Hypothetical JV Sales to Value JV Interests in ROFOs, Buy/Sells, Puts, and Calls

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This article examines the hypothetical sale of a JV's property that is contemplated in many real estate JV Agreements to determine the pricing for an inter-partner JV interest sale under a right of first offer, buy/sell, put or call.

Many real estate joint ventures ("JVs") between an operator and an investor contemplate a sale of one partner's interest to the other in connection with certain exit strategies and dispute resolution mechanisms. Such an inter-partner sale may occur, for example, when one of the following rights is triggered:

- a right of first offer;[1]
- buy/sell right;
- a put right; or
- a call right.

And when the JV is not "straight-up" (i.e., with each partner having a fixed percentage of all contributions and distributions), the price for the selling partner's interest is often established by what the selling partner would receive from a hypothetical sale by the JV. The provisions governing this hypothetical JV sale may get little attention (on the theory that they may cut both ways[2] or are not likely to come into play); they often vary from deal to deal; and they are sometimes inconsistent[3] within the same document (for a right of first offer, buy/sell, put or call). This article identifies some of the questions to be considered when drafting hypothetical JV sale provisions and provides some sample provisions (the "Sample Provisions") in Appendix A. Partnership terminology is used although most, if not all, of the discussion applies equally to limited liability companies.

Assumptions

For purposes of this article, the following statements are assumed as facts (unless otherwise stated):

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(1) an operator and an investor form a single-purpose partnership[4] to acquire and operate a real estate project (the "Project" or "Property"); and

(2) the partnership agreement includes:

- a unilateral sale right subject to a right of first offer ("ROFO"), which provides that at any time either partner[5] may give notice of its desire to sell the Project, and for a certain period of time after this notice, the non-initiating partner[6] may name a price for the Project,[7] in which event the initiating partner may either (i) sell its partnership interest to the non-initiating partner for the amount the initiating partner would receive from a hypothetical sale of the Project at the stated price or (ii) attempt to sell the Project for a price that is not less than the stated price (subject to a margin of error);

- a buy/sell right ("Buy/Sell") which provides that at any time either partner may name a price for the Project[8] and the other partner must then decide whether to sell its partnership interest to the initiating partner or buy the initiating partner's partnership interest, where the price for each partner's partnership interest is based on what it would receive from a hypothetical sale of the Project at the stated price; and

- a put/call right ("Put/Call"), which provides that one specific partner (the purchasing partner) may call, and the other partner (the selling partner) may put, the selling partner's interest, for a price equal to what the selling partner would receive from a hypothetical sale of the Project[9] at its then appraised value.[10]

Questions

Many partnership agreements include ROFO, Buy/Sell, put or call provisions that differ from the assumptions above[11] and even when they are consistent, many of the details of the hypothetical sale provisions may differ from one another and in particular, the Sample Provisions. The discussion that follows focuses on some possible variations and how and why the hypothetical sale works. In particular, the following questions are considered:

- *Why* have a hypothetical sale?
- *What* is hypothetically sold (and priced)?
- Is there a hypothetical *liquidation*?
- *When* does the hypothetical sale/liquidation occur?
- *How* is the hypothetical sale/liquidation distribution determined?

1. Why Have a Hypothetical Sale?

To get started, it may be helpful to understand the reasons for the hypothetical JV sale. Basically, the hypothetical JV sale is used to make partnership interest sale pricing comparable to real estate sale pricing: hypothetical JV sale pricing allows the partners to be in a similar economic position under a ROFO, Buy/Sell or Put/Call as they would have been in had the partnership sold the real estate to the purchasing partner; it also gives the partners a way to trigger the Buy/Sell with a single price when the ownership interests are not simply proportionate.[12] Although the selling partner does not get the benefit of a fully marketed real estate sale, and the price may be established by appraisal or one of the partners, the hypothetical JV sale arguably facilitates an exit for the selling partner based on a price for the real estate (rather than the selling partner's partnership interest) to account for the fact that, in a perfect world, where the partners' interests are completely aligned, the partners would remain in the partnership until the real estate is sold.

JV Real Estate Sale vs. Inter-Partner Partnership Interest Sale. It is certainly possible to effectuate a ROFO, Buy/Sell or Put/Call with an actual JV real estate sale (and some partnership agreements so provide): the purchasing partner simply buys the Project (or the JV's assets) rather than the other partner's partnership interest.[13] With an actual JV real estate sale, there is, of course, no need for a hypothetical JV sale. However, an inter-partner partnership interest sale (that utilizes a hypothetical JV sale for pricing) may be a way to achieve (indirectly) a result similar to a JV real estate sale: the pricing will be comparable to an actual JV real estate sale; and the purchasing partner will own (indirectly through its ownership of the partnership) the real estate that would have been acquired directly in a JV real estate sale. And it may be more efficient and cost-effective.

Advantages. The advantages of using a hypothetical JV real estate sale and an actual inter-partner partnership interest sale (rather than an actual JV real estate sale) may include one or more of the following:

- Eliminating the purchase by the purchasing partner of the portion of the investment it already owns, which may have both tax and non-tax benefits: (1) avoiding partnership gain on the sale of the *entire* property (and, in particular, the portion of that gain that would be allocated to the purchasing partner);[14] and (2) avoiding the need for the purchasing partner to effectively pay itself a portion of the purchase price (which might occur if the purchasing partner were to pay the full cash price for the Project and then receive back its distributable share of the net sale proceeds);[15]

- Avoiding consents (e.g., with existing lenders, franchisors, and ground lessors) that would be required for a JV real estate sale but not for an inter-partner partnership interest sale;[16]

- Reducing closing costs (e.g., transfer taxes may be avoided or reduced,[17] and there may be no recording or title insurance costs);[18]

- Expediting the process (e.g., there is no need to record documents or to assign leases, partnership contracts, reports and other partnership assets);

- Retaining title insurance in a safer and more efficient manner;[19] and

- Improving state income tax consequences.[20]

The benefits of keeping the real estate sale "hypothetical" may be more readily apparent when the Project is encumbered by financing: an inter-partner partnership interest sale utilizing a hypothetical JV sale may avoid the need to prepay the loan (and pay a prepayment premium) or assume the loan (and pay an assumption fee), which could be required for an actual JV sale of the Project to the purchasing partner. Moreover, an actual real estate sale may not even be possible if the loan is not prepayable or assumable at the time in question.

Disadvantages. The hypothetical JV sale and inter-partner partnership interest sale are not, however, free from disadvantages, which may include:

- the effective transfer to the purchasing partner of *liabilities* of the partnership that would not be assumed (or otherwise acquired) in a JV real estate sale (especially when the purchasing partner is a passive investor who is not familiar with the partnership, or teams up with a third-party investor to make the purchase);
- similarly, although generally less of a concern than liabilities, the effective transfer to the purchasing partner of *assets* of the partnership that would not be sold in a JV real estate sale (especially when the partners would prefer to retain those assets in a partnership format, whether due to valuation issues or otherwise);[21] and
- difficulties in addressing contingent assets and liabilities (as discussed in Appendix B), when compared to using the preexisting dissolution provisions of the partnership agreement.

An inter-partner partnership interest sale might also raise the following concerns:

- Might it be more difficult to specifically enforce a partnership interest sale when compared to a real property sale?
- Will the partnership interest to be sold constitute a security and, if so, will the securities laws impose a heightened level of disclosure duties and other obligations on the selling partner that might not be present in a property sale?

For one or more of these reasons, some partnership agreements may (and the Sample Provisions do) give a partner the option under certain circumstances to proceed with a real estate sale. However, in the authors' experience, such an option is not common.

Best of Both Worlds? Is it possible to get the benefits of both a real estate sale and an inter-partner sale with a hybrid structure? Indeed, the inter-partner sale may be structured so that the purchasing partner purchases an undivided interest in the Property from the selling partner (based on the selling partner's anticipated share of net sale proceeds). This alternative is explained further in Appendix C, which concludes that while this hybrid structure may be more complicated than the two approaches described above and fails to capture many of the benefits of an inter-partner sale of partnership interests, it may be worth considering to make a real estate sale option more tax-efficient.

The balance of this article is devoted to questions (and complications) to be considered when implementing a hypothetical JV sale. It is worth noting that some of these matters (e.g., what is being sold and priced) should be considered even if there is an actual JV real estate sale to the purchasing partner.

2. What is Hypothetically Sold (and Priced)?

(All-Asset Pricing vs. Project Pricing)

One of the first steps in a ROFO, Buy/Sell and Put/Call is to determine the price for the hypothetical JV sale. For this purpose (among others), it is of course essential to know *what* is being sold (and priced).

Alternative Approaches. Typically, there are two possibilities:

- *all the assets* of the JV; or
- *the Project* (or *Property*).[22]

In other words, the alternative assets to be hypothetically sold are (1) *all JV assets*, or (2) only those JV assets that would be involved in a third-party sale of *the Project*.

The Difference. The obvious difference between these approaches is that a third-party sale of the Project would typically not include cash on hand (except to the extent this cash represents prepaid rent and other receivables allocable to the post-closing period, or tenant deposits, in which event it may be addressed in the prorations), warrants, cash equivalents, and various other assets (e.g., receivables owed by, or other claims against, tenants who no longer occupy the property).[23]

Consequences of Pricing Approach. The alternative chosen may have a ripple effect resulting in other differences (e.g., regarding closing adjustments that are discussed further in Section 5.2 of this article). The *Project* approach is generally designed to replicate the pricing for a sale of the Project, which may be a familiar subject for most real estate professionals. By contrast, the *all-asset* approach does not match the pricing for a typical real estate deal. For example, it may require pricing of receivables, contingent claims and other assets which may otherwise be prorated when received or left with the partnership after a sale of the real estate. The *all-asset* approach seems to be motivated by the desire for a simple and clean break, to minimize the likelihood of disputes, which is a laudable goal. But while the *all-asset* approach seems simple on its face, query whether it takes real estate professionals into foreign territory that increases the risk of errors and misunderstandings? And query whether the hypothetical JV sale requires further tailoring to make it more likely that the *all-asset* approach will accomplish its goal? For example, should liabilities, both fixed and contingent, also be covered by the initial price? More generally, should the *all-asset* approach replicate the pricing of a corporate asset acquisition that takes into account both included assets and assumed liabilities (in this case, *all* assets and liabilities)[24] by pricing the (net) equity of the partnership as of the date of the pricing, and then having a balance sheet adjustment at closing rather than prorations (or no adjustment at all)? If so, will the partners be surprised by the results? In the authors' experience, in real estate partnerships, the *all-asset* approach is usually not accompanied by these further changes.

Custom and Practice. In the authors' experience, the *Project* approach is common in connection with a unilateral sale right subject to a ROFO and both the *all-asset* and *Project* approaches are common in connection with a Buy/Sell or a Put/Call.

ROFO. In the ROFO context, if the first offer is not accepted, the stated price usually establishes a floor price (which may be subject to a margin of error) for a third-party sale of the Project. Therefore, for purposes of comparison, the partners presumably want to be pricing the same thing a third-party buyer would purchase. To maintain this symmetry between the price offered to the market and the ROFO price, *Proj-*

ect pricing seems like the better (if not the only good) alternative for a ROFO.

Buy/Sell and Put/Call. In the Buy/Sell and Put/Call context, there is usually no need for such a comparison; moreover, there may be an intuitive appeal to pricing everything because it may eliminate (or address) valuation issues for non-Project assets that are not easily monetized. Indeed, the *all-asset* approach might seem particularly well suited for the Put/Call because it typically involves an appraisal process. But query whether an additional appraiser may be required to value assets other than the Project (e.g., a litigation claim)? Either the *all-asset* or *Project* approach can be used for the Buy/Sell and Put/Call and, as noted above, each often appears in practice in either context.

Consolidated/Consistent Approach. What if the partners wish to consolidate the provisions governing the price and other terms for the inter-partner sale for the ROFO, Buy/Sell and Put/Call and to make consistent adjustments to account for what happens during the inter-partner sale process (i.e., post-trigger and pre-closing)? This consolidation may mandate the *Project* approach simply because it may be the only suitable candidate for the ROFO.

Unless otherwise indicated, it is assumed in this article that *Project* pricing is adopted. However, because *all-asset* pricing is relatively common, this article frequently includes a comparison of *all-asset* pricing in the context of the relevant subject. To avoid confusion, it may be helpful to keep in mind that *all-asset* pricing (as typically encountered by the authors and as discussed in this article) is not limited to the assets owned by the partnership at the time of the pricing; if additional assets are acquired by the partnership before closing, they are covered by the hypothetical JV price (absent an adjustment).

3. Is There a Hypothetical Liquidation?

If the Project were actually sold, then the partnership would typically be dissolved and liquidated.[25] Yet some partnership agreements that refer to a hypothetical sale of the Project (in determining the pricing for the sale of a partner's interest) do not refer to a hypothetical liquidation of the partnership following such hypothetical sale. In many deals, this omission may not make a significant difference. But sometimes it could leave the purchasing partner with the burden of the selling partner's share of partnership liabilities (e.g., the outstanding balance on an unsecured operating line of credit) or, depending on how the partnership agreement is worded, give the purchasing partner the selling partner's share of the partnership non-Project assets (e.g., cash on hand that was not taken into account in the pricing of the Project), without appropriate compensation. Consequently, many partnership agreements (and the Sample Provisions) do provide for a hypothetical *liquidation* in addition to a hypothetical *sale*.[26] For purposes of the balance of this article, it is assumed that there is both a hypothetical sale *and a hypothetical liquidation* (which generally seems to be the preferred drafting approach when there is Project pricing).[27]

4. When Does the Hypothetical Sale/Liquidation Occur?

The next question is: *when* does the hypothetical JV sale/liquidation (and therefore the hypothetical distribution waterfall calculation) occur? There are two obvious possibilities:

- *early calculation alternative*: at the *begin-*

ning of the inter-partner sale process (e.g., when the hypothetical JV sale price is established or when the partnership interest sale offer is accepted); or

- *closing calculation alternative*: at the *end* of the inter-partner sale process (i.e., the closing).

Some partnership agreements reviewed by the authors fail to specify the timing of the hypothetical JV sale, which may lead to confusion and arguments. When the timing is specified, the closing calculation alternative seems to be more customary, but one may encounter either alternative in practice. In both cases, an underlying JV asset price is determined at the outset. The primary difference is whether and how the calculation and adjustments are made to take into account prorations, interim events and the mere passage of time during the interim period (i.e., the period between the beginning and the end of the inter-partner sale process).

Early Calculation. The goal behind the early calculation alternative seems to be certainty of execution, which may be important to one or both partners when there is a concern about potential disagreements and disputes. To achieve this goal, the early calculation may be coupled with *all-asset* pricing (which may be worded to cover, in effect, both assets *and liabilities*)[28] and most, if not all, of the adjustments may be eliminated. (Although adjustments can be made at the time of the early calculation, if avoiding disputes is an important objective, then an adjustment *at any time* may be problematic.) There is an obvious price to pay for this certainty: the partners may sacrifice economic precision and run the risk of (what may in hindsight appear to be) an unfair result. Partners who put a premium on certainty may be willing to pay this price (and it may not be significant in the absence of interim events that cannot be controlled or material contingencies that are difficult to value).

Closing Calculation. In the authors' experience, partners often want to make some adjustments (e.g., prorations) and, if so, they want to make these adjustments at the closing to make sure they take into account interim events. Although it is possible to have the hypothetical JV sale at the outset and adjust the partnership interest price at closing, some of these adjustments (e.g., prorations) are more naturally made at the underlying asset (rather than partnership interest) level before the partnership interest price is finalized. Moreover, the adjustments may be more easily taken into account (in a manner that preserves the sharing contemplated by the distribution waterfall) by making the hypothetical sale/liquidation distribution at the end of the interim period. Objections to an early calculation encountered by the authors that may lead to a closing calculation include:

- The early calculation alternative may not accomplish its goal without all-asset pricing, which may not be desirable if the inter-partner sale pricing provisions are intended to apply to a ROFO.
- If the operator is entitled to a promote,[29] then the investor may resist the early calculation alternative because it stops the accrual of the investor's return even though the investor's investment may still be outstanding. In other words, it may "lock in" the promote as of the date of the calculation. This issue is sometimes compromised by adding an interest factor when the investor is the selling partner. But the investor may not always be the

selling partner[30] and even when it is, it may be difficult to find a mutually acceptable interest factor.[31]

- The early calculation alternative may create a risk that the sale is recharacterized as having occurred as of the date of calculation with disguised seller financing.[32] This shift in timing could be important if, for example, the date of calculation is in one calendar year and the closing is in the next calendar year.

If certainty is paramount, but the investor insists on a closing calculation, then (at least for the Buy/Sell) it is also possible to use the closing calculation with no adjustments (as described in the "Initial Pricing Alternative" discussion in Appendix B).

Duration of Interim Period. The difference between these two alternatives (early calculation and closing calculation) becomes less important if the interim period (between the time the hypothetical JV sale price is determined and the closing of the inter-partner sale closing) is shortened. But, with the possible exception of a Put/Call (which may not involve an election period), it is often, if not usually, impractical to make this interim period short enough to render the differences immaterial.

In light of these considerations, it is assumed in the balance of this article (unless otherwise stated) that the closing calculation alternative has been adopted.

5. How is the Hypothetical Sale/Liquidation Distribution Determined?

Perhaps the most difficult question to answer is *how* the hypothetical sale/liquidation distribution is determined. Two key components of this determination are:

- The method of pricing and valuing assets; and
- The adjustments to establish the net hypothetical distribution amount.

5.1. Pricing and Valuation

The pricing and valuation discussion is divided into three parts:

- Pricing for Assets sold in Hypothetical Sale;
- Valuation for Other Assets and Liabilities; and
- Whether to Discount for a Partial Interest.

