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SHORT FORM ORDER

INDEX
NO.: 8055-06

SUPREME COURT - STATE OF NEW YORK
COMMERCIAL DIVISION
TRIAL TERM, PART 44 SUFFOLK COUNTY

PRESENT: Hon. Elizabeth Hazlitt Emerson

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In the Matter of the Application of

RONALD A. BEATTIE,

Holder of Twenty Percent (20%) or more of all Outstanding Shares Entitled to Vote,

Petitioner,

For the Dissolution of PLANDATA SYSTEMS CORP., a Domestic Corporation, Pursuant to Section 1104-a of the Business Corporation Law.

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DECISION AFTER TRIAL

Introduction

On April 12, 2006, Ronald A. Beattie ("Beattie") filed a petition for the dissolution of PlanData Corporation ("PlanData") pursuant to Section 1104-a of the Business Corporation Law. At the time of the petition, Beattie held 40% of the issued and outstanding shares of PlanData. The remaining 60% was held by Steven D. Smith ("Smith"). On May 4, 2006, pursuant to Section 1118 of the Business Corporation Law, Smith filed a Notice of Election to Purchase Beattie's 40% interest for fair value as of April 12, 2006 (hereinafter referred to as "Fair Value"). After numerous attempts to reach an agreement as to Fair Value, the parties submitted this issue to the court for its consideration.

As the record reflects, the parties do not dispute certain important facts that surround the issue of Fair Value. In particular, the parties agree that PlanData was a company initially formed by Smith prior to 1996. At the time of its formation, Smith owned 100% of the issued and outstanding stock. Subsequent to its formation, Beattie purchased an initial 35 % interest in PlanData. Such purchase was memorialized in a Stock Purchase Agreement dated February 1, 1996, between Steven D. Smith and Ronald A. Beattie (the "Stock Purchase Agreement"). Pursuant to the terms of the Stock Purchase Agreement, Smith agreed to transfer 35 shares of the

100 issued and outstanding shares to Beattie at a price of $1,150 per share. The Stock Purchase Agreement further provided that Beattie had the option to purchase an additional 5 shares (representing an additional 5% of the issued and outstanding stock) at the price specified therein on or before February 18, 2004. Beattie exercised such option sometime in 2003. Accordingly, as of the date of the Petition for dissolution Beattie owned 40% of PlanData. The Stock Purchase Agreement also contains provisions regarding the valuation of PlanData as of the date of the Stock Purchase Agreement. Specifically, paragraph Third of such Agreement reads as follows:

> Valuation of the current organization shall be basis of the value of the shares as described above and shall be the basis for future valuations:
>
> Fixed Assets: $5,000
> Goodwill (SpaceMan Software): $70,000
> Fixed Income (Existing Clients): $40,000
> **Total: $115,000**
> Price per Share $1,150

The parties agree that PlanData's principal business involves a computer program known as SpaceMan, and generally that PlanData provides services to owners and managers of commercial estate. The services involve the preparation of CAD drawings and the use of Spaceman and other similar software programs to manage the clients' commercial real estate. However, the parties sharply disagree on the impact of the business description on the question of Fair Value. Each has presented a different theory as to how such business shapes the central question under consideration by the court.

As the record demonstrates, each side's proof rested mainly on expert testimony. The petitioner retained Financial Appraisal Services, Ltd., to determine Fair Value. The petitioner called as its witness Mr. Joel A. Rakower, President of Financial Appraisal Services, Ltd. Mr. Rakower was qualified as an expert in business valuations and appraisals at trial and testified at length on the issue of Fair Value. Prior to Mr. Rakower's testimony, the petitioner introduced testimony from Mr. Robert Crichlow, president and owner of Crichlow Technology, Inc. Mr. Crichlow provided testimony regarding replacement cost (as described below) that was relied on by Mr. Rakower in his analysis of Fair Value.

