1104-a ✓

STATE OF NEW YORK
SUPREME COURT COUNTY OF MONROE

MICHELLE HAYES, MICHAEL R. HAYES, RICHARD HAYES, MARIE HAYES, and SHAUN HAYES,

Petitioners,

v.

SHEILA REYNOLDS, GERARD REYNOLDS, MAUREEN BARNES, RALPH BARNES, MARION HAYES as Trustee for KATHY HAYES, KEVIN HAYES and ONTARIO PLASTICS, INC.,

Respondents.

DECISION AND ORDER

Ind # 2004/11956

Respondents, Sheila Reynolds, Gerard Reynolds, Maureen Barnes, Ralph Barnes, Marion Hayes as Trustee for Kathy Hayes, Kevin Hayes and Ontario Plastics, Inc., have moved for a stay of proceedings under BCL §1104-a and directing the parties to proceed to value the shares of corporate stock pursuant to the methodology outlined in a shareholders agreement dated January 1, 1995.

Petitioners, Michelle Hayes, Michael R. Hayes, Richard Hayes, Marie Hayes and Shaun Hayes, have submitted a cross motion for the following relief pursuant to BCL §1118: (a) an order directing that a trial be held before the Court to ascertain and render a judgment for the value of petitioners' shares in the corporation as of October 14, 2004, with interest, and directing payment; (b) to the extent a bench trial is not granted, an order

directing that the valuation of the shared be based on the value of the corporation as of October 14, 2004 as provided by law, with interest, and that judgment be entered in petitioners' favor in that amount; and (c) an order directing respondents to post a bond or other security sufficient to secure petitioners for the fair value of their shares with interest.

The litigants in this matter have been involved in numerous court proceedings over Ontario Plastics, Inc. ("OPI") in recent years. OPI was originally owned and operated by two brothers, Leo J. Hayes and Michael J. Hayes. Both of the brothers have retired from the business and died and OPI is now run by the brothers' children who received most of the brothers' shares in January 1995, when the families executed a shareholders' agreement which provided that ownership and control of the company was to be divided equally between the two family groups: the Leo Hayes Group and the Michael Hayes Group.

Each family group currently owns fifty percent of the outstanding shares of OPI. Petitioner Michelle Hayes was installed as president of OPI by Leo and Michael Hayes in 1995, and she maintained that office until June 10, 2004 when she was removed from office by respondents. Respondent Kevin Hayes (a member of the Michael Hayes Group) has become estranged from his fellow members of the Michael Hayes Group and is now aligned with the Leo Hayes Group, giving that group a majority. Several court

proceedings have been brought relating to shareholder disputes that have arisen following Kevin Hayes' alignment with the Leo Hayes Group, but the specifics relating to those proceedings are not relevant to the discussion herein.

On October 15, 2004, petitioners commenced this proceeding for judicial dissolution pursuant to BCL §1104-a, alleging oppression and corporate mismanagement by respondents who, it is claimed, are attempting to drive them out of OPI, denying them a voice in OPI's affairs, and wasting the corporate assets. On November 4, 2004, the Leo Hayes Group served notice of their election under BCL §1118 to purchase the petitioners' shares. The BCL §1118 election states as follows:

> [Respondents]... hereby elect[], pursuant to §1118 of the Business Corporation Law, to purchase the shares of the petitioners herein, at their fair value and upon such terms and conditions as may be approved by the Court, including the conditions of paragraph (c) of §1118.

As the BCL §1118 election has been made, the sole issue to be determined in the course of this proceeding is the fair market value of the petitioners' shares. The parties disagree as to the method of valuation, which has led to the instant motions. Respondents have moved for a stay of proceedings under BCL §1104-a and an order directing the parties to proceed to value the shares of corporate stock pursuant to the methodology outlined in a shareholders agreement dated January 1, 1995. Petitioners have

submitted a cross motion as described above.

DISCUSSION

Disenfranchised minority shareholders in close corporation are entitled to turn to BCL §1104-a to seek protection from alleged oppressive conduct and corporate waste by way of a judicial dissolution. N.Y. BCL §1104-a (a)(1-2). See also In re Pace Photographers, Ltd., 71 N.Y.2d 737, 744 (1988). The BCL provides a complementary provision in BCL §1118. BCL §1118 provides the other shareholders in the corporation with "an absolute right to avoid the dissolution proceedings and any possibility of the company's liquidation by electing to purchase petitioner's shares at their fair value and upon terms and conditions approved by the court." Pace, 71 N.Y.2d at 744-45. Without obtaining a determination of the allegations of oppression and/or wrongdoing, the remaining shareholders can "avoid the potential drain and risk of dissolution proceedings by simply offering to buy out the minority interest." Id. at 745. "Thus, the Business Corporation Law protects both the right of the allegedly oppressed shareholder to liquidate an investment at fair value and the right of the remaining shareholders to preserve an ongoing - and likely prosperous - business." In re Seagroatt Floral Co., Inc., 78 N.Y.2d 439, 444 (1991)(citations omitted). The minority shareholders are "protected by a court-approved determination of fair value and other terms and

conditions of the purchase." Id. BCL §1118 states:

> (b) If one or more shareholders or the corporation elect to purchase the shares owned by the petitioner but are unable to agree with the petitioner upon the fair value of such shares, the court, upon the application of such prospective purchaser or purchasers to the petitioner, may stay the proceedings brought pursuant to section 1104-a... and determine the fair value of the petitioner's shares as of the day prior to the date on which such petition was filed....

