

Loconte Family, LLC v Keyway Pride Ltd., LLC

2024 NY Slip Op 35083(U)

September 16, 2024

Supreme Court, Westchester County

Docket Number: Index No. 62231/2022

Judge: Gretchen Walsh

Cases posted with a "30000" identifier, i.e., 2013 NY Slip Op 30001(U), are republished from various New York State and local government sources, including the New York State Unified Court System's eCourts Service.

This opinion is uncorrected and not selected for official publication.

To commence the statutory time period for appeals as of right (CPLR 5513[a]), you are advised to serve a copy of this order, with notice of entry, upon all parties.

SUPREME COURT OF NEW YORK
COUNTY OF WESTCHESTER: COMMERCIAL DIVISION

-----X

LOCONTE FAMILY, LLC, individually and derivatively on behalf of BABY PHAT HOLDING COMPANY, LLC,

Index No. 62231/2022
Motion Seq. No. 5

Plaintiffs,

- against -

KEYWAY PRIDE LIMITED, LLC, and KIMORA LEE SIMMONS-LEISSNER,

Defendants,

DECISION & ORDER

BABY PHAT HOLDING COMPANY, LLC,

Nominal Defendant.

-----X

WALSH, J.

The following e-filed documents, listed in NYSCEF under document numbers 167-175, 181, 191 and 192 were read on this motion in limine by Keyway Pride Limited, LLC (“Keyway”) Kimora Lee Simmons-Leissner (“Simmons”) (together “Defendants”) for an order excluding the proposed testimony of David B. Smith, CPA/ABBV/CFP/ASA of DLA, LLC (“Smith”), an expert witness for Plaintiff Loconte Family, LLC (“Loconte Family” or “Plaintiff”) individually and derivatively on behalf of Baby Phat Holding Company, LLC (“Baby Phat”). Plaintiff opposes the motion. Upon the foregoing papers and for the reasons stated herein, Defendants’ motion shall be denied.

FACTUAL AND PROCEDURAL HISTORY

The factual and procedural history of this action is set forth in this Court’s Decision and Order dated May 17, 2024 (NYSCEF Doc. No. 157 [the “May 2024 Decision”]) which granted in part, and denied in part, Defendants’ motion for summary judgment, and which is incorporated

herein by reference.¹ In this action, Loconte Family asserts claims both in its individual capacity, and derivatively on behalf of Baby Phat, in which Loconte Family holds a thirty percent interest. In its Second Amended Complaint, Plaintiff asserts claims of breach of contract, fraud, breach of fiduciary duty and conversion, arising from Plaintiff's and Defendant Keyway's entry into various agreements concerning: (1) Keyway's purchase in November 2017 of a 70% ownership interest in Baby Phat (which at the time was wholly owned by Plaintiff); and (2) Baby Phat's purchase in October 2021 of Plaintiff's 100% interest in a related company Phat Farm Holding Company, LLC ("Phat Farm"). According to Plaintiff, a material aspect to the Baby Phat transaction was the representation set forth in the Operating Agreement that Keyway would contribute \$5 million to Baby Phat's coffers, which monies would be used to grow Baby Phat's business and could not be removed without Plaintiff's consent. However, Plaintiff alleges that shortly after the transaction closed, in breach of their fiduciary duties to Plaintiff and Keyway, Defendants and Leissner secretly removed approximately \$4.2 million of those funds to provide unsecured loans to Simmons' and Timothy Leissner's² ("Leissner") relatives and then altered Baby Phat's financial statements, which were provided to Plaintiff in 2018, 2019, 2020 and 2021, in a manner to keep Plaintiff from discovering that Baby Phat no longer had these monies at its disposal for use in growing its business.

This case is scheduled to begin trial on September 18, 2024. The trial is bifurcated and the jury will only hear evidence concerning liability issues during its first phase and it is only if a liability verdict occurs will this case proceed to damages. In the verdict sheet, the jurors will be called upon to decide liability as to each cause of action and it is axiomatic that if the jury finds Defendants not guilty on certain counts, the Smith Report may be rendered inadmissible. Thus, it is not until liability is established that it will become clear whether the Smith Report will be admissible. In any event, a decision on a motion in limine is advisory only and the Court is at liberty to change its decision as borne out by the evidence presented at trial. As such, the Court reserves the right to modify its determination regarding the admissibility of the Smith Report following the first liability phase of the trial.

EXPERT REPORT OF DAVID SMITH

Plaintiff has retained the services of David Smith, who has authored an expert report, dated August 16, 2023, setting forth his estimate of the economic damages suffered by Plaintiff Loconte Family (*see* NYSCEF Doc. No. 170 [the "Smith Report"]). In his report, Smith asserts that, at the time of Keyway's purchase of 70% interest in Baby Phat from Loconte Family on November 9, 2017, Baby Phat had a loan which was payable to ConnectOne Bank ("ConnectOne") in the amount of \$2,544,700 (the "ConnectOne Loan") (Smith Report at 1). Smith states that Keyway

¹ In its May 2024 Decision, the Court dismissed Plaintiff's claim for breach of the implied covenant of good faith and fair dealing and its Fifth Cause of Action that asserted a claim of breach of a letter agreement.

² Leissner is Simmons' husband and was originally a defendant in this action, but because of various procedural and scheduling issues, he has been severed from this action.

and Loconte Family agreed that, as consideration for the 70% interest purchase, Keyway would pay \$2,500,000 towards satisfying the ConnectOne Loan (*id.*). Smith further states that Keyway was obligated to make a \$5,000,000 capital contribution for the purposes of marketing costs (the “Additional Capital Contribution”) to Baby Phat as part of the Amended Operating Agreement executed concomitantly with the sale and purchase of the 70% ownership interest (*id.* at 1-2).

Smith states that Defendants caused Baby Phat to execute an unsecured loan to an entity known as Blaze Ventures LLC (“Blaze”) in the amount of \$1,200,000 on May 10, 2018, with the contemporaneous promissory note (the “Blaze Promissory Note”) bearing an interest rate of 5.0% per annum, due and payable on May 10, 2019. Subsequently, Defendants caused Baby Phat to execute another unsecured loan, to Dr. Emilio Stock, in the amount of \$3,000,000 on May 25, 2018, with the contemporaneous promissory note (the “Stock Promissory Note”, and together with the Blaze Promissory Note, the “Promissory Notes”) bearing an interest rate of 5.0% per annum, due and payable on May 10, 2019 (*id.* at 2). Smith asserts the Promissory Notes were “entirely unrelated to the business operations of Baby Phat” (*id.*). Based upon the Promissory Notes, Smith alleges that “at least \$4,200,000 of the required minimum \$5,000,000 Additional Capital Contribution was diverted to make unsecured loans that served no legitimate business purpose for Baby Phat” and that, further, “[n]o interest was ever paid on [the Promissory Notes, which] remain in default until [the authoring of the Smith Report]” (*id.*). Smith explains his understanding that Plaintiff received modified financial statements which disguised the discrepancy in the Capital Contributions (*id.*).³

Smith asserts, based upon “[r]elevant documents and testimony,” that Willard Jackson (“Jackson”)⁴ improperly modified Baby Phat’s financial statements for the year of 2021, and provided previously modified financial statements for 2020 to Loconte Family (*id.* at 3).⁵ Smith further asserts that Tim Leissner represented that some of the Additional Capital Contribution had been used, and the rest would be used in a future marketing opportunity, in a November 26, 2019 email to Adam Lefkowitz as Loconte Family’s corporate representative (*id.*). Smith states that Loconte Family received projections of Baby Phat’s future financial performance from Leissner in or around November 2019, which showed

³ As an example, Smith states, based upon review of the relevant financial statements, Baby Phat had a cash position of \$29,509 with \$4,559,775 in notes receivable based upon its December 31, 2020 balance sheet, yet the December 31, 2020 financial statements, provided to Loconte Family, listed Baby Phat’s held cash and cash equivalents at the amount of \$4,589,283 (Smith Report at 2).

⁴ Smith characterizes Jackson as an individual who joined Baby Phat in or around July/August 2021, and “first acted as a consultant before assuming the unofficial role of president/CEO” (*id.* at 5, n16).

⁵ Specifically, Smith asserts that Jackson “included the notes receivable balance in the line item for ‘Cash/S-T Liquidity’, giving the appearance that Baby Phat had more than \$4,500,000 in liquid assets” (*id.* at 5).

Approximate Projected Revenue for Baby Phat	Fiscal Year
\$7.6 million	2020
\$8.7 million	2021
\$10.1 million	2022

(*id.*). Smith states that Leissner emphasized direct-to-consumer business (“DTC Business”) as key to Baby Phat’s future success at this time. Subsequently, in July 2021, an updated set of financial statements, which included projections showing

Approximate Projected Revenue for Baby Phat	Fiscal Year
\$1.2 million	2020
\$1.16 million	2021
\$17 million	2022
\$35.5 million	2023
\$45.8 million	2024
\$61.5 million	2025

(*id.*, NYSCEF Doc. No. 172). Smith states that Loconte Family requested an updated budget for fiscal year 2022 on November 4, 2021, and received it on January 4, 2022 (the “January 2022 Budget”). The January 2022 budget projected revenue for fiscal year 2022 at \$3.1 million (*id.*). Smith explains that, in or around March 2022, Loconte Family was made aware that Baby Phat would not be able to make the loan payments associated with the purchase of Phat Farm, as Baby Phat did not have the necessary cash on hand to meet this expense, which contravened Defendants’ prior representations to Plaintiff (*id.*).

Smith offers a brief summary of his opinions, stating: (1) “Plaintiff sustained measurable economic harm as a result of the diversion of the Additional Capital Contribution that should have remained in Baby Phat and been used for working capital purposes, including the advertising and marketing expenditures necessary to launch the DTC business”; (2) “Damages can reasonably be measured as the difference between the ‘but-for’ value of the Company and the actual value of the Company as of July 7, 2022, the date of the Complaint”; and (3) “Based on my review of the documents provided to me in this case, as well as my education, training, and knowledge, the damages sustained by Plaintiff in this matter are reasonably estimated at \$21,820,000” (*id.* at 4). Smith next explains the bases for his conclusions. Preliminarily, he states that: (1) “Plaintiff sold 70% of Baby Phat to Keyway with the expectation that a direct-to-consumer business channel would be established, and, with Kimora again as the face of the Company, brand value would be maximized”; (2) “Due to the diversion of the necessary capital to fund the establishment of the DTC business, there was no value added to the Company, rather, Defendants caused Baby Phat to incur losses year-over-year from 2018 through 2021”; (3) Defendants’ “diversion of the required Additional Capital Contribution and the failure to invest that money into Baby Phat’s operations . . . caused the Company’s earnings and financial condition to suffer, resulting in a diminution in the value of the business”; and (4) “It was reasonably foreseeable that the deprivation of capital to Baby Phat caused the Company to fail to meet its revenue and profit projections, resulting in a decline in the value of the business relative to its prospective value ‘but-for’ the lack of adequate capital” (*id.*).

