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

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF WESTCHESTER
COMMERCIAL DIVISION

Present: HON. ALAN D. SCHEINKMAN,
Justice.

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LUIGI LA VERGHETTA,

Plaintiff,

-against-

GABRIELLE LAWLOR, JEFFREY INNOCENTI and JAMES INNOCENTI,

Defendants.

JGJ HOLDING COMPANY, LLC AND JGJg HOLDING COMPANY, LLC,

Nominal Defendants.

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JEFFREY INNOCENTI and JAMES INNOCENTI, individually and on behalf of JGJ HOLDING COMPANY, LLC,

Counterclaim-Plaintiffs,

-against-

LUIGI LA VERGHETTA,

Defendant.

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JEFFREY INNOCENTI and JAMES INNOCENTI, individually and on behalf of JGJ HOLDING COMPANY, LLC,

Third-Party Plaintiffs,

-against-

LUIGI LA VERGHETTA, CPA, P.C.

Third-Party Defendant.

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Index No. 59346/2014

DECISION AFTER TRIAL

Scheinkman, J:

This Court is called upon to determine the value of two corporate entities for purposes of permitting the buy-out of a minority shareholder. It is not surprising, and rather in

the nature of things, that the parties have a significant disagreement as to the value of the enterprises. The would-be seller relies on a valuation report that places the value of both corporations at over $162 million and the seller's share at over $53 million. The would-be buyers rely on a valuation report that values one entity at $6.2 million, the other at $208,000, for a total for the two of approximately $6.4 million, and with the buyer's share of the total being approximately $2.2 million. The Court must resolve the difference.

RELEVANT BACKGROUND

The principal protagonists in this litigation are Plaintiff Luigi La Verghetta ("Plaintiff" or "La Verghetta") and Defendants Jeffrey and James Innocenti (collectively "Defendants" or the "Innocentis"). They banded together to own and operate Planet Fitness brand health clubs under a franchise given by the Planet Fitness franchisor, Pla-Fit Franchise, LLC ("Franchisor")

JGJ Holding LLC ("JGJ"), a New York limited liability company, was formed in 2012 to hold 29 existing Planet Fitness franchises and to develop new clubs in accordance with an Area Development Agreement with the Franchisor ("ADA"). JGJ holds 100 percent interest in PFNY Holdings, LLC, which is the parent of PFNY, LLC. For purposes of this Decision, the Court will refer to the owner/operator of the New York Planet Franchises as JGJ, which is the ultimate controlling entity and the entity that is the subject of the valuation issue, and will disregard the subordinate entities, unless the context requires otherwise.

Under the ADA, JGJ has the exclusive right to develop Planet Fitness franchises in New York City, Rockland and Westchester counties, and portions of Long Island. JGJ committed to developing 11 new clubs by December 31, 2014 and at least 6 new clubs per year thereafter through 2028.

JGJg Holding Company, LLC ("JGJg") is also a New York limited liability company. It was formed in December 2013 to serve as the holding company for PF CALI Holdings, LLC ("PF CALI"), which, in March 2014, entered into an Area Development Agreement with the Franchisor to develop and operate Planet Fitness health clubs in portions of Orange, San Bernardino and Los Angeles, California ("CA ADA"). As with the New York operation, the Court will focus on JGJg, which is the ultimate controlling entity of the California operation and the subject of the valuation issue, and will disregard the subordinate entities, unless the context requires otherwise.

JGJ has a line of credit with General Electric Capital Corporation, which includes a $20 million term loan component and a $20 million revolving line of credit, for a total credit limit of $40 million (the "GE Credit Facility"). Both components carry interest at the six month Libor Rate plus 5 percent. The term portion of the debt requires quarterly payments of $500,000 as reduction in principal, with a balloon payment of $12.5 million due on November 30, 2017.

This action was originally commenced on June 12, 2014. The Verified Complaint, filed on June 20, 2014, asserted various causes of action: declaratory judgment,

breach of contract, tortious interference with contract; breach of fiduciary duty; aiding and abetting breach of fiduciary duty; fraud; civil conspiracy to defraud; conversion; judicial dissolution; accounting; contractual indemnification; and constructive trust. On August 11, 2014, the Innocentis interposed a Verified Answer, which included denials of the material allegations of the complaint, affirmative defenses, counterclaims and third-party claims.

On June 24, 2014, after hearing counsel for the parties, the Court issued a temporary restraining order and, on October 20, 2014 commenced a hearing in connection with Plaintiff's request for a preliminary injunction. On October 23, 2014, counsel entered into a stipulation on the record which resolved the issues regarding the requested preliminary injunction and streamlined the issues to be litigated. This Court "so ordered" the transcript on October 28, 2014, thus making it an order of the Court (the "So-Ordered Stipulation").

THE ISSUES WHICH WERE IDENTIFIED BY STIPULATION

The So-Ordered Stipulation provided that each side would retain an appraiser to value the interests in JGJ and JGJg and that the Court would conduct a trial to "determine the following issues and no others":

A. the fair value of La Verghetta's interest in JGJ and JGJg as of June 11, 2014;

B. the reasonable terms and conditions upon which JGJ would acquire such interest;

C. the percent interest and other understandings and agreements among the parties in respect of La Verghetta's interest in JGJg; and

D. the reasonable terms and conditions upon which JGJg would acquire such interest.

All claims asserted in this action were stayed until the above-referenced trial is concluded and thereafter all claims are to be discontinued with prejudice.[1]

It was agreed that JGJ and JGJg would not engage in certain significant transactions without giving La Verghetta's counsel at least 10 days notice. The transactions requiring notice include: the sale, merger, refinancing or issuance of new stock in PFNY; an amendment to the GE Credit Facility; draw downs on the GE Credit Facility in excess of $50,000; new borrowings in excess of $50,000; and distributions. Except with regard to these items, it was agreed that "the plaintiff shall have no other right in the business affairs of JGJ and JGJg".

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[1]The Court is aware that the parties have disputes that go beyond the four issues identified. However, as the Court made clear in its Decision and Order dated July 30, 2015, the Court confined the scope of the hearing to the four identified issues.

It is undisputed that, as of June 11, 2014 (the "Valuation Date"), La Verghetta, Jeffrey Innocenti and James Innocenti each owned 1/3 of the interest in JGJ. As to JGJg, as will be discussed further *infra*, there is something of a dispute, which the Court resolves by determining, as it is empowered to do under the So-Ordered Stipulation, that the ownership interests are: La Verghetta, 31.6666%; James Innocenti, 31.6666%; Jeffrey Innocenti, 31.6667%; Gabrielle Lawlor, 5%. Thus, the percentages among the principal protagonists are essentially equal, the difference being that Lawlor, who had acted as counsel to JGJ, was provided with a minor equity interest in JGJg.

The Court notes that JGJ and JGJg are the parties under the So-Ordered Stipulation who would acquire La Verghetta's interest in themselves. Nonetheless, the Court recognizes that, as a practical matter, the Innocentis, who would be left as the sole members of JGJ and as owners of 95% of JGJg if La Verghetta is bought out, are the real parties in interest.

As of the Valuation Date, JGJ operated 35 Planet Fitness clubs in New York, Rockland and Westchester. As of the Valuation Date, JGJg had not actually opened any clubs in California, the CA ADA having been signed roughly three months earlier. The clubs are fitness training facilities offering the use of exercise equipment, fitness training services, tanning services and other similar services.

OVERVIEW OF PLANET FITNESS AND THE HEALTH INDUSTRY

Plaintiff relies upon a valuation report produced by Bruce S. Schaeffer; Defendants rely upon a valuation report prepared by Gary R. Trugman of Trugman Valuation Services, Inc. Both reports, and both valuators in their testimony, addressed trends in the economy generally and in the health fitness industry in particular. While there are not many obvious disagreements in the background pictures that these valuators paint, Trugman provides a more comprehensive, thorough, researched, documented and credible analysis of the general economy, the regional economies, and the health fitness industry. Therefore, the Court relies more heavily on the Trugman report and testimony for this portion of this Decision.

Planet Fitness is one of the largest chains of full-sized health clubs in the United States. It is known for its ultra low cost membership fees and for its catering to casual gym users. Members pay both an annual fee and a monthly fee. Membership levels are $10 per month for basic membership and $19.99 for "Black Card" membership, which entitles the member to use any location, to use tanning beds and massage chairs, and to purchase drinks at half price. The target market is casual gym users who are looking for a low-cost means to maintain a healthier lifestyle.

The principal reason why members join health clubs is for health and wellness. On the other hand, the major reason why club members leave their gyms, or potential members did not join, is cost. The number of health clubs in the United States has increased over the past five years as has the number of Americans who are health club members. The number of times that the average members visits his or her club has increased as well, though

only 44% of all members are "core" members, defined as those who use the club at least 100 days per year. Growth in the industry is driven by efforts to encourage younger persons to join as well as by increasing concerns about health and the cost of health care. Efforts to combat obesity and other diseases increase the promotion of exercise and physical activity which, in turn, reduces health care costs for treating such conditions.

There is a great deal of competition in the fitness industry, ranging from luxury clubs offering boutique services such as personal training and nutrition, fitness facilities placed in offices and residential buildings, private studios, home fitness equipment providers, country clubs, and traditional YMCA and similar non-profit organizations. Planet Fitness' primary advantage in relation to the competition is that it is the lowest cost provider of health club services. In addition, all franchisees are required to contribute to a national advertising fund which promotes the Planet Fitness brand over the internet, print and electronic media, both nationally and regionally. The Planet Fitness model has its disadvantages, since the facilities generally lack revenue-generating services and amenities, such as personal training and nutrition programs.

