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QUESTIONS PRESENTED

Question #1 When valuing a corporation pursuant to New York Business Corporation Law § 1118 should the Court apply a discount for the lack of marketability of the shares of a closely held corporation?

The Court Below Answered “No”.

Question #2 When valuing an operating corporation pursuant to New York Business Corporation Law § 1118 should the Court value the corporation as an on-going concern?

The Court Below Answered “No”.

PRELIMINARY STATEMENT

This matter involves the filing of a Petition for Judicial Dissolution by the Petitioners pursuant to New York Business Corporation Law § 1104-a. Subsequent to the filing, the Appellant DAPA Communications, Inc. elected to buy out the shares of the Petitioners, pursuant to New York Business Corporation Law § 1118. The Petitioners and Appellant were subsequently unable to agree on a value for the Petitioners' shares and this matter came on for trial before the Hon. Larry M. Himelein J.S.C in the Supreme Court in Cattaraugus County, Little Valley, New York.

In its original decision, the Court used a liquidation value to determine the value of the shares of the Petitioners and applied a discount for lack of marketability to the interest of the Petitioners. [Record, Volume I, pp. 13 & 14].

The Petitioners subsequently filed a motion pursuant to New York CPLR R 4404 requesting the Court to modify its decision and make new conclusions of law and findings of fact. After oral argument on the motion, the Court changed its original decision and removed the

30% discount which it had applied to the Petitioners' shares based on lack of marketability. Judgment was subsequently entered by the Petitioners and the Appellant filed this Appeal from that judgment. [Record, Volume I, pp. 17 & 18].

Pursuant to an Order of Justice Himelein, execution on the judgment by the Petitioners was stayed on February 1, 2008 by the Appellant posting a bond in the amount of \$58,850.18 with the Cattaraugus County Treasurer. [Record, Volume III, pp. 705-707.]

ARGUMENT

I. THE NEW YORK COURT OF APPEALS HAS MANDATED THAT WHEN VALUING A CORPORATION, THE LACK OF MARKETABILITY OF THE SHARES MUST BE CONSIDERED.

The Petitioners have argued in their answering Brief that any discount for lack of marketability may only be applied to the intangible asset of good will. The Petitioner cites for this proposition a line of cases from the Second Department which are not binding on the Fourth Department Appellate Division.

However, the New York Court of Appeals, despite the claims of Petitioners, has mandated in Amodio, that the lack of marketability of shares must be considered when valuing a company.

Whatever method is used, however, must take into consideration inhibitions on the transfer of the corporate interest resulting from a limited market or contractual provisions (*see* 3 Foster, Law and the Family, *op. cit.*, at 645; 11C Zett New York Civ.Prac. *op. cit.* at 69-25, 69-46-69-48; *cf.*, Matter of Blake v. Blake Agency, *supra*, 107 A.D.2d at 149, 486 N.Y.S.2d 341).” Amodio v. Amodio, 70 N.Y.2d 5, 516 N.Y.S.2d 923.

Therefore, the Court of Appeals has clearly mandated that a lack of marketability must be taken into account when valuing the shares of a corporation. Furthermore, the Court added an invitation to compare its ruling in Amodio with Matter of Blake v. Blake Agency 107 A.D.2d

139, 486 N.Y.S. 2d 341 (2nd Dept. 1985). Matter of Blake is the root case of the series of four cases from the Second Department Appellate Division which Petitioner claims limit lack of marketability discounts to the good will component of assets. The Court of Appeals stops just short of stating the discount was improperly applied in Matter of Blake. But it is clear that in Amodio the Court of Appeals has advocated a different, broader approach to the application of discounts for corporate and commercial reality than has the court in Matter of Blake.

Petitioners quote from In Matter of Seagroatt stating that in regards to a specific method of calculating a discount for lack of marketability,

Certainly this court has never mandated one. Thus, to the extent respondent corporations suggest that illiquidity can only be taken into account by application of a percentage discount against value--such as the referee applied--the argument fails as a matter of law. Matter of Seagroatt Floral Company Inc., 78 N.Y.2d 439, 576 N.Y.S.2d 831 (1991).

The problem with Petitioners' argument is that the court in Seagroatt is not saying that a discount does not have to be applied. Rather, the court in Seagroatt is clearly saying that a discount does not have to be employed in any specific form or place in the calculation; but rather, can be employed in the calculation of value by a number of different methods and in different portions of the calculation. In fact, Petitioner has conveniently chosen to omit from its brief the statement of the court earlier in the same paragraph.

While lack of a public market for the shares of a closely held corporation should certainly be considered in determining what a willing purchaser would pay for such shares--which is the purport of the quoted language from Amodio, involving contractual restrictions on transfer--there is no single method for calculating that factor. Matter of Seagroatt Floral Co., Inc., *supra*.

