THE SUFFOLK LAWYER

THE OFFICIAL PUBLICATION OF THE SUFFOLK COUNTY BAR ASSOCIATION

DEDICATED TO LEGAL EXCELLENCE SINCE 1908

website: www.scba.org

Vol. 29 No. 4
January 2014

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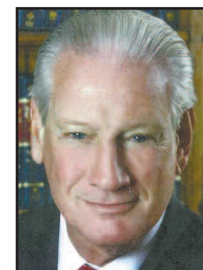
New Law Limits Liens of Insurance Companies Formed Under Federal ERISA

By A. Craig Purcell

The New York State Legislature recently passed an act amending the General Obligations Law as it pertains to the parties to the settlement of tort claims. The bill, which was signed into law on November 13, 2013 by Governor Cuomo, eliminates certain health care insurance company liens, reimbursements and subrogation claims.

The legislation, long supported by the New York State Bar Association, adds a new subdivision four to GOL 5-101 and amends Section 5-335. The present legislation is intended to protect all parties to the settlement of a tort claim from liens asserted by health insurance companies which were organized and exist under federal ERISA law. Oddly, it covers only settlements, and not judgments.



A. Craig Purcell

The legislation was prompted by the continued insistence by ERISA plans that they have the right to assert liens or rights of subrogation for reimbursement of medical expenses they have paid injured parties who then go on to successfully prosecute bodily injury claims. In 2009 the legislature enacted the current General Obligations Law Sections 5-101 and 5-335 in order to protect injured parties from such claims. However, ERISA plans have continued to assert their right to reimbursement, and federal courts in other states that have similar legislation continued to rule that states cannot trump the federal legislation under which ERISA plans were set up (see, e.g., *Rice v. Panchal*, 65 F.3d 637, 644-45 (7th Cir. 1995), *Arana v. Ochsner Health Plan*, 338 F.3d 433 (5th Cir. 2003), *Levine v. United Healthcare Corp*., 402 F.3d 156 (3d Cir. 2005). (See article in the November, 2013, Suffolk Lawyer, by Paul Devlin, Esq. with

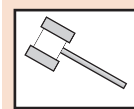
(Continued on page 20)

SCBA Offers Pro Bono Refresher

Photo by Barry Smolowitz

SCBA member Raymond B. Lang, a foreclosure volunteer has been involved in the program since its inception and is very valuable to the association. More photos on page 15.

The staff at the SCBA worked very hard to make the annual holiday party a perfect occasion. They include from left, Joy Ferrari, Nicolette Ghiglieri, Tina O'Connor, Jane LaCova, Edith Dixon and Laura Latman.



BAR EVENTS

Judicial Swearing-In and Robing Ceremony

Monday, Jan, 13, 9 a.m.

Touro Law Center, 225 East View Drive, Central Islip

The annual judicial ceremony of newly appointed and reelected justices and judges hosted by the SCBA. All are welcome. Refreshments served.

Meet, Greet and Mingle

Thursday, Jan. 23, 6 p.m.

Polish Hall, Riverhead

Please join your colleagues for the first evening in a series of complementary opportunities to meet, greet, mingle and network. Reservations are a must and can be made by clicking on the link, http://www.scba.org/post/mgm1.pdf.

Cohalan Cares for Kids

Thursday, Feb. 6, at 6 p.m.

Bar Center

Third annual Cohalan Cares for Kids hosted by SCBA in cooperation with the Suffolk County Matrimonial Bar, the Long Island Hispanic Bar Association, the Suffolk County Women's Bar and Enright Court Reporting. The fundraiser will benefit the Cohalan Children's Center and will include a night of wine and cheese. $50 pp.

FOCUS ON
COMMERCIAL LITIGATION
SPECIAL EDITION

'Irreparable Harm' Distinctions Between Delaware and New York When Seeking an Injunction

By Hon. Thomas F. Whelan

Often, corporate agreements, such as operating agreements and buy-sell agreements, contain choice-of-law provisions requiring the application of Delaware law. Where a party to such an agreement, however, seeks injunctive relief in a New York court instead of a Delaware court, how can the conflict on the 'irreparable harm' element between the respective states be synthesized by the New York court?

One of the more common examples arises when a shareholder of a Delaware corporation seeks to enjoin, in a New York court, the shareholder vote scheduled to be held at the annual general meeting of shareholders until such time as more complete disclosures regarding agenda proposals are made. Proposals to be put to shareholders at such meetings that are common targets of injunctive relief include proposals to increase the number of shares of common stock issuable under a corporation's Stock Incentive Plan and votes to approve executive compensation. Plaintiffs, in a class action suit, will often complain that the Proxy Statement filed with the Securities and Exchange Commission is incomplete and that insufficient information has been disclosed to shareholders concerning the dilutive effect such proposals may have on existing shareholders. The court's assistance is sought to postpone the shareholder vote on such proposals to afford the Board of Directors time to "correct its breaches of fiduciary duty."

