M E M O R A N D U M

SUPREME COURT QUEENS COUNT
CIVIL TERM PART 2

HON. ALLAN B. WEISS

MAN CHOI CHIU and 42-52 NORTHERN BLVD.,LLC,

Plaintiffs,

-against-

WINSTON CHIU,

Defendant.

Action #1

Index No. :21905/07

WINSTON CHIU,
Counterclaim Plaintiff/Third Party Plaintiff,

-against-

MAN CHOI CHIU,
Counterclaim Defendant/Third Party Defendant

-and-

HELEN CHIU and THERESA CHIU,
Nominal Counterclaim Defendants,

-and-

42-52 NORTHERN BLVD., LLC,
Nominal Counterclaim Defendant.

WINSTON CHIU,

Plaintiff,

-against-

MAN CHOI CHIU and NORTHERN BLVD., LLC,

Defendants.

Action # 2

Index No. 25275/07

I. Background

A. Introduction

There are two cases pending before the court: (1) *Man Choi Chiu and 42-52 Northern Boulevard, LLC v. Winston Chiu* (Index No. 21905/07) (the MCC action)and (2) *Winston Chiu v. Man Choi Chiu and 42-52 Northern Boulevard, LLC* (Index No. 25275/07) (the WC action).

This Court conducted the joint bench trial of these actions on October, 25, 26,27,28 , and 31, 2011; November 1, 2, 3, 28, and 29, 2011; December 2, 2011; February 2, 3, 6, and 7, 2012; March 14, 20, 21, 22, 28, and 30, 2012; and April 3, 2012.

Briefly, the plaintiff, Man Choi Chiu (MCC) , claims that in 1999, in order to assist his older brother, the defendant Winston Chiu (WC), in deferring the payment of federal taxes owed on the sale of California property, he allowed his brother to participate in the purchase of property located at 42-52 Northern Blvd., Long Island City, New York (the NB property). According to MCC, at no time did he intend that his brother have any real interest in a limited liability company formed to hold the property. MCC asserts that the tax returns, corporate resolutions, opinion letters, guarantees, etc. were all created to give the illusion of ownership without any real benefit in order to assist his brother in deferring the payment of federal taxes on the sale of the California property. On the other hand, WC alleges that his interest in the NB property was real, that tax planning was not his motive, and that a compensable interest in the amount of at least 25% was created.

B.. The Complaint in the MCC action

1. The First Cause of Action

MCC alleges the following: On or about May 13, 1999, he organized 42-52 Northern Boulevard, LLC (the LLC) for the purpose of acquiring commercial property known as 42-52 Northern Boulevard, Long Island City, New York (the NB property). By contract dated May 13, 1999, Weeks Office Products, Inc. sold the property to Henry Chiu, MCC's son, for $5,450,000, and MCC largely paid the purchase price by (1) making a $535,000 down payment, (2) refinancing other properties he owned or controlled to raise $1,272,566, and (3) obtaining a $3,500,000 mortgage. WC, the brother of MCC, paid $193,854 toward the purchase price for the purpose of obtaining a tax advantage pursuant to Internal Revenue Code § 1031 relating to the sale of property he owned in California. The first cause of action seeks a judgment declaring the extent of WC's ownership interest in the LLC, if any.

Pursuant to a decision and order of Justice James P. Dollard dated March 11, 2008, the first cause of action has been dismissed to the extent that MCC sought a judgment declaring that "Winston Chiu has, at best, a nominal financial interest or ownership interest in and to the LLC."

2. The Second Cause of Action

MCC alleges that in or about April, 2001, WC, falsely representing himself to be the sole member of the LLC, fraudulently transferred the NB property to a trust controlled by himself. After discovering the fraud, MCC began an action in the New York State Supreme Court, County of Queens, to set aside the conveyance (*Chiu v. Chiu,* Index No. 21170/02), and the Appellate Division, Second Department, eventually affirmed that part of a judgment rendered after trial which set aside the conveyance. (*Chiu v. Chiu,* 38 AD3d 619 [March 13, 2007].) The second cause of action seeks a judgment removing WC as a member of the LLC.

Pursuant to a decision and order of Justice James P. Dollard dated March 11, 2008, the second cause of action was dismissed. Upon reargument, Justice Dollard adhered to his determination in a decision and order (one paper) dated July 7, 2008.

C. The Counterclaims in the MCC Action and Third Party Causes of Action

1. The First Counterclaim and First Third Party Cause of Action

WC alleges that after the death of Henry Chiu (HC), MCC and his two daughters, Helen Chiu and Theresa Chiu, in breach of their fiduciary duties (1) deprived him of his rights to participate in the affairs of the company, (2) caused the company to incur unnecessary and inappropriate legal fees, and (3) permitted one of MCC's companies to occupy the building without paying rent. WC purports to bring the first counterclaim and first third party cause of action as a derivative claim on behalf of the LLC, and he seeks monetary and injunctive relief.

2. The Second Counterclaim and Second Third Party Cause of Action

WC alleges that Helen Chiu and Theresa Chiu are liable to him in his individual capacity for breaches of fiduciary duty and aiding and abetting the breach of fiduciary duty.