The arrangements between JGJ and JGJg and the Franchisor are heavily weighted in favor of the Franchisor. JGJ is required to open six new clubs per year through 2028. JGJg is required to open 18 new clubs in California, with 18 leases to be signed by December 31, 2017. The franchisees must purchase their gym equipment from the Franchisor. The Franchisor sets the prices to be charged to the members and must approve any deviations from the Planet Fitness business model. The Franchisor has the right of first refusal with respect to any sale by the owners.

With regard to the New York operation, as new locations must be rented, or existing leases expire, rents will increase. Historically, clubs take several years from opening to obtain profitability but profitability declines after five or six years of operation. Still, older clubs tend to be more profitable than newer clubs and the newer clubs are taking longer to reach profitability because of higher rents, higher labor costs, and higher capital expenses.

FAIR VALUE

The parties, by their stipulation, have charged the Court with the responsibility of determining the "fair value" of JGJ and JGJg. The pre-hearing submissions of both sides reflect a common understanding of the legal constructs underlying "fair value".

"Fair value" enters the law through the Business Corporation Law. 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." BCL §623 provides minority stockholders with the right to withdraw from a corporation and be compensated for "fair value" of their interests when the corporate majority takes significant action deemed inimical to the position of the minority.

"Fair value", while not defined in the statute, has become a term of art used to describe the consideration that the holder of a minority interest in a business should receive by

compensation for a sale of that interest to the majority interest. As the Court of Appeals has stated, in 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' " (*Matter of Friedman v Beway Realty Corp.*, 87 NY2d 161, 168 [1995], *quoting Matter of Pace Photographers*, 71 NY2d 737, 748 [1988]), *quoting Matter of Blake v Blake Agency*, 107 AD2d 139, 146 [2d Dept 1985], *lv denied* 65 NY2d 609 [1985]). The three major elements of fair value are net asset value, investment value and market value. The particular facts and circumstances will dictate which element predominates, and not all three elements must influence the result (*Matter of Friedman*, 87 NY2d at 168).

The general valuation principles were well stated by a Commercial Division colleague in *Ferolito v Arizona Beverages USA, LLC* (2014 NY Slip Op 32830[U], 2014 WL 5834862 at *7-8 [Sup Ct, Nassau County 2014]). As Justice Driscoll wrote:

> 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.*
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> 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 [the company's] "strategic" or "synergistic" value to a hypothetical third-party purchaser.... A valuation that incorporates such a "strategic" or "synergistic" element would not rely on actual facts that relate to [the company] as an operating business, but rather would force the Court to speculate about the future.

LA VERGHETTA'S ITNEREST IN JGJg

The Court begins its resolution of the enumerated issues with the third issue: "the percent interest and other understandings and agreements among the parties in respect of La Verghetta's interest in JGJg". While this issue is not complicated, and is of little practical consequence in the valuation of JGJg, the facts underlying it are, in fact, vital to the Court's determination of fair value of JGJ.

JGJg was formed in December 2013 to serve as the holding company for the parties' prospective California operations, as allowed by the CA ADA entered into in March 2014. It is not disputed that the CA ADA reflects that La Verghetta, Jeffrey Innocenti and James Innocenti each held 31.66% of the interest, with Lawlor holding 5%.

By the time the parties were approaching the entry into the California operation, they had already encountered serious disagreements.

According to La Verghetta, in late 2013, Jeffrey Innocenti approached him and pointed out that, as a result of obtaining the impending California area development agreement, both Jeffrey and James Innocenti would be doing more traveling. Jeffrey wanted assurances that La Verghetta "would do the right thing"; La Verghetta said he would and they shook hands on that. A similar assurance was given a few weeks later. Then, Jeffrey Innocenti proposed a specific accommodation: he suggested that La Verghetta should have only a 20% interest in JGJg. La Verghetta objected, pointing out the assets of JGJ were being pledged to support the California operation. La Verghetta testified that he and Jeffrey Innocenti agreed that, instead of La Verghetta having his interest reduced by 11.66%, he would give Jeffrey and James Innocenti $3 million to preserve his interest at 31.66%.

According to La Verghetta, Jeffrey accepted this resolution but demanded a down payment. In January, 2014, a distribution of $2.4 million was to be made out of JGJ. While originally each of the three were to receive $800,000, the distribution was reconfigured so that La Verghetta received $500,000, with the other $300,000 being divided between James and Jeffrey Innocenti equally, such that each of them received $950,000. La Verghetta testified that this $150,000 per Innocenti was a down payment toward the $1.5 million they were each to receive from him so that he could preserve his 31.66% interest. La Verghetta also testified that a written agreement memorializing this understanding was maintained in a folder in his office at the company.

However, according to La Verghetta, in April, 2014, La Verghetta was notified by the company bookkeeper that James Innocenti wanted La Verghetta's banking information. La Verghetta called Jeffrey Innocenti and was told by Jeffrey Innocenti that he was "no longer good" with the deal and wanted La Verghetta to have a reduced interest in California of 15%. The Innocentis returned the $300,000 to La Verghetta.

James Innocenti's version of events is somewhat different. He denied that there was an agreement that a $3 million payment be made by La Verghetta in lieu of a reduction in his interest. Rather, he said, the $3 million was a payment for the extra work that James and Jeffrey Innocenti would be undertaking in order to develop the California clubs. James Innocenti vehemently denied that there was any linkage between the $3 million payment and the percentage interest to be held in JGJg by La Verghetta. He insisted that the $3 million was payment for services to be rendered.

James Innocenti acknowledged that La Verghetta offered the $950,000 distributions and he and his brother accepted them but thereafter changed their minds. James Innocenti claimed that, after the $300,000 was returned, La Verghetta agreed to accept a lesser percentage in JGJg. He claims that, after the money was returned, La Verghetta insisted upon having a 20% interest, James Innocenti was willing for La Verghetta to have only a 15% interest, and they compromised at 17.5%. According to James Innocenti, he and La Verghetta shook hands on the 17.5% deal but La Verghetta said he was going to go home, discuss it with his wife, and "solidify" the deal the next day. But, according to James Innocenti, the parties never discussed it again.

Jeffrey Innocenti's version is similar to his brother's. He testified that he and La Verghetta had a history of "handshake" deals. In this instance, he believed that he was entitled to more of a percentage in the California entity on account of the work that James and Jeffrey Innocenti were doing and on account of the La Verghetta's lack of involvement in procuring the California opportunity. Jeffrey, like James, testified that an agreement was reached whereby Jeffrey and James would receive $3 million extra on account of their California work. Jeffrey acknowledged that he received a $950,000 distribution (as did his brother) in January 2014 while La Verghetta received $500,000. He also acknowledged that he, his brother, Lawlor and La Verghetta each signed the CA ADA dated March 3, 2014 in which the percentage interests between La Verghetta and the two Innocentis were equal.

Jeffery Innocenti claimed that they sent the money back because they could not figure out how the $3 million made sense. California was different from New York and they did

not know how well they would do. But Jeffrey also stated, and the Court viewed this as the most important consideration, they did not want to have to "hat in hand" to La Verghetta to obtain the balance of the $3 million. Jeffrey Innocenti claimed that he told La Verghetta that the Innocentis "just want to do the percentages".

Having heard the witnesses, the Court finds that La Verghetta's version is the credible one; the Court does not accept the testimony of the Innocentis on this score.

There is no dispute that La Verghetta agreed to pay the Innocentis $3 million and they agreed to accept that sum. The dispute is what was the money supposed to be for. It defies credulity that La Verghetta would have agreed to pay the Innocentis $3 million on account of additional services they would be rendering to start up the California operation. There was no testimony as to the value of those additional services or, correspondingly, as to what services toward the New York operation the Innocentis would no longer be performing so as to travel and work in California. Any disparity in services could have readily been addressed by an agreement for JGJg to pay the Innocentis a salary for their work in California.

It is evident that the Innocentis believed that La Verghetta had little, if anything, to do with procuring the CA ADA and, therefore, wanted to minimize his percentage interest in JGJg. They stated as much. It makes no sense that, in the context of a discussion about La Verghetta's interest in JGJg , the parties would have come to an agreement for La Verghetta to pay $3 million to compensate the Innocentis for work to be performed in the future. Rather, the only credible explanation for the $3 million payment is the one offered by La Verghetta; that he was willing pay $3 million, and the Innocentis were willing to accept $3 million, so that La Verghetta could retain 31.66% of the interest in JGJg, rather than accede to the Innocenti's demand that his interest in JGJg be reduced to 15% or 20%. Indeed, this view is supported by Jeffrrey's testimony that he did not want to have La Verghetta paying out of pocket and that he "rather just do the percentages". This confirms that the $3 million was offered and accepted in order to avoid a reduction in La Verghetta's percentage.

Additionally, the agreement – for $3 million to avoid a percentage reduction – is confirmed by the timing. The agreement was reached by January and the down payment was quickly tendered. The three signed the CA ADA in March 2014, with their percentages being stated as equal. The money was not returned until April. The Court believes that the parties would not have signed the CA ADA without having an understanding as to their respective percentage interests. The Court believes that the parties would not have misrepresented their percentage interests to the Franchisor. Notably, the parties never advised the Franchisor of a change in percentage interests.

Trugman's report indicates that the $180,000 paid for the CA ADA came out of the New York operation, of which La Verghetta was a one-third owner. There is no indication that the Innocentis ever offered to refund La Verghetta for the difference between a 1/3 share of $180,000 and a 17.5% share of $180,000.

