July 12, 2005 reflected was, as he acknowledged, "the representation of management." (R. 500). This was so even though:

> Management has elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included with the balance sheet, they might influence the user's conclusions about the Company's financial position. Accordingly, this balance sheet is not designed for those who are not informed about such matters. (Id.; see R. 165).

Why this is important is that the Company's own contemporaneously-produced reports (and also its virtually identical reports prepared approximately four months later) showed total shareholders' equity of approximately $622,000 on June 30, 2005, and approximately $595,000 on July 31, 2005. Yet, through the magic of relying on management's representations -- made after the commencement of this litigation -- Mr. Proto compiled management-provided figures that resulted in a total shareholders' equity figure of only $165,223. (R. 164, 501). That is less than 28% of what the Company reported both as of 12 days prior to the valuation date, and 19 days after the valuation date. This was so even though the tax returns for 2004, signed by the Company and by Mr. Proto, used the higher inventory figures that Mr. Koller used. (R. 93-94).

Obviously, at some point after the fact (and after litigation was commenced), the numbers were adjusted to lower the value of the inventory. (R. 95, 181-183, 191-193, 502, 525). If this was done to reflect depreciation, it was the Company's decision how quickly to accelerate depreciation and that would not affect the true market value of such equipment. (R. 114-115, 237 [Mr. Graff acknowledging that "equipment could be worth more than its depreciated value"], and 247-248 [also acknowledging that his company's website says that book value is "usually much lower than the true value"]). While the Company had adjusted the value of inventory previously, it had done so in much smaller amounts. (R. 185-186). Mr. Proto conceded that if the Company told him "they had zero inventory" he "would have plugged" that in. (R. 172). In fact, Mr. Czock did assign a value of zero to all of the finished products. (R. 191, 239-240). This was done while knowing that it would benefit the Company in this litigation to have a lower number. (R. 194; see R. 206). Similarly, Mr. Graff acknowledged that he, too, would "[l]ikely" have used whatever number management told him for the value of inventory. (R. 270-271).

In both of its Decisions, the court below consistently used a total value of the Company of $180,000. (R. 14, 15, 18). How, then, can Respondent complain on appeal about the Court's ultimate determination when it is so close to what it claimed, yet so far below what Petitioners claimed based on Respondent's own documentation as to its value?

Respondent's expert reduced even the figure Mr. Proto arrived at by first reducing it (he started with $167,088 instead of 165,223) by $20,670, which he referred to as "fair market value adjustments." (R. 545; see R. 165-167, 187, 233-234, 270). He then applied, cumulatively, a minority discount of 25% and a lack of marketability discount of another 30%. (R. 545). As discussed in the Argument section of this Brief, a minority discount is improper as a matter of law, and a lack of marketability discount is not appropriate when valuing hard assets, only goodwill, which was not valued by either expert. Thus, both of these discounts would be inappropriate.

The trial court found that the value of DAPA was $180,000. This was well within the range of the evidence presented: approximately $728,000-$755,000 by Petitioners' expert and approximately $146,000 by Respondent's expert (including the nearly $21,000 reduction but not counting the inappropriate discounts applied). While it should have been Petitioners who appealed, they chose not to and respect the determination of the trial court, which should be affirmed in all respects.

## ARGUMENT

I. THE TRIAL COURT DID NOT COMMIT REVERSIBLE ERROR BY NOT APPLYING A LACK OF MARKETABILITY DISCOUNT TO PETITIONERS' SHARES WHERE GOODWILL WAS NOT PART OF EITHER EXPERT'S VALUATION OF SUCH SHARES

Both sides' experts valued DAPA, and hence Petitioners' 34% share of DAPA, using the same method: one based on valuing the assets of the Company. Petitioners' expert, Mr. Koller, referred to this method as "the adjusted net asset value approach." (R. 445). Respondent's expert, Mr. Graff, referred to it as "the asset-based approach." (R. 530). Mr. Koller noted that there were a number of generally accepted methods to use in valuing a closely held business, and stated why he chose the adjusted net asset value approach. (R. 444-445, 77). He pointed out that "[t]he logical calculations was to come up with some liquidating value since I had little access to continuing information." (R. 77). Indeed, prior to trial Respondent had opposed Petitioners' request to produce certain books and records of DAPA, and cross-moved for a protective order, with the result being that Respondent only had to produce business records that pre-dated July 13, 2005. (R. 55). Thus, Respondent effectively precluded Petitioner from doing anything but an asset-based valuation.