Smith explains that he valued Baby Phat to measure its “but-for” value as of July 7, 2022 (the “Valuation Date”) based on the future operating performance projections generated by Defendants (*id.*). Smith calculates the measure of damages by subtracting the actual value of Baby Phat from this “but-for” value calculation (*id.*). Smith asserts this method of measuring damages “is widely supported by authoritative literature addressing lost profits damages” (*id.*). Smith explains he employs a fair value standard of value – “defined as ‘a pro rata share of the value of the company as a whole as opposed to *fair market value*, which would consider discounting the pro rate share for lack of control and . . . marketability” (*id.* at 4-5 [citations omitted]). Smith next explains the three approaches of business interest valuation available in the absence of an active, established market: (1) the income approach – divided into (a) the Discounted Cash Flow method (“DCF Method”) and (b) the Capitalization of Earnings Method; (2) the market approach; and (3) the asset-based approach (*id.* at 5-6). Smith states that he employed the DCF Method of the income approach, “which requires a forecast of earnings or cash flows for several discrete future periods and an estimated terminal value for the business,” with those amounts “discounted to present value to determine the present value of the Company” (*id.* at 6). The DCF Method uses a discount rate based on “the Company’s cost of equity capital and represents the total expected rate of return that is required to attract capital to the investment, based upon the assessed risk of the Company” (*id.*).

Smith states that his DCF analysis model begins with the July 28, 2021 profit and loss projection for Baby Phat (*id.* at 7). Smith noted that the projections utilized a ratio of “projected DTC sales to advertising spend of 9-to-1,” which “is consistent with industry data on return on investment” (*id.*). Smith performed the following adjustments in his valuation: (1) replacing the projections for fiscal year 2021 with Baby Phat’s actual profit and loss for fiscal year 2021; (2) replacing the projections for fiscal year 2022 with the projected profit and loss reflected in the January 2022 Budget; (3) pushing the projected valuations for fiscal year 2022 one year ahead to 2023, doing the same with the remaining years of projection (2023 projections moved to 2024, etc.); (4) making a downward adjustment for the projected licensing revenue for fiscal year 2022 in the January 2022 Budget as the projection “appeared to be an anomaly . . . out of line with the growth trajectory set forth in the July 28, 2021 projections”; (5) using a “blended federal and New York state corporate tax rate of 28.3% to earnings before tax” to measure net operating profit after taxes; and (6) adjusting the estimated working capital and capital expenditures necessary for growth (*id.* at 6-7). Smith states these adjustments provide a derived measure of free cash flow to the firm (“FCF”), and that each FCF for a future fiscal year was discounted to the present (*id.* at 12). Smith states he then calculated the value of the company beyond the forecast period (the “Terminal Value”) by using a 7x multiple to the projected earnings before interest and taxes (“EBIT”) for fiscal year 2026 (*id.*).⁶ Smith states that he then added the present FCF value for

⁶ Smith states that “[t]he terminal value multiple was informed by an analysis of the market value of invested capital to EBIT multiples for guideline public companies in the same or similar business as Baby Phat as of the Valuation Date. The terminal value must also be discounted back to the present” (NYSCEF Doc. No. 170 at 8).

fiscal years 2022 through 2026 to the present Terminal Value, which indicated a “but-for” value of Baby Phat at approximately \$81,060,000 (*id.*).

Smith explains that “the future earnings capacity of the subject Company must be discounted to arrive at the present value of the future cash flows” – the discount rate is measured as the estimated cost of Baby Phat’s equity capital, with the equity cost calculated through the “Buildup Method” (*id.* at 8). Smith describes the Buildup Method as an additive model wherein the return on a company’s asset is measured “as the sum of a risk-free rate plus one or more risk premia,” with each premium representing an investor’s positive return given the specific risk with regard to their owned asset (*id.*). Thus, risks specific to the particular investment, differentiated from a risk-free investment, must be calculated to form the discount rate (*id.*). Smith explains there are four risk premium components in the Buildup Method, the sum of which is the applicable discount rate: (1) Risk-Free Rate – the yield on a U.S. Treasury security; (2) Equity Risk Premium – premium expected for the additional risk on the asset; (3) Size Premium – the premium added to reflect the inherent risk of smaller company stocks; and (4) the Company-Specific Risk Premium – the individual, unsystematic risk associated with the measured company (*id.* at 8-9). Smith estimated Baby Phat’s cost of equity, and their derived discount rate, as 21.7%, calculated by adding: (1) 3.5% - the Risk-Free Rate measured as the normalized yield on a 20-year U.S. Treasury Bond on July 7, 2022; (2) 5.5% - the Equity Risk Premium recommended by Kroll (f/k/a Duff & Phelps); (3) 4.8% - the Size Premium utilized for “the smallest companies in the universe in the 10th decile [of the universe of stocks on the NYSE, NYSE American and NASDAQ]”; and (4) 8.0% - the Company-Specific Risk Premium calculated by Smith after “[c]onsidering the risks associated with the Company’s efforts to develop the direct-to-consumer business, lack of a professional and experienced executive management team, and inadequate capital balance” (*id.* at 10). Smith concludes “with reasonable certainty” that Baby Phat’s “but-for” fair value was approximately \$81.1 million as of July 7, 2022 and, based on Loconte Family’s thirty-percent interest in Baby Phat, the fair value of Loconte Family’s interest in the company is approximately \$24.3 million (*id.*).

Smith asserts that, following his calculation of “But-For” value, he had to calculate the fair value of Baby Phat, which was based upon the Company’s past and prospective financial performance (*id.*). Smith states he reviewed Baby Phat’s financial statements for fiscal years 2013 through 2021, as well as the nine-month period which ended on September 30, 2022, and then reviewed the profit and loss statements for Baby Phat for December 31, 2013 through 2017, when the company was owned wholly by Loconte Family (the “Loconte Period”) (*id.*)⁷.

Smith states that Baby Phat generated revenue through licensing agreements during the Loconte Period in the following amounts:

Royalty Income	Fiscal Year
----------------	-------------

⁷ Smith acknowledges that the 70% sale occurred in November 2017, but assumes “for the purposes of [his] analysis, that Defendants’ control of the Company began January 1, 2018” (NYSCEF Doc. No. 179 at 9).

\$1.0 Million	2013
\$875,000	2014
\$293,000	2015
\$385,000	2016
\$485,000	2017

(*id.* at 11). The licensing business had minimal expenses, and accordingly, Smith asserts, Baby Phat's operating margins in this sector averaged 81% during the Loconte Period (*id.*). Smith states that Baby Phat generated operations income during the Loconte Period in the following amounts:

Operations Income	Fiscal Year
\$847,000	2013
\$672,000	2014
\$190,000	2015
\$360,000	2016
\$417,000	2017

(*id.* at 11-12).

Smith claims that, as of November 7, 2017 the fair value of Baby Phat was established by virtue of Keyway's purchase of a 70% interest in the company for consideration valued at \$2.5 million, for a valuation of the company as a whole at \$3,571,000 (*id.* at 14). Smith asserts that he bases the valuation of Baby Phat as of July 7, 2022 based on the operating results and financial condition of the company during the period of December 31, 2018 through 2021 and the nine-month period ending September 30, 2022 (the "Keyway Period"). Smith states that Baby Phat generated royalty income during the Keyway Period in the following amounts:

Royalty Income	Fiscal Year
\$641,000	2018
\$381,000	2019
\$625,000	2020
\$715,000	2021
\$863,000	Nine Month 2022 Period

(*id.* at 12). Smith states the compound annual growth rate for this royalty income was 12.2% (*id.*). Smith states that Baby Phat launched the DTC sales channel in 2020, and generated the following revenue from such during the Keyway Period:

DTC Income	Fiscal Year
\$610,000	2020
\$58,000	2021
\$25,000	Nine Month 2022 Period

(*id.*). Smith states that various indirect costs associated with Baby Phat's DTC business, which began occurring in 2019, caused a considerable variation in gross profit margin during the Keyway Period, ranging from 0.0% of sales in 2018 to 54.2% of sales in 2019 (*id.*). Smith asserts Baby Phat's operating expenses underwent similar variation, with the operating profit margin for the period of 2018 through 2021 averaging -118.0% (*id.*). Smith states Baby Phat's sustained operating losses in the following amounts:

Operating Loss	Fiscal Year
\$1.3 Million	2018
\$1.5 Million	2019
\$146,000	2020
\$451,000	2021

(*id.*). Further, during the Keyway Period, Baby Phat operated in a working capital deficit with short term liabilities exceeding short term assets (*id.*).

Smith explains that he considered other valuation approaches, but that, given Baby Phat's failure to generate positive earnings during the Keyway Period, as well as the failure to launch the DTC business, "the application of the Income Approach, using historical financial metrics, would result in no value for the Company" (*id.* at 14-15). This lack of positive earnings also precluded, according to Smith, a valuation based upon the Market Approach (*id.* at 15). Further, the Asset-Based Approach was not appropriate, in Smith's view, given Baby Phat's significant decline in net worth and the inclusions on the balance sheet of: (1) an uncollectible note receivable amounting \$4.6 million; (2) liabilities in the amount of \$5.7 million from a "questionable loan to a member"; and (3) \$1.9 million in accounts payable – Smith asserts none of these entries existed in November 7, 2017 (*id.*). Smith states that, given the financial performance of Baby Phat during the Keyway Period, relative to the performance during the LoConte Period, Baby Phat "was worth no more than \$3,571,000, which was its established value as of November 2017" and accordingly, "the fair value of a 30% interest in Baby Phat as of the Valuation Date is no more than \$2,500,000" (*id.* at 13).

Smith summarizes his opinion that a 30% ownership interest in Baby Phat, measured using the "But-For" fair value, is \$24,320,000 as of the Valuation Date, and that the fair value of that 30% ownership interest, based upon the actual performance of Baby Phat during the Keyway Period, is worth "no more than \$2,500,000" (*id.*). Accordingly, Smith calculates the total economic damages as such:

"But-for" Fair Value LoConte Family LLC Ownership Interest	\$24,320,000
Less: Fair Value Loconte Family LLC Ownership Interest	\$(2,500,000)
Total Damages	\$21,820,000

(*id.*). Smith states that should a "trier of fact" determine that a lack-of-marketability discount ought to be applied to the 30% ownership interest in Baby Phat, a 15% discount should apply for total damages in the amount of \$18,172,000 (*id.*).