It remains to consider whether the $3 million payment represented a realistic value for 11.66% of JGJg. In this regard, the Court notes that JGJg paid the Franchisor $180,000 in March 2014 when the CA ADA was signed and the Court does not agree that the

parties perceived that they were getting the deal of the century, *i.e.*, acquiring health club development rights worth millions for a mere $180,000. Given the extensive control over the operation by the Franchisor, the Court also does not perceive that the Franchisor would have sold development rights worth millions for only $180,000. But there is a rational explanation.

On cross-examination, La Verghetta was confronted with a statement he made in an affidavit to the effect that he had agreed with the Innocentis that if they were successful in increasing the value of the enterprise through an ultimate liquidating event, they would be entitled to $3 million. Defendants contend that this shows that La Verghetta understood that the additional $3 million would only be paid on a sale of JGJg. However, this does not advance their position.

The Court perceives that the parties had a solid economic understanding of the agreement they reached. The Court finds that La Verghetta and the Innocentis perceived that $3 million was a fair price for 11.66% percentage in the California entity that La Verghetta was to forego, based on the expected value of the California entity once developed. Since the parties did not conduct a valuation, the only basis upon which they could have come to the $3 million price was their prior experience in New York. Since the Innocentis were pushing for greater recognition of their expected greater contributions to the California enterprise, their reward would be La Verghetta's payment to them of $3 million to offset the additional value it was expected that the Innocentis' efforts would create for him.

The Court does not accept Jeffrey Innocent's assertion that he walked away from the $3 million deal because he was uncertain as what would happen in California. Had that been the case, he and his brother should have been glad to accept $3 million for selling 11.66%, thus selling only a small piece of the pie, gaining $3 million in hand, and mitigating against downside risk. Nor does it make sense to think that the Innocentis walked away from $3 million as being insufficient compensation for their additional services Rather, the explanation is that, after reflection, the Innocentis perceived that the value of the California operation would eventually be greater than the value experienced in the New York operation and they wanted that benefit for themselves in the form of a greater percentage interest in the profits.

Nor does the Court believe that the Innocentis returned the $300,000 for the reason that Jeffrey Innocenti articulated -- that they did not want to go to La Verghetta "hat in hand" to get him to pay the balance of the $3 million. The predicate for the agreement was that the $3 million was to be paid out of the eventual sale proceeds, not over time. Foremost, the Innocentis had not actually done anything yet to develop the California operation; it only represented potential. There was no reason for them to be concerned with demanding immediate payment of the bulk of the $3 million since they had not delivered on their end. Further, there was more than sufficient means available to cover the balance. For one thing, the prospect of further unequal distributions out of JGJ was available. If the California operation developed as expected, there would have been more than sufficient funds to pay out the bulk of the $3 million. And the fact that La Verghetta proceeded with dispatch and without prompting to make a down payment reflects his trustworthiness. Jeffrey Innocenti's explanation is not credible. His brother's explanation is more credible – they just changed their minds.

This all being said, the interests in JGJg are as set forth in the CA ADA and the parties never agreed after the making of the CA ADA that the interests be changed. Hence, the Court concludes that La Verghetta holds 31.6666%; James Innocenti, 31.6666%; Jeffrey Innocenti, 31.6667%; and Gabrielle Lawlor, 5%.

JGJg SHOULD BE VALUED AS A STAND ALONE ENTITY AND AS SUCH HAS NO VALUE

One of the major valuation disputes concerns the valuation of JGJg, the California entity. Schaeffer argues that JGJ and JGJg, while separate entities holding separate ADAs with the Franchisor, function as a single entity, with administrative functions being handled from a central location, supported by a single credit facility, which is secured by the members' interests in both entities. He maintains that the two entities bring synergistic value to each other. Schaeffer, using data calculated from his analysis of the history of the New York operation, developed projections as to the net present value of each newly opened club. For example, he projected a net present value of a club opening in 2015 at $1,577,980. He then applied that number to the 8 clubs he projected would be opened in New York in 2015 and to the 3 clubs he projected would be opened in California that year. Using this methodology, he set forth a total enterprise valuation of $150,635,764, of which he attributed $23,278,074 to the California operation, as of the June 11, 2014 valuation date.

The Court does not agree with this approach and it defies economic reality that JGJg acquired the right to develop clubs in California in March, 2014 for $180,000, which payment was funded by JGJ. It makes absolutely no sense that JGJg increased in value from essentially zero ($180,000 less the $180,000 provided by JGJ) to over $23 million in just three months time. Indeed, it is highly improbable, if not inconceivable, that the Franchisor, which carefully crafted area development and franchise agreements heavily in its own favor and which is accountable to its own owners, would have sold development rights worth $23 million for just $180,000. The CA ADA contains a provision prohibiting JGJg from reselling its development rights at a profit, thus protecting the Franchisor by prohibiting the CA ADA from being flipped for a quick profit. It is highly unlikely that the Franchisor would consent to waiving this provision so as to permit JGJg to obtain an unheard of return on $180,000 invested just three months earlier.

As Trugman notes in his report, the assets of the California operation as of May 31, 2014 consisted of $28,282 in cash and $169,261 (representing the capitalized value of the area development, less amortization of $11,739). Since the funding for these assets came from the New York entity, there was a $235,420 payable from JGJg to JGJ. Members' equity was at a *negative* $38,887.

As of the Valuation Date, JGJg had not hired any employees, signed any leases or engaged in any operations. It did not have any budgets or forecasts in place. The Court agrees with Trugman's opinion that it would be highly speculative to try to calculate positive cash flow out of non-existent California clubs. While Schaeffer used his construct of the net present value of a future New York club to extrapolate the net present value of a future

California club, he did not attempt to make any study of, or account for, how the operating environment in California may differ from the operating environment in New York. Schaeffer's analysis is entirely speculative, made without any forecast of revenue, expenses or profits and without consideration of the significant multi-million start-up costs for equipment and other capital items.

Likewise, it is pure speculation as to whether there is any "synergistic" value in operating the New York and California franchises together. Since there was no history of operations in California, it cannot be said that there was any intent to maintain joint operations, much less evidence of doing so. To the contrary, the evidence is unrefuted that La Verghetta and the two Innocentis were in agreement that the California opportunity would be placed in a separate entity which was not a subsidiary of the New York entity.

There are only two points of commonality between JGJ and JGJg. First, there is overlapping ownership, but common ownership does by itself imply common operation. There was nothing to indicate that the parties had a plan to use JGJ personnel, other than the principals themselves, to operate California. Second, the parties arranged to have the GE Credit Facility increased from $30 million to $40 million so as to support the need for capital to pursue the development in California. However, there was no evidence as to what amount, if any, was drawn down between March 2014 (when the CA ADA was signed) and June 11, 2014 to support the California development.

The Court accepts Trugman's view that JGJg should be considered an early stage development company which should be valued on an asset-based approach. The assets consist of the $28,282 in cash and the CA ADA valued at $180,000. Since the parties paid that amount for the CA ADA only three months earlier, the price actually paid between the willing buyer and willing seller reflects the market value of what JGJg acquired. Trugman thus values JGJg at $208,282 as of June 11, 2014.

The Court notes that the parties had, in effect, agreed that an 11.66% interest in JGJg would eventually be worth $3 million. Thus, this does not reflect the actual value of JGJg as of June 11, 2014; rather, it reflects what the value of that percentage interest would be in the future, upon development of the contemplated franchises.

Trugman's report showed no liabilities as he was treating the monies advanced by JGJ as a capital contribution, rather than a loan, and further suggesting that, if it was treated as a loan, it would be treated as a loan from the principals, who then would be deemed to have borrowed it from JGJ. The Court does not agree. The Court sees no reason why the money advanced by JGJ should not be treated as a loan. It is clear that the individuals, including Lawlor, agreed not to make capital contributions and to have JGJ provide the funding, at least at the outset, for JGJg. Since this money was advanced out of JGJ, it should be returned thereto.

The Court views JGJg as having no value as of June 11, 2014. The Court will, however, add the $180,000 paid to the Franchisor and the $28,282 cash on hand to the value of JGJ. The Court has chosen to ignore the impact of capitalizing the payment to the Franchisor.

This view also accords with the economic realties that a sale of La Verghetta's interests in JGJg would not take place except as incident to a sale of his interests in JGJ. A prospective hypothetical buyer would not, in reality, be seeking to acquire just La Verghetta's interest in California. Hence, inclusion of JGJg within the larger umbrella of JGJ makes economic sense. But the Court, recognizing that the parties stipulated that the Court should value JGJg separately, discharges that obligation by valuing it at nil.

The Court recognizes, as it did during the hearing, that there is value to having the right to having the opportunity to build out health clubs in California. However, La Verghetta has failed to show that the opportunity was worth more than what the parties paid for it three months earlier. Further, since the parties did not themselves put any money in JGJg, with the monies coming solely from JGJ, there is no reason to deal with a separate buy-out.

Last on this issue, La Verghetta personally guaranteed the obligations to the Franchisor under the CA ADA. Consequently, as part of a buy-out transaction, Defendants must obtain his release from those obligations.

THE EVIDENCE AS TO THE VALUE OF JGJ

Both Schaeffer and Trugman offer valuations of JGJ. Both valuations are fraught with issues, Schaeffer's much more so than Trugman's. Apart from the opinions of Schaeffer and Trugman, there was other, informal evidence of JGJ's value.

A. The Schaeffer Valuation

Bruce Schaeffer reported that the fair value of the entire enterprise – New York and California – is over $160 million, with the New York operation having allocated share of approximately $139 million and California having an allocated share of over $23.27 million.

