Rosenblum v Rosenblum
2024 NY Slip Op 32075(U)
June 14, 2024
Supreme Court, New York County
Docket Number: Index No. 654177/2015
Judge: Melissa A. Crane
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SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: HON. MELISSA A. CRANE **PART 60M**

Justice

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KENNETH ROSENBLUM, **INDEX NO.** 654177/2015

Plaintiff,

- v -

Decision after valuation bench trial

BERNICE ROSENBLUM,

Defendant.

---X

Melissa A. Crane, J.S.C.

The parties here are 50/50 members in two LLCs. This case is notable for being a particularly acrimonious, multi-generational family dispute. It has also been lengthy. The parties have been fighting since 1996. They agree on practically nothing, are uncompromising, and change legal positions as it suits them in the moment. This court is confident this decision will only foster further litigation, both here and on the appellate level. There appears to be no real interest in resolving this matter.

On January 4, 2022, after a bench trial, this court granted judgment to plaintiff on his withdrawal claim and determined that plaintiff's withdrawal date from the two LLCs at issue (132 Realty LLC and Village Realty LLC) was September 20, 2019. The Appellate Division, First Department affirmed that part of the bench trial decision setting the September 20, 2019 withdrawal date. (*see Rosenblum v. Rosenblum*, 214 AD3d 440 [1st Dept 2023]).

This necessitated a valuation hearing to determine the "fair value" of plaintiff's interests in each LLC as of the valuation date. The hearing took place in April 2023. Post trial briefing concluded by September 2023. The main areas in dispute are the value of certain properties the LLCs hold (132 Thompson Street and 35-39 Christopher Street) as well as valuation issues related to the LLCs themselves, such as whether to impose a discount for lack of marketability.

OTHER ORDER – NON-MOTION

The parties' valuation experts agree that the proper method to value the LLCs is by net asset value. Under this approach, the book value of the LLCs' assets is adjusted to reflect market value, the LLCs' adjusted liabilities are subtracted, and then there may or may not be a marketability discount to apply.

The experts disagree as to: (1) the underlying value of each LLC's real property, (2) the market value of the loans from Standard Realty and (3) the appropriate marketability discount to apply. Mr. Feeny was the property valuation expert for plaintiff. Mr Farrell was the property valuation expert for defendant. Mr. Mercer valued the entities for plaintiff, while Mr. Klein valued the entities for defendant. All experts were qualified. The parties also disagree about whether the Appellate Division, First Department's decision in this case from last year forecloses the issue of an award of prejudgment interest.

Valuation of closely held corporations is not an exact science, and it is the "particular facts and circumstances of each case that will dictate the result. (*Matter of Friedman v. Beway Realty Corp.* 87 NY2d 161, 167 [*Beway*] [1995]; see also *Giaimo v Vitale*, 101 AD3d 523, 524 [1ST Dep't 2012]).

I. The value of the LLC's real property

To determine the value of the real property underlying the LLCs, both parties looked at comparable properties (comps), net operating income, and capitalization rates.

A. Comps

At the 2020 trial, defendant's prior appraisal of 132 Thompson as of 2016 amounted to $23.4 million. Yet valuing for 2019, the appraised value decreased to $18.5 million, a 21% decline in value. Defendants proffer no explanation for the marked decrease in value for Manhattan real estate in prime Greenwich Village. Meanwhile, defendant's expert, Mr. Farrell, admitted that the West Village, between 2016 and 2019, was "an excellent environment for real estate values in that the interest rates were low, supply was limited, demand was high" – which would "lead to higher values going up over time," so that one "could expect real estate prices in the West Village [to] have been increasing over that period." (Tr. at 245).

For the Christopher Street properties, defendant's prior appraisal as of the 2016 valuation date was $24.1 million. Mr. Farrell's current appraisal as of the 2019 valuation date is $16 million. This represents about a 34% decrease in value. Mr. Farrell could not point to anything in the marketplace that would explain such a sharp decline in value within these three years. The only real explanation is that defendant decided at some point after the first trial that it was somehow to their advantage that the properties be worth less, perhaps because they now have to buy out plaintiff, rather than the other way around.

Nor were Mr. Farrell's comps appropriate. For example, 124 W 73rd St. is not a good comp. The building is on the Upper West Side, is under 17 feet wide and has only 8 residential units. Not only is the neighborhood totally different, but this building is much smaller than 132 Thompson.

Meanwhile, 11 Carmine Street, although in the village, has had no known renovations since 1891. The property to which 11 Carmine was compared, 132 Thompson, was renovated in 2014. (Ex. 3 at 84 and Tr. 211-212). Moreover, 11 Carmine had a much higher percentage of commercial rent income than either subject property. (Ex. 9 at 3).

In addition, 22 St. Marks, in the East Village (rather than the West Village where the subject properties are), was last renovated in 1984. Also, it has over 50% of rent regulated units. (Ex. 5 at 2).