Specifically, Mr. Rakower testified at length regarding the manner in which he calculated a value for PlanData and ultimately the Fair Value of Mr. Beattie's shares. Such anyalysis was also set forth in his written report introduced at trial as petitioner's Exhibit 12. Mr. Rakower noted that his valuation was performed in a manner consistent with the guidelines set forth in Revenue Ruling 59-60, C.B. 1959-1, 237. Mr. Rakower pointed out that this revenue ruling does not contain a specific formula for valuation. Instead, it provides a general approach and a series of factors that willing buyers and sellers should consider in buying or selling stock in closely held corporations. With this in mind, Mr. Rakower explained that he calculated Fair Value using three commonly known methods which he referred to as Asset (Cost) Approach, Market Approach, and Income Approach. Mr. Rakower's testimony, as well as his written report, details the information that he relied upon and the manner in which he calculated each of the foregoing

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methods. For reasons set forth below, Mr. Rakower determined that none of these methods provided an accurate assessment of Fair Value. In his opinion, a weighed approach using data produced by all three methods was more appropriate. Mr. Rakower took the totals calculated for each approach, assigned each a percentage, and arrived at a weighed value. Mr. Rakower testified that he selected the percentages based on his business judgment and experience. In fact, he testified that determining the weight to be ascribed to each of the approaches was based on informed judgement i.e., that it was an experience call. Such calculation is set forth on page 25 of his report. Mr. Rakower then used such weighted approach, as described below, to arrive at a value of $618,000 for Mr. Beattie's 40% interest.

Mr. Rakower explained that, in his opinion, the choice of methodology used depends primarily upon the purpose of the valuation report and the specific characteristics of the company to be evaluated. Mr. Rakower testified that he had been instructed to assume that PlanData is best described as a software company. In fact, he highlighted this designation as one of the major differences between his valuation and the one performed on behalf of the respondent. With this designation as a given, Mr. Rackower was provided with a calculation of the value of the software underlying PlanData's business. Such calculation was supplied by Mr. Crichlow. Mr. Crichlow identified himself as the president and owner of Crichlow Technology, Inc., a company that provides computer consulting for Microsoft Windows and Web platform applications. Mr. Crichlow then went on to provide a value for the software that he believed constituted PlanData's business. Mr. Crichlow described his methodology by stating that it calculated a replacement cost for such software. To determine this replacement cost, Mr. Crichlow made a variety of assumptions regarding the steps necessary to recreate a program like SpaceMan in today's market. These assumptions included the amount of time necessary to create a new SpaceMan program, the number and types of employees or consultants who would be required to compete in such a task, and the salaries such individuals might receive. Mr. Crichlow testified that, based on his calculations, replacement costs for SpaceMan would be equal to $718,000. As previously noted, Mr. Crichlow acknowledged that these calculations were based on good-faith estimates derived from industry norms and his overall business experience rather than specific data supplied or derived by Mr. Crichlow from PlanData's books and records. Mr. Rakower then used this information, as well as the direction to designate PlanData as a software company, to prepare his calculation using the three previously identified methods.

In presenting his case respondent Smith also relied primarily on expert testimony. The respondent retained Getty Marcus Stern & Lehrer CPA, P.C., to provide a valuation for PlanData. Such firm was represented at trial by Mark S. Warshavsky, the partner-in-charge of the Business Valuation and Litigation Support Group. Mr. Warshavsky was qualified at trial as an expert in business valuation and testified as to the method he used in determining the value of PlanData and Beattie's 40% minority interest. Mr. Warshavsky supplied the court with a written report which was introduced as defendant's Exhibit J.

In preparing his valuation report, Mr. Warshavsky also recognized three different methods of determining Fair Value. He identified these methods as Market Approach, Asset Approach and Income Approach. Mr. Warshavsky also considered each of these methods as the basis of calculating a value for PlanData. Mr. Warshavsky, however, rejected the Market

Approach, which is based on industry comparisons, because of the lack of data on companies that are sufficiently similar to PlanData. He also rejected the Asset Approach because it is generally used for companies the real value of which is in assets such as a real estate. In selecting the Income Approach, Mr. Warshavsky reasoned that PlanData is a company that provides a service for its clients using various software programs, but it is not a "software" company. He concluded that over 83% of PlanData's revenue is derived from the company's measuring and drafting services. Mr. Washavasky used actual data for a period of several years from PlanData's books and records to calculate a value using the Income Approach. Using that method, Mr. Warshavsky arrived at a value of $102,159 for PlanData. However, Mr. Warshavsky went on to apply a marketability discount. Mr. Warshavsky believed, the appropriate discount to be 25% or $25,540, which produced a value of $76,619 for PlanData. This calculation resulted in a value of $30,648 for Mr. Beattie's 40% interest. Mr. Warshavsky also calculated excess cash in the amount of $245,454 and added 40% of such excess cash, or $98,181, to the $30,648 to arrive at a total value of $128,829 for Mr. Beatties shares.

