Ferolito v Arizona Beerages USA LLC
2014 NY Slip Op 32830(U)
October 14, 2014
Supreme Court, Nassau County
Docket Number: 004058-12
Judge: Timothy S. Driscoll
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SUPREME COURT-STATE OF NEW YORK
DECISION AND ORDER AFTER TRIAL

Present:

HON. TIMOTHY S. DRISCOLL
Justice Supreme Court

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TRIAL/IAS PART: 15
NASSAU COUNTY

JOHN M. FEROLITO and JMF INVESTMENTS HOLDINGS, INC.,

Index No: 004058-12

Plaintiffs,

-against-

ARIZONA BEVERAGES USA LLC,
AZ NATIONAL DISTRIBUTORS LLC,
ARIZONA BEVERAGE COMPANY LLC,
ARIZONA INTERNATIONAL, LLC,

Defendants.
---x
In the Matter of the Application of John M. Ferolito, the Holder of More Than 20 Percent of All Outstanding Shares of Beverage Marketing, USA, Inc.,

Petitioner,

For the Dissolution of Beverage Marketing, USA, Inc.
---x
JOHN M. FEROLITO and the JOHN FEROLITO, JR. GRANTOR TRUST (John M. Ferolito and Carolyn Ferolito as Co-Trustees), both individually and derivatively on behalf of Beverage Marketing USA, Inc.,

Plaintiffs,

-against-

DOMENICK J. VULTAGGIO and DAVID MENASHI,

Defendants.

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Plaintiff John Ferolito commenced this action in October 2010 seeking dissolution of Beverage Marketing USA, Inc. ("BMU") under Business Corporation Law ("BCL") § 1104-a. Defendant Domenick Vultaggio then exercised his statutory right under BCL § 1118 to purchase Ferolito's shares of BMU. In early 2011, plaintiff John Ferolito, Jr. Grantor Trust (the "Trust") joined this action by seeking common law dissolution of BMU, and also sought to have Vultaggio purchase its shares. Another valuation action concerning the parties was later commenced in spring 2012 and joined the earlier matters. Simplified greatly, the consolidated case encompasses valuation of the "AriZona Entities" (abbreviated throughout as "AriZona"), which is a collection of companies that produce beverages and other food and beverage-related products. The Ferolito parties together own 50 percent of AriZona. They claim that AriZona is worth some $3.2 billion and that they should receive prejudgment interest on the value of their shares. Vultaggio counters that AriZona is worth approximately $426 million and that any recovery by the Ferolito parties should be reduced because of Ferolito's allegedly improper actions.

Pursuant to a Scheduling Order entered by the Court on May 13, 2014, this non-jury trial commenced with pre-trial proceedings on May 22, 2014. The Court heard opening statements on May 28, 2014 and then proceeded to hear the testimony of some 34 witnesses on an almost daily basis until July 2, 2014. Pursuant to the Scheduling Order, many of these witnesses presented affidavits in lieu of or supplementary to their live in-court testimony. Approximately 1000 pages of affidavits were thus presented for the Court's review. Each witness was subject to cross-examination, re-direct examination, and re-cross examination. Tens of thousands of pages of exhibits were also introduced into evidence. The parties provided post-trial memoranda in

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August 2014 and presented oral summations in September 2014. At the Court's direction, the parties provided additional post-trial memoranda in September 2014 regarding the applicable rate of prejudgment interest.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

1. AriZona's Background

By any measure, AriZona has been an extremely successful company. Founded in 1992 by Ferolito and Vultaggio, who had been partners in various beverage business ventures for some twenty years prior, it has grown to the largest privately owned beverage company in the United States. Almost from its founding, it achieved great success. It is a leader in the ready-to-drink ("RTD") tea market and the non-carbonated beverage market.

The business was originally headquartered in Brooklyn and moved to Nassau County in 1994. That move began to sow the seeds of discontent between Ferolito and Vultaggio, starting with Ferolito's displeasure with the significant increase that the move to Nassau added to his commuting time from his home in New Jersey. As their disagreements involved matters big and small, they eventually agreed to keep day-to-day control of the business in the hands of one partner. Vultaggio became that partner in the late 1990s. The business, however, was still equally funded by its two shareholders, and profits were equally distributed between them. The company's success is reflected in the magnitude of these distributions; the Vultaggio family and the Ferolito family have received over $500 million per side in distributions since AriZona was founded.

To ensure continuity in the company, Ferolito and Vultaggio agreed that only one of them would have final authority over the AriZona business, and that Vultaggio would fill this role.

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The parties characterized this agreement as their "One Captain" agreement. They also came to another agreement in 1998, known as the "Owners' Agreement" which, in effect, prevented one partner from transferring his shares in AriZona to persons and entities not specified in the agreement without the consent of the other partner. The validity of the Owners' Agreement was recognized by the Appellate Division, First Department. *See Ferolito v. Vultaggio*, 78 A.D.3d 529, 530 (1st Dept. 2010) ("Considered in light of the larger business transaction between plaintiffs and defendants, the restraint on alienation set forth in the agreement is reasonable in light of the circumstances and the purposes sought to be accomplished. The parties, after some negotiation and with the aid of counsel, entered into a valid agreement whereby they sought to ensure managerial continuity of their closely held business by limiting the alienation of stock to a prescribed class of transferees. The restraint furthers the intended purpose and ensures its effectuation.") The Owners' Agreement, and specifically its provisions that have prevented Ferolito from selling his shares in the company, when coupled with subsequent attempts by Ferolito to sell his shares, have, in large part, resulted in the present litigation.

2. <u>AriZona's Past Financial Success / EBITDA</u>

AriZona continued to succeed under Vultaggio's leadership. The company has earned significant and substantial sums, including such amounts calculated via the widely-recognized measure known as "EBITDA" (Earnings Before Interest, Taxes, Deductions and Amortization). In determining the proper measure of AriZona's EBITDA, the Court credits the testimony of Ferolito's expert Basil Imburgia regarding AriZona's financial statements, and more specifically credits the entirety of his testimony that "normalized" the company's financial statements. Such a normalization process is essential, as recognized by the caselaw. *See Matter of Raskin v.*

Walter Karl, Inc., 129 A.D.2d 642, 643 (2d Dept. 1987) ("in order to truly reflect [a company's] earning power, the net income is adjusted by eliminating from the corporate expenses a portion of the officer-shareholders' salaries that is considered excess compensation"); *Matter of Adelstein v. Finest Food Distrib. Co., N.Y., Inc.*, 2011 N.Y. Misc. LEXIS 5956 (Sup. Ct. Queens County November 3, 2011), *aff'd*, 116 A.D.3d 850 (2d Dept. 2014); *In re Jamaica Acquisition*, 25 Misc. 2d 1212A (Sup. Ct. Nassau Co. Sept. 29, 2009).

Applying that methodology, Imburgia properly adjusted AriZona's EBITDA to add back to the company's EBITDA calculations significant amounts of "management fees" and "officer payroll" paid to Ferolito and/or Vultaggio, and adjusted what AriZona had considered a one-time payment from AriZona's aluminum can supplier Rexam and instead booked that payment over several years. Imburgia also properly added back other non-recurring fees in 2008, including $2.7 million to AriZona's now-president, David Menashi, and $300,000 to its outside accountant David Petshaft. With these and other normalizing adjustments, Imburgia further concluded that AriZona's EBITDA for the last twelve months between October 1, 2009 and September 30, 2010 was approximately $173 million. The Court credits that conclusion, as well as all other adjustments to EBITDA that Imburgia made, all of which incorporate the approved methodology.