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In New York, courts have long pronounced that to prevail on a motion for preliminary injunctive relief, the movant must clearly demonstrate a likelihood of success on the merits, the prospect of irreparable harm or injury if the relief is withheld, and that the balance of the equities favors the movant's position. *Nobu Next Door, LLC v Fine Arts Hous., Inc*., 4 NY3d 839 (2008). Of the various recognized factors militating against the granting of preliminary injunctive relief, the one that is critical to this discussion is that the movant will not be irreparably harmed because it can be fully recompensed by a monetary award or other adequate remedy at law. *Di Fabio v Omnipoint Communications, Inc.*, 66 AD3d 635, 636–637 (2d Dept 2009). Therefore, New York courts have held that a preliminary injunction is not a proper remedy under such circumstances. *Mar v Liquid Mgt. Partners, LLC*, 62 AD3d 762 (2d Dept 2009).

Thomas F. Whelan

Under Delaware law, directors are required to "disclose fully and fairly all material information within the board's control when they seek shareholder action." *Netsmart Tech., Inc. Shareholders Litig*., 924 A2d 171(Del. Ch. 2007). Therefore, Delaware courts, and in particular cases decided by Chancellor Leo E. Strine, Jr., have typically found a threat of irreparable harm to exist when it appears stockholders may make an important voting decision based upon inadequate disclosures made by the issuing company. Therefore, to avoid the incurrence of such irreparable harm, it is not uncommon for a shareholder to obtain injunctive relief restraining a shareholder vote emanating from a claim of inadequate disclosure from the board of directors and requiring that additional disclosure be made. *Netsmart Tech., supra*, 924 A2d at 199; *Staples, Inc. Sharholders Litig*., 792 A2d 934 (Del. Ch. 2001); *Mony Group Inc. Shareholder Litig*., 852 A2d 9 (Del. Ch. 2004).

So, when an injunction is sought in New York involving a Delaware corporation where a Delaware choice-of-law provision is involved, how does a New York court reconcile these significant differences?

New York courts will generally enforce a clear and unambiguous choice-of-law clause in an agreement so as to give effect to the parties' intent. *Welsbach Elec. Corp. v MasTec N. Am., Inc*., 7 NY3d 624, 629 (2006). However, "under common law rules matters of procedure are governed by the law of the forum." *Martin v Dierck Equip., Co.*, 43 NY2d 583, 588 (1978). On the other hand, matters of substantive law fall within the course chartered by choice of law analysis. *Tanges v Heidelberg N. Am.*, 93 NY2d 48, 53 (1999). New York courts therefore apply contractual choice-of-law clauses only to substantive issues. *Educ. Res. Inst., Inc. v Piazza*, 17 AD3d 513 (2d Dept 2005). Importantly, "the law of the forum normally determines for itself whether a given question is one of substance or procedure." *Tanges, supra*, 93 NY2d at 53.

Here, we meet one of the most elusive borderlines in the law: the one that presumes to separate "substance" from "procedure." Siegel, NY Prac §616, at 1135 (5th Ed). In New York, matters of procedure include remedies and remedial rights. A preliminary injunction is a provisional remedy. *Notaro v Sterling Transp. Servs*., LLC, 943 NYS2d 793 (Sup Ct Queens County 2012).

Viewed in this "procedural" light, New York courts are often not convinced that long-standing rules of common law equity and the application of same to the issuance of a preliminary injunction, must give way to Delaware's search for "adequate" or "fair" disclosures. In New York, the preferred remedy is the after-the-fact monetary damages claim, when available. *Morrison v The Hain Celestial Group, Inc*., 2012 WL 5842888 (Sup Ct Nassau County Nov 14, 2012, DeStefano, J.); *Wenz v Globecomm Systems, Inc*., 964 NYS2d 63 (Sup Ct Suffolk County 2012, Whelan, J.)

Additionally, the relief sought by the shareholder almost always sounds in a breach of a fiduciary duty, which is a tort claim. Since the shareholder could be adequately compensated by monetary damages, New York courts typically find that there is a failure to demonstrate irreparable injury. As noted, "[e]conomic loss, which is compensable by money damages, does not constitute irreparable harm." *EdCia Corp. v McCormack*, 44AD3d 991, 994 (2d Dept 2007).

New York case law holds that temporary injunctive relief preventing stockholders from voting on proposals at a corporate meeting should be granted only in such extreme circumstances as would render the issuance of the injunction imperatively necessary to prevent irreparable wrong or damage. *Katz v R. Hoe & Co.*, 99 NYS2d 899 (Sup Ct New York County 1950), *modified on other grounds,* 277 AD 966, 99 NYS2d 853 (1st Dept 1950).