Thus, while the central question in a BCL §1104-a action is liquidation, once a BCL §1118 has been made, "the central question" becomes "one of valuation." Pace, 71 N.Y.2d at 746. As the parties herein cannot agree to the valuation of the shares, the task of setting the value of shares falls upon this court pursuant to BCL §1118(b).

Respondents ask the court to direct the parties to value the shares pursuant to the methodology outlined in the January 1, 1995 shareholders' agreement. Petitioners, however, want the court to conduct a bench trial to determine the value of the shares. BCL §1118 "offers no definition of fair value and no criteria by which a court is to determine price or other terms of purchase." Seagroatt, 78 N.Y.2d at 445. "Rather, fair market value, being a question of fact, will depend upon the circumstances of each case; there is no single formula for mechanical application." Id. See also, In re Dissolution of Penepent Corp., Inc., 96 N.Y.2d 186, 193 (2001) (stating that fair value "will depend on the circumstances of each case").

"[T]he value to be ascertained [after an 1118 election] is that of an interest in a going concern rather than a share of a business in the throes of liquidation." Seagroatt, 78 N.Y.2d at 445. As valuation under BCL §1118 is "not an exact science," a court will "confront a variety of evidence and methods aimed at determining the price of minority interests in closely held corporations...." Id. "Value 'should be determined on the basis of what a willing purchaser, in an arm's length transaction, would offer for the corporation as an operating business...." Pace, 71 N.Y.2d at 748, quoting Matter of Blake v. Blake Agency, 107 A.D.2d 139, 146 (2nd Dep't 1985). The issue as to the valuation of OPI is therefore a matter for determination by the court. Id. at 747.

The impact of the shareholders' agreement entered into by the parties on valuation is the next line of inquiry. In re Pace Photographers discussed at length the impact a shareholders' agreement has on the determination of "fair value" under BCL §1118. Id. at 746-748. In Pace, the court noted the following:

> [I]n the absence of explicit agreement a shareholders' agreement fixing the terms of a sale voluntarily sought and desired by a shareholder does not equally control when the sale is the result of claimed majority oppression or other wrongdoing... (citations omitted). Here, the shareholders' agreement neither provided that an 1104-a dissolution proceeding would be deemed a voluntary offer to sell, nor fixed fair value in the event of an 1118 election. The buy-out provisions were explicitly limited to the desire of any

> party to 'sell, hypothecate, transfer, encumber or otherwise dispose of' his shares.

Id. at 747 (emphasis supplied). Consequently, the court concluded that the shareholders' agreement at issue in Pace did not contemplate "an 1104-a petition premised on abuse by the majority." Id. at 748. At the same time, however, the court observed that "it may well be that shareholders can agree in advance that an 1104-a dissolution proceeding will be deemed a voluntary offer to sell, or fix 'fair value' in the event of judicial dissolution, and that their agreement would be enforced." Id. at 747. "Participants in business ventures are free to express their understandings in written agreements, and such consensual arrangements are generally favored and upheld by the courts." Id.

Here, under Section 3 entitled Valuation of Stock, the shareholders' agreement between the parties states:

> (b) The Stockholders agree that the purchase price for stock determined under Paragraph 3 and Paragraph 2(b) of this Agreement represents the fair value of the shares for all sales of shares as contemplated under Section 1118 of the New York Business Corporation Law and that any sale of shares under Section 1118 shall be made on the terms and conditions set forth in this Agreement.

The parties in the shareholders' agreement chose to make the express agreement for valuation under BCL §1118 that was alluded

to in Pace.[1] This court, therefore, can and will use the valuation methodology set forth in the shareholders' agreement to make a determination as to the valuation of the shares of OPI. The valuation method is set forth in the shareholder's agreement at Section 3(a):

> It is agreed that, for the purpose of determining the purchase price to be paid for the interest of a stockholder, the value of all shares of stock shall be the value agreed upon by the stockholders at the close of each fiscal year during the company's existence, as evidenced by a written valuation statement executed and dated by the parties which shall be attached to this Agreement. In the event that the last written valuation agreement is more than one (1) year old, the purchase price shall be the last agreed value increased by the increase in fair market value of the Company between the last day of the fiscal year preceding the event

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[1] Thus, Matter of Pace Photographers, Ltd. clearly indicated that shareholders may, by "explicit agreement," establish an extra-judicial procedure for determining "fair value" in the event of an election under §1118. The problem in that case was the absence of such an explicit agreement. The shareholder agreement only provided a mechanism to determine the value of the stock in the event of a voluntary sale. The court held that "a sale occasioned by a § 1104-a petition premised on abuse by the majority does not fall within the contemplation of [a] shareholders' agreement regarding a [voluntary] sale," noting that the determination of "fair value" in the context of a forced buy-out under §1118 "may be very different from ... fixing value for a voluntary sale" (id., at 748). While a court in reaching a determination of fair value may take into account the shareholders' agreement regarding a voluntary sale (id., at 748), the court said that it may not, in the absence of an explicit agreement, consider those provisions as controlling (id., at 747). Here, we have a provision expressly applicable to a forced buy-out under §1118, and there is no suggestion that it is against public policy. Cf., Schimel v. Berkun, 264 A.D.2d 725, 728 (2d Dept. 1999).

