

Ruggiero v Ruggiero
2013 NY Slip Op 31955(U)
July 29, 2013
Sup Ct, Suffolk County
Docket Number: 36299-2012
Judge: Emily Pines
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SHORT FORM ORDER

INDEX NO. 36299-2012

SUPREME COURT - STATE OF NEW YORK
COMMERCIAL DIVISION, PART 46, SUFFOLK COUNTY*Present:* HON. EMILY PINES
J. S. C.

**NILVIA RUGGIERO Individually and as
Executrix of the Estate of ANTHONY
RUGGIERO,****Plaintiff,****- against -****PASQUALE RUGGIERO, and 784 8TH Street
Corp., dba ZAN'S KOSHER
DELICATESSEN & RESTAURANT,****Defendants.**Attorney for PlaintiffHoward Fensterman, Esq.
Keith Singer, Esq.
Abrams, Fensterman, Fensterman Eisman
Formato Ferrara & Einger LLP
1111 Marcus Avenue, Suite 107
Lake Success, New York 11042Attorney for the DefendantsJohn Bracken, Esq.
Harvey Besunder, Esq.
Bracken, Margolin and Besunder, LLP
1050 Old Nichols Road, Suite 200
Islandia, New York 11749

DECISION AFTER HEARING

Plaintiff, Nilvia Ruggiero, individually and as Executrix of the Estate of Anthony Ruggiero ("Nilvia or Plaintiff") commenced this action on November 30, 2012, against her brother-in-law [Pasquale Ruggiero ("Pasquale")] and co-shareholder of Defendant 784 8th Street Corporation d/b/a Zan's Kosher Delicatessen & Restaurant [("Zan's") (collectively "Defendants")]. Plaintiff asserted that Pasquale had sought to capitalize upon the death of her late husband, Anthony Ruggiero, in order to force her and her family out of a business which the brothers had operated together for twenty five years. She alleged that Pasquale had thereafter terminated her daughter's employment; terminated her and her daughter's health insurance

her daughter's employment; terminated her and her daughter's health insurance benefits upon which they relied; demanded that she contribute \$4,000 per month towards a monthly rent obligation; and denied her access to Zan's premises. She sought, in her Complaint, an appointment of a Temporary Receiver and an accounting; and asserted alleged causes of action for breach of fiduciary duty and unjust enrichment.

Pasquale Ruggiero opposed Plaintiff's motion to appoint a Temporary Receiver and set forth that after his brother's death, he discovered that his brother had been systematically stealing funds from the business. In addition, he allegedly learned that his brother, in charge of the business finances, had left accounts receivable of over \$400,000, which he was doing his best to pay down. He also claimed to have learned that his brother had interfered with relations with vendors due to consistent late payments. Moreover, rent and utility payments were long overdue. He averred that he was bringing all these obligations current. Pasquale also set forth that Nilvia had unclean hands as she had removed over \$25,000 from the corporate account without any notice. In addition to his opposition to Plaintiff's motion, Defendants cross moved, seeking to compel arbitration of the parties' disputes, based upon the allegation that Zan's is a successor corporation of Sheri-Nel LLC, which is the successor corporation of Alexander Avenue Kosher Restaurant Corporation. Pasquale asserted that both he and Anthony Ruggiero were 50% shareholders of each of these corporate entities and that all of the assets, liabilities and obligations of Zan's were rolled over from the original corporate entity with no capital contribution. In 1989, upon the formation of the first entity, the brothers entered into a Shareholders' Agreement which contained a broad Arbitration Clause, setting forth that any claim arising out of or relating to such agreement would be resolved in arbitration in the City of New York.

Nilvia opposed Pasquale's cross motion, setting forth that she is a 68 year old widow, with no assets, except for her 50% ownership of the stock in Zan's. She stated further that Pasquale had a history of drug abuse and after two stays in drug

rehabilitation programs, he was the last person to be running Zan's, a largely cash business. She stated further that Zan's owes her at least \$450,000 for money provided to Pasquale, secured by his stock in the corporation. She also countered that the corporations following Sheri-Nel LLC were created as new entities. Thus, the Alexander Avenue Corporation agreement states that the agreement would terminate, inter alia, by virtue of dissolution, which has occurred.

