forecasts. R. 793-795.

- The Management Forecasts assumed sales and income from the new products when in reality, as of the Valuation Date, those products were still ideas "in the very early stages and hadn't [been] developed yet." R. 979, 1014-1015.

- To achieve the ambitious sales and income figures projected by the Management Forecasts, Kraus would need at least $2.9 million dollars in working capital which it did not have. R. 1104.

- As of the Valuation Date, Kraus had used up all actually available credit. Pursuant to strict loan covenants, wherein it had a $7 million (maximum) cap, Kraus' borrowing base was limited to about $6 million dollars and

had been fully drawn down. There was no more credit accessible. R. 1027. *See also,* n. 2, *infra*.

The foregoing testimony made clear that: (1) the Management Forecasts, while well-meaning, were not reliable, and (2) Appellant's Expert latched onto the Management Forecasts as a tool to justify a higher earnings growth rate and, thus, a higher value. He never visited Kraus' offices, spoke, or met with CFO Lusby, or took any other steps to understand by whom the Management Forecasts were prepared, their skill level, etc. R. 153. Paulikens simply adopted them blindly without ever questioning the reliability of the projections, the underlying economic assumptions or whether the any of the aspirational milestones had ever been achieved.

By contrast, Respondents' Expert took a more granular approach. He looked at the experience of who made the projections, when they were made and for what purpose. He visited the facility and interviewed management at least a half dozen times. He considered the assumptions baked into the projections and whether those assumptions had proven accurate or true as of the Valuation Date. Most importantly, he noted discrepancies between aspirations and achieved results, including what was known and knowable as of the Valuation Date. In short, one expert adopted the Management Forecasts as the gospel – the "be all and end all" – while the other was more careful and took the time and made the effort to understand the Management Forecasts, and, therefore, understood their lack of reliability and credibility. No

conceivable error flows from choosing one expert over another, so long as the choice made is consistent with the facts and testimony presented. *See, e.g.*, *Livreri v. Berliner*, 123 A.D.2d 670, 670 (2d Dep't 1986) ("Despite conflicting testimony from the plaintiff's and the defendant's experts" it was within the province of the factfinder to resolve such conflicts).

Throughout his appeal, Appellant drones on the argument that the value ascribed by the IAS Court "makes no sense" because Kraus had a $7 million dollar credit line in 2015, and "a bank would never lend more money to a company than the company is worth." App. Br. 6 (*see also* App. Br. 30: "It defies common sense to believe (and Respondents presented no evidence) that a bank would lend a company more money *(as much as nearly $4 million more)* than the value of the company"; *see also* App. Br 37, 41 (same)). This *ad hominem* argument has no substance and cannot serve as a basis for any appeal. The weight to be afforded to any particular fact and the inferences or deductions to be drawn from the facts is a quintessential trial court function. *Oppenheim v. Travelers Ins. Co.*, 118 A.D.2d 841 (2d Dep't 1986) ("The admissibility of the evidence is a question for the trial court, and the weight to be accorded the evidence is an issue to be determined by the trier of fact.")

More importantly, Appellant's Expert admitted that *he had no personal knowledge as to the weight, if any, that BHI gave to the Management Forecasts* when

issuing the revolving credit note. R. 202-203. Without any information in the Record as to how much (if any) weight BHI afforded the Management Forecasts, Appellant's speculative argument holds no water.

Further, even assuming *arguendo* that BHI relied upon the Management Forecasts, it would not render the IAS Court's Decision any less sound. Appellant appears to completely misunderstand the BHI bank loan, as well as commercial lending in general. Kraus is a wholesaler – the proverbial middleman. The BHI loan was an asset-based revolving credit facility ("ABL") that Kraus used to purchase sinks and faucets from manufacturers and then re-sell them to retailers.[2] The loan was secured by real inventory and accounts receivable, not hypothetical projections that were never met. Kraus' profitability turned on the narrow margin between its costs of goods *purchased* and cost of goods *sold* after accounting for

