

**T&E - Alert February 24, 2011**

Matter of Abraham [Elite Technology NY, Inc.] 2010 slip Opinion 33225 in Supreme Court New York County 11/10/2010 commercial division

Elite Technology is a New York corporation started in 1993 by 2 businessmen to distribute office machines; in 2003, the corporation admitted 2 new shareholders with a combined stake of 49%. The new shareholders expanded the sales capability of Elite Technology by hiring and training salesmen. As a result, the company grew from one to 3 locations and from few salesman to a sales force of 26; sales tripled. In 2006 however, the 2 groups of shareholders had a fall-out, and the Company fired the new shareholders as sales managers, claiming that the latter had neglected their duties. The fired shareholders jointly filed a petition for judicial dissolution of Elite under the NYS Business Corporation Law, section 1104-1, alleging minority shareholder oppression. The minority shareholders alleged that they were excluded from corporate governance, while majority owners wasted and depleted Elite's assets. The majority replied by electing to purchase the petitioners' shares for fair value under BCL section 1118.

The issue of valuation was referred by the Court to a referee, who held 4 days of hearings during which both sides' experts testified. The referee rejected the respondents' calculation which had increased its discount rate by 6% for key man considerations because the departing shareholders could not be deemed to be key persons; they had being brought in as sales managers and built a trained sales force; after that was accomplished, the new shareholders could no longer be deemed key to Elite; in fact they were replaced within the year of their dismissal as sales continued to climb. On the other hand, the referee decided that normalized earnings were much closer to the petitioners' expert data of \$1 million than the respondents' \$246,000. Normalization was performed by the petitioners based on data published by Robert Half International, a staffing firm. The respondents made small normalization adjustments, but tax effected earnings, while the petitioners did not. The petitioners used 2004-5 data, corresponding to the period before the firing, while the respondents used 2006 only. Capitalization rates used by the experts were not exactly comparable: the petitioners' rate was 18.8% less 7% for growth, while the respondents used 25% [see above] less 4% growth. The lack-of-marketability discounts were 25% and 19%, respectively. In the final analysis, the referee concluded that the value of the petitioners' stake was \$3.2 million, or 6 times the amount calculated by the respondents primarily because of the normalization. The Court agreed with all recommendations of the referee, and gave the respondent one year to pay.

The Court decision and the referee's report can be found at <http://nycourts.gov/ecourts> enter the index number 602895/2006; then click on Show Decisions. The referee's report is also available at <http://www.NYNJCT-BV.com/EliteReportFV.pdf>. Please do not hesitate to call or e-mail to discuss this or any other business valuation issue.

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