The Court's Calculation of Fair Value

As previously stated, the central issue before the court is the question of Fair Value. Fair Value requires that the exiting stockholder be paid for his proportionate interest in a going concern, that is, the intrinsic value of the shareholder's economic interest in the corporate enterprise (*see*, **Matter of Cawley v SCM Corp**., 72 NY2d 465). For the court to make such a determination, it must decide the proper valuation method to be applied based on the facts of each case. There is no one formula that must be applied to every case. Rather, the court must determine the proper calculation for the business at hand (*see*, **Matter of Gerzof v Coons,** 168 AD2d 619).

Further, as part of a determination of Fair Value for a closely held corporation, the question of the applicability of a marketability discount must be considered. The Second Department in **Matter of Blake v Blake Agency** (107 AD2d 139) has acknowledged that Business Corporation Law § 1104(a) was enacted for the protection of minority shareholders and that the corporation should not receive a windfall in the form of a discount because it elected to purchase a minority interest pursuant to Business Corporation Law §1118. Accordingly, no discount should be applied simply because the interest to be valued represents a minority interest in the corporation. However, the Second Department noted that a discount recognizing the lack of marketability of shares could and should be considered when, as here, the corporation is closely held.

Turning to the facts of this case, the court has not adopted the calculation offered by either party for reasons set forth below. Rather, the court has credited certain portions of the testimony regarding the appropriate method for valuing PlanData, and it has relied the facts in the record to fashion its conclusion. First, the court declines to follow the petitioner's calculation as supplied by Mr. Rakower. While the court understands Mr. Rakower's calculations, the court fails to find sufficient support in the record for the use of the weighted average of three different valuation methods and the percentage assigned to each. Although Mr. Rakower provided detailed reasoning for his analysis, he failed to persuade the court that such a blended method was the appropriate method and contained the required degree of certainty. In particular, Mr. Rakower acknowledged that his methodology required the use of comparable data and that it was difficult to find companies or transactions that were sufficiently similar to PlanData. In fact, when researching his calculations, in certain instances he relied on only one similar transaction. The court did not find this to be sufficient to support the calculation of Fair Value. In addition, the court notes that Mr. Rakower's calculations, assumptions, and analysis were based on the finding that PlanData should be treated as a software company, and, certain important calculations were based on Mr. Crichlow's analysis. The court finds that the assumptions used to support certain calculations do not relate to facts in the record. Moreover, the court disagrees with Mr. Crichlow's use of replacement cost as a proper method of valuing PlanData and notes that Mr. Crichlow's analysis also contains a number of important assumptions that do not relate to specific data derived from PlanData's books and records.

The court also considered the valuation provided by Mr. Warshavsky. The court agrees with Mr. Warshavsky's the assertion that the Income Approach advocated by him is the proper method of valuation for PlanData. However, the court declines to adopt Mr. Warshavsky's calculation as it disagrees with certain elements of such calculation. Such disagreement is set forth below. Accordingly, the court has used the income approach and has relied upon facts in the record to supply an alternative calculation. As both experts have provided a calculation using the Income Approach, the court has considered each and will note which elements of each the court has adopted.

The court's calculation is set forth in Exhibit A. The first figure that goes into this calculation is the net income for the company. Using the average of the net income for 2003 (-$54,098), 2004 (-$25,298) and 2005 ($185,738) and adjusting for the portion of the Programer's Salary of ($43,200) while he was working solely on SpaceMan 7, an unadjusted net income of $49,847.33 is derived. Certain adjustments must be made to this figure. First, both parties agree that the officers' compensation should be added back to the net income to account for the salaries of Beattie and Smith. This figure has been presented as $254,884.00. Second, the parties contend that certain perquisites were received by each of the officers including allowances for automobiles and personal expenses. Smith claims that the amount for these perquisites should be estimated at $10,000.00 and added back to net income. Beattie argues that this figure should be $20,000.00. Based on the salaries of the officers and the testimony presented, the court finds that the $20,000.00 figure better represents the amount of perquisites to be figured into the equation. Third, the parties agree that, if the officers were not employed by the company, PlanData would have an expense for employees performing similar duties. Smith argues that to fill those positions, it would cost PlanData $250,000.00 in compensation. Beattie estimates this figure to be $200,000.00. It is the court's opinion, based on facts set forth in the record, that a reasonable figure for officers' compensation is $200,000.00, which is the figure that was used in the court's calculation.