5.1.1. Pricing for Hypothetical Sale Assets

What is the method for determining the initially stated price? With the Put/Call, there is typically an appraisal process. But what about a Buy/Sell or ROFO, where one partner usually must name a price? Must the pricing be reasonable, made in good faith, or subject to some other requirement? Or is the partner who states the price free to choose any amount without restriction? Imposing a standard or other requirement may be a way to protect the parties from manipulation (e.g., an artificially deflated or inflated price within a certain range might benefit primarily or solely one partner because there are subordinated or priority distribution levels). But is such a restriction — even a subjective good faith standard[33] — an invitation to fight? Consider what would happen if a party's records indicate that it thought the value was different from the price named? What if there were conflicting views internally but only one set of views is documented? Even if there is no damaging evidence in the initiating partner's files, might the other partner attempt to discover such evidence as a delaying tactic? Some practitioners believe that it is important to have no restriction on the pricing to eliminate second-guessing and to reduce the likelihood of a dispute.[34] Moreover, there may be circumstances where an artificial valuation seems appropriate (e.g., if the value of the Project is uncertain but is perceived to be less than the amount of the partnership debt, one of the partners is anxious to end the JV relationship, and that partner is willing to trigger a Buy/Sell using a price that yields partnership interest prices of $0).[35] Pricing issues may be most troublesome in the Buy/Sell context because of potential imbalances in what is often advertised as an evenhanded procedure; such imbalances have discouraged some partners from using Buy/Sell provisions at all, especially when they are likely to invite mischief.[36]

5.1.2. Valuation for Other Assets and Liabilities

What about assets that are not priced as part of the initial pricing?[37] And what about liabilities? How are they valued?

Valuing Unpriced Assets. In many transactions, the only assets that are not initially priced are cash reserves and cash equivalents.[38] Such assets are easily quantified. But what if there are non-cash assets? How will they be valued? It may be easy to monetize some non-cash assets. For example, publicly traded stock may be valued based on the average closing price for such stock for a certain period of time before the hypothetical distribution calculation. But other non-cash assets (e.g., warrants issued by a tenant that are not, or are infrequently, traded) may be more challenging. Perhaps the most difficult category of non-cash assets are claims against third parties, which are in a sense *contingent* assets (because the amount or collectibility of the claim may be uncertain). For example, the partnership may have a claim against a former tenant that could be worthless or could be worth millions of dollars (depending on a number of factors that may not be ascertainable with certainty at the time of the hypothetical sale). The treatment of such contingent assets, along with certain contingent liabilities, is discussed in Appendix B.

Valuing Liabilities. With the exception of a reference to the hypothetical liquidation (and sometimes a statement that all liabilities of the partnership are paid), there tends to be little focus on, and few provisions addressing, how liabilities should be accounted for in the hypothetical sale.[39] The mortgage debt on the Property is typically deducted from the Project price in determining what amount would be run through the distribution waterfall. Presumably, other fixed monetary liabilities, such as repayment of an unsecured line of credit, are simply deducted as well. But what happens in practice with respect to *contingent* liabilities, such as a claim *by* a former tenant for wrongful eviction (which, like the claim *against* a tenant described earlier, could be worthless or could involve a very material amount)? The partners (and others) may have vastly different views of the exposure involved. The treatment of such contingent liabilities, along with certain contingent assets, is discussed in Appendix B.

Who Makes the Valuation? The partners may of course attempt to agree on dollar amounts to account for non-cash unpriced assets and unliquidated liabilities, but this may be difficult without the help of a third party. With the exception of an appraisal process in the

Put/Call, in the authors' experience, partnership agreements rarely provide for a valuation process for this purpose other than to defer to the partnership accountants. Indeed, some partnership agreements contain language letting the partnership's accountants resolve all disputes regarding the determination of partnership interest pricing based on a hypothetical JV sale. But will the accountants (or the appraisers, as to assets, such as litigation claims, with which they have no valuation expertise) discharge this responsibility? And is there any risk in having them do so? Moreover, might things be so uncertain that it would make more sense to defer the monetization of these assets and liabilities until there is adequate information? These questions are considered (in the context of contingent assets and liabilities) in Appendix B.

5.1.3. Discount for a Partial Interest?

Should the hypothetical JV sale price be discounted to avoid an inflated valuation of the selling partner's interest?[40] One might argue that the value of the sum of the (partnership interest) parts is *less* than the value of the (partnership asset) whole. The sale of the Project (or all the assets of the partnership), the argument would go, is likely to yield more to each partner than a sale of its interest because an asset sale is cleaner (avoiding the issue of unknown JV liabilities that would be inherited by the buyer of a partnership interest and the difficulties of dealing with a continuing partner) and more complete (a partnership interest sale may be subject to partial discount, especially for a minority or non-controlling interest). Although minority interest and marketability discounts are relatively common when valuing interests in a closely held corporation or a family limited partnership,[41] the authors have rarely seen a discount to account for any variance between asset and ownership interest values in the context of a hypothetical JV sale (or the associated inter-partner sale). Indeed, the apparent purpose of the hypothetical JV sale is to give the selling partner the benefit of real estate pricing.

5.2. Adjustments

Once the assets that are to be hypothetically sold or liquidated have been priced or valued, there are a number of adjustments that may be made in order to determine the net liquidation distribution amount to be run through the applicable distribution waterfall in the partnership agreement. There may, for example, be adjustments to account for:

- Prorations;
- Closing Costs;
- Asset Changes During Sale Process;
- Liability Changes During Sale Process;
- Interim Distributions; and
- Loans Between a Partner and the Partnership or the Other Partner.[42]

Each of these subjects is discussed below. Each is complicated enough by itself, but the interplay among these adjustments can make them particularly challenging. Some examples illustrating how these adjustments may work together are set forth in Appendix A.

5.2.1. Prorations

In the authors' experience, it is common to provide that there will be customary prorations in connection with the hypothetical JV sale. Rarely, however, do the partnership agreements reviewed by the authors go into any detail as to how the prorations should work, even though the proration provisions in a typical real estate purchase agreement may cover several pages. Usually, as may be done in the Sample Provisions, there is simply a reference to local custom.

Potential Disagreements. This shorthand approach may, of course, lead to disagreements over points that are often negotiated in a purchase agreement (e.g., employee benefits, hotel receivables, leasing commissions and tenant improvement costs) or points that might not clearly translate in the context of hypothetical sale pricing (e.g., amounts that are not prorated until received). For example, what happens to delinquent rents? In a typical purchase agreement, these are receivables that are not prorated at closing but are shared if and when they are received. A similar approach may be taken for a shortfall in the tenant reimbursements paid to the seller due to low expense estimates. Should these receivables be shared with the selling partner and if so, how? If the final level of the distribution waterfall has not been reached in the hypothetical sale and liquidation, then do the partners need to redo the distribution calculation each time additional payments are to be shared? Similarly, what about tax reprorations (when initial prorations are based on prior year's taxes because the current year tax information is not available at closing) or year-end lease reconciliations?

Common Practice. If the partners do not want to take the risk of a fight as to how the prorations should work, they may need to go into more detail. However, the Sample Provisions and, as noted above, most partnership agreements reviewed by the authors, do not necessarily do so. The reason, perhaps, is that the likelihood of actually utilizing a hypothetical JV sale is often perceived as being remote (e.g., in a deal with a Buy/Sell that the partners don't expect to trigger), and the partners are both at risk and likely to work out their differences if the inter-partner sale occurs. Moreover, in most inter-partner sale transactions in which the authors have been involved, after some initial posturing, the partners chose to ignore the process in the partnership agreement and instead reached a new consensual resolution that spelled out the necessary sale terms. In some deals, it may be possible simply to incorporate the proration provisions from the purchase agreement under which the partnership acquired the Project.

Variations Depending on Alternatives. The timing and manner of prorations may vary depending on how the hypothetical JV sale works. For example, if the early calculation alternative were chosen, then prorations would likely occur simultaneously (at the time of the early calculation); something in the nature of prorations might still occur at closing, but they would be adjustments to the partnership interest sale price. One of the reasons this article assumes that the early calculation alternative has not been chosen is that there may not be a clear custom for such closing prorations. Similarly, if all-asset pricing were utilized, it is not clear how the prorations would work. Presumably, all-asset pricing covers assets (e.g., security deposits and prepaid rents) that would be credited to a buyer purchasing the Project at the time of the hypothetical JV sale. If such assets are so covered so that, for example, the hypothetical buyer has already paid for prepaid rents allocable to the period after closing, then prorating in accordance with local custom may not make sense. If the assets that would normally be addressed by prorations are excluded from all-asset pricing, then should there be prorations at the time of the hypothetical JV sale (in addition to prorations at the closing)?

Double-Counting Issues. There may be some duplication between the prorations and other closing adjustments. For example, if there are both prorations and a hypothetical liquidation, then accrued and unpaid operating expenses should not be credited to the buyer in the hypothetical JV sale and also deducted in the subsequent hypothetical liquidation of the partnership.

5.2.2. Closing Costs

There are two layers of closing costs to consider:

- the hypothetical JV closing costs in the hypothetical sale of the Project by the partnership; and
- the actual partner closing costs in the actual inter-partner partnership interest sale.

While only the hypothetical JV closing costs may be involved in the hypothetical sale by the partnership, the partners may take the actual partner closing costs into account in determining the amount and allocation of hypothetical JV closing costs. Therefore, both categories of costs are discussed below.

Generally. In determining how to address these various closing costs, the partners may have differing views as to the ultimate goal. To find a mutually acceptable approach, it may be helpful to start by remembering the following fact: *the amount the seller receives* from the closing of an actual property sale is generally not the same as *the amount the buyer pays* (due to closing costs, mortgage debt payments and other closing adjustments). Indeed, the buyer pays a *gross* amount (the purchase price), in addition to the buyer's closing costs, and the seller receives a *net* amount (after deduction for, among other matters, its closing costs). A fundamental question for the hypothetical JV sale is whether and how to bridge this gap: should the price be *net* to match what the selling partner would receive (after closing costs) or should it be *gross* to match what the purchasing partner would pay, or should there be some middle ground? The appropriate approach should take into account whether the amount and customary allocation of the hypothetical closing costs can be determined with certainty, and the additional layer of actual closing costs that may be incurred in connection with the inter-partner sale. The conclusion may also vary depending on the amount and customary allocation of closing costs in the state in which the Project is located and the other facts of the transaction.

Uncertain Amounts of Hypothetical Closing Costs. While some hypothetical sale closing costs may be easy to determine (e.g., transfer taxes), others may vary from deal to deal and may not always be easy to establish if they are not actually incurred. For example, if a broker is not engaged, what would the brokerage commission be? Isn't this sometimes a negotiated amount? As additional examples, title insurance premiums are negotiable in some states, and attorneys' fees often vary depending on the identity of the buyer and the level of negotiations. This uncertainty sometimes leads to the fixed percentage deductions discussed below.

Uncertain Allocations of Hypothetical Closing Costs. If a hypothetical closing cost is to be deducted from the stated Project price, the deduction should not be more than the portion of such cost that would have been paid *by the seller* of the Project in the hypothetical sale. But what if it is not clear how a particular cost would be allocated between a seller and a buyer? Although many closing cost allocations are firmly established by custom, that is not always the case. For example, guides published by national title companies indicate that the allocation for the cost of title insurance is negotiable in a number of states (including Alabama, Georgia, and Tennessee).[43] If there is any doubt regarding the allocations, it should be resolved (e.g., by splitting the cost of negotiable items).

Double-Counting of Hypothetical and Actual Closing Costs. There may be some overlap between the hypothetical closing costs at the asset sale level and the actual closing costs at the partnership interest sale level. For example, in California, a sale of a partnership interest of 50% or more may give rise to a transfer tax.[44] If the selling partner were obligated to pay this tax in connection with the actual sale of its partnership interest, it should not also be required to deduct a transfer tax at the asset level in calculating the partnership interest sale price (or there would be double-counting of a transfer tax). As another example, what if the broker engaged by the JV is entitled to receive its commission in connection with the partnership interest sale?[45] Who will be responsible to pay these actual costs? Some partners may be willing to impose responsibility on the selling partner for costs (e.g., transfer taxes) that are customarily imposed on a seller and are actually incurred and any brokerage commission actually due to the broker engaged by the partnership (recognizing that the selling partner may be able to reduce some of these costs in the context of partnership interest sale), if there is no deduction to take into account hypothetical JV closing costs. Other partners may claim that the JV should pay these costs just as it would in a hypothetical JV sale or the selling partner may in some circumstances[46] effectively be picking up the purchasing partner's share of these costs (and could therefore end up getting less than it would have received in a JV sale).[47]

Hypothetical Closing Cost Savings. How should the savings resulting from not having to incur hypothetical JV closing costs be shared? As suggested at the outset of this Section 5.2.2: some partners may argue that the selling partner should get no more than the *net* amount it would have received from an actual sale of the Project; and other partners may argue that a purchasing partner should pay no less than the *gross* amount it would have paid in a purchase of the Project (for the selling partner's share).[48] In a Buy/Sell, each of these extremes may skew the decision-making process by making a sale or purchase more attractive than the other (depending, of course, on how actual closing costs are allocated).[49] In a Put/Call, neither partner will want an approach that gives the hypothetical closing cost savings only to the other partner. In a unilateral sale subject to a ROFO, a partner expecting to exercise its sale right may have similar concerns. Uncertainty as to who will be the selling partner and who will be the purchasing partner may take some pressure off the foregoing issues and lead to a mutually acceptable solution. The ultimate approach should take into account how actual closing costs are shared.

- *Some Alternative Ways to Share*. To address the sharing of hypothetical closing costs, partnership agreements may provide the following, among other solutions:

(1) no deduction of hypothetical closing costs; (2) a fixed percentage reduction of the gross Project price to reflect a hypothetical closing cost allocation to the seller; or (3) a hybrid approach where there is a reduced fixed percentage to effectuate a sharing of the cost savings for certain hypothetical closing costs (e.g., transfer taxes) that are not in fact incurred in the inter-partner sale. The appropriate alternative may, of course, depend on the facts. The Sample Provisions take the first approach.[50]

- *Net vs. Gross Prices*. In Buy/Sell provisions, it may seem simpler to use a price that is *net* of hypothetical closing costs, because it may appear that either a gross or net price can easily be factored into the pricing (and a net price eliminates a step for the documents). For example, assuming for simplicity, $2X of hypothetical closing costs and no prorations or other adjustments: a $100X gross price less a closing cost adjustment of $2X and a $98X net price with no closing cost adjustment, both result in a $98X distribution amount. But, as noted earlier, this may skew the Buy/Sell by making a purchase more attractive: if in the example above, there are no actual closing costs, the selling partner may be getting the same net price it would get from a third-party sale (arguably *a market deal* for the selling partner), but the purchasing partner may be paying less than the gross amount it would pay for the selling partner's share in a Property purchase (arguably *a better-than-market deal* for the purchasing partner). For a Put/Call, the partners could instruct the appraisers to determine a net price, but the selling partner may resist that approach for the same reasons. Moreover, if the Put/Call is intended to be a dispute resolution mechanism, the selling partner may feel it is not appropriate to deduct substantial costs that could be avoided by the partnership when it actually sells the Project (e.g., by selling the Project during a free prepayment window near the end of the term of the loan, a substantial prepayment fee could be avoided).[51] When there is a ROFO involved, a net price would make it harder to compare third-party offers (because it requires a deduction of closing costs that could give rise to disputes). For these reasons, it is assumed in the discussion above that a gross price is named or determined in each of the unilateral sale/ROFO, Buy/Sell and Put/Call procedures.

Actual Closing Costs. The solutions to sharing hypothetical closing costs are not complete without addressing the allocation of the actual closing costs in the inter-partner sale. The Sample Provisions provide that the partnership will pay for transfer taxes and loan satisfaction/assumption costs that are required to be incurred in connection with the inter-partner sale,[52] that the partners will share escrow charges equally and that other actual closing costs will be borne by the partner incurring the costs. Many other approaches are possible and no one approach may be appropriate for all deals. For example, one common alternative is to allocate actual closing costs in accordance with local custom.[53] This approach is not followed in the Sample Provisions because it may not always be clear what the custom is for an inter-partner partnership interest sale. Moreover, the Sample Provisions attempt to avoid any argument over what costs should be allocated.

5.2.3. Asset Changes During Sale Process

What is considered in establishing the price for the hypothetical JV sale (i.e., either the Project or all assets) may no longer be the same at the closing: it may be more (e.g., by the acquisition of an outparcel) or less (e.g., by the sale of an outparcel). How do the partners account for such asset changes during the inter-partner sale process (post-trigger and pre-closing)? Some partners try to eliminate the possibility of any interim asset changes by prohibiting them (or limiting them by requiring ordinary course operations). But this is not always desirable or practical (e.g., due to emergencies, work in progress, or opportunities the partnership may prefer not to miss).

All-Asset Pricing. All-asset pricing effectively freezes the price for all the assets of the partnership. As a result, subsequent changes in assets (other than changes in associated liabilities) may not be taken into account in the hypothetical liquidation. To avoid an unfair result, the partners may want to track changes to the assets during the partnership interest sale process. Obviously, mere changes in value are not relevant because the pricing has been fixed (which, insofar as non-Project assets are concerned, could be perceived as an advantage or disadvantage of the all-asset approach, depending on your perspective). But it may be relevant to track (x) increases (e.g., due to acquisitions and improvements) in assets, for which the selling partner may want to be paid, and (y) decreases (e.g., due to dispositions) in assets, for which the purchasing partner may not want the selling partner to be paid more than once. Some partnership agreements attempt to address this problem by *adding all contributions* and *subtracting all distributions* during the inter-partner sale process.[54] These adjustments have some intuitive appeal:

- contributions may represent new cash assets that were not taken into account so an increase in pricing avoids losing the new assets in the calculation; and
- distributions may represent the depletion of assets that were taken into account so a decrease in pricing may avoid double-counting these assets.

But this approach may be too simplistic[55] as explained in Appendix D.

Project Pricing. By pricing only the Project, the other assets of the partnership may generally be taken into account in the hypothetical liquidation (along with the partnership's liabilities),[56] but there are still some adjustments that may be required. The partners may want to track both expansions and improvements in the Project, on the one hand, and depletions of the Project, on the other hand, to make sure the selling partner isn't overcompensated or undercompensated because:

- something *included* in the Project (when it was priced) is later *removed* from the Project and effectively double-counted in the calculation (e.g., a partial sale of an adjacent strip of land or other portion of the Project could result in a pre-closing distribution or simply become additional cash on hand that is added to the pot in the hypothetical distribution); or
- something *not included* in the Project (when it was priced) is later *incorporated*

into the Project and thereby effectively lost in the calculation (e.g., existing cash reserves, interim contributions or loan advances are used to improve the Project or buy an adjacent strip of land or other property that expands the Project).