Schaeffer is, by training, a tax lawyer, holding both a J.D. and an L.L.M. in taxation. He does not have either formal training from, or certification by, any professional valuation organization or society. Rather, his experience in valuation began in the context of estate planning and he became involved in franchise valuations. He is co-author of a treatise on Franchise Regulation and has taken courses in valuation and has read treatises and other works on valuation, including works by Shannon Pratt, a leading valuation authority, and by Trugman, Defendants' expert.

As previously noted, the case law has identified three elements to be considered in assessing fair value: market value, investment value and net asset value. Schaeffer, however, in his report identified the three "recognized" methods of valuation to be book value, capitalization of earnings and comparable sales. He did not relate how these three "recognized" methods relate to the three elements identified in the governing case law.

The methodology that Schaeffer employed was to value each of the 32 existing health clubs, develop a value for corporate overhead, and calculate a present value for "future

clubs" (i.e., clubs to be developed and brought into operation in the future, which includes 3 clubs that were opened prior to the valuation date). As he acknowledged upon inquiry from the Court, Schaeffer valued "three pockets" – an existing clubs pocket; an administrative pocket; and a future clubs pocket (both New York and California). Indeed, for each existing club, Schaeffer provided a discrete value and set forth what he regarded as "Gino's 1/3 share". This approach, by itself, is flawed. First, by reason of the Stipulation, the Court was charged with developing values for only two "pockets" – JGJ and JGJg. Second, as previously noted, as a matter of economic reality, a hypothetical buyer would be looking for the value of an integrated enterprise to be acquired as a whole, not the value of three distinct "pockets", much less a purchase of club-by-individual club.

While Schaeffer purported to engage in a discounted cash flow analysis, he did not actually do so. Rather than project free cash flow, Schaeffer developed projections of "net income", which included depreciation, which is a non-cash expense. His analysis did not take into account capital expenditures and working capital.

Hence, the Court finds his entire approach to be flawed. While the Court was willing to allow Schaeffer to testify as to his work and conclusions, the Court finds that his expertise in the area of valuations to be lacking and his analytical approach seriously flawed. But even assuming the validity of the approach, Schaeffer's execution of it is fraught with misjudgments and errors.

In valuing the existing clubs, Schaeffer engaged in a number of adjustments, which seriously inflated the value of the clubs. When a member does not pay his or her monthly fee, JGJ records that under "returns and allowances". For 2014, management forecast 8.86% for returns as a percentage of revenue and, through May 31, 2014, had actually experienced 8.7% of actual returns and allowances. Schaeffer capped returns and allowances at 7.5%, though he had no basis for doubting management's figures and without understanding the actual facts. He also subtracted royalties that JGJ was required to pay the Franchisor on membership fees charged but not collected from customers. He contended that because he thought JGJ's having to pay royalties on uncollected fees was unfair or abhorrent, the royalties should not be considered a real expense, notwithstanding that the agreement with the Franchisor explicitly required the franchisee to pay royalties on uncollected fees.

The result of these adjustments turned losses at certain clubs into "profits" and and significantly increased the "profits" projected into the future for other clubs. Similarly, he reduced depreciation for existing clubs to conform to New York's tax code, without regard to whether the depreciation reported by management reflected actual economic depreciation, bearing in mind that the clubs need exercise equipment and that equipment, used by many, will wear out and will periodically need to be refurbished and/or replaced. It developed on cross-examination that the depreciation adjustment was not, in fact, required since the JGJ did not take accelerated depreciation. Schaeffer capped depreciation at 12.5% of total revenues, thus linking revenues and depreciation, with the result that two identically equipped clubs would have differing depreciation expenses solely because their revenues were different.

Schaeffer baked in increases in net revenue to certain clubs and carried those increases forward into subsequent years, which increases are inconsistent with the historical

trends in those clubs. For example, the Pelham Bay club, showed net revenue of $1,326,591 in 2011, $1,036,020 in 2012, $705,407 in 2013, and $473,359 in 2014 (annualized from year to date result). Yet, Schaeffer projected a growth rate of 3.92% in 2015, again in 2016, and again in 2017, with a 3% decline in each year thereafter through 2021. The effect of the use of the growth rate, and other adjustments, turned net income of $473,359 in 2014 into net income of $617,418 by 2017 and $546,651 by 2021, according to Schaeffer. Some of this is explained by his use of revenue growth to extrapolate net income growth. For example, with respect to the Dyckman club, he used projected revenue growth of 1.8% between 2014 and 2015 to extrapolate net income growth of 1.8% in 2016 and 2017, even though his report shows that net income was actually projected to decline 7.3% between 2014 and 2015.

Schaeffer theorized that it would take several years for a new club to reach peak revenues and thereafter revenue would slowly decline. But this analysis, even if accepted, has no application to the Pelham Bay club, which opened in December 1995, with a lease expiring in March 2017. While Schaeffer noted that the rent was favorable, he did not consider or project the impact of the lease expiration.

The Court notes that Schaeffer did not consistently apply a decline in revenue to all clubs. No such decline was taken with regard the West 27th Street Club, the Wyckoff Club and other newer clubs. Even granting that these newer clubs, according to Schaeffer, would take some years to reach peak revenue, it would still be expected, under Schaeffer's model, for these clubs to reach peak revenue and start downward by 2018 or thereafter.

The same significant inflation of revenues and diminishment of expenses appears throughout Schaeffer's analysis of the existing clubs. As another example, Schaeffer projected, through his revenue and expense adjustments, that the Yonkers club would see net income of $501,513 in 2014 and reach $554,218 by 2018, even though net income had peaked at $676,076 in 2011 and had dropped thereafter. The Yonkers club was opened in 2002 and its lease, said by Schaeffer to be very favorable, is due to expire in December 2017.

Schaeffer's valuation of the "future clubs" fares no better. Essentially, he used clubs that were opened between 2010 and 2013 to create a net present value of cash flows for a hypothetical future club. He determined that the present value of the right and obligation to open future clubs in 2014 was $1,767,338 and determined that the present value of such right and obligation to open new clubs in subsequent years would decline each year thereafter. He then multiplied the present value of a new club for a given year by the number of clubs to be opened that year. By following this method through 2021, he reached a valuation of roughly $84.4 million for future clubs in both New York and California.

Schaeffer's analysis does not account for the costs to build and equip each new club nor does it account for the operating expenses incurred for new clubs prior to opening. Further, the Court does not accept that Schaeffer's sampling of clubs from 2010 to 2013 provides a reliable forecast of future performance for new clubs. And, in any event, his work contains mathematical errors, some of which he acknowledged and attempted to correct.

The Court finds that Schaeffer's analysis is not worthy of being relied upon in evaluating JGJ. That Schaeffer's analysis was presented not as a genuine effort to place a

fair value on JGJ, but as an effort to extract as maximum a recovery as could be viewed as remotely plausible, is shown by the fact that Schaeffer found an "enterprise value" for JGJ of approximately $139 million, which excluded the approximate $29 million in debt outstanding as of the Valuation Date. Hence, what he was measuring, if anything, was "gross" value and for the equity value to be $139 million, the "gross" value would have to be approximately $167.8 million, a figure for which he does not argue. In other words, Schaeffer presented the Court with an argument for valuing La Verghetta's interest as if JGJ had no debt. Such an approach is not professional. And this is without regard to $6.8 million in uncorrected math errors.

The Court turns to Schaeffer's belated effort to develop a valuation based upon a comparable transactions. There is only a single comparable – the acquisition by the Franchisor of 8 New York fitness clubs on March 31, 2014 for $41.63 million. The information regarding this transaction comes from publicly disclosed information released by the Franchisor with its financial statements.

The information includes the amount of the payment ascribed to various categories of assets:

Fixed Assets	$ 7,634,000
Reaquired Franchise Rights	8,950,000
Membership Relationships	5,882,000
Favorable leases, net	700,000
Other Assets	35,000
Goodwill	19,771,000
Liabilities Assumed	(1,334,000)
Total Payment	41,638,000
Price per Club	5,204,750

It is impossible to determine from this scanty information whether the figures ascribed to various sale components were predicated upon actual valuations, accounting calculations, or other means. For one, there is no information as to how the $19.7 million for "Goodwill" is determined. Other categories do not seem relevant. For one, the almost $9 million ascribed to Reacquired Franchise Rights would seem applicable only in transaction with the Franchisor, as opposed to an outside party, and it is unclear whether these rights relate to the 8 stores actually sold or to an unknown number of stores that the seller had the right to build in the future. Likewise, the Franchisor appears to have paid some $5.9 million for "Membership Relationships" but it is not clear what the Franchisor was buying and how the price was calculated. Further, while the Franchisor assumed $1.3 million in liabilities, it is not stated whether that was the sole debt of the seller or whether there was other debt that the seller retained and had to pay off.

Accordingly, the Court cannot rely upon the Schaeffer comparable method either.

B. The Trugman Valuation

In contrast to Schaeffer, Trugman is a true valuation professional. Rather than having a background in law and taxation from a legal point of view, Trugman is a Certified

Public Account, accredited in business valuation by the American Institute of Certified Public Accountants, accredited as a Master Business Appraiser by the Institute of Business Appraisers, and an accredited Senior Appraiser by the American Society of Appraisers. He has a Masters in Valuation Sciences and has extensive appraisal education. He widely lecturers and instructs on valuation, including participation at the National Judicial College. Overall, the Court finds Trugman to have a great deal more professional expertise and experience in valuation than Schaeffer.

Trugman explored three approaches to valuation: income approach, market approach, and asset-based approach. He used two of these approaches: the income approach, based on discounted cash flow, and a market approach. However, he put all of the weight on the income approach.