Similarly, Respondents' expert also expressly rejected the use of valuation methods other than the asset-based approach. Mr. Graff stated that "**the market approach to estimate fair value of the interest was not utilized**" (R. 538 [emphasis in original]); "[b]ased upon the above and because the capitalized economic interest method assumes a going concern premise of value, we determined that this method was not relevant." **Accordingly, the market approach to estimate fair value of the interest was not utilized."** (R. 538 [emphasis in original]); and **"the income approach to estimate the value was not utilized."** (R. 539) ([emphasis is original]). Rather, like Mr. Koller, Mr. Graff used "the asset accumulation method to determine value. This method is used to value a business based on the difference between the fair market value of the business assets and its liabilities." (Id.). Mr. Graff referred to this valuation method as a "sound" one and "determined that this approach and method were appropriate to arrive at a fair market value of the interest." (Id.).

Not surprisingly, both experts valued the same five elements of assets: cash, accounts receivable, prepaid expenses, inventory and equipment. (R. 445, 545). Mr. Koller used DAPA's internally prepared financial statements for June 30, 2005 and July 31, 2005. Mr. Graff used figures for July 12, 2005 which were never made available to Petitioners. (R. 246). However, he, like Mr. Proto, agreed that the differences between the two appraisals were not really dependent on which date was used but moreso on the adjustments made to each. (R. 246, 159-160).

The exact numbers used by each, and any adjustments made, are not relevant to the issue addressed in this Point of the Brief. What is relevant is that none of the five assets valued by each expert is, or includes, goodwill. Rather, only "hard" assets were valued, i.e., cash (including pre-paid expenses and accounts receivable, which would convert to cash), inventory and equipment. A lack of marketability discount, which Respondent argues must be applied, applies only to any goodwill component and not to these "hard" assets. See, Cohen v. Cohen, 279 A.D.2d 599, 600, 719 N.Y.S.2d 700 (2d Dept. 2001); Matter of Whalen v. Whalen's Moving & Storage Co., Inc., 234 A.D.2d 552, 554, 651 N.Y.S.2d 579 (2d Dept. 1996); Matter of Cinque v. Largo Enterprises of Suffolk County, Inc., 212 A.D.2d 608, 609-610, 622 N.Y.S.2d 735 (2d Dept. 1995); Matter of Blake v. Blake Agency, Inc., 407 A.D.2d 138, 486 N.Y.S.2d 341 (2d Dept. 1985).

In Cohen, supra, the Appellate Division held that the Supreme Court's determination on value "should be given great deference" and held that because the assets were real property, with no goodwill component, "the Supreme Court properly determined not to apply a discount for lack of marketability." (279 A.D.2d at 600).

In Matter of Whalen, supra, the Appellate Division actually modified the Supreme Court's valuation of the petitioner's 31% ownership of the closely-held corporation, increasing the valuation by $173,718 to eliminate the 20% reduction applied for lack of marketability. The court stated in ever-so strong language:

> However, the Supreme Court should not have discounted its operating value for lack of marketability. Such a discount should only be applied to the portion of the value of the corporation that is attributable to goodwill. *** Here, the operating value of the corporation is attributable solely to tangible assets. Thus, the value of the petitioner's shares must be increased by $73,718.

(234 A.D.2d at 554 [citations omitted]).

In Matter of Cinque, supra, the Appellate Division held that "[t]he Judicial Hearing Officer properly refused to discount the value of the petitioner's shares of the corporation due to their lack of marketability. Such a discount should only be applied to the portion of the value of the corporation that is attributable to goodwill. *** Here, the value of the corporation is attributable solely to real property and cash." (212 A.D.2d at 609-610 [citations omitted]).

Respondent has failed to even address any of these cases even though the same ones were relied upon below by Petitioners. Rather, Respondent relies on the case of Matter of Seagrott Floral Co., Inc., 78 N.Y.2d 439, 576 N.Y.S.2d 831 (1991), which Petitioners already distinguished on their post-trial motion. (R. 702). As noted therein, the court in Matter of Seagrott did not apply a lack of marketability discount.

In Matter of Seagrott, the Supreme Court approved a Referee's determination, which applied a 25% lack-of-marketability discount to the petitioner's expert's opinion as to the net asset value. The Appellate Division, Third Department, set aside the 25% discount. On further appeal, the Court of Appeals agreed with the Appellate Division that the discount was improper. The Court of Appeals rejected the respondent corporations' argument -- like respondent's argument herein -- "that an identifiable discount must in all cases be applied...." (78 N.Y.2d at 446). The Court stated (at 446-47):

> 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.