The Sample Provisions contain closing adjustments intended to account for these asset changes.[57]

Comparison. For further discussion of these two approaches and how they differ, see Appendix D.

5.2.4. Liability Changes During Sale Process

How do the partners account for changes in liabilities during the inter-partner sale process? In the authors' experience, the partnership agreement provisions relating to the hypothetical JV sale typically include nothing more than prorations and a hypothetical liquidation to address partnership liabilities. For all-asset pricing, this approach may not be adequate. But in the case of Project pricing, it may be sufficient.[58]

All-Asset Pricing. The authors do not recall a partnership agreement using all-asset pricing that had closing adjustments for interim changes in assets and liabilities other than (x) prorations, (y) the adjustments for contributions and distributions described earlier, and (z) the hypothetical liquidation. As discussed further in Appendix D, such adjustments may not adequately address interim changes in liabilities.

Example 5.2.4A. Assume the following facts: (1) the inter-partner sale closes at the beginning of a calendar month, (2) the stated price for all assets of the partnership equals $100X, (3) the Project is subject to $20X of Project financing, (4) during the inter-partner sale process, there are no contributions and no distributions, and the operating expenses (which, to simplify the examples and illustrations in this article, will be assumed to include interest under the Project financing) incurred equal the operating revenues received, (5) there are no prorations, and (6) there are no closing costs and no other partnership assets or liabilities. Under these facts, if there were no change in the Project financing, then the net hypothetical liquidation amount would be $80X. But if there were an interim partial sale or casualty generating $20X of net sale or insurance proceeds that were applied to satisfy the Project financing, then (without an adjustment) the net hypothetical distribution would be artificially increased to $100X (because the all-asset price would remain at $100X and there would be no debt to be deducted in the hypothetical liquidation). The selling partner would get a windfall due to the $20X increase.

Project Pricing. In the authors' experience, there is usually no separate adjustment for liability changes when Project pricing is utilized. Any interim increase or decrease in partnership liabilities is addressed by prorations (e.g., an increase or decrease in accrued and unpaid operating expenses) or by the hypothetical liquidation because of the corresponding increase or decrease in the deduction for partnership liabilities. But because liabilities are often tied to assets (e.g., when liabilities are created to increase assets, through financed acquisitions and improvements, or when assets or their proceeds are used, and consequently depleted, to reduce liabilities), there may be an adjustment to address the corresponding change in assets (as discussed earlier).[59]

Example 5.2.4B. Assume the same facts as in Example 5.2.4A except that there is Project (rather than all-asset) pricing and the stated price for the Project is $100X. If there were an interim partial sale or casualty generating $20X of net sale or casualty insurance proceeds that are applied to satisfy the Project financing, then (without an adjustment) the net hypothetical distribution would be artificially increased to $100X (because the Project price would remain at $100X and there would be no debt to be deducted in the hypothetical liquidation). But there may be a corresponding *asset* adjustment (reduction) to the Project price when the Project generates net sale or casualty insurance proceeds (as there is in the Sample Provisions), and that adjustment should be sufficient: if there are $20X of net sale or casualty insurance proceeds, then a $20X reduction in the Project price would achieve the intended result (namely, an $80X net hypothetical distribution).[60]

5.2.5. Interim Distributions

Some partnership agreements prohibit interim distributions during the inter-partner sale process. However, many partnership agreements (and the Sample Provisions) require that distributable cash be distributed prior to the inter-partner sale closing. Such distributions may, of course, have an impact on the hypothetical liquidation/sale distribution amount.

All-Asset Pricing. As noted previously, when all-asset pricing is utilized, it is relatively common to deduct all interim distributions from the all-asset price. This deduction could (in effect) deprive the selling partner of its share of interim operating cash flow. (Even if the distribution is not made, the selling partner may be deprived of its share of the interim operating cash flow, because that cash may not be taken into account in the hypothetical liquidation, due to the all-asset pricing.)

Example 5.2.5A. Assume the following facts: (1) the inter-partner sale closes at the beginning of a calendar month, (2) the stated price for all the assets of the partnership equals $100X, (3) the partnership has no debt, (4) during the inter-partner sale process, there are $15X of operating revenues received, and $10X of operating expenses incurred, (5) there are no prorations, and (6) there are no closing costs and no other partnership assets or liabilities. Presumably, the selling partner expects to get its share of the $5X interim net operating cash flow plus its share of the $100X price. However, if there were no interim distributions (i.e., distributions after the commencement and prior to the closing of the inter-partner sale process), because the $5X interim net operating cash flow is used to create a reserve, then without an adjustment, there would be a net hypothetical liquidation amount equal to $100X, and the selling partner would not get its share of the interim net operating cash flow during the inter-partner sale process. If there were a distribution of the $5X of interim net operating cash flow, and the partnership agreement deducted all interim distributions from the all-asset price (resulting in an adjusted price of $95X), then the selling partner would again be deprived (in effect) of its share of the interim operating cash.

Project Pricing. With Project pricing, interim distributions reduce the cash on hand that would otherwise be taken into account in the hypothetical liquidation. For simplicity, it is assumed throughout this article that there is a single distribution waterfall (so that, for example, there are not separate distribution waterfalls for net operating cash flow and net capital proceeds).

Example 5.2.5B. Assume the same facts as in Example 5.2.5A except that there is Project (rather than all-asset) pricing and the stated price for the Project is $100X. Presumably, the selling partner expects to get its share of the $5X interim net operating revenues plus its share of the $100X price. If there were no interim distributions because the $5X interim net cash flow is used to create a reserve, then there would be a net hypothetical liquidation amount equal to $105X, which leads to the expected result. If there were a distribution of the $5X of interim net operating revenue, then there would be a net hypothetical liquidation amount equal to $100X, which again leads to the intended result.

5.2.6. Loans Between a Partner and Partnership or Other Partner

How are loans between a partner, on the one hand, and the partnership or the other partner, on the other hand, addressed? Presumably, such internal loans will be taken into account in the hypothetical liquidation and distribution calculation: usually loans from a partner to the partnership must be repaid before there are any distributions; and usually loans from one partner to the other (and presumably, loans from a partnership to a partner, such as tax loans) must be repaid (out of the borrowing partner's share of distributions) before the borrowing partner is entitled to retain any of its distributions. But the hypothetical liquidation and distribution may not completely account for such internal loans and the return they are expected to provide.

When Hypothetical Sale Proceeds Are Not Sufficient to Satisfy Internal Loans. What if the hypothetical cash that would otherwise be used to pay such internal loans owed by the partnership, and then (to the extent remaining) run through the distribution waterfall, is not sufficient to satisfy all the internal loans? In such event, the partners should consider:

- whether the result of the hypothetical liquidation and distribution should stand (with the resultant loss to the lender, because its "collateral" is underwater); or
- whether there should be some provision requiring the payment of any remaining deficiency (beyond what is already stated in the liquidation provisions of the partnership agreement) and, if so, from whom (recognizing that an SPE partner will have no assets with which to pay).[61]

See, for example, Section 10.4 of the Sample Provisions, which requires repayment and contributions to the extent there is a deficiency.

When Deemed Payoff Occurs Before Actual Payoff. If the early calculation alternative is used, then the portion of the internal loans that is paid with the hypothetical liquidation and distribution will stop accruing interest, which may not be fair to a selling partner who has made a loan. Although this loss of interest could be offset somewhat by an interest factor, the relevant internal loans may involve a different rate or rates (from one another, the relevant equity hurdle rates and any other rates involved), that make it more difficult to establish a single interest rate factor. This is part of the reason why the early calculation alternative is not used in the Sample Provisions.

6. Conclusion

Is there any reason to be concerned about the hypothetical JV sale provisions that are often used to price an inter-partner sale of partnership interests? Admittedly, they represent a fictitious construct, which may seem abstract and distant, and they are often reciprocal, and may consequently appear to be innocuous boilerplate. But the consequences of the hypothetical JV sale are real and even if the relevant provisions are reciprocal, in the end each partner is on only one side of the inter-partner sale. By considering and answering a few simple questions, the partners may be better prepared for the application of the hypothetical JV sale provisions and avoid unwelcome surprises. For example:

(1) *What* is being priced and sold in the hypothetical sale? All the assets of the partnership or only the assets that would be sold in a third-party sale of the Project?

(2) In either case, will the hypothetical sale be immediately followed by a hypothetical *liquidation*? If not, the purchasing partner might be left holding the bag of liabilities or the selling partner might miss out on unpriced assets that are not accounted for in the hypothetical sale.

(3) Do the partners know both *when* and *how* the hypothetical sale and liquidation occur? The devil is in the details, and there is no shortage of details in a hypothetical sale (and liquidation):

- If, for example, there are customary prorations, what happens to the receivables (e.g., delinquent rents) that are not typically credited at closing?

- How do the partners account for contingent assets and liabilities (such as a claim and counterclaim under a previously terminated contract)? Should they be valued or should they be shared only when they are known and fixed? And if the latter, what assurance should be given that each partner will pay or receive its share?

- And what about the executory period (from the time the inter-partner sale contract is created until it is closed)? What happens during that time, and how might interim events affect the price for the selling partner's interest?

(4) Are the partners more concerned with a fair economic result or certainty of execution and if the latter, have the hypothetical JV sale provisions been tailored so that a recalcitrant partner will not find fertile ground for litigation?

There is much to consider here and rarely enough time to undertake a complete analysis during the heat of a deal. Consequently, it is worth taking the time in advance to understand and appreciate the alternative approaches and their impact on the pricing.

* * *

APPENDIX A
HYPOTHETICAL JV SALE PROVISIONS

This Appendix A is comprised of the following two parts, which are attached:

- Appendix A-1: Sample Provisions

- Appendix A-2: Closing Adjustment Examples

APPENDIX A-1
SAMPLE PROVISIONS

(Project Pricing)

This Appendix sets forth sample (not necessarily model) inter-partner sale provisions for a partnership interest sale based upon the hypothetical JV sale contemplated in the Buy/Sell, ROFO and Put/Call provisions described (see Assumptions) at the outset of the body of this article. These are consolidated inter-partner sale provisions that are intended to apply whether the hypothetical JV sale relates to a ROFO, Buy/Sell or Put/Call. This Appendix does not, however, include:

- the provisions under which the price for the Project is named or determined under the ROFO, Buy/Sell, or Put/Call (which, for simplicity, may be assumed to be whatever price is named for the ROFO or Buy/Sell and an appraised value for the Put/Call); or

- inter-partner (partnership interest) sale provisions that would apply even in the absence of a hypothetical JV sale.

Section 10. Sale of a Partner's Partnership Interest Under ROFO, Buy/Sell or Put/Call. The provisions of this Section 10 shall apply to any sale ("**Partnership Interest Sale**") of the Partnership Interest of a Partner ("**Selling Partner**") to the other Partner ("**Purchasing Partner**") contemplated under the provisions (the "**ROFO Provisions**") of Section ____, the provisions (the "**Buy/Sell Provisions**") of Section ____, or the provisions (the "**Put/Call Provisions**") of Section ____. The delivery of a "Partnership Interest Sale Acceptance Notice" (as hereinafter defined) shall create a contract between Selling Partner and Purchasing Partner for the Partnership Interest Sale on the terms and conditions hereinafter set forth in this Section 10.

10.1. Certain Definitions. As used herein:

10.1.1. "**Project Price**" means (1) the ROFO Project Price in the case of a Partnership Interest Sale under the ROFO Provisions, (2) the Buy/Sell Project Price in the case of a Partnership Interest Sale under the Buy/Sell Provisions, and (3) the Project Value in the case of a Partnership Interest Sale under the Put/Call Provisions.

10.1.2. "**Partnership Interest Sale Trigger Notice**" means (1) the First Offer Notice in the case of a Partnership Interest Sale under the ROFO Provisions, (2) the Buy/Sell Notice in the case of a Partnership Interest Sale under the Buy/Sell Provisions, and (3) the Put/Call Notice in the case of a Partnership Interest Sale under the Put/Call Provisions.

10.1.3. "**Partnership Interest Sale Acceptance Notice**" means (1) the ROFO Sale Acceptance Notice in the case of a Partnership Interest Sale under the ROFO Provisions, (2) the Buy/Sell Election Notice in the case of a Partnership Interest Sale under the Buy/Sell Provisions, and (3) the Put/Call Notice in the case of a Partnership Interest Sale under the Put/Call Provisions (recognizing that the Partnership Interest Sale Acceptance Notice is the same as the Partnership Interest Sale Trigger Notice for purposes of the Put/Call Provisions).

10.1.4. "**Partnership Interest Sale Closing**" means the closing of the sale by Selling Partner to Purchasing Partner pursuant to this Section 10.

10.1.5. "**Partnership Interest Sale Closing Date**" means the date which is ________ (____) days after the Partnership Interest Sale Acceptance Notice is delivered (or deemed delivered), or such other date as may be agreed upon by the Partners. However, for purposes of the Put/Call, the Partnership Interest Sale Closing Date shall be 10 business days after the Project Value has been determined under Section ____.

10.1.6. "**Partnership Interest Sale Interim Period**" means the period from and including the date of the Partnership Interest Sale Trigger Notice to and including the Partnership Interest Sale Closing Date, but not including the portion, if any, of the Partnership Interest Sale Closing Date after the Partnership Interest Sale Closing.

10.2. Partnership Interest Sale Purchase Price. The purchase price of the Partnership Interest of Selling Partner will be such as will produce for Selling Partner the same cash consideration as Selling Partner would have received if the Project had been sold on the Partnership Interest Sale Closing Date for an all-cash price equal to the Project Price (and the prorations and adjustments under Section 10.3 below had been made, but without deduction for hypothetical closing costs) and the Partnership had been dissolved and liquidated immediately following such sale and the proceeds of such sale and the other assets of the Partnership,[62] remaining after satisfaction of (or setting aside reserves for the expected payment of) the actual debts and liabilities (taking into account anticipated discounts and settlements) of the Partnership (without double-counting in light of the prorations in Section 10.3.1 below), had been distributed to the Partners in accordance with the provisions of this Agreement (and any amount payable under Section ____ ["**Clawback**"] had been paid). If Selling Partner would receive nothing in such event and would instead be obligated to pay some amount to the Partnership or Purchasing Partner or both, the purchase price of the Partnership Interest of Selling Partner shall be deemed to be a negative amount and Selling Partner shall be obligated to pay such amounts.[63] Such purchase price shall be calculated as of the Partnership Interest Sale Closing Date after making the adjustments under Section 10.3 below (such purchase price, as so adjusted, being herein called the "**Partnership Interest Sale Purchase Price**").

10.3. Closing Adjustments.[64] At the closing, the following adjustments shall be made in order to complete the final calculation of the Partnership Interest Sale Purchase Price under Section 10.2:

> 10.3.1. Prorations. The Project Price shall be adjusted by prorations that would be made between a hypothetical seller and a hypothetical buyer of the Project, on and as of the Partnership Interest Sale Closing Date, of **[**if applicable**: leasing costs,**]** operating expenses and operating income of the Partnership in accordance with **[**Choose alternative**: the applicable local custom ****OR**** the proration provisions in Exhibit "____" ****OR**** the proration provisions in Section ____ of the Purchase Agreement, *mutatis mutandis***]**. However, no proration adjustment shall be double-counted in the hypothetical liquidation contemplated in Section 10.2 (e.g., if the Project Price is reduced by a proration credit for accrued and unpaid expenses, such expenses will not also be deducted in the hypothetical liquidation) **[**if applicable**: ; and no proration for leasing costs shall be double-counted as a capital expenditure under Section 10.3.3A (e.g., if the Project Price is increased by a proration credit for a leasing cost incurred for a new lease, such cost shall not also increase the Project Price under Section 10.3.3A as a capital expenditure)****]**. Unpaid receivables will not immediately adjust the Project Price or be included in the hypothetical liquidation under Section 10.2, but shall be allocated as and when received (with the understanding that all receipts from any particular payor shall be applied to the most recently accrued receivables from such payor); and the partners shall promptly make such payments as may be required to effectuate the foregoing.

> 10.3.2. Closing Costs. There shall be no adjustment to the Project Price for hypothetical closing costs (e.g., brokerage commissions) of the Partnership in connection with the hypothetical sale of the Project. Without limitation on the foregoing, no prepayment/defeasance costs shall be deducted (and no prepayment/defeasance lockout shall be deemed to apply) under Section 10.2 above; however, for the avoidance of doubt, any prepayment/defeasance costs actually payable in connection with the Partnership Interest Sale shall be paid by the Partnership in accordance with the immediately following sentence and consequently, may reduce the assets that are taken into account in the hypothetical liquidation contemplated by Section 10.2 above. Each of the Partners shall bear the actual closing costs incurred by it in connection with the Partnership Interest Sale under this Section 10, except that (1) escrow charges shall be shared equally, and (2) the Partnership shall pay with funds obtained (and set aside) prior to the Partnership Interest Sale Closing: (x) any prepayment/defeasance or transfer/assumption costs under the Project Financing required to be paid by the Partnership or a subsidiary or either Partner as a result of the Partnership Interest Sale, and (y) any transfer taxes required to be paid by the Partnership or a subsidiary or either Partner as a result of the Partnership Interest Sale. If the Partnership does not have sufficient

funds to pay such costs, then the Partners shall contribute the deficiency in accordance with Section ____.

10.3.3. Interim Event Adjustments.[65] The following adjustments shall be made to the Project Price in order to address certain expansions, improvements and depletions of the Project during the Partnership Interest Sale Interim Period:

A. Capital Expenditures. There shall be added to the Project Price the sum of all capital expenditures[66] paid or incurred by the Partnership during the Partnership Interest Sale Interim Period (other than capital expenditures for the estimated costs of work or restoration that are deducted in the calculation of net sale proceeds or net property insurance proceeds under subsection B or C below). For the avoidance of doubt, if such a capital expenditure is incurred but not paid and the Partnership has a corresponding right to reimbursement or payment for the same (e.g., under insurance), then the outstanding expense for such capital expenditure will be offset by the value of such receivable in the hypothetical liquidation contemplated by Section 10.2 above.

