

**Matter of Empire State Realty Trust, Inc.**

2013 NY Slip Op 33205(U)

April 30, 2013

Supreme Court, New York County

Docket Number: 650607/2012

Judge: O. Peter Sherwood

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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: O. PETER SHERWOOD  
*Justice*

PART 49

IN RE EMPIRE STATE REALTY TRUST, INC.  
INVESTOR LITIGATION

INDEX NO. 650607/2012  
MOTION DATE April 29, 2013  
MOTION SEQ. NO. 003  
MOTION CAL. NO. \_\_\_\_\_

The following papers, numbered 1 to \_\_\_\_\_ were read on this motion pursuant to CPLR 907(2).

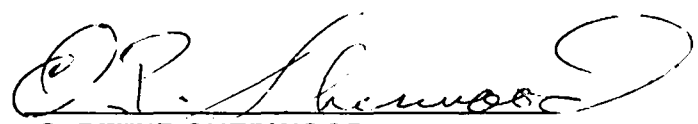
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...  
Answering Affidavits — Exhibits \_\_\_\_\_  
Replying Affidavits \_\_\_\_\_

PAPERS NUMBERED
_____
_____
_____

Cross-Motion:  Yes  No

Upon the foregoing papers, it is ordered that this application pursuant to CPLR 907(2) is decided in accordance with the accompanying decision and order.

Dated: April 30, 2013

  
O. PETER SHERWOOD, J.S.C.

Check one:  FINAL DISPOSITION  NON-FINAL DISPOSITION  
Check if appropriate:  DO NOT POST  REFERENCE  
 SUBMIT ORDER/ JUDG.  SETTLE ORDER/ JUDG.

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

**SUPREME COURT OF THE STATE OF NEW YORK  
COUNTY OF NEW YORK: IAS PART 49**

-----X  
**IN RE EMPIRE STATE REALTY TRUST, INC.  
INVESTOR LITIGATION**

**DECISION AND ORDER**

**Index No. 650607/2012  
Mot. Seq. No.: 003**

-----X  
**O. PETER SHERWOOD, J.S.C.:**

Applicants Mary Jane Fales, Hope Ratner, Mark Esses, Mildred Blutstein, as Trustee of the Mildred Blutstein Revocable Trust, Empire State Equity Fund LLC and Cathy Johnson (the “Movants” or “Applicants”) were granted leave to appear in this action, pursuant to CPLR 907 (2), to brief the issue of whether the Buy Out Provisions in certain Participation Agreements violate the New York Limited Liability Company Law (“LLC Law”). Having reviewed the written submissions of the parties and heard oral argument, the question is now ready to be decided.

***BACKGROUND***

ESBA owns the fee and master lease to the Empire State Building. ESBA was organized in 1961 as a general partnership, with three partners. The beneficial ownership of each partner’s interest in the partnership was separately syndicated to “Participants” through a separate joint venture. The rights and duties of Participants are contained in joint venture agreements known as Participation Agreements. Each of the three ESBA partners’ interests was syndicated into 1,100 participation interests and sold for \$10,000 per unit. Movants are among the 3,300 passive investors who are participants in ESBA.

Under the terms of the Participation Agreements, the partners have complete discretion to act for their respective joint ventures. In order to give ESBA the decentralized management attributes of a partnership for tax purposes, each Participation Agreement required the partner to obtain the consent of all of his joint venture’s Participants before acting on behalf of the entity regarding fundamental limited partnership matters. Because obtaining unanimity was viewed as impractical, (a single dissenting Participant could thwart an entire transaction), the Participation Agreements provide that if Participants holding 80 percent of the joint venture consent to a proposed action, the

partner may, after giving dissenters written notice and an opportunity to join in approval, buy interests of the continuing dissenters for the remaining book value of a Participant's \$10,000 investment, but not less than \$100 (the "Buy Out Provision"). The Buy Out Provision thus provides a mechanism for resolving any gridlock occasioned by the unanimity requirement. The current buy-out price is the \$100 floor.

In September 2001, after the 9/11 terrorist attacks, the three partners converted ESBA into an LLC through a Conversion Agreement. This was done because the master lease with the then-fee owner arguably imposed an obligation on ESBA partners to rebuild the Empire State Building if it was destroyed. Conversion to an LLC shielded the partners from personal liability in the event of such a catastrophe. The Conversion Agreement states that there was no alteration in the rights and duties of the partners and Participants. The only purpose of the transaction was to provide against third-party liability claims.