Conversely, the Court disagrees with Vultaggio's expert David Nolte's criticism of Imburgia's EBIDTA calculations and Nolte's resulting acceptance of the company's EBITDA calculations. It is significant that AriZona's EBITDA calculations appear to be based on consolidations of various financial statements for the AriZona entities that were completed after this litigation was commenced. This is not, in itself, untoward. Indeed, AriZona's president, David Menashi, testified that the company does not rely on EBITDA as part of its normal course

of operations. Nevertheless, it logically flows that the company's EBITDA calculations might not be as carefully completed as calculations relied upon by the company in its normal course of business. This conclusion is buttressed by the fact that the company has been embroiled in litigation for quite some time, and may well have incentive to understate its EBITDA which it has known Ferolito would rely upon to determine value. The Court thus credits Imburgia's conclusion that AriZona's financial statements for 2011 and beyond are suspect because of the ongoing litigation between Ferolito and Vultaggio regarding AriZona's value. The Court thus does not credit the EBITDA conclusions derived from AriZona's post-litigation financial statements and any testimony relying on those conclusions.

The company's adjusted EBITDA, as credibly testified to by Imburgia, is as follows:

1993	17,925,327
1994	35,819,057
1995	35,523,011
1996	46,493,402
1997	40,465,302
1998	31,312,652
1999	47,840,938
2000	45,818,154
2001	49,745,653
2002	54,762,421
2003	61,983,064
2004	90,488,308
2005	110,996,511
2006	122,462,603

2007	133,635,764
2008	115,795,853
2009	154,840,667
2010	169,351,482

3. Other Expressions of Interest in Acquiring AriZona and Assessments of its Value

AriZona's success has led to other companies expressing an interest in acquiring all or part of AriZona.

A. Tata

The Court heard the videotaped testimony of three senior executives from the global conglomerate Tata. Tata has stakes in myriad companies and multiple industries. It is also a leader in the beverage industry and is the second largest tea manufacturer in the world, in part due to its ownership of Tetley Tea.

Since 2005, Tata frequently expressed interest in acquiring all or part of AriZona. As part of those expressions of interest, Tata estimated the value of AriZona to be as high as $4.5 billion. It has made similar estimations approaching that value over the past ten years. Nevertheless, as readily conceded by all of the Tata witnesses, Tata did not conduct appropriate due diligence that would typically precede an actual offer to acquire all or part of AriZona. Tata also did not seek, and did not obtain, board approval for any of these expressions of interest. Moreover, while Tata representatives claimed that the financial means would be available to support the expression of interest, that company has not consummated any acquisition of more than $1 billion since the beginning of the "Great Recession" in the fall of 2008. Ratan Tata, a

then-senior Tata executive, further acknowledged that, in November 2008, he advised the company's directors to "tighten their belts" and put off any further large acquisitions as a result of the global financial crisis. He further admitted that Tata does not finalize any acquisitions without due diligence, and that Tata's expression of interest in AriZona was never brought to Tata's board for approval for any further action.

B. Nestle

Nestle Waters, N.A. ("Nestle") began discussions in 2009 with Vultaggio and Ferolito regarding a potential acquisition of AriZona. According to Kim Jeffrey, Nestle's then-CEO, that company was very interested in a deal with AriZona because it had high growth and a great distribution system. Jeffrey testified credibly that Nestle had a hard time getting "good financial data" from AriZona, and that the information Nestle did receive was "woefully inadequate for a proper due diligence." He further testified credibly that Nestle required, prior to making a binding offer, a "path to control" of AriZona upon which both Ferolito and Vultaggio agreed. Nestle's discussions with Ferolito and Vultaggio never reached that point because Vultaggio ceased returning Jeffrey's phone calls.

Nevertheless, Nestle did express interest in July 2010 in acquiring Ferolito's shares for $1.3 billion, provided that (a) due diligence was conducted, (b) Vultaggio's shares were eventually acquired, and (c) Nestle, along with Ferolito and Vultaggio, arrived at a mutually agreeable path for Nestle to control AriZona. Ferolito rejected that proposal outright, and Nestle subsequently increased its proposal to $1.45 billion. Again, there was no due diligence or agreement on a path to control. After Ferolito indicated that he would accept $1.45 billion for

his shares, Jeffrey learned that Ferolito and Vultaggio were engaged in litigation with each other, and that AriZona did not have audited financial statements. According to Jeffrey, "until things cleared up, we couldn't go anywhere." In any event, Jeffrey acknowledged that any expression of interest in Ferolito's shares was subject to the approval of Nestle's board of directors as well as regulatory authorities. He also stated that the information provided by AriZona during the courtship between Nestle and AriZona was "woefully short" of what was needed for due diligence.

William Pearson, Nestle's CFO, corroborated Jeffery's testimony that Nestle neither made a binding offer for any shares in AriZona, nor did its board ever authorize any expression of interest in acquiring AriZona. He further corroborated that Nestle needed, among other things, a path to control AriZona prior to making any firm offer, and such path did not materialize. Finally, he testified credibly that AriZona's lack of audited financial records deleteriously affected Nestle's ability to finalize any expression of interest in acquiring AriZona.

C. Ferolito

Ferolito himself has offered as much as $2 billion for Vultaggio's share of AriZona, and even made such an offer during trial. There was insufficient evidence, however, to conclude that this offer was any more than bluster or had appropriate financial backing. Indeed, Tata executive KK Kumar testified that his company did not have any agreement to provide such backing, and Ratan Tata testified that he did not remember ever being asked to fund any offer by Ferolito. While Ferolito's investment banker, Rita Keskinyan, testified that she was confident that such funding could be arranged with her bank, the history of AriZona and the dealings between the

parties readily demonstrates that what may appear "easy" on its face is far different when it concerns the relationship between Ferolito and Vultaggio and the prosperous company they have formed.

D. Other Assessments

In addition to the expressions of interest described above, the investment bank Merrill Lynch assessed AriZona's value in 2008 as part of an attempt to tout Merrill Lynch's investment banking experience to guide AriZona in a merger or acquisition. Merrill Lynch concluded that the company was worth approximately $3.2 billion. The Court does not give any credence to the Merrill Lynch "valuation." Put simply, Merrill Lynch told AriZona what it wanted to hear in an effort to get its business.

The Court also rejects any assessments of AriZona's value by Rabo Bank, which is an investment bank hired by Ferolito to sell his share of the company. Rabo calculated AriZona's value in 2007 as 30 times its EBITDA, resulting in a value of over $4 billion. Nevertheless, these computations were made in an effort to sell the company and thereby earn a commission for the bank, rather than to assess its fair value.

Finally, the Court rejects any reliance on materials prepared by Morgan Stanley in conjunction with Nestle's expression of interest. Unlike the assessments by Merrill Lynch and Rabo, no one involved in the preparation of the Morgan Stanley materials testified at trial and thus the Court has no way to assess the validity of any of the assumptions and conclusions in those materials.

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4. Other Transactions Involving AriZona — The Adonailo Transaction

Rick Adonailo, a Certified Public Accountant, was AriZona's Chief Financial Officer from 1994 to 2008. He was well paid throughout his tenure, beginning with a base salary of $500,000 and bonus of $125,000 in 1994. His compensation rose to a base salary of $1,000,000 and a bonus of $2,000,000 in 2008.

The evidence before the Court made it readily apparent that Ferolito develops fierce allegiance to those who, he believes, are loyal to him, and in turn seeks to ensure the economic security of those individuals. Adonailo is one such individual. After the Coca-Cola corporation ("Coke") expressed interest in acquiring AriZona in the early to mid 2000s, Ferolito sought to provide financial protection to Adonailo in the event that Coke actually acquired AriZona and fired Adonailo. As a result, Ferolito sold to Adonailo one-half of Ferolito's interest in AriZona International, which is one of the companies within the AriZona umbrella, and provided Adonailo with the option to resell those shares to Ferolito for $70 million. This transaction was ultimately rescinded in October 2010 upon the payment to Adonailo of $5 million over ten years. It is this $5 million that Vultaggio claims is indicative of the true value of AriZona, and corroborates his claimed valuation. The Court disagrees. At the outset, AriZona International does not control any of AriZona's intellectual property, and does not have any real assets. Moreover, Adonailo did not gain any voting or governing authority in the AriZona entities as part of the transaction. Finally, the transaction was not preceded by any real negotiation between Adonailo and Ferolito, much less any attempt to ascertain AriZona's value. In short, this transaction was simply an attempt to give Adonailo some measure of financial security if a contingent event occurred. It is not indicative of AriZona's value.