B. Dispositions. To the extent that any portion of the Project has been sold or condemned during the Partnership Interest Sale Interim Period, the Project Price shall be reduced by the amount of sale or condemnation proceeds (other than the proceeds from a temporary taking, which shall be treated like rent for the period to which they relate), net of closing (and collection) costs and the estimated cost of work required to be done by the seller, received therefrom by the Partnership (or as to which a Partnership receivable is created) during the Partnership Interest Sale Interim Period. However, there shall be no double-counting of such closing (and collection) costs that remain outstanding (x) in the foregoing calculation of "net" proceeds, on the one hand, and (y) in the calculation of net distribution proceeds in the hypothetical liquidation contemplated by Section 10.2 above, on the other hand.

C. Damage. The Project Price shall be reduced by (1) the amount of any property insurance proceeds (excluding rental income proceeds which shall be treated as rent for the period to which they relate), net of collection and estimated restoration costs, received by the Partnership (or as to which a Partnership receivable is created) for damage to the Project occurring during the Partnership Interest Sale Interim Period and (2) the amount of the applicable deductible with respect to such damage under any insurance carried by the Partnership covering such damage (not greater than the estimated restoration costs). However, there shall be no double-counting of such closing, collection and restoration costs that are deducted and the restoration and other costs attributable to such deductible, in each case that remain outstanding, (x) in calculating the amount of such reduction, on the one hand, and (y) in the calculation of net distribution proceeds in the hypothetical liquidation contemplated by Section 10.2 above, on the other hand.

[Note to Drafter: Consider defining "capital expenditures."]

10.3.4. Process. All adjustments to the Project Price pursuant to this Section 10.3 shall be made on the basis of good faith estimates of the Partners using currently available information, and final adjustment shall be made by the Partners promptly after precise figures are determined or available, and in any event within ______ (____) days after the Partnership Interest Sale Closing Date. Unless the Partners otherwise agree in writing, the Partners shall engage the Partnership accountants to calculate the Partnership Interest Purchase Price and shall use reasonable efforts to maintain the confidentiality of any confidential information provided to the Partnership accountants. If either Partner disputes the results of such calculation, then at the election of either Partner, to be exercised by written notice (the "**Estimated Price Closing Election**") to the other Partner prior to the Partnership Interest Sale Closing, the Partners shall proceed with Partnership Interest Sale Closing using the calculation of the Partnership accountants but reserving their rights to dispute the amount of the Partnership Interest Purchase Price after the Partnership Interest Sale Closing; and if it is ultimately determined by a court of competent jurisdiction that the amount used for the Partnership Interest Purchase Price was incorrect, then the Partners shall promptly make such adjustments (and payments to one another) including adjustments to the amounts payable under Section 10.4 below, as may be required to reflect the correct amount of the Partnership Interest Sale Price.

10.4. Satisfaction of Internal Loans. Internal Loans shall be paid in full to the extent not effectively repaid by reason of the calculation (including the hypothetical sale, liquidation and distribution) in Section 10.2 and payment of the Partnership Interest Sale Purchase Price on the Partnership Interest Sale Closing Date. If the Partnership does not have sufficient funds to make any such required payment payable by the Partnership, then the Partners shall contribute the deficiency in accordance with Section ____. "**Internal Loans**" means any loans pursuant to this Agreement between a Partner (whether as borrower or lender), on the one hand, and the other Partner or the Partnership, on the other hand.

10.5. Distributable Cash. The Partners shall be distributed their share of Distributable Cash up to the Partnership Interest Sale Closing Date (immediately prior to the calculation of the Partnership Interest Sale Purchase Price under Section 10.2), with final adjustment thereafter if final figures of Distributable Cash are not available.

10.6. **[Note to Drafter: Add other provisions regarding Partnership Interest Sale, which are likely to be similar to the provisions for any partnership interest sale whether or not there is a hypothetical JV sale involved.]**

10.7. Alternative Structure: Sale of Project to Purchasing Partner. Notwithstanding anything to the contrary in this Section 10:

10.7.1. Election.

A. Initial Right to Elect Alternative Structure. At the election of any Partner (an "**Eligible Partner**") having a Company Percentage of not less than ____%[67] made by giving written notice thereof to the other Partner within three (3) business days after the Partnership Interest Sale Acceptance Notice is delivered, the Partnership shall sell the Project to Purchasing Partner for the Project Price on the Partnership Interest Sale Date, and Purchasing Partner shall not acquire the Partnership Interest of Selling Partner. However, in the case of the Put/Call, such three (3) business day period shall be extended to ten (10) business days.

B. Subsequent Right to Elect Alternative Structure. If no Eligible Partner has timely made the election under Section 10.7.1A above, and for any reason the Partners fail to confirm in writing the amount of the Partnership Interest Sale Purchase Price at least one (1) business day prior to the Partnership Interest Sale Closing Date (whether by reason of a dispute over the amount of a contingent liability or otherwise), and neither Partner has timely given an Estimated Price Closing Election, then at the election of an Eligible Partner made by giving written notice thereof to the other Partner prior to written confirmation by the Partners of the Partnership Interest Sale Purchase Price, the Partnership shall sell the Project to Purchasing Partner for the Project Price on the date ("**Delayed Closing Date**") that is ________ (____) days after such notice is given, and Purchasing Partner shall not acquire the Partnership Interest of Selling Partner.

10.7.2. Sale of Project to Purchasing Partner. If there has been an election under Section 10.7.1, then the Partnership shall sell to Purchasing Partner, and Purchasing Partner shall purchase from the Partnership, the Project on the Property Sale Closing Date for the Project Price, and this Section 10.7.2 shall constitute a contract between the Partnership, as seller, and the Purchasing Partner, as purchaser. As used herein, "**Property Sale Closing Date**" means the Partnership Interest Sale Date if there is an election under Section 10.7.1A above, and means the Delayed Closing Date if there is an election under Section 10.7.1B above. The terms of such sale shall be as set forth on Exhibit ____.

[Note to Drafter: Add purchase agreement provisions. In lieu of Section 10.7.2, the Partnership Agreement might include a sentence to the effect that, if there is an election under Section 10.7.1 for the Partnership to sell the Project to the Purchasing Partner, the Partnership and the Purchasing Partner shall enter into a purchase agreement in the form of the purchase agreement attached as an exhibit to the Partnership Agreement. But it may be preferable to make the provisions self-operative so that it is not necessary to sign a new agreement.]

10.7.3. Tax Considerations. Each Partner shall cooperate with any reasonable request made by the other Partner to implement the sale contemplated by this Section 10.7 in a tax-efficient manner. However, this Section 10.7.3 shall not obligate a Partner to incur any material increased cost, liability or risk without acceptable indemnification from the requesting Partner.

* * *

APPENDIX A-2
CLOSING ADJUSTMENT EXAMPLES

(Project Pricing)

This Appendix provides examples of the closing adjustments described in Section 5.2 of the body of this article when Project Pricing is used. This Appendix refers to the applicable sections of (and uses the defined terms of) the Sample Provisions (in Appendix A-1).

The various closing adjustments should not be viewed in isolation. There is considerable interplay between them. Indeed, with Project Pricing, there may be five moving parts that impact the net hypothetical liquidation amount through different adjustments.

- Prorations that would be made between a hypothetical buyer and hypothetical seller of the Project (which may be added to or subtracted from the Project Price);
- Closing costs that would be incurred by the Partnership (which may be added to or subtracted from the Project Price, but which, for purposes of this discussion, are ignored because the Sample Provisions provide that there is no deduction for hypothetical seller closing costs, and it is assumed that buyer closing costs are paid outside of escrow);

- Interim changes in assets comprising the Project (which may result in a downward or upward adjustment to the Project Price);

- Partnership liabilities (including loans from partners) and non-Project Partnership assets (which will be debited or credited in determining the net hypothetical liquidation distribution amount); and

- Interim distributions (which go hand in hand with the previous non-Project asset point because any *increase* or *decrease* may have the opposite effect on the net hypothetical liquidation amount: there will be *less* or *more*, respectively, non-Project Partnership assets to distribute upon liquidation).

The first three items above determine the adjusted Project Price that is taken into account in the hypothetical sale/liquidation. The final two items relate to (or affect) the Partnership liabilities to be deducted, and the other Partnership assets to be added, to the adjusted Project Price to determine the net hypothetical liquidation amount.

Assumptions

To illustrate how these various adjustments work together, assume the following facts (unless otherwise indicated):

- the Partnership Interest Sale Closing occurs on the first day of a calendar month;

- the stated Project Price equals $100X;

- the Partnership has $20X of reserves at the beginning of the Partnership Interest Sale Interim Period;

- the Project is subject to Project financing with a balance of $20X at the beginning of the Partnership Interest Sale Interim Period;

- during the Partnership Interest Sale Interim Period, the operating expenses (which, to simplify the examples and illustrations in this article are deemed to include interest under the Project financing) incurred equal $20X and the operating revenues received equal $20X;

- there are no prorations (because the $20X of operating revenues is used to pay the $20X of operating expenses, all other operating expenses have been paid, none of the operating expenses relate to any period after the closing, no operating revenues have been received for any period after the closing, and there are no security deposits or deposits with third parties);

- there are no closing costs; and

- there are no other (and no subsequent changes in) Partnership assets or liabilities.

Under these facts, the net hypothetical liquidation amount in the hypothetical liquidation would be $100X. References in this Appendix to the "hypothetical liquidation" will mean the hypothetical liquidation and distribution contemplated by Section 10.2.

A. Purchase Price	B. Interim Asset Changes	C. Prorations	D. Partnership Liabilities	E. Other Assets	F. Liquidation Distributions (A+B+C+D+E)	G. Interim Distributions	H. Total Distributions (F+G)
100	0	0	(20)	20	100	0	100

Illustration 1: Interim Sale or Casualty Insurance Proceeds

What if the Partnership receives $20X of net sale, condemnation or casualty insurance proceeds (after closing, collection and estimated restoration costs) during the Partnership Interest Sale Interim Period?[68] The receipt of such proceeds results in a *decrease* in the Project Price to $80X under subsection B or C of Section 10.3.3 of Appendix A-1. Observe that in each of the cases considered below (which reflect different uses of such proceeds), the Sample Provisions establish total distributions (both interim distributions and liquidation distributions) equal to $100X, as one would expect:

(a) if simply retained by the Partnership (i.e., not spent or distributed, but set aside as reserves), then the $20X *decrease* in the Project Price under Section 10.3.3 attributable to the receipt of such proceeds would offset the corresponding *increase* in additional Partnership assets, by reason of such $20X proceeds, taken into account in the hypothetical liquidation;

(b) if used to pay operating expenses, then the $20X *decrease* in the Project Price under Section 10.3.3 attributable to the receipt of such proceeds would offset the corresponding *increase* in Distributable Cash under Section 10.5 (or to the extent the resulting $20X of artificially created net operating cash flow is set aside as reserves, by the corresponding *increase* in other Partnership assets taken into account in the hypothetical liquidation);

(c) if used to pay capital expenditures for the Project (that are not for restoration costs deducted in the calculation of the amount of such proceeds), then the *decrease* in the Project Price under Section 10.3.3 attributable to the receipt of such proceeds would offset the *increase* in the Project Price under Section 10.3.3A attributable to such capital expenditures;

(d) if used to pay principal under the Project financing, then the *decrease* in the Project Price under Section 10.3.3 attributable to the receipt of such proceeds would offset the corresponding *increase* in hypothetical distributions resulting from the reduction of Partnership liabilities in the hypothetical liquidation; or

(e) if distributed, then the *decrease* in the Project Price under Section 10.3.3 attributable to the receipt of such proceeds would offset the corresponding *increase* in interim distributions.

	A. Purchase Price	B. Interim Asset Changes	C. Prorations	D. Partnership Liabilities	E. Other Assets	F. Liquidation Distributions (A+B+C+D+E)	G. Interim Distributions	H. Total Distributions (F+G)
(a)	100	(20)	0	(20)	40	100	0	100
(b)	100	(20)	0	(20)	20*	80*	20*	100
(c)	100	0	0	(20)	20	100	0	100
(d)	100	(20)	0	0	20	100	0	100
(e)	100	(20)	0	(20)	20	80	20	100

* If the artificially increased net operating cash flow is set aside as reserves, then there would be no interim distributions, but the "Other Assets" would increase so that 20*, 80*, 20* become 40, 100, 0 as in case (a).

Illustration 2: Interim Financing Proceeds

What if the Partnership receives $20X of net financing proceeds (after closing costs) during the Partnership Interest Sale Interim Period? In that event, there would be a $20X *decrease* in the net hypothetical liquidation distribution amount by reason of the additional $20X liability. Observe that in each of the cases considered below (which reflect different uses of such proceeds), the Sample Provisions (which do not provide for any price adjustment solely by reason of the receipt of such proceeds) establish total distributions (both interim distributions and liquidation distributions) equal to $100X, as one would expect:

(a) if simply retained by the Partnership (i.e., not spent or distributed, but set aside as reserves), then the loan proceeds and the loan repayment liability would offset one another in the hypothetical liquidation;

(b) if used to pay operating expenses, then the *decrease* resulting from the additional $20X liability for the loan in the Hypothetical Liquidation would offset the corresponding *increase* in Distributable Cash under Section 10.5 (or to the extent the resulting $20X of artificially created net operating cash flow were set aside as reserves, by the corresponding *increase* in other Partnership assets taken into account in the hypothetical liquidation);

(c) if used to pay capital expenditures for the Project, then the *increase* in the Project Price under Section 10.3.3A attributable to such capital expenditures would offset the *decrease* resulting from the additional liability for the loan in the hypothetical liquidation;

(d) if used to pay principal under the original Partnership financing, then (ignoring transaction costs) the loan *increase* and loan *decrease* would offset one another in the hypothetical liquidation; or

(e) if distributed, then the *decrease* resulting from the additional $20X liability (to repay the borrowed funds) taken into account in the hypothetical liquidation would offset the corresponding *increase* in interim distributions.

	A. Purchase Price	B. Interim Asset Changes	C. Prorations	D. Partnership Liabilities	E. Other Assets	F. Liquidation Distributions (A+B+C+D+E)	G. Interim Distributions	H. Total Distributions (F+G)
(a)	100	0	0	(40)	40	100	0	100
(b)	100	0	0	(40)	20*	80*	20*	100
(c)	100	20	0	(40)	20	100	0	100
(d)	100	0	0	(20)	20	100	0	100
(e)	100	0	0	(40)	20	80	20	100

* If the artificially increased net operating cash flow is set aside as reserves, then there would be no interim distributions, but the "Other Assets" would increase so that 20*, 80*, 20* become 40, 100, 0 as in case (a).

Illustration 3: Interim Operating Revenues

What if the $20X of operating revenues were not used to pay the $20X of operating expenses? Observe that in each of the cases considered below (which reflect different uses of the $20X of operating revenues), the Sample Provisions (which do not provide for any adjustment to the Project Price under Section 10.3.3 based solely on the receipt of operating revenues) establish total distributions (both interim distributions and liquidation distributions) equal to $100X, as one would expect:

(a) if simply retained by the Partnership (i.e., not spent or distributed, but set aside as reserves), then the $20X *increase* resulting from the additional Partnership assets (such revenues) taken into account in the hypothetical liquidation would offset the $20X *decrease* in the Project Price resulting from the proration credits in favor of the buyer under Section 10.3.1 for unpaid $20X operating expenses;[69]

(b) if used to pay the $20X of operating expenses (as originally assumed but contrary to the assumption in this Illustration), then, of course, there would be no adjustment;

(c) if used to pay capital expenditures for the Project, then the $20X *increase* in the Project Price under Section 10.3.3A attributable to such capital expenditures would offset the *decrease* in the Project Price resulting from the additional proration credits in favor of the buyer under Section 10.3.1 for the unpaid $20X operating expenses;

(d) if used to pay principal under the Project financing, then the *increase* from the $20X reduction of Partnership liabilities in the hypothetical liquidation would offset the corresponding *decrease* in the Project Price resulting from the additional proration credits in favor of the buyer under Section 10.3.1 for the $20X of unpaid operating expenses; or

(e) if distributed, then the seemingly unjustified *increase* in interim distributions would offset the *decrease* in the Project Price resulting from the additional proration credits in favor of the buyer for $20X of unpaid operating expenses.

	A. Purchase Price	B. Interim Asset Changes	C. Prorations	D. Partnership Liabilities	E. Other Assets	F. Liquidation Distributions (A+B+C+D+E)	G. Interim Distributions	H. Total Distributions (F+G)
(a)	100	0	(20)	(20)	40	100	0	100
(b)	100	0	0	(20)	20	100	0	100
(c)	100	20	(20)	(20)	20	100	0	100
(d)	100	0	(20)	0	20	100	0	100
(e)	100	0	(20)	(20)	20	80	20	100

Illustration 4: Interim Contributions

What if the Partnership receives $20X of contributions during the Partnership Interest Sale Interim Period? Observe that in each of the cases considered below (which reflect different uses of such proceeds), the Sample Provisions (which do not provide for any price adjustment solely by reason of the receipt of such contributions) establish total distributions (both interim distributions and liquidation distributions) equal to $120X, as one would expect:

(a) if retained by the Partnership (i.e., not spent or distributed, but set aside as reserves), then there would be a corresponding *increase* by reason of the additional Partnership assets taken into account in the hypothetical liquidation (so that the net hypothetical liquidation amount would be $120X as expected);

(b) if used to pay operating expenses, then there would be a corresponding *increase* in Distributable Cash under Section 10.5 (or to the extent the resulting $20X of artificially created net operating cash flow were set aside as reserves, in additional Partnership assets taken into account in the hypothetical liquidation);

(c) if used to pay capital expenditures for the Project, then there would be an *increase* in the Project Price under Section 10.3.3A to account for the capital expenditures;

(d) if used to pay principal under the Project financing, then there would be an *increase* resulting from the reduction of Partnership liabilities in the hypothetical liquidation; or

(e) if distributed, then the contribution and distribution would offset one another.

	A. Purchase Price	B. Interim Asset Changes	C. Prorations	D. Partnership Liabilities	E. Other Assets	F. Liquidation Distributions (A+B+C+D+E)	G. Interim Distributions	H. Total Distributions (F+G)
(a)	100	0	0	(20)	40	120	0	120
(b)	100	0	0	(20)	20*	100*	20*	120
(c)	100	20	0	(20)	20	120	0	120
(d)	100	0	0	0	20	120	0	120
(e)	100	0	0	(20)	20	100	20	120

* If the artificially increased net operating cash flow is set aside as reserves, then there would be no interim distributions, but the "Other Assets" would increase so that 20*, 100*, 20* become 40, 120, 0 as in case (a).