REBUTTAL REPORT OF CRAIG JACOBSEN

In rebuttal to the Smith Report, Defendants provide the "Rebuttal Report" of Craig Jacobsen, Managing Director of B. Riley's New York office (NYSCEF Doc. No. 171 [the "Jacobsen Report"]). Jacobsen asserts that he has over thirty years of experience in forensic accounting, including business valuation, quantification of damages, investigations of business disputes, tracing of funds and financial analysis consulting (Jacobsen Report at ¶ 16). Jacobsen

begins his report with a summary of his opinions, asserting the Smith Report contains two problems which render its conclusions meaningless: (1) the Smith Report uses an incorrect valuation date; and (2) assuming the valuation date used was in fact correct, the valuation analysis contains a substantial number of fatal errors (*id.* at ¶ 10). According to Jacobsen, Baby Phat's ability to execute its business plan had no relationship with the level of capital maintained by Baby Phat, and assuming this is correct there are no actual damages available to Plaintiff (*id.* at ¶ 11). Jacobsen proffers his conclusion that the correct measure of economic damages owed to Plaintiff amounts to, at most, \$2.5 million (*id.* at ¶ 12).

Jacobsen describes the "but for" valuation analysis performed by Smith (*id.* at ¶ 36). Jacobsen explains that Smith performed a DCF analysis, which is a common valuation method (*id.* at ¶ 37). Jacobsen summarizes the findings of the Smith Report, before asserting that it "contains a large number of fundamental valuation errors" which "demonstrate that even if Mr. Smith had not used an incorrect valuation date, his report is based on unsupportable projections . . . rendering its calculations meaningless" (*id.* at ¶ 41).

Jacobsen asserts that the Smith Report does not explain its designation of the relevant valuation date as July 7, 2022, the date of the filing of the original Summons and Complaint, and asserts that he cannot conceive of a valid reason why that date would be used as the valuation date (*id.* at ¶ 42). Jacobsen explains that the valuation date should reflect a date relevant to the dispute – he asserts that, generally, damages analysis is divided into: (1) an ex-ante perspective, with damages calculated from the date of breach; or (2) an ex-post perspective, calculating damages on the date of trial (*id.* at ¶ 43). Jacobsen asserts that May 2018 would have been the relevant valuation date for an ex-ante approach, whereas there is nothing on record which would indicate July 7, 2022 as the relevant date to measure damages (*id.* at ¶¶ 44-45).

Moving to the purported valuation errors, Jacobsen states that the Smith Report does not explain how the allegedly diverted capital would have affected Baby Phat's operations, despite the analysis' premise "that if the Loans had not been made, Baby Phat would have reasonably achieved the operating results depicted" in the Smith Report (*id.* at ¶ 48). Jacobsen states that the sole basis proffered by the Smith Report for this connection is the 9-1 ratio of marketing expenditure to revenue (*id.*). Jacobsen states that the Smith Report failed to perform any analyses supporting the connection, and that the testimony of Willard Jackson as consultant to Baby Phat demonstrates that Baby Phat failed to meet its projections for economic and business reasons unrelated to the alleged diversion of capital (*id.* at ¶¶ 49-50). Jacobsen further states that the Smith Report fails to consider the loans made by Simmons to Baby Phat in the amount of \$1.4 million between August 16, 2018 and August 11, 2023 in order to cover losses, and that Smith ought to have considered that the capital at issue would have been more likely used for the funding of Baby Phat's losses rather than capital for the DTC business (*id.* at ¶ 51).

Jacobsen asserts that the projections used by Smith were "unreasonable," and submits that, had Smith spoke with Baby Phat management or performed basic verification, it would be evident that the utilized projections were not reasonable for the purposes of a valuation analysis (*id.* at ¶ 52). Jacobsen states that he interviewed both Simmons and Joseph Yemeni, the manager of Z One

LLC (which is the manager of Keyway) and asserts that Simmons indicated she was unaware of the \$5 million capital contribution and that such funds were not taken into account in drafting Baby Phat's projections and further, "irrespective of whether the projections were reasonable, [Simmons] never knew about or discussed the marketing expenditure" (*id.* at ¶ 54). Jacobsen next relays his interview with Jackson, which indicated, in pertinent part: (1) the July 2021 Projections were prepared by Jackson and a consultant which was a "quick and dirty" measure of what Jackson hoped Baby Phat would achieve given optimal conditions and outcomes; (2) the projections contained numerous assumptions and were not based on Baby Phat's historical performance; (3) the projections were not approved by Baby Phat management or fiduciaries; (4) the projections were not shared with any prospective investors in Baby Phat or other outside parties; (5) the projections did not consider the timing necessary for the DTC business; (6) the total marketing spend contemplated in the July 2021 Projections was approximately \$100,000; (7) neither Jackson nor his consultant was aware of the \$5 million capital contribution nor its removal and did not factor such into the July 2021 Projections; and (8) Baby Phat's failure to meet the July 2021 projections was unrelated to any capital constraints given the contemplation of vendor financing and Simmons own funding of Baby Phat expenses (*id.* at ¶ 55). Accordingly, Jacobsen concludes that: (1) Baby Phat did not meet the July 2021 Projections for fiscal year 2022; (2) the July 2021 Projections are not representative of reasonably achievable operation results for the purposes of valuation or damages calculation; and (3) the DTC model's vendor financing demonstrates the lack of a relationship between the DTC business and the Additional Capital Contribution, and thus there are no damages available (*id.* at ¶ 56).

Jacobsen asserts that the projected "but-for" growth of Baby Phat in the Smith Report is unrealistic, defying any business logic that the additional \$5 million in capital would transform Baby Phat's moribund status to a successful business valued at \$60 million in just 4 years (*id.* at ¶¶ 57-59). Jacobsen states that the decline in DTC revenue by approximately 90% between 2020 and 2021, unmentioned in the Smith Report, demonstrates that DTC revenue had been driven by factors including the COVID-19 pandemic and the initial bounce provided by the launch (*id.* at ¶ 61). Jacobsen states that the 9-1 DTC sale to advertising ratio used in the Smith Report is without any support, and, further, the ratio demonstrates a logical failure of consistent investment growth (*id.* at ¶¶ 63-65). Jacobsen also notes the Smith Report's optimistic profitability forecast, which is inapposite to the losses Baby Phat suffered between August 16, 2019 and August 11, 2023 (*id.* at ¶¶ 66-67).

Jacobsen asserts that the Smith Report is improperly assembled – specifically, that Smith assembled various data points in the source projections when he "pushed" certain projections forward while substituting others with actual or imagined revenue, making them "unreasonable for using in a valuation analysis for the purpose of calculating damages" (*id.* at ¶¶ 68-71). Jacobsen states that the DCF approach used in the Smith Report also commits a "fundamental error" in mixing the "equity and debt" and "equity basis" approaches of DCF valuation (*id.* at ¶¶ 72-73). Specifically, Jacobsen asserts that the Smith Report: (1) improperly uses a discount rate based on the cost of equity, despite measuring cash flow to invested capital of both equity and debt; and (2)

fails to adjust the present value of invested capital to account for Baby Phat's debt, including the \$1.4 million loan from Simmons (*id.* at ¶¶ 73-75).

Jacobsen claims that the Smith report uses an inappropriate standard of value – *i.e.* fair value – when the fair market value should have been used (*id.* at ¶¶ 76-77). Jacobsen states that, under this approach, Plaintiff's 30% ownership interest would require adjustments for both a discount for lack of control and a discount for lack of marketability, whereas the fair value measurement used by Smith does not require these adjustments (*id.* at ¶¶ 78-80). However, Jacobsen asserts that under New York's definition of fair value, consideration for discount for lack of marketability is allowed (*id.* at ¶ 81). Moreover, Jacobsen asserts that the 15% discount for lack of marketability is "unreasonably low" given: (1) Baby Phat's status as a private, not publicly traded, company; and (2) the unreliable financial statements of Baby Phat (*id.* at ¶ 82). Jacobsen contends that when the appropriate fair market value is used, with the downward adjustments made for both discount for lack of control and discount for lack of marketability, the value of Baby Phat in the Simon Report would be significantly reduced (*id.* at ¶¶ 83-84).

Jacobsen explains that, in determining Terminal Value, a commonly used method is to select a multiple from the final year of projections, and that the Smith Report used a 7x multiple onto the projected 2026 EBIT (*id.* at ¶¶ 85-86). Jacobsen states that the Smith Report does not provide any support for the use of this multiple, rendering the calculation meaningless, and given the terminal value of \$63.4 million represents 78.2% of the total \$81.1 million calculation of "but-for" value, the bulk of that proffered valuation is unsubstantiated, regardless of any other errors (*id.* at ¶¶ 86-87). Moreover, Jacobsen states that the use of an EBIT should be supplemented by an examination of the given company's fixed assets, but that there is no evidence of this occurring in the Smith Report (*id.* at ¶ 88). Jacobsen next points out several alleged theoretical and mathematical errors present in the Smith Report, including: (1) a failure to add depreciation back into the DCF cash flow analysis; (2) a failure to provide support for the 4% incremental working capital adjustment; (3) a failure to support the 2.8% capital expenditure adjustment; (4) an unreasonably low discount rate of 21.8% given the high growth projections for Baby Phat; (5) a failure to analyze or even include a balance sheet for Baby Phat, and resultant failures to perform a financial statement analysis of historic balance sheet information and to assess the level of working capital at Baby Phat; and (6) an incorrect calculation of the fair value of Loconte's 30% interest in Baby Phat⁸ (*id.* at ¶¶ 88-99).

Jacobsen next provides his calculation of the "but-for value," based on the assumption that the alleged bad acts occurred (*id.* at ¶ 100). Jacobsen uses May 2018 as the valuation date and calculates the value with a capitalization of earnings model converting single year cash flow into a value indication given the "static" nature of the business (*id.* at ¶¶ 101-102). Based upon his calculations, the equity value of Baby Phat was measured at approximately \$2.0 million (*id.* at ¶¶

⁸ Specifically, Jacobsen asserts that the "actual" value of the 30% ownership interest in the Smith Report is a "but-for" value given the intent of Baby Phat to grow through development and expansion of the DTC channel. Jacobsen measures the actual value of the 30% ownership interest as \$3,214,286.