5. Non-Operational Challenges Faced by AriZona

The disagreements between Ferolito and Vultaggio may not have affected AriZona's operational and financial success, but these disagreements have led to a number of other issues.

First, central to AriZona's financial success is its status as an S-Corporation. Simplified greatly, this means that AriZona's profits are passed on directly to its shareholders and taxed at the individual level, rather than the potentially higher corporate level. Pursuant to IRS regulations, such a corporation has more stringent administrative requirements than a C-Corporation, in which profits are taxed at the corporate level before being passed on to shareholders as dividends. In 2008, Ferolito, through his attorney David Buss, questioned whether AriZona was a viable S-Corporation, and litigation between the parties eventually ensued on that issue. While the litigation was ultimately resolved, it was readily apparent to the Court that reasonable minds can differ on the effect of AriZona's S-Corporation status.

Second, the relationship between Vultaggio and Ferolito has been beset with litigation for at least the past five years. Lawsuits between the parties have been filed in this Court, the New York County Supreme Court, and the United States District Court for the Eastern District of New York.

Third, AriZona's financial statements have not been audited in some time. Eugene Gelling, a partner at Deloitte, has managed the audit process for the AriZona entities, and has attempted to complete his work. He testified credibly that it has become increasingly difficult to finalize the audit process due to the S-Corporation issues and the dissension among the parties. The continued delay in the audit process has resulted in significantly more work for the

accountants, as they must continue to revise any audit to incorporate the latest financial standards in effect at the time of the final audit.

It appears that all of these issues help explain why the preliminary expressions of interest discussed above never resulted in a consummated deal. Indeed, Jeffery acknowledged that the "woefully inadequate" information provided by AriZona to Nestle never included any audited financial information, and that he was unaware of the existence of the shareholder litigation prior to Ferolito sharing that news with him on September 1, 2010 — which was followed by Nestle terminating its discussions with AriZona.

6. General Principles of Valuation

BCL § 1118 provides that the respondent in a dissolution proceeding filed under BCL § 1104-a may purchase the shares of the petitioner seeking dissolution "at their fair value." The statute neither defines "fair value" nor provides criteria for the determination of "fair value." The case law does, however, offer such guidance: "[I]n fixing fair value, courts should determine the minority shareholder's proportionate interest in the going concern value of the corporation as a whole, that is, what a willing purchaser, in an arm's length transaction, would offer for the corporation as an operating business." *Friedman v. Beway Realty Corp.*, 87 N.Y.2d 161, 168 (1995), citing *Matter of Pace Photographers, Ltd.*, 71 N.Y.2d 737, 748 (1988), quoting *Matter of Blake v. Blake Agency*, 107 A.D.2d 139, 146 (2d Dept. 1985). The value to be ascertained is "that of an interest in a going concern rather than a share of a business in the throes of liquidation." *In the Matter of the Dissolution of Seagroatt Floral Company, Inc.*, 78 N.Y.2d 439, 445 (1991). Fair market value is a "question of fact [and thus] depend[s] upon the

circumstances of each case; there is no single formula for mechanical application." *Id.*

As *Seagroatt* recognized, "valuing a closely held corporation is not an exact science," and thus "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." *Id.* The Court thus has discretion to determine a valuation that "rests primarily on the credibility of the expert witnesses and their valuation techniques." *Adelstein v. Finest Food Distributing Co*, 2011 N.Y. Misc. LEXIS 5956 at *20. A court determining fair value may look to "market value, investment value and net asset value," *Blake*, 107 A.D.2d at 146. Nevertheless, "all three elements do not have to influence the result in every valuation proceeding. It suffices if they are all considered." *Matter of Endicott Johnson Corp. v. Bade*, 37 N.Y.2d 585, 588 (1975). Because closely held corporations "by their nature contradict the concept of a market value," *Seagroatt,* 78 N.Y.2d at 445, market value may be of "little or no significance" *Blake, 107* A.D.2d at 146. Rather, investment value is often the "appropriate valuation methodology." Such a methodology may incorporate a discount for the company's lack of marketability ("DLOM"), which recognizes that a potential investor would pay less for shares in a close corporation because they could not readily be liquidated for cash. *Friedman v. Beway Realty Corp., 87 N.Y.2d 161,* 165 *(1995), Blake,* 107 A.D.2d at 149 (DLOM is appropriate because "the shares of a closely held corporation cannot be readily sold on a public market").

The Court may consider the company's past performance as well as future events that are "known or susceptible of proof" as of the valuation date. *Murphy v. U.S. Dredging Corp.*, 74 A.D.3d 815 (2d Dept. 2010), quoting *Matter of Miller Bros. Indus. v. Lazy Riv. Co.*, 272 A.D.2d

166, 168 (1st Dept. 2000) (internal quotation marks omitted). But the Court must not speculate about the company's future performance. *See Matter of Cohen*, 168 Misc. 2d 91 (Sup. Ct. N.Y. Co. 1995); *aff'd*, 240 A.D.2d 225 (1st Dept. 1997).

These principles make clear that the Court may not consider AriZona's "strategic" or "synergistic" value to a hypothetical third-party purchaser, as Ferolito urges. A valuation that incorporates such a "strategic" or "synergistic" element would not rely on actual facts that relate to AriZona as an operating business, but rather would force the Court to speculate about the future. Tellingly, the Court has not found any cases arising under BCL § 1118 that assume a synergistic buyer. Moreover, other courts determining valuation with requirements similar to New York law have rejected evidence regarding a hypothetical synergistic purchaser as "speculation as to what might happen" that is "not a proper way to value." *See Estate of Simplot v. Comm'r*, 249 F.3d 1191, 1195-96 (9th Cir. 2001). The Court will thus not assume a valuation that relies on hypothetical so-called synergies, as these would be too speculative to quantify with any certainty. Instead, the Court will value AriZona using the "financial control" measurement, that is, "the value of a company exposed to a representative group of buyers who are not expecting synergies, who are looking at the value of the business on a standalone basis, who may not be able to run the company a little differently but not – a little better but not differently like the synergies." Trial Tr. at p. 2429, lines 19-24.

7. Valuation Date

The valuation date for Ferolito's shares of AriZona is not in dispute. It is October 5, 2010, which is the day before Ferolito filed the instant dissolution proceeding. The parties differ

about the valuation date for the Trust's shares in the company. That date requires judicial determination, as the Trust's action is for common law dissolution of AriZona, rather than dissolution under BCL § 1118. Ferolito claims that the appropriate date is January 31, 2011, which is the day before the Trust filed for common law dissolution. Vultaggio asserts that this date should be December 31, 2012.

The Court agrees with Ferolito that adopting any date for the valuation of the Trust's shares that is later than January 31, 2011 would, in effect, impermissibly permit Vultaggio to use the Trust's own dissolution action to dilute the value of the Trust's shares. The Court also rejects Vultaggio's claim that the Trust somehow improperly maneuvered in the months after filing its common-law dissolution action to justify a valuation date for the Trust's shares at some point after January 31, 2011. *See In re Davis*, 174 A.D.2d 449, 450-51 ("We also approve the fixing of the valuation date as the day preceding initiation of the instant proceeding" in a common law dissolution).