[2] Marquez testified that Kraus was limited in accessing its ABL based upon its actual borrowing base and other operating and financial statement conditions in the loan. Marquez pointed out that as of September 30, 2015, Kraus' book value (or tangible net worth = TNW) was less than $758,000, wherein Kraus was required to have a TNW of $1.5 million in order to increase the ABL from $7.0 million to $10 million that would allow Kraus to meet any working capital shortfall. The maximum amount that Kraus was able to borrow under the BHI loan terms was barely $6 million, i.e., only $1 million dollars more than the funds that they had available prior to the BHI refinance. R. 207, 778-804, 875. The impression that Appellant seeks to convey, that this was an outright $10 million dollar loan, is simply not the case. R. 623, 627, 875; App. Br. 4, 18.

overhead. The amount of credit extended by a bank, and Kraus' enterprise value, for purpose of a BCL § 1118 proceeding, has nothing to do with one another.[3]

For valuation purposes, cash flow is more important than leverage, something the IAS Court keenly considered when it held that Kraus, while "successful and growing", was "not especially liquid." R. 8. The IAS Court also found that Kraus experienced "negative cash flow," and suffered from a "lack of cash." R. 9. While the distinction between leverage and value may have been lost upon Appellant, it made eminent sense to the IAS Court and should not be disturbed on appeal.

Of paramount note is that *Kraus never borrowed more than $6 million dollars (the IAS Court's valuation) from BHI as of the Valuation Date*. R. 207, 778-804, 875. So while Appellant repeatedly questions why "a bank would lend [Kraus] more money . . . than the value of the company" – in actuality, BHI never did.

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[3] Appellant spills ink on the fact that Kraus shared these projections with BHI to "induce" the bank. *See* App. Br. 17-18. This argument does not hold water, especially on appeal. At trial, the IAS Court heard evidence that these projections, while well meaning, were inaccurate and unreliable. On cross-examination, Appellant attempted (unsuccessfully) to confront Respondents' witnesses with evidence of prior allegedly inconsistent statements made to a bank – suggesting that anything shared with a bank must be accurate – or else. The IAS Court was unmoved and found that the projections were "ambitious," "overstated," and "never realized." R. 8. What Appellant claims is "error" is nothing more than a failed impeachment effort. Impeachment by prior inconsistent statements is a tool utilized by a fact finder to determine credibility. *People v. Wise*, 46 N.Y.2d 321, 337 (1978). The weight afforded to impeachment evidence is discretionary, and should not disturbed on appeal. *Id.*

Appellant concedes that in a BCL § 1118 valuation proceeding "it does not matter what the Company is worth today, *or any other day*," just the Valuation Date. App. Br. 2 (emphasis added). However, Appellant repeatedly insists that the IAS Court committed reversible error by refusing to summarily adopt a valuation with an earnings growth rate based on Management Forecasts that were from June 2015, and, by admission of the very people who created them, were guestimates at best. Appellant's argument that his expert "followed the industry norm and relied on the projections that Respondents gave the bank right before the Valuation Date" (App. Br. 5) is rich. Appellant's Expert adopted the Management Forecasts because it supplied Appellant a windfall, not out of honorable adherence to some "industry norm."

The factual record makes clear that the Management Forecasts, and Appellant's Expert's valuation, was appropriately rejected by the IAS Court.

3. The IAS Court Did Not "Go Beyond" The Valuation Date Simply Because It Rejected The Management Forecasts

It is not until the very end of Appellant's brief (page 38 of 41) that Appellant stops rehashing his expert's opinion and finally attempts – unsuccessfully – to identify if and what legal error the IAS Court committed. The Appellant argues that the "main flaw in the lower court's decision concerning the income approach " was that the court impermissibly looked beyond the Valuation Date in determining that the projections "were proven to be unrealized and wrong." App. Br. 38.

Specifically, Appellant argues that, when the IAS Court rejected the Management Forecasts, it "chose to go beyond the Valuation Date to see if the projections came true or not." App. Br. 39. Appellant argues that "[l]ooking back on how things eventually panned out over time – to see whether the projections came true or not – is not the legal standard." App. Br. 28. Appellant's argument is a fiction.