Therefore, a discount for lack of marketability of the shares must be employed, but can be factored into the calculation by any number of means. There is no requirement that it be specifically labeled; merely that a discount for the marketability factor be employed. That means

that if the referee has applied the discount in some other portion of the calculation, such circumstance will be acceptable since the discount for lack of marketability would have been taken into account at another point in the calculation. Nowhere in Seagroatt does the Court state that there is no need to apply such a discount. In fact, the court in Seagroatt found that in that case, illiquidity had been properly factored into the calculation of the value of the corporation.

We agree with the Appellate Division as to the discount; its holding that illiquidity had indeed been considered by petitioners' expert more closely comports with the weight of the evidence than that of the trial court adopting the Referee's findings. Matter of Seagroatt Floral Co., Inc., *supra*.

The case law is clear and the New York Court of Appeals has mandated, that in valuing shares of a corporation under BCL §1118, a discount must be applied, in some form, for lack of marketability of shares of a closely held corporation. That discount is not to be applied to the marketability of the assets of the corporation, but rather to the shares themselves. Shares of a closely held corporation are not discounted because the assets are either easy or difficult to sell. The shares of a closely held corporation must be discounted because of the lack of a market for the **shares**. Therefore, in the case at bar, the failure by the trial court to apply a lack of marketability discount to the shares of Dapa Communications, Inc., was a serious error which warrants reversal of the decision of the lower court. Therefore, this Court should vacate the decision of the trial court which failed to apply the proper lack of marketability discount.

II. THE NEW YORK COURT OF APPEALS HAS MANDATED THAT WHEN VALUING A CORPORATION PURSUANT TO NY BCL § 1118, AN OPERATING CONCERN VALUE MUST BE USED.

A. The Petitioners Determined Only A Liquidation Value For The Corporation.

The Petitioners state in their answering Brief "...when the Courts generally recite the mantra that, in general, the corporation should be valued as an on-going concern, that is for the

benefit of the party to be bought out because such a valuation would generally result in a higher determination of value than one based on a liquidation value.” Of course, the Petitioner provides no authority for this statement because the statement is in fact, completely false. The New York Court of Appeals has clearly mandated in Matter of Seagroatt that when valuing a business under BCL § 1118, an on-going concern for operating business value must be employed.

The objective of a proceeding under Business Corporation Law § 1118--including the one now before us--is to determine what a willing purchaser in an arm's length transaction would offer for petitioner's interest in the company as an operating business. Matter of Seagroatt Floral Company, Inc., *supra*. [Citations omitted].

Justice Kaye, in her decision, insightfully recognizes that the statutory scheme in fact requires valuation as an on-going concern. In speaking about BCL § 1104-a and §1118 she states:

The statute allows holders of 20% or more of the outstanding shares of a corporation to present a petition for dissolution based on any of several enumerated grounds, including oppressive acts by the directors or those in control of the corporation. (Business Corporation Law § 1104-a[a][1]). In order to afford the other shareholders the option to continue the enterprise as a going concern, a buyout provision was concomitantly added as section 1118 of the Business Corporation Law. Under that provision, those interested in maintaining the business--a class of "prospective purchasers" explicitly limited to the other shareholders or the corporation itself--may within 90 days of the filing of an 1104-a petition elect to purchase the shares owned by the petitioners (Business Corporation Law § 1118[a], [b]). 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. Matter of Seagroatt Floral Company, Inc., *supra*. [Citations omitted].

Justice Kaye recognizes that once the election is made to purchase the business, liquidation value has no application. What is being purchased is an interest in an on-going operating concern and therefore the value of the shares must be determined on that basis. The right of the petitioner to liquidation of the corporation's assets is lost upon the exercise of the

rights afforded to a respondent under BCL §1118. Therefore, the statement by Petitioners that this is simply a mantra recited by the Courts is in fact incorrect and completely overlooks the meaning and intent of the relevant statutes as enacted by the Legislature. Absent 1104-a, the petitioner has no right to liquidate the assets of the corporation. After an election under §1118, the right to liquidate the assets of the corporation is gone. Therefore, what must be valued by the court is the worth of the shares in an on-going concern; one in which the petitioner has no right to cause the assets of the corporation to be liquidated.

The court below recognized that there was a problem with using a valuation method other than as an on-going concern. The court stated:

Initially, the Court wishes to stress its discomfort in valuing this company by it's [sic] net asset value. As I noted in the August 16, 2007 decision, for BCL 1118 purposes, the overwhelming weight of authority holds that a business should be valued as a going concern. [Citations omitted]. [Record, Volume I, p. 16].

Therefore, the lower court recognized that there was a serious conceptual and legal problem with using something than an on-going or operating concern value in determining the value of the Petitioner's shares under BCL § 1118.

Despite the protestations of the Petitioners in the case at bar, the case law is clear that the value of the Petitioner's shares should have been determined on an on-going or operating concern basis and not by means of the liquidation value. Consequently, the decision of the lower Court was clearly in error in using a liquidation value to determine the value of the Petitioners' shares.