Illustration 5: Reserves

What if the Partnership uses the reserves (or cash on hand) existing as of the commencement of the Partnership Interest Sale Period (which are assets other than the interim sale, casualty insurance or financing proceeds, interim operating revenues, or interim contributions considered above)? Observe that in each of the cases considered below (which reflect different uses of such reserves), the Sample Provisions (which would otherwise be taken into account in the hypothetical liquidation) establish total distributions (both interim distributions and liquidation distributions) equal to $100X, as one would expect:

(a) if retained by the Partnership (i.e., not spent or distributed, but set aside as reserves), then nothing would change;

(b) if used to pay operating expenses, then the *decrease* resulting from the exclusion of such assets in the hypothetical liquidation would offset the *increase* in Distributable Cash under Section 10.5 (or to the extent the resulting $20X of artificially created net operating cash flow were set aside as reserves, the additional Partnership assets to be taken into account in the hypothetical liquidation);

(c) if used to pay capital expenditures for the Project, then the *increase* in the Project Price under Section 10.3.3A attributable to such capital expenditures would offset the corresponding *decrease* resulting from the exclusion of such assets in the hypothetical liquidation;

(d) if used to pay principal under the Project financing, the *decrease* resulting from the exclusion of such assets in the hypothetical liquidation would offset the *increase* resulting from the reduction in Partnership liabilities taken into account in the hypothetical liquidation; or

(e) if distributed, then the *decrease* resulting from the exclusion of such assets in the hypothetical liquidation would offset the corresponding *increase* in interim distributions.

	A. Purchase Price	B. Interim Asset Changes	C. Prorations	D. Partnership Liabilities	E. Other Assets	F. Liquidation Distributions (A+B+C+D+E)	G. Interim Distributions	H. Total Distributions (F+G)
(a)	100	0	0	(20)	20	100	0	100
(b)	100	0	(20)	(20)	0*	80*	20*	100
(c)	100	20	(20)	(20)	20	100	0	100
(d)	100	0	(20)	0	20	100	0	100
(e)	100	0	0	(20)	0	80	20	100

* If the artificially increased net operating cash flow is set aside as reserves, then there would be no interim distributions, but the "Other Assets" would increase so that 20*, 80*, 20* become 40, 100, 0 as in case (a).

* * *

APPENDIX B
CONTINGENT ASSETS AND LIABILITIES

This Appendix discusses how the partners may account for certain contingent assets and liabilities of the partnership, namely *claims of the JV against third parties*, and *claims of third parties against the JV*. For example, assume that the JV switched contractors while completing a building, and there is litigation between the JV and the original contractor in which the original contractor is seeking damages from the JV (in essence, a contingent liability of, or claim against, the JV) and the JV is seeking damages from the original contractor (in essence, a contingent asset of, or a claim by, the JV). How are such claims addressed?

Common Practice

In the authors' experience, there are rarely any special provisions that specifically address these claims in connection with a hypothetical JV sale. There may, of course, be a hypothetical liquidation but little more is usually said (other than perhaps a statement that all liabilities of the partnership are paid). One could argue that in an actual liquidation, the partners may (and may be required by law to) set aside reserves to cover contingent liabilities and would determine a way to share any contingent assets. Thus, the argument would go, the hypothetical liquidation should be interpreted to require the same approach. Unfortunately, the details of this approach may vary.

Usually, there are no significant claims to address in the hypothetical JV sale, but what if there were? What if there were a $10 million claim (whether by or against the JV) and what if the partners have vastly different views of the true value of that claim?

Initial Pricing Alternative

Some practitioners believe that (at least in the Buy/Sell context) it is best to address these claims as part of the initial pricing and make that determination final. These are often the same practitioners who advocate the early calculation alternative discussed in Section 4 of the body of this article (although this initial pricing alternative may also be implemented with a closing calculation). This approach is intended to facilitate a clean break and in particular:

- to avoid the time and expense of determining and implementing an acceptable way for two different parties to share claims over an extended period of time; and

- to avoid giving a partner a litigable claim that could be used to delay or frustrate the other partner's desire to end the JV relationship.

For the Buy/Sell, the initiating partner could, for example (instead of being required to name a price for the Project), be required to name a "Net Liquidation Amount" which would (hypothetically) remain, after liquidating all partnership assets and paying all third-party liabilities (including contingent liabilities), to repay any loans from a partner to the partnership[70] and then to make a liquidating distribution to the partners. The purchasing partner under such a Buy/Sell would pay the selling partner the amount the selling partner would receive if the partnership were to use the Net Liquidation Amount to repay such loans and then make distributions under the distribution waterfall set forth in the partnership agreement. This price would not be adjusted at closing for changes in the claims (or new ones). Implicitly, the partner who initiates the Buy/Sell (and the other partner in deciding whether to buy or sell) takes into account the value of claims by and against the partnership in setting (or evaluating) the Net Liquidation Amount. Of course, a partner might be unhappy with this approach if a claim it valued at $10 million (in determining or evaluating the Net Liquidation Amount) turned out to be worthless, or a new $10 million claim is made, as a result of some event occurring between the Buy/Sell trigger and the Buy/Sell closing. But that may be one of the risks of taking such an approach to achieve certainty and finality. With the Put/Call, the appraisal or other applicable pricing method may cover the claims, but it will be subject to the same premature valuation and interim event risks, absent a closing adjustment. And with the ROFO, there are not only the premature valuation and interim event risks; the claim may be one that would not affect a third-party buyer (e.g., a claim by or against a former tenant who has vacated the premises and no longer has anything to do with, or rights against, the Project) and therefore one that is not taken into account in the third party's pricing.[71] As a result, the claim may distort the comparison required to ensure a minimum price and for that reason the permanent initial pricing of claims may not be a viable alternative for a ROFO. Finally, the partners who agree to take a claim into account as part of the initial pricing need to be careful not to double-count the claim as part of a hypothetical liquidation. In particular, if there is an all-encompassing initial evaluation, then (as discussed above) there may be no hypothetical liquidation.

Liquidating the Amount?

The initial pricing alternative discussed above assumes that the amount of a claim will be liquidated. Similarly, some partners may also expect a claim to be liquidated in the hypothetical liquidation. How is it done? Often this question is not answered by the partnership agreement.

Determination by One Partner. The initial pricing alternative discussed above involves a permanent determination made by one of the partners in the context of a Buy/Sell or a ROFO. But for a Put/Call (or to value liabilities and non-priced assets in a hypothetical liquidation), the determination would likely be made in some other manner. However, a determination made unilaterally by one partner is still possible. For example, query whether a selling partner would be willing to give the purchasing partner (who will remain in the JV) the right to make a *reasonable* estimate of a claim (which would be used in the hypothetical liquidating distribution) if the purchasing partner is willing to take the risk that its estimate is wrong?

Agreement of the Partners. The partners may, of course, attempt to agree on the amounts involved. But what if they don't agree?

Valuation Process: Appraisal/Averaging. It is possible to have a valuation process, which is relatively common in partnership agreements for valuing real property, but the authors do not recall encountering such provisions for claim valuation in a hypothetical JV sale/liquidation except in a Put/Call process when they are part of a larger process valuing all partnership assets (and even when there is an appraisal, the authors do not recall agreements that addressed the potential need to hire separate appraisers to value assets that a real estate appraiser may not be competent to address). If this approach were desired, there are numerous potential variants (similar to a Put/Call valuation approach) involving several possible steps. For example:

- the partners may begin by negotiating for a certain period;
- failure to reach agreement may be followed with averaging if the partners' proposed amounts are within a certain percentage difference;
- at some point in the process (assuming the amount has not been determined by agreement or other means), each partner may appoint a third party (e.g., an appraiser) to determine the amount involved;
- if the proposed amounts of the two third parties are close enough, some procedures use the average; if not, the two third parties often appoint another third party to make a determination (and in some agreements, there is no initial determination or averaging and instead the two third parties simply appoint a single third party to make the determination);
- sometimes the final party chooses between the amounts proposed by the first two third parties (which is so-called "baseball arbitration"); sometimes it makes its own final determination; and sometimes the average of the two closest amounts is used.

However, in the authors' experience, a valuation process is typically not used for contingent assets or liabilities unless they exist at the time of an initial all-asset valuation that is already being made by appraisal (and, as noted above, it is not clear that the appraiser will be qualified to value anything other than the real estate).

Auction. It may also be possible to auction the claims to the partners. The partnership could *sell* claims *by* the partnership and pay for, or in effect *buy*, the assumption of claims *against* the partnership: each claim *by* the partnership could be sold to the partner who offers the higher price to buy the claim; and each claim *against* the partnership could be assumed by the partner who demands the lower price to assume the claim. However, the partners may not want to complicate the partnership agreement with an additional procedure. They may also be concerned that this procedure could unfairly prejudice the selling partner if separating the claim from the partnership creates disadvantages. The authors have not encountered this alternative in practice.

Accountants. The most common approach encountered by the authors is to use the partnership's accountants, who are often delegated responsibility for all the computations regarding the hypothetical JV sale.

Determination by Third Parties: Risks

Will some third parties be reluctant to make a value determination, and even if they are willing, is a third-party determination free from risk?

Engagement Risk. Arbitrators and appraisers, who make a living providing valuations even in contentious situations, may be willing to perform the valuation function. But query whether the appraisers or arbitrators who are qualified to value the Project are also qualified to value non-Project assets (such as a litigation claim)? And what about the third party who is most often assigned the task in the partnership agreement, namely the partnership accountants? Valuation may be a sensitive issue for the partnership accountants for a number of reasons:

- they may not want to run the risk of alienating either partner;
- they may not want to proceed because they are concerned that a partner with whom they have a close relationship may not like their number or may put pressure on them to propose a number that is contrary to their view;
- they may be limited by internal quality and risk management requirements which would preclude them from accepting such an arrangement; or
- they may simply not want to get in the middle of a dispute (which could be aggravated by their preexisting relationships with one or both partners).

Consequently, it may be advisable to check with the partnership accountants to ensure that they have the time, the expertise and the interest to undertake the responsibilities assigned to them in the partnership agreement.

Disclosure Risk. If a third party is willing and capable to make the determination, is there a risk that the information provided to the third party to explain the claim might be discoverable by the party to the dispute with the JV? As observed in one article:

> The general inability of a client's agent to engage in privileged communications with . . . clients or their lawyers (and the waiver implications of sharing privileged communications with those agents) represents perhaps the most counter-intuitive aspect of the attorney-client privilege. [Clients] might logically assume that members of their problem-solving "teams" such as . . . outside accountants . . . — who have fiduciary duties of loyalty and confidentiality to the clients just like lawyers do — should be able to participate in joint communications . . . . Lawyers must educate their clients about the erroneous nature of this assumption.[72]

The risk of losing the privilege may pose a dilemma for the partners: if privileged information is disclosed and the privilege is lost, then that loss may adversely affect the disposition of the claim (and then may also affect the reliability of the valuation); but if an understanding of privileged information is necessary to properly value the claim and it is not disclosed, then the valuation may not be accurate. In California, as in many if not most states, "the general rule [is] that a privilege is waived upon voluntary disclosure of the privileged information to a third party" and the exceptions to this rule are limited.[73] Here, the partners would be turning to an expert to put a price on the claim. But "in order for communications with a retained expert to be protected from compelled disclosure, the expert must have been retained to assist an attorney in providing legal advice."[74] And in some states, if the expert is not an employee within the so-called "Control Group" of the partnership, the privilege might not apply regardless of the nature of the engagement.[75]

Thus, delegating the valuation task to a nonlegal professional, such as an accountant,[76] may be dangerous. But what if the assignment were given by the partnership to an attorney who, in turn, seeks the assistance of an accountant or other third-party professional to reach his or her legal conclusion as to the merits and value of the claim?[77] Unfortunately, merely interposing an attorney is no guaranty that the privilege will apply.[78] The privilege may not be available unless the client "sought, and the attorney rendered, legal advice."[79] Query whether the underlying purpose of this exercise, namely to complete an inter-partner sale, would eliminate the desired protection?[80]

The partners may face a similar conundrum with respect to the third-party valuation itself. For the valuation to be subject to the attorney-client privilege, it may need to be done "for the purpose of . . . providing legal assistance to the client."[81] Would this requirement be met if the accountant assists an attorney in valuing the claim by monetizing the attorney's conclusions?

If the attorney-client privilege is not available, might protection be provided by the work product doctrine? While in some circumstances, the work product doctrine may be "broader in scope and reach than . . . the attorney-client privilege,"[82] it may also impose a requirement that could be difficult to satisfy in this context:

> The work-product [doctrine] . . . applies . . . only to those materials that were prepared in anticipation of litigation or for trial.[83]

If the motivation for requiring the valuation is to facilitate an inter-partner sale, query whether it will be possible to protect?[84] And, if discoverable, is it possible that the valuation could be harmful to the JV's position in connection with the claim?

To further complicate matters, the partners may not know, at the time the JV is formed, what law will govern the attorney-client privilege and work product issues involved.[85] And even if there is protection under applicable law, query whether that protection might be lost if there is litigation between the partners regarding the valuation?

De Facto Arbitration Risk. Even if a third party is willing and capable to make the determination and the partners are willing to take the disclosure risk discussed above, have the partners unwittingly subjected themselves to arbitration rules under the Federal Arbitration Act (FAA)? The FAA applies to contracts involving interstate commerce that contemplate arbitration.[86] Interstate commerce would seem to exist for most real estate partnerships because the entity is typically formed in Delaware, the real estate is usually located in another state, and one or more partners are often based in other states.[87] But is there "arbitration"? As noted by one commentator:

> [W]hen the contract at issue does not explicitly mention arbitration, but instead describes some other alternative means of dispute resolution, it is left to the courts to grapple with what does and does not fall within the scope of the FAA.[88]

The law is not uniform and commentators appear to have differing views. Some courts and commentators seem to view any contract process providing for a final third-party resolution of a financial dispute as an arbitration:

> [C]ontract clauses that allow an appraisal process to determine a value, or an accountant to resolve a financial dispute, are generally deemed arbitration clauses under federal law, even when no derivative of the word "arbitration" appears in the clause.[89]

According to one court:

> An adversary proceeding, submission of evidence, witnesses and cross-examination are not essential elements of arbitration. . . . If the parties have agreed to submit a dispute for a decision by a third party, they have agreed to arbitration.[90]

On the other hand, it is possible that the third-party determination might be treated as an "expert determination" governed by state law, instead of an arbitration under the FAA.[91] According to a report of the Committee on International Commercial Disputes of the New York City Bar:

> [T]he law of expert determination in the United States is found in the common law of appraisal, and this has both hidden and hampered the recognition and development of the law of expert determination.[92]

The chair of the subcommittee that issued this report (which criticizes many of the federal cases that have found an expert determination to be arbitration) has stated that:

> Expert determinations are governed by their own body of law that is separate, distinct, and materially different from the law of arbitration. . . . Expert determinations are governed by state law, not the FAA.[93]

Given this uncertainty,[94] query whether the partners should consider providing that the third-party determination is subject to the approval of the partners and if not approved, providing for one of the three alternatives discussed below? Alternatively, the partners might consider providing that the third-party determination is subject to a more formal arbitration on terms spelled out in the partnership agreement.[95]

Premature Valuation?

Some partners may be concerned that claims by and against third parties may be too uncertain to provide for any adjustment either at the time of the initial pricing or at the closing. If such a claim is potentially large, the partners may want to consider other alternatives. Three possible solutions to this problem are:

- to adjust the pricing for the claims after the closing of the inter-partner sale when the ultimate value of the claim is established;
- to proceed with the closing based on the accountants' determination of the current value of the claim while reserving rights to dispute that determination after the closing; or
- to switch to an actual property sale and address the claims as part of partnership's existing dissolution process after the closing of the property sale.

Each of these solutions is considered below.

Post-Closing Adjustments

The partners may consider having a post-closing adjustment to share the benefits or burdens of the claim when the actual amount of the claim has been finally determined (whether by a court, settlement or otherwise). However, how does either partner know that it will receive its share of a claim by the JV or that the other partner will bear its share of a claim against the

JV? And who will pursue or defend the claim and where will the money come from to do so?

Estimate. It may be possible to take some of the pressure off the determination process if an initial adjustment is made based on an estimate of the ultimate value of the claim with the understanding that the partners will make appropriate adjustments when the final amount is known. One of the alternatives discussed below involves an estimate by the accountants and a reservation of rights (without going into the details of any future resolution of their differences). The alternative discussed here assumes that the partners are willing to wait until the claims are liquidated for the final adjustment, but want to address some of the details of their final post-closing adjustments in advance.

- *Claims Against the JV*. If the amount deducted in the partnership pricing on account of a *claim against the JV* turns out to be too much (i.e., the deduction is *more* than the actual payments made by the JV, and the related litigation costs of the JV, on account of such claim, so the purchasing partner has underpaid), then the purchasing partner could have a post-closing obligation to pay the selling partner the selling partner's share of the savings. Conversely, if the deduction turns out to be too little (i.e., the deduction is *less* than the actual payments and costs, so the purchasing partner has overpaid), then the selling partner could have a post-closing obligation to pay the purchasing partner the selling partner's share of the deficiency.

- *Claims by the JV*. Similarly, if the amount added in the partnership pricing on account of a *claim by the JV* turns out to be too much (i.e., the addition is *more* than the actual sums received by the partnership on account of such claim, net of collection costs, so the purchasing partner has overpaid), then the selling partner could have a post-closing obligation to pay the purchasing partner the purchasing partner's share of the deficiency. Conversely, if the addition turns out to be too little (i.e., the addition is *less* than actual net receipts, so the purchasing partner has underpaid), then the purchasing partner could have a post-closing obligation to pay the selling partner the selling partner's share of the surplus.

Security. Although the use of estimates may reduce the amount of any post-closing adjustment, what assurance does a partner have that the other partner will pay its share of the post-closing adjustment?