Appellant's Brief is rife with oft-repeated general statements as to the legal standard(s) to be applied in valuation cases such as the one at bar, each time culminating in one or more conclusory statements that the IAS Court erred in failing to follow or apply such standards, without citation to the Record to support those conclusory statements. In reality, the IAS Court did not "look back" (or forward) on how things eventually panned out over time post-Valuation Date when rejecting the Management Forecasts. At the risk of repeating this *ad nauseam*: by the time of the Valuation Date – *prior to September 20, 2015* – the Management Forecasts were *already* patently unrealized and unreliable. *See, e.g.*, R. 788-89, 967. The IAS Court did not, and had no need to, look beyond the Valuation Date to disregard the Management Forecasts and the valuation of Appellant's Expert.[4]

[4] What can be described as little more than sheer irony is that it was *Appellant's* Expert who impermissibly relied upon post-Valuation Date information as part of his valuation. Specifically, Appellant's Expert used Kraus' annual 2015 financial statements ending December 31, 2015 – *three months after the Valuation Date*, and admitted several times to having used 2016 forecasts. R. 106, 134, 800, 844. Therefore, Appellant's valuation was the one in direct violation of BCL § 1118, which mandates that fair value be determined as of one day before the Petition was

Further, and most tellingly, Appellant has not (and cannot) point to a single finite example of something the IAS Court considered *after* the Valuation Date. Nowhere in the 42 page Brief does Appellant provide a single citation to the Record to support his claim. It is not enough for Appellant to infer superficially that, since the IAS Court rejected the Management Forecasts, it must have considered something beyond September 20, 2015. Such phantom presupposition has no basis in the Record. The IAS Court's rejection of inflated Management Forecasts, predicated on ambitious and overstated projections that were not realized, is not tantamount to the utilization of the wrong valuation date. As summarized in Section V B. 2 *supra*, the IAS Court heard and saw evidence from Respondents' Expert, as well as from the individual Respondents and CFO Lusby, that the Management Forecasts were proven wrong, unreliable and not credible as of the Valuation Date. There is not a scintilla of evidence in the Record to support Appellant's claim that the IAS Court looked at, let alone based its Decision upon, post-Valuation Date facts.

Appellant relies on two cases to support its fantastical argument, but such reliance is – to put it mildly – misplaced. *Murphy v. U.S. Dredging Corp*., 74 A.D.3d

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filed. Appellant should only have used the interim financial statements, available through September 30, 2015. As Appellant concedes, using data post Valuation Date is improper, the Kraus' 4th quarter financial statement should not have been used.

Had the IAS Court adopted Appellant's Expert's approach, *then* it would have looked beyond the Valuation Date.

815 (2d Dep't 2010) and *Miller Bros. Indus. v. Lazy River Inv. Co.*, 272 A.D.2d 166, 167-8 (1st Dep't 2000), both stand for the proposition that a court cannot consider new or unknown additional earnings or liability occurring after the set valuation date. Neither case mandates, by any measure, that a trial court is constrained to accept an internal company forecast as the proper measure of future growth no matter how unreasonable and irrespective of whether such forecasts were proven unreasonable and overstated prior to the Valuation Date.

Appellant's reading of *Murphy* is tortured at best. In *Murphy*, a dissenting minority shareholder sought fair value for his shares as of a statutory valuation date. The majority shareholders met *after* the valuation date and awarded themselves a generous pension. The majority then argued that the same post-valuation date pension liability from which they benefited should also depress the company's value creating a windfall for them while frustrating the minority's rights. They argued that even though the pension liability was foisted on the company after the valuation date, the idea of the pension was previously discussed verbally and, thus, was known or knowable evidence that the trial court properly considered. Unsurprisingly, the appellate court disagreed holding that the trial court "improperly considered a liability for pensions awarded to the Corporation's officers pursuant to a resolution dated March 29, 2006, after the valuation date of February 13, 2006." 74 A.D.3d at 818.

In *Miller*, dissenting shareholders unhappy with a tender offer made in connection with a merger, sued claiming that 11 months post-merger, the company did much better and *ergo*, the tender offer was too low. Much of the debate in *Miller* focused on whether these improved earnings were ever known, knowable or projected pre-merger. In discovery, the dissenting shareholders could never come up with any evidence that such projections existed. Furthermore, they offered no expert testimony on the point. With no evidence and no expert, the appellate court had little difficulty determining that the dissenting shareholders had failed to make their case. 272 A.D.2d. at 167-168.