105-106). Then, subtracting the “corrected” actual value from the “corrected” but-for value of Loconte’s 30% ownership interest, Jacobsen calculates the correct measure of damages, assuming liability and causation, as \$2,485,286 (*id.* at ¶¶ 107-109).

DEFENDANTS’ CONTENTIONS IN SUPPORT OF THEIR MOTION

In support of their motion, Defendants submit: (1) the affirmation of Russell T. Gorkin, Esq. (NYSCEF Doc. No. 169), along with attached exhibits (NYSCEF Doc. Nos. 170-175); and (2) a memorandum of law (NYSCEF Doc. No. 168 [the “Defs’ Mem.”]).

Defendants describe Plaintiff as alleging “that Defendants caused Baby Phat to issue loans totaling \$4.2 million for improper purposes, and that Baby Phat, and by extension, the Loconte Family, were harmed as a result” (Defs’ Mem. at 1). Defendants state that Smith’s methodology led him to determine that Baby Phat would have increased more than 2,200% in five years, with a total increase in overall worth of nearly \$80 million dollars (*id.*). Defendants state that, based upon Loconte Family’s thirty percent ownership, Smith concludes that the Plaintiff’s individual economic damages amount to over \$21.8 million (*id.*). Defendants assert that Smith’s conclusion is “built on an unreliable foundation” – specifically, that Smith’s model “[utilizes] unreasonably optimistic draft financial projections that Baby Phat itself disavowed just months after their creation,” and incorporates a “valuation multiple based on the multiples at which a group of publicly traded fashion companies trade, even though those companies bear no operational or financial similarities to Baby Phat at all” (*id.* at 2). Defendants argue that Smith’s “fundamentally unreliable opinion that is designed to introduce an artificially high anchoring point” risks “polluting the jury’s deliberations” and, as such, this Court should grant Defendants’ motion and bar Smith’s testimony (*id.*).

Defendants assert that Smith utilized an “‘Income Approach,’ which ‘is based on the theory that the value of a business is equal to the present value of the entity’s future stream of returns’” (*id.* at 3, *quoting* Smith Report). Defendants explain Smith’s position that future earnings streams can be predicted based upon previous results, before stating that “Baby Phat’s historical results were poor” – specifically, Defendants assert that “Baby Phat generated between \$290,000 and \$1.25 million in annual revenue, and its pre-tax income ranged from **negative** \$1.6 million to **positive** \$445,000,” with Baby Phat suffering an operating loss in six of those nine years (*id.* at 3). Defendants assert that Smith did not consider these losses, despite acknowledging their relevance, in attempting to predict future earnings streams but instead “adopted ‘projections contemporaneously prepared by Baby Phat’s management’” (the “Initial Projections”) (*id.*, *quoting* Smith Report).

Defendants explain these Initial Projections “predicted an explosion in Baby Phat’s direct-to-consumer revenue beginning in 2022, and continuing through 2025” (*id.*). Defendants specifically assert that the Initial Projections “predicted Baby Phat’s direct-to-consumer sales would increase from \$122,259 in 2021 to more than \$15.3 million in 2022; more than double again to \$33.7 million in 2023; and nearly double again to almost \$60 million by 2025” (*id.*). However,

Defendants assert that Baby Phat “substantially revised those projections when it created its 2022 budget just five months later, reducing its 2022 forecast for direct-to-consumer sales from \$15.3 million to just \$315,000” (*id.*). Defendants state that Smith utilized these revised budget figures, but also “adopted [the Initial Projections] as Baby Phat’s future earnings streams for 2023 through 2026 by simply moving each year’s forecast forward a year” (*id.* at 3-4, *citing* Smith Report at 7). They note that Smith used a 7x multiplier to the projected earnings before interest and taxes of Baby Phat for the fiscal year of 2026, “based on the multiples of invested capital to EBIT of ten publicly traded companies ‘in the same or similar business as Baby Phat’” (*id.* at 4, *quoting* Smith Report at 8). Defendants state that Smith did not disclose how or why he selected these companies (*id.*) Defendants assert that in rebuttal they provided the Jacobsen Report and that Jacobsen concluded Smith’s “valuation analyses contain a **substantial number of errors** that render its conclusions **meaningless**” (*id.*, *quoting* Jacobsen Report at ¶ 10).

Defendants argue that the New York State Court of Appeals “has repeatedly recognized the great ‘danger in allowing unreliable or speculative information . . . to go before the jury with the weight of an impressively credentialed expert behind it’” (*id.* [citations omitted]). Defendants assert it is a vitally important duty for the Court to screen expert testimony for its trustworthiness and reliability (*id.*). Defendants explain that “[e]xpert testimony lacking a proper foundation is fundamentally defective and must be excluded to ensure that the jury will not be improperly swayed or misled” (*id.* at 6). They further explain that “[a] proper foundation is lacking where, among other things, (1) the expert’s assertions are ‘speculative or unsupported,’ . . . ; (2) the expert fails to appropriately apply the accepted methods to the facts of the case, . . . ; (3) the expert ‘cherry-pick[s]’ . . . data points so as to make [the] ultimate conclusion stronger,’ . . . ; or (4) the expert’s opinion is based on assumptions that ‘are so unrealistic and contradictory as to suggest bad faith’” (*id.* [citations omitted]).

For their legal argument, Defendants first argue that Smith’s expert opinion “suffers from a plethora of defects,” including: (1) that “his model relies on pie-in-the-sky revenue projections that Baby Phat itself disavowed just five months after their creation”; (2) that he compounds the previous error “by applying a multiple similar to those at which a handful of the world’s most successful fashion brands trade, even though the operations, historical sales and profitability, customer base, risk profile, and financial situations of those companies bear no resemblance to Baby Phat’s”; and (3) that Smith’s central theory “that the disputed loans left Baby Phat with insufficient capital to establish its direct to consumer business [] finds no support in the record” (*id.* at 6-7). Defendants assert that these defects are “egregious” and each individually “provides an independent basis for excluding Mr. Smith’s opinion” (*id.* at 7).

Regarding the first alleged defect, Defendants explain that Smith’s factual foundation underlying his opinion is the assertion that Defendants made improper loans which “diverted capital that Baby Phat needed to fund its direct-to-consumer business” and that he “further asserts that this purported ‘deprivation of capital . . . caused the Company to fail to meet its revenue and profit projections, resulting in a decline in the value of the business relative to its prospective value ‘but for’ the lack of adequate capital’” (*id.*, *quoting* Smith Report at 4). Defendants argue that Smith fails to support his factual assertions with “any documentary or testimonial evidence . . .

[n]or does he identify any particular initiative that Baby Phat was unable to pursue or expenditure that it was unable to make due to a lack of funds” (*id.*). They argue that Smith failed to investigate, analyze, or consider other possible reasons which may have “caused or contributed to Baby Phat missing its revenue and profit projections” such as increased competition, changes in consumer behavior, or that the Initial Projections “were not reliable or realistic to begin with” (*id.*). They claim Smith’s approach fails as it impermissibly reaches a conclusion through assuming material facts not in evidence, and/or because he guesses or speculates in drawing his ultimate conclusion (*id.* at 8). Defendants argue that “the ‘opinion testimony of an expert must be based on facts in the record or personally known to the witness’” but that Smith “fails to point to any facts in the record [nor does he have] any personal knowledge to support his assertion that Baby Phat experienced some sort of capital shortfall that prevented it from reaching its financial goals” (*id.* [citations omitted]). Accordingly, Defendants argue that Smith’s opinion is, at best, speculative and thus inadmissible (*id.*).

Defendants assert it is not their burden to demonstrate that the Smith opinion is faulty; instead, it is Plaintiff’s burden to demonstrate the opinion is reliable and that “common sense and the record evidence demonstrate that Mr. Smith’s core premise is not even plausible” (*id.*). Specifically, Defendants assert that Baby Phat had less than \$30,000 in available capital and “[i]t would defy logic to create financial projections that depend on the deployment of capital that Baby Phat knew it did not have” (*id.*). Accordingly, Defendants argue that “any failure to meet the 2021 financial projections must be attributable to factors other than a purported lack of access to the \$4.2 million that had previously been loaned because the business plan created to achieve those projections never accounted for or depended upon the availability of that capital in the first place” (*id.* at 8-9). Thus, Defendants argue that Smith’s opinion is not only unsupported by the record, but “is undermined by the evidence that is available” (*id.* at 9).

Moving to the second alleged defect, Defendants assert that assuming there was evidence in the record to support the contention that Baby Phat did not generate revenue and profit at the level it would have “but-for” the allegedly improper loans, the methodology used by Smith nevertheless “still requires him to reliably show the amounts Baby Phat likely would have earned had that cash been available” (*id.*). Defendants claim that Smith attempts to do so by asserting, “without evidence, analysis or explanation that Baby Phat would have met its 2021 financial projections had the disputed loans not been made, and simply inputs those amounts into his ‘but for’ model” (*id.*). Defendants state that this is insufficient, as any projections for a business must have an evidentiary basis of its reliability, and that without such basis “any valuations based on [them] must be stricken” (*id.* [citations omitted]).

Defendants state that Smith further “ignored Baby Phat’s historical results when predicting its future revenue streams” despite acknowledging that historical results may predict future earnings streams (*id.*). They claim that examining the historical results demonstrates that it was “inexcusable . . . for Mr. Smith to utilize the Initial Projections absent sufficient evidence to demonstrate their reliability” (*id.*). As an example, Defendants cite Baby Phat’s direct-to-customer revenue generation in 2020 at “a little more than \$600,00 in revenue,” with the Initial Projections forecasting such business “would generate a little less than \$125,000 in 2021, an 80% decline from

the year before” (*id.*). Nevertheless, Defendants argue that Smith assumed, without evidence, “that Baby Phat’s DTC business would explode, generating **\$15.3 million** in 2022, an increase of **more than 12,000 percent**; that those sales would **more than double again** to **\$33.7 million** in 2023; and by 2025, would **nearly double again**, reaching **\$59.3 million**” (*id.*). They assert that the demonstration of “a **negative 3.5 percent** compound annual revenue growth rate from 2013 to 2021,” yet “the Initial Projections adopted by Mr. Smith forecasted a positive 164.3 percent compound annual growth rate between 2022 and 2026” (*id.* at 10-11). Thus, in light of the actual historical data, Defendants cast the Initial Projections as “pie-in-the-sky figures with no basis in reality” and that, accordingly, Baby Phat generated a budget on January 4, 2022 which “disavow[ed] that had been set out just five months earlier in the Initial Projections” (*id.*). Defendants state that Smith correctly used the 2022 Budget Projections, before inexplicably moving the “discredited \$15.3 million 2022 revenue projection reflected in the Initial Projections to 2023, and so forth for the following years” (*id.*).