The proposed transaction contemplates the contribution of ESBA assets along with other assets controlled by a member to a real estate investment trust ("REIT") in exchange for operating partner units and REIT securities and other consideration. The consideration received will then be distributed to the Participants. In the original S-4 filed with the SEC in connection with the transaction, and all further amendments to the S-4, Malkin Holdings explained the Buy Out Provision and further disclosed that Participants do not have an appraisal remedy. The S-4 also explained that the transaction involves contribution of ESBA assets to the operating partnership of the REIT. During the review, the SEC sought information about why Participants do not have an appraisal remedy under the Limited Liability Company Law. Malkin Holdings responded "that the appraisal right under Section 1002(e) of the New York Limited Liability Company Law is not applicable to the proposed transaction" because "[t]he transaction is, in fact, an asset transfer to the operating partnership and not a statutory consolidation" and that "the participants are not members who can asserts an appraisal right." The SEC did not communicate with Malkin Holdings further on this issue.

The current transaction documents contain a provision designed to allow dissenters to avoid selling at the current Buy Out Provision price of \$100. If 80% or more of the Participants consent to the transaction, it will proceed and dissenters and abstainers will have ten days after getting written notice thereof to change their votes to “yes” and thereby gain the same benefits as the members of the supermajority.

### ***DISCUSSION***

The central issue to be decided on this application is whether the Buy Out Provision of the Participation Agreements violates the LLC Law, because it does not afford dissenting Participants appraisal rights. If Applicants are “members” or have “membership interests,” they have statutory appraisal rights even though such rights are not provided for in the Buy Out Provision. If Applicants are not “members” and have no “membership interests” under the LLC Law, they have no appraisal rights and the application must be denied. Applicants claim that Participants have “beneficial ownership interests in the membership interest” of ESBA and consequently are entitled to assert the statutory appraisal rights provided for in the LLC Law.

The relevant provisions of the Limited Liability Company Law are as follows:

#### **§ 1002. Procedures for merger or consolidation**

(a) In connection with a merger or consolidation under this chapter, rights or securities of, or interests in, a limited liability company or other business entity that is a constituent party to the merger or consolidation may be exchanged for or converted into cash, property, rights or securities of, or interests in, the surviving or resulting limited liability company or other business entity or, in addition to or in lieu thereof, may be exchanged for or converted into cash, property, rights or securities of, or interests in, a limited liability company or other business entity that is not the surviving or resulting limited liability company or other business entity in the merger or consolidation.

...

(e) Any member that is a party to a proposed merger or consolidation who is entitled to vote with respect to such proposed merger or consolidation may, prior to that time of the meeting at which such merger or consolidation is to be voted on, file with the domestic limited liability company written notice of dissent from the proposed merger or consolidation. Such notice of dissent may be withdrawn by the dissenting member at any time prior to the effective date of the merger or consolidation and shall be deemed to be withdrawn if the member casts a vote in favor of the proposed merger or consolidation.

(f) Upon the effectiveness of the merger or consolidation, the dissenting member (referred to in subdivision (e) of this section) of any domestic limited liability company shall not become or continue to be a member of or hold an interest in the surviving or resulting limited liability company or other business entity but shall be entitled to receive in cash from the surviving or resulting domestic limited liability company or other business entity the fair value of his or her membership interest in the domestic limited liability company as of the close of business of the day prior to the effective date of the merger or consolidation in accordance with section five hundred nine of this chapter but without taking account of the effect of the merger or consolidation.

...

(h) A limited liability company whose original articles of organization were filed with the secretary of state and effective prior to the effective date of this subdivision shall continue to be governed by this section as in effect on such date and shall not be governed by this section, unless otherwise provided in the operating agreement.

#### **§ 1001. Merger or consolidation**

(a) As used in this article, “merger” means a procedure in which two or more limited liability companies or other business entities merge into a single limited liability company or other business entity that shall be one of the constituent limited liability companies or other business entities, and “consolidation” means a procedure in which two or more limited liability companies or other business entities consolidate into a single limited liability company or other business entity that shall be a new limited liability company or other business entity to be formed pursuant to the consolidation.