Mr. Warshawsky provides in his valuation certain adjustments that he argues must be considered in the calculation including invoices billed in a prior year but earned in the current year ($16,407.00) and invoices billed in the current year but not earned until the following year ($40,275.00). Mr. Rakower does not provide for these adjustments. Because PlanData operates on an accrual basis, such adjustments should be made in determining valuation. Accordingly, the court will apply Mr. Warshawsky's figures of $16,407.00 and $40,275.00, respectively. Similarly, Mr. Warshawsky's adjusts his calculation to reflect a three-year average bad debt write-off ($1,767.00) and an adjustment for Federal and State taxes ($5,174.00). Since these figures were not provided by Mr. Rakower, the court has applied them as presented by Mr. Warshawsky.

Both experts have provided a capitalization rate to be used in the calculation. This rate has been defined in the record as a percentage based on the expected growth rate of the company's income stream. The lower the expected growth rate, the higher the capitalization rate. Mr. Warshawsky calculated this figure to be 19.11%, and Mr. Rackower, 19.53%. Since these percentages are relatively similar and PlanData's income of the company appears to be on the rise, the court will use the lower 19.11% figure, which better reflects the expected growth rate of PlanData. Applying this percentage to the figures set forth above, the court has calculated the total value of PlanData to be $491,482.64.

In reviewing the arguments raised by the parties regarding the marketability discount, the court reviewed the recommendation by both experts. Mr. Warshavsky claims that 25% is an appropriate rate to apply to reduce the value of PlanData, while Mr. Rakower argues that no marketability discount should be applied. As previously cited, a discount for lack of marketability is properly factored into the equation because the shares of a closely held corporation cannot be readily sold on a public market (**Matter of Blake v Blake Agency** 107 AD2d 139). In light of the foregoing the court has applied a 25% discount as advocated by Mr. Warshavsky.

Both parties agree that, over a period of time, PlanData has retained excess cash, reflected on the balance sheet on the valuation date, in the amount of $345,454.00. Both parties also agree that Beattie is entitled to 40% of the excess cash on hand. However, Smith argues that this figure should be reduced by $100,000.00 to account for PlanData's cash needs to cover operating expenses for approximately one and one-half months. Beattie argues that he is entitled to 40% of the entire $345,454. Upon review of the record, the court finds Smith's argument to be more persuasive. The excess cash on hand should be reduced by the $100,000.00 representing the current cash flow needs for the on-going operations of PlanData. Beattie is entitled to receive 40% of the remaining $245,454.00; to wit $98,181.60.

Accordingly, the court finds that Beattie is entitled to receive $245,626.39 as the fair value of his 40% interest in PlanData plus interest from April 12, 2006, the date of the valuation. Courts have held that cases arising under §1104-a and §118 Business Corporation Law require the payment of interest (see, **Matter of Blake v Blake Agency** 107 AD2d 139) . The appropriate rate is to be determined by the court and should run from the date prior to the filing of the petition until the date of payment (**Id**. at 150). In the absence of evidence in the record regarding the appropriate rate, the court awards interest at the statutory rate (*see*, CPLR 5004).

Dated: January 15, 2009

HON. ELIZABETH HAZLITT EMERSON

J.S.C.

COURT EXHIBIT A

Income Approach				
	Warshavsky		**Court's Application**	
Average net income (Warshavsky used 3 years)	$35,447.33		$49,847.33	*
Add back officers' compensation	$254,884.00		$254,884.00	
Add Back Perks	$10,000.00		$20,000.00	
Adjustment for invoices billed but not earned	$16,407.00		$16,407.00	
Adjusted gross income	$316,738.33		$341,138.33	
officers' income for like employment	$250,000.00		$200,000.00	
income adjustment for invoices	$40,275.00		$40,275.00	
bad debt write off	$1,767.00		$1,767.00	
Tax Adjustment	$5,174.00		$5,174.00	
net income after taxes	$19,522.33		$93,922.33	
capitalization rate	19.11%		19.11%	
Total Value	$102,157.68		$491,482.64	
Value after Lack of Marketability discount	$76,618.26		$368,611.98	
40% interest	$30,647.31		$147,444.79	
Add Back 40% of excess cash less $100,000.00 claimed as necessary to ongoing operations	$98,181.60	**	$98,181.60	
Total figure to Beattie	$128,828.91		$245,626.39	

* This is a three year average however, for the year 2005, the Court adjusted for the portion of the programer's salary of $43,200, while he was working solely on updated SpaceMan for SpaceMan 7 version.