

Matter of Burntisland II LLC v Falkland, LLC
2017 NY Slip Op 32482(U)
November 20, 2017
Supreme Court, New York County
Docket Number: 159020/2016
Judge: Erika M. Edwards
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

In the Matter of the Application of
BURNTISLAND II LLC,

Petitioner,

to Determine the Value of the Shares of Respondent
Falkland, LLC Under NY LLC Law § 1005

Index No.: 159020/2016

DECISION/ORDER

Motion Seq. 001

Recitation, as required by CPLR 2219(a), of the papers considered in the review of this motion:

Papers	Numbered
Notice of Petition, Petition and Affidavits/Affirmations Annexed	1
Amended Answer	2
Opposition Affidavits/Affirmations and Memos of Law Annexed	3
Reply Affidavits/Affirmations and Memos of Law Annexed	4

ERIKA M. EDWARDS, J.:

Petitioner BurntIsland II LLC’s (“BI II”) brings this application to determine the rights and value of the shares owned by Respondent Falkland, LLC’s (“Falkland”) 4.5% interest in BurntIsland, LLC (“BI I”) as of the date of a merger on June 30, 2016, under Limited Liability Company Law § 1005(b) and Business Corporation Law § 623. Based on the evidence submitted, the court determines that Falkland’s 4.5% interest in BI I at the time of the merger was \$422,482.51.

BI II is the surviving entity of a merger with BI I on June 30, 2016. The company’s sole asset is a four-story, landmark building known as the Andrew Norwood House, located at 241 West 14th Street, New York, New York. The building is leased to another company who has a 25-year triple net lease and that company subleases it to a private arts club. The property has two bars, a restaurant, outdoor garden, private rooms and other amenities.

At the time of the merger, Falkland had a 4.5% interest in BI I, 241 Owner LLC had a 51% interest, 241 Owner II LLC had a 40% interest and Ralston LLC had a 4.5% interest. Falkland dissented to the merger and BI II offered Falkland \$166,500 in cash for the fair value of its interest in BI I at the time of the merger, but Falkland rejected the offer. BI II amended its offer to \$291,081, but Falkland failed to accept it in a timely manner.

BI II argues that Falkland’s 4.5% ownership interest as of June 30, 2016, was \$330,000 (rounded up from \$326,500.60). BI II submitted an appraisal, expert report with supporting

documents prepared by Cushman & Wakefield, Inc. ("CW"), dated September 26, 2016, indicating that Falkland's 4.5% ownership interest was \$326,500.60. CW's appraisal of the value of the property used the Income Capitalization Approach based on the anticipated future rental income from the property because of the terms of the long-term lease. CW determined that the retrospective value of the property on June 30, 2016 was \$17,279,400 (rounded up to \$17,300,000). CW based its analysis on a gross income from rent in the amount of \$901,000, minus operating expenses of \$37,030 for a net operating income of \$863,970. CW determined that 5% capitalization was appropriate. Then, CW deducted \$8,230,539 in outstanding financial obligations and determined the equity to be \$9,069,461. Based on Falkland's 4.5% ownership interest in BI I, its pro rata share of the equity was \$408,125.75. Next, as CW explained in a separate report, dated September 20, 2016, it determined that a 20% Discount for Lack of Marketability ("DLOM") was appropriate. Therefore, it determined that Falkland's interest in BI I on June 30, 2016 was \$326,500.60, or \$330,000 (rounded up).

In opposition to BI II's proposed valuation analysis, Falkland argues that its 4.5% ownership interest in BI I at the time of the merger was \$583,609. On August 2, 2017, Falkland provided the court with two appraisals and an expert valuation report. The first appraisal was a subpoenaed appraisal from Citigroup prepared by CBRE-Valuation & Advisory Services ("CBRE"), dated July 18, 2016, and the second was from Metropolitan Valuation Services ("MVS"), which gave a retrospective value of the property as of June 30, 2016.

The CBRE appraisal was prepared in connection with a refinance and it was the subject of a discovery dispute in this case. CBRE valued the property at \$20,151,129, not including the unused air rights. CBRE arrived at this figure by using the gross income of \$901,000, minus operating expenses of \$44,577, for a net operating income of \$856,423. It applied 4.25% capitalization. After \$8,230,539 in outstanding obligations was deducted, the equity was determined to be \$11,969,461. Therefore, Falkland's share of the equity was \$538,625.75, without applying a DLOM.

MVS valued the property at \$21,112,444. MVS used a higher anticipated rental income of \$955,060 and reduced it by a much lower operating expense total of \$5,000 because rent was collected from only one tenant. Therefore, the net operating income was \$950,060. MVS determined 4.5% capitalization and after the \$8,230,539 was deducted, the total equity was \$12,869,461. Therefore, Falkland's 4.5% ownership interest was worth \$579,125.75 with no DLOM.

