NOT FOR PUBLICATION WITHOUT THE
APPROVAL OF THE APPELLATE DIVISION

SUPERIOR COURT OF NEW JERSEY
APPELLATE DIVISION
DOCKET NO. A-3600-09T3

MICHAEL GAINES, Individually and
as a Shareholder of Gaines,
Goldenfarb and Luongo, LLC,

Plaintiff-Appellant,

v.

JOHN LUONGO, Individually and
as a Shareholder of Gaines,
Goldenfarb and Luongo, LLC,

Defendant-Respondent.

Submitted March 1, 2011 - Decided March 25, 2011

Before Judges Parrillo, Yannotti and Espinosa.

On appeal from Superior Court of New Jersey, Chancery Division, Middlesex County, Docket No. C-276-08.

Tobia & Sorger, LLC, attorneys for appellant (Ronald L. Tobia and Jill Tobia Sorger, on the brief).

Harwood Lloyd, LLC, attorneys for respondent (Michael B. Oropollo, of counsel and on the brief).

PER CURIAM

In this oppressed minority shareholder litigation, N.J.S.A. 14A:12-7, involving dissolution of a limited liability partnership, plaintiff, Michael Gaines, appeals from a February 22, 2010 order of the General Equity Part refusing to: (1)

enforce a restrictive covenant against defendant, John Luongo; and (2) include clients as "assets" subject to distribution upon dissolution. We affirm.

Some background is in order. In 1997, Gaines began working with accountant Gerald Goldenfarb until 2003 when Gaines effectuated a buyout of Goldenfarb's business for approximately $500,000 paid to Goldenfarb over a five year period (the Goldenfarb Note). In August 2004, Luongo left his position as principal at Schonbraun, Safris, McCann, Bekritsky & Co., LLC (Schonbraun), to join Gaines in forming Gaines, Goldenfarb and Luongo, LLC (GGL, the Company, or the Partnership) an accounting firm governed by the New Jersey Limited Liability Company Act, N.J.S.A. 42:2B-1 to -70 (LLCA or the Act). Gaines and Luongo formalized this entity in an Operating Agreement executed in October 2004. While the Operating Agreement provided Gaines with seventy percent ownership in the entity and Luongo with thirty percent ownership, the two would share profits, losses and net cash flow equally.

The Operating Agreement provided that dissolution would be triggered by certain events, including the parties' unanimous agreement to dissolve the Company, the bankruptcy of GGL, or other events making it "impossible, unlawful or impractical" to carry on the business:

8.1 Events Triggering Dissolution. The Company shall dissolve and commence winding up and liquidating upon the first to occur of any of the following ("Liquidating Events"):

(a) the unanimous agreement of all of the Members that the Company should be dissolved;

(b) the insolvency or bankruptcy of the Company;

(c) the sale of all or substantially all of the Company's assets; or

(d) ninety (90) days after the date of any act that causes the Company to have less than the minimum number of members required under the Act . . . ; or

(e) any event that makes it impossible, unlawful or impractical to carry on the business of the Company.

The Members agree that the Company shall not be dissolved or liquidated prior to the occurrence of a Liquidating Event, as set forth in this Article 8.

[(emphasis added).]

Initially, the parties worked only on Gaines's and Goldenfarb's clients because Luongo was obligated under a two year restrictive covenant with Schonbraun. Luongo did, however, refer a substantial client, USLR, to Gaines. In this regard, the Operating Agreement, in Section 10.3, contained a restrictive covenant prohibiting Luongo, upon termination, from

competing with GGL for one year and within a ten mile radius and from soliciting GGL's clients or employees. If, for instance, Luongo left GGL and retained any of Goldenfarb's former clients, he would be responsible for a proportionate share of the Goldenfarb Note.

Within a few years of forming GGL, the relationship between the partners began to deteriorate. This much is undisputed. The parties, however, disagree over how and why the process of dissolution occurred.

