M E M O R A N D U M

SUPREME COURT - STATE OF NEW YORK
COUNTY OF QUEENS - IAS PART 16

| | |
|---|---|
| RICHARD A. SMITH, ET AL,<br><br>Plaintiffs,<br><br>- against -<br><br>MICHAEL J. RUSSO, ET AL,<br><br>Defendants. | BY: KELLY, J<br><br>DATED: NOVEMBER 13, 2009<br><br>INDEX NUMBER: 11882/90<br><br>MOTION DATE: SEPTEMBER 8, 2009<br><br>MOT. SEQ. NUMBER 11 |

Plaintiffs Richard A. Smith and Nelsi A. Smith have moved for, inter alia, partial summary judgment in the amount of $733,333.33. (The papers have designated the parties as "plaintiff" and "defendant" even though this is a special proceeding, and for continuity sake, the court will adhere to such designations).

In June 1980, plaintiff Richard A. Smith (Smith), and defendants Dennis Bekatoros, Michael J. Russo, and Francis X. Russo organized Meadow Mechanical Corporation (Meadow). The Russos received ten shares each in the new corporation, Bekatoros received nine shares, Smith received nine shares, and Smith's wife, plaintiff Nelsi A. Smith, received two shares. On May 26, 1990, Bekatoros and the Russo defendants voted to remove Smith as President of the corporation, and they barred Smith and his wife from Meadow's premises.

By petition dated July 11, 1990, Smith and his wife, the

holders of a 27.5% interest in Meadow, began a special proceeding for the dissolution of the corporation pursuant to Business Corporation Law § 1104-a on the ground that those in control of the corporation had committed illegal, fraudulent, and oppressive acts against them. On or about October 3, 1990, pursuant to BCL § 1118, the other shareholders of Meadow served a notice of election to purchase the shares of Meadow stock held by the Smiths.

The IAS part issued an order dated November 1, 1994 which granted a motion by the defendants to revoke their BCL § 1118 election and also vacating its order dated April 26, 1993 which directed the defendants to post a $750,000 security bond. The Smiths appealed, and on August 19, 1996, the Appellate Division, Second Department, reversed both branches of the order (Smith v Russo, 230 AD2d 863).

On or about January 12, 1996, Smith filed a petition in bankruptcy with the United States Bankruptcy Court for the Eastern District of New York. The plaintiffs allege that the defendants appeared in the bankruptcy proceeding through their attorney and initially offered to pay $400,000 and subsequently $350,000 for Smith's interest in Meadow. The trustee in bankruptcy thereafter sought to settle the Meadow dissolution proceeding for $400,000 as well as another action brought by Smith against Meadow in the New York State Supreme Court, County of Queens to recover on a

$275,000 promissory note (Smith v Meadow Mechanical Corp., Index No. 749/91). The dissolution proceeding and the action on the note constituted the only assets of the debtor's estate. The Smiths opposed the settlement.

The trustee then brought a motion before the bankruptcy court for the approval of a compromise and settlement in the amount of $350,000, and Smith opposed the motion. The bankruptcy judge scheduled a hearing for the purpose of giving the trustee an opportunity to offer evidence concerning how he arrived at the value of Smith's shares in Meadow as of July 10, 1990, the day before he began the dissolution proceeding and, thus, the proper date of valuation. The bankruptcy judge held hearings on November 19, 2003, December 17, 2003, and January 5, 2004, and she heard testimony from two witnesses produced by the trustee. The first was an accountant retained by the trustee, and the second an accountant from a firm that prepared Meadow's financial statements. Smith offered the testimony of an accountant that he had retained to assess the value of Meadow. The plaintiffs allege that the defendant shareholders received notices of motions, opposed discovery motions, and participated in the hearing through their cooperation with the trustee.

In determining the motion to approve the proposed settlement, the bankruptcy court, quoting In re Teltronics Services, Inc. (762 F2d 185, 189), noted that its function was not to decide the

issues of law and fact raised by the underlying litigation, "but rather to canvass the issues and see whether the settlement fall[s] below the lowest point in the range of reasonableness." (Internal quotations omitted). The bankruptcy court gave as factors to be considered, inter alia, "(1) the probability of success in the litigation; (2) difficulties to be encountered in collection; (3) the complexity of the litigation and related expense and inconvenience; and (4) the interests of the creditors" (In re Marvel Entertainment Group, Inc., 222 BR 243, 249) as well as "[5] the competency and experience of the trustee and trustee's counsel (although their recommendation alone is not dispositive), [6] the nature and breadth of releases to be issued as a result of the settlement, [7] the extent to which the settlement is not the product of fraud or collusion ... and [8] whether the proposed settlement is supported by an adequate record" (In re Remsen Partners, Ltd., 294 BR 557, 565).