As such, Seagrott is controlling and Respondent's assignment of error in this regard must be rejected as a matter of law.

Even in Matter of Blake v. Blake Agency, Inc., 107 A.D.2d 139, 486 N.Y.S.2d 341, supra, where the court upheld a lack of marketability discount as to the portion of the total value of the corporation relating to its intangible value (i.e., its goodwill), it held that the referee was justified in not discounting the petitioner's share of net tangible assets. (See 107 A.D.2d at 142-143, 149, 151).

Other cases that Respondent relies on are inapposite either because the valuation method was not the net asset one (e.g., Matter of Brooklyn Home Dialysis Training Center, Inc., 293 A.D.2d 747, 741 N.Y.S.2d 280 [2d Dept. 2002] [investment value approach used for service business]; Matter of Vetco, Inc., 292 A.D.2d 391, 738 N.Y.S.2d 599 [2d Dept. 2002] [investment value approach used]; Matter of Funplex, Inc., 252 A.D.2d 923, 676 N.Y.S.2d 321 [3d Dept. 1998] [discounted cash flow methodology used]), or because goodwill was being valued and then discounted (e.g., Lehman v. Piontkowski, 203 A.D.2d 257, 609 N.Y.S.2d 339 [2d Dept.

1994] [goodwill of a medical practice]). Only the case of Hall v. King, 265 A.D.2d 244, 697 N.Y.S.2d 19 (1st Dept. 1999), even remotely supports the notion that a discount can be applied to tangible assets. However, as the Supreme Court's decision made clear, the plaintiff in Hall was estopped from opposing a lack of marketability discount because his own expert applied such a discount to the entire value of the corporation. (See 177 Misc. 2d 126, 135, 675 N.Y.S.2d 810 [Sup. Ct. N.Y. Co. 1998]). Thus, anything else said therein with regard to discounting tangible assets is dicta.

Thus, not only was the trial court not obligated to apply a lack of marketability discount, it was actually precluded from doing so under applicable case law since neither side's expert valued DAPA's goodwill. Each expert only valued the net assets of DAPA and no discount is, or would be, appropriate with respect to "hard" assets. Tangible assets do not lose their value merely because they are owned by a closely held corporation. See, Cohen v. Cohen, supra; Matter of Whalen, supra; Matter of Cinque, supra; Matter of Blake, supra. While a discount to reflect the illiquidity of shares that could not readily be liquidated for cash might be appropriate using a different valuation method, it clearly does not apply to a valuation of net assets, virtually all of which are cash or readily converted into cash.

This is why the trial court commendably modified its first Decision when, in its second Decision, it granted Petitioners' post-trial motion in part by eliminating a 30% discount that it had initially applied. While Justice Himelein had acknowledged that a lack of marketability discount "may not be appropriate when talking about selling hard assets" (R. 13), he nevertheless initially applied a 30% discount because he believed that "there would be significant costs involved in selling off the equipment." (Id.). He then applied the discount, stating he was doing so "whether deemed a lack of marketability discount or a cost of sale discount." (R. 13-14).

In his second Decision, Justice Himelein correctly recognized that "no proof of an appropriate discount was introduced, and theoretically, if the company simply sold its assets, there might be little, if any, costs associated with the sale." (R. 17-18). He, therefore, vacated "the 30% discount previously applied." (R. 18). This was entirely correct.

Since the court has the obligation to establish fair value, neither party necessarily has the burden of proof. See, Matter of Cohen v. Four Way Features, Inc., 168 Misc.2d 91, 636 N.Y.S.2d 994 (Sup. Ct. N.Y. Co. 1995), aff'd., 240 A.D.2d 225, 659 N.Y.S.2d 735 (1st Dept.. 1997). Logically, Respondent, not Petitioners, would want to have shown the court proof of any expected expenses in selling off assets. It did not do so, however.

In fact, cash and cash equivalents (prepaids and accounts receivable) could not possibly have expenses associated with their "liquidation." (See R. 127 ["Cash is cash."]; and R. 261-263 [Mr. Graff conceding the same point]). Even for the equipment and inventory, the trial court had already assigned valuation figures that were greatly reduced from their value as carried on the books of DAPA and as assessed by witness Michelle Cranston, who had checked and verified the value of certain "big ticket" items. Thus, using any further discount would have amounted to "double dipping" and the trial court, correctly and commendably, eliminated the discount originally employed upon recognizing that Respondent had not offered any proof of any supposed costs of sale of these "hard" assets.

