Walnut Hous. Assoc. 2003 L.P. v MCAP Walnut Hous. LLC
2014 NY Slip Op 30077(U)
January 15, 2014
Sup Ct, New York County
Docket Number: 653945/2013
Judge: Shirley Werner Kornreich
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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: JUSTICE SHIRLEY WERNER KORNREICH **PART** 54
Justice

Walnut Housing

- v -

MCAP

INDEX NO. 653945/2013
MOTION DATE 12/17/13
MOTION SEQ. NO. 1
MOTION CAL. NO. _____

The following papers, numbered 1 to _____ were read on this motion to/for _____

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	3-11
Answering Affidavits — Exhibits	12-13
Replying Affidavits	14-15

Cross-Motion: ☐ Yes ☒ No

Upon the foregoing papers, it is ordered that this motion

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION AND ORDER.

Dated: 1/15/14

J.S.C.
SHIRLEY WERNER KORNREICH
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: PART 54

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WALNUT HOUSING ASSOCIATES 2003 L.P., BF WALNUT PARK, LLC, as General Partner, BFIM SPECIAL LIMITED PARTNER, INC. and MMA WALNUT PARK PLAZA, L.P., Derivatively on behalf of WALNUT HOUSING ASSOCIATES 2003 L.P., and WALNUT PARK PLAZA, L.P., in its Individual Capacity

Plaintiffs,

-against-

MCAP WALNUT HOUSING LLC, MUNICIPAL CAPITAL APPRECIATION PARTNERS II, L.P., and RICHARD G. COREY,

Defendants.

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Index No.: 653945/2013

DECISION & ORDER

SHIRLEY WERNER KORNREICH, J.:

Plaintiffs Walnut Housing Associates 2003 L.P. (the Partnership), BF Walnut Park, LLC (the New General Partner), BFIM Special Limited Partner, Inc. (the SLP), and MMA Walnut Park Plaza, L.P. (the ILP) moved by order to show cause for a temporary restraining order and a preliminary injunction, pursuant to CPLR 6301, to enjoin defendants MCAP Walnut Housing LLC (the Old General Partner), Municipal Capital Appreciation Partners II, L.P. (MCAP II), and Richard G. Corey from: "(1) interfering with the Special Limited Partner's removal of the Old General Partner as general partner of the Partnership; (2) interfering with the authority and power of the New General Partner over the assets, investments, or management of the Partnership; (3) removing, altering, or destroying the Partnership's books and records (including, but not limited to, any of the Old General Partner's records pertaining to the Partnership, or preventing the New General Partner access to them); (4) taking any action on behalf of or in the name of the Partnership or any entity controlled by the Partnership; or (5) taking any action that

would impair the value of the Partnership or its assets." The court has already issued a temporary restraining order granting plaintiffs some of their requested relief. The court now issues a preliminary injunction, granting the balance of plaintiffs' motion for the reasons that follow.

I. Procedural History & Factual Background

This action concerns alleged wrongdoing by defendants in their management of the Partnership, which is governed by Delaware law under a Second Amended and Restated Agreement of Limited Partnership dated October 6, 2006 (the Partnership Agreement). The Partnership owns a housing building for low-income, senior citizens, which is located in Philadelphia (the Property). Plaintiffs invested in the Partnership in order to obtain the Property's housing tax credits. The Property is eligible for such tax credits so long as it meets certain conditions, including not defaulting on its mortgage loans. There is a mortgage loan between the Partnership and defendant MCAP II which had an original balance of approximately $8.9 million (the MCAP II Loan). The MCAP II Loan documents prohibit MCAP II from foreclosing so as to not jeopardize the Partnership's tax credit eligibility.

Corey owns both MCAP II and the Old General Partner, which manages the day-to-day operations of the Property. Plaintiffs SLP and ILP are limited partners in the Partnership. They have the right to remove the Corey controlled Old General Partner in certain instances. On this motion, plaintiffs seek to remove the Old General Partner pursuant to Section 7.7(A) of the Partnership Agreement, which allows for such removal upon the occurrence of a Material Default. Section 7.7(B) lists five types of Material Defaults, including a material breach of the representations and warranties in Section 6.5 (the Representations) [§ 7.7(B)(i)], a violation of

any legal duty arising under the Partnership Agreement or related Project Documents [§ 7.7(B)(ii)], the commencement of a foreclosure proceeding with respect to a mortgage on the Property (such as the MCAP II Loan) [§ 7.7(B)(iv)], and "gross negligence, fraud, willful misconduct, misappropriation of Partnership funds, or a breach of fiduciary duty by a General Partner" [§ 7.7(B)(v)]. Plaintiffs have the right under Section 7.7© to remove a General Partner for a Material Default if written notice is provided and the breach is not cured. Upon removal, the General Partner is obligated to provide plaintiffs with the Partnership's books and records.