Luongo claims that the parties mutually agreed to dissolve, and amicably did so, until a dispute regarding telephone call forwarding and use of the GGL website. According to Luongo, starting in late 2007 and early 2008, he exchanged memos and letters, and engaged in discussions with Gaines on a potential reworking of the Partnership. To this end, Luongo drafted an Amended and Restated Operating Agreement in January 2008; however, the document was never signed by the parties. Apparently, the inability of all of the parties, including Spencer Tucker, a non-equity partner of GGL, to reach an accord on a client fee splitting arrangement rendered GGL's dissolution all but inevitable.

According to Luongo, on August 13, 2008, he and Gaines agreed to dissolve GGL. Spencer Tucker confirmed that Gaines

told him he was leaving GGL. Gaines arranged for new office premises, advising that he was vacating the current location by October 1, 2008. Consequently, on August 27, 2008, Luongo established a new firm, Luongo, Tucker & Associates, LLC, with Tucker. Luongo claims that he and Gaines mutually agreed to retain their own clients. They also agreed, during the months of September and October 2008, on the allocation of furniture, computer equipment and personnel, and for Luongo to assume the lease of the existing office space.

Gaines offers a conflicting version. He denies ever telling Luongo that he wanted to dissolve GGL. Instead, Luongo, without discussing dissolution, formed a new company with Tucker and began taking GGL clients in violation of the Operating Agreement. Gaines, on the other hand, made every effort to continue operating GGL, billing clients and depositing customer payments into the GGL operating account. Meanwhile, however, Luongo "cleaned out" the jointly maintained account by cashing checks totaling more than $20,000 without Gaines's knowledge or approval, resulting in returned checks for insufficient funds. These actions forced Gaines to arrange for new office premises, only then to have Luongo refuse to allow him access to GGL business records and computer data, including Gaines's client files. According to Gaines, Luongo's actions made it

"impossible, unlawful or impractical to carry on the business of the Company" under Section 8.1(e), requiring dissolution and liquidation.

During that time, namely September and October 2008, Gaines never sought to enforce any of the provisions of Article 10 of the Operating Agreement, including 10.3, the restrictive covenant, or 10.4, termination of Luongo's membership interest. In fact, Gaines did not provide any notice of the exercise of his purchase rights triggered by Luongo's so-called termination as required by paragraph (i) of Section 10.4. During this time, Gaines continued to pay the amount due on the Goldenfarb Note to Goldenfarb, as Gaines had retained seventy-two percent of Goldenfarb's former clients with the exception of one client, which neither party retained.

On December 1, 2008, Gaines filed a complaint against Luongo in the General Equity Part, asserting a cause of action as an oppressed minority shareholder under N.J.S.A. 14A:2-7. Gaines's complaint sought injunctive relief enjoining Luongo from blocking transfer of telephone lines, altering the Company's website, prohibiting access to client files, and spending the Company's money; appointment of a fiscal manager to render an accounting and assist in dissolution; an order determining fair value of GGL shares and including clients as

assets to be distributed; an order dissolving GGL and enforcing the restrictive covenant against Luongo; and compensatory damages. Following Luongo's answer and counterclaim, the judge, on Gaines's motion, bifurcated the bench trial, with the first phase focusing on the issue of dissolution and the second phase determining the remaining issues of winding up company operations and distribution of GGL's assets.

At the conclusion of the first phase, the judge determined that the parties mutually agreed to dissolve GGL and because the Company ceased to exist, the Operating Agreement's restrictive covenant no longer applied to Luongo. As to the former, the court found that "there has been a 'happening of events specified in the Operating Agreement' under paragraph b. That is, both parties have agreed to dissolution of the Company. This is the unanimous consent of the Members, as contemplated by various Agreements." In this regard, the court specifically found:

> Gaines had unimpeded access to everything in the office, which included the computer system, computer programs and services, client files, phones and fixed assets of the Company until November 7, 2008 when the locks were changed, a week after Gaines had moved out. Gaines moved out over the weekend of November 1, 2008 and could have taken anything he wanted. It was his decision to leave the remaining assets.
>
> . . . .