As for 202 Ninth Avenue, this building is in a different neighborhood (it is at 23rd Street) and has only 5 total units. (Ex. 10 at 2). Thus, none of the comps defendants proffered are all that comparable. Considering the inexplicable dive in defendant's appraised value from prior junctures in this litigation, the court finds defendant's comparable analysis not credible and disregards it. Meanwhile, plaintiff's comps were all in the West Village and were more similar to the properties at issue here (see e.g. Ex 1 pg. 60 [chart of properties]).

B. Net Operating Income (NOI)

But plaintiff's valuation is not reliable either. The rent roll projections are inflated and speculative. Plaintiff used rents that the units in the building were not currently achieving. Instead of

using the rent rolls the units were actually collecting, he used some overstated amounts listed in the RENT column on the rent rolls that he admitted were NOT the amounts the properties actually collected or even billed [see Ex A]. This was not reasonable (*see Cinque v. Largo Enterprises of Suffiolk Cnty*, 212 AD2d 608, 609 [2d Dept 1995] ["The fair market value of the property is limited to the income due under the lease"] [cf. *Levine v. Seven Pines Assocs. Ltd. P'ship*, 156 AD3d 524, 525 [1st Dept 2017] ["It makes sense that, when valuing a building, one would use its actual, historical expenses instead of market estimates, especially when respondent explained why the expenses for its building were higher than average"]).

By contrast, defendant's net operating income calculation relied on actual contract rents, not some theoretical higher amount the market clearly would not bear or that higher rent would have been charged.

Then, defendant's expert, Mr. Farrell, applied a standard vacancy and collection loss deduction to arrive at effective gross income of $1,524,213 for Thompson Street and $1,538,511 for Christopher Street. (Ex. 3 at 73; Ex. 4 at 78). Mr. Farrell calculated expenses using the actual historical expenses of the buildings. (Ex. 3 at 76-79; Ex. 4 at 81-84). Subtracting expenses from income yielded NOI for Thompson Street of $869,222 (Ex. 3 at 80) and $757,912 for Christopher Street (Ex. 4 at 85). Given defendant's reliance on actual contract rents renders defendant's analysis of net operating income more reliable than plaintiff's.

C. Cap Rates

However, the precipitous drop in defendant's appraisals from the 2016 valuation at the last trial to the current valuation based on 2019 numbers is highly suspicious. Mr. Farrell's then used these inappropriate comps to generate an artificially high capitalization rate. Therefore, plaintiff's cap rates are more reliable. The court finds the remaining contentions of the parties concerning the value of the real property to be unavailing, including defendant's speculative argument that the Tenant Protection Act of 2019 depressed the value of the real estate. Accordingly, the court directs the parties to recalculate the

valuation for the real property underlying the LLCs in accordance with the foregoing (i.e. use plaintiff's comps and cap rate, but defendant's NOI).

II. Valuation of the LLCs –other factors than the value of the real property

A. Treatment of Cash and Loans

1. Cash on Hand

It appears to be undisputed that the amount of cash on hand for 132 Realty was $503,690 as of the valuation date and $874,018 for Village Realty. (*see* Ex. 11 at 105, 108). These amounts should be split 50/50.

2. Loans

The Estate argues that the loans owed to the LLC's should be eliminated because Standard Realty is insolvent. Assuming that Standard Realty is insolvent, the loans are still fully collectible. This is because Standard Realty is a partnership and partners are personally liable for the debts of the partnership (see, e.g., *City of New York v Evaston Ins. Co.*, 165 AD3d 1032, 1034 [2d Dep't 2018]). Thus, any loan the Partnership is unable to pay would be covered half from Kenneth and half from the Estate. Therefore, it was improper for the Estate to devalue the LLCs by $4.7 million on the grounds that the loans were uncollectible. Moreover, the LLC loans payable and loans receivable should be treated the same way. The estate only credited the loans the LLCs owed with no real explanation for the disparate treatment.

Nevertheless, it is difficult to understand how, as a practical matter, with each side owing 50% of these loans, the amounts do not cancel out at the individual level once payment occurs.

B. Marketability Discount

Mr. Klein, the estate's expert applied a 15% marketability discount primarily due to the protracted litigation between the parties (they have been fighting since 1996) and the lack of an operating agreement that has contributed to the protracted litigation.

"The method of valuing a closely held corporation should include any risk associated with the illiquidity of the shares." (*Giaimo v. Vitale*, 101 AD3d 523, 524 [1st Dept 2012]). "The value of the

corporation itself should be determined on the basis of what a willing purchaser, in an arm's length transaction, would offer for the corporation as an operating business, rather than a business in the process of liquidation" (*Matter of Blake v. Blake Agency*, 107 AD2d 138, 146 [2d Dept 1985]; *see also*, *Beway*, 87 NY2d at 168). A lack of marketability discount reflects "the illiquidity of a petitioner's shares, i.e. that a potential investor would pay less for shares in a close corporation because they could not readily be liquidated for cash." (*Beway,* 87 NY2d at 165). The unmarketability discount is supposed to be taken against "the aggregate net asset value of the corporations...." ([*Id.* at 166]; see also *Hall v. King*, 177 Misc2d 126, 134 [New York County 1988]).