Plaintiffs contend that the Old General Partner committed the cited forms of Willful Misconduct by engaging in multiple fraudulent schemes. To begin, they allege, on October 13, 2011, Corey emailed the ILP, requesting permission for the Partnership to obtain a $4 million loan for the purpose of making repairs to the Property (the AFAH Loan). The ILP requested information regarding the intended use of the loan proceeds. On November 2, 2011, Corey emailed the ILP, with a breakdown showing the loan proceeds would be allocated to fund various needed repairs, such as roof repairs and electrical work. This breakdown, however, did not account for the full $4 million. On November 9, 2011, the ILP asked Corey why this was so. Corey responded that the amounts set forth in his November 2 email were merely estimates and that any extra money from the AFAH Loan would be used to pay off the MCAP II Loan. Corey assured the ILP, however, that the AFAH Loan proceeds would not be used to pay off the MCAP II Loan until all of the Property's repair expenses were paid. As a result of these assurances, on November 14, 2011, the ILP approved the AFAH Loan. An audit of the Partnership (discussed below) revealed that Corey did not use the proceeds to make the repairs. Rather, Corey used the proceeds to make payments on the MCAP II Loan (which had been in default since July 2009)

and to pay for other expenses owed by his companies. Plaintiffs aver that Corey fraudulently induced them to consent to the AFAH Loan, which Corey then used to pay himself – not only the amount due under the MCAP II Loan – but also almost $2 million in default interest charges. Plaintiffs claim Corey's conduct was that much more egregious because the Property did indeed need the repairs.

Subsequently, on May 14, 2012, Corey informed the ILP of his plan to spend $2.9 million on repairs to the Property, which were to include the electrical work and roof repairs originally discussed in his November 2, 2011 email. Corey informed the ILP that the $2.9 million would be funded as follows: $1.5 million would come from a new loan taken out by the Partnership (the PRA Loan), $1 million would come from MCAP II, and $400,000 would come from the Property's surplus cash flow. On June 7, 2012, the ILP emailed Corey, expressing concern about the Property's $400,000 contribution, as its financial records did not show any cash flow surplus. Although another MCAP II employee responded to the ILP, attempting to alleviate these concerns, Corey did not respond. On July 2, 2012, Corey hired McDonald Building Company (McDonald) to perform the construction and electrical work on the Property. The total value of the McDonald contracts is approximately $1.7 million.

The following year, on April 5, 2013, plaintiffs received an audit of the Partnership's finances, which indicated that the Partnership's liabilities significantly exceeded its assets. Such liabilities included approximately $1.5 million in unpaid construction expenses. The ILP asked Corey for an explanation, especially about why the Old General Partner was not paying for the Property to be repaired. Corey did not respond. The ILP's concern was not only triggered by the failure to pay for the long-talked-about repairs, but also because the audit showed that

MCAP II was charging the Partnership for a new loan to supposedly pay for such repairs. Additionally, the audit indicated that the Property's mortgage was again in default as of April 3, 2013. Neither Corey nor any representative of defendants responded.

Instead, one month later, on July 17, 2013, Corey, on behalf of MCAP II, issued a written default letter on the MCAP II Loan. As plaintiffs observe, "Corey sent the default letter as lender, to himself as borrower, from and to the same address." Pl. Mem. at 8. One of the Representations (which, as discussed earlier, a violation of which is a Material Default and grounds for removal) is that the Old General Partner would not cause the Partnership to default on its loans, which, the audit revealed, had occurred on at least two occasions. Again, as he did with the AFAH Loan proceeds, Corey profited by charging the Partnership late fees and default interest incurred due to his causing the Partnership to default. These charges further imperiled the Partnership's ability to pay for repairs to the Property. Indeed, back on May 1, 2013, McDonald filed a mechanics lien in Pennsylvania state court, indicating that the Partnership owes it over $1 million. This lien is of great concern to the ILP since it can cause the loss of tax credits, thereby wiping out the ILP's investment. This concern is specifically recognized in the Partnership Agreement [*see* § 6.5(xiv) (causing the Partnership to incur a lien is a breach of a Representation)] and, thus, grounds for termination of the Old General Partner.

On October 9, 2013, plaintiffs sent the Old General Partner a Removal Notice. Moreover, plaintiffs notified the Property's management company that it intended to replace it. On October 10, 2013, Corey responded to the Removal Notice, refusing to recognize its validity And refused to turn over the Partnership's books and records. Plaintiffs responded on October 15, 2013, listing the myriad discussed breaches.