Falkland's expert was prepared by Kevin Vannucci ("Vannucci"), dated March 22, 2017, who was retained to determine a reasonable range of discounts related to the determination of Falkland's ownership interest in BI I at the time of the merger. Vannucci reviewed the CW and MVS appraisals and based upon several factors, he opined that the DLOM range that should be applied is 0 to 6.9 %.

In its reply, BI II renewed its argument that Falkland's interest was \$330,000, and it argued in substance that the court should not consider the CBRE appraisal as it is inadmissible hearsay and it is biased as it was prepared for Citigroup, which most likely prefers an appraisal at a higher amount so it can close on a higher loan amount. However, BI II further argued that if the

court chose to consider the CBRE appraisal, then if the court averaged the amounts provided in the three appraisals based on the rounded figures and applied a 20% DLOM, then the value of Falkland's interest would be \$402,100.60.

Based on the evidence submitted and arguments raised during oral arguments before this court held on April 6, 2017, July 12, 2017 and August 24, 2017, the court determines that Falkland's 4.5% interest in BI I at the time of the merger was \$422,482.51. The court determines that the gross rental income at the time of the merger was \$901,000 and that the operating expenses should be estimated at \$25,000. The court finds that the operating expenses in the CW and CBRE appraisals are too high based on the anticipated expenses for this property, since they include anticipated vacancies, management fees based on industry wide averages and/or other costs which are unrelated to the unique nature of this property. As Falkland correctly noted, there was only one tenant, who generally paid its rent on time. However, as BI II correctly argued, the \$5000 total set forth in the MVS appraisal was extremely low because there were additional expenses distinct from the collection of rent, including attorney's fees, accounting fees and other costs. Therefore, the court determines \$25,000 in operating expenses to be appropriate in this case, with a net operating income of \$876,000 (difference of \$14,151). The court applies a capitalization figure close to the average set forth in the three reports to determine that the value of the property as of June 30, 2016, was \$19,407,325. After the \$8,230,539 is deducted, the equity is \$11,176,786. Thus, Falkland's equity interest without a DLOM is \$502,955.37.

Based on the arguments presented and the relevant case law, the court determines that a DLOM of 16% is appropriate in this case. Here, the court is persuaded by BI II's arguments in favor of a DLOM, however, the court determines that 16%, instead of 20%, more accurately reflects the appropriate discount commensurate with the lack of the public market for a private LLC of this type. Therefore, the court finds that the fair value of Falkland's 4.5% interest in BI I as of June 30, 2016 is \$422,482.51.

Additionally, Falkland seeks prejudgment interest at 9% from the date the petition was filed on October 25, 2016, plus attorney's fees, expert's fees, costs and disbursements, pursuant to BCL § 623(h)(6) and (7). BI II argues in substance that Falkland should not be entitled to prejudgment interest at 9% and that no interest or attorney's fees and costs should be awarded because Falkland delayed the proceedings for approximately 220 days by filing its Answer late, seeking immaterial discovery and failing to provide a competing appraisal and valuation report until over seven months after their Answer was due. Therefore, Falkland should be fortunate if the court does not award fees to BI II. In the alternative, BI II argues that the court has the discretion to impose an equitable interest rate and the court could impose a minimal amount of interest at a rate of BI II's borrowing rate of 4.09%, beginning from June 30, 2016, until the date of payment, minus the 220-day delay.

As BI II correctly argues, Falkland first provided a competing appraisal and expert report extremely late in this proceeding. In fact, the court had a decision drafted and was prepared to render its ruling based solely on the evidence provided by BI II, without the benefit of Falkland's submissions. However, pursuant to BCL § 623(h)(6), based on the circumstances in this case, the court determines that an equitable interest rate is 4.25% imposed from June 30, 2016, until the

date of payment. The court declines to exclude any portion of this period from its interest calculation.

Accordingly, it is hereby

ORDERED that Petitioner BurntIsland II LLC's application is granted to the extent that the court determines that the fair value of Respondent Falkland, LLC's shares in BurntIsland LLC as of the date of the merger on June 30, 2016, is \$422,482.51; and it is further

ORDERED that the Clerk is directed to enter judgment in favor of Respondent Falkland, LLC as against Petitioner BurntIsland II LLC in the amount of \$422,482.51, plus pre-judgment interest at a rate of 4.25% from June 30, 2016, until the date of this decision and order, which is November 20, 2017, and thereafter at the statutory rate of 9% until satisfaction of the judgment, as calculated by the Clerk, without attorney's fees, expert's fees, costs or disbursements to either side.

Date: November 20, 2017


HON. ERIKA M. EDWARDS