- *Claims Against the JV*. The selling partner may get some comfort from the fact that the purchasing partner may still have its interest in the partnership. Consequently, the selling partner may not be worried about security to ensure that the selling partner gets its share of savings from an overestimated *claim against the JV* unless the facts warrant it (e.g., the anticipated period during which the claim will be outstanding is likely to exceed the partnership's holding period for the Project). But the selling partner might still want cash equal to the estimated claim (and initial adjustment) to be escrowed (to match what would have been reserved by the partnership in a hypothetical liquidation) to make sure that money is available to pay at least the estimated portion of the claim (especially if the selling partner is a general partner).[96] And what about a shortfall if there is an underestimated *claim against the JV*? The selling partner may be an SPE with no assets after the closing. Some partners may prefer to reach agreement on the reserve and let the purchasing partner have both the risk and reward of an incorrect estimate. Another possibility (if it is too difficult or time-consuming to reach agreement) is to let the purchasing partner determine the reserve unilaterally (which determination could be subject to some soft limitations, such as a requirement for a subjective good faith estimate) but limit only the downside of the selling partner: the purchasing partner would take the risk that the claim exceeds the amount of the reserve (so that the selling partner's liability would be capped by its share of the reserve) but the selling partner would share any savings in the reserve if the purchasing partner's estimate were too high.

- *Claims by the JV*. In the case of a *claim by the JV*, the purchasing partner may want cash equal to the selling partner's share of the estimated claim (and initial adjustment) to be escrowed in case the JV doesn't collect the estimated amount of the claim (i.e., the claim is overestimated). The selling partner might also want the purchasing partner's share held in escrow to address concerns of the selling partner about receiving its share of any excess amount when there is an underestimated *claim by the JV*. However, due to the purchasing partner's retained interest in the partnership, the selling partner may not be concerned about the risk of getting its share of the unanticipated surplus from an underestimated *claim by the JV* absent special facts.

Determining Sharing Percentages. If the partners are to share in any surplus or shortfall, how are those shares determined? The selling partner's share might be different for a *payment by* that partner than a *payment to* that partner and it might vary depending on the amount. For example, if the partnership agreement has a multi-tiered distribution waterfall (as is typically the case when there is a hypothetical JV sale), a *payment by* the selling partner might be based on a reverse waterfall approach (which effectively refunds the most recent distributions in the proportions received). Similarly, *payments to* the selling partner from reserve savings or collections on the partnership's claims might be based on how those amounts would have been shared if they had been included in the hypothetical sale distribution (recognizing that the selling partner may have received a certain percentage of the first X dollars and a different percentage of the next Y dollars).

Control Over Litigation and Reserve. There is also the question of who controls the litigation and reserve and what approval rights, if any, the other partner may have over litigation decisions and use of the reserve. The purchasing partner (as the sole owner of the JV) may expect to control the litigation and the reserve, and have the selling partner live with the results, especially if the purchasing partner bears the risk of an insufficient reserve, or if the purchasing partner had control over litigation matters prior to the sale. But the selling partner may want to be part of the process if it is expected to share that risk or has a share in the reserve (and may want to be a big part of the process if it has a big share), especially if the selling partner had control over litigation prior to the sale. One advantage to the purchasing partner of the sharing approach (so that the selling partner has a stake in the outcome) is that the selling partner has an economic incentive to continue to cooperate fully in any litigation by the partnership with respect to such claim.

The authors do not recall seeing provisions in partnership agreements along the lines described above, perhaps because they may be too complicated and time-consuming. Indeed, it may be difficult to anticipate all the concerns related to claims that will be relevant at the time of the hypothetical JV sale. For this reason, it may not be practical to draft and negotiate the provisions necessary to implement the post-closing adjustment solution, especially in light of the fact that contingent assets and liabilities are not a typical problem in a hypothetical JV sale (in the authors' experience).

Closing With Reservation of Rights

The Sample Provisions allow either Partner to elect to proceed to closing based on the accountants' calculations while preserving the rights of the Partners to dispute the calculations after the closing. In this way, the partners may minimize the disruption to the partnership that might otherwise occur if closing was held up pending resolution of prolonged dispute over the pricing.

Property Sale

If there is a significant and uncertain claim, then the partners may wish to abandon the hypothetical JV sale altogether and structure the transaction as a sale of the Property to the purchasing partner. Such a property sale would enable the partners to share in the benefits or burdens of the claim, and the costs of enforcing or defending the claim, by retaining the contingent asset or liability in the partnership. The partnership could simply sell the Property and then address the claim as part of the dissolution and liquidation procedures that are already set forth in the partnership agreement. By selling the Property, the partners may defer their disputes regarding contingent assets and liabilities until after the closing of the sale rather than having pre-closing disputes that prevent the sale. Section 10.7 of the Sample Provisions contemplate this option at the election of an eligible partner[97] at the outset of the inter-partner sale process and if not then exercised, again near the end of that process if there is a dispute over the partnership interest price and neither partner has elected to proceed to closing based on the accountants' determination with a reservation of rights. If the Partners have chosen the early calculation alternative without closing adjustments, to maximize the certainty of execution, then the property sale option may allow them to hedge some of the risk that the pricing is wrong. Of course, the advantages of a hypothetical JV sale and the disadvantages of an actual property sale (especially the tax disadvantages), which are discussed in Section 2 of the body of this article, should be considered before proceeding with this alternative.

* * *

APPENDIX C
HYBRID STRUCTURE: PARTIAL PROPERTY SALE TRANSACTION

This Appendix considers whether there is an alternative to the real estate sale (by the JV) and the partnership interest sale (by the other partner) described in the body of this article that captures the best of both of those two approaches. In particular, this Appendix considers the following two-step *partial* real estate sale transaction (which involves both a real estate sale and an inter-partner sale): The partnership distributes undivided interests in the property (i.e., the Project or all JV assets, as applicable) to the partners and then the selling partner sells its undivided property interest to the purchasing partner. This alternative structure still involves a hypothetical JV sale and an inter-partner sale. But the hypothetical JV sale is used to determine the partners' respective undivided percentage interests in property (in addition to the purchase price payable to the selling partner); and then a direct interest in the JV's property rather than a partnership interest is transferred in the inter-partner sale. This approach may:

- avoid the problem of the purchasing partner buying the portion of the investment it already owns (and the corresponding tax[98] and non-tax issues identified above); and
- reduce transfer taxes in at least one state when the selling partner is a majority owner.[99]

Thus, income taxes and transfer taxes might not always be factors driving an inter-partner sale of partnership interests (and it is even possible that transfer tax considerations make this alternative more desirable). This hybrid structure might also make it easier to address contingent assets and liabilities by leaving them in the partnership and relying on the dissolution procedures already set forth in the partnership agreement.[100] However, unlike a real estate sale *by the partnership*, the partnership would not receive the proceeds of the sale, so there may be no money to reserve for contingent and other remaining partnership liabilities. Indeed, most (if not all) of the partnership's assets of value may have been distributed, which could give rise to fraudulent conveyance and improper distribution issues.[101] Moreover, this two-step process (involving multiple transfers) may be more complicated than an inter-partner sale and may fail to address many, if not most, of the other issues discussed with a real estate sale, especially those relating to project financing. It is not surprising, therefore, that the authors have not seen this alternative structure used as a substitute for a hypothetical JV sale and the accompanying inter-partner sale of partnership interests. However, the authors have encountered partnership agreements that provide for actual real estate sales by the partnership to a partner and also provide for optional restructuring to make the transaction tax-efficient, which could lead to this alternative structure. Indeed, the hybrid structure may be worth considering to make a real estate sale option more tax-efficient.

* * *

APPENDIX D
ASSET CHANGE CLOSING ADJUSTMENTS

This Appendix discusses asset change closing adjustments under all-asset pricing or Project pricing.

All-Asset Pricing

As indicated in the body of this article, some partnership agreements simply provide that all-asset pricing is *increased by contributions* and *decreased by distributions* during the inter-partner sale process. While this approach may have intuitive appeal, it may also be too simplistic.

- It fails to account for an increase in assets due to *new borrowings*: new assets (or improvements to existing assets) may be obtained by a loan advance. In such event, shouldn't the pricing be increased? Otherwise, the reduction for the new debt in the hypothetical liquidation would artificially reduce the net distributions.

- It fails to account for the depletion of existing assets to reduce debt: if reserves or other existing assets (other than interim operating revenues) are used to pay down debt, then the price might be artificially increased because there would be less debt to deduct in the hypothetical liquidation (without a corresponding decrease to account for the use of the existing assets).

- It fails to account for the impact on the prorations of contributions to pay interim operating deficits: if a contribution is used to pay interim operating deficits, why should it increase the pricing? Won't the payment already result in a price increase due to reduced proration credits in favor of the buyer? The partners may wish to exclude contributions used to pay operating expenses from the price adjustments (other than the prorations).

- It fails to account for the fact that the selling partner may expect its share of net operating cash flow to be in addition to its share of the hypothetical sale proceeds: many selling partners may not want a price decrease on account of distributions of net operating cash flow.

- It fails to account for the use of operating revenues to increase assets through reserves or capital expenditures: if there is an increase in assets resulting from the use of interim operating revenues to create reserves or pay capital expenditures, then the selling partner may wish to have a price increase to offset the reduction in distributions of net operating cash flow or the price decrease resulting from additional proration credits in favor of the buyer for accrued but unpaid expenses.

Project Pricing

As suggested above, the asset change closing adjustments for all-asset pricing often, if not usually, start with the notion that the pricing is increased by contributions and decreased by distributions, but this might not work very well in practice. Because Project pricing takes into account new assets through the hypothetical distribution, and distributions need not be tracked unless there are distributions of assets that were priced (i.e., Project assets or their proceeds), the asset change closing adjustments for Project pricing often start with the opposite premise, namely that contributions and distributions do not affect the Project pricing. As may be seen from a review of the asset change closing adjustments, it may be easier to focus on the expansion of the Project (through capital expenditures) and the depletion of the Project through sale, condemnation and casualty insurance proceeds (and the applicable deductible).

Comparison

For some asset changes, the adjustment will be the same under the two approaches. For example, if there is a distribution of sale proceeds from an interim sale of a portion of the Project, there is a depletion of a priced asset and consequently, the partnership agreement may provide for a reduction in the hypothetical sale price by the amount of the distribution to avoid giving the selling partner a windfall (double benefit): its share of the actual distribution of sale proceeds from the asset sold, on the one hand, and its share of the hypothetical distributions from the hypothetical sale, the price for which *also* takes into account the asset sold, on the other hand. But often the results will be different, as illustrated by the following chart:

EXAMPLES OF POTENTIAL ASSET CHANGES (and Adjustments to Hypothetical Sale Price)			
	Distribution of Existing Cash Reserves[1]	***Contribution to Create New Cash Reserves***	***Sale of Priced Parcel to Create New Cash Reserves***[6]
***All-Asset* Pricing**	Reduce Price by Amount of Dist[2]	Increase Price by Amount of Cont[4]	No Adjustment[7]
***Project* Pricing**	No Adjustment[3]	No Adjustment[5]	Reduce Price by Net Sale Proceeds[8]

[1] "Existing Cash Reserves" means reserves existing at the time of the initial pricing.

[2] To avoid the following windfall (double benefit) to selling partner: its share of the actual distribution of such reserves and its share of the hypothetical distribution from the hypothetical sale of all assets of the partnership (the price for which took into account such reserves).

[3] Because there is no windfall (double benefit): the distributed reserves will not be taken into account in the hypothetical sale/liquidation.

[4] To avoid depriving selling partner of its share of the new reserves: there is no distribution of the new reserves and the new reserves will not be taken into account in the hypothetical sale/liquidation.

[5] Because the new reserves will be taken into account in the hypothetical sale/liquidation.

[6] "Priced Parcel" refers to a parcel that is part of the initial pricing (i.e., any parcel of the partnership for all-asset pricing and a parcel that is part of the Project for Project pricing).

[7] Because there is no windfall (double benefit): one priced asset has simply been exchanged for another, which will not change the amount available for distribution in the hypothetical sale/liquidation.

[8] To avoid the following windfall (double benefit) to selling partner: proceeds from the sale of the parcel in effect being counted twice — first as part of the hypothetical sale of the Project (because the price took into account the parcel) and second as part of the hypothetical liquidation of the assets of the partnership at closing (because the reserves from the actual parcel sale proceeds are among those assets).

* * *

NOTES:

[1]There are many possible rights of first offer that may be given to a partner in a partnership agreement (e.g., when the other partner proposes to sell all or a portion of its partnership interest or all or a portion of the assets of the partnership). This article is concerned with a right of first offer given to a partner when the other partner proposes to sell the partnership's real estate.

[2]Not knowing who will be the buyer or the seller in inter-partner sale provisions makes these provisions easier to negotiate. This uncertainty may be present in a buy/sell or when each partner has a unilateral sale right subject to a right of first offer in favor of the other partner. It may not be present in a put or a call (because the partner with the put right may always be the seller and the partner with the call right may always be the buyer) unless each partner has a similar right (e.g., when each partner has a call right to purchase the other partner's interest if the other partner's parent company goes bankrupt). Moreover, several factors (e.g., disproportionate financial wherewithal) may affect how each partner perceives provisions that may otherwise appear reciprocal.

[3]As discussed later in this article, there are some provisions that may be justifiably different for a right of first offer, a buy/sell, a put or a call. But many of the inconsistencies encountered by the authors are hard to explain. To avoid the complexities of too many possible alternative fact patterns, it is assumed that the client wants common provisions to govern the inter-partner sale associated with each of the hypothetical JV sales in the partnership agreement.

[4]The reader may wonder whether an inter-partner sale in a two-partner partnership is a problem because a partnership needs two partners. Of course, having a single owner is possible when using a limited liability company (which is the typical two-party real estate venture structure encountered by the authors). But even in the partnership context, the entity existence problem is easily solved. In the authors' experience, when an investor and

an operator form a real estate partnership, it is usually a limited partnership formed due to state tax concerns. Both the operator and the investor are typically involved in management. For example, there may be two general partners and two limited partners, where each party owns one general partner and one limited partner. In this example, the inter-partner sale would be a sale of the selling party's general partner and limited partner interests so that one general partner and one limited partner would survive the sale and the partnership would remain intact. There are other possible partnership structures and other solutions to this problem for different structures. There are even solutions in the general partnership context. But further attention is not devoted to this subject. For simplicity, it is assumed that there are only two partners (and the single-partner partnership issue is ignored).

[5]Often only one of the partners has a unilateral sale right and the other partner may or may not have a ROFO.

[6]In many partnership agreements, the *initiating partner* must name the price and make an offer to sell its interest based on what it would have received from the hypothetical sale.

[7]As discussed in Section 2, in some partnership agreements, the price is for "all the assets" of the partnership (rather than only the Project).

[8]*Ibid.*

[9]*Ibid.*

[10]Sometimes there is only a put or only a call, but we have assumed that both are present. Under the Put/Call (unlike the Buy/Sell), it is known in advance which partner will be the seller and which partner will be the buyer.

[11]*See, e.g.*, *supra* note 5 (regarding who has the right to cause a sale and who has a ROFO), note 6 (regarding who makes the offer under a ROFO), and notes 7, 8 and 9 (regarding what is priced under a ROFO, Buy/Sell or Put/Call). Other variations include having a third response option under a ROFO to trigger a buy/sell and having a third response option under a buy/sell to cause a sale of the Property. The possibilities are seemingly endless and can be very complicated.

[12]*See, e.g.*, Stevens A. Carey, *Buy/Sell Provisions in Real Estate Joint Venture Agreements*, 39 Real Prop. Prob. & Tr. J. 651, 663–65 (Winter 2005) (hereinafter, Carey, *Buy/Sell Provisions*).

[13]This approach is particularly common in partnerships with multiple projects when the ROFO, Buy/Sell or Put/Call applies to less than all the projects. In this article, it is assumed for simplicity that there is only one Project. However, even those deals that provide for a sale of one or more projects may be structured to give the purchasing partner the option to proceed with a partnership interest purchase if that is preferable (especially to mitigate income tax consequences). For example, in some states, the following steps might be taken: each project may be owned by a separate single-member LLC owned by the same master partnership; before the purchase by the purchasing partner with respect to a given project, the partnership may distribute to the partners membership interests in the relevant LLC in accordance with their respective percentages of the hypothetical liquidation proceeds (assuming the LLC sold the relevant project and then liquidated, and the net proceeds were distributed by the partnership to the partners); and then the purchasing partner may acquire the other partner's membership interest in that LLC so that it ends up with 100% of the membership interests.

[14]It may, however, be possible to engage in a two-step *partial* property sale transaction that avoids the income tax consequences of a sale of the *entire* Property, as described in Appendix C.

[15]It may be possible to draft around the problem of this seemingly unnecessary "round-trip" travel of the purchasing partner's share of the cash: if the actual cash amount payable by the buyer under the sale is $X, and the share of distributions from the sale that the purchasing partner would receive is $Y, then the partnership agreement could provide instead that the purchasing partner will actually fund $X - $Y, and will be deemed to have paid $Y to the partnership to pay the balance of the purchase price and to have received $Y of distributions from the partnership. But if the reason for using an actual property sale is to avoid a dispute over the calculation of $Y, then this drafting solution may not be very helpful.

[16]Of course, even a partnership interest sale may trigger consent requirements, but the consent requirements for a real estate sale tend to be greater.

[17]But not always. As discussed later in Appendix C, in some cases there may be no transfer tax savings and it may even be possible to restructure the transaction to sell an undivided interest in the Property that could result in less transfer taxes than those payable in connection with an inter-partner sale.

[18]How these savings are shared is an issue considered in Section 5.2.2. Note that there may be cost savings under a ROFO, Buy/Sell or Put/Call *whether or not* there is a property sale or an inter-partner sale: the absence of or reduction in a brokerage commission, which may result from not engaging a broker or getting the broker to agree to accept a lesser or no commission for a sale to a partner. Thus, even in an actual JV sale to the purchasing partner, the partners may want to address how any brokerage cost savings should be shared.

