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Too Late Gets Too Little: LLC Minority Member Fails to Block Merger, Must Accept $465 Buy-Out

By Peter Mahler on October 15th, 2012

The picturesque Village of Sag Harbor, New York, located on eastern Long Island, was a major whaling port through the mid 1800s, became a blue collar industrial town for the next 100 or so years, and eventually took on its current character as a summer resort and second-home favorite of the Hamptons crowd. Part of its architectural legacy is the Bulova watchcase factory that was built in 1881, vacated in 1981, and sat crumbling for the next 30 years in large part due to environmental contamination problems that led to its designation as a Superfund cleanup site.

Thanks to a court decision earlier this month, in *Alf Naman Real Estate Advisors, LLC v. Capsag Harbor Management, LLC*, 2012 NY Slip Op 32559(U) (Sup Ct NY County Oct. 3, 2012), the Bulova watchcase factory can also lay claim to a small legal legacy in the nascent field of limited liability company (LLC) mergers.

Background

The story picks up around 2006, when a Manhattan-based developer known as Cape Advisors acquired the watchcase factory site for development as condominiums. The project stalled for about two years while the developer wrangled with Village officials over various issues which were resolved just in time for the 2008 crash of Wall Street and the real estate market. At that point the developer put the project on hold, only to reappear three years later, in mid-2011, with new financing and plans that were quickly approved by the Village. The renovation of the factory building and new construction on the site are well underway.

The litigation back-story also begins around 2006, when Cape Advisors enlisted developer Alf Naman to assist with the project. Together they formed Capnam Sag Management, LLC ("Capnam"), in which Alf Naman Real Estate Advisors, LLC ("ANRE") held a 46.56% membership interest and Cape Sag Developers, LLC ("CS Developers") held the remaining 53.44% membership interest. Capnam's operating agreement stated its purpose to act as the managing member of Cape Sag Group, LLC ("CS Group") which, in turn, is the sole member of the entity that took title to the project site. According to its complaint, ANRE made an unspecified but "significant" investment in the project by purchasing an interest in CS Group, and "protected" its investment by participating in project management through its membership in Capnam.

The Merger

On July 15, 2011, just as the project was being revived, CS Developers sent ANRE a written notice of action taken by majority consent without a meeting, for the merger of Capnam with a newly formed entity known as Capsag Harbor Management, LLC ("Capsag") with the latter as the surviving entity managed by CS Developers. The merger notice also stated that if ANRE chose to dissent from the merger it would receive in cash the fair value of its membership interest in lieu of a membership interest in Capsag, and that Capnam's value was determined to be $1,000 of which ANRE would be paid $465.60 based on its 46.56% interest.

The merger notice set forth an offer and appraisal process tracking the governing provisions of LLC Law §1005, namely, that Capsag had the option to make an offer for ANRE's membership interest within 10 days after receiving ANRE's notice of dissent; that if ANRE rejected the offer, the parties had 90 days from the notice of dissent to reach agreement on the value; and that absent such agreement the judicial appraisal procedure set forth in Business Corporation Law (BCL) §623(h), (i), (j) and (k) would be followed.

On August 4, 2011, ANRE gave CS Developers a written notice of dissent that objected to Capnam's $1,000 valuation and the proposed $465.60 payment. Eight days later, on August 12, 2011, Capsag sent ANRE a letter repeating its offer of $465.60 for ANRE's membership interest in Capnam. On November 7, 2011 (87 days later), ANRE replied with a written rejection of the offer.

Under BCL §623(h)(1), Capsag had 20 days after the expiration of the 90-day negotiation period, or until November 30, 2011, within which to commence a judicial valuation proceeding. It did not do so. This triggered ANRE's option under BCL §623(h)(2) to commence a valuation proceeding within the next 30 days, or by December 30, 2011. It did not do so.

ANRE Files Suit

On January 23, 2012, Capsag sent ANRE a notice that its right to dissent had expired and enclosed a check for $465.60. Three days later, on January 26, 2012, ANRE filed a petition seeking an appraisal and determination of the fair value of its membership interest in Capnam (read petition here). The petition alleged that CS Group is contractually obligated to pay "significant fees" to Capnam in connection with the project, including a developer's fee, a property management fee, leasing commissions, a financing fee and a project management fee, all of which gave Capnam a fair value that "materially exceeded" $1,000. The developer's fee alone, according to the petition, would be over $1.6 million.

The same day ANRE filed its petition, it also filed a separate complaint (read here) for declaratory and injunctive relief to nullify the merger on the ground it was prohibited by Section 2(c) of Capnam's operating agreement which qualified the circumstances under which, *inter alia*, a merger of the company could take place.