He concluded that the enterprise value of JGJ is $38,537,716 from which he subtracted debt of $28,928,696 to reach an equity value of $9,609,020. He applies a discount for lack of marketability at the enterprise level of 35% and adds $377,792 of non-operating assets to reach a final equity value of $6,577,620, rounded to $6,600,000. Since La Verghetta holds a 1/3 interest in JGJ, he would receive $2,200,000 if Trugman's valuation is accepted.

The first step in Trugman's analysis involves normalizing historic statements, a process that involves adding or eliminating items that a hypothetical buyer would add or eliminate, such as non-recurring expenses. Trugman eliminated legal fees and data processing expenses. Trugman also increased the officers' compensation as he viewed the existing compensation as artificially low. He also modified the rent expense, converting rents recorded under GAAP standards to actual cash rents paid.

Of these adjustments, the Court questions the adjustment of officer compensation. The three principals of JGJ are the three officers. Hence, whether their compensation was low is immaterial since they would benefit from distribution of profit. Hence, the increase in compensation would only serve to reduce their profit distribution. Further, since JGJ is a pass-through entity, all earnings of JGJ (whether paid out to them as compensation, paid out as profit distributions, or retained in the company) will be taxed to them. It is true, of course, that an investor who purchased JGJ would need someone to run it if the investor lacked the skill set or time to run himself or herself. However, Trugman nearly doubled the officer compensation, accounting for a significant increase in this category of expense and raising the compensation for three officials: Chief Executive Officer, Chief Operating Officer, and Chief Financial Officer. While Trugman claims that the compensation levels he fixed are consistent with the levels in other companies, he did not identify the other companies as also being pass-through entities and, further, did not opine as to whether JGJ needed a CEO, a COO, and a CFO.

Trugman proceeded to use his normalized results to project future financial results. Since JGJ did not have a five-year forecast, Trugman constructed a model, based on

all but 8 of the existing clubs.[2] He gave greater weight to the performance of more recent clubs, since those were opened in a more competitive environment and their results were more indicative of how future clubs would be likely to perform.

Trugman adjusted his net income forecasts to eliminate depreciation (a non-cash item), to incorporate anticipated capital expenditures, and to adjust for changes in working capital needs as the business expands. Trugman calculated a terminal value by growing the last year's forecast net free cash flow by a long-term stabilized growth rate of 2.5%. In doing this, he tax-affected future earnings. Even though JGJ is a pass-through entity for tax purposes, he applied an 18.75% tax rate. (The tax aspect of Trugman's analysis will be discussed further, *infra).*

A discounted cash flow forecast must take into account the company's current financial position, the markets in which it operates, the industry at large, and the broader economy. The Court, in this regard, accepts Trugman's view that JGJ was facing increasing competition. On the other hand, as will be discussed further, *infra*, Trugman's forecast of revenue declines is far too pessimistic.

While Trugman suggests that JGJ will face increases in operating costs such as rent and wages as the local and national recovery improves, the Court believes that Trugman has overstated the level of increase and does not accept this part of his analysis. Trugman did not address the specific locations where new clubs would be developed nor did he do any specific analysis of the rents prevailing in the locations where leases on existing clubs would be expiring. The Court does agree with Trugman that the development of additional clubs requires significant capital expenditures which will increase JGJ's debt. Trugman essentially agrees with Schaeffer that it takes some time for a new club to develop membership and after a few years, membership and profitability peak.

In discounting expected cash flows to present value, Trugman developed a discount rate predicated upon the weighted average costs of capital methodology. He calculated a 20.4% cost of equity; a tax-affected cost of debt of 4.88% and arrived at a 79.8%/20.2% weighting of debt and equity, resulting in a weighted average cost of capital of 17.3%

The upshot of these calculations lead Trugman to conclude that the value of the operations of JGJ was $9,600,000 on a "non-marketable" basis. He applied a 35% discount for lack of marketability, resulting in a valuation of $6,200,000. The Court will address this aspect of Trugman's report separately *infra*. The Court will also separately address another major flaw in Trugman's report, which is the issue of the constant $10 membership fee.

The Court notes that the Court had requested, during Trugman's testimony, that he develop an alternative valuation of JGJ using the capitalization of net earnings approach.

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[2]Trugman gave reasons for the exclusion of these 8 clubs, mostly because data was not available from some clubs' inception and other clubs were opened or commenced operations too recently.

Using that approach, with his normalized net income and a system of weighting the more recent years more heavily, and his 20.4% discount rate, he developed a $13.5 million value (without discount for lack of marketability).[3] This would result in a buy-out figure to La Verghetta of $4.5 million.

C. *Other Indicia of Value*

In 2010, the parties secured life insurance which provided for a payment of $15 million to the estate of a deceased member in exchange for relinquishment of the member's interest in JGJ. The Innocentis claim that this level of insurance was not based on a valuation of JGJ but was arrived at based upon considerations as to the amount of premium that JGJ could pay and what would be sufficient protection for the family of a deceased member. La Verghetta, on the other hand, claims that the $15 million was based on the parties' assessment of what would be a fair reflection of the value of a member's interest. Moreover, the life insurance buy-out does not directly account for JGJ's debt. All parties agree that they did not spend a lot of time developing the amount of life insurance protection to be obtained. Nevertheless, it remains relevant that had La Verghetta died, as opposed to being bought out, his estate would have received $15 million. A $15 million life insurance buy-out per member would imply a $45 million enterprise value.

On the other hand, in the Operating Agreement, the parties established a separate formula for a buyout in the event of disability. JGJ would pay for the shares of the disabled member, with the disabled member's share of debt to be deducted from the overall value. Under the formula, the value of the disabled member's share was set at 2.25x JGJ's trailing twelve-month GAAP EBITDA (less the debt), payable over 20 years, without interest. As of June 2014, JGJ's trailing twelve-month GAAP EBITDA was $11,295,936 and the debt was $28,744,432, yielding a negative number. Thus, under the formula that the parties had agreed to, had La Verghetta become disabled, as opposed to being bought out, he would have received nothing on account of his interest in JGJ. This, too, is relevant.

Jeffrey Innocenti testified that there had been informal communications among the parties that a possible valuation formula was two to four times GAAP EBITDA. Use of two as multiple would yield a negative number, *i.e.,* there would be no value to JGJ. Use of four as a multiple would yield a value of $16,437,572B, with a value for La Verghetta's interest of $5,479,190.[4]

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[3]Trugman would invoke an $8.8 million discount for lack of marketability.

[4]Trugman also developed multiples from information available for competitors Life Time Fitness and New York Sports Club. He adjusted these downward based on size (4.01 for Life Time Fitness; 2.84 for New York Sports Club). Trugman further adjusted Life Time Fitness' multiple further downward to 3.50, asserting that, while JGJ outperformed Life Time Fitness in liquidity and turnover rations, JGJ lagged behind in profitability and leverage. Because Trugman did not provide his original unadjusted multiples, did not identify the extent of the size adjustment or the rationale for such extent, and did not detail how he arrived at .51 adjustment down from 4.01, the Court does not accept the use of these multiples as a basis for comparison.

There is nothing in Jeffrey Innocenti's testimony that indicates that the parties had any informed, educated discussions as to the appropriateness of such a formula, much less an agreement to use such a formula.

THE VALUE OF JGJ

If this were simply a battle of the experts and the Court's task was simply to decide which of the two experts was more convincing, there is no doubt that Trugman was more persuasive and credible, while Schaeffer was utterly unreliable. However, the Court perceives significant issues with Trugman's analysis and, therefore, the Court cannot simply just accept Trugman's report on the ground that it is the better of two evils.

That Trugman's valuation is much too low is revealed by the fact that his equity value for JGJ – $6.6 million – is just over half of the remaining capacity on the GE Credit facility – approximately $11 million, which Credit Facility had been increased in order to accommodate the California operation. As Trugman testified, if the credit line is fully utilized, under Trugman's value, the entire equity in the company would be depleted. It does not make economic sense that the value of the equity in the company would be so low in relation to the existing, and the additional, foreseeable, debt. Likewise, it does not make any economic sense to accept that the Franchisor, who generates its own revenue from franchise fees, royalties, and the sales of equipment, would have granted an additional large territory (California) for these principals to develop if their existing enterprise had such a questionable equity base.

A. Trugman's Analytical Flaw

In addition to the issues with the Trugman report previously referenced, there is a major analytical flaw. He reported that, historically, club revenue increased substantially in the second and third years of club operation, growth moderated in the fourth year, and then declined 8.40% in the fifth year, and then further declined in year six and thereafter by 6.63% and 10.43%, respectively. Therefore, in his model, for the year 2015, he baked in a10% decline in revenue and 1% decline for each year thereafter. But he acknowledged that he reduced the level of decline from 10% to 1% because otherwise he was projecting that the clubs would go out of business. Thus, after projecting a 10% decline in 2015, he builds in a 9% decline for the ensuring year. But, then after five years of declines, he replaced the declines with a 2 ½% growth rate. He explained as follows:

> Again, it wasn't a ten percent decline per year overall. It started off as a ten percent based on management's experience.
>
> I then reduced the decline by one percent per year to eventually cut it off and after the fifth year of the declines, I then kept it in the terminal period at a two and a half percent constant growth rate.
>
> So I brought it back so that the company would at least be keeping up with the rate of inflation because, theoretically, they shouldn't

continue to decline or they should shut down the clubs.