On December 4, 2012, this Court signed an Order to Show Cause, on Plaintiff's behalf, directing Defendants to restore health insurance coverage to Nilvia and her daughter. Thereafter, following a conference with the Court, the Court directed, on April 3, 2013, that Defendant Pasquale continue to maintain health insurance for Plaintiff and her daughter Denise Ruggiero and that he pay Nilvia \$1500 per week beginning April 8, 2013. The counsel for both parties then agreed, at the suggestion of the Court that both parties be directed to retain expert business evaluators and/or accountants to value Defendant Zan's; that the parties were to exchange expert reports; and that the Court would conduct a hearing on the issue of valuation of the business. It was further agreed that the Court would resolve this case by: 1) determining the value of Zan's based upon expert testimony; 2) determining which party would purchase the shares of the other party; and 3) at a later date, determining whether either party was entitled to any credits for amounts due and owing other than their share of the business value. Both counsel set forth to the Court that they were agreeable to the procedure and that the sole appealable issue would relate to the Court's determination of the numerical amounts due and owing.

Prior to a hearing set for valuation of Zan's, the Court received reports from Klein Liebman & Gresen, LLC (retained by Plaintiff), and Gettry Marcus CPA, PC (retained by Defendants), both setting forth their specialization, inter alia, in business valuation and litigation support.

The report on behalf of Plaintiff, signed by Ronald Klein, David Gresen and David Gralnick stated that they reviewed financial information for the five years

ending December 31, 2012. This included the corporation's revenues; actual purchases; payroll; operating expenses; accounts receivable; accounts payable and inventory. In some instances, they brought these figures through the time of their report in April 2013. It was Klein Liebman & Gresen's opinion that the Market Approach is the best method to value a business such as Zan's. Although this is generally done by looking to sales of similar entities, they were unable to identify any similar to Zan's; however, they set forth that the Market Approach, using what they termed the Price to Revenue method, was preferable to the Income or Asset Approach. They concluded that looking at normalized revenues and operating profits for years of operation and years left on the lease, Zan's should be valued at 40% of annual gross revenue. For the twelve months ending August 18, 2012, they found Zan's revenues were \$2,669,037, 40% of which amounts to \$1,067,614. From this amount they considered cash on hand, accounts receivable, inventory, accounts payable and arrived at a working capital deficit of \$359,076. After subtracting this deficit from the \$1,067,614, they arrived at a fair value for the entity of \$709,000, 50% of which, as of the date of Anthony Ruggiero's death, equals \$354,000. The firm then made a similar calculation for the period ending April 30, 2013. They arrived at a value of \$1,188,538 based upon 40% of revenues of \$2,971,346. After adjusting this figure for working capital items as above, they arrived at a fair value of Zan's as of April 30, 2013, of \$1,002,000, 50% of which amounts to \$501,000. Klein, Liebman & Gresen then cross checked these figures by viewing owners' cash flow and found that Zan's cash flow available to the owners for the period August 19, 2012 through April 30, 2013 amounted to \$297,000. The report sets forth that it was not considering outstanding loans to any of the shareholders in its calculations.

Mr. Glazer of Gettry Marcus utilized the Income Approach to determine the fair value of Zan's, by computing the present value of future benefits to be received by the shareholders, typically in the form of cash flow. He rejected the Market Approach because Gettry Marcus' search of available data bases, in his view, did not result in sufficient transactions whose pricing multiples were applicable to a valuation of Zan's.

Mr. Glazer compared Zan's total revenues to the revenues set forth on its tax returns for the 2011 and 2012 years as well as the fiscal year ending August 31, 2012 and the seven month period September 1, 2012 through March 31, 2012. He analyzed Zan's cash payout to vendors and for payroll compared to those amounts set forth on the tax returns. He also looked to payments actually received and compared those to Zan's invoices. He made the same comparison for accounts payable with actual invoices received. Mr. Glazer reviewed Zan's accounting records for nonrecurring expenses so they would be removed from his analysis and analyzed assets and liabilities to determine cash outflows that are not captured in a review of Zan's income statements. The Defendants' expert stated that for a period of nine years after the valuation date, the company's net income will not be available for distribution to shareholders due to nine years remaining on an installment loan payable to Nilvia Ruggiero as well as three loans due to shareholders totalling \$124,955. However, Mr. Glazer estimated a sixty month repayment term for the shareholders' loans on a non-interest bearing basis, subtracting \$24,991 per year for five years from his estimate of net income. In order to avoid a cash flow estimated at below Zan's expected annual net income, the expert employed a discounted cash flow for several years into the future. Mr. Glazer arrived at a value for Zan's of \$273,000 as of August 2013. He subtracted \$54,620 for what he termed a discount for lack of marketability and added \$21,848 as an estimated increase in value due to pass-through tax status, translating into a December 31, 2012 value for the company of \$240,328 - a 50% interest then equaling \$120,200. This analysis also indicates that the adjusted pre-tax income of Zan's for the period from September 1, 2012 through March 31, 2013 amounts to \$77,490.