In examining the merits of the underlying dissolution action, the bankruptcy judge noted that in arriving at a valuation "the Court of Appeals of New York has frequently approved a methodology utilizing capitalization of earnings, taking into account the lack of marketability of stock in a closely held-corporation such as Meadow." Using financial statements for several years (not just those for year-end 1990 relied upon heavily by the trustee and his accountant), the bankruptcy court approximated Smith's share of

the earnings of Meadow to be $300,000. After applying a conservative "multiplier" to the earnings and making a discount for lack of marketability, the court found that "the value of the Debtor's interest in Meadow would most likely increase to no less than $600,000." By decision and order (one paper) dated March 8, 2003 [sic: 2004], the bankruptcy court denied the trustee's motion to approve the settlement without prejudice "as the proposed Second Settlement does not adequately reflect the value of the Dissolution Action and the note owed to the Debtor's estate."

The trustee appealed to the United States District Court for the Eastern District of New York. However, by a decision and order dated March 31, 2005 (one paper) the district court judge affirmed the order of the bankruptcy judge and dismissed the trustee's appeal. One of the issues raised by the trustee on appeal was whether, in assessing the valuation of the dissolution action, the "application of a multiplier to the value of Meadow was erroneous because: no specific multiplier was proffered by any expert; and Meadow ceased operations in 1993."

The district court judge noted: "The capitalization of earnings approach is an accepted valuation method which requires the following: (1) an assessment of a company's net earnings in excess of reasonable compensation over a time period; and (2) multiplying that figure based on a 'multiplier' that reflects

the growth prospects of the company."

The district court found that the selection of a multiplier of two was not erroneous and that it was not error to take into account Meadow's growth prospects, even though the company allegedly ceased operations in 1993; and accepted "the Bankruptcy Court's conclusion that the Dissolution Action would permit a recovery of, at a minimum, $600,000."

By order dated July 14, 2005, the bankruptcy court authorized the trustee to abandon to the debtor the claims of the debtor against any party. Pursuant to a decision and order (one paper) dated October 18, 2006, this court restored the instant special proceeding to active status.

The plaintiffs now raise the doctrine of collateral estoppel for the purpose of establishing that the minimum value of the shares that they hold in Meadow amounts to $600,000 for Smith and $133,333.33 for his wife for a total of $733,333.33.

Initially, the court notes that the doctrine of collateral estoppel is available in this proceeding as it has been successfully invoked in courts of this state based on prior determinations of a bankruptcy court. For example, in Loving v Abbruzzese, 298 AD2d 749, a bankruptcy court order approving a corporation's reorganization plan collaterally estopped shareholders from asserting claims in a subsequent action against the corporation's officers and financial advisor for breach of

fiduciary duties. In Aryeh v Altman, 36 AD3d 492, an order in a bankruptcy proceeding was given collateral estoppel effect in a subsequent replevin action on the issue of whether the purchase of a painting had been made in good faith.

"The doctrine of collateral estoppel, a narrower species of res judicata, precludes a party from relitigating in a subsequent action or proceeding an issue clearly raised in a prior action or proceeding and decided against that party or those in privity, whether or not the tribunals or causes of action are the same ...." (Ryan v New York Telephone Co., 62 NY2d 494, 500; Parker v Blauvelt Volunteer Fire Co., Inc., 93 NY2d 343; Altegra Credit Co. v Tin Chu, 29 AD3d 718; Sam v Metro-North Commuter Railroad, 287 AD2d 378). "The doctrine applies if the issue in the second action is identical to an issue which was raised, necessarily decided and material in the first action, and the plaintiff had a full and fair opportunity to litigate the issue in the earlier action ...." (Parker v Blauvelt Volunteer Fire Co., Inc., supra, 349; Sam v Metro-North Commuter Railroad, supra). The proponent of collateral estoppel has the burden of demonstrating the identity of the issue, while the opponent must establish the absence of a full and fair opportunity to litigate (See, Jeffreys v Griffin, 1 NY3d 34).

Turning to the facts of this motion Smith did not establish that the issue to be determined in this dissolution proceeding is

identical to the issue determined in bankruptcy court. The issue before the bankruptcy court was whether the proposed settlement of the Meadow dissolution proceeding "[fell] below the lowest point in the range of reasonableness." This differs from the issue of what is actually the proper full value of the plaintiff's shares in Meadow. At most, as part of its inquiry into the reasonableness of the proposed settlement, the bankruptcy court resolved the issue of what was the minimum reasonable value of the plaintiff's shares in Meadow. This court need not resolve that issue in the dissolution proceeding, but rather must determine the actual, full value of the plaintiff's shares.