Neither *Murphy* nor *Miller Bros.*, nor any other case anywhere, compel the IAS Court to treat internal company forecasts as gospel when performing a BCL § 1118 valuation. The *Murphy* case has nothing to do with projections at all. The *Miller Bros.* case mentions projections in a completely different context. In other words, *Miller Bros*. does not stand for the proposition that if projections exist they *must* be used. Rather, the court noted that had the post-merger increase in income been reflected in pre-merger projections then maybe (just maybe) the dissenting shareholders would have something to argue. The holding is a far cry from the proposition for which it is cited. Ultimately, Appellant offers a torturous presentation of these cases to mislead this Court into believing something that simply does not exist, and consequently, those efforts should be rejected.

Importantly, Respondents presented the IAS Court with overwhelming authority that, in valuation proceedings, the trial court is not confined to accepting internal company projections or forecasts – particularly where, as here, companies have a confirmed history of falling short of their own projections. *See, e.g.*, *In Re Cysive, Inc. Shareholders Litigation*, No. 20341 (Del. Chan. Ct. August 15, 2003) (considering the weight given to "management projections", rejecting the shareholders' claim, and affirming the appraiser's decision to apply zero value to the company-produced software in that case, finding that while management had projected substantial revenues from the sale of the software in issue, those projections were totally unreliable because the revenue was never realized); *In re Global Technovations, Inc.*, 2010 WL 2671706 (Bankr. E.D. Mich.) (rejecting expert's Discounted Cash Flow Analysis, finding, among other things, that the company "had demonstrated a historical inability to create accurate projections..."); *In PetSmart, Inc.*, 2017 WL 2303599, at page 86 (Del Ch 2017) ("this court has deemed projections unreliable where the company's use of such projections was unprecedented, where the projections were created in anticipation of litigation, where the projections were created for the purpose of obtaining benefits outside the company's ordinary course of business, where the projections were inconsistent with a corporation's recent performance, or where the company had a poor history of meeting its projections.").

Moreover, although the IAS Court did not do it here, a court *is* entitled to consider subsequent facts "to evaluate the accuracy of opinions of value that may have been formed close to the valuation date." *Estate of Roberts v. Commissioner*, T.C. Memo. 1969-10, 49 (*citing Tex-Penn Oil Co. v. Commissioner*, 83 F.2d 518 (3d Cir. 1936), *aff'd* 300 U.S. 481 (1937)) (court increased valuation of contract payments where petitioner's valuation was based on erroneous assumptions as to company's financial position at the valuation date). No case cited by Appellant precludes a "reality check" on if hypothetical assumptions inherent in a valuation analysis resemble what actually transpired given the passage of time. In fact, case law from the Delaware Court of Chancery adopted in New York cautions *against* reliance on "*pro forma* data and projections of a speculative variety." *Weinberg v. UOP, Inc.*, 457 A.2d 701 (Del. Ct. Ch. 1983) (*cited by Miller Bros.*, *infra*, relied on by Appellant).

Here, the IAS Court did not use or consider unforeseen post-Valuation Date events to alter Kraus' fair value. Appellant's claim that "[a]ll of the evidence confirmed that the projections were realistic, and there was no proof to the contrary" (App. Br. 27) is simply and stunningly false. Instead, the Record resoundingly demonstrates that the IAS Court was correct in having determined that "Paulikens' income approach was based on unrealistic projections, proven to be unrealized and wrong." R. 9. Thus, there is no basis for Appellant's appeal.