[19]If the partnership delivers a deed to the purchasing partner, then the benefits of the partnership's title insurance may be retained (e.g., under a 2006 ALTA Owner's Policy) to the extent of any warranties in the deed, but the purchasing partner may not have any direct rights under the partnership's title insurance (as it would, for all practical purposes, if it owned 100% of the interests in the partnership). *See* ¶ 2 of the printed Conditions of the 2006 ALTA Owner's Policy, *available at* www.alta.org/forms/. Retaining the partnership's title insurance through a warranty deed may be a cumbersome and potentially risky solution (possibly requiring that (x) the warranties in the deed be tailored in an attempt to avoid providing more protection than is contemplated by the original title insur-

ance policy, and to avoid successor owners from successfully making claims under the deed, and (y) the partnership (or a successor who will qualify as the "Insured" under the policy) stay intact so that it can honor the warranties in the deed and make claims under the policy) especially if the partners would like to dissolve the partnership after the sale. *See, e.g.*, Michael J. Berey, *Continuation of Insurance Under an Owner's Title Policy*, N.Y. L.J. (Apr. 6, 2012). By comparison, any concern that an inter-partner partnership interest sale could vitiate the partnership's title insurance is, in the authors' experience, usually addressed easily with a 2006 ALTA policy or a *Fairway* endorsement. *See, e.g.*, James L. Gosdin, Title Insurance: A Comprehensive Overview 22 (3d ed. A.B.A. 2007).

[20]For example, if the Property is in California and the selling partner is not doing business in California, then the sale of a partnership interest may also be a way to minimize state income taxes for out-of-state investors. *See, e.g.*, Appeal of Amyas and Evelyn P. Ames et al., No. 87-SBE-042 (Cal. St. Bd. of Equal., June 17, 1987). *But see also* Cal. Rev. & Tax Code § 25125(d), which addresses a *corporate* partner's disposition of a partnership interest; Robert W. Wood, *California Sourcing and M&A*, 21 M&A Tax Rep. 1 (Feb. 2013), which discusses the disposition of a limited liability company membership interest; Kathleen K. Wright, California Income Tax Manual ¶ 705.05, at 223 (2009) ("Most states (including California) treat income from the sale of a partnership interest as gain from the sale of intangible personal property. The gain is therefore usually allocable to the state of the selling partner's residence under the doctrine of *mobilia sequuntur personam* (movables follow the law of the person). [citing Appeal of Amyas, *supra*] However, a different rule is applied where the partnership interest is owned by a corporation.").

[21]*See infra* note 23 for a discussion of the assets that would typically be excluded in a third-party sale.

[22]In the authors' experience, the "Project" (or "Property") sold in a hypothetical JV sale is usually defined by reference to the purchase or contribution agreement under which the JV acquired it (or in a manner similar to what would appear in a sale contract if it were being sold to a third party).

[23]The list of valuable reserved or excluded assets can sometimes be extensive and may include:

(a) to the extent not assigned by and credited to the seller in the prorations, cash or cash equivalents (including certificates of deposit), deposits held by third parties (e.g., utility companies), rights to refunds, accounts receivable and other payments relating to a period prior to the sale closing (such as refunds for an overpayment to a lawyer or accountant, real estate tax refunds, and refunds in connection with the termination of the seller's existing insurance policies) and development bonds, letters of credit or other collateral held by or posted with governmental authorities or other third parties with respect to any improvement, subdivision or development obligations;

(b) claims or other rights against related parties (such as present or prior partners, members, employees, agents, managers, officers or directors of the seller or its direct or indirect owners);

(c) claims against unrelated parties (such as tenants who have vacated the Property or contractors who have been replaced);

(d) trademarks, service marks, brand marks or other intellectual property that has value and is not expected to be included in a sale;

(e) artwork; and

(f) furniture, equipment and office supplies in a management office.

As noted in Section 1 of this article, unless otherwise provided in the partnership agreement, all assets of the partnership may effectively go to the purchasing partner in the inter-partner sale that accompanies the hypothetical JV sale even if there is Project pricing (in contrast to an actual property sale, which would transfer to the purchasing partner only the assets included in the property being sold). This would include not only the assets identified above, but also assets that may not have clear monetary value (e.g., employee contracts and engagements with accountants and attorneys and any associated privileged information).

[24]The partners may want to carve out liabilities to a partner under the partnership agreement (e.g., loans by a partner to the partnership) so that the partner creditor does not inadvertently forgive the other partner's share of the liability in the inter-partner sale. To illustrate, assume for simplicity that, other than $100X owed by the partnership to one of the partners under the partnership agreement, the partnership has no assets or liabilities. Under these simplified facts, if the net price for the partnership assets and liabilities were set at $0, then the creditor partner could lose its $100X receivable under the partnership agreement: if it were the purchasing partner, then it would inherit the partnership liability, including the selling partner's share; and if it were the selling partner, then, assuming the right to receive $100X under the partnership agreement would be transferred as part of the selling partner's rights under the partnership, then the purchasing partner would acquire the benefit of the $100X receivable at no cost. *See also* liability valuation discussion in Section 5.1.2 and net pricing discussion under "Initial Pricing Alternative" in Appendix B.

[25]Remember, it is assumed at the beginning of this article that the partnership is a single-purpose entity that was formed to own the Project. If the partnership owns assets in addition to the Project (other than cash and ancillary assets associated with the Project), it might not make sense to speak of a hypothetical liquidation following a hypothetical sale of the Project. But even then, the partners might still want to address the partnership liabilities and ancillary assets associated with the Project.

[26]*See, e.g.*, Carey, *Buy/Sell Provisions*, *supra* note 12.

[27]For all-asset pricing, if both assets and liabilities are valued, then a hypothetical liquidation may duplicate much of what has already been priced and therefore may be discarded or materially modified. If only assets (and not liabilities) are part of the all-asset pricing, then a hypothetical liquidation would result in changes only on account of liabilities because all the assets would be priced (although there may be other adjustments to account for changes in assets, as discussed later in Section 5.2).

[28]*See* asset and liability pricing discussion under "Consequences of Pricing Approach" in Section 2, liability valuation discussion in Section 5.1.2 and net pricing discussion under "Initial Pricing Alternative" in Appendix B.

[29]For an explanation of "promotes," *see, e.g.*, Stevens A. Carey, *Real Estate JV Promote Calculations: Basic Concepts and Issues (Updated 2013)*, Real Est. Fin. J., Summer 2013, at 5.

[30]The investor may be the only selling partner in some partnership agreements (e.g., when the only hypothetical JV sale is for a ROFO in favor of the operator). But in many, if not most, partnership agreements involving hypothetical JV sales, the operator may also be a selling partner (e.g., when there is a Buy/Sell or a ROFO or call right in favor of the investor). And if the operator is the selling partner, then the investor may want the value of the operator's interest to account for the increase in the investor's hurdle(s) during the remaining time before closing. This may prove to be difficult: there may be resistance (psychologically) to a reduction in value; the corresponding discount is generally not proportionate to the corresponding increase in value for the investor's interest; and the calculation is not simply a matter of making the interest factor for the investor a discount factor for the operator. Query whether the pricing calculation could be done at the outset based on the assumption that the hurdles are calculated as of the anticipated closing date? Or would such a calculation open the door to other adjustments that could defeat the purpose of an early calculation?

[31]If there are multiple promote hurdles, the investor may feel that it could be shortchanged by any interest factor that is less than its highest hurdle rate, while the operator may feel that even the lowest hurdle rate could be too high (if, for example, the investor had already achieved all of the promote hurdles so that, assuming no further contributions by the investor, the accrual of a return for the investor had effectively already stopped).

[32]This risk may be exacerbated if there are Project prorations only as of the time of the early calculation (so that the purchasing partner is effectively taking responsibility for taxes and other operating expenses accruing after the calculation). Failure to make closing adjustments to account for interim events (e.g., an increase in an operating line of credit to pay operating expenses; receipt of a delinquent receivable that had been written off; or receipt of a cash settlement or release of liability from a third party) may further contribute to this risk. Query whether this risk is mitigated in whole or in part if there is a condition to closing beyond the control of the parties under which the purchaser can terminate the sale (e.g., if there has been a major uninsured casualty during the sale process).

[33]*See, e.g.*, *In re El Paso Pipeline Partners, L.P. Derivative Litigation*, 2014 WL 2768782 (Del. Ch. 2014).

[34]Query whether such a dispute could derail the process? For example, in the ROFO context, would a title company be willing to insure title to a third-party buyer if a good faith pricing obligation were being contested?

[35]In theory, the responding partner under a Buy/Sell can protect itself from a price that materially deviates from fair market value by electing to buy or sell, as appropriate. However, it may not always work out that way in practice. Due to asymmetries in the positions of the partners (whether relating to resources, expertise, information or otherwise), the responding partner may not be in a position to utilize the Buy/Sell in the same manner as the initiating partner. Sometimes the partners provide for so-called "schmuck" protection or insurance to mitigate against the purchasing partner flipping the Property shortly after the closing for a big profit (by requiring the purchasing partner to share the profits in some manner). However, such provisions can be difficult to negotiate and if not drafted properly, can backfire. *See, for example*, *Charron v. Sallyport Global Holdings, Inc.*, 2014 WL 7336463 (S.D.N.Y. 2014), aff'd, 2016 WL 791068 (2d Cir. 2016), in which the selling owner ended up getting more than it would have received had it stayed in the venture (because what may have been intended to be a percentage of profit was interpreted by the court to be a percentage of total proceeds). Peter A. Mahler, *"Jerk Insurance" Takes on New Meaning in Buyout Dispute*, N.Y. Bus. Divorce Blog (Jan. 19, 2015), *available at* http://www.nybusinessdivorce.com/2015/01/articles/buyout/jerk-insurance-provision-in-disputed-buy-out-agreement-doubly-deserves-its-name/. While the authors have encountered such windfall protection to protect the selling partner from selling too low, they have not encountered windfall protection to protect the purchasing partner from buying too high. And either such protection is likely to be short-lived and is therefore not likely to help when the purchasing partner intends to hold (rather than flip) the Property. Moreover, some partnership structures may increase the possibility of manipulation. For example, assume the appraised value of the Property is less than the debt, but interest rates are sufficiently low so that there is sufficient operating revenue to cover all debt service and operating expenses; and both partners hope and expect that the property value will recover. In other words, assume that each partner's interest has a current value of $0 but each partner hopes that it will have value in the future. If one partner has some preferred capital and is therefore entitled to 100% of the first $X of distributions, then it could name a price that would yield $X of distributions in the hypothetical sale and liquidation, in which event the other partner could be faced with a Hobson's choice: buy the initiating partner's interest for $X (which, depending on the magnitude of X, may not be a viable alternative, because it could be viewed as an $X overpayment) or sell its interest for $0. *See* Stevens A. Carey, *Five Joint Venture Calculation Issues That May Be*

Overlooked or Misunderstood, CAL. BUS. L. PRAC., Winter 2013, at 17, 19–20.

[36]*Ibid. See also* Carey, *Buy/Sell Provisions*, *supra* note 12 at 667. Buy/Sells may generally be more prone to imbalances than ROFOs because the partners will always be on opposite sides of the transaction under a Buy/Sell (and either might be a buyer or seller) whereas in a ROFO, the partners will be on the same side of a transaction in the case of a third-party sale (and the initiating partner will always be a seller, directly or indirectly). For this reason, some partners opt instead for a Put/Call (where the price is determined by appraisal) or a sale right subject to a ROFO, not only for an exit strategy but also for a dispute resolution mechanism. But many partners favor the Buy/Sell as the easiest way to make a clean break without involving third parties (e.g., third-party buyers or appraisers).

[37]Of course, when all-asset pricing is used, *all* assets are part of the initial pricing — even if they are acquired after the initial pricing. (This is assumed in Section 2 above, and is consistent with the all-asset pricing typically encountered by the authors.) But subsequently acquired assets may or may not require a closing adjustment in order to avoid an unfair result.

[38]By assumption, unpriced assets occur only if Project pricing is used. If cash reserves and cash equivalents are created with contributions or loan advances received during the sale process, then, if all-asset pricing is used, they may be addressed by closing adjustments. *See* discussion in Section 5.2.3.

[39]As discussed briefly in Section 2 of this article, it is also possible to price all assets *and liabilities* in the initial pricing. If this approach were taken, then it would be important to avoid double-counting liabilities (in the initial pricing and then again in prorations or in the hypothetical liquidation).

[40]If there were to be a discount on account of the partial ownership interest, it would make more sense (and in light of debt complications at the real estate level, be easier) to apply it to the partnership interest sale price after it is determined.

[41]*See, e.g.*, Robert P. Schweihs, *The Combined Discount*, GIFT & EST. TAX VALUATION INSIGHTS, Winter 2010, at 52; Philip Saunders, Jr., Ph.D., *Control Premiums, Minority Discounts, and Marketability Discounts*, which appears as Chapter 16 in ROBERT B. DICKIE, FINANCIAL STATEMENT ANALYSIS AND BUSINESS VALUATION FOR THE PRACTICAL LAWYER (2d ed. A.B.A. 2006).

[42]Actually, only loans payable *by the partnership* may affect the determination of the net hypothetical liquidation amount: they are generally paid before any distributions. However, loans payable *by a partner to the other partner or the partnership* may affect the price for the selling partner's partnership interest; and such internal loans to a partner are also addressed in the discussion in Section 5.2.6.

[43]*See, e.g.*, COMMONWEALTH LAND TITLE COMPANY, REAL ESTATE LAWS & CUSTOMS BY STATE, http://www.fntgemarketing.com/cltc/ebooks/Real_Estate_Laws_Customs/ (last visited May 2014); FIRST AMERICAN TITLE INSURANCE COMPANY, REAL ESTATE CUSTOMS GUIDE, http://www.firstam.com/rep/gneri/ (under "Helpful Links") (last visited Sept. 2014).

[44]According to the California Revenue & Taxation Code statutes regarding transfer taxes (which may be supplemented by local ordinances and other rules in "charter cities" (Cal. Const. art. XI, § 5); *Fisher v. County of Alameda*, 20 Cal. App. 4th 120, 124; 24 Cal. Rptr. 2d 384 (1st Dist. 1993)), "[i]f there is a termination of any partnership or other entity treated as a partnership for federal income tax purposes, within the meaning of Section 708 of the Internal Revenue Code . . . , the partnership or other entity shall be treated as having . . . conveyed . . . all realty held by the partnership or other entity at the time of the termination." Cal. Rev. & Tax Code § 11925(2)(b). Section 708 provides, in part, that "a partnership shall be considered as terminated . . . if . . . (A) no part of any business, financial operation, or venture of the partnership continues to be carried on . . . in a partnership, or (B) within a 12-month period there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits." I.R.C. § 708(b)(1). Thus, the sale of the majority partner's interest could result in a termination under I.R.C. § 708(b)(1)(B) and therefore a transfer tax as to all the realty owned by the partnership. Even the sale of a minority interest could result in a termination under § 708(b)(1)(A), and therefore such a transfer tax, if purchased directly by the majority member in a two-member LLC (because, absent an election to be taxed as a corporation, a single member LLC is a disregarded entity and, in particular, not a partnership, for federal income tax purposes; Treas. Regs. § 301.7701-3(a), (b)(ii)). For this reason, it may be advisable in California for a majority member to use a separate taxpayer affiliate to acquire the minority member's interest.

[45]Another example might be an inter-partner sale in which the purchasing partner is obtaining title insurance (in a state in which the seller typically pays title insurance costs). But in many inter-partner sales, no title insurance is obtained.

[46]Such circumstances would exist when the amount of the closing cost is the same for a property sale and for an inter-partner sale (e.g., a transfer tax in California if the selling partner owns 50% or more of the partnership).

[47]Thought should be given to what it means for the partnership to pay a closing cost. If the partnership uses a priced asset to pay the closing cost, will the selling partner bear its share? This may be an issue when using all-asset pricing without appropriate adjustments. *See infra* note 52.

[48]Some partners may argue that the purchasing partner is getting all the buyer closing cost savings (i.e., the savings attributable to hypothetical buyer closing costs in the hypothetical JV sale that are not being incurred in the actual inter-partner sale), so the selling partner should get the seller closing cost savings. Some partners may

want to allocate savings for a particular cost based on who is intended to benefit from the cost: they may argue that (1) brokerage savings should go to the selling partner (or, more precisely, that there should be no deduction for brokerage commissions that are not incurred) because brokerage services are for the benefit of the seller and without a broker, it doesn't get the benefit of marketing, (2) title insurance savings should go to the purchasing partner (or, more precisely, that there should be a deduction for the title insurance costs that would be incurred by the seller in a property sale but are not incurred) because title insurance is for the benefit of the purchaser, and (3) savings that relate to other costs that are not of a discretionary nature (arguably including loan satisfaction/assumption costs and transfer taxes) should be shared. For example, in some states, such as Virginia or Maryland, transfer taxes are shared (*see supra* note 43), but there is no transfer tax for the sale of a non-controlling interest. *See, e.g.*, Robert Mouton & Matt Hart, *The Controlling Interest Transfer Tax*, 29 PRAC. REAL EST. LAW. 33 (July 2013); Loren Kessler Higgins, *Real Estate Transfer Taxes: Unanticipated Expenses in the Context of Equity Transfers*, LEXOLOGY (June 19, 2012); Michele Randall & Joseph Gurney, *Controlling-Interest Real Estate Transfer Taxes: The Potential State Tax Trap in Mergers and Acquisitions*, 888 ANALYSIS & PERSP. 1 (2011); National Association of Realtors, *Transfer Tax Advocacy Study 2011 Update*, LEGAL RES. CENTER (2011); The Corporation Secretary, *M&A: Real Estate Transfer Taxes in a Sale of a "Controlling Interest" of a Company*, CORP. SECRETARY'S BLOG (Sept. 27, 2011). If the inter-partner sale in such a state involves a non-controlling interest, the purchasing partner will get 100% of the buyer transfer tax savings, so the selling partner may not want to share the seller transfer tax savings.

[49]*See* discussion later in this Section 5.2.2 of "Net vs. Gross Prices." Also, note that if the partners were to use a Buy/Sell to resolve a deadlock over whether to sell the Project (or more generally, if only one of the partners wants to sell the Project at the time the Buy/Sell is triggered), then the partner who wants to exit may be at a disadvantage (in addition to facing the problem of possibly being required to invest more money in the Project in order to sell it): if it acquires the other partner's interest and then sells the Property, then (unlike the partner who does not want to sell) it may bear actual closing costs in the near future and therefore may not get much (if any) benefit from hypothetical closing cost savings.