8. Valuation of AriZona

A. Valuation Method

Neither party attempted to value AriZona by the net asset value approach, and thus the Court will neither rely upon, nor attempt to calculate AriZona's value based upon, that approach. Both parties attempted to determine investment value by calculating the company's Discounted Cash Flow ("DCF"). The parties disagree, however, on the weight to be provided to the DCF in determining AriZona's value. Ferolito argues that the DCF should factor as 80% of AriZona's value, with an additional calculation based on "comparable" merger and/or acquisition

transactions providing the remaining 20%. Vultaggio claims that the DCF should be the full measure of AriZona's value. The Court agrees with Vultaggio, and concludes that the companies and transactions that Ferolito claims are comparable are in fact not so. *See Matter of Vetco*, 292 A.D.2d 391, 392 (2d Dept. 2002), *app. den.*, 99 N.Y.2d 206 (2003) (referee determining fair value of shares appropriately rejected "comparable appraisal" approach where so-called "comparable" companies were not in "similar financial situations").

As credibly explained by Ferolito's expert Christopher Stradling, an investment banker, the "comparable" transaction component of valuation claimed by Ferolito initially requires the determination of an "EBITDA multiple" for each "comparable" transaction by dividing the acquisition price in that transaction by the EBITDA of the acquired company. The aggregate average EBITDA multiple of the "comparable" transactions are then subject to further statistical analysis as well as qualitative analysis based on the expertise of the investment bankers analyzing those transactions. This leads to an EBITDA multiple for a proposed acquisition of the "target" company, which here is AriZona. The EBITDA multiple is then multiplied by AriZona's EBITDA for the last 12 months prior to the valuation date. That product is the valuation of AriZona under the guidelines transaction method of valuation. Stradling also performed a related analysis in which he analyzed so-called "comparable" public companies based on their market value to arrive at a similar EBITDA multiple.

While the Court was impressed with Stradling's analytical skills, it rejects the premise of Stradling's assumptions, which were later echoed by Ferolito expert Z. Christopher Mercer, that there are comparable companies to AriZona that engaged in similar transactions and, therefore, that consideration of the comparable transaction approach is warranted here. As summarized

succinctly by Vultaggio in his post-trial submissions, "Ferolito's proposed comps are distinguishable due to lack of similarity in size, timing, products . . . and are also synergistic market transactions" that are not recognized by the governing case law. The Court credits the sentiments expressed by Vultaggio's experts — and mirrored by Ferolito himself — that AriZona is truly *sui generis*, and thus any attempts to find comparable companies are truly lacking. Myriad reasons exist for this conclusion, ranging from AriZona's extremely advantageous position in the RTD tea market and its significant plurality of market share in that market to the various difficulties that have plagued the company due to the constant battles between the partners. Indeed, there truly is not a comparable company to AriZona in which (a) the company sells RTD beverages, (b) one of its partners has raised issues regarding its subchapter S status, (c) the company has unaudited financial statements, and (d) there are questions as to how a company acquiring a stake in AriZona would establish a path to control of AriZona. Accordingly, the Court rejects the EBITDA multiple approach as a method to derive AriZona's value. In short, the Court concludes that AriZona is truly an "incomparable" company.

Moreover, even if there were "comparable" companies to AriZona that have consummated mergers and/or acquisitions in past years, the credible evidence at trial regarding the state of the economy on the valuation dates in October 2010 and January 2011 renders suspect Ferolito's reliance on those transactions. The vast majority of the transactions relied upon by Ferolito significantly preceded the valuation dates here. More importantly, those transactions significantly preceded the onset of the "Great Recession," from which, the evidence shows, the economy was still reeling on the valuation dates. Indeed, very few mergers in any industry — much less industries comparable to AriZona's market — were completed around the

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valuation dates among companies with sales or EBITDA of AriZona's magnitude.

Nor can the Court determine AriZona's value based on the expressions of interest in the company from other entities such as Tata and Nestle, much less the assessment of the investment bankers at Merrill Lynch, Rabo or Morgan Stanley. Indeed, neither Tata nor Nestle received anywhere near the voluminous documents and information that are requisite to the rigorous due diligence process that typically precedes transactions of this magnitude. As credibly summarized by Vultaggio's expert David Stowell, a former investment banker who is now a clinical professor of business, the preliminary communications between AriZona and Nestle/Tata left unresolved numerous material issues. These included management and strategic control of AriZona, the route to control of AriZona, questions regarding tax liabilities, and the uncertainty of AriZona's S-Corporation status. There was a limited exchange of information regarding those and other issues that would lead to an actual offer for the AriZona's shares. Stradling himself conceded that the due diligence process, which was not conducted by Tata or Nestle, creates significant risks that could jeopardize the possibility that an expression of interest blossoms into a completed transaction. These include (a) risk in the market and overall economy, (b) the question whether the acquiree is a proper fit for the acquirer, (c) any financial and operational risks of the acquiree, which are learned during due diligence, and (d) potential misstatements of information. Rita Keskinyan, Ferolito's investment banker at Rabo, further conceded that many things were unresolved in any "offers" by Tata, including governance, the percentage of ownership that Tata would acquire, and the tax effect of the S-Corporation status. She also acknowledged that Tata did not have true financial information from AriZona. She further explained that Nestle's expression of interest did not result in a final offer because of the

"path to control" issue as well as questions regarding litigation between Ferolito and Vultaggio and the company's status as an S-Corporation.

Nor does the Court accept AriZona's reliance on gross profit, rather than adjusted EBITDA, for purposes of valuing the company. There was no credible testimony before the Court that any buyer— whether a "strategic" or "financial control" buyer — would merely look to gross profit rather than adjusted EBITDA for purposes of valuing AriZona.

Finally, as already discussed, the Court does not accept Vultaggio's reliance on the Adonailo transaction as somehow indicative of AriZona's value. Accordingly, the Court rejects the reliance of Vultaggio's expert Harold Furchtgott-Roth on that transaction. Incredibly, Furchgott-Roth's conclusion that the Adonailo transaction results in a valuation as low as $137 million would result in a valuation that is less than half of the over $300 million that the company had in cash on hand during the trial.

In sum, the Court recognizes that it may well be advantageous to consider different valuation methodologies to assure the validity of any valuation calculation. *See Matter of Adelstein.* Nevertheless, none of the methodologies relied upon by the parties, other than the DCF, provide such assurance.

B. Application of the Discounted Cash Flow Analysis in the Present Case

An accurate DCF in this case requires the Court to make determinations as to each of the following variables identified by the parties: (1) Anticipated revenues, (2) Anticipated costs, (3) Terminal value of AriZona at the end of the discount period, (4) Existence of a tax amortization benefit for a potential buyer, (5) Anticipated tax rate on AriZona's income, (6)

potential "key man" discount, (7) discount rate, (8) outstanding cash, non-operating assets, and debt on the valuation date, and (9) Potential discount for lack of marketability ("DLOM"). Each component is analyzed separately below.

(1) Revenue

The Court credits Ferolito's revenue projections, which are based on the credible assessments of AriZona's prospects as initially developed by Michael Bellas, who is the chairman and founder of Beverage Marketing Corporation of New York ("BMC"). That company, which Bellas founded in 1972, provides strategic consulting and research in the global beverage industry. It provides market reports on various segments of the beverage industry, and obtains information from a host of sources regarding trends in the marketplace and the drivers of those trends.

As credibly expressed by Bellas, the market for RTD tea grew in the United States at a compounded annual rate of 2% per year in the five years preceding 2010. AriZona grew at an even greater rate during that period, thereby taking market share from its competitors There are several reasons for AriZona's success, including its products' taste, quality, packaging, product array, pricing, ability to develop new products and its "hybrid" distribution system, in which the company distributes product both to "big box" stores such as Wal-Mart and smaller "mom and pop" convenience stores.

Bellas credibly predicted that AriZona would continue to grow. He acknowledged that much of AriZona's recent growth rate is due to its "Arnold Palmer" line of beverages, which are marketed pursuant to an agreement with the eponymous golf legend. The Arnold Palmer line is

currently responsible for 20% of AriZona's revenue, and Palmer can cancel that agreement upon a change of control in AriZona. There is no evidence before the Court, however, that Palmer will cancel that agreement upon a change in control. Moreover, and perhaps more importantly, it is readily apparent that the innovation that has characterized AriZona throughout its history ---- and indeed which led to its partnership with Arnold Palmer ---- will continue in the future. Indeed, as Bellas explained, AriZona has a two-month "innovation timeline" between the conception of a new product and that product coming to market, which gives it a significant advantage over its competitors. That innovation has consistently resulted in the introduction of new products.