The fundamental question for this Court to decide is whether this "separation" was an agreed to dissolution of [GGL], or whether as Mr. Gaines contends, a "take over" by Messrs. Luongo and Tucker. The Court finds that Mr. Gaines' actions are consistent with him agreeing to the dissolution of [GGL]. He testified that by the middle of August 2008, he was aware that Luongo and Tucker were joining forces. Gaines moved to Woodbridge, he kept the [GGL] phone number. He took "his files" and Luongo kept "his files". It was not until December 1, 2008 that this action was instituted by Mr. Gaines. If this was a "take over" as Mr. Gaines contends, he would have and should have been before this Court in August, or certainly by September, 2008.

The Court finds the testimony of Mr. Tucker to be credible. Mr. Tucker testified that within a couple days after August 13, 2008, he spoke to Mr. Gaines and said "I understand you are leaving," and Mr. Gaines said "yes, probably by no later than August 1st or stated yes, by October 1st or sooner."

The Court finds the most "credible" evidence is: (1) [the 2004 Operating Agreement], the only signed document that at least one party seeks to enforce; (2) the testimony of Mr. Tucker; and (3) the conduct of the parties, particularly Mr. Gaines, all of which are consistent with an agreed dissolution.

. . . .

. . . The preponderance of the credible evidence adduced at trial establishes that a unanimous dissolution was agreed to by the parties.

Having found that the Operating Agreement executed in 2004 controlled, and that the parties mutually agreed to dissolve GGL in accordance therewith, the court then determined that the restrictive covenant provision no longer applied to Luongo:

> [GGL] ceased to exist. Gaines went his direction and formed his own company, and Luongo went his direction and formed his own company. Therefore, the restrictive covenant is inapplicable — there being no competition with [GGL]. Even if the restrictive covenant had application, this Court finds [it] consistent with [the law] that the covenant is unenforceable as written.
>
> In sum, this Court finds that the parties agreed to part company and to dissolve [GGL], and that [the 2004 Operating Agreement] controls the various rights and obligations with respect to the dissolution. The Court finds that as a result of the dissolution of [GGL], Luongo is not restricted from "competing" since [GGL] has ceased to operate.

The second phase of the trial concentrated on the dissolution of partnership assets, in particular whether "clients" of GGL are "assets" to be revalued pursuant to Section 8.4 of the Operating Agreement, which provides:

> 8.4. <u>Revaluation.</u> <u>If the Company's assets are not sold, but instead are distributed in kind, such assets, for purposes of determining the amount to be distributed to the parties, shall be revalued on the Company books to reflect their then current fair market value</u> as of a date reasonably close to the date of liquidation. Any unrealized appreciation or

depreciation shall be allocated among the Members (in accordance with the provisions of Article 3 [Allocation Of Profits And Losses] as if such assets were sold at such fair market value) and taken into account in determining the Capital Accounts of the Members as of the date of liquidation.

[(emphasis added).]

In this regard, the following testimony was elicited at trial:

[GAINES]: [T]he way it typically works, [Luongo] has his set of clients that he deals with and communicates on a daily, weekly, monthly basis as I do. I know for a fact I never contacted any of [Luongo's] clients out of respect and I believe he never contacted any of mine.

THE COURT: Okay. So what you're saying is there were clients that you were working on. They looked upon you as their accountants.

[GAINES]: They only knew me.

THE COURT: There were clients that only knew Mr. Luongo and the two of you as far as you can best determine after you separated, neither of you invaded that territory so to speak.

[GAINES]: No. Exactly, yes. We did not invade it.

. . . .

THE COURT: But of the universe of clients at the time of separation, some of them contacted you when they needed accounting work or regular clients where you were doing quarterly statements on the like [sic].

[GAINES]: Sure.