(b) Pursuant to an agreement of merger or consolidation and to the extent not expressly prohibited by law, a domestic limited liability company may merge or consolidate with or into one or more domestic limited liability companies or other business entities formed or organized under the laws of this state or any other state or the United States or any foreign country or other foreign jurisdiction, with such domestic limited liability company or other business entity as the agreement shall provide being the surviving or resulting domestic limited liability company or other business entity.

#### **§ 1005. Payment of interest of dissenting members**

(a) Within ten days after the occurrence of an event described in section ten hundred two of this article, the surviving or resulting domestic limited liability company or other business entity shall send to each dissenting former member a written offer to pay in cash the fair value of such former member's membership interest. Payment in cash shall be made to each former member accepting such offer within ten days after notice of such acceptance is received by the surviving or resulting domestic limited liability company or other business entity.

(b) If a former member and the surviving or resulting limited liability company or other business entity fail to agree on the price to be paid for the former member's membership interest within ninety days after the surviving or resulting domestic limited liability company or other business entity shall have made the offer

provided for in subdivision (a) of this section, or if the domestic limited liability company or surviving domestic limited liability company or other business entity shall fail to make such an offer within the period provided for in subdivision (a) of this section, the procedure provided for in paragraphs (h), (i), (j) and (k) of section six hundred twenty-three of the business corporation law (or any successor provisions or statute) shall apply, as such paragraphs may be amended from time to time.

....

## § 102. Definitions

...

(q) "Member" means a person who has been admitted as a member of a limited liability company in accordance with the terms and provisions of this chapter and the operating agreement and has a membership interest in a limited liability company with the rights, obligations, preferences and limitations specified under this chapter and the operating agreement.

(r) "Membership interest" means a member's aggregate rights in a limited liability company, including, without limitation: (i) the member's right to a share of the profits and losses of the limited liability company; (ii) the member's right to receive distributions from the limited liability company; and (iii) the member's right to vote and participate in the management of the limited liability company.

....

Applicants argue that after the post-9/11 LLC conversion, the former partners (referred to by Applicants as "Agents" of the Participants) became LLC members, each of whom continued to hold a one-third membership interest in trust for the Participants, the sole beneficial owners of the membership interests in ESBA. Applicants argue that as beneficial owners, the ESBA Participants are entitled to the statutory appraisal remedy under the LLC Law. The argument is based on the Applicants' reading of the First Amendment to the ESBA LLC Agreement, which defines the term "Participation Interests" to mean "beneficial ownership interests of participants in the membership interest of the Company held by an agent for the benefit of such participants." Thus, Applicants argue that ESBA Participants are beneficial owners of membership interests in ESBA, and accordingly, are entitled to the protections of LLC Law § 1002 and 1005, and BCL 623(h)-(k).

Alternatively, Applicants argue that even if the "rights" or "interests" of the Participants were not to be regarded as "membership interests," the Participants are still be entitled to the statutory

protections. They cite to LLC Law § 1002(a), which is captioned “procedures for merger or consolidation”. The section states:

(a) In connection with a merger or consolidation under this chapter, *rights or securities of, or interests in*, a limited liability company or other business entity that is a constituent party to the merger or consolidation may be exchanged for or converted into cash, property, rights or securities of, or interests in, the surviving or resulting limited liability company or other business entity or, in addition to or in lieu thereof, may be exchanged for or converted into cash, property, rights or securities of, or interests in, a limited liability company or other business entity that is not the surviving or resulting limited liability company or other business entity in the merger or consolidation.

(emphasis added). Applicants argue that this section broadly defines the categories of persons enjoying minority dissenter fair value protections as those persons owning “rights or securities of, or interests in” an LLC.

In a tacit recognition that the section contains no such meaning, Applicants reference a general tenet of statutory construction, that “[t]o determine the intent of a statute, ‘inquiry must be made of the spirit and purpose of the legislation, which requires examination of the statutory context of the provision’” (*New York State Psychiatric Ass’n v New York State Dep’t of Health*, 19 NY3d 17, 24 [2012], citing *Matter of Sutka v Conners*, 73 NY2d 395, 403 [1989]). Applicants then contend that subsequent references in § 1002(f) (and elsewhere in § 1002) to “members” or “membership interests” must be construed consistently with the broad “rights or securities of, or interests in, a limited liability company” language appearing in subsection (a). Accordingly, while the fair value protections set forth in § 1002 (f) apply to “the dissenting member (referred to in section (e) of this section) . . . ,” taken in context, the term “member” must be read to include persons who hold “rights or securities of, or interests in, a limited liability company.”