Defendants assert that Smith proffers a sole justification for this methodology, *i.e.*, that the Initial Projections projected DTC sales to advertising expenditures at a ratio of 9:1, which he claims, purportedly without evidence, “is consistent with industry data on return on investment” (*id.*, quoting Smith Report at 7). However, Smith fails to reference any source for this 9:1 ratio, nor explain why Baby Phat, as “an [sic] historically underperforming brand with a nascent DTC business” would attain such figures (*id.*). Defendants assert, as reflected in the Jacobsen Report, that the categorial adoption of this ratio as a rule would lead to all DTC businesses engaging in advertising perpetually “and none would ever fail” (*id.*). Accordingly, they assert that the reliance on the Initial Projections renders Smith’s analysis an exercise without any factual basis requiring that his opinion be stricken (*id.*).

As to the third alleged defect, Defendants state that Smith “‘calculated the value of the Company beyond the forecast period, otherwise known as the terminal value, by applying a 7.0x multiple to projected EBIT . . . for fiscal year 2026,’” which “was informed by ‘the market value of invested capital to multiples for guideline public companies in the same or similar business as Baby Phat’” (*id.* at 13, citing Smith Report at 8). Defendants claim that Smith “cherry-picked” several of the most successful public retail companies in business today, without any “analysis of those companies’ underlying fundamentals, each of which generates billions of dollars in annual sales,” compared to Baby Phat “a company that generated less than \$1 million in sales in eight of the past ten years” (*id.*).

Regarding the fourth alleged defect, Defendants assert that Smith’s analysis is incomplete – specifically, Defendants assert that “[t]he only way that the Loconte Family can realize the value associated with its thirty-percent interest in Baby Phat is if it sells its stake,” and, accordingly, “[t]he price . . . at which the property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller” is the most common standard for valuation (*id.* at 4 [citations omitted]). Defendants explain that “[i]t is well-accepted that it is more difficult to sell only a partial interest in a Company as opposed to the entire company, and that a non-controlling partial interest is less valuable than a controlling one,” but that Smith, in creating his report, “did not take account of either of those basic principles in his analysis” (*id.*). Rather, Smith

assumed that Loconte Family would realize its proportional share based upon the full valuation of Baby Phat in a hypothetical sale of its non-controlling partial interest (*id.*). Defendants assert that “Mr. Smith’s analysis is [therefore] incomplete and designed to artificially anchor the jury to a damages figure that is higher than it would be had he appropriately applied the accepted methodology to the facts of this case,” and, “Mr. Smith should be precluded from testifying at trial” (*id.*).

PLAINTIFF’S CONTENTIONS IN OPPOSITION

In opposition to Defendants’ motion in limine, Plaintiff submits a memorandum of law (NYSCEF Doc. No. 181 [“Plfs’ Mem.”]).

In its memorandum, Plaintiff asserts that Defendants’ motion is an attempt to wholly discredit Smith’s opinion as “unreliable,” but “Defendants’ gripes” are merely issues of credibility appropriately weighed by the trier of fact (Plfs’ Mem. at 1). Plaintiff explains that Defendants will have the opportunity to cross-examine Smith and introduce rebuttal testimony at trial, and their mere disagreement with Smith’s Report is insufficient grounds to prevent Smith’s testimony (*id.*). Further, it asserts that aside from the inherently improper nature of the motion which seeks to resolve an issue for the fact-finder at trial, Defendants’ substantive arguments are unsuccessful (*id.*). Plaintiff highlights four central shortcomings of the motion in limine: (1) contrary to Defendants’ claims, Smith’s assumptions are based upon the factual record, relying upon documents, pleadings and transcripts (i.e., the facts in evidence) to form the bases of his opinion; (2) Defendants assert Smith’s methodology is flawed, yet offer no more than opinion as to their disagreement with his reasoning; (3) the companies selected by Smith in the calculation of Baby Phat’s terminal value are logical and reasonable selections and, in any event, Defendants’ disagreement is merely a credibility issue for the fact-finder; and (4) contrary to Defendants’ claim, Smith’s accounted for a lack-of-marketability discount given Loconte Family’s minority ownership interest in Baby Phat (*id.* at 1-2). Plaintiff states that Defendants filed the motion in limine based on their disagreement with Smith’s ultimate conclusion, but that it is the jury’s duty to determine the weight afforded to expert opinion testimony (*id.* at 2-3).

Plaintiff next provides the factual background for the Smith Report, as well as its conclusion that “Plaintiff suffered economic damages in the amount of \$21,820,000, as a result of the alleged unlawful scheme to defraud LoConte Family, LLC and for breaches of fiduciary duties owed to Baby Phat Holding Company, LLC and LoConte Family, LLC” (*id.* at 3 [citations omitted]). Plaintiff explains that the Smith Report was based on factors including: (1) Plaintiff’s expectation in selling its 70% ownership interest in Baby Phat to Keyway that the DTC business would be established and the brand value of Baby Phat would be maximized; (2) Baby Phat incurred losses year-over-year from 2018 through 2021 due to the improper diversion of capital necessary to fund the DTC business; and (3) Baby Phat suffered a diminution in value as a result of the diversion of the Additional Capital Contribution and failure to invest such into Baby Phat’s operations, “assuming Defendants are liable” for such diversion (*id.*). In sum, Plaintiff asserts the Smith Opinion was based upon his determination that the diversion of capital led to a resultant decline in Baby Phat’s value relative to the “but-for” prospective value (*id.* at 3-4).

Plaintiff states that the Smith Report described, step-by-step, the methodology employed – “a commonly accepted business valuation model to measure the ‘but-for’ value of Baby Phat, based on projections of future operating performance developed contemporaneously by Defendants and compared [to] the ‘but-for’ value to the actual value of Baby Phat as of July 7, 2022” (*id.* at 4). Plaintiff notes that Smith explained why the income approach was the appropriate approach for his valuation given the background and circumstances of this case (*id.*). Plaintiff further notes Smith’s DCF analysis used Baby Phat’s own financial projections – specifically the July 28, 2021 projections – to develop a model of present value (*id.*). Smith then adjusted his model, which provided the measure of total cash flow (*id.*). Plaintiff then explains the Smith Report employed a 7x variable to the projected EBIT for fiscal year 2026 to determine terminal value, informed by EBIT standards for public companies in the same or similar business as Baby Phat, as well as calculated a 21.8% interest rate (*id.*). Using the resulting “but-for” value and subtracting the “fair value,” Smith calculated the Plaintiff’s damages as \$21,820,000, excluding interest (*id.* at 6). Smith also provided a measure with a 15% lack of marketability discount, for an amount of \$18,172,000 (*id.*).

Plaintiff next provides the legal standard in reviewing a motion in limine (*id.*). Plaintiff asserts that Defendants make four primary arguments for the preclusion of the Smith Report: (1) the Smith Report is unsupported by record evidence; (2) the Smith Report fails to establish the reliability of Baby Phat’s internal financial projections; (3) the Smith Report improperly calculated Baby Phat’s terminal value through the improper selection of companies bearing no resemblance to Baby Phat; and (4) the Smith Report fails to adjust the valuation given Plaintiff’s minority interest in Baby Phat (*id.* at 7).

For its first legal argument, Plaintiff asserts that, based upon Rule 27 of the Commercial Division Rules, a motion in limine is designed to address broader issues regarding expert testimony, such as the expert’s qualifications or the use of expert testimony in a given subject area, and is not intended to bar expert testimony on the grounds of credibility (*id.*). However, Plaintiff claims that Defendants offer nothing but challenges as to credibility, and do not at any time challenge Smith’s qualifications or the business valuation methods employed in the Smith Report (*id.*). Plaintiff argues that the sole ground provided to preclude Smith’s testimony is Defendants’ categorization of his damages figure as “fanciful” – that is, merely a disagreement with the analysis as opposed to an objection to the methodology used in the Smith Report (*id.* [citations omitted]). Plaintiff asserts that this motion reiterates the same major points as the Jacobsen Report, which is insufficient to challenge the admissibility of Smith’s expert opinion given the opportunity for cross-examination and rebuttal evidence, and given the nature of credibility issues as going to the weight of the testimony, not its admissibility (*id.* at 9).

Plaintiff next asserts, even if the relief sought were proper, the arguments to preclude Smith’s opinion are substantively defective (*id.*). Plaintiff asserts that Smith “relied exclusively on facts in the record,” including documents provided by Defendants themselves, which renders Defendants’ arguments unsupported (*id.*). Plaintiff argues that Smith did not guess or speculate in calculating any figures in his analysis, which was based upon evidence in the record as reflected by Addendum B to the Smith Report (*id.* at 9-10, *see also* the Smith Report, Addendum B).

Plaintiff further argues the analysis was based on the proposed DTC model, which the evidence purportedly demonstrates would have generated additional revenue had the Additional Capital Contribution not been diverted (*id.* at 10). Plaintiff characterizes Smith's reliance on the assumption that the removal of the Additional Capital Contribution directly reduced cash necessary for Baby Phat's growth as "logical and reasonable, especially when analyzed in conjunction with the documentary evidence and factual record he utilized to generate his conclusions" (*id.* at 11). Plaintiff disputes Defendants' characterization of the Smith Report as using imaginary figures arguing that the Smith Report clearly defines Smith's methodology as utilizing the DCF method which required a forecast of future cash flow earnings and an estimation of Baby Phat's terminal value, and that Smith projected these figures based upon the assumption the Additional Capital Contribution was not diverted (*id.*). Plaintiff asserts that, in drafting the Smith Report "[i]t did not matter what Baby Phat knew it had or did not have -- the entire purpose of the DCF analysis is to make future projections" (*id.* at 11-12).