The Court perceives that Trugman added a level of revenue growth arbitrarily as he did not provide any rationale for why revenue would grow again after years of significant decline. It appears he developed a roller-coaster model, with a major drop, followed by lesser drops and then a slight hill. As Trugman acknowledged, he had to adjust his model since taking it out into perpetuity would not make sense. "I cut it off intentionally because it wouldn't make sense to have negative growth until every one of these clubs went out of business at some point in time."

Revenue at JGJ is driven by two primary, if not exclusive, factors: the number of members and the amount of membership fees paid by each member.

As to the latter, the membership fees are set by the Franchisor which had not increased them for ten years. Thus, Trugman was projecting increasing expenses but, if membership remained constant, revenue would be stagnant and profitability would erode. As he acknowledged, his model accounted for rising expenses but not for any rising fees. While it would be purely speculative to assume that membership fees would be increased, it is highly problematic and unfair to assume that the fees would stay constant for years, though expenses continually increase. Since Trugman did not claim that the constancy of the membership fees would attract more members, keeping the fees frozen for years more would clearly be a recipe for disaster. Trugman suggested, in response to questions from the Court, that freezing the fees might be part of a predatory effort by the Franchisor to swoop in and buy back the franchises at low prices:

THE COURT: I can understand your saying it doesn't make economic sense to assume that these companies would run into the ground, but as we also discussed previously, it doesn't make economic sense to assume that the franchisor would be so adherent to a – to its pricing, that it would run its franchisee into the ground, particularly if one of the ways it makes its money is by selling equipment.

Or, even if you were going to assume that, I don't know why you wouldn't assume that at some point this becomes an incredible deal for the membership because anybody who can get something for $10 a month in 2020, that they could get for $10 a month in 2009, that would be a pretty good deal.

[TRUGMAN]: It is a good deal for not only the members, but also for the franchisor who is collecting royalties and selling equipment.

THE COURT: Not if the effect is to drive these companies into the ground.

[TRUGMAN]: Which then they have the right to buy under the franchise agreement.

THE COURT: At a really low price.

And what is it going to do for all their other franchisees, not to mention the prospect that they would have serious legal problems with doing that because this sounds suspiciously like predatory pricing.

You know, that's the classic monopoly; you keep everything so low as to drive out all the competition and then you run the whole show.

And its's great if you can do that on the backs of your franchisees, doesn't even cost you any money then.

That's why I'm not sure that this makes any sense.

[TRUGMAN]: I can't argue with your Honor's opinion.

(Trial Transcript at 787-788).

The Innocentis were firm in their testimony that they would not sell their interests in JGJ or JGJg at any price, even the price sought by La Verghetta, which would be economically suicidal if their operations were on a perpetual downward trajectory. Indeed, it would be irrational for the Innocentis to go further into debt to develop California franchises in the face of a perpetually frozen membership fee.

While the Court cannot assume that membership fees will go up, it can and must conclude that the Innocentis, as management, do not anticipate the degree of revenue decline that Trugman is forecasting. If they did, it would make no sense for them to continue to hold on to their New York interests, which they have insisted that they will do, even declining to sell out at Schaeffer's inflated number, much less incur substantial debt to build out California.

B. *The Tax Impacting*

Another issue that arises is that Trugman applied a discount to JGJ's anticipated future earnings on the basis of an assumed future tax burden of 18.5%. JGJ is a pass-through entity for tax purposes, meaning that JGJ does not itself pay any income taxes and, instead, any gain or loss is passed through to the owners of the entity, who pay taxes as

individuals. There are significant advantages and disadvantages to being a pass-through entity. The traditional C corporation pays taxes on its income and which reduces the amount available to pay dividends or salary to officer/shareholders, who then have to pay taxes on that income. With a pass-through entity, the company pays no income taxes so that category of expense is eliminated. On the other hand, an owner of a pass-through entity becomes personally liable for taxes on income of the entity, regardless of whether the owner actually receives the money. But, this too has advantages in that, if distributions are not made, the owner's tax basis is increased which leads to a reduction in capital gains when the interest in the entity is sold.

Trugman testified that he believed it was appropriate to impose an 18.5% tax rate at the entity level, on the theory that a buyer of the company would want to build into a cash flow projection what the taxes are that they would most likely going to pay. This rate was arrived at by an adjustment to account for the avoidance of the double taxation experienced by a traditional C corporation.

Trugman, in his report, acknowledged that this was an issue that until recently received little attention. The argument is that members of a pass-through entity have the incentive to pay themselves distributions in an amount equal to their estimated tax obligation, which may create an appearance that the investment has excellent liquidity. Therefore, it is argued, true return on investment can only be measured after taxes are considered. On the other hand, Trugman also concedes: "[p]ersonal tax rates may vary depending on many factors that have nothing to do with the investment. A valuation analyst cannot be expected to consider items such as personal exemptions and itemized deductions." Moreover, whether an owner may wish to receive distributions to pay taxes may be dependent on a number of factors, such as the amount of other income or loss that the owner may have in a given year, the amount of income or loss that the owner's spouse may be reporting, assuming a joint return, and the owner's spending/saving during the course of the year.

Trugman's own lack of familiarity with tax issues is revealed by his determination, in developing an 18.75% tax discount, to estimate personal and city taxes "at 10.85 percent based on New York State and City taxes effective at the valuation date". But neither La Verghetta nor the Innocentis reside in New York City; all are Westchester residents.[5] Hence, they do not pay New York City income tax. It would be purely speculative as to whether a hypothetical buyer would pay New York City taxes or even New York State taxes.

By building in a fictional entity-level tax, Trugman was unduly focusing on the buyer's side of the equation and effectively ignored the seller's side. Accepting, for argument's sake, that a buyer would want to know the after-tax income stream they are buying, a seller would also want to tax-impact his/her/its side of the transaction. A buy-out of La Verghetta's interest is a taxable event to him, with the proceeds being taxed as ordinary income, rather than as a capital gain. In effect, La Verghetta would be double-taxed, once by way of Trugman's 18.5% discount at the entity level and then again at his personal level at tax rates

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[5]James Innocenti testified he resides in Mount Kisco and Jeffrey Innocenti testified that he resides in Bedford Hills. La Verghetta resides in Eastchester.

of 35% or 20% federally and 10.85% state and local (the rates used by Trugman). If it is fair to consider the buyer's perspective on the transaction, it is fair to give like consideration of the seller's side.

Additionally, while Schaeffer was not a reliable valuator, he is a knowledgeable tax attorney. He points out the Innocentis could make an election under Section 754 of the Internal Revenue Code to allow themselves to step up the basis of JGJ's assets and to deduct, over time, the cost of the buy-out. This would result in significant individual tax savings to them and to the extent that doing so brings them below the 18.75% discount taken by Trugman, give them a windfall at La Verghetta's expense.

The Court asked Trugman to compute what the results would be without the 18.75% discount and he did so. He reported that, if taxes are removed from the cash flow, the market value would be $55,041,633 and, after accounting for debt of $28,928,696, the market value of the equity would be $26,112,937 (without a minority discount), of which a one-third share would be $8,704,312.33.

C. *Discounting for Lack of Marketability*

Trugman was also of the view that the equity value of JGJ should be reduced by a 35% discount for lack of marketability. But examination of his report indicates that only a portion of this suggested discount is related to marketability and much of it is related to a tax issue.

Trugman points to a number of provisions in the franchise agreements which are very favorable to the Franchisor and which, Trugman says, would detract from the marketability of JGJ. The most salient provisions, from the Court's perspective, are those which require that a transfer of ownership must be approved by the Franchisor and that the Franchisor be given the right of first refusal on a sale of a franchise. The Court is not persuaded that the other provisions cited by Trugman are of any real import.[6] The Court agrees, however, that a potential buyer could well be inhibited from putting the time and money in to investigate, negotiate, and perform due diligence with respect to a purchase of JGJ by the fact that the Franchisor could swoop in and match the deal.

However, Trugman also included as part of his "marketability" discount consideration of a potential tax liability to the sellers. Trugman states that the owners of JGJ have taken advantage of favorable cash flow resulting from the accounting treatment of deferred rent. While paying lower rent, the owners have recognized a greater expense for accounting purposes, thus reducing the profit passed through to them and lowering their taxes. He states that this will not continue into the future and the remaining owners will experience the reversing of timing differences of the accounting treatment with less favorable

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[6]For example, while Trugman points to provisions requiring the owners from competing with Franchisor for two years after expiration of the agreements, these provisions are personal to the sellers and have no apparent impact on the ability of the sellers to market their franchises for sale.

future tax treatment. Trugman does not explain in narrative fashion in his report why or when the favorable tax treatment ends. His chart suggests that the unfavorable treatment would not really begin in earnest until October 2016 and would accelerate and continue for the next 30 years.

Apart from Trugman's failure to adequately explain when the unfavorable tax treatment would begin, and his acknowledgment that tax rates will likely change before 2036, this tax issue is not, in this Court's view, truly an impediment to marketability. While it may present the principals with a tax liability, it does not inhibit them from selling. As Trugman states, a discount for lack of marketability may be considered where there interest being sold is illiquid, that is, is not capable of being readily sold, as with publicly traded stock. Such a discount may be considered as well where the ownership interests have legal or contractual restrictions placed upon them. While a right of first refusal, or right of approval, falls into that category, a potential tax liability does not, any more than the prospect that the owners would face a capital gains tax on a profit they make on sale is an impediment to a sale.

The lack of marketability discount proposed by Trugman is 35%, a discount which he concedes is "towards the high end", which he justifies "in light of the assumed holding period of [JGJ] imposed by the restrictions on sale and transfer" as well as by the "large detriment due to the tax implications of the deferred rent liabilities." While Trugman refers in his report to Securities Rule 144 (17 CFR 230:144) which imposes a two year holding period on the sale of unregistered securities, there is no indications that the interests in JGJ are subject to any holding period or that any such holding period would not be met. Trugman only "assumed" that there was such a holding period.