The Court's Decision

CS Developers and Capsag moved to dismiss both lawsuits. With respect to the appraisal proceeding, they argued that ANRE's failure to commence its appraisal proceeding within the 30-day period following the expiration of Capsag's 20-day period to file such a proceeding, required dismissal under BCL §623(h)(2) which provides that "[i]f such proceeding is not instituted within such thirty day period, all dissenter's rights shall be lost unless the supreme court, for good cause shown, shall otherwise direct."

ANRE argued, first, that the appraisal proceeding was timely if calculated using the 15 and 30 day periods referred to in the preamble of BCL §623(h) and, second, that any untimeliness should be excused for "good cause shown" based on ANRE's "good faith reading of the interplay between LLCL §1005(b) and BCL §623(h)."

In her decision, Manhattan Supreme Court Justice Donna M. Mills concluded that ANRE's appraisal proceeding was untimely and that ANRE failed to establish good cause to excuse its failure to comply with the statutory mandate. The 15 and 30-day periods mentioned in BCL §623(h)'s preamble, she explained, "refer back" to BCL §623(g) which is not one of the BCL provisions incorporated by LLC Law §1005 and was not mentioned in the notice of merger. "Thus," she continued,

> **the obvious interpretation is that the parties intended not to make use of those procedures or time periods. Secondly, it is equally obvious that BCL §623(g) is a provision of the Business Corporation Law, while LLCL §1005 (b) is a provision of the Limited Liability Company Law, and that all of the companies that are parties to this litigation are limited liability companies and, thus, subject to the provisions of the latter statute. Therefore, even if the parties had intended otherwise (which is not indicated by the terms of the Capsag merger notice), the governing law would oblige the court to use the 10 and 90-day time periods that Capsag utilized when calculating the timeliness of ANRE's petition, and *not* the additional 15 and 30-day periods that ANRE favors. [Italics in original.]**

Justice Mills also held that ANRE's untimeliness was not excusable for good cause which, citing a federal court decision in *Pay TV of Greater New York, Inc. v. Gutman*, 1989 US Dist LEXIS 5467 (SDNY 1989), she defined as "the party asking for relief was in some way prevented from meeting the time limit." ANRE's untimeliness, she observed, was occasioned by its own "admitted lack of diligence, rather than by any action by defendants or by circumstances beyond any party's control." Further, "nothing prevented ANRE from commencing this proceeding much earlier than it did, given its three-to-four month long awareness that Capsag intended to compensate ANRE with $465.60 for its interest in Capnam Sag."

In its motion to dismiss ANRE's other action seeking to reverse the merger, the defendants argued that the Section 2(c) of Capnam's operating agreement expressly authorized a merger into an "Affiliate" which elsewhere was defined as "any entity which . . . is owned or controlled by or which is under common ownership or control with" Capnam. Defendants contended that because Capsag is under the same degree of "common ownership and control" by CS Developers as Capnam was, the condition of a contractually authorized merger was present.

ANRE argued that the term "common ownership or control" as used in the operating agreement was ambiguous, because "it was ANRE's understanding that ANRE would have an ownership interest in an 'Affiliate' with whom Capnam would be authorized to merge."

Justice Mills rejected ANRE's position, finding no ambiguity in the contested language:

> **It is . . . self evident that the plain meaning of this phrase simply describes one corporate entity (e.g., Capnam Sag or Capsag) that is owned or controlled by another (e.g., Cap Sag) in its capacity as the former entity's managing member. ANRE fails to explain why this interpretation is not reasonable and likewise fails to offer an alternative interpretation that could be deemed to be reasonable. ANRE also certainly fails to explain why its**

“understanding that ANRE would have an ownership interest in any ‘Affiliate’ with whom Capnam Sag would be authorized to merge” was a reasonable understanding rather than a wishful one.

The court’s rulings, dismissing both ANRE’s appraisal petition and its complaint seeking to reverse the merger, leaves ANRE with nothing to show for its efforts other than a check for $465.60 and, most likely, a somewhat larger bill for its own attorney’s fees.

A year ago I wrote about a case called *Stulman v. John Dory, LLC* which, at the time, was the one and only reported New York case involving a contested LLC merger (read here). As I pointed out there, under the LLC Law a non-controlling LLC member unhappy with a proposed merger does not have the right to challenge the merger on grounds of fraud, illegality or self-dealing, as do minority shareholders challenging the merger of a corporation under the BCL. This distinction between LLCs and corporations makes it all the more important for LLC members to bargain for protection in the operating agreement, either by insisting on super-majority or unanimous consent to merger, or by incorporating buy-sell provisions triggered by merger that guarantee payment of fair value.

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