AriZona's assessment of its future domestic performance is centered on its plan to continue to price its flagship 24 ounce can at 99 cents. In arriving at their own revenue figures, Ferolito's experts also honored that assumption. Nevertheless, as explained credibly by Ferolito expert economist David Tabak, AriZona certainly could consider raising prices at some point in the future. Tabak noted that other companies that initially committed to a fixed pricing strategy had to adjust their prices. Included among these companies are the motel chain Motel 6, which draws its name from its original pricing strategy of offering a room for $6 per night, the Charles Shaw wine nicknamed "two-buck Chuck" due to its original price of $2 which is now sold for $2.49, and McDonald's "dollar menu" for which items are now sold for $1.19. By contrast, Vultaggio could not credibly explain why he would insist on keeping to AriZona's business-as-usual strategy of charging 99 cents for its flagship 24 ounce can even if it did not make economic sense. Indeed, it might well make sense for AriZona to consider alternatives such as raising prices, shrinking the size of the can, tinkering with the product formula, or developing new

products that are less expensive. It thus appears that, from Vultaggio's perspective, AriZona simply is his company, and he wishes to operate it as he sees fit. This may well also explain why he scuttled any potential deal with Nestle in 2010. In the vernacular, Vultaggio is trying to "have his cake and eat it too," as he will neither sell the company nor permit Ferolito to sell his share, while at the same time silencing any expressions of interest from other purchasers. Indeed, if the company is as unattractive as Vultaggio suggests, then it would make sense for Vultaggio to use his best efforts to sell the company at the highest price. The fact that he has not done so further demonstrates that the company's prospects are quite good, but Vultaggio admittedly does not want to sell and instead wants to stay in the business and keep the company for his children. Trial Tr. at 3178, line 22 - 3179, line 2.

Based on the depth and breadth of Bellas' experience, the significant research regarding the trends in the RTD industry and AriZona in particular, and his demeanor throughout this testimony, the Court credits Bellas' testimony in its entirety regarding AriZona's future revenues. In so doing, the Court notes that the parties essentially agree on the anticipated future revenue corresponding to AriZona's domestic business. Bellas predicted fairly consistent growth in revenue, and Ruback also, in essence, adopted those predictions. Mercer in turn predicted domestic revenues based on Bellas' predictions. The Court thus adopts Mercer's domestic revenue projections.

The Court also adopts Bellas' forecast for AriZona's international business. Bellas did acknowledge that, as of 2010, the vast majority of AriZona's success was in the United States. Indeed, less than 10% of its sales were international, and approximately 6% of its gross profits flowed from its international business. Nevertheless, the Court credits Bellas' testimony that

"From the perspective of where AriZona stood in 2010, a well-crafted international expansion program would have been expected to generate a significant international presence for AriZona by the end of 2020." Bellas credibly explained that the international RTD business was expected to grow between 2010 and 2020 in both dollars and volume at a rate faster than the United States, and that AriZona could position itself to capture a portion of that market. His conclusion was properly based on the view that AriZona had already successfully competed in the United States against market giants Nestea and Lipton, and thus he reasonably believed that AriZona could similarly succeed on the international level. The conclusion was buttressed by the recent international success of Monster Beverage Company upon that company introducing a focused program for international expansion. Accordingly, the Court credits Bellas' testimony that Europe, Latin America and Australia are ripe for an international expansion effort by AriZona. The Court also credits Bellas' prediction that AriZona can ultimately penetrate 20% of the market currently held by Coca-Cola.

Nor is Bellas' forecast for AriZona's international growth woven from whole cloth. To the contrary, as Bellas tesified, the CanaDean, a respected beverage industry publication, predicted that the global market for RTD tea would grow at a compounded annual rate significantly greater than Bellas' forecast for AriZona, which by all accounts is a leader in the RTD industry. This further demonstrates that Bellas' forecast for AriZona's international prospects is conservative and credible.

The Court does not credit the testimony of Vultaggio's expert Tom Pirko that painted a grim view of AriZona's future prospects. Pirko testified that AriZona was facing a great deal of pressure in 2010, including a maturing market, rising costs, barriers to new outlets, increasing

competition and limited international opportunities. But Pirko's experience pales in comparison to that of Bellas. Moreover, Pirko continually relied on data that he conceded were incomplete or inaccurate, or relied on generalities to support his analysis. Finally, AriZona's supposedly grim future as of the valuation dates was preceded by a 25% increase in sales in the two-year period from 2008-2010.

Nor does the testimony of senior AriZona operations executives David Menashi, Robert Marciano, Jay Petrigiani and John Posillico change the Court's reliance on Bellas' testimony and his conclusions. To be sure, AriZona, like any established company, faces challenges in the future. The company's challenges include finding new distribution channels for its products, competing with larger beverage companies such as Coca-Cola and Pepsi, adjusting to fluctuations in prices for commodities, energy and metal, and addressing difficulties in international expansion. The company has more than met similar challenges in the past, and it thus makes sense, as Bellas concluded, that it will continue to do so in the future.

Significantly, AriZona itself predicted international success in early 2010, prior to the commencement of this litigation. The company's own notes from a January 2010 managers' meeting demonstrate its own view of its positive international prospects. Those notes reflect that both Menashi and Vultaggio were confident about AriZona's future based on, among other things, expansion in production, the then-positive communications between Vultaggio and Ferolito, and diversification of the company's products. As a result, Menashi noted that "in 12 months we have become the largest selling ready-to drink tea in Mexico," and that "We are growing in Holland and we are having discussions with people in Moscow." Overall, Vultaggio noted that "We have achieved tremendous growth in the past ten years, but we have only

scratched the surface. Internationally, we know now that we had the wrong person – we have to understand that things work differently in different countries." While AriZona may well certainly face challenges in its international expansion efforts, many of which were identified at trial (such as freight costs, tariffs, different consumer taste preferences, and existence of currently-existing companies protecting their "turf"), AriZona's track record of success in the United States and Mexico has readily demonstrated its ability to overcome many similar obstacles over the past twenty years. Moreover, the Court does not credit Ruback's reliance on AriZona's post-litigation internal predictions to the contrary. Indeed, it is in the interests of Vultaggio, and thus his senior management team, to ensure that as dim a picture as possible of AriZona's future is painted, lest the value of the company (and thus the amount of Vultaggio's obligation to Ferolito) increase.

Upon relying on Bellas' projections for AriZona's domestic and international prospects, Mercer projected AriZona's revenue to grow at a compounded annual growth ("CAGR") rate of 10.2%, which is consistent with (and may well be conservative when compared to) AriZona's CAGR from 2006-10 of 13.9%. The Court thus adopts Mercer's revenue projections. In so doing, the Court notes Mercer's impressive expertise in the field of business valuation, including (a) completing some 400 business valuations per year, including a significant number of valuations exceeding $1 billion, (b) extensive business appraisal credentials, and (c) publication of over 80 articles regarding different valuation issues. By contrast, Ruback's experience in business valuation is almost entirely academic in nature.