D. The Complaint in the WC Action

1.The First Cause of Action

The first cause of action seeks a judgment declaring, inter alia, the extent of WC's interest in the LLC. Pursuant to a decision and order of the Honorable Timothy J. Flaherty dated March 31, 2008, as modified and affirmed (*Chiu v. Chiu,* 71 AD3d 621 [March 2, 2010]), the first cause of action has been dismissed "to the extent that the first cause of action seeks a declaration that 'in all events [WC] has no liability to [MCC] or the LCC because of, among other things, the eight causes of action asserted in this complaint.' "

2. The Second Cause of Action

The second cause of action seeks a judgment permitting WC to withdraw as a member of the LLC and awarding him the fair value of his membership interest. The court notes that the Appellate Division affirmed that part of the order rendered by Justice Flaherty which denied MCC's CPLR 3211 motion directed toward the second cause of action. The Appellate Division held that plaintiff WC had alleged "a cognizable cause of action for a judgment declaring that the plaintiff properly withdrew as a member of the defendant 45–52 Northern Blvd., LLC ***." (*Chiu v. Chiu,* 71 AD3d 621, 622.)

3.The Third Cause of Action

The third cause of action seeks the dissolution of the LLC. The third cause of action has been dismissed to the extent that it alleges a failure to observe the formalities necessary to the formation of the LLC. (See the decision and order of Justice Flaherty.) The third cause of action otherwise "alleges a cognizable cause of action for dissolution of the LLC ***." (*Chiu v. Chiu,* 71 AD3d 621, 623.)

4. The Fourth Cause of Action

The fourth cause of action seeks a "set off" against "any amounts claimed by Man Choi Chiu." The fourth cause of action has been dismissed. (See the decision and order of Justice Flaherty.)

5. The Fifth Cause of Action

WC alleges that in May, 1999, he and HC signed an agreement providing that the former had the right to purchase 25% of the shares of the LLC for $25 and the latter had the right to purchase 75% of the shares of the LLC for $75 and that WC had the

right of first refusal to purchase HC's shares. WC alleges that MCC breached the May, 1999 agreement. The fifth cause of action has been dismissed. (See the decision and order of Justice Flaherty.)

6. The Sixth Cause of Action

The sixth cause of action alleges that MCC tortiously interfered with the agreement made between HC and WC. The sixth cause of action has been dismissed. (See the decision and order of Justice Flaherty.)

7. The Seventh Cause of Action

The seventh cause of action alleges that MCC "misappropriated" the LLC. The seventh cause of action has been dismissed. (See the decision and order of Justice Flaherty.)

8. The Eighth Cause of Action

The eighth cause of action alleges that MCC breached his fiduciary duty owed to WC as another member of the LLC. The eighth cause of action has been dismissed to the extent that it seeks to recover damages for breach of fiduciary duty occurring prior to October 10, 2004. (*See Chiu v. Chiu*, 71 AD3d 621.)

E. Relevant Prior Decisions and Orders

1. *Chiu v. Chiu* (38 AD3d 619 [March 13, 2007])

MCC brought an action to set aside WC's conveyance of the NB property to a trust he controlled. The Appellate Division affirmed that part of the judgment which set aside the conveyance, but, in effect, reversed that part of the judgment which found that WC was "never a member" of the LLC and precluded him from participating in its affairs. The Appellate Division also held that "the trial court lacked a proper factual and legal basis to grant the plaintiffs' application, after the close of the evidence, to amend the complaint to include a new cause of action for a declaration that Winston Chiu was merely a 'nominal member' of the LLC ***." (*Chiu v. Chiu* 38 AD3d 619, 620-621.) The appellate court noted that the LLC's tax returns for the years 1999 and 2000 both listed WC as a member having a 25% ownership of capital, profit sharing, and loss sharing and MCC as a member having a 75% ownership of capital, profit sharing, and loss sharing.

2. Dollard decision and order dated March 11, 2008 in the MCC action

Justice Dollard granted a motion by WC for an order dismissing the complaint against him pursuant to CPLR 3211(a)(1), (2), (4), (5) and (7) to the extent of (1) dismissing the first cause of action insofar as it sought a judgment declaring that WC had only a nominal interest in the LCC and (2) dismissing the second cause of action which sought a judgment expelling WC as a member of the LLC.

3. Dollard decision and order dated July 7, 2008 in the MCC action

Upon reargument, Justice Dollard adhered to his decision dismissing the second cause of action

4. Flaherty decision and order dated March 31, 2008 in WC action

Justice Flaherty rendered a decision and order pursuant to CPLR 3211(a) partially dismissing the first and third causes of action and dismissing the fourth, fifth, sixth, and seventh causes of action.

5. *Chiu v. Chiu* (71 AD3d 646 [March 2, 2010])

The Appellate Division, Second Department, affirmed the order rendered by Justice Dollard on July 7, 2008 and held that MCC had failed to state a cause of action for the expulsion of WC as a member of the LLC.

6. *Chiu v. Chiu* (71 AD3d 621 [March 2, 2010])

The Appellate Division modified the order of Justice Flaherty rendered in the WC action on March 31, 2008 by dismissing the eighth cause of action insofar as it sought to recover damages for breach of fiduciary duty occurring prior to October 10, 2004. The Appellate Division otherwise left the decision and order of the IAS judge undisturbed.

7.Strauss decision and order dated January 26, 2011in MCC action

Ruling on a motion brought by WC, Justice Strauss (1) denied him partial summary judgment declaring that he had a 25% interest in the LLC and (2) denied him summary judgment on his counterclaim for breach of fiduciary duty. Ruling on a cross motion by MCC and related parties, Justice Strauss, inter alia, granted that branch of the cross motion which sought an order *in limine* that the "buy out" value of WC's alleged interest in the LLC would be "limited to" February 9, 2008 and not thereafter. Justice

Strauss wrote: "In his decision of March 31, 2008, Justice Flaherty found that Winston's amended counterclaims were tantamount to the notice to withdraw, as required by the Limited Liability Company Law. Thus, this court finds that Winston is bound by this determination ***."