Ronald Klein testified on behalf of the Plaintiff, essentially in accordance with his report which was admitted into evidence as Court's 1. He set forth that he rejected the Cost Approach for several reasons, including 1) the inadequacy of sales data in Defendant's records; 2) the fact that there were numerous cash purchases not set forth in the general ledger; 3) an inability to reconcile payroll on the company's books and records with cash payments; and 4) the fact purchases were made through

cash, Amex cards and barter. Mr Klein stated that in his “price to revenue” approach, he was able to calculate revenues from sales from what he called the company’s day books both for the twelve month period prior to Anthony Ruggiero’s death and for the twelve months preceding the date of his report on April 13, 2013. To revenues he stated that he added working capital, which was a deficit, to achieve normalized revenues for the periods in question. To reach his value for the business, Mr. Klein then applied a 40% price to revenue multiple, stating that this was a figure he derived based upon his experience in the business valuation field. Based upon these steps, he arrived at the \$798,000 value for the first period and the \$1,002,000 for the second period. According to Mr. Klein, the increase in value could be ascertained by seeing that there had been a significant pay down in accounts payable during the period between August 2012 and early 2013; an increase in menu prices; and the addition of three new meals on wheels programs. Mr. Klein set forth that he considered, inter alia, the location of Zan’s; the type of restaurant; the staff and management; and the increases in revenues based on higher pricing and an increase in meals on wheels programs. With regard to the company’s existing debt, he did state that such does affect the value but that he was asked not to include such in his calculations. He also stated that he did consider the downturn in the economy since 2008 but felt that it would recover substantially by 2014. Finally, Mr. Klein stated that if the meals on wheels program was as high as 40% of the restaurant’s business, that he would reconsider and perhaps lower his 40% multiple.

Mr. Klein stated that he reviewed the Getty Marcus report and that it contained certain flaws. These included the following: 1) it was based upon inadequate records of income, expenses as well as accounts payable and receivable; 2) it deducted too much for salaries for officers as it was higher than that actually paid and was unreasonable based upon the same at other delicatessens; 3) it applied a unusually high discount rate, where the risk free rate should have been about 2.55% as this is a niche business with a stable employee base.

Russell Glazer testified in accordance with the report provided on behalf of the

Defendants, which was admitted into evidence as Court's 2. He determined the value of the business based upon an Income Approach, which is gleaned from the books and records of the subject company and is often referred to as the discounted cash flow method. In order to reach his conclusions, Mr Glazer stated that he looked at numerous books and records of the company, including, the general ledger, lines of credit, vendor cards, the tenant ledger, payroll records and cash register receipts. According to the witness, he was able to derive revenues from what both witnesses called the day book and also to determine the following: 1) accounts receivable balances; 2) accounts payable balances from actual purchases; 3) revenues; 4) payroll that had not been set forth on the tax returns; 5) cash payouts to vendors as well as non vendors, such as office suppliers and utilities; 6) checks never paid; and 7) the previous year's sales tax. Unlike Mr. Klein, Mr Glazer included the corporate debt and loans to shareholders in his calculation of value. Mr Glazer stated that he attributed salaries to officers in the amount of \$208,000 by doubling what the remaining officer was being paid, based upon the assumption that such would be paid to an incoming manager/officer. Once Mr. Glazer determined income, he applied a discount rate to determine the present value of \$273,000 as of the date of Anthony Ruggiero's death. The witness then reduced this amount by 20% for lack of marketability and added a figure to the result due to the favorable tax treatment that the corporation receives due to its Subchapter S status. Based on the above, he reached his figure of \$120,200 for 50% of the value attributable to Anthony Ruggiero.

With regard to Mr. Klein's projected revenues, based upon types of meals served, Mr. Glazer stated that Mr. Klein miscalculated the percentage of business attributed to the meals on wheels programs, which carried a far lower profit than regular menu items and accounted for up to 34% of the company's revenues. With regard to the alleged increases in menu prices, Mr. Glazer set forth that Mr. Klein ignored the fact that certain items were decreased in price, thereby balancing out any projected increase for 2013. Mr. Glazer also stated that Mr. Klein's citation of a 2.55% risk free rate was incorrect based upon the expert publication both witnesses