Applicants also cite to § 1002 (e), which refers to “any member that is a party to a proposed merger or consolidation who is entitled to vote with respect to such merger or consolidation.” Applicants argue that since ESBA Participants are “entitled to vote,” they fall within the class the statute was enacted to protect.

Plaintiffs and Defendants argue in opposition that the statutory language is clear: Participants are not LLC members and therefore are not entitled to statutory appraisal protections. It is well settled that where statutory language is clear and unambiguous, the court must “construe it so as to give effect to the plain meaning of the words used” (*Patrolmen’s Benevolent Ass’n v City of NY*, 41 NY2d 205, 208 [1976]). Applicants are not members because, in the plain words of the LLC Law, “‘member’ means a person who has “been admitted as a member of a limited liability company” (LLC Law 102[q]). Further, none of the Participants have any “membership interest” because they do not possess “a member’s aggregate rights in a limited liability company” or a “member’s right to vote and participate in the management of the limited liability company” (LLC Law 102[q]).

As to Applicants’ arguments based on LLC Law §1002, plaintiffs and defendants note correctly that the rights provided by that section are explicitly provided only to members. Indeed, each subsection specifically references the word “members.” The “rights or securities of, or interests in” language in § 1002 (a) on which Applicants base their claim, merely provides that interests other than and in addition to membership interests may be included in a merger or consolidation. The phrase has nothing to do with who should be considered a member.

Plaintiffs and defendants’ arguments are also supported by case law. In *Cordts-Auth v Crunk, LLC*, 815 F Supp 2d 778, 800 (SDNY 2011), *affd* 479 F Appx 375 (2d Cir 2012), the court held that since plaintiff was not a member of the LLC, but merely owned “performance units” entitling her to a share of the LLC’s profits, plaintiff did not have “rights of access to an LLC’s books and records” because such rights “are reserved only for members of an LLC”. Here the Participants have no statutory appraisal right.<sup>1</sup>

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<sup>1</sup>The absence of a right of appraisal does not mean that Participants are being subjected to oppressive buy out terms. Under the terms of the REIT transaction, each dissenting Participant will have the opportunity to change an initial “no” vote or abstention to a “yes” vote and thereby to obtain the same benefits as the Participants who voted in favor of the transaction.

Accordingly, based on a plain reading of the statutory language, Participants are not ESBA members, and are thus are not entitled to any statutory appraisal protections under the LLC law.

As a separate defense, defendants argue that §1002(e) provides an appraisal remedy only for a statutory “merger or consolidation,” and that since this transaction is neither, Participants are not entitled to an appraisal even if the court were to hold that Participants are members.

LLC Law §1001(a) sets forth the relevant terms:


(a) As used in this article, “merger” means a procedure in which two or more limited liability companies or other business entities merge into a single limited liability company or other business entity that shall be one of the constituent limited liability companies or other business entities, and “consolidation” means a procedure in which two or more limited liability companies or other business entities consolidate into a single limited liability company or other business entity that shall be a new limited liability company or other business entity to be formed pursuant to the consolidation.

Defendants contend that a merger contemplates Company A and Company B merging into Company B. A consolidation contemplates Company A and Company B consolidating into new company C. This transaction is an asset exchange. ESBA will contribute its assets to the REIT operating partnership. In exchange, the operating partnership will distribute operating partnership units and REIT securities (and any residual cash) to ESBA, which will then distribute that consideration to the Participants. Defendants acknowledge that Malkin Holdings has characterized the transaction as a “consolidation,” but contend that this non-technical use of the term should not be controlling, as the transaction is not a “consolidation” within the meaning of the LLC Law. The Applicants are not entitled to assert any appraisal rights because the transaction is neither a merger nor a consolidation as defined in the LLC Law.

ESBA Participants are not LLC members. Additionally, the transaction is not a merger or consolidation as defined by the LLC Law (to which appraisal rights would apply if the Participants were members). The application is DENIED.

This constitutes the decision and order of the court.

**DATED: April 30, 2013**

**ENTER,**  
  
**O. PETER SHERWOOD**  
**J.S.C.**