8. Strauss decision and order dated January 26, 2011 in the WC action

Justice Strauss, inter alia, rendered in an order in limine limiting WC's recovery of damages for breach of fiduciary duty to the period from October 11, 2004 to February 9, 2008.

9. *Chiu v. Chiu* (92 AD3d 922 [February 28, 2012]

The Appellate Division, Second Department, affirmed the denial of that branch of WC's motion which was for summary judgment declaring that his interest in the LLC is at least 25% since WC had not requested a declaration as to the precise amount of his interest in the LLC.

II. Findings of Fact

A. The Requirement that the Court Make Findings of Fact

CPLR 4213, " Decision of the court," provides in relevant part: "(b) Form of decision. The decision of the court may be oral or in writing and shall state the facts it deems essential." (*See, Whitaker v. Murray*, 50 AD3d 1185; *Kaywood Properties, Ltd. v. Glover,* 34 AD3d 645.) "While the court need not set forth evidentiary facts, it must state ultimate facts: that is, those facts upon which the rights and liabilities of the parties depend." (*Matter of Jose L. I.,* 46 NY2d 1024, 1025-1026; *Whitaker v. Murray, supra* ; *In re Erika G,* 289 AD2d 803.)

B. The Findings of Fact

1. In 1999, MCC decided to buy the NB property for the use of his companies that engage in the restaurant supplies and equipment business. Win Depot, Inc, owned by MCC, sells restaurant equipment and supplies, and it now occupies the NB property.

2. MCC permitted WC, his older brother, to invest $193,854.51 in a limited liability company formed to hold title to the NB property so that the latter could obtain a section 1031 tax advantage pertaining to the sale of property he owned in California.

3. MCC and WC formed the LLC on May 13, 1999 for the purpose of receiving title to the NB property. They did not sign an operating agreement.

4. They agreed to divide ownership of the LLC according to certain cash contributions each made toward the purchase of the NB property. MCC and WC made certain cash contributions of $581,562.93 and $193,854.51 respectively toward the purchase of the NB property. This resulted in an initial 75% - 25% ownership split.

5. The LLC bought the NB property in September, 1999 for a purchase price of $5,450,000.

6. Weeks Office Products, Inc., the seller, first deeded the NB property to WC and Mary Chiu, his wife, for the purpose of the section 1031 exchange. WC and Mary Chiu then deeded the property to the LLC.

7. MCC made the down payment for the NB property in the amount of $535,000. There were two checks drawn on East Bank, and HC delivered the checks.

8. 1-9 Bond Street Company is a real estate holding company for commercial property located on Bond Street, New York, New York, and MCC also owns this company. MCC refinanced this property to obtain part of the funds he needed to purchase the NB property

9. MCC made a loan to the LLC in the amount of $1,142,000, the proceeds of which he obtained from the refinancing of property owned by 1-9 Bond Street Company..

10. WC put $193,854.51 into the LLC for the two purposes of (1) obtaining a tax advantage pertaining to the sale of property he owned in California and (2) making an investment in the hope of profit. WC deferred capital gains taxes amounting to approximately $20,000 by making the section 1031 exchange.

11. WC also opened an account at Eastbank in the name of MCC's 1-9 Bond Street Company, placing $60,000 into the account. He made disbursements from this account to cover LLC expenses such as a bank application fee, a building inspection fee, and insurance, leaving a balance of approximately $42,000 which was then transferred into an LLC account.

12. The $60,000 WC placed into the 1-9 Bond Street account was a transfer of funds to MCC which was used for the purposes of the LLC, and the funds were credited to MCC as part of his capital contribution to the LLC by agreement of the parties. It was not a contribution by WC to the LLC placed in an account of the Bond Street company because the LLC had not yet been formed.

13. WC only made the $193,854.51 contribution to the LLC, and he made no other contributions. In dividing ownership of the LLC, the parties agreed not to take into account as contributions the guarantees given to obtain the purchase money mortgage for the NB property . The purported LLC Eastbank and Charles Schwab accounts opened by WC ,who alone had signature authority, were not actually LLC accounts.

14.. The LLC placed a mortgage on the property in the amount of $3,500,000. The guarantors of the mortgage were HC, WC, and two companies owed by MCC (the Win Restaurant Equipment and Supply Corporation and Win Restaurant Supplies, Inc.).

15.. MCC's initial cash contribution to the LLC amounted to $581,562.93 and WC's initial cash contribution to the LLC amounted to $193,854.51. MCC made 75% of the initial total cash contribution , and WC made 25% of the initial total cash contribution.

16. The LLC filed tax returns for 1999 and 2000 which were received by the Internal Revenue Service on August 7, 2001. The 1999 Schedule K-1 for MCC stated that his ownership of capital amounted to 75%. The 1999 Schedule K-1 for WC stated that his ownership of capital amounted to 25%. The 2000 Schedule K-1 for MCC stated that his ownership of capital amounted to 75%. The 2000 Schedule K-1 for WC stated that his ownership of capital amounted to 25%.

17. The LLC did not file tax returns after 2000.

18. On March 7, 2000, WC deposited $290,623 into an Eastbank account he opened in the LLC's name. WC did so in an attempt to gain the benefit from another section 1031 exchange involving another California property that he had sold. The sum increased to $302,856 with interest.

19. On March 7, 2001, WC closed the account at Eastbank and transferred the sum of $302,856 to an account at the Charles Schwab brokerage that he opened in the LLC's name and that he alone controlled.