referred to in their reports because such were based upon the treasury note rate of return in 2008 prior to the downturn in the economy and that the risk free rate at this juncture was much closer to his figure of 4.6%. Mr. Glazer also disagreed about the state of knowledge of revenues and expenses based upon the available material. He set forth that he was able to see the true revenues and purchases as well as payroll despite their variation from the tax returns. He also set forth that Mr. Klein's use of the 40% multiple was not justified in any way in his report as there existed no comparison with comparable companies to compare their debt and growth rate. He also stated that Mr Klein's use of a \$133,000 figure for officers' salaries was not reasonable in a cash business where the amounts paid for such clearly exceed the amounts set forth on a general ledger. Mr. Glazer also stated that it was inappropriate to value a company without consideration of its existing loans. With regard to an increase in revenues set forth by Mr. Klein for early 2013, Mr. Glazer stated that such was inappropriate as this was the busiest time period of the restaurant occurring between the Jewish holidays of Rosh Hashonah and Passover.

Lisa Giosi testified that she has been employed at Zan's for over eleven years, currently as its bookkeeper. She stated that she was familiar with the company's day book which each set of experts reviewed. She set forth that such books contained all of the cash totals for the company for each day and that she was trained in the use of such by Anthony Ruggiero. She also stated that both sets of experts were given the same material including copies of day books, cash receipts, the general ledger, vendor cards and cash register tapes. She claimed that the use of barter for payment to vendors was utilized and introduced by Anthony Ruggiero. According to Ms. Giosi, the restaurant's busiest period is between September and April, during which period it brings in the bulk of its revenues and after which its revenues fall for the remainder of the year.

Based upon consideration of the evidence presented, it is the Court's conclusion that Mr. Glazer has provided a more accurate valuation of the subject enterprise. The Court found credible Mr. Glazer's testimony that he was able, based

upon his review of the company's day book as well as invoices and actual payments, including those by cash and barter, to review the true revenues and expenses of the business for the period in question. Since both witnesses were provided with identical information, the Court does not accept the testimony of Plaintiff's expert that he was not provided with sufficient information to determine the company's income. In addition, it appears that Plaintiff's expert did not take into consideration the large proportion of business attributable to the meals on wheels programs, which result in a lower margin of profit; and, most significantly, failed to include corporate loans and debts in his valuation, which he admitted affected corporate value. The Court does not find that there was sufficient explanation of Mr. Klein's choice of the 40% figure he utilized in his price to revenue formula. The Court also found credible Mr. Glazer's use of the 4.6% risk free discount rate cited in the more recent expert report, based upon the downturn in the economy since the 2008 report by the same author on which Mr. Klein relied. While both experts explained that Zan's is largely a cash business, the Court accepts Mr. Glazer's statement that the officers' salaries utilized by Mr. Klein do not take into account the true amounts paid to such over a one year period. While Mr. Klein did bring his figures forward to April 2013, the Court does not accept his conclusions that there was any increase in the period between the date of Anthony Ruggiero's death and the 2013 date based upon Mr. Glazer's and Ms. Giosi's statements that the great bulk of business revenues are earned during the period between the date of Anthony Ruggiero's death and April of the following year.

The sole issue the Court had with Mr. Glazer's valuation was his 20% discount for lack of marketability for which he did not provide sufficient explanation. In this sense, the Court agreed with Plaintiff's expert that Zan's does constitute a somewhat unique niche business. Thus, the Court removed from Mr. Glazer's calculation the deduction of \$54,620 for lack of marketability. Utilizing Mr. Glazer's value of \$273,000 and adding his estimated increase in value due to preferred tax status of \$21,848, the Court finds that the correct valuation for the entity is \$294,848, which translates into a 50% share attributable to the estate of Anthony Ruggiero of

\$147,424. It is this Court's determination that Pasquale Ruggiero, who has been involved in the actual operation of this business for over twenty five years, is the proper party to remain as the operator of the corporate business and to purchase the shares owned by his deceased brother's estate. The amount set forth is as of the date of Anthony Ruggiero's death.

At the close of the hearing, the Court suggested that it would give the parties a period of time to calculate the amounts each believes are due and owing, including any debt to a shareholder, outstanding shareholders' loans, and credits each is claiming so that it can arrive at a final figure for payment. The parties will have ninety days to complete such discovery and counsel are then directed to provide the Court with written proof of such amounts so that the Court can make adjustments, if necessary to the purchase price set forth above. In the interim, the Court is continuing its Order that the corporation pay Nilvia Ruggiero \$1500 per week and to maintain her health insurance and that of her daughter.

Counsel for the parties are directed to appear for a conference to finalize the procedure set forth on August 21, 2013 at 10 a.m. This constitutes the Decision and Order of the Court.

Dated: July 29, 2013
Riverhead, New York



EMILY PINES
J. S. C.

Final
 Non Final