Plaintiff next asserts that the Smith Report's methodology is sound (*id.* at 12). For its first point on this issue, Plaintiff states that Defendants' argument that Smith did not investigate why the Initial Projections were provided is irrelevant, as the model "'starts with profit and loss projections for Baby Phat dated July 28, 2021, which were provided by Counsel and were contemporaneously prepared'" (*id.* at 12, quoting the Smith Report at 7). Smith subsequently utilized documents created by Baby Phat – the profit and loss data for fiscal year 2021 and the January 4, 2022 budget projection – to adjust his figures (*id.*). Thus, Plaintiff asserts that Smith's analysis was informed by projections and actual financials of Baby Phat (*id.* at 12). Plaintiff argues that Defendants' attempt to disavow these documents which they themselves generated "does not render Mr. Smith's reliance on those documents inappropriate, and contrary to Defendants' position, that does not affect the admissibility of the opinion" (*id.*). For its second point, Plaintiff states that Smith did not ignore the historical results of Baby Phat and, in fact, utilized both the projections prepared by Defendants, and the historical results (*id.* at 13). For a final point as to the propriety of the methodology employed by Smith, Plaintiff states that Defendants' attack Smith's alleged use of "pie-in-the-sky" figures is irrelevant to the issue of the Smith Report's admissibility, and, in any event, Defendants fail to understand that these projections were merely used as the starting point for Smith's analysis (*id.*). Plaintiff notes that Defendants also fail to offer any authority which would render expert testimony based on internal company documents inadmissible; instead, it goes to the weight and credibility of Smith's testimony (*id.* at 13-14).

Plaintiff states the argument Smith "cherry-picked" companies used in coming to the 7x multiple in the DCF analysis is similarly unavailing at this stage and Defendants are free to challenge the use of these companies at trial (*id.* at 14). According to Plaintiff, Defendants' opinion that the use of these companies was improper does not affect the admissibility of Smith's expert testimony, as reflected in Defendants' own proffered case law (*id.* at 14). Plaintiff asserts this failure to cite analogous case law for their proposition that Smith's expert testimony is inadmissible is "telling" (*id.* at 15).

For its final argument, Plaintiff states that the assertion Smith failed to take into account the lack-of-marketability of Loconte Family's 30% ownership stake is simply incorrect (*id.* at 15).

In support, Plaintiff relies on Smith's statement that "a trier of fact may determine that it is appropriate in this case to apply a discount for lack of marketability to the derived value of Plaintiff's 30% interest in Baby Phat" (*id.*, quoting the Smith Report at 11). Plaintiff submits that Smith, acknowledging this concern, provided an alternate figure of damages factoring in a 15% discount rate for lack of marketability of a minority ownership interest (*id.*). Plaintiff asserts that, accordingly, the Smith Report does account for a potential lack of marketability deduction, and provides the trier of fact an alternate measure of damages reflecting such, thus rendering the determination of the applicability of such a discount rate to the trier of fact, as is proper (*id.*).

SUPPLEMENTAL SUBMISSIONS

At the pre-trial conference held on September 3, 2024, the Court gave Defendants the right to submit a short letter raising new items not originally contained in their moving papers based upon a discussion during that conference over whether Smith's Report would be admissible on all of Plaintiff's claims. Defendants submitted their letter brief on September 4, 2024 (*see* NYSCEF Doc. No. 191). Plaintiff responded in a letter brief on September 5, 2024 (*see* NYSCEF Doc. No. 192).

In their September 4th letter, Defendants first argue that in his report, Smith asserts that his opinion was tendered to establish Plaintiff's economic damages Plaintiff allegedly suffered "as a result of the unlawful scheme to defraud Plaintiff and for breaches of fiduciary duties owed to Baby Phat and Plaintiff" (NYSCEF Doc. No. 191 at 1). Defendants contend that the Smith Report has no applicability to the derivative claims representing the damages Baby Phat suffered as opposed to the damages the Loconte Family suffered and, therefore, the Smith Report is irrelevant and inadmissible in connection with Count II (breach of fiduciary duty) and Count III (conversion) (*id.*).

Second, Defendants assert that Plaintiff's fraud claim is predicated on Defendants' alleged "failure to disclose to Plaintiff that Baby Phat had loaned \$4.2 million to third parties and that Plaintiff would not have sold [Phat Farm] to Baby Phat in October 2021 had Plaintiff known about the loans" (*id.*, quoting Plf's Mem. at 2). Defendants point out that "Smith, however, does not proffer an opinion as to the damages that Plaintiff allegedly sustained as a result of that alleged omission—*i.e.*, any additional amount Plaintiff would have received or earned from its sale of Phat Farm had Baby Phat not made any such loans . . . Instead, Mr. Smith's opinion is that Plaintiff's 30 percent interest in Baby Phat was worth less than it would have been had Baby Phat not loaned \$4.2 million to third parties in the first place—*i.e.*, damages resulting from the diversion of capital *itself*, rather than a *failure to disclose* that such capital had been diverted during negotiations pertaining to a separate transaction taking place more than years after the fact" (*id.*). It is Defendants' contention that because Plaintiff's fraud claim is limited solely to the Phat Farm transaction, and because Smith did not opine on the amount of damages Plaintiff sustained by selling Phat Farm based on allegedly incomplete knowledge, the jury should not be permitted consider the Smith Report in connection with Count I (*id.*). Finally, Defendants argue that because

the breach of fiduciary duty claim embodied in Count VI is just a repackaged fraud claim from Count I, the jury should also not be permitted to consider the Smith Report in connection with Count VI (*id.*).

In their opposition letter brief, Plaintiff first concedes that the Smith Report does not address the damages Baby Phat suffered as a result of Defendants' alleged removal of \$4.2 million in capital and their alleged altering of Baby Phat's financial statements to cover-up this removal. As such, Plaintiff stipulates that the Smith Report is inadmissible for the purposes of establishing Plaintiff's derivative claims asserted on behalf of Baby Phat, which constitute Counts II and III (NYSCEF Doc. No. 192 at 1, n1).

Plaintiff contends that it "always understood that \$5 million would be infused into Baby Phat for marketing and advertising, which would increase the value of Plaintiff's 30% interest" which never occurred (*id.* at 1). Plaintiff argues that "[t]he basis of the Smith expert report is that Plaintiff suffered measurable economic harm when Defendants removed the Additional Capital Contribution from [Baby Phat]" and that Plaintiff's fraud claim is not, as Defendants suggest, limited to "the inducement of the Phat Farm transaction" (*id.*). Thus, Plaintiff asserts that the fraud claim also involves "the act of intentionally removing the funds and falsifying documents to give off the illusion that the Additional Capital Contribution was still available to be invested into the business for years. In other words, Plaintiff alleges that 'Defendants engaged in an unlawful scheme to defraud LF of its 70% interest in Baby Phat, and undermine the parties' relationship'" (*id.* at 2, *quoting* Second Amended Complaint [NYSCEF Doc. No. 161] at ¶ 119). Furthermore, Plaintiff disputes Defendants' contention that its breach of fiduciary duty claim against Simmons (Count VI) is simply its repackaged fraud claim and asserts that the allegations of the Second Amended Complaint found at paragraphs 119-129 and 161-175 belie Defendants' position (*id.* at 2, n3). Plaintiff further points out that in addition to its fraud claim, Plaintiff is pursuing claims based on breach of the Operating Agreement and Simmons' breach of fiduciary duty and that "[b]oth of those claims are rooted in the allegation that the Additional Capital Contribution was improperly removed, with Defendants' knowledge and/or active concealment, which hinders the value of Plaintiff's 30% interest in Baby Phat" (*id.* at 2). Plaintiff states that "[a]s Smith opines, there is a direct correlation to Plaintiff's 30% interest and the improper removal and concealment of the Additional Capital Contribution in that it is the 'but for' cause of Plaintiff's economic harm" (*id.*).

The Court notes that Defendants have filed yet another supplemental response responding to Plaintiff's opposition letter (NYSCEF Doc. No. 195), but because this letter was not authorized by the Court, it has not been considered for the purposes of this Decision and Order.⁹ Again, as

⁹ The Court does note that in many respects, the submission improperly seeks an order granting summary judgment to Defendants dismissing Plaintiff's fraud claim as legally insufficient to the extent it involves Plaintiff's claim that it was defrauded based on Defendants' affirmative misrepresentations contained in the altered financial statements as well as their fraudulent omissions in failing to advise Plaintiff that \$4.2 million had been removed from Baby Phat's account and that the financial statements had been altered. Defendants also argue that the fraud

the trial unfolds, the Court will address all issues concerning the admissibility of the Smith Report as against which claims, as well as the propriety of Plaintiff's revisions to its verdict sheets (e.g., any claims that are predicated on new theories not articulated in the pleadings), which will be addressed prior to closing arguments at the charge conference.

DISCUSSION

As an initial matter, as stipulated by Plaintiff, the Smith Report shall not be admissible in connection with Plaintiff's derivative claims (i.e., Counts II and III). The Court also agrees that to the extent Plaintiff's fraud claim is predicated on Plaintiff's alleged fraudulent inducement in entering into the Phat Farm transaction, the Smith Report is inadmissible because it does not address Plaintiff's damages arising from this transaction.

However, the Court does not agree that Plaintiff's fraud (Count I) and breach of fiduciary duty (Count VI) claims are limited to its claim that it was fraudulently induced by the altered financial statements to enter into the Phat Farm transaction. As noted by the Court in its May 2024 Decision:

In its First Cause of Action for fraud against Defendants, Plaintiff alleges that they "engaged in an unlawful scheme to defraud LF of its 70% interest in Baby Phat, and undermine the parties' business relationship" (*id.* at ¶¶ 110-111). Specifically, Plaintiff alleges that they "intentionally misrepresented it maintained the Additional Capital Contribution in Baby Phat's cash reserves for years" and falsified financial records (*id.* at 112). Plaintiff asserts that the discovery demonstrates that Defendants and Kimora in particular, possessed balance sheets that expressly contradicted the false financial documents allegedly provided to Plaintiff and that, despite being aware of the falsity of these documents, Kimora never advised Plaintiff of the true financial state of Baby Phat (*id.* at ¶¶ 113-114) (NYSCEF Doc. No. 157 at 9).

The Court denied the branch of Defendants' motion seeking to dismiss the fraud claim finding the existence of triable issues of fact (*id.* at 36-40).¹⁰ Regarding Plaintiff's direct breach of fiduciary duty claim, the Court summarized that claim as follows:

and breach of fiduciary duty claims are duplicative of Plaintiff's breach of contract claim. These arguments are entirely improper because a motion in limine is an inappropriate substitute for a motion for summary judgment (*Rondout Elec., Inc. v Dover Union Free Sch. Dist.*, 304 AD2d 808 [2d Dept 2003]; *Marshall v 130 N. Bedford Rd. Mount Kisco Corp.*, 277 AD2d 432 [2d Dept 2000], *lv denied* 96 NY2d 714 [2001]; *Downtown Art Co. v Zimmerman*, 232 AD2d 270 [1st Dept 1996]). The Court will not in the context of a motion in limine, decide to dismiss the complaint (or a claim contained therein) (*see Rivera v City of New York*, 306 AD2d 456 [2d Dept 2003]).