Therefore, shareholders should carefully choose the forum to litigate an injunction claim and not simply rely upon a favorable choice-of-law provision in an agreement.

Note Supreme Court Justice Whelan is a member of Suffolk County's Commercial Division.

Valuation of Closely Held Business Interests

By Jeffrey L. Catterson

As recognized by the Court of Appeals in *Amodio v. Amodio,* 70 N.Y.2d. 5 (1987), there is no uniform rule for valuing a closely held business. The preferred indicator of value is the objective standard of Fair Market Value, i.e. "the price for which the property would sell if there was a willing buyer who is under no compulsion to buy and a willing seller under no compulsion to sell." *Kaye v. Kaye*, 102 A.D.2d 682, 687 (2d Dept. 1984). However, due to the inherent nature of closely held businesses, where ownership is generally held by a small group of stockholders and where the shares are not usually saleable, the shares are not so easily valued. *Id.* at 687.

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One of the most widely accepted approaches to the valuation of closely held businesses is that recommended by the Internal Revenue Service's Revenue Ruling 59-60. Specifically, I.R.S. Revenue Ruling 59-60 identifies eight fundamental factors which should be considered when determining a value for a closely held business: (1) the nature of the business and the history of the enterprises from its inception, (2) the economic outlook in general and the condition and outlook of the specific industry in particular, (3) the book value of the stock and the financial condition of the business, (4) the earnings capacity of the company, (5) the dividend-paying capacity, (6) whether or not the business has good will or other intangible value, (7) sales of the stock and the size of the block of stock to be valued, and (8) the market price of stocks and corporations engaged in the same or a similar line of business having their stocks actively traded in a free and open market. (Rev Rul 59-60, Amodio at 7).

Jeffrey L. Catterson

In conducting a valuation, there are three generally accepted methodologies utilized by the valuation profession, to wit: (1) the Capitalization of Income Method; (2) the Excess Earnings Method; and (3) the Market / Transaction Method.

The Capitalization of Income Method ("CIM") is a valuation approach that values a business by converting historical cash flow into an asset. CIM's first step is to normalize the cash flow of a business by adding to its reported earnings expenses such as depreciation, non-recurring expenses and non-business related expenditures. Thereafter, a capitalization rate ("cap rate") is applied to the "normalized" income to convert it into the ultimate value of the business. The cap rate reflects a rate of return needed to attract investors to a particular investment given the specific risks associated with that investment. The cap rate is developed using a build-up model incorporating historical rates of return in the market and the specific risk factors of the subject business. Significantly, the company specific risk factors are based upon the valuation expert's subjective judgment and usually are not based upon empirical data. Given that most valuation experts rely upon the same underlying data to compute the "normalized" income, it is these subjective determinations of the valuation expert which are most prone to critique.

The Excess Earnings Method, in accordance with I.R.S. Revenue Ruling 68-609, separates the value of the business into two components: tangible assets (i.e. cash, receivables, inventory) and intangible assets (goodwill). After adjusting the company's assets and liabilities to determine the net value of the tangible assets, an estimated rate of return is applied to the net tangible assets' value. The return of the net tangible assets is deducted from the "normalized" earnings to determine the excess earnings. A cap rate, calculated by the valuation expert considering industry specific risks, is then applied to the excess earnings to arrive at the intangible asset value. This intangible asset (goodwill) value is added to the net tangible assets value for the total value for the company. This cap rate, arrived at by considering various industry specific risk factors, is, again, the judgment call of the valuation expert, and is, therefore, most vulnerable to attack by the attorney on cross-examination.

The third methodology, the Market / Transaction Method, is based upon actual sales of similarly situated businesses. In applying the market approach to value the subject business, a sufficient sample size of similar companies must be available to develop a valuation multiple. This valuation multiple is then applied to the actual revenues, as opposed to a "normalized" income, of the business.

In determining a company specific risk premium to calculate the cap rate, the valuation expert must consider a multitude of factors that would affect the specific industry risk of the subject business. In identifying the risk factors to consider, most valuators follow the guidelines outlined in authoritative texts on valuations such as *Valuing a Business* written by the renowned Shannon P. Pratt. However, the authoritative texts, while identifying the risk factors to consider, do not provide the valuation expert the specific weight to be given to each risk factor. In reviewing the valuation expert's cap rate calculation, and the corresponding determination of value, the attorney must attack the subjective nature of the valuation expert's conclusions. Without concrete empirical data to guide the valuation expert as to what rates are appropriate, the valuation expert is in no better position to determine the weight given to a specific industry risk factor than a knowledgeable attorney or the business owner himself.

Note: Jeffrey L Catterson, a member of Langione, Catterson & LoFrumento, LLP, can be contacted at jcatterson @lcllaw-firm.com.