An issue in a prior action must be determined with sufficient finality to be accorded collateral estoppel effect (See, Zangiacomi v Hood, 193 AD2d 188). The figure arrived at by the bankruptcy judge as the minimum reasonable value of the plaintiff's shares was just an estimate. The bankruptcy judge expressly noted that her function was merely to "canvass" the issues in the underlying litigation, "not to decide the issues of fact and law" raised therein. The bankruptcy judge speculated about the weight this court would give to certain financial documents, and stated in a tentative manner: "*For the sake of argument*, this court will reduce the Debtor's interest in Meadow to $300,000." (Italics added). The bankruptcy judge did not take evidence on the crucial matter of the "multiplier" to be applied

to the $300,000 in estimated earnings, but merely picked a conservative number suggested by other cases.

Further, plaintiffs failed to establish that the bankruptcy court (1) actually and finally decided (2) an identical issue present in this case (See, Parker v Blauvelt Volunteer Fire Co., Inc., supra; Sam v Metro-North Commuter Railroad, supra).

On the other hand, the defendants established that they did not have a full and fair opportunity to litigate the issue pertaining to the minimum value of plaintiff's Smith's interest in Meadow (See, Parker v Blauvelt Volunteer Fire Co., Inc., supra; Sam v Metro-North Commuter Railroad, supra). They were not parties to the bankruptcy proceeding, and the only parties to the motion for an order approving the proposed settlement were the trustee in bankruptcy, Smith, and creditors who opposed the proposed settlement.

The defendants deny that they were given the opportunity to testify and to submit evidence concerning the valuation of Meadow from their own experts, nor did they have a right to appeal the order rendered by the bankruptcy judge on the motion.

Nor were the defendants in privity with the trustee. The term "privity" for collateral estoppel and res judicata purposes includes "those who control an action although not formal parties to it [and] those whose interests are represented by a party to the action ...." (Watts v Swiss Bank Corp., 27 NY2d 270, 277;

see, Juan C. v Cortines, 89 NY2d 659; All Terrain Properties, Inc. v Hoy, 265 AD2d 87). The record does not permit the court to infer that the defendants had control of the motion for the approval of the settlement or that the trustee represented the defendants' interests exclusively, if at all.

While certainly many of the issues disputed herein were raised in the prior proceedings, the doctrine of collateral estoppel need not be applied even if some of its formal prerequisites like identity of issues and opportunity to litigate are satisfied (See, Jeffreys v Griffin, 1 NY3d 34; People v Roselle, 84 NY2d 350). "[C]ollateral estoppel is a flexible, equitable doctrine that requires a case-by-case analysis of the facts and realities of a particular litigation, and should not be rigidly or mechanically applied ...." (White v Frize, 35 AD3d 983, 984; see, Jeffreys v Griffin, supra; Buechel v Bain, 97 NY2d 295; D'Arata v New York Cent. Mut. Fire Ins. Co., 76 NY2d 659). "Collateral estoppel ..., is grounded on concepts of fairness and should not be rigidly or mechanically applied ...." (D'Arata v New York Cent. Mut. Fire Ins. Co., supra, 664). In the case at bar, Smith is essentially attempting to obtain partial collateral estoppel in a manner that can only benefit him, i,e., he seeks to foreclose the defendants from litigating the issue of valuation where a floor has allegedly been established and at the same time he seeks to

contest the issue where no upper limit has been set. Smith does not postulate that the figure arrived at in bankruptcy court is the full amount of his interest in Meadow, thereby effectively ending this valuation dispute.

In utilizing this approach, Smith leaves open the possibility that this court will reach a determination as to valuation inconsistent with that of the bankruptcy court. His procedural maneuver does not advance the policies underlying the doctrine of collateral estoppel, one of which is the prevention of inconsistent decisions by different courts (See, Buechel v Bain, supra; 10 Weinstein- Korn - Miller, NY Civ Prac, ¶ 5011.23). This court may, for example, find a different multiplier, if any, to be appropriate, thereby drastically altering the value up or down to be placed on Smith's shares. Moreover, the conservation of resources, the other policy consideration underlying the doctrine of collateral estoppel (see, Jeffreys v Griffin, 301 AD2d 232, affd, 1 NY3d 34), will not be promoted in this case where the issue of valuation will have to be tried de novo.

Accordingly, the motion is denied.

Short form order signed simultaneously herewith.

**Peter J. Kelly, J.S.C.**