Here, a marketability discount is appropriate at the holding company level. The parties' inability to work together permeates every aspect of their relationship. They could barely agree on anything, necessitating two levels of court involvement and two separate trials. This particular piece of the litigation is nearly ten years old. The amount of time and money that has been wasted due to an unwillingness to compromise reflects poorly on the value of these companies. Compounded by the lack of an operating agreement and a set process for withdrawal, a third-party investor (which is the correct perspective from which to be evaluating [see, e.g., *Gaiamo* supra]) would be unlikely to risk buying into this business at all, much less without a discount.

Contrary to plaintiff's position, the LLCs are not merely "wrappers" for the underlying real estate which does have a fixed market. Nor is a marketability discount somehow baked in at the property level.

To consider the LLCs as mere "wrappers" ignores that the exercise here is to value the entirety of the business as a going concern. We cannot do that while ignoring the horrible relationship between the parties and the lack of operating documents. (see *Giaimo*, 101 AD3d at 524 ["While there are certainly some shared factors affecting the liquidity of both the real estate and the corporate stock, they are not the same. There are increased costs and risks associated with corporate ownership of the real estate in this case that would not be present of the real estate was owned outright. These costs and risks have a

negative impact on how quickly and with what degree of certainty the corporations can be liquidated, which should be accounted for by way of a discount"]).

Plaintiff overstates the holdings of the cases it cites to support its proposition that it is prohibited to apply marketability discounts to real estate holding companies. What case law prohibits is a de facto minority discount. (*see, e.g. Vick v. Alpert*, 47 AD3d 432 [1st Dept 2008]; *Zelouf International v. Zelouf*, 47 Misc3d 346 [New York County 2014]). However, "while New York law does not permit a 'minority discount,' it does permit a 'lack of marketability' discount." (*see Matter of Murphy v. U.S. Dredging Corp.*, 74 AD3d 815, 818 [2d Dept 2010]; see also *Beway*, 87 NY2d at 170 [distinguishing between minority discount and discount for unmarketability]).

The situation at hand does not involve a minority shareholder. Rather, plaintiff is a 50% shareholder. Plaintiff has not been frozen out of the LLCs, but voluntarily chose to withdraw. Accordingly, the cases prohibiting a de facto minority discount are inapposite. Finally, as plaintiff does not argue that the discount was too high, but merely sticks to his guns that no discount should apply at all, there is nothing to contravene defendant's expert's application of a 15% discount, as opposed to a smaller percentage.

C. Statutory Interest

Although this court may have overlooked the issue of Plaintiff's prejudgment interest in its trial decision dated January 4, 2022 [EDOC 526], plaintiff made sure to raise the issue with the Appellate Division, First Department along with all other issues upon which it believed this court erred. On appeal, Plaintiff argued that "an award of [prejudgment] interest must be added to the principal sum," and that the First Department had "the power to rule on the issue [of prejudgment interest]." Brief for Plaintiff - Appellant -Respondent, No. 2022-00549, NYSCEF 22, at 20 (1st Dept Sept. 16, 2022); *see also* Reply Brief for Plaintiff-Appellant-Respondent, No. 2022-00549, NYSCEF 28, at 23 (1st Dept Nov. 30, 2022) ("[A]n award of [prejudgment] interest in LLC dissolution, withdrawal, and buyout cases is authorized by CPLR §5001(a) . . .").

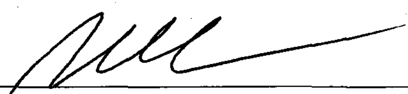
The First Department took up the issue and ruled that "the trial court also did not improvidently exercise its discretion in declining to award prejudgment interest on plaintiff's withdrawal distribution," (214 AD3d 440), notwithstanding that this court did not award plaintiff any "withdrawal distribution" at that time.

Plaintiff, having raised the issue of his right to prejudgment interest with the Appellate Division and having lost, this court's hands are now tied. The Appellate Division's decision is not only law of the case, it also binds this court. Accordingly, the court cannot award plaintiff any prejudgment interest on its withdrawal distribution.

Accordingly, it is

ORDERED that the parties shall file and email a proposed judgment that conforms to this decision within 30 days from its e-filed date; and it is further

ORDERED that the parties are directed to attend a conference, over Microsoft teams, on July 24, 2024, at noon, to discuss what remains of this case.



DATE: 6/14/2024 **MELISSA A. CRANE, JSC**

Check One: ☐ **Case Disposed** ☒ **Non-Final Disposition**

Check if Appropriate: ☐ **Other (Specify**