> THE COURT: Some of them contacted Mr. Luongo and after the separation, those that you were responsible for and did work for went to you and those that Mr. Luongo was responsible for and did work for went to him.
>
> [GAINES]: Yes. That's just common practice in our business. You know, I wouldn't even know, you know, some of his clients, nor would he know mine. And I know for a fact I would have heard from my clients if he contacted any and I'm sure he would have heard if I contacted them. We didn't do that.

Additionally, Luongo testified that he did not consider clients as assets of GGL and that Gaines took his clients upon dissolution.

Based on the testimony and the plain language of Section 8.4, the court determined that "clients" were not "assets" and, therefore, were not to be revalued and distributed upon dissolution:

> The plain language of Section 8.4 indicates that the first place to look is "the company books" to determine what value if any was placed on clients on the company's books. The "value on the company books" is to be "revalued" as of a date reasonably close to the date of liquidation. <u>It is absolutely clear that "the company books" did not carry "clients" as an asset</u>, i.e., no value was assigned to clients on "the company books". The balance sheets contained in the Federal and State Tax Returns filed by GGL did not assign any value whatsoever to clients. The parties in the Operating Agreement specifically dealt with "clients" as clients

> and not as "assets". See Article 10 of the Operating Agreement.
>
> [(emphasis added).]

Moreover, the court determined that an in-kind distribution was inconsistent with the nature of professional clients, whose value is found in personal goodwill:

> A discussion of enterprise and personal goodwill is helpful to an analysis of whether a client is an asset. Fair market value assumes a hypothetical sale and looks to the value of the asset based upon what would be realized upon the sale at the valuation date. Value assigned to a client would only be paid with the expectation that the elements of value associated to the client could be transferred to another owner, as opposed to value that resides solely with the current owner. Enterprise goodwill is the goodwill of the business. In selling a business one has the ability to transfer enterprise goodwill to the buyer. Personal goodwill is goodwill that adheres to an individual. It consists of personal attributes of a practitioner including personal relationships, skill, personal reputation and various other factors. It is usually not transferrable. A useful working definition of personal goodwill is "the part of increased earning capacity that results from the reputation, knowledge and skills of an individual person and is not transferrable and unmarketable. For example, personal goodwill is that which would make a doctor's patients follow him even if he changes location, staff and phone number.
>
> The value of clients in a professional corporation is found in the personal goodwill of the particular professional. Gaines and Luongo recognized this when they

> dissolved GGL and left it up to the clients to determine who they wanted to utilize as their accountant. This Court finds that in a dissolution of GGL clients are not an asset which is to be revalued for the purposes of determining their fair market value when there is an in kind distribution. In fact, the clients were not distributed in kind. Gaines and Luongo left it up to the clients to decide who they wanted to utilize for their professional services.
>
> [(citations omitted).]

On appeal, Gaines raises the following issues:

I. THE OPERATING AGREEMENT IS NOT UMAMBIGUOUS WITH RESPECT TO THE ISSUE OF WHETHER "CLIENTS" ARE ASSETS TO BE DISTRIBUTED UPON DISSOLUTION AND, THEREFORE, EXTRINSIC EVIDENCE AS TO THE PARTIES' INTENT SHOULD HAVE BEEN CONSIDERED.

II. THE RESTRICTIVE COVENANT IN THE OPERATING AGREEMENT IS ENFORCEABLE AGAINST THE RESPONDENT.

A. THE TERMINATION OF GGL WAS NOT AN UNANIMOUSLY AGREED DISSOLUTION.

B. THE RESTRICTIVE COVENANT IS ENFORCEABLE.

C. THE RESTRICTIVE COVENANT SURVIVES DISSOLUTION.

We find these issues to be without merit, <u>Rule</u> 2:11-3(e)(1)(A) and (E), and accordingly affirm substantially for the reasons stated by Judge Ciufani in his letter opinions of August 4, 2009 and December 24, 2009. We add only the following comments.