20. . On May 21, 2001, WC wrote a check drawn on the purported LLC Charles Schwab account in the amount of $193,854.41 (just ten cents less than his contribution to the LLC) and deposited the check into a personal account he maintained at Charles Schwab.

21. On May 30, 2001, WC withdrew $60,000 from the purported LLC Charles Schwab account and deposited the funds in his own personal account at Charles Schwab.

22. WC did not withdraw his initial cash contribution of $ 193,854 to the LLC in May, 2001 or at any other time before February 9, 2008. The only money he returned to himself

stemmed from the $290,623 he first deposited in Eastbank, and this account and the subsequent Charles Schwab account in the LLC's name were not actually LLC accounts.

23. WC created the mere appearance that he had withdrawn his $193,854 from the LLC for his own tax and accounting purposes. WC's initial contribution of $193,854 actually remained in the LLC at least until February 9, 2008.

24. Except for a water bill and an elevator bill totaling $2,000 paid by WC in 2005, MCC or his companies paid all of the LLC's operating expenses such as the mortgage, real estate taxes, and insurance for a total of $3,800,000 from September, 1999 to February, 2008.

25.. There is a mortgage on the NB property obtained at the time of the purchase of the property, and the original principal amount was $3,500,000. MCC made the mortgage payments on the property.

26. As of February, 2008, the balance of the principal amount was about $2,500,000. MCC paid approximately $920,000 toward the reduction of the principal of the mortgage by February, 2008, using funds obtained from his companies.

27. When the LLC purchased the NB property, it was an empty warehouse. Between 2000 and 2002, the LLC improved the property by building a second floor, installing escalators, installing a freight elevator, changing the electrical system, and doing HVAC work. The LLC also had renovations done from 2002 to 2008.

28. MCC paid for the renovations by using funds generated from his restaurant supply companies. MCC paid $1,233,014 for the renovations done as of February 9, 2008.

III. WC's Withdrawal from the LLC

Limited Liability Company Law (LLCL) §606,"Withdrawal of a Member," sets out the circumstances under which a member of a limited liability company may end his participation in it. As previously determined by Justice Flaherty, the version of LLCL §606 in effect prior to the 1999 amendments controls the company in which WC had an interest since it was formed on May 13, 1999 and the effective date of the statutory amendments was August 31, 1999. (*See*, LLCL § 606[b]; *Klein v. 599 Eleventh Avenue Co. LLC*, 14 Misc 3d 1211[A] [Table]. 2006 WL 3849059 [Text]; Rich, Practice Commentaries, McKinney's Cons Laws of NY, Book 32A, p210.] As also previously determined by Justice Flaherty, "[u]nder the prior version of LLCL § 606, a member of a limited liability company could withdraw, if, inter alia, he gave six months written notice to the company," and the service of certain counterclaims by WC were "tantamount to the

notice required by the prior version of LLCL §606." WC withdrew his membership in the LLC effective February 9, 2008. (See the decision and order of Justice Strauss dated January 26, 2011.)

IV. WC's Right to The Fair Value of His Interest Upon His Withdrawal

A. LLCL §§ 504 and 509

LLCL §509, "Distribution upon withdrawal," provides: "Except as provided in this chapter, upon withdrawal as a member of the limited liability company, any withdrawing member is entitled to receive any distribution to which he or she is entitled under the operating agreement and, if not otherwise provided in the operating agreement, he or she is entitled to receive, within a reasonable time after withdrawal, the fair value of his or her membership interest in the limited liability company as of the date of withdrawal based upon his or her right to share in distributions from the limited liability company."

LLCL § 504, " Sharing of distributions," provides in relevant part: "Distributions of cash or other assets of a limited liability company shall be allocated among the members, and among classes of members, if any, in the manner provided in the operating agreement, which may, among other things, establish record dates for distributions. If the operating agreement does not so provide, distributions shall be allocated on the basis of the value, as stated in the records of the limited liability company, if so stated, of the contributions of each member ***."

B. The Valuation Date

Both sides proceeded on the basis of the order made by Judge Strauss dated January 26, 2011 fixing the valuation date as of February 9, 2008.

C. The Contribution Made by WC

WC made only the initial contribution of $193,854 to the LLC. The $60,000 he placed into the account of the 1-9 Bond Street company was a transfer of funds to MCC, who, by agreement of the parties, received credit for these funds as part of his capital contribution to the LLC. The approximately $300,000 WC placed into purported LLC accounts at Eastbank and Charles Schwab that he alone controlled was not actually a capital contribution. As conceded by WC's attorney: "Winston also later provided the LLC with approximately $300,000 (id) which was repaid. Winston makes no claim that this $300,000, which the LLC also booked as a loan, increased his capital contribution ***." (Pre-Trial Memorandum of Law, p.5, fn 2.)

Although WC guaranteed the $3,5000,000 purchase money mortgage, the parties themselves did not regard this as a contribution, and the guarantees, which were given by both sides and which would be off-setting, did not factor into the ownership split initially reached by the members. Moreover, neither side offered evidence that WC's guarantee had a particular monetary value that could be taken into account in calculating the ownership interests of the members.

D. No Operating Agreement Made the Parties

LLCL §102, " Definitions," provides in relevant part: "(u) 'Operating agreement' means any written agreement of the members concerning the business of a limited liability company and the conduct of its affairs and complying with section four hundred seventeen of this chapter."

LLCL § 417, "Operating Agreement," provides in relevant part: "(a) Subject to the provisions of this chapter, the members of a limited liability company shall adopt a written operating agreement that contains any provisions not inconsistent with law or its articles of organization relating to (i) the business of the limited liability company, (ii) the conduct of its affairs and (iii) the rights, powers, preferences, limitations or responsibilities of its members, managers, employees or agents, as the case may be."