(2) Costs

Historically, AriZona has been able to manage its costs. This is initially due to the company's rather unique ownership and financing structure, which allows it, in Vultaggio's words, to be "nimble and responsive to the market." As a result, the company's EBITDA margins, which are the proportional relationship between its sales and its EBITDA, have been consistent with its sales. Mercer, with vast experience in business valuation, correctly used the company's past costs to estimate its future costs. By contrast, Ruback estimated merely that AriZona's future costs will track inflation. After being evasive throughout the questions posed on this issue during his cross-examination, Ruback conceded an affirmative answer in response to the following question "Instead of using more detailed data to project specific cost increases, you basically simplified them and used an inflation based forecast." Trial Tr p. 4402. While Ruback termed this approach "reasonable simplification," he nonetheless assumes that the company's costs will increase faster than they had in the years prior to 2010. Mercer's credible testimony succinctly summarizes why such testimony should be rejected:

> [Ruback] utilizes a business plan that I don't believe has any bearing in history or any bearing in any of the evidence I have seen. He conducts — he assumes a business plan that basically assumes that Mr. Vultaggio and the management at AriZona are incompetent and [in]capable of adapting to evolving business conditions.

Trial Tr. p. 2476 line 24 - 2477 line 4. In sum, Ruback's assumption that AriZona's total costs will track inflation has never been supported by AriZona's past historical data. The Court credits Mercer's testimony in its entirety regarding AriZona's anticipated costs.

(3) Terminal Value

The terminal value component of a DCF analysis is the net present value of a company's expected cash flows at the end of the forecast period into perpetuity. The terminal value thus necessarily reflects the company's long-term growth. Here, the Court has determined that AriZona's anticipated revenues and costs reflect a company that is poised for continued long term growth. The Court thus rejects Ruback's terminal value, which is predicated on the assumption that AriZona is a company in decline. By contrast, Mercer's assessment of AriZona's long-term growth rate may well be overly conservative, as he projects that the company will grow based upon expected inflation and expected real growth in gross domestic product. That rate is 4 ½ percent per year. Mercer's assessment of the terminal growth rate recognized that, even with the anticipated significant growth that he believes (and the Court credits) AriZona will have during the years he projected cash flows, its growth may nevertheless slow to that of the economy as a whole as the company continues to mature.

(4) Tax Amortization Benefit

The tax amortization benefit, which is proposed solely by Ferolito, assumes that a purchaser can amortize the purchase price of AriZona, an S-Corporation, thereby reducing the future tax liability to the purchaser and increasing cash flow. The Court does not credit Mercer's testimony in this area. Initially, Mercer's decision to include this component of a DCF appears to rest solely on the direction he received from David Buss, a tax attorney employed by Ferolito. Mercer readily admitted that, despite having valued numerous S-Corporations in past engagements, he has never included a tax amortization benefit in conjunction with a valuation of

such a corporation. This appears to be with good reason; Mercer admitted that including a tax amortization benefit in the valuation of an S-Corporation would make it more valuable than an equivalent C-Corporation. Nevertheless, Mercer further admitted that, in his extensive experience, buyers do not pay more for S corporations than they do for C-Corporations. Moreover, the Court has not found any BCL § 1118 cases that support the application of a tax amortization benefit for valuation of a C-Corporation. Indeed, as credibly explained by Vultaggio's expert David Nolte, an accountant, such a benefit would grant a seller an "unjustified windfall" that is not appropriate in a fair value calculation. Moreover, as Nolte credibly testified, it may well be that a tax amortization benefit is still unavailable even if there is a 100% sale of AriZona. There was no credible analysis by Stradling or Mercer to the contrary. Finally, given that Buss, who is Ferolito's agent and attorney, is an interested witness, the Court does not credit his assumptions that such a benefit does exist or would exist upon a 100% sale of AriZona. In sum, the Court will not factor a tax amortization benefit into its calculation of AriZona's value.

(5) Tax Rate

The tax rate component of the DCF analysis requires the Court to determine the tax rate that would be paid on AriZona's future income. A greater tax rate necessarily reduces the potential cash flow and the resulting valuation, while a lesser tax rate necessarily increases the potential cash flow and the resulting valuation. The parties differ on the amount of the tax rate; Ferolito claims a 38% tax rate that applies to C-Corporations is appropriate, while Vultaggio claims that a 43.5% tax rate that applies to the pass-through income of S-Corporations is appropriate. The Court adopts Vultaggio's view. In so doing, the Court notes that Mercer

never testified to any rationale for a tax rate of 38%. His reports and the demonstrative exhibits used throughout his testimony also do not offer any support for using that tax rate. There is no basis for the Court to impute a rationale for such a rate, much less to assume that a willing buyer would necessarily pay the lower C-Corporation tax rate of 38% percent. By contrast, the tax rate of 43.5% urged by Vultaggio reflects the actual pass-through tax rate paid by both Vultaggio and Ferolito over the years. That tax rate shall be applied here.

(6) "Key Man" Discount

A DCF valuation under BCL § 1118 may include a discount of a company's anticipated cash flow to reflect the contributions of current essential personnel. This is known as a "key man" discount. Some semblance of such a discount is appropriate here.

The credible evidence established that AriZona's success has been partly due to the presence, charisma, work ethic, leadership and talent of its co-founder Domenick ("Don") Vultaggio. Vultaggio's efforts at the company are legion. He is at the company's headquarters in Woodbury every day. He oversees product development, candidly admitting that time in traffic on the Long Island Expressway is where many of his ideas germinate. He is immersed in all aspects of the company's business, including product development, packaging, marketing, and celebrity endorsements. He developed the 99 cents pricing strategy as a way to increase market share. He also developed the hybrid distribution system that is central to AriZona's ability to get product to a variety of merchants.

The sentiment that Vultaggio contributes significantly to AriZona's success was further explained by senior AriZona employees such as Robert Maricano and John Posillico. They

credibly testified that Vultaggio inspires confidence, nimbly leads the company to react to the challenges in the business and the industry, and is a hands-on manager.

Nevertheless, Ruback did not include a key man discount in his calculations, even though Vultaggio expert Shannon Pratt, who has published numerous articles and books on valuation, recognized that such a discount might be appropriate. Rather, Mercer was the only witness who quantified Vultaggio's role in the company. That calculation was incorporated into Mercer's discount rate, which is analyzed below. The Court accepts Mercer's assessment of the discount for Vultaggio's role, as there is no evidence to the contrary of any other appropriate rate. Even if there was such evidence, the Court concludes that Mercer's assessment is appropriate inasmuch as AriZona does not have key man insurance to guard against the possibility that Vultaggio separates from the company or is no longer able to serve as the catalyst for AriZona's success. The Court further notes that Pratt testified that a "key person discount can be reflected in adjustment to a discount or capitalization rate in a DCF." That is what Mercer did here.

(7) Discount Rate

A discount rate is the rate used to discount expected future cash flow to present value. Here, there appeared at trial to be very little dispute about the applicable discount rate. Indeed, even though Mercer testified to a discount rate of 10.8% and Ruback testified to a discount rate of 11%, Ruback testified "Now, I just want to remind you, there is no dispute about discount rates in this case ...[T]here's no disagreement." To the extent there is now any discrepancy notwithstanding Ruback's testimony, the Court adopts Mercer's discount rate.

In so doing, the Court notes that, as discussed above, Mercer — unlike Ruback —

appropriately discounted for the possibility that Vultaggio would separate from the company. The remainder of Mercer's proposed discount rate, which is based on rates applicable to long-term government bonds for anticipated equity and rates applicable to corporate bonds for anticipated debt, are reasonable. Thus, the Court finds that Mercer's discount rate is appropriate.

(8) Outstanding Cash, Non-Operating Assets, and Debt

AriZona's outstanding cash, non-operating assets, and debt on the applicable valuation dates are all assets of the company. Inasmuch as the Court is analyzing all other assets of the company, it must also compute the outstanding cash and debt as part of the DCF. The Court accepts Mercer's calculations in this area, which add approximately $137.6 million to AriZona's value as of October 5, 2010, and approximately $161.4 million on January 31, 2011. The Court rejects Vultaggio's claim that accounting for AriZona's net cash "ignores the real AZ" and would lead to "no cash reserve whatsoever, bleeding real AZ dry to pay Ferolito his bunkum billions." In the Court's view, this is incorrect for two reasons. First, AriZona's net cash on hand on the valuation dates is the "real AZ," as it reflects AriZona's position on those dates, just as every other component of the DCF reflects AriZona's position on those dates. Second, simply accounting for AriZona's cash position in a DCF will hardly "bleed[] AZ dry." To the contrary, any payment to either or both of the Ferolito parties will be determined by the Court in the course of subsequent proceedings on the terms and conditions of such payout. The fact that the Court determines that the outstanding cash, net of debts, is an asset of AriZona no more "bleed[s] real AZ dry" than if the Court adopted the entire valuation scheme proposed by Vultaggio.