D. *JGJ Valuation Conclusion*

The Court declines to impose 35% discount for lack of marketability on the ground that the Court does not accept that two of the three reasons given by Trugman for such a discount have any factual validity: the deferred tax issue and the assumed holding period. While the Court would have given consideration to an entity-level discount for lack of marketability based upon the transfer restrictions imposed by the Franchisor, Trugman does not provide a basis for calculating the appropriate amount of the discount. Stated differently, Trugman does not set forth how much discounting would be appropriate solely by reason of the transfer restrictions. Indeed, he testified that he did not even attempt to quantify such a discount. Since Defendants seek to impose such a discount, their failure to establish what the appropriate level of discount would be results in the discounting of the discount. Trugman's effort to maximize Defendants' position by a "high-end" discount is thus not persuasive.

Moreover, even if the Court could determine an appropriate discount level, the Court would nevertheless conclude that no discount for lack of marketability is appropriate in this situation. No New York appellate court has ever held that a lack of marketability discount is mandatory (*Zelouf Intl. Corp. v Zelouf*, 47 Misc 3d 346, 350 [Sup Ct, NY County 2014]). In this case, the parties have agreed that the best means for resolving the disputes between La Verghetta and the Innocentis is to have JGJ buy out La Verghetta's interest for fair value. In exchange for that buy-out, La Verghetta agreed to give up his claims based upon, *inter alia*, breach of fiduciary duty and conversion, and Defendants agreed to give up their

counterclaims. The construct is that La Verghetta will receive his fair value and the Innocentis can move on with JGJ free of him. The Innocentis made clear in their testimony that they did not intend to sell JGJ and that no amount of money would tempt them to do so. Thus, while they correctly contend that Schaeffer's valuation for JGJ and JGJg is widely inflated, they refuse to sell at Schaeffer's value.

Consequently, the imposition of a lack of marketability discount would be inappropriate in this context. As the Court observed in a similar context in *Zelouf*, since the Innocentis are not likely to sell JGJ, La Verghetta should not recover less due to possible illiquidity costs in the event of a sale that is not likely to occur. While La Verghetta was not compelled to stipulate to sell, he will be obligated to sell at the price fixed by the Court. Hence, applying a discount for lack of marketability would be the economic equivalent of imposing an impermissible minority discount—that is, La Verghetta will realizing less for his interest while the Innocentis get to realize their full value by staying in control. (*Zelouf*, 47 Misc 3d at 350-351).

For similar reasons, the Court does not accept the tax-impacting that Trugman imposed in calculating JGJ's future earnings. There is no New York appellate authority for such tax impacting. The only New York case on the subject cited by the parties is *Ferolito v Arizona Beverages USA LLC* (2014 NY Slip Op 32830 [U]). But in that case both experts agreed that, in the extent of the valuation of that business, tax-impacting was appropriate. All that the trial court was required to decide was the applicable tax rate.

There is considerable debate in tax and sister state case law as to whether tax impacting is appropriate in the valuation of pass-through entities (*see, e.g., Estate of Gallagher v Commr.*, 101 TCM [CCH]1702 [2011]); *Gross v Commr.*,78 TCM [CCH] 201 [1999], *affd* 272 F3d 333 [6th Cir 2001], *cert denied* 537 US 827 [2002]; *Delaware Open MRI Radiology Assocs., P.A. v Kessler*, 898 A2d 290 [Del Ch 2006]; *Bernier v Bernier*, 449 Mass 774 [2007]). The Delaware court has expressed its concern that to ignore personal taxes would overestimate the value of an S corporation and would lead to a value that no rational investor would be willing to pay. In *Delaware Open MRI*, the Delaware court held: "This is a simple premise—no one should be willing to pay for more than the value of what will actually end up in her pocket" (898 A2d at 329). On the other hand, as the Court of Appeals of Minnesota has pointed out in *Hamelink v Hamelink* (2013 WL 6839700 [2013]):

> Husband argues that ignoring the economic reality that an S corporation owner will pay personal taxes on corporate profits leads to an overvaluation because an investor would purchase the corporation with after-tax funds and would account for personal tax liability in the valuation. But, for the valuation of C corporations, the practice of ignoring the effect of personal tax liability "has been generally accepted by the courts, the IRS and the valuation profession for decades." Keith F. Sellers & Nancy J. Fannon, Valuation of Pass–Through Entities: Looking at the Bigger Picture 2 (2011). Therefore, we do not find it unreasonable to employ the same practice for the valuation of S corporations in a hypothetical transaction. Whether to do so is for the experts to explain, the

parties to prove, and the district courts to decide (*Hamelink* at *6).

In this context, the Court again relies upon cogent observations made by Justice Shirley Kornreich in *Zelouf, supra*:

> This court's understanding of the applicable precedent is that, while many corporate valuation principles ought to guide this court's analysis, this court's role is not to blithely apply formalistic and buzzwordy principles so the resulting valuation is cloaked with an air of financial professionalism. (*Cf. Agranoff*, 791 A2d at 896 ["Although valuation exercises are highly dependent on mathematics, the use of math should not obscure the necessarily more subjective exercise in judgment that a valuation exercise requires"].) To be sure, sound valuation principles ought to be and indeed were utilized in computing the Company's value .... Nonetheless, the gravamen of the court's valuation is fairness, a notion that is undefined, making it a classic question of fact for the court. Fairness, in this court's view, necessarily requires contextualizing the applicable valuation principles to the actual company being valued, as opposed to merely deciding a priori, and in a vacuum, that certain adjustments must be part of the court's calculus (47 Misc 3d at 354-355).

This Court is of the view, as previously noted, that Trugman substantially understated the future income, principally by the use of a model that predicts declines to the point that gyms would close, which result is avoided by Trugman solely through the artifice of a revenue increase in later years for which there is no rationale, other than it was necessary to avoid the result that the gyms would be out of business. During the course of Trugman's cross-examination, the Court inquired of him whether it would be possible to calculate what the future income stream would be on the basis of an alternative hypothesis – no revenue declines or increases over the future years. Trugman testified that he could not do so without substantial further work and the Court's inquiry was not addressed. However, Trugman was able to provide the Court with the calculation as to the result without tax impacting.

It would be fundamentally unfair to require La Verghetta to accept a buy-out on the basis of an artificially low future income stream, which low income stream is further reduced by an 18.75% discount for future personal taxes. Having heard the witnesses, having considered the expert reports and testimony, and having also heard the evidence as to other valuation efforts, the Court is of the view that Trugman's value of $6.6 million for JGJ is far too low and the use of such a low value would be fundamentally unfair. On the other hand, adjusting Trugman's calculation by eliminating the 18.75% tax discount results in a $26,112,937 valuation for JGJ which, to the Court's view, offsets the understatement of the value of the future revenue stream.

Had Trugman not so significantly underreported the future earnings of JGJ,

perhaps tax impacting would have been appropriate[7]. But since the Court has no present means of correcting for the undercounting of future revenue than to eliminate the tax impacting, the Court believes that fairness requires that it do so rather than apply a formalistic adjustment for taxes.

To value JGJ, the Court will take Trugman's non-tax impacted value of JGJ and add to it consideration of the $180,000 paid by JGJ for the California opportunity and the $180,000 paid to the Franchisor and the $28,282 cash on hand provided to JGJg.

Thus, the Court arrives at a fair value of JGJ of $26,400,000. La Verghetta's share thereof is 1/3 or $8,800,000. At trial, it was shown that JGJ is entitled to a credit of $141,091.64 for payments made to La Verghetta, or on his behalf, since the Valuation Date.[8]

It remains to now consider the reasonable terms and conditions upon which JGJ would acquire La Verghetta's interest.

REASONABLE TERMS AND CONDITIONS

A. *Relevant Background*

As of the Valuation Date, there was $16.4 million cash on hand and, as of September 21, 2015, the cash on hand was $6 million. As of July, 2015, JGJ could only borrow $2.9 million on the GE Credit Facility because of a decrease in the EBITDA formula that governs that Facility. Further, JGJ is required to maintain $4 million cash on hand under the agreement with GE. JGJ is permitted to borrow only $500,000 outside of the GE Credit Facility and, if such borrowing occurs, it reduces the amount that can be borrowed from GE dollar for dollar.

Defendants seek to continue to draw down the GE Credit facility in order to develop and maintain the New York business as well as to develop the nascent California business. They contend that, absent such borrowings, JGJ and JGJg will not be able to meet their lease, franchise, and area development agreement obligations. Plaintiff, on the other hand, maintains that Defendants have already had the use of his share of the enterprise for many months and have been able to use his funds to litigate against him and to develop businesses in which he will not share. He also argues that he should not be exposed to the risk of a future downturn while being deprived of the benefit of any future upside.

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[7]But the Court would not have allowed a discount relating to New York City taxes since none of the parties reside there and, perhaps, not for New York taxes either, since it is purely a matter of speculation whether a hypothetical buyer would be a person from New York.

[8]Pursuant to the So-Ordered Stipulation, JGJ is entitled to credit for salary and COBRA payments made thereafter (50% through June 10, 2015 and 100% thereafter).

Additionally, during several court conferences, counsel and the Court agreed that the So-Ordered Stipulation does not require JGJ and JGJg to buy out La Verghetta's interest; it essentially gives them the option to do that. Further, the Innocentis have not personally guaranteed the buy-out. And La Verghetta continues to have liability under personal guaranties of JGJ and JGJg debt, which debt continues to grow.