> triggering application of this Agreement, and the date of the last agreement as to value, or decreased by the decrease in fair market during that period value of time. The Stockholders agree that the valuation of all of the shares of the Company for the year beginning January 1, 1995, and ending December 31, 1995, shall be $1,000,000.00. If the stockholders have never agreed to a value, then the value of all shares of stock shall be the fair market value of the Company, and the price per share shall be determined by dividing such fair market value by the total number of issued and outstanding shares of the Company....

Section 3(a) then continues and sets forth a procedures by which the company and the "responding party" must agree upon or exchange names of accountants to perform the valuation. If the parties fail to agree upon an accountant within a time frame specified, "then each shall select an accountant and the accountants so selected shall mutually select a third certified public accountant who shall independently appraise the fair market value of the Company." The "fair market value" is determined by the third certified accountant. Paragraph 3(a) provides that an appraiser is to be chosen in the same manner.

Petitioners have cross moved for a trial for determination of valuation of OPI. "A hearing is required only when there is some contested issue determinative of the application." In re Kline, 212 A.D.2d 1002, 1003 (4th Dep't 1995), citing Matter of Goodman v. Lovett, 200 A.D.2d 670, 670 (2nd Dep't 1994). Where a shareholders' agreement covers "involuntary redemptions and

served as the only basis from which the court could fix the fair value of the stock," a hearing is not warranted. Id. Given the methodology prescribed in the Agreement, it is difficult to foresee a scenario in which a hearing would be required, but I need not reach this question yet.

CONCLUSION

Valuation of the shares of OPI will occur pursuant to Paragraph 3 of the shareholders' agreement. Respondents' motion papers indicate that respondents and petitioners have exchanged the names of valuations professionals (both accountants and appraisers) to perform the valuation as contemplated by the shareholders' agreement. See Affidavit of Jason DiPonzio, ¶¶27-30; Shareholders' Agreement, §3(a). The correspondence attached to the Affidavit of Jason DiPonzio indicates that the parties did not agree upon an accountant or appraiser and that each side has put the other on notice of professionals they have selected. Pursuant to Paragraph 3(a) of the shareholders' agreement, the selected professionals, Robert Penta, CPA and Kevin Bruckner, MAI for OPI, and Edward Thaney, CPA and John Rynne, MAI for the Petitioners, will choose third professionals to conduct the valuation and appraisal. Inasmuch as there was never an agreed value under the Shareholders' Agreement, the first part of section 3(a) is not applicable, and the "value of all shares of stock shall be the fair market value of the Company," as

determined in the manner set forth in the balance of section 3(a). Because no valuation date is prescribed in the agreement in the case of an absence of prior agreement on value, the date provided in the BCL shall apply, which is October 14, 2004, as Petitioners contend. The calculation of interest shall be as provided in the BCL. Petitioners' concern about the 10 year payout provision of section 1(j) appears to be misplaced. Section 3(b) only incorporates section 2(b) of the agreement, and therefore section 1(j) is not applicable.

Respondents' application for a stay of proceedings pending the valuation of the shares pursuant to the methodology set forth in the shareholders' agreement is granted. See N.Y. BCL §1118(b) ("...the court, upon... application... may stay the proceedings brought pursuant to section 1104-a"). Petitioners' cross motions for a bench trial is denied without prejudice as premature.

Due to Petitioners' allegations of respondents' corporate waste in relation to their operation of OPI, petitioners seeks the imposition of a bond pursuant to BCL §1118(c)(2). "The primary purpose of the bond requirement under §1118(c)(2)is to protect minority shareholders against tactical fluctuations in their share prices during the valuation process. In re 212 East 52nd St. Corp., 185 Misc.2d 95, 99 (S. Ct. N.Y. Cty. 2000). In an effort to "preserve the Corporation's assets pending dissolution" and in light of the allegations of oppressions and

waste, the court has discretion to require a bond. Id. Petitioners' cross motion for an order requiring respondents to post a bond sufficient to secure petitioners for the fair value of their shares with interest is granted in principal. But I promised Mr DiPonzio that I would let him respond to Mr. Williams' post argument submission before settling any amount. Either settle the amount of bond forthwith, or respond to the post argument submission by March 11, 2005.

SO ORDERED.

KENNETH R. FISHER
JUSTICE SUPREME COURT

DATED: March 4, 2005
Rochester, New York