¹⁰ It is important to note that Defendants did not move for summary judgment on the fraud claim based on Plaintiff's lack of evidence concerning its damages (*see* NYSCEF Doc. No. 43).

The Sixth Cause of Action for breach of fiduciary duties against Kimora alleges that Section 6.1 of the Amended Operating Agreement provides that the Company shall have a Board of Managers consisting of five people, with Keyway having the authority to appoint four Managers, which initially consisted of Kimora and non-party Matthew Norby, and Plaintiff having the authority to appoint one Manager (*id.* at ¶ 153). Plaintiff alleges that pursuant to Section 6.1, Keyway appointed Kimora to the Board of Managers (*id.* at ¶ 154). Plaintiff asserts that the Amended Operating Agreement “also vested the Board of Managers with the ability to appoint officers of the Company, including: (a) Chief Executive Officer; (b) President; (c) one or more Executive Vice Presidents or Vice Presidents; (d) Secretary; and (e) Treasurer or Chief Financial Officer” and that Kimora was appointed the President, Chief Executive Officer, Treasurer and Secretary and maintained these positions at all relevant times (*id.* at ¶¶ 155-156). Plaintiff alleges that, in these positions, Kimora owed Plaintiff fiduciary obligations, including to act in good faith (*id.* at ¶ 157). Plaintiff further alleges that Kimora also owed Plaintiff fiduciary obligations as a member of the Board of Managers and points to Section 6.5 of the Amended Operating Agreement (*id.* at ¶¶ 158-159). Plaintiff asserts that Kimora breached these fiduciary duties by falsifying financial information and intentionally concealing from Plaintiff the truth about Baby Phat’s financials and the ACC (*id.* at ¶ 160). Plaintiff claims that Kimora authorized Baby Phat to make purported loans to third parties without receiving reasonable security (*id.* at ¶ 161). Plaintiff alleges that the discovery “confirms that Kimora had knowledge that the Additional Capital Contribution was removed from Baby Phat, but actively concealed that information from LF” and that, when Plaintiff discovered the ACC was missing, Kimora “attempted to use Leissner as a scapegoat by proclaiming he worked ‘unilaterally’ and without her knowledge,” which was “false and misleading, and was intended to undermine LF’s rights as a 30% owner of Baby Phat” and that these actions are “gross, wanton, and egregious, and were undertaken without regard to the duties she owed LF but, instead, for Kimora’s own personal motives and benefit” in breach of Kimora’s fiduciary duties (*id.* at ¶ 162-166) (NYSCEF Doc. No. 157 at 10-11).

The Court denied the branch of Defendants’ motion seeking to dismiss the breach of fiduciary duty claim finding the existence of triable issues of fact (*id.* at 34-36).

Clearly, based on the allegations of Plaintiff’s First Amended Complaint (which are almost identical to the now operative Second Amended Complaint except that in the Second Amended Complaint, Plaintiff adds a claim for breach of the Operating Agreement based on additional breaches learned during discovery),¹¹ Plaintiffs’ fraud and breach of fiduciary duty claims are not

¹¹ These additional allegations assert that, without obtaining LF’s required consent, Keyway and in contravention of the Operating Agreement: (i) authorized salary of over \$100,000 annually to

limited to a claim that Plaintiff was fraudulently induced to enter into the Phat Farm transaction. Accordingly, for present purposes, which, of course may change based on the outcome of the liability phase of this trial, the Court shall not preclude the admission of the Smith Report as it opines on Plaintiff's damages emanating from its direct fraud¹² and breach of fiduciary duty claims.

The Court now turns to Defendants' primary argument, which is that the Smith Report should be precluded because of the numerous fatal flaws contained therein.

The Court has the authority to grant a motion in limine to exclude evidence in advance of trial (*Matter of PCK Dev. Co. v Assessor of Town of Ulster*, 43 AD3d 539 [3d Dept 2007]). "[T]he function of a motion in limine is to permit a party to obtain a preliminary order before or during trial excluding the introduction of anticipated inadmissible, immaterial, or prejudicial evidence or limiting its use" (*State v Metz*, 241 AD2d 192, 198 [1st Dept 1998]). An advance ruling as to whether evidence may be received before a jury aids counsel in framing their positions for their opening statements, and prevents the jury from being contaminated with knowledge arising from inadmissible evidence or from arguments based upon inadmissible evidence (*see* 4A Haig, Commercial Litigation in New York State Courts §§ 43.1 et seq. [5th ed 2020]). The proper focus of a motion in limine is whether evidence that a party anticipates offering is admissible (*Matter of PCK Dev. Co.*, 43 AD3d at 540). The decision on a motion in limine is, by its nature, tentative, as the Court may change or alter its ruling during trial. For that reason, the decision on a motion in limine is generally regarded as an advisory opinion and, as such, is not appealable (*see, e.g., id.; Chateau Rive Corp. v Enclave Dev. Assoc.*, 283 AD2d 537 [2d Dept 2001]).

Expert testimony is admissible when it helps to "clarify an issue calling for professional or technical knowledge, possessed by the expert and beyond the ken of the typical juror" (*De Long v County of Erie*, 60 NY2d 296, 307 [1983]; *see also Fortunato v Dover Union Free Sch. Dist.*, 224

third-parties; (ii) entered into a "consulting" agreement with Kimora's wholly-owned entity, KLS Holdings, LLC for KLS to be paid \$100,000 annually; and (iii) signed an indemnity agreement whereby Kimora (on Keyway's behalf) unilaterally agreed that Baby Phat would indemnify Keyway (Second Amended Complaint [NYSCEF Doc No. 161] at ¶¶ 14, 109-114, 176-188). The indemnity agreement dated February 7, 2018 provides that Simmons on behalf of Keyway and Baby Phat, agrees that Baby Phat would indemnify Keyway and Simmons for any disputes that were to arise in connection with Baby Phat (*id.* at ¶ 112).

¹² The Court recognizes that there may be an issue concerning Plaintiff's reliance on the Smith Report for the calculation of its fraud damages because: (1) Plaintiff is not claiming it was fraudulently induced into entering into the Baby Phat transaction, just that Defendants committed fraud by providing it with the altered financial records upon which it relied; and (2) the out-of-pocket rule relating to fraud damages. Nevertheless, because these issues were only raised in the Defendants' submission on September 9, 2024 which the Court has not considered for purposes of this motion, and because the issue over the propriety of this damage calculation as it relates to the fraud claim may be entirely moot if there is no finding of liability on the fraud claim, the Court is not resolving these issues at the present time.

AD2d 658 [2d Dept 1996]). “[T]he admissibility and scope of expert testimony is a determination committed to the sound discretion of the trial court” (*Mariano v Schuylerville Cent. Sch. Dist.*, 309 AD2d 1116, 1117 [2d Dept 2003]). An expert is qualified to render an opinion if he or she is possessed of the requisite skill, training, education, knowledge or experience from which it can be assumed that the information imparted or the opinion is reliable (*Lopez v Gem Gravure Co.*, 50 AD3d 1102 [2d Dept 2008]). Here, based on the professional and educational background of Smith set forth in his CV, his extensive experience in valuing companies, and his prior retainment as an expert on the issues of economics and business valuations, the Court finds Smith “possess[es] the requisite skill, training, education, knowledge or experience from which it can be assumed that the opinion rendered is reliable” (*Schechter v 3320 Holding LLC*, 64 AD3d 446, 449 [1st Dept 2009]).

It is well settled that an expert's opinion may not be based on speculation. “To be properly admitted, expert opinion evidence must generally be based upon facts either found in the record, personally known to the witness, derived from a “professionally reliable” source or from a witness subject to cross-examination” (*McAuliffe v McAuliffe*, 70 AD3d 1129, 1132 [3d Dept 2010], quoting *Brown v County of Albany*, 271 AD2d 819, 820 [3d Dept 2000], *lv denied* 95 NY2d 767 [2000]; see also *Pember v Carlson*, 45 AD3d 1092 [3d Dept 2007]; *Pascuzzi v CCI Cos., Inc.*, 292 AD2d 685 [3d Dept 2002]; *Reilly v Nirla*, 81 AD3d 913, 916 [2d Dept 2011] [“conclusions reached by the hospital's expert assumed facts not supported by the evidence, were not based on any facts in the record or personally known by the witness, and were not supported by facts fairly inferable from the evidence”]). An expert witness “may testify that he or she relied upon specific, inadmissible out-of-court material to formulate an opinion, provided[:] (1) it is a kind accepted in the profession as reliable as a basis in forming a professional opinion [i.e., data that is generally accepted in the particular field][:] and (2) there is evidence presented establishing the reliability of the out-of-court material referred to by the witness” (*Wagman v Bradshaw*, 292 AD2d 84, 85 [2d Dept 2002]). “Where the expert's ultimate assertions are speculative or unsupported by any evidentiary foundation . . . the opinion should be given no probative force . . .” (*Diaz v New York Downtown Hosp.*, 99 NY2d 542, 544 [2002]; *Reilly*, 81 AD3d at 916 [“An expert opinion grounded on a nonexistent fact is not significantly probative”]). A review of the Smith Report reveals that for the most part, it is based on evidence in the record (i.e., Defendants’ projections, budgets and other financial records as well as witness testimony). As discussed infra, to the extent Defendants argue that his Report is unreliable because the projections were not based in reality and he did nothing to test their accuracy before relying on them, these issues go to the weight of Smith testimony and not its admissibility.

The use of expert testimony “must be carefully circumscribed to assure that the expert does not usurp either the role of the trial judge in instructing the jury as to the applicable law or the role of the jury in applying that law to the facts before it” (*United States v Bilzerian*, 926 F2d 1285, 1294 [2d Cir 1991], *cert denied* 502 US 813 [1991]). Thus, “[w]hile an expert may give [his/her] opinion on an issue of fact within the jury’s province, [he or she] ‘may not give testimony stating ultimate legal conclusions based on those facts’” (*Taylor v Evans*, 1997 WL 154010 at *2 [SDNY 1997], quoting *Bilzerian*, 926 F2d at 1294; see also *AUSA Life Ins. Co. v Dwyer*, 899 F Supp 1200 [SD NY 1995]). Nevertheless, an expert is permitted to provide testimony that could assist the jury in determining whether the conduct in question conformed to that normally accepted in a particular business, trade, or profession and may be admitted on the issue of a party's compliance with the

applicable standard of care (*Selkowitz v Nassau County*, 45 NY2d 97, 102 [1978] [expert testimony "appropriate to clarify a wide range of issues calling for the application of accepted professional standards . . . includ[ing] the standard of care for contractors, firefighters, window washers, and mariners"]; *Adirondack Classic Design, Inc. v Forrell*, 182 AD3d 809 [3d Dept 2020] [expert testimony concerning industry standards properly admissible]; *French v Ehrenfeld*, 180 AD2d 895, 896 [3d Dept 1992 ["[p]roof of customary practice within a particular industry is admissible to establish a standard of care"]; *Jacobs v Larry Biscornet, Inc.*, 155 AD2d 644 [2d Dept 1989]). Furthermore, an expert may testify whether a certain act or omission was a violation of a statute or regulation (*Boruch v Morawiec*, 51 AD3d 429 [1st Dept 2008]).

