Fair Value - Alert May 11, 2011

Matter of Giaimo [EGA Associates, Inc.] 2011 NY Slip Opinion 50714U in Supreme Court NY County April 25, 2011 and Report & Recommendation by Special Referee Louis Crespo dated June 30, 2010 [Shareholders' dispute, Fair Value, NYS anti-oppression and judicial Dissolution/re-purchase statutes, Real Estate Holdings.]

This Fair Value decision under NYBCL §1118 [the NYS law which defines the right of oppressed shareholders to obtain payment for their shares] covers two real estate holding entities structured as regular, non-passthrough corporations almost equally owned by two feuding siblings. The two entities own a number of walk-up apartment buildings and a development site in NY City. Valuing the two corporations under the fair value statutes is first a matter of valuing the underlying real properties, then making appropriate adjustments to value the stock of the two corporations. The Special Referee's report has a total of 181 pages and first devotes 80 pages to the work products and testimonies of several real estate appraisers. The report is a must-read for all appraisers. The referee's conclusion was that the corporations owned real property worth $26.6 million, cash and other assets of $6.9 million, offset by liabilities of $1.4 million. Not being a real estate appraiser, my comments will be limited to the valuation of the two corporations.

The report carefully considers applying a Lack-of-Marketability ["LOMD"] discount, an adjustment for Built-In Capital Gains ["BIG"] tax, and a "discounted" portion of the BIG tax adjustment. The Court generally followed the recommendation of the Special Referee, and, in the end, disallowed any LOMD because it appeared to be double counting and conflicted with appellate decisions. Despite the explanation of a noted business appraiser/author who testified, the Court disagreed with the referee's reasons for not requiring an LOMD. The main reason for excluding the LOMD is that fair value is based on control, and that a control owner can sell the underlying properties in the market.

The Court also authorized a reduction in value equal to the present value of the built-in capital gains or BIG tax, following the computation sanctioned by the NYS appeals court decision Murphy v. U.S. Dredging Corp [74 AD3rd 815, 2nd department] of June 1,2010. The BIG discount is an unavoidable issue for C corporations which own appreciated assets, and the complexity of the two corporations' portfolios of rental properties suggest that even partial liquidation would take time, hence the discounted BIG discount model makes sense. The Court used 3% growth over a ten year period, resulting in a deduction equal to 45.9% of the BIG tax. The Court also gave the corporations six months to pay for the shares.

The referee's report is available at: http://www.NYNJCT-BV.com/GiaimoRefereeRptNYFV.pdf. Please do not hesitate to call or e-mail to discuss this or any other business valuation issue.

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