During the trial, and thereafter, the Court expressed the view that it was fundamentally unfair for Defendants to utilize JGJ's assets (including its borrowing capacity) to support their California operation, from which La Verghetta was to be excluded. As the Court expressed to defense counsel on November 25, 2015: "you're not going to run up more debt to make the buyout impossible". On that date, the Court specifically directed that the company's assets not be further pledged to support the California operation. The Court remarked again on December 1, 2015: "it doesn't seem very fair to me for your folks, and it never has, to allow your folks to bleed the hell out of New York while depriving him of any interest in California. That doesn't make any sense. If they want to go ahead, buy him out". The Court made clear that Defendants could not detour around the restraint by having JGJ draw down on the credit facility and turn the money over to JGJg. The Court, on that date, allowed Defendants relief from this restraint upon the posting of a $5 million undertaking.

Defendants formally moved to modify the injunction, which motion was resolved by a stipulation dated January 8, 2016, which was "so ordered" by the Court the same day. The stipulation provides, in material part:

a) JGJ may make intercompany loans to JGJg for its ordinary and necessary business expenses, including payroll, rent, and costs to open new clubs, provided that $5 million cash or bond is posted with the Court or placed in escrow, pending further order;

b) JGJ was to provide a certificate of compliance with the injunctive order;

c) beginning January 22, 2015, Defendants were to provide a certification from JGJ's controller as to the amount and purpose of any intercompany loans between JGJ and JGJg.

The Court has not been advised as to whether the $5 million has been posted.

B. *Determination as to Reasonable Terms and Conditions*

To begin with, since Defendants have the option to pursue a buy-out or not on the terms set herein, the Court should impose a deadline by which they must notify Plaintiff as to their intention. The Court will give Defendants twenty (20) days from the date of this Decision and Order to notify Plaintiff in writing as to their determination. In the event that Defendants decline to pursue the buy-out, the parties shall forthwith contact Chambers to schedule a conference to discuss the next steps in the underlying litigation. The Court now turns to the issue of the terms of the buy-out, assuming Defendants seek to pursue it.

The principal amount of the buyout is $8,800,000. Since that valuation is as of June 11, 2014, La Verghetta is entitled to interest on that sum to date. Defendants argue that

the Court should set an "equitable" interest of 3%, tied to the true anticipated value of lost money, rather than the "artificial" statutory rate. The Court does not agree. Since the Valuation Date, La Verghetta has essentially been reduced to a bystander in organizations that he helped found. The assets of JGJ have been used to support the development of a California operation in which he has no stake of value. Defendants have used the assets of JGJ to further their own self-interests and, in doing so, have been La Verghetta's share at risk. Moreover, he remains exposed to significant personal liability. Given the nature of the risks that La Verghetta has been exposed to, and the use of his significant interests by Defendants which has had the effect of increasing his personal liability (on which interest runs at significant rate), the Court does not view the 9% statutory rate as being unfair or inequitable (*see Ferolito v Arizona Beverages USA LLC, supra*). Accordingly, the buy-out price is set at $8,800,000 with interest from June 11, 2014 at the statutory rate to the date of final payment, less the credit of $141,091.14 and any other credits to which JGJ may be entitled.[9]

It is readily apparent that JGJ, which is the perspective buyer, does not have the ability to pay the buyout in a single immediate lump sum. Since there is a balloon payment of $12.5 million due on the GE Credit Facility on November 30, 2017, it is apparent that JGJ will have to restructure its indebtedness by that time. By restructuring the debt, Defendants will able to secure Plaintiff's release from personal liability on the existing credit line. The period between now and November 30, 2017 should also afford Defendants sufficient time to secure the release of Plaintiff from any other matters upon which he has personal liability, such as the ADAs and any leases.

Therefore, the Court will direct that, if JGJ elects to pursue the buyout, JGJ shall pay the payout to Plaintiff in full (inclusive of interest) by not later that November 30, 2017. Interest shall run on the buyout at the statutory rate until the date of payment, for the same reasons as previously set forth, *i.e.*, the substantial risk to which La Verghetta is exposed, inclusive of continuing and increasing personal liability.

Assuming that JGJ elects to buy out La Verghetta, La Verghetta shall be entitled to a money judgment against JGJ and JGJg in the amount of the buy-out, with the enforcement of such judgment stayed until November 30, 2017, provided that JGJ shall pay La Verghetta on account of such money judgment: (a) $2.5 million within sixty (60) days of the date of this Decision and Order; (b) $2.5 million by November 30, 2016; (c) $2.5 million by June 30, 2017; and (d) the remaining balance by November 30, 2017. In the event that JGJ fails to make any of these payments, the judgment (less any credits for monies paid thereon) shall become immediately due and enforceable and La Verghetta may apply on one (1) days notice to Defendants for an order vacating the stay.

In addition to paying La Verghetta the buy-out, JGJ shall also secure La Verghetta's release from any and all personal guaranties that he gave for indebtedness of JGJ

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[9]In connection with the settlement of the judgment hereon, Defendants may submit evidence as to the amount, if any, of any other credits due them by affidavit (with any appropriate documentary support). Plaintiff may submit opposition to such credit. Hopefully, the parties will be able to resolve any issue by agreement.

and JGJg and any affiliated entities. Such releases of liability shall be provided to Plaintiff in writing. The buy-out shall not be considered complete unless and until both the buyout sum has been paid and the requisite releases of liability have been provided to La Verghetta.

Upon completion of the buyout, La Verghetta shall provide to JGJ any and all documents necessary to effectuate the transfer of his interests in JGJ and JGJg to JGJ or such other person or entity as JGJ shall designate in writing.

Article 7 of the Operating Agreement for JGJ provides that Major Decisions, as defined therein, must be approved by all of the Managers of JGJ. Pending completion of the buy-out, La Verghetta shall be continued (and if this has lapsed, restored and continued) as a Manager of JGJ and shall be entitled to exercise all of the rights that he has or had under the Operating Agreement as set forth therein. JGJg does not have a written operating agreement; hence, the Court directs that, pending completion of the buyout, La Verghetta shall have all rights and privileges of a member in JGJg as may be provided by law.

In order to provide clarity, and without limiting the generality of the foregoing, the following decisions or actions by JGJ, JGJg, any affiliate, or related company shall require the consent of La Verghetta prior to completion of the buy-out:

1) incurrence of any new or further debt in excess of $50,000;

2) encumbering the assets or rights of JGJ or JGJg;

3) issuance of any Interests (as defined in the JGJ Operating Agreement) or other equity interests of any kind in JGJ or JGJg or making any capital call from the Members;

4) merging or consolidating with any person or entity or acquiring all or substantially all of the assets or equity of any person or recapitalizing JGJ and/or JGJg or any affiliate or related company;

5) transferring all or substantially all of the assets of JGJ and/or JGJg or any affiliate or related company;

6) conducting an initial public offering of the interests or other equity interests of any kind in JGJ and/or JGJg or any affiliate or related company;

7) making any capital expenditure or otherwise entering into any contract that would require payments by JGJ and/or JGJg or any affiliate or related company of more than $50,000;

8) guaranteeing in the name of or on behalf of JGJ or JGJg or any affiliated or related company the payment or performance of any contract in excess of $50,000;

9) lending the funds of JGJ and/or JGJg or any affiliate or related company

to any person or entity;

10) instituting any proceedings in bankruptcy;

11) amending or terminating the Articles of Organization of JGJ, JGJg or any affiliate or related company;

12) admission of any new members to JGJ or JGJg or any affiliate or related company;

13) electing, appointing, or terminating the Articles of Organization of JGJ, JGJg or any affiliate or related company;

14) admission of new members to JGJ, JGJg or any affiliate or related company;

15) electing, appointing, or terminating the employment of the general counsel, comptroller, regional manager, human resources administrator or billing manager of JGJ, JGJg or any affiliate or related company;

16) making any dividends or distributions to any member of JGJ or JGJg or any affiliate or related company;

17) the adoption of the annual operating budget and annual capital budget for JGJ or JGJg or any affiliate or related company;

18) taking any action or entering into any agreement in furtherance of the foregoing.

In addition, La Verghetta's consent shall be required to increase the salary or benefits of any member (including the Innocentis and Lawlor) above the level of such salary or benefits as of January 1, 2014. La Verghetta shall have the right to inspect, examine and copy all books and records of JGJ, JGJg and any affiliate or related company, upon reasonable notice, as well as such rights of inspection as may be provided in the JGJ Operating Agreement or by applicable law.

The Court recognizes that the parties, in the So-Ordered Stipulation, had limited La Verghetta's exercise of his membership rights. It was by reason of this limitation that the Court determined it was appropriate to grant injunctive relief against the incurrence of additional debt by JGJ. Rather than continue to provide for injunctive relief, the Court deems it appropriate to require that, pending a buy-out, the parties continue to regard La Verghetta as a member. Indeed, until the buy-out is completed, he is a member. As such, he should be able to exercise the rights that the parties themselves agreed the members should have, as set forth in the Operating Agreement and applicable law. If Defendants find that uncomfortable or inconvenient, they may complete the buy-out. And, if Defendants elect not to purse the buy-out, La Verghetta is entitled to be restored to his full membership status.

CONCLUSION

The foregoing constitutes the Court's findings of fact and conclusions of law for purposes of CPLR 4213(b).

Settle judgment on notice.

Dated: White Plains, New York
March 9, 2016

ENTER:

Alan D. Scheinkman
Justice of the Supreme Court

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