This court sustained an objection to the admission of a purported operating agreement pursuant to CPLR 4519 (the Deadman's Statute).

The court is mindful that the Appellate Division has written: "Additionally, the trial court erred in refusing to receive as evidence offered by the defendants *an operating agreement*, purportedly entered into before the organization of the LLC (see Limited Liability Company Law § 417[c]), between Winston Chiu and Man Choi Chiu's late son, Henry Chiu. As correctly noted by the defendants in their brief, the very same agreement, which, inter alia, granted Winston Chiu the right to acquire up to 25% of the ownership interest in the LLC and Henry Chiu the right to acquire the remaining 75% interest, was included as part of the closing statement prepared by Wander & Golden, which had previously been admitted into evidence on consent of the parties." (*Man Choi Chiu v. Chiu* 38 AD3d 619, 621 [Italics added].)

This court regards the phrase "an operating agreement" to be dicta. The Appellate Division did not decide the issue of whether the agreement met the standards of LLCL §§102(u) and 417(a).What mattered to the appellate court was simply the existence of an agreement – any type of an agreement – evidencing that WC had an interest in the LLC.

In any event, both sides proceeded on the basis that (1) WC was entitled to receive " the fair value of his *** membership interest in the limited liability company as of the date of withdrawal based upon his *** right to share in distributions from the limited liability company" (LLCL § 509) and (2) the fair value of WC's interest would be determined according to his relative contribution to the LLC. (*See*, LLCL § 504.)

Although the parties did not have an operating agreement, the evidence in this case permits the inference that they did have an agreement providing for a 75%-25% initial ownership split in MCC's favor.

E. The Membership Interest of WC in 1999 and 2000

LLCL §1102, "Records," provides in relevant part: "(a) Each domestic limited liability company shall maintain the following records, which may, but need not, be maintained in this state: ***(2) a current list of the full name set forth in alphabetical order and last known mailing address of each member together with the contribution and the share of profits and losses of each member or information from which such share can be readily derived; ***." (*See*, *Chiu v. Chiu*, 38 AD3d 619.) In the cited case, the Appellate Division wrote on March 13, 2007: "The only documentary evidence that arguably satisfied this requirement consisted of the LLC's tax returns for the years 1999 and 2000, both of which listed the defendant Winston Chiu as a member having a 25% ownership of capital, profit sharing, and loss sharing and the plaintiff Man Choi Chiu as the other member having a 75% ownership of capital, profit sharing, and loss sharing." (*Chiu v. Chiu,* 38 AD3d 619, 621.) At the trial of the instant actions, neither side submitted evidence of a list current as of February 9, 2008 which complied with LLCL §1102(a).

The LLC filed tax returns for 1999 and 2000 which were received by the Internal Revenue Service on August 7, 2001. The Schedule K-1's attached to the tax returns for those years stated that MCC had a 75% interest in the LLC and WC had a 25% interest. The parties are estopped from changing those percentage interests for the years 1999 and 2000. "A party to litigation may not take a position contrary to a position taken in an income tax return ***." (*Mahoney-Buntzman v. Buntzman,* 12 NY3d 415, 422; *Stevenson-Misischia v. L'Isola D'Oro SRL*, 85 AD3d 551; *Peterson v. Neville*, 58 AD3d 489; *Czernicki v. Lawniczak*, 74 AD3d 1121.) " We cannot, as a matter of policy, permit parties to assert positions in legal proceedings that are contrary to declarations made under the penalty of perjury on income tax returns." (*Mahoney-Buntzman v. Buntzman, supra,* 422.) At the trial, MCC attempted to prove through expert testimony that the initial capital contributions should correctly have been stated as $1,948,343 from MCC and $193,855 from WC. for a 90%-10 % ownership split. However, MCC is estopped from taking the position that the correct split initially should have been 90% to 10 % in his favor.

The estoppel cannot be taken as far as WC would like. The estoppel merely pertains to the years 1999 and 2000, and it does not bar the admission of evidence showing that the relative interests of the parties changed in subsequent years.

MCC did not prove that an estoppel can be avoided on the ground of good faith mistake or unintentional error or for any other valid reason. (*See, Simon v. Safelite Glass Corp.* 128 F3d 68.) The testimony adduced from his accounting expert concerning the supposed inaccurate characterization of the initial payments made by the brothers lacked credibility. The parties had an agreement that the initial ownership split would be 75%-25%. Moreover, the brothers have been engaged in this litigation for over ten (10) years. The testimony of these litigants and their family members is of extremely limited value. An inability to recollect key facts together with a strong self-interest in winning this litigation prevents the Court from utilizing their testimonial evidence to vary the statements made in the tax returns. The documents executed contemporaneously with the creation of the LLC and purchase of the subject property and the tax returns must, therefore, play an overriding role in clarifying and determining the issues before this Court.

In her testimony Helen Chiu was specifically asked how the percentage split was created. She indicated that she had no idea, that her father had no idea, and that it was probably the accounting firm that came up with the idea to formulate the 75/25 percent interest. (See testimony Helen Chiu, page 46). When provided with the opportunity to clear up this issue the accounting firm responded "no clue". (See testimony Paul Miller, page 248).

Neither party produced the accountant who actually prepared the tax returns for 1999 and 2000, and MCC's position that the accountant just pulled the 75%-25% split out of thin air has no support in the record made at trial.