[50]Part of the rationale for the first approach (i.e., no deduction for hypothetical closing costs so the selling partner gets 100% of the seller cost savings) is the built-in bias in favor of the purchasing partner (who gets 100% of the buyer cost savings). Another reason is simplicity. Trying to share cost savings can be particularly difficult for loan satisfaction/assumption costs. For example: What if the value of the Property is $100X without the debt and $99X with the debt and the satisfaction costs are anywhere from 5% to 0% depending on the time of sale and the assumption costs are always 1%? What, if anything, should be deducted in the hypothetical sale? Without knowing more facts, it is difficult to prescribe in advance any deduction of hypothetical costs. For example, if you were to deduct 3% prepayment costs when the partnership might have sold the Project subject to the debt for a 1% assumption fee, then the selling partner might get less from an inter-partner sale than from a sale of the Project by the partnership to a third party. And if you were to deduct a 1% assumption fee when the partnership might sell the Project for all cash with a 3% prepayment fee, then the selling partner functionally may be getting a disproportionate amount of the cost savings. But even a 1% deduction might seem unfair to the selling partner if there is an open prepayment window at the time (or if the Property is expected to be sold during a future open prepayment window, but the partners are parting ways earlier under the Buy/Sell).

[51]If the Put/Call is an accommodation to the selling partner or is triggered by a default of the selling partner, then the selling partner may have a difficult time improving the position it would have been in assuming a sale of the Project.

[52]*See supra* note 47. The purchasing partner will want to make sure that the selling partner pays its share in the same manner it would have if the amount had been contributed. In particular, the purchasing partner doesn't want the cost to be paid after the selling partner has left the partnership without having the selling partner participate. So the purchasing partner will want the partnership to set aside the cash needed to pay this cost prior to the final pricing calculation (and if there is all-asset pricing, the purchasing partner will want to make an adjustment to account for the depletion of any cash on hand). The selling partner will want to avoid double-counting the cost so it won't want a deduction in the hypothetical JV sale except to the extent it reduces cash on hand.

[53]There are other possible solutions. For example, one possibility is to require that the purchasing partner pays all actual anticipated closing costs (other than attorneys' fees) so that the purchasing partner pays a gross amount. With this approach, the initiating partner is likely to name a price that is net of these costs and this may wreak havoc with the ROFO: third-party buyers are not likely to pay all closing costs and name such a "net price." Moreover, if seller costs are deducted to facilitate a comparison of prices that are net to the seller, there would no longer be a straightforward comparison of two stated prices; there would be a calculation which could be challenged.

[54]The authors have encountered a slightly modified version of this approach with all-asset pricing under which (x) the early calculation alternative is utilized, and (y) the purchase price for the purchasing partner's partnership interest is increased and decreased by *its share* of interim contributions and distributions, respectively.

[55]For example, why should the distribution of net operating cash flow received after the initial pricing reduce the hypothetical JV sale price? And why should a distribution of financing proceeds from an interim borrowing reduce the hypothetical JV sale price (if there is already a

price reduction on account of the liability for the interim borrowing in the hypothetical liquidation)? *See* Carey, *Buy/Sell Provisions, supra* note 12 at Sections VIB and VIC.

[56]The Sample Provisions in Appendix A-1 provide in relevant part that "the Partnership had been dissolved and liquidated immediately following such sale and the proceeds of such sale *and the other assets of the Partnership*, remaining after satisfaction of (or setting aside reserves for the expected payment of) the actual debts and liabilities . . . of the Partnership . . . had been distributed to the Partners in accordance with the provisions of this Agreement . . . ." The italicized language would not be included if all-asset pricing were used because there would be no "other assets."

[57]*See* Section 10.3.3 of Sample Provisions.

[58]This relatively common treatment of liabilities may not, however, solve the liability valuation problems mentioned in Section 5.1.2.

[59]Of course, it is also possible that a liability is created or eliminated without involving a corresponding asset (e.g., an old lawsuit is dismissed or a new lawsuit is filed), but then the change in liabilities may be addressed in the hypothetical liquidation by the corresponding increase or decrease in partnership liabilities to be deducted (and there is no need for an asset adjustment). There is also the possibility that old liabilities are replaced with new liabilities (e.g., a new line of credit might be used to satisfy an old line of credit). In that event, the increase and decrease should offset one another (because the hypothetical liquidation will reflect only the new liabilities). Of course, there is room for deviation around the margins (e.g., due to the costs incurred in getting a replacement line of credit). Such deviation may sometimes be avoided if there are adequate controls.

[60]The asset adjustment described in this Example is set forth in Section 10.3.3B or C of Appendix A-1. It is not dependent on the application of the net sale or insurance proceeds to satisfy the loan. Appendix A-2 considers some different possible applications of the $20X of net sale or insurance proceeds, each of which leads to approximately $80X of net liquidation proceeds and preclosing distributions (assuming no other assets or liabilities other than equal amounts of operating expenses, including interest under the loan, and operating revenues that offset one another during the closing period).

[61]The conclusion may depend on the nature of the internal debt that is contemplated. For example, if the partners expect no internal debt other than contribution default loans (which the partners want the defaulting partner to repay, whether *its share* in the case of a loan to the partnership or *100%* in the case of a loan to the defaulting partner), then the partners may want to insist on repayment at closing (so that a partner is not permitted to circumvent repayment through the inter-partner sale). On the other hand, if the partnership has been capitalized primarily with internal debt (as is sometimes the case in foreign transactions), then the partners may not want to require repayment (so that the repayment obligation does not neuter the ROFO, Buy/Sell or Put/Call when the asset value is not sufficient to effect the repayment).

[62]The words "and the other assets of the Partnership" would not be used if there were all-asset pricing (instead of the Project pricing which is assumed in this Appendix A-1).

[63]The preceding sentence may be necessary if there is a clawback or other obligation to share losses that would have occurred in an actual third-party sale, but otherwise may not be required.

[64]As suggested by Appendix D and the examples in Sections 5.2.4 and 5.2.5 of the body of this article, different closing adjustments would be required for all-asset pricing.

[65]Remember that it is assumed (for simplicity) that there is only one Project (i.e., no other real estate) so no additional real estate (other than ancillary real estate to expand the Project) would be acquired during the Partnership Interest Sale Closing Period.

[66]It is possible to limit this adjustment to capital expenditures that *expand* or *improve* the Project. It is also possible to narrow the applicable category of capital expenditures to those that are not expected to be recouped from tenant reimbursements, but the selling partner is not likely to get the benefit of such tenant reimbursements.

[67]There are many alternative formulations that may be used (including giving the right to either partner or not giving the right to a partner who has done something wrong). Some thought should be given to whether one of the partners might be disproportionately affected by a Project sale and whether there is a way to mitigate that disproportionate effect. For example, a partner who expects to receive 99% of the net hypothetical sale and liquidation proceeds might not want to fund so much money to itself (or incur the income tax resulting from a sale to itself). *See* Appendix C.

[68]The illustrations below do not necessarily reflect the consequences of transaction costs. For example, if hypothetical sale closing costs are treated differently than actual interim sale closing costs, then the results of an actual interim sale may be different from the results of the hypothetical JV sale. To see this, assume the Property is comprised of a main parcel worth $79X and an out-parcel worth $21X and due to transaction costs, an interim sale of the out-parcel generates $20X of net sale proceeds. If the partnership agreement does not deduct hypothetical closing costs, then (assuming no prorations and no other costs, assets or liabilities) the purchasing partner would pay its share of $80X for a $79X parcel. The problem in this particular example could be solved, of course, by changing the adjustment so that gross proceeds are deducted.

[69]If there were $40X of operating revenues (instead of $20X), and $20X were used to pay the operating expenses and the remaining $20X were retained as reserves, then the *increase* resulting from the additional Partnership

assets (such excess revenues) taken into account in the hypothetical liquidation would offset the *decrease* in interim distributions the selling partner may have expected if such revenues constituted net operating cash flow.

[70]If the partnership agreement provides for payments to a partner, other than loan repayments and distributions, that partner may want those payments to be addressed as well. *See supra* note 24.

[71]Even if a claim is relevant to a third-party buyer, the third party may value the claim very differently. This may be a risk with the ROFO regardless of whether initial pricing (with a permanent determination of claims) is utilized.

[72]Craig D. Bell et al., *A Guide to the Attorney-Client Privilege and Work Product Doctrine for Tax Practitioners*, Wm. & Mary Ann. Tax Conf., at 29 (2007). *See also* Edna Selan Epstein, The Attorney-Client Privilege and the Work-Product Doctrine, Vol. I, at 3 (5th ed. 2007; supp. 2012), indicating that not only clients but also many lawyers do not understand the attorney-client privilege: "The privilege is far narrower in scope and in application than are the myriad matters confided to lawyers, which many lawyers . . . assume, incorrectly, to be privileged."

[73]*OXY Resources California LLC v. Superior Court*, 115 Cal. App. 4th 874, 888; 9 Cal. Rptr. 3d 621 (1st Dist. 2004), as modified, (Mar. 4, 2004) (which discusses "the controlling law regarding waiver of privilege by disclosure" at 890). *See also Center Partners, Ltd. v. Growth Head GP, LLC*, 2012 IL 113107, ¶ 35; 367 Ill. Dec. 20; 981 N.E.2d 345 (Ill. 2012) ("The basic, well-settled rule is that when a client discloses to a third-party [sic] a privileged communication, that particular communication is no longer privileged . . . ."); Erik J. Olson et al., *The Wheels Are Falling Off the Privilege Bus: What Deal Lawyers Need to Know to Avoid the Crash*, 66 Bus. Law. 901 (Aug. 2011); Jennifer W. Leland, *When Third Parties Destroy Privileges*, L.A. Daily J. (Sept. 20, 2013).

[74]Epstein, *supra* note 72 at 220. *See also id.* at 491: "Often an attorney's advice may be shared with another agent of the client, such as an accountant. To do so will constitute a waiver of the privilege unless the agent is retained by the attorney to assist the attorney in assimilating or understanding facts so that legal advice may be given."

[75]*See, e.g.*, *Consolidation Coal Co. v. Bucyrus-Erie Co.*, 89 Ill. 2d 103; 59 Ill. Dec. 666; 432 N.E.2d 250 (1982); David Winters & Vincente A. Tennerelli, *Employees Only: Communications Between a Corporation's Non-Employee Consultants and Its Counsel Create Complex Privilege Issues in States Governed by the "Control Group" Doctrine*, 18 Corp. Couns. A2–3 (Sept. 2011). In states that follow the Control Group test, the privilege might apply to communications to a non-employee, but the application of the privilege may not be very predictable. *Ibid.* ("[T]he degree to which the Control Group doctrine extends to non-employee consultants remains murky."). *See also* Brian A. Zemil, *Attorney-Client Privilege Protections for Non-Employees: Criteria for the Functional Equivalent Test*, 38 Litig. News 4 (Fall 2012).

[76]One might wonder whether hiring an accountant to do the valuation might shield the communications under an *accountant*-client privilege. While many states have enacted statutes that create an accountant-client privilege, it is generally limited to tax advice and therefore not likely to be relevant for the valuation described in this article. *See* Pilar Mata & Melissa J. Smith, *Demystifying Accountant-Client Privileges in State Tax Litigation*, 64 St. Tax Notes 41 (Apr. 2, 2012).

[77]*See* Kerri A. Eble, *Dueling Professionals: The Debate Over the Need for an Accountant-Client Privilege*, John Marshall Law School TaxEB | InBrief Mag. (Apr. 2013); Emily Jones, *Keeping Client Confidences: Attorney-Client Privilege and Work Product Doctrine in Light of United States v. Adlman*, 18 Pace L. Rev. 419, 459–61 (1998) (discussion of "Application of the Attorney-Client Privilege to an Accountant as an Agent of the Attorney").

[78]Jackie Unger, *Maintaining the Privilege: A Refresher on Important Aspects of the Attorney-Client Privilege*, Bus. L. Today (Oct. 2013) ("[A] client can never protect facts simply by incorporating them into a communication with the attorney.").

[79]*Id.*

[80]If the partnership wants to know what a claim is worth so it can divide it up among its partners, is that a request for confidential legal advice? *See, e.g.*, Jennifer Poppe et al., *Legal vs. Business Advice: Knowing When Your Advice Is Privileged*, St. B. Tex., Corp. Couns. Sec. Newsl. (Winter 2014) ("In order to qualify as privileged, a communication must satisfy two requirements: (1) the attorney must have been acting in his role as an attorney; and (2) the advice given must be legal, not business, advice . . . . Identifying the line between legal and business advice is not always clear. . . . Texas courts often take a fairly broad view of what constitutes legal advice . . . . However, other jurisdictions have adopted different tests.").

[81]Epstein, *supra* note 72 at 65.

[82]*Id.*, Vol. II, at 801.

[83]*Id.* at 824. In some jurisdictions, such as California, the work product doctrine does not require that there be existing or anticipated litigation. *See, e.g.*, *County of Los Angeles v. Superior Court (Axelrad)*, 82 Cal. App. 4th 819, 833 n.8; 98 Cal. Rptr. 2d 564 (2d Dist. 2000) ("The protection afforded by the privilege is not limited to writings created by a lawyer in anticipation of a lawsuit. It applies as well to writings prepared by an attorney while acting in a nonlitigation capacity."); *Rumac, Inc. v. Bottomley*, 143 Cal. App. 3d 810, 815 n.7; 192 Cal. Rptr. 104 (4th Dist. 1983) (contrasting the federal rule, which requires preparation "*in anticipation of litigation or for trial*," the Court states that "had the Legislature intended to limit the privilege to litigation only it would have said so."); Cal. Civ. Proc. Code § 2018.010; 2 Witkin, California Evidence, Witnesses § 152, at 466. Indeed, the California statute provides, in part, that "[a] writing that reflects an attorney's impressions, conclusions, opinions . . . is not discoverable under any circumstances." § 2018.030(a).

It does not even refer to a writing prepared *by the attorney*. Thus, a California court has stated that "reports prepared by an expert as a consultant are protected until the expert is designated as a witness. . . . Then, the opponent may seek disclosure of the reports . . . . However, to the extent that said reports embrace counsel's impressions and conclusions, the work-product doctrine gives absolute protection to that information." [citations omitted]. *Shadow Traffic Network v. Superior Court*, 24 Cal. App. 4th 1067, 1079; 29 Cal. Rptr. 2d 693 (2d Dist. 1994). Query whether a third party's valuation could be construed to be a reflection of the attorney's impressions and conclusions as to the merits and likely recovery of the claim?

[84]Robb C. Adkins, *Protection of Accountant Documents and the Attorney-Client Privilege and Work Product Doctrine: Bernardo v. Commissioner*, 49 Tax Law. 949 (Summer 1996); *Construction Industry Services Corp. v. Hanover Ins. Co.*, 206 F.R.D. 43, 48 (E.D.N.Y. 2001), adhered to on reconsideration, (Jan. 25, 2002).

[85]*See, e.g.*, Olson, *supra* note 73 at 912–15 (discussion of which state's privilege applies).

[86]9 U.S.C. §§ 1 to 14; Henry C. Strickland, *The Federal Arbitration Act's Interstate Commerce Requirement: What's Left for State Arbitration Law?*, 21 Hofstra L. Rev. 385 (1992).

[87]*See, e.g.*, Stephen Smerek & Daniel Whang, *Preemption and the Federal Arbitration Act: What Law Will Govern Your Agreement to Arbitrate?*, A.B.A. Bus. L. Sec., Committee on Corp. Couns. eNewsletter (Spring 2006) ("As interpreted by the Supreme Court, the FAA creates a uniform '' 'body of federal substantive law' '' regulating the enforceability of agreements to arbitrate that applies to all contracts involving interstate commerce in both state and federal court. [citation omitted] Given the broad interpretation of interstate commerce adopted by the Supreme Court, the FAA will apply to most every contract."). Strickland, *supra* note 86 at 443–44 ("Partnership agreements, for example, "involve" commerce within the meaning of the FAA when the partners reside in different states and the partnership does business in more than one state. A partnership agreement between residents of the same state "involves" commerce when the partnership is formed to engage in activities in another state. The same rules apply to joint ventures. [footnotes omitted]").

[88]Asa Lopatin, *What Constitutes Arbitration for Federal Arbitration Act Purposes?*, A.B.A. (June 16, 2014), *available at* http://apps.americanbar.org/litigation/committees/adr/articles/spring2014-0614-federal-arbitration-act.html.

[89]Liz Kramer, *6th Circuit Holds that Accountants Conducting Financial Arbitration Can Also Make Legal Determinations*, Arb. Nation (Apr. 8, 2015), *available at* http://arbitrationnation.com/6th-circuit-holds-that-accountants-conducting-financial-arbitration-can-also-make-legal-determinations/.

[90]*AMF Inc. v. Brunswick Corp.*, 621 F. Supp. 456, 460 (E.D.N.Y. 1985). *See also Bakoss v. Certain Underwriters at Lloyd's of London Issuing Certificate No. 0510135*, 707 F.3d 140 (2d Cir. 2013); *Harrison v. Nissan Motor Corp. in U.S.A.*, 111 F.3d 343, 350 (3d Cir. 1997) (quoting AMF Inc. v. Brunswick Corp., *supra*) ("If the parties have agreed to submit a dispute for a decision by a third party, they have agreed to arbitration."). *See also* those cases cited in Lopatin, *supra* note 88, that apply federal law to determine whether there is an arbitration; *c.f.* Robert M. Loeb & Brian D. Ginsberg, *What is 'Arbitration'? The Supreme Court Refuses to Say*, Law360, New York (Nov. 13, 2013), *available at* http://www.law360.com/articles/488134/what-is-arbitration-the-supreme-court-refuses-to-say ("Seven of the eight circuits that categorically apply [federal law in determining what is arbitration] exclude ADR that does not provide for decision based upon adversarial presentation of evidence and witness testimony.").

[91]*See, for example*, the 5th and 9th Circuit cases cited in Lopatin, *supra* note 88, under "State Statute as Source of Missing FAA Definition."

[92]New York City Bar Report by the Committee on International Commercial Disputes, *Purchase Price Adjustment Clauses and Expert Determinations: Legal Issues, Practical Problems and Suggested Improvements*, at 3 (June 2013). The report provides the following suggestions at 54: "Where, however, the parties intend [to] be governed by the law of expert determination, then the parties should make clear that this is their intent. The parties should include language that the accounting firm is to make its determination 'acting as an expert and not as an arbitrator.' The parties should recite that the [determination] is not an arbitration agreement, but is to be governed by the law of expert determination and appraisal. Finally, parties may also wish to consider including contractual provisions expressly stating that the accounting firm's authority is limited to