Contrary to Respondent's repeated voicing of the claim that the trial judge was "conceptually confused" with respect to the lack of marketability discount (Brief, pp. 8, 16), the trial court correctly applied the applicable law to the facts, and justifiably did not apply a separate lack of marketability discount since both experts valued DAPA based on a net asset approach.

For these reasons, the trial court did not err in not applying a lack of marketability discount to DAPA's tangible assets, which were the only things being valued.

## II. THE TRIAL COURT DID NOT COMMIT REVERSIBLE ERROR BY NOT VALUING THE CORPORATION AS AN ON-GOING CONCERN WHERE NEITHER SIDE'S EXPERT DID SO EITHER

Respondent claims that the trial court erred in failing to value DAPA "an operating business" or "an on-going concern." Respondent fails to recognize, however, that when the courts generally recite the mantra that, in general, the corporation should be valued as an ongoing 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.

The trial court in Hall, supra, recognized this in considering the plaintiff's challenge to the report of the Referee, who relied on the testimony of the defendant's expert who used a net asset approach to valuation. The court noted that this approach does not include a value "for future business and new business" and "is directed at determining the present assets of a corporation, not its future potential." (177 Misc.2d at 131). The court acknowledged that this method "does not value certain intangibles which, by their nature, may have infinitely more value than tangibles, such as good will." (Id.).

That is the very reason why the Court in Matter of Pace Photographers, 71 N.Y.2d 737, 748, 530 N.Y.S.2d 67 (1988), cited by Respondent, held that a shareholder's agreement fixing value should not be used, but rather the court should determine value using all "pertinent evidence" with the objective of valuing the business as a going concern (citing Matter of Blake, supra, where the court valued both tangible and intangible assets). Obviously the Court was looking to maximize the value for the petitioner. Thus, where a higher value can be ascertained through a liquidation of assets, that method is not precluded.

Thus, the only complaint that could be advanced with respect to the use of the net asset valuation method is that it resulted in too low a valuation because it did not consider the value of all assets, including intangible ones. Certainly Respondent is not complaining that the trial court's determination of value is too low so it is incongruous for it to raise this point as a ground for its appeal.

Of course, the trial court has to base its findings on the proof presented at trial. Here, both sides' experts used the same valuation method:

a net asset valuation. Petitioners' expert, Mr. Koller, explained in his report that he did so, and testified at trial why, as follows:

> The logical calculations was to come up with some liquidating value since I had little access to continuing information. (R. 77).

This, coming from an individual who had valued businesses at least "a couple hundred times" (R. 76), should have, and presumably did, carry great weight. However, it was not as if Respondent's expert, Mr. Graff, disagreed with Mr. Koller's method of valuing DAPA. Indeed, Mr. Graff's report makes clear that he used the same method:

> **As the premise of value in this valuation is liquidation value (orderly liquidation), we determined that [the asset-based] approach and method were appropriate to arrive at the fair market value of the interest. (R. 530 [emphasis in original]).**

Similar to Mr. Koller, Mr. Graff also explained his choice of valuation methodology in his testimony, stating that he had used the "net asset value before," as well. (R. 163). His report explained why he did not use the other methods he considered (R. 529-530, 537-539), as did his trial testimony. (R. 215-219). He acknowledged that he and Mr. Koller "used exactly the same" method. (R. 242). So did Mr. Koller, in reverse. (R. 84-85). Mr. Graff concluded that the net asset value method was the only "proper method" because "there appeared to be some tangible value to the company." (R. 243-244). So, even if a company were losing money, "there is certainly tangible net value." (R. 245).

There "is no single formula for mechanical application" and thus value "will depend on the circumstances of each case." Matter of Burnham, 261 A.D.2d 863, 689 N.Y.S.2d 792 (4th Dept. 1999), citing Matter of Seagrott, supra. Certainly the trial court's approach was permissible, and given that both experts had used the same valuation method it was more likely mandated.

Because Respondent's own expert also used a net asset value method of valuation, Respondent is estopped from arguing that the trial court erred in basing its Decision on the method used by both sides' experts. Cf. Hall v. King, 177 Misc.2d at 135, supra (where plaintiff's own expert applied a discount, plaintiff was estopped from contending there should not be a discount).

For these reasons, the trial court did not err in using the net asset valuations that both sides' experts used, rather than an on-going concern value, which neither side's expert used.