The court finds based on the preponderance of the evidence that MCC and WC initially agreed to a 75%-25% split of ownership of the LCC based on their initial cash contributions to the company. The court further finds that the parties maintained their 75%-25% ownership split for 1999 and 2000.

F. The Contributions of MCC to the LLC

1. LLCL §§ 102 and 501

Upon his withdrawal from the LLC, WC became entitled to receive the fair value of his ownership interest in the company, and the determination of the fair value of that interest depends on his right to share in the distributions of the company. WC's right

to share in the distributions of the LLC, in turn, depends on the relative value of the parties' contributions to the LLC.

LLCL § 102, "Definitions," provides in relevant part: "(f) 'Contribution' means any cash, property, services rendered, or a promissory note or other binding obligation to contribute cash or property or to render services that a member contributes to a limited liability company in his or her capacity as a member."

LLCL § 501, "Form of capital contributions," provides: "The contribution of a member to the capital of a limited liability company may be in cash, property or services rendered or a promissory note or other obligation to contribute cash or property or to render services, or any combination of the foregoing."

2.Relevant Case Law

"Ordinarily, the partnership agreement expressly sets forth the amounts that are contributed to partnership capital by each partner. All additional amounts generally are treated as advances, unless the partnership agreement provides that they shall be treated as additional capital contributions." (Partnership Law & Practice § 10:5 [2011]; *see, M. & C. Creditors Corp. v. Pratt,* 172 Misc. 695 [1938], aff'd, 255 App Div 838, aff'd, 281 NY 804.) There are some old cases which hold that a sum voluntarily provided for the use of a partnership over and beyond the amount required by the partnership agreement is considered to be an advance to the company. (*See, e.g., M. & C. Creditors Corp. v. Pratt, supra*; *Fazio v. Tracy* 39 Misc.2d 172.) More recent cases show that courts will consider the circumstances surrounding the infusion of money in classifying it as a loan or capital contribution. (*See, e.g, 38 Town Associates v. Barr*, 225 AD2d 613.)

A loan to a company does not, of course, amount to a capital contribution. (*See, In re Eight of Swords, LLC*, 96 AD3d 839; *Rosen Trust v. Rosen*, 53 AD2d 342.)

Whether the provision of funds to a company should be classified as a loan or a capital contribution depends on the surrounding circumstances and the conduct of the parties. (*38 Town Associates v. Barr, supra*; *Hynes v. Barr*, 225 AD2d 588.)

"The primary factor this Court is to consider when evaluating whether funds advanced by a shareholder are the result of an equity contribution or a loan is whether the transaction bears the earmarks of an arm's length negotiation." (*In re Cold Harbor Associates, L.P.* 204 B.R. 904, 915.) " The more such an exchange appears to reflect the characteristics of such an arm's length negotiation, the more likely such a transaction is to be treated as debt." ((*In re Cold Harbor Associates, L.P. , supra*, 915; *In re AutoStyle Plastics, Inc.,* 269 F3d 726..)

Factors which the courts have used to distinguish a capital contribution from a loan include: "(1) the names given to the instruments, if any, evidencing the indebtedness; (2) the presence or absence of a fixed maturity date and schedule of payments; (3) the presence or absence of a fixed rate of interest and interest payments; (4) the source of repayments; (5) the adequacy or inadequacy of capitalization; (6) the identity of interest between the creditor and the stockholder; (7) the security, if any, for the advances; (8) the corporation's ability to obtain financing from outside lending institutions; (9) the extent to which the advances were subordinated to the claims of outside creditors; (10) the extent to which the advances were used to acquire capital assets; and (11) the presence or absence of a sinking fund to provide repayments." (*Roth Steel Tube Co. v. C.I.R.*, 800 F2d 625, 630; *see*, *In re AutoStyle Plastics, Inc.*, 269 F3d 726.) These factors all concern whether the transaction has the characteristics of an arm's length negotiation. (*See*, *In re Official Committee Of Unsecured Creditors for Dornier Aviation (North America), Inc* , 453 F.3d 225.) The significance of the individual factors varies depending on the circumstances of the case, and no one factor is dispositive. (*See*, *In re Official Committee Of Unsecured Creditors for Dornier Aviation (North America), Inc , supra.*)

3.Discussion

The court rejects MCC's attempt to change the designation of $1,142,000 which he obtained from the refinancing of his Bond Street property and which he used to purchase the NB property from a loan to a contribution. Considering the surrounding circumstances and the conduct of the parties. (*see, 38 Town Associates v. Barr*, *supra*, *Hynes v. Barr*, *supra*), the court finds that the parties had agreed to a 75%-25% split of ownership based on cash contributions and that the $1,142,000 infusion was intentionally and correctly recorded as a loan on the company's books and records. The testimony of Joseph Nelson, MCC's valuation expert, to the contrary lacks credibility. The court rejects his conclusion that the correct split initially should have been 91% to 9% in MCC's favor.

This purported capital contribution is the product of "litigation hindsight" asserted in an effort to change the plain language of the capital contribution accounts of the plaintiff and defendant as reported to the Internal Revenue Service prior to the initiation of litigation.

On the other hand, the parties had no agreement concerning how the sums spent by MCC on major renovations would be characterized, and the court finds that it is necessary to apply the guidelines found in the case law.