(9) Discount for Lack of Marketability

A discount for the lack of marketability, or DLOM, reflects that shares in privately held companies may be less marketable because those shares cannot be readily liquidated for cash. *Blake*, 107 A.D.2d at 149. Vultaggio claims that the Court should apply a DLOM of 35%, while Ferolito argues that no DLOM is necessary. The Court agrees with Vultaggio that a DLOM is appropriate, although not in the same amount as Vultaggio seeks.

At the outset, nearly all courts in New York that have considered the question whether to apply a DLOM have answered in the affirmative. The instant case is readily distinguishable from each of the three cases upon which Ferolito relies in support of his claim that there should not be any DLOM at all. First, in *In re Walt's Submarine Sandwiches, Inc.*, 173 A.D.2d 980 (3d Dept. 1991), *lv. app. den.*, 78 N.Y.2d 860 (1991), the trial court determined, and the Third Department agreed, that a DLOM was not appropriate where there was testimony of increased profits, expansion and "120 responses to a "for sale" advertisement in the Wall Street Journal." *Id.* at 981. There are a geometrically smaller number of expressions of interest for AriZona in the present case, even assuming that those expressions of interest here had as much depth and breadth as those in *Walt's Submarine*. Second, *Ruggiero v. Ruggiero*, No. 36299-2013 (Sup. Ct. Suffolk Co. July 29, 2013) did not arise under BCL § 1118, and the court in any event noted that there was "insufficient explanation" to support a DLOM which is far from the case here. Finally, in *O'Brien v. Academe Paving, Inc.*, No. 99-2594 (Sup. Ct. Broome Co. September 25, 2000) the trial court appears to have applied an impermissible minority discount, rather than a DLOM. And, although not cited by the parties because it was decided after briefing concluded, the recent case of *Zelouf International Corp. v. Zelouf*, No. 65352/2013 (Sup. Co. N.Y. Co.

October 6, 2013), in which the court declined to impose a DLOM, is also distinguishable. There, Judge Kornreich concluded "any liquidity risk associated with [the company to be valued] is more theoretical than real." *Id.* at 14. By contrast, as readily demonstrated by the stalled Nestle negotiations, the very reasons for a DLOM here have resulted in — or are at least strongly correlated with — the failure of Ferolito to sell his shares prior to this proceeding.

The Court rejects Ferolito's contention that a DLOM should not be applied simply because AriZona has been successful and because other companies have expressed an interest in acquiring all or part of AriZona. The expressions of interest, which never manifested into a bona fide offer, do not refute the difficulties any of AriZona's present shareholders have had, or will have, as they attempt to liquidate their shares. Indeed, the fact that those expressions did not bloom into offers may well further support the view that a DLOM is appropriate.

The very purpose of a DLOM, as Vultaggio correctly argues, is to reflect that the shareholders in a closely held company cannot readily liquidate their shares. Such a conclusion is appropriate here, as the Owners' Agreement itself readily demonstrates that the current owners of the company cannot easily liquidate their shares. The Court further agrees that Vultaggio's claimed bases for a DLOM do, in fact, justify some semblance of a discount. Those bases include (a) the fact that AriZona did not have audited financial statements for many years prior to the valuation date, (b) the extensive litigation between the shareholders, (c) the uncertainty about the company's S-Corporation status, and (d) the transfer restrictions in the Owners' Agreement. Indeed, the shareholders' litigation and lack of audited financial statements were among the reasons that Nestle's interest in purchasing Ferolito's shares stalled in late August-early September 2010. These factors are not, however, as insurmountable as Vultaggio claims, and

thus the DLOM percentage must be less than the percentage that he desires. First, as Gelling's testimony established, AriZona's financial statements can be readily audited, particularly when the shareholders are no longer battling with each other. Moreover, as Pratt conceded, most closely held private companies do not have audited financial statements. Trial Tr. at 3831, lines 23-25. Second, as credibly explained by Ferolito's investment banker Rita Keskinyan, the litigation between the two shareholders would necessarily cease when one shareholder's interests are acquired. Third, the uncertainty about the company's S-Corporation status is, at most, a scenario about which reasonable minds have differed.

Neither party quantified the components of their proposed DLOM, although they did present significant qualitative evidence to support their respective views. That approach is certainly reasonable; the caselaw notes that there is "no single method for calculating [DLOM"]. *Seagroatt*, 78 N.Y.2d at 446. Perhaps in light of that principle, both parties here concede that the Court does have discretion in determining the amount of any DLOM and need not accept either party's view of the appropriate DLOM. Such an approach is present throughout the case law. *See In the Matter of Giaimo*, 101 A.D.3d 523 (1st Dept. 2012), *lv. app. den.*, 21 N.Y.3d 865 (2013) (motion court correctly held that method of valuing closely held corporation should include any risk associated with the illiquidity of the shares); *Mandelbaum v. Comm'r,* T.C. Memo 1995-255, *aff'd,* 91 F.3d 124 (3d Cir. 1996) (listing the now-eponymous "Mandelbaum factors" for consideration of a discount for lack of marketability). The Court concludes that a 25% DLOM is appropriate, which even one commentator opposed to application of a DLOM in most if not all cases admits "hover[s] in the range" of the DLOM typically applied. *See* Peter Mahler, "The Marketability Discount in Fair Value Proceedings: An Emperor Without Clothes,"

New York Business Divorce, July 11, 2011. And Pratt, who has published extensively on the various components of valuation, acknowledged that while he believed the 35% DLOM advocated by Ruback was appropriate, smaller discounts are often appropriate for large and growing companies — which certainly describes AriZona.

9. Effect of Ferolito's "Bad Acts" on Valuation

Vultaggio claims that Ferolito has been sacrificing AriZona's interests in favor of his own interests, thereby supporting counterclaims against Ferolito and ultimately reducing any payout to him. He identifies myriad "bad acts" that he believes support this claim. The Court disagrees.

At the outset, Ferolito's alleged "bad acts" appear identical to those brought before the Court and ultimately dismissed by the Second Department in July 2012. But even upon consideration of the merits of these claims, the Court would conclude that the claims are not actionable to reduce Ferolito's share of the value of AriZona.

Despite his wealth, Ferolito did not make an impression as a sophisticated, urbane businessman. Rather, he was almost refreshingly simple in his extensive testimony, and his message was clear and credible: he just wants his money from his investment in AriZona, and wants to be free from any further entanglement with Vultaggio. Viewed through that lens, all of Ferolito's actions about which Vultaggio complains appear to be due to Ferolito's frustration with his inability to sell his shares in the company, as Vultaggio has scuttled Ferolito's efforts at every turn. Ferolito testified credibly that his frustration heightened after 2007 when he realized the full effect of the Owners' Agreement and its terms that prevented him from selling his shares without Vultaggio's consent. The Court thus credits Ferolito's testimony that he signed the

Owners' Agreement without fully understanding it or appreciating its consequences. While Ferolito's actions may have distracted AriZona's management team as a result of his often immature attempts to communicate with Vultaggio and key AriZona employees, his motivation was consistent ---- to get appropriate value for his share of the company. Put in the vernacular, Ferolito only "interfered" with the company to shake loose the tree that contained his wealth.

