

TRENDS IN THE REMOVAL OF GENERAL PARTNERS UNDER NEW YORK LAW

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Subject to the terms of a written partnership agreement, general partners have historically been given great latitude in managing a partnership's affairs. Even when they have crossed the line and committed acts that might constitute a breach of fiduciary duty, removal of the general partner has been a drastic and rarely-invoked remedy. However, a recent New York decision has highlighted and clarified the standard for removal of a general partner from a position of control when such a breach has been committed.

It has long been established that a general partner owes a fiduciary duty of loyalty to limited partners, requiring that he or she place the interests of the limited partners over his or her own interests. However, even where breach of fiduciary duty is found, removal of the general partner from its position has rarely been ordered by the New York courts, often occurring only when the partnership agreement itself explicitly provides for such a remedy in the event of a breach. Courts will look to other legal and equitable remedies instead. Recent New York case law may indicate a change in that trend, with one case in particular reaffirming the equitable remedy of removal when it replaced the breaching general partner by elevating a group of limited partners to that position.

Generally, the legal and equitable remedies for breach of fiduciary duty by a general partner include an award of monetary damages, an order that an accounting be provided to the limited partners, disgorgement of any profits or commissions obtained by the general partner as a result of the breach, imposition of a constructive trust, and an injunction barring wrongful conduct at issue. Removal of the partner, on the other hand, is an unusual remedy. The New York courts look first to the partnership agreement for any provision providing for such a remedy, which would require the court to do no more than enforce an explicit provision of the contract between the parties. But partnership agreements, often prepared at the direction of the general partner, generally do not include such provisions, and in the absence of such a provision, New York courts have been reluctant, with a few exceptions, to order removal.

Still, while "the court-ordered removal of a partner or judicial dissolution of a partnership are rarely-invoked remedies," it can be warranted and appropriate under certain circumstances. *Drucker v. Mige Associates II*, 225 A.D.2d 427, 639 N.Y.S.2d 365, 367 (1st Dep't 1996). Perhaps indicative of a future trend, in a recently-issued decision in the case of *Garber v. Stevens*, 601917/05, N.Y.L.J. 1202562441883 (Sup. Ct. N.Y. Co. June 6, 2012), the New York Supreme Court held that a group of limited partners should *replace* the general partner of a partnership, in light of the general partners' egregious breaches of fiduciary duty. More importantly, the court seemed to set forth a new standard applicable to the remedy of removal.

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In *Garber*, the partnership purchased title to an apartment building in Brooklyn. The partnership agreement provided various restrictions on the authority of the general partners who could not, for example, refinance the property without majority approval of the limited partners, nor could they take management fees for performing their duties as general partners. However, over the course of thirty years after the partnership acquired the property, the general partners had (i) refinanced it six times, (ii) did not distribute any of the proceeds resulting from the refinancing to the limited partners, instead diverting those proceeds to their own use, and (iii) collected management fees from partnership funds. Even after the limited partners brought suit against the general partners for these breaches, these breaches continued and the degree of self-dealing and disloyalty by the general partners only increased.

Although the partnership agreement did not have a provision providing a specific means for the limited partners to remove the general partners, the *Garber* court held it was appropriate to remove them here, and set forth a 2-part standard for doing so.

A court has the power to remove a general partner from a partnership and elevate a limited partner to general partner where the limited partners have shown that (i) the general partner violated his fiduciary duties to the partnership and that (ii) removal is necessary to preserve the partnership. . . . A court has discretion to remove a general partner and elevate a limited partner to the status of general partner as necessary to protect the principal asset of the partnership.

The court was clear that lack of contractual authority did not prevent it from ordering removal of the general partners, as “[t]his court, having obtained jurisdiction of the parties and subject matter in this action must adapt its relief to the exigencies of the case,” and to exercise the full range of its equitable powers. The removal of the general partners here would allow the partnership to continue, would allow the partnership the opportunity to retain its sole asset, and would eliminate the profound abuse of power committed by the general partners.

The *Garber* decision provides a clear outline of the factors to evaluate and a standard to apply that may allow for the more frequent and consistent use of removal to remedy a breach of fiduciary duty. Where the general partner’s conduct in abusing its position is significantly harmful to the partnership and/or the limited partners’ interests, the general partner can be removed. After *Garber*, this may be precisely the action taken with increasing frequency by the New York courts.