Applying the *Roth Steel Tube* factors to the sums that MCC's companies provided for the renovations: (1) there were no instruments evidencing an indebtedness, (2) there was no repayment schedule, (3) there was no provision for the payment of

interest, (4) there was no source of repayment for the advances since the LLC was merely a holding company for the NB property which did not collect rents, (5) the LLC was thinly capitalized, (6) there was an identity of interest between MCC and the LLC which was often treated as his alter ego, (7) MCC and his other companies did not demand any security from the LLC, (8) the LLC already had placed a $3,500,000 mortgage on its property, (9) the mortgage had priority over any purported loans made by MCC, (10) the advances were directly used for capital improvements, and (11) there was no sinking fund. In short, the *Roth Steel Tube* factors indicate that the advances made by MCC to the LLC for renovations should be characterized as capital contributions rather than as loans. There was no arm's length transaction between a creditor and a debtor.

The fair preponderance of the evidence in this case concerning the surrounding circumstances and the conduct of the parties (*see*, *38 Town Associates v. Barr*, *supra*; *Hynes v. Barr*, *supra*), which includes the *Roth Steel Tube* factors, establishes that the sums provided by MCC for renovations to the property were capital contributions. This court has attempted to discern MCC's intent in making the infusions by looking at the actions of the parties and "the economic reality of the surrounding circumstances." (*See*, *In re SubMicron Systems Corp*,. 432 F.3d 448, 456.) Based on the evidence in this case concerning those factors, the court finds that the sums MCC provided for renovations were capital contributions.

At the trial, this court expressed its concern that the unilateral contributions of MCC had a dilutive effect on WC's interest in the company. This concern is lessened by WC's failure to prove that he expressed opposition to the renovations made by MCC or offered to share in their expense. Moreover, the renovations increased the value of the property, as Eric Haims, a commercial real estate appraisal expert called by MCC, testified, and WC will share in that benefit.

Contrary to WC's contention, the payment of the structural renovation cost was not simply a substitute for the payment of rent rather than a capital contribution. "A triple net lease (Net-Net-Net or NNN) is a lease agreement on a property where the tenant or lessee agrees to pay all real estate taxes, building insurance, and maintenance (the three "Nets") on the property in addition to any normal fees that are expected under the agreement (rent, premises utilities, etc.). In such a lease, the tenant or lessee is responsible for all costs associated with the repair and maintenance of any common area." (Http:// en.wikepedia.org.) The major structural alterations undertaken by MCC must be distinguished from the ordinary maintenance required of a tenant in a standard triple net lease, and this court rejects WC's contention that MCC would have been responsible for the costs of the renovations under a triple net lease.

Turning to the sums spent by MCC on mortgage payments, real estate taxes, insurance, etc., the court finds that these sums were not capital contributions, but merely payments made as a substitute for rent. As MCC's attorney states in his post-trial memorandum (p.14), " Nelson recorded funds advanced for capital improvements to the Property (totaling $1.23 million) as 'capital' or 'equity,' and for the operating expenses of the property as 'loans.' From June 2002 (after the renovations were completed) through the end of 2005, Nelson calculated the 'rent' as being equal to the total operating expenses of the Property (mortgage, real estate taxes, insurance, etc.)."

G. The Relative Interests of WC and MCC

MCC should be credited with a capital contribution in the sum of $1,233,014 for money spent on renovations made before February 9, 2008. His total capital contributions made as of February 9, 2008 amounted to $1,814,576.90 ($581,562.93 + $1,233,014). WC's total capital contribution made as of February 9, 2008 amounted to $193,854.41. The total capital contribution made by the members as of February 9, 2008 amounted to $2,008,431.30, and MCC contributed 90% of this sum and WC contributed 10% (rounded off).

H. The Fair Value of WC's Interest in the LLC

The LLCL does not define the term "fair value," and the parties have not called the court's attention to any cases which discuss the term in connection with a limited liability company. There are cases which interpret the term as used in connection with other business forms.

"The three major elements of fair value are net asset value, investment value and market value. The particular facts and circumstances will dictate which element predominates, and not all three elements must influence the result " (*Friedman v. Beway Realty Corp.*, 87 NY2d 161, 167.) "Net asset value is generally the applicable standard for evaluating real estate or investment holding companies, while investment value is the primary criterion on which fair value is based for a business ***." (*Giaimo v. Vitale,* 31 Misc.3d 1217[A] [Table], 2011 WL 1549064, 2 [Text].) In the case at bar, both sides took the net asset value approach. Net asset value refers to the value of an entity's assets less the value of its liabilities.

As of February 9, 2008, WC's appraisal expert (Salmon) valued the NB property at $13,500,000, and MCC's appraisal expert (Haims) valued the property at $13,700,000. After making determinations about the liabilities of the LLC, WC's valuation expert (Mercer) concluded that the LLC had a net asset value of $10, 427,000, and MCC's valuation expert (Nelson) concluded that the LLC had a net asset value of

$10,449,739. (Surprisingly, WC, who is seeking the buy-out, produced experts who arrived at the lower figure.) Nelson offered the more credible testimony about MCC's capital contributions for improvements (they were not loans), and the court adopts his net asset valuation of $10,449,739.

MCC is not entitled to a lack of marketability discount.(See, *Vick v. Albert* , 47 AD3d 482; *Cohen v. Cohen*, 279 AD2d 599.) It is true that in determining the fair value of a limited liability company, as with a close corporation, the illiquidity of the membership interests should be taken into account." (See, *Matter of Friedman v. Beway Realty Corp.*, 87 NY2d 161; *Matter of Seagroatt Floral Co. [Riccardi],* 78 NY2d 439; *Murphy v. U.S. Dredging Corp.* , 74 AD3d 815.) While the application of a lack of marketability discount is not always limited to the goodwill of a business (*see*, *Murphy v. U.S. Dredging Corp. supra; Giaimo v. Vitale, supra*), in the case at bar, the LLC's business consisted in nothing more than the ownership of realty which is easily marketable. (See, *Vick v. Albert, supra; Cohen v. Cohen, supra.*) In any event, Nelson's testimony that MCC is entitled to a whopping 25% lack of marketability discount for what is essentially real property placed in a limited liability company package has no credibility, and the record does not permit the court to determine what lesser percentage might be appropriate.