Plaintiffs commenced this action on November 13, 2013. On December 3, 2013, plaintiffs filed the instant injunction motion, seeking removal of the Old General Partner and access to the Partnership's books and records. The alleged facts recited above are based on the Complaint and plaintiffs' supporting affidavits and documentary evidence. The facts are not based on defendants' version of events, as defendants did not rebut plaintiffs' account. Rather, in their opposition papers, defendants merely proffer legal excuses as to why plaintiffs are not entitled to their requested relief. Defendants articulate two supposed issues: (1) plaintiffs' unreasonable refusal to consent to a new bank loan to replace the MCAP II Loan; and (2) plaintiffs' failure to obtain the requisite governmental approval to change General Partners.

In 2012, defendants sought plaintiffs' approval of a loan from Citibank to replace the MCAP II Loan. Plaintiffs refused to consent because the proposed Citibank loan did not have the same foreclosure restriction as the MCAP II Loan, a term essential to plaintiffs, since it protects their ability to receive tax credits. As for the regulatory issue, defendants rely on Section 7.7(J) of the Partnership Agreement and the Property's government contract (the HAP Contract), which requires the government's approval of new General Partners.

II. Discussion

To succeed on a motion for a preliminary injunction, the movant must demonstrate a likelihood of ultimate success on the merits, that irreparable injury would result in the absence of injunctive relief, and that a balancing of the equities to effect substantial justice and to preserve the status quo warrants the grant of this extraordinary relief. CPLR 6301; *Key Drug Co. v Luna Park Realty Assoc.*, 221 AD2d 598, 599 (2d Dept 1995); *Pilgreen v 91 Fifth Ave. Corp.*, 91 AD2d 565, 567 (1st Dept 1982), *app dismissed*, 58 NY2d 1113 (1983).

Plaintiffs have established a likelihood of success on the merits. The described conduct, which is not refuted in any meaningful way in defendants' opposition, constitutes a Material Default on multiple grounds, including unrefuted allegations of fraud. The irreparable harm the Partnership would suffer if such conduct is permitted to continue is obvious, and, for the same reason, the equities strongly favor plaintiffs. Simply put, the fiscal ruin caused by Corey warrants removal of the Old General Partner.

Defendants' legal arguments are unpersuasive. Given the material difference between the MCAP II Loan and the proposed Citibank loan (the lack of foreclosure protection with the latter), plaintiffs' rejection of the Citibank loan was reasonable. And, regarding the issue of government approval, plaintiffs correctly note that Section 7.7(J) only applies *after* the general Partner is removed. Additionally, plaintiffs demonstrated that their attempt to comply with the HUD Contract has created an infinite loop, because the government refuses to deal with plaintiffs "until [they] receive the court decision documenting any changes of management control." *See* Corey Aff., Ex. D. Consequently, plaintiffs argue, the government's deferral of its decision should not stand in the way of the court granting their motion. Indeed, plaintiffs' obligation to seek government approval arises from its obligation to comply with the Partnership's contracts. Given the government's indication that it looks to this court to decide the question of who will be the General Partner, plaintiffs argue, compliance with the HUD Contract is not imperiled by this motion. Indeed, plaintiffs risk losing their tax credits if the HUD Contract is violated. In sum, while plaintiffs obviously must comply with the HUD Contract and obtain the requisite government approval, plaintiffs' demonstration of the likelihood of success on the merits of their claims, the clear and imminent irreparable harm if

defendants are allowed to continue acting on behalf of the Partnership, and the heavy weight of the equities in plaintiffs' favor, the court grants the requested injunction. Accordingly, it is

ORDERED that plaintiffs' preliminary injunction motion is granted, and, for the pendency of this action, defendant MCAP Walnut Housing LLC (the Old General Partner) shall not serve as the Partnership's general partner and, instead, plaintiff BF Walnut Park, LLC (the New General Partner) shall serve in such role, and defendants are enjoined from: (1) interfering with the authority and power of the New General Partner over the assets, investments, or management of the Partnership; (2) removing, altering, or destroying the Partnership's books and records (including, but not limited to, any of the Old General Partner's records pertaining to the Partnership, or preventing the New General Partner access to the same); (3) taking any action on behalf of or in the name of the Partnership or any entity controlled by the Partnership; and (4) taking any action that would impair the value of the Partnership or its assets; and it is further

ORDERED that within 7 days of the entry of this order on the NYSCEF system, defendants shall e-file an affidavit of compliance with the terms of this order, including a representation from Richard G. Corey that all of the Partnership's books and records have been produced to the New General Partner.

Dated: January 15, 2014

ENTER:

J.S.C.

SHIRLEY WERNER KORNREICH
J.S.C