C. The IAS Court Properly Considered All of the Evidence, Not Just the Management Projections

Appellant places disproportionate emphasis on the Management Forecasts. While relevant, they are by no means the end all be all of a valuation analysis and the IAS Court did not treat them as such. Consistent with prevailing law, which holds that "valuing a closely held corporation is not an exact science," (*Matter of Seagroatt Floral Co., Inc.*, 78 N.Y.2d 439, 445 (1991)) the IAS Court dutifully considered a "variety of evidence and methods aimed at determining the price of [Appellant's] minority interests" (*id.*) including: (i) Kraus' relative youth, (ii) the inexperience of its management team, (iii) its negative cash flow, (iv) its substantial debt, (v) the fact that the company was not "especially liquid", (vi) the strength, *vel non*, of its brand name (which the company did not even own) and (vii) the highly competitive nature of the internet business where household goods, such as sinks, can and are sold by any reseller with a website. R. 8-10. After taking everything into account, the IAS Court found that while Kraus was "successful and growing" it was not especially liquid and that while Kraus had a "successful business model" it also had "debt and cash flow issues." *Id.* In short, the IAS Court weighed all of the evidence – good and bad – in its totality and exercised discretion. In a valuation proceeding the "final decision lies with the judge, who can confirm or reject the recommendations and findings [of experts] as a whole or, in part, and, if so disposed, make different findings." *Matter of Cohen*, 168 Misc. 2d 91, 95 (N.Y. Cnty. 1995).

Appellant elevates the Management Forecasts to *cause celebre* not because they are determinative or dispositive of value, but because Appellant has nothing else to go on. However, all of the evidence pointed to the fact that as a whole, Appellant's exaggerated valuation was a means to achieve a self-serving litigation objective, not an objective assessment of Kraus' value. Through cross-examination, the premises and assumptions underlying Appellants valuation were proven to be unreliable and economically unrealistic. As explained *supra,* Appellant's expert used the Management Forecasts to impute aggressive future earnings from sales of products not developed or launched as of the Valuation Date. Then, while projecting aggressive future earnings, Appellant neglected to include the working capital demands associated with these future sales. R. 1027. Put differently, Appellant prognosticated that Kraus' sales would grow exponentially but did not calculate the cost of those sales. Appellant also neglected to consider where the working capital necessary to achieve these future sales would come from. As of the Valuation Date, Kraus had used all of its available credit. It had no more money to borrow and no other sources of working capital waiting in the wings. Testimony at trial showed that what Appellant was proposing was economically impossible. To achieve metrics advocated by Appellant, Kraus would have had a $2.9 million dollar working capital deficit *as of the Valuation Date.* R. 1104. That is precisely why the IAS

Court found that Kraus was successful but "illiquid" and struggling with "debt and cash flow issues." R. 7-9.

In the course of the trial, the extent of the experts' investigation and the validity of their assumptions were tested and laid bare before the finder of fact. Block by block, the foundation upon which Appellant's position was built crumbled, as noted by unmistakable credibility determinations apparent on the face of the IAS Court's decision. R. 7-10. The IAS Court considered the evidence and afforded it the weight it was due. Appellant's own case law seals its appellate fate as "deference is owed to the credibility findings of the [Court] who heard the [expert] witnesses and was in the best position to determine the factual issues." *Cohen*, 168 Misc. 2d at 95.

There is one final point to be made. At page 2 of its decision, the IAS Court notes that Appellant's "request that the court average the two incredibly disparate valuations is rejected." This one sentence says an awful lot. The two techniques employed by Appellant's Expert resulted in two vastly different conclusions. Appellant asserted that under the income approach Kraus was worth $21 million dollars yet under the market approach, the value was $39 million dollars. Respondents hammered the home the discrepancy throughout the trial. In post-trial briefing, unable to intelligently explain or reconcile the breathtaking inconsistency between the two values, Appellant urged the IAS Court to simply

average both and call it a day. This request, a desperate hedge, revealed the disingenuousness of Appellant's entire position. Appellant's income-based methodology cannot be so inviolate that its rejection is outright error and yet so malleable that it can be halved when it suits Appellant's needs. Nor can Appellant complain that the IAS Court rejected his Expert's market comparables when Appellant himself was willing to cut those comparables in half at the drop of a hat. The IAS Court saw right through Appellant, as should this Court. The is no colorable basis for any claim of error and the Judgment below should be affirmed.

VI. CONCLUSION

For the foregoing reasons, Appellant's appeal should be denied in full and the IAS Court's determination should be affirmed.

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