In this case, in the event of a liability verdict, the jury will be required to assess damages for at least some of Plaintiff's claims based on the economic harm Plaintiff suffered as the result of Defendants' alleged misdeeds, which, could involve a determination of the value of Plaintiff's 30% interest in Baby Phat if Defendants had not removed the \$4.2 million of capital from Baby Phat's account. Plaintiff's and Defendants' experts opine on the value of Baby Phat and a review of their reports' opinions reflects a large schism between their respective opinions. Jacobson strongly criticizes the methodology and conclusions drawn by Smith. "Where, as here, both parties present expert testimony in support of their positions, it is the province of the jury to determine the experts' credibility" (*Monroy v Glavas*, 57 AD3d 631, 632 [2d Dept 2008]).

There is no uniform rule for valuing stock in closely held corporations; instead, a valuation method must be tailored to the particular case, and that can be done only after a discriminating consideration of all information bearing upon an enlightened prediction of the future (*Sullivan v Trouser Mgt, Inc.*, 104 AD3d 1127 [4th Dept 2013]). "Valuing a closely held corporation is not an exact science. Accordingly, courts in such proceedings confront a variety of evidence and methods aimed at determining the price of minority interests in closely held corporations – legal entities that by their nature contradict the concept of a 'market' value" (*Matter of Seagroatt Floral Co.*, 78 NY2d 439, 445 [1991]; *Burns v Burns*, 84 NY2d 369 [1994]; see also *Mesholam v Mesolam*, 11 NY3d 24 [2008] [valuation is an exercise properly within the fact-finding power of the trial courts, guided by expert testimony]; *Miness v Minness*, 229 AD2d 520 [2d Dept 1996] [same]). "The determination of a fact-finder as to the value of a business, if it is within the range of the testimony presented, will not be disturbed on appeal where valuation of the business rested primarily on the credibility of expert witnesses and their valuation techniques" (*Dempster v Dempster*, 236 AD2d 582, 582 [2d Dept 1997], *lv denied* 90 NY2d 806 [1997], quoting *Matter of Dissolution of Penepent Corp.*, 198 AD2d 782, 783 [4th Dept 1993], *lv denied* 83 NY2d 797 [1994]). Given the difficulty in ascertaining the fair market value of a closely held company, "the opinions of experts are considered to be peculiarly appropriate" (*Righter v United States*, 439 F2d 1204, 1207 [US Ct Claims 1971]).

As the Appellate Division, Second Department has made clear, the valuation of a closely held corporation is difficult:

The process of evaluating a closely held corporation where such corporation or a part thereof is a marital asset, necessarily complicates the court's task even further. Due to the inherent nature of such corporations, in which ownership is generally vested in a

small group of stockholders and in which the shares are not usually salable, the value of the shares therein often cannot be measured by objective evidence of fair market value,¹³ i.e., “the price for which the property would sell if there was a willing buyer who was under no compulsion to buy and a willing seller under no compulsion to sell” . . . One commentator on the problem has noted that “[w]hen the property is not freely exchanged, as is the usual case with stock of closely held corporations, valuation not only demands considerable judgement [sic] but also invites dispute” . . . The methods of making an evaluation in these circumstances are not exact since neither book value, nor sales of stock when they occur, may prove to be reliable indicators of real worth (*Kaye v Kaye*, 102 AD2d 682, 686-687 [2d Dept 1982] [citations omitted]).

Here, Plaintiff has demonstrated that Smith’s DCF methodology is accepted in the valuation community as valid and reliable. Indeed, Jacobson does not quibble with the use of DCF for the valuation of Baby Phat. In so holding, the Court is not finding that Smith’s methodology properly determines the fair market value of what Plaintiff’s 30% interest would have been if the \$4.2 million had not been removed from Baby Phat or that it is without flaws or unsusceptible to challenge. As noted by the Hon. Leonard B. Austin, J.S.C., a former Commercial Division justice and Appellate Division, Second Department Justice:

courts in the Second Circuit have stressed that liberality and flexibility are required in evaluating qualifications should be the rule in applying the Daubert factors . . . “[a]ttacks

¹³ The definition of FMV is set forth in Revenue Ruling § 59-60, which defines it as

“[T]he price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of the relevant facts.” The Internal Revenue Service (Revenue Ruling § 59-60) has developed the following factors to be considered in determining the fair market value of closely held corporate stock for estate and gift tax purposes:

- (a) The nature of the business and the history of the enterprise from its inception[;]
- (b) The economic outlook in general and the condition of the specific industry in particular[;]
- (c) The book value of the stock and the financial condition of the business[;]
- (d) The earning capacity of the company[;]
- (e) The dividend paying capacity[;]
- (f) Whether or not the enterprise has goodwill or other intangible assets[;]
- (g) Sales of the stock and the size of the block of stock to be valued[;]
- (h) The market price of stocks of corporations engaged in the same or a similar line of business having their stocks actively traded in a free and open market, either on an exchange or over-the-counter (*Matter of Blake v Blake Agency, Inc.* (107 AD2d 139, 146-147 [2d Dept 1985], *lv denied* 65 NY2d 609 [1985]).

relating to faults in the experts methodology and lack of textual authority for the opinion all are improper criteria for advancing a motion under 702, go to the weight and credibility . . . [D]isputes as to the strength of [the witnesses's] credentials, faults in his use of differential etiology as a methodology, or lack of textual authority for his opinion goes to the weight, not the admissibility, of testimony”

Frye and *Daubert* stand for the proposition that only in the most extreme and thereby prejudicial circumstances should the trier of fact be preventing from hearing and weighing the opinion of the expert . . . It is for [the trier of fact] to measure the expert's qualifications and the facts and assumptions made by the expert against all of the other evidence and testimony, including Defendants' expert, in reaching its decision (*Stanley Tulchin Assoc., Inc. v Grossman*, 2002 NY Slip Op 50428[U], 2002 WL 31466800 at *3-5 [Sup Ct, Nassau County 2002] [citations omitted]).

The Court has reviewed Defendants' cases and finds them largely irrelevant to the procedural posture of this motion as they involved either: (1) various courts' decisions rendered after a trial addressing the unreliability of admitted expert testimony concerning business valuations (*Zheng v Icahn*, 53 Misc 3d 1213[A] [Sup Ct, NY County 2016], *affd sub nom R2 Investments LDC v Icahn*, 161 AD3d 567 [1st Dept 2018]; *Shalor Designs v NBA Props., Inc.*, 264 AD2d 686 [1st Dept 1999]; *Capasso v Capasso*, 129 AD2d 267 [1st Dept 1987], *lv dismissed* 70 NY2d 988 [1988]; *Seibel v Ramsay*, 225 AD3d 529 [1st Dept 2024]; *Charron v Sallyport Global Holdings, Inc.*, 2014 WL 7336463 [SDNY 2014], *affd* 640 Fed Appx 80 [2d Cir 2016]); or (2) the decisions are otherwise distinguishable.¹⁴ As noted supra, until the liability phase of the trial is completed, the admissibility of the Smith Report remains in flux. The Court agrees that there may be flaws in Smith's analysis, but those flaws go to his credibility (i.e., the weight of his testimony) rather than to its admissibility (*Sadek v Wesley*, 27 NY3d 982 [2016]; *Adamy v Ziriakus*, 92 NY2d 396 [1998]). For example, his alternative use of a 15% discount for lack of marketability but applying no discount for lack of control is certainly something Defendants can challenge since while a discount for lack of control is inapplicable to a valuation based on fair value, it has been considered in valuations based on fair market value. In addition, the alleged comparable companies on which

¹⁴ *Dreyer v Ryder Automotive Carrier Group, Inc.* (2005 WL 1074320 [WDNY 2005]) involved a motion in limine where the court was confronted with the issue of excluding an expert's opinion on a novel issue of “injury per exposure rate,” which the court excluded because, inter alia, the expert had failed to verify the accuracy of the data upon which he relied. In *Lightbox Ventures, LLC v 3rd Home Limited* (2017 WL 5312187 [SDNY 2017]), the court excluded valuations performed by expert witnesses who had never before testified as expert witnesses. The court excluded their testimony on valuations of plaintiff because they were predicated on, inter alia, unverified data and plaintiff's optimistic projections. By contrast, here, while Defendants contend that the internal projections they made were exaggerated and unrealistic, they neglect to acknowledge that Smith's opinion is based not only on these allegedly grossly exaggerated projections, his opinion is also based on Baby Phat's revised projections and its actual results contained in its financial statements. The jury will ultimately decide what weight, if any, to give to Smith's testimony, as informed by Defendants' cross-examination of Smith concerning his alleged failure to investigate the propriety of the Baby Phat projections.

Smith relied to obtain the 7X multiple may also be inappropriate. However, because it is the trier of fact who must assess the credibility of Plaintiff's and Defendants' expert witnesses, and because, following the jury's verdict, the Court would potentially have an opportunity to weigh-in on the damages awarded, the Court shall not preclude Plaintiff's use of the Smith Report at trial by usurping the jury's function in the first instance.

CONCLUSION

Accordingly, for the reasons stated and based upon the papers aforesaid, it is hereby

ORDERED that Defendants' motion to preclude the use of the Smith Report at the trial of this matter is granted in part and denied in part as set forth more fully herein.

The foregoing constitutes the Decision and Order of this Court.

Dated: White Plains, New York
September 16, 2024

ENTER:


HON. GRETCHEN WALSH, J.S.C.

TO:

COLE SCHOTZ, P.C.

By: Arnold P. Picinich, Esq.

Attorneys for Plaintiffs

25 Main Street

Hackensack, New Jersey 07601

BARNES & THORNBURG, LLP

By: Joseph A. Matteo, Esq.

Attorneys for Defendants Keyway Pride Limited, LLC, Kimora Lee Simmons-Leissner
and Nominal Defendant Baby Phat Holding Company, LLC

390 Madison Ave., 12th Floor

New York, New York 10017