The Court also rejects Vultaggio's claim that Ferolito somehow caused any delay in prosecuting this case, or in guiding the Trust's interests. This is a complicated case, with significant stakes. Each party necessarily moved deliberately, without any actionable ill motives. Indeed, the fact that this case has proceeded to verdict only four years after its initial filing in the face of extensive discovery, voluminous pretrial motion practice, and initial party witness lists that contemplated over two months of direct testimony alone per side is a tribute to the skills of all counsel and the focus of the parties.

The allegation that Ferolito steered money from the plaintiff Trust to himself is not a cognizable "bad act." Such distributions to the Trust, and instructions to the Trust accountants to move funds to Ferolito, were not proven to be harmful to AriZona.

Nor is it significant that Ferolito hired celebrity detective "Beau" Dietl for security services in July 2008. While Dietl may have caused some agita to Menashi and perhaps other AriZona employees when he accompanied Ferolito to the company's headquarters on July 16, 2008, there is no evidence that Dietl or any of his associates implicitly or explicitly threatened AriZona employees, or that they even were present at any time on the AriZona corporate campus or interacted with AriZona employees any time before or afterwards.

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Finally, even if any of the "bad acts" were, in fact, legally improper — which the Court concludes they were not — there was no credible evidence that these acts caused any damage to Vultaggio or to the company. Indeed, any causal connection between the bad acts and any damage to Vultaggio and/or AriZona is, at best, speculative and thus an improper basis for any recovery. *See Kenford Co., Inc. v. Erie Cnty.*, 67 N.Y.2d 257, 261 (1986) ("damages may not be merely speculative, possible or imaginary, but must be reasonably certain and directly traceable to the breach, not remote or the result of other intervening causes."). By many measures, in fact, the company has thrived during the period of Ferolito's "bad acts," as it continues to innovate and maintain significant share in the RTD market. In sum, the "bad acts" do not reduce the amount to which Ferolito is entitled.

10. Prejudgment interest

The Court must award prejudgment interest in this case, and is initially guided by the Second Department's pronouncement in *Blake:*

> Although [BCL 1118] . . . do[es] not specifically provide for the payment of interest on the fair value of the shares, justice requires that in cases arising under Business Corporation Law § 1104-a and § 1118, interest be paid. The appropriate rate is to be determined by the court, and the interest should run from the date prior to the filing of the petition until the date of payment, unless a determination is made that petitioner has acted in bad faith.

Blake, 107 A.D.2d at 150. The principle that prejudgment interest is to be awarded absent some showing of bad faith has since been repeated numerous times, without exception, in cases at both the trial and appellate level. Put simply, prejudgment interest is necessary not to punish a

party, but rather as a "cost imposed for having the use of another party's money over a period of time." *Giaimo*, 101 A.D.3d at 526.

There is no evidence of bad faith in this case to justify denial of prejudgment interest. As noted above, the "bad acts" complained of by Vultaggio are not actionable. Even if there was a distinction between actionable "bad acts" and "bad faith," however, the Court's analysis would not change. First, the actions of Ferolito and the Trust throughout this case appear to have been motivated simply by a desire to achieve the maximum recovery possible for their interests, just as Vultaggio acted in a manner to protect his interests. Second, there is no evidence of unnecessary delays attributable solely to the Ferolito parties that might otherwise justify denial of prejudgment interest. *See Adelstein* (denying prejudgment interest because of delays that were "wholly attributed" to Petitioner's decision to change counsel); *McDaniel v. 162 Columbia Heights Housing Corp.*, 25 Misc. 3d 1024, 1053 (Sup. Ct. Kings County, September 29, 2009) (prejudgment interest denied because petitioner "prolong[ed] the instant litigation unnecessarily"). To the contrary, counsel for all parties are to be commended for their professionalism, dedication and integrity in zealously representing their clients throughout this case and at the same time bringing this case to trial as expeditiously as they did.

The Court is not required, however, to award the statutory rate of nine percent for prejudgment interest set forth in CPLR § 5004. *Murphy v. United States Dredging Corp.*, 74 A.D. 3d 815 (2d Dept. 2010). Rather, prejudgment interest must be awarded at an "equitable" rate. *See* BCL § 1118(b); *see also Whalen v. Whalen's Moving & Storage Co.*, 234 A.D.2d 552 (2d Dept. 1996). Typically, that rate does, in fact, mirror the statutory nine percent rate. *See, e.g., Blake*, 107 A.D.2d at 150-51; *Murphy*, 74 A.D.3d at 820.

An interest rate of nine percent on the award here is appropriate and equitable. As noted above, the vast majority of cases both inside and outside the Second Department award that amount of interest. Moreover, the evidence before the Court unequivocally established that AriZona pays Vultaggio 10 percent interest on the loans that he makes to the company. There is no controlling authority from the Second Department to justify that rate, but the evidence of the company's own practices and dealings with Vultaggio nevertheless demonstrates that prejudgment interest at 9 percent here is far from unreasonable or is somehow inequitable.

The appellate cases awarding prejudgment interest at a lower rate than nine percent are readily distinguishable. For example, in *Balk v. 125 West 92nd Street Corp.*, 805 N.Y.S.2d 352 (1st Dept. 2005), a lower interest rate was appropriate because the petitioner's shares "could have been sold on the open market." By contrast, not only could Ferolito's shares not have been sold on the open market, but the Court has computed a DLOM because of the eponymous lack of marketability of Ferolito's shares. And in *Whalen*, the company at issue had loaned money and provided other financial benefits to the petitioner during the litigation. By contrast, Ferolito has not received a distribution of any of AriZona's profits since this litigation ensued.

CONCLUSION

Even upon a completed analysis of all of the elements of the DCF, the precise value of AriZona pursuant to the Court's findings and conclusions, and thus the value attributable to each petitioner's shares, is not readily apparent. Indeed, the Court's findings are somewhat different from either party's claims, particularly with respect to the discount for lack of marketability. Moreover, the amount of Mercer's financial control value that is attributable to the 38% tax rate,

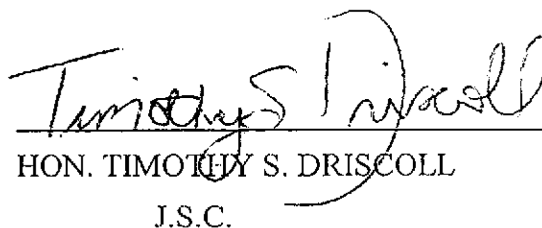
which was rejected by the Court, is not apparent. The Court's "back-of-the-envelope" calculations, based on the DCF methodology and the conclusions set forth above, suggest that AriZona's value approached $2 billion on October 5, 2010, and was a few percent less than that on January 31, 2011. *See* DX R277. After applying the 25% DLOM to the Ferolito parties' shares, and adding simple interest of 9 percent per annum, the total valuation plus interest of those shares approaches $1 billion as of the date of this writing, and may well exceed $1 billion on the date that the Court enters judgment. Because these precise arithmetic results are not readily apparent, further proceedings are necessary to ensure the most accurate computation.

The Court is also mindful of Vultaggio's claim that any valuation other than one based on Vultaggio's assertions would render the company insolvent. Even taking into account any claimed effect on AriZona, the Court declines to adjust further the value of the Ferolito parties' shares. Such an adjustment could provide Vultaggio with a windfall he could easily exploit if he decided to sell the shares he acquires from the Ferolito parties. Moreover, the risk of insolvency is not dependent solely upon the valuation of the Ferolito parties' shares, but also on the terms and conditions of any payout of that valuation. Inasmuch as the Court has not yet set those terms and conditions, the ability of AriZona to pay the valuation amount shall be the subject of further proceedings. The Court thus rejects Vultaggio's claim that the amount of the award and interest to the Ferolito parties, in itself, is somehow hazardous to AriZona's health in a cognizable way.

The parties shall appear before the Court on November 3, 2014 at 11:00 a.m. for further proceedings consistent with this Decision and Order.

ENTER

DATED: Mineola, NY
October 14, 2014



HON. TIMOTHY S. DRISCOLL
J.S.C.

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