Based on all of the foregoing, the court finds that MCC failed to prove that the fair value of WC's interest in the LLC as of the valuation date amounted to $440, 471. The court also finds that WC failed to prove that the fair value of his interest in the LLC as of the valuation date amounted to $2,606, 750.

Based on all of the foregoing, the court finds that the LLC had a fair value of $10,449,739 as of February 9, 2008. The court further finds that the fair value of WC's interest in the LLC as of February 9, 2008 amounted to $1,044,974. (10% x $10,449,739.) In the event of a buy-out, WC would be entitled to the sum of $1,044,974 plus statutory interest from the valuation date. (*See*, *In re Superior Vending, LLC*, 71 AD3d 1153; *Blake v. Blake Agency, Inc.*, 107 AD2d 139 ["Special Term erred by not awarding interest on its award of the 'fair value' of petitioner's shares."].)

V. Judicial Dissolution of the LLC

The third cause of action in the WC complaint, which seeks the judicial dissolution of the LLC, withstood a CPLR 3211(a)(7) dismissal motion except insofar as it concerned the formation of the company. (*See*, *Chiu v. Chiu,* 71 AD3d 621; decision and order of Justice Flaherty dated March 31, 2008)

LLCL § 702., "Judicial dissolution," provides in relevant part: "On application by or for a member, the supreme court in the judicial district in which the office of the limited liability company is located may decree dissolution of a limited liability company whenever it is not reasonably practicable to carry on the business in conformity with the articles of organization or operating agreement." (*See, In re 1545 Ocean Ave., LLC,* 72 AD3d 121.)

The court notes that WC filed his complaint on October 10, 2007 and did not effectively withdraw as a member until February 9, 2008.

The evidence adduced at the trial shows that the relationship between the brothers has become so acrimonious and the disagreement about the fundamental matter of ownership interests has become so bitter that it is not reasonably practicable to carry on the business for the purpose for which the brothers formed the LLC. They formed the LLC to provide an investment vehicle for both of them. The dispute between WC and MCC was shown to be "inimicable to achieving the purpose of [the LLC]." (*Cf, In re 1545 Ocean Ave., LLC, supra,* 132.)

Although WC met the statutory standard of LLCL § 702, the appropriateness of an order of dissolution rests within the sound discretion of the court. (*In re 1545 Ocean Ave., LLC, supra.*) Buy outs are preferred to the dissolution of going companies, and a buy out is the most equitable method of adjusting the parties' rights in this case. (*See, In re Superior Vending, LLC,* 71 AD3d 1153). Dissolution will not be ordered unless MCC fails to purchase WC's interest in the LLC in compliance with the judgment to be entered hereon.

VI. WC's Claims for Breach of Fiduciary Duty

The elements of a cause of action for breach of fiduciary duty are (1) the existence of a fiduciary relationship, (2) misconduct by the defendant, and (3) damages directly caused by the defendant's misconduct (*See, Daly v. Kochanowicz,* 67 AD3d 78; *Fitzpatrick House III, LLC v. Neighborhood Youth & Family Services,* 55 AD3d 664; *Kurtzman v. Bergstol* 40 AD3d 588.)

The eighth cause of action in the WC action is vaguely pleaded, and WC did not prove that MCC breached fiduciary duties owed to him by, e.g, causing the LLC to take unauthorized actions.

The remaining claims for breach of fiduciary duty primarily concern the alleged freeze-out of WC and the failure of MCC's companies to pay rent to the LLC. In regard to the freeze-out, WC did not prove that he suffered damages as a result of any

deprivation of an opportunity to participate in the company affairs. In regard to the failure to pay rent, such a wrong belongs to the company, not to WC individually (*see*, *Yudell v. Gilbert,* -AD3d-, _-NYS-, 2012 WL 3166788), and his direct claims based on the alleged failure to pay rent must be dismissed. Furthermore, WC cannot maintain derivative claims on behalf of the LLC. WC first asserted derivative claims in his answer dated May 30, 2008 interposed in the MCC action, nearly four months after he had withdrawn as a member. While members of a limited liability company may sue derivatively (*Tzolis v. Wolff,* 10 NY3d 100), WC was not currently a member when he brought the derivative claims.

VII. Disposition

In regard to the MCC action: MCC is entitled to judgment on the first cause of action declaring that WC had a 10% interest in the LLC as of February 9, 2008. The first cause of action is otherwise dismissed. The counterclaims and the third party complaint are dismissed.

In regard to the WC action: WC is entitled to judgment on the first cause of action declaring that he had a 10% interest in the LLC as of February 9, 2008. WC is entitled to judgment on his second cause of action to the extent that (1) the court declares that he validly withdrew as a member of the LLC effective February 9, 2008 and (2) the court directs MCC to purchase WC's interest in the LLC by the payment of $1,044,974 plus statutory interest from February 9, 2008 within ninety days of the service upon MCC of a copy of the judgment to be entered hereon.. WC is entitled to judgment on the third cause of action to the extent that the LLC will be dissolved if MCC fails to complete the buy out as directed herein. The remaining causes of action are dismissed.

Settle judgment.

Dated: August 30, 2012

J.S.C.