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New York state court rules that exercising an option to redeem a limited partners' interests in a LIHTC partnership does not trigger a liquidation under the partnership agreement

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On January 7, 2020, Judge Deborah A. Chimes of the New York Supreme Court—Erie County in *Centerline/Fleet Housing Partnership, L.P. v. Hopkins Court Apartments, L.L.C., et al.*, No. 812426 (N.Y. Sup. Ct. 2016) ruled from the bench that a general partner's election to redeem the limited partners' interests in a low-income housing tax credit partnership did not trigger liquidation provisions under the partnership agreement because the partnership still owned all, or substantially all, of the assets of the partnership. Thus, in effect, exercise of the option by redeeming interests, rather than by acquiring title to the property, did not require repayment of the limited partners' capital accounts.

The investor limited partner and special limited partner filed suit against the general partner for breach of the partnership agreement, breach of fiduciary duty, and other claims arising out of the general partner's decision to undertake a refinancing transaction without first obtaining consent, and the general partner's exercise of an option to redeem the limited partners' interests in the partnership after the end of the compliance period without treating it as a liquidation (which would have required return of the limited partners' capital accounts).

Although the partnership agreement apparently delegated significant authority to the general partner to “sell, lease, exchange, refinance[,] or otherwise transfer, convey, or encumber all or substantially all of the assets of the [p]artnership,” it still required the general partner to obtain prior consent of the special limited partner. At the same time, however, the general partner had the right to refinance the partnership's assets *without* the special limited partners' consent where the terms and conditions of the new loan were “substantially similar” to the original loan. The partnership agreement also included a “waterfall” provision that described how proceeds from a sale or refinancing transaction were to be applied. The general partner would receive 70% of the proceeds, while the remaining 30% would be allocated to the limited partners.

The limited partners alleged the general partner breached the partnership agreement by undertaking a refinancing without first obtaining consent. They claimed the new refinancing terms

were far from “substantially similar” to the terms of the original loan. This, in turn, resulted in an alleged breach of fiduciary duty because the refinancing left the partnership with “insufficient equity to repay capital account balances upon a final liquidation” in light of the general partner’s subsequent redemption of the limited partners’ interests in the partnership. The option agreement provided that the general partner could either “purchase” the property or “reform” the option agreement to a redemption of the limited partners’ interests in the partnership. The “redemption price” would “equal the amount otherwise payable to the limited partners” if the property were sold to a third party based, in part, on the property’s “fair market value” i.e., a “hypothetical sale.” The option agreement required that the economic consequences of the transaction on the limited partners be materially similar whether the transaction was an acquisition of the property or a redemption of the interests.

At the motion’s hearing, one of the issues before the court was which section of the partnership agreement governed the distribution of the redemption proceeds. As part of the analysis, the parties, along with the court, treated the redemption as a “hypothetical sale” because, as the court noted, the limited partner was “not relinquishing its ownership” interest in the property, but rather its interest “as a limited partner in the ultimate partnership[.]” Within this context, the limited partners argued that the redemption should be governed by the partnership agreement’s liquidation provisions because even though the general partner elected to redeem interests instead of acquiring the property, such a redemption, treated as a hypothetical sale, would constitute a “sale or other disposition of all or substantially all of the assets of the [p]artnership.” The general partner, on the other hand, argued that the distribution provisions pertaining to a refinance should apply, which would not take into account the limited partners’ capital accounts.

The court ultimately agreed with the general partner. Initially, the court found that the option agreement was “unambiguous on the issue of which section applie[d] to the distribution of proceeds” following the redemption, explaining that “in exercising the option, the price defendants would pay plaintiffs for their interest is *equal* to the amount plaintiffs would receive if the [property] was sold at fair[-]market value, or what the parties refer to as a hypothetical sale.” The court then rejected the limited partners’ contention that the liquidation provisions should apply because, the court ruled, the partnership “still own[ed] all of, or substantially all, of the assets of the partnership.” The court therefore held that the distribution provisions of the partnership agreement applied to the “hypothetical sale used to establish the value of the plaintiffs’ interest” as part of the redemption process and that “the waterfall provisions contained therein appl[ied] to the distribution of proceeds from the redemption of the plaintiffs’ interest in the partnership.” In effect, the court ruled that the election by the general partner to redeem the interests of the limited partners, rather than acquire title to the property, had very different economic consequences for the partners, despite language in the option agreement seemingly negating that result and requiring that the limited partners’ tax and economic consequences be materially similar regardless of whether a redemption or property sale was chosen.

The court declined to dismiss the limited partners’ breach of fiduciary duty claim against the general partner because whether the general partner’s “actions with respect to the [] re-financ[ing] [were] fair as to all concerned” remained “a question of fact” for the jury.

Although the trial court’s unpublished decision is not binding precedent and remains subject to appeal, *Centerline/Fleet Housing* nonetheless provides a glimpse into how a state court may view a redemption of a limited partner’s interest under the specific language at issue in this case.

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