Findings of fact "by the trial court are binding on appeal when supported by adequate, substantial, credible evidence." Cesare v. Cesare, 154 N.J. 394, 411-12 (1998); see also Rova Farms Resort, Inc. v. Investors Ins. Co. of Am., 65 N.J. 474, 483-84 (1974). "Deference is especially appropriate 'when the evidence is largely testimonial and involves questions of credibility[,]'" Cesare, supra, 154 N.J. at 412 (quoting In re Return of Weapons to J.W.D., 149 N.J. 108, 117 (1997)), because the trial court "hears the case, sees and observes the witnesses, hears them testify, and has better opportunity to judge their credibility than the reviewing court." Gallo v. Gallo, 66 N.J. Super. 1, 5 (App. Div. 1961) (citing Capozzoli v. Capozzoli, 1 N.J. 540, 543 (1949)). Thus, the trial court maintains "a better perspective than a reviewing court in evaluating the veracity of witnesses." Pascale v. Pascale, 113 N.J. 20, 33 (1988); State v. Locurto, 157 N.J. 463, 471 (1999). Consequently, an appellate court will not disturb these findings on appeal unless the trial court's findings "'are so wholly insupportable as to result in a denial of justice.'" Rova Farms, supra, 65 N.J. at 483-84 (quoting Greenfield v. Dusseault, 60 N.J. Super. 436, 444 (App. Div.), aff'd o.b. 33 N.J. 78 (1960)). And in cases of mixed findings of fact and law, the appellate court should "give deference . . . to the

supported factual findings of the trial court, but review de novo the lower court's application of any legal rules to such factual findings." State v. Harris, 181 N.J. 391, 416 (2004) (citing State v. Marshall, 148 N.J. 89, 185, cert. denied, 522 U.S. 850, 118 S. Ct. 140, 139 L. Ed. 2d 88 (1997)), cert. denied, 545 U.S. 1145, 125 S. Ct. 2973, 162 L. Ed. 2d 898 (2005); see also Manalapan Realty, L.P. v. Twp. Comm. of Manalapan, 140 N.J. 366, 378 (1995).

As to the latter, GGL is a limited liability company governed by the LLCA, which vests members of limited liability companies broad discretion to establish structure and procedures, with the Act controlling in the absence of a contrary operating agreement. Kuhn v. Tumminelli, 366 N.J. Super. 431, 440 (App. Div.), certif. denied, 180 N.J. 354 (2004); Union Cnty. Improvement Auth. v. Artaki, LLC, 392 N.J. Super. 141, 152 (App. Div. 2007). On this score, the LLCA directs dissolution upon the happening of an event specified in a limited liability company's operating agreement. N.J.S.A. 42:2B-48(b). Here, Section 8.1(a) of the Operating Agreement provides for dissolution upon "unanimous agreement" of all of the members of the Company. Thus, upon the happening of such an event, GGL must be dissolved pursuant to the Operating Agreement and the LLCA.

The record below amply supports the court's finding that the parties mutually agreed to dissolve GGL. Although Gaines and Luongo offered conflicting accounts of the events leading up to dissolution, the court credited the testimony of Tucker, who confirmed Luongo's version that breakup of the Partnership was both consensual and voluntary. Moreover, at no point prior to the filing of the instant action did Gaines provide notice of Luongo's so-called "termination" from GGL, as required by Section 10.4 of the Operating Agreement. Having found that there was a dissolution rather than a withdrawal, separation or termination of a partner, the court correctly concluded that the agreement's restrictive covenant provision had no application to the matter at hand.

The trial court also properly determined, based on the LLCA, the plain language of Section 8.4 of the Operating Agreement, and the evidence adduced, that the assets to be distributed upon dissolution of the Partnership did not include clients. Simply put, the Partnership's clients were never carried on GGL's books as an asset; no value was ever assigned to them on the Company's balance sheets; and they were free to stay in business with either partner or neither. Here again, the court's findings are supported by substantial credible

evidence. See Cesare, supra, 154 N.J. at 411-12; Rova Farms, supra, 65 N.J. at 483-84.

Affirmed.

I hereby certify that the foregoing is a true copy of the original on file in my office.

CLERK OF THE APPELLATE DIVISION