B. The Appellant Did Value The Company As An Operating Concern.

The Petitioners in their Brief falsely state that neither party's expert valued the company as an operating concern. This is a deliberate misstatement of the truth. While the Petitioners' expert admitted under cross-examination that he had not done any valuation of the corporation as

an on-going or operating concern, the Appellant's expert did in fact perform such a calculation. In fact, Appellant's expert, Darren Graff of the Phoenix Consulting Group performed calculations on a number of bases. These included calculations for Dapa Communications, Inc., both as to its value as an on-going concern and also as to its liquidation value. This point was discussed in the lower Court's decision of August 16, 2007. The court stated:

Respondents [Appellants] argue that petitioners initial approach was correct and the company should be valued as an ongoing concern. Their expert, Darren Graff, a CPA with the Phoenix Consulting Group on Grand Island, testified that, as a going concern, the company is worth zero dollars. Alternatively, Mr. Graff opined that, using liquidation value, petitioners' shares in the company are worth \$26,136. (Record, Volume I, p. 12).

In fact, Appellant's expert Mr. Graff was asked about on-going concern value on direct examination. Mr. Graff stated his expert opinion as to the value of the 34% interest of the Petitioners in Dapa Communication, Inc. on an operating concern basis. He stated that under the market approach or the income based approach the value of the Petitioners' shares would be zero dollars. [Record, Volume I, p. 219].

In direct contrast, the Petitioner's expert did not do any calculations as to the value of the Petitioners' shares on an on-going or operating concern basis. In fact upon cross examination the Petitioners' expert stated:

“Q. So, to be clear, you made no calculation as to the 34 percent interest in an ongoing business?”

A. I determined it was not appropriate to use, that's correct.

Q. And so, you didn't actually make the calculation of what the dollar value of that business would be?

A. As I said, I deemed in inappropriate to use that method, so no.

Q. So, no, you didn't make the calculation?

A. That's a true statement.

Q. Okay. You assumed a liquidation value?

A. True. [Record, Volume I, pp. 122 & 123].

The Petitioners, before trial, had argued in a pre-trial memorandum that on-going concern value was the correct measure of value for Dapa Communications, Inc. [Record, Volume I, p.11]. However, by the day of trial, the Petitioners had changed their position and now claimed that liquidation value was the correct measure for the Petitioners' shares. One might conclude that the change in position resulted from the fact that the Petitioners discovered before trial that on an on-going concern basis their shares were worth much less than they had believed.

In any event, the statement by the Petitioners that neither party presented any evidence as to on-going concern or operating concern value of the petitioners' shares is simply not true. The clear and unequivocal evidence of the Appellant was that the value of the Petitioner's shares in the corporation calculated on an on-going concern basis was zero. That expert evidence was not refuted by any testimony presented on behalf of the Petitioners. As before stated, since the lower court performed the valuation of Dapa Communications, Inc. on an improper basis, namely a liquidation basis, the decision of the lower Court must be vacated.

III. THE LOWER COURT'S DECISION HAD NO EVIDENTIARY SUPPORT AND THEREFORE HAD NO RATIONAL BASIS.

The lower court was presented with two different values for the shares of the Petitioners. The two alternate values were provided by the expert witness for each party. Additionally, the Petitioners introduced evidence that there were numerous items carried on the balance sheet for less than that which they claimed was market value. The lower court was free to choose whichever value it felt was supported by the evidence. However, in both its initial decision, and

in its later decision, the lower court made clear that it discounted the testimony of the Petitioners as to the value of those certain items. [Record, Volume I, p. 14 and p. 17]. Therefore, the court below was left with the two different values for the Petitioners' shares presented by the two experts. However, instead of selecting one of those values, the lower court selected a value in between the two values supported by the two experts. The court did not explain the rationale behind this selection of a value for the Petitioners' shares. Furthermore, because the court had deliberately disregarded the Petitioners' testimony as to value of certain items, it is apparent that there was no evidentiary support for the value which the court assigned to the Petitioners' shares. Because there was no evidentiary support or rational basis for the assignment of value to the shares by the lower court, the choice of a value was arbitrary and capricious. Consequently, the decision of the lower court must be vacated by this Court.

CONCLUSION

Despite the protestations of the Petitioners, the New York Court of Appeals has mandated a number of factors and standards which must be employed when valuing a corporation pursuant to NY BCL §1118. First, a discount must be applied at some point in the calculation to reflect the fact that there is a lack of marketability of the shares of a closely held corporation. Secondly, the value of the shares must be determined as the value of shares in an on-going, operating concern, and not the shares of a company in liquidation. Liquidation value may not be used.

However, the court below both failed to apply a discount for lack of marketability and also failed to value the Petitioners' shares as the shares of an on-going, operating concern. Instead, the lower court used the value of a corporation in liquidation, an approach even the lower court itself was uncomfortable with. [Record, Volume I, p. 16]. For either of these reasons alone, this Court should vacate the decision of the lower court.

Additionally, the decision of the value of Dapa Communications, Inc. was not in agreement with the value selected by either party's expert, but was merely selected at will by the lower court. Since the decision was not supported by the evidence and was not rational, the selection of a value for the shares was arbitrary and capricious. On these grounds alone, the lower court's decision should be vacated.

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