## III. THE TRIAL COURT'S DETERMINATION OF THE VALUE OF PETITIONERS' SHARES OF DAPA WAS NOT ARBITRARY AND CAPRICIOUS

Preliminary, there is no "arbitrary and capricious" standard for the review of a judicial determination of value following a trial. Perhaps that is why Respondent cites no authority -- statutory or case law -- for its argument in this regard. The CPLR article 78 standard for challenging an administrative determination has no applicability here. Rather, this Court's review powers, pursuant to CPLR 5501(c), include the power to review questions of law and fact, and exercises of discretion. By arguing that the Decision was arbitrary and capricious, Respondent apparently is attempting to use this as a "catchall" argument in place of assigning specific claimed error to any determinations of fact or law, other than the two specific ones already addressed herein.

To the extent this argument may be treated as a contention that the trial court's finding of value was an erroneous determination on a question of fact, or unsubstantiated by the Record, it is without merit. "As the trier of fact, the Supreme Court's determination should be given great deference, especially in connection with issues of creditability, such as expert evaluation of property value." Cohen vs. Cohen, 279 A.D.2d 599, 719 N.Y.S.2d 700, supra. Indeed, this Court has repeatedly held that where the determination "is within the range of testimony presented, [it] will not be disturbed on appeal...." Matter of Petralia, 267 A.D.2d 1013, 701 N.Y.S.2d 193 (4th Dept. 1999); Matter of Burnham, supra; Matter of Penepent Corp., 198 A.D.2d 782, 605 N.Y.S.2d 691 (4th Dept. 1993), lv. to app. denied, 83 N.Y.2d 797, 611 N.Y.S.130 (1994); and see Matter of Carter, 2 A.D.3d 865, 769 N.Y.S.2d 393 (2d Dept. 2003).

Here, the trial court's findings and figures are supported in all respects by the Record evidence. While the value set by the court is far closer to the value proposed by Respondent, Petitioners have not appealed, recognizing that it was within the range of values presented by the respective experts.

Respondent states (Brief, p. 14), correctly, that "the Court was presented with two vastly different opinions as to the value of" DAPA. Respondent then acknowledges that "[t]he Court was free to choose between the amounts offered by either expert. However, the Court did not accept the testimony of either ... [expert]; but instead the Court assigned an arbitrary value to the assets of the company...." (Id. at 15). This "analysis" is flawed.

The trial court was not bound to accept either expert's opinion as to value *in toto*, all or nothing at all. Like the testimony of any other witness, the trial court, as finder of fact, was free to weigh such testimony as would a jury. See, generally, PJI 1:8; see PJI 1:90 ("[s]uch an opinion is subject to the same rules concerning reliability as the testimony of any other witness"; "it is entitled to such weight as you find" warranted). That clearly is what the court did here.

As Respondent points out (Brief, pg. 15), the trial court stated that it weighed the testimony of Mr. Czock for Respondent and Ms. Rateau for Petitioners. That resulted in the Court's ultimate valuation being much closer to Respondent's proffered value than Petitioners' proffered value. However, each side cross-examined the other side's witnesses, perhaps decreasing the weight such testimony would otherwise have had, and it would have more likely been "arbitrary and capricious" to have simply adopted either expert's opinion of value as is.

For example, Respondent's expert also employed a minority discount (in addition to a lack of marketability discount) (R. 545), which the courts of this state have uniformly held to be improper in an "election to purchase" situation such as exists here. See, Matter of Penepent Corp., 96 N.Y.2d 186, 194, 726 N.Y.S.2d 345 (2001); Matter of Blake v. Blake Agency, 107 A.D.2d 139, 486 N.Y.S.2d 341, supra. The court heard testimony in this regard because it had not yet researched this point, which was raised in Petitioners' pre-trial memorandum of law. (R. 118-120).

In its initial Decisions, the trial court correctly held that a minority discount was inappropriate. (R. 13). (The second Decision did not alter this finding.) Was the trial court obligated to reject Respondent's expert's opinion in total because of this defect? Under Respondent's analysis, ironically it would be. Cf. Matter of Carter, supra (the referee used a multiplier outside the range provided by the experts but this lowered the valuation so respondent, who sought a reduction in the valuation, could not complain). But this is not what the trial court had to do. It did not have to pick one value or the other. It was free to weigh both, along with all of the other testimony and exhibits. See Matter of Petralia, supra ("Here the court used the valuation method advanced by both experts. The court cannot be faulted for failing to adopt an appraised method or to consider stock sale data not relied upon by either expert.").

Since the trial court's finding of value was within the range of values proposed, and is well supported by the Record, it cannot possibly be found to be "arbitrary and capricious," which is not the correct standard of review, in any event.

## CONCLUSION

For all of these reasons, the Order and Judgment appealed from should be affirmed in all respects.

Dated: Tonawanda, New York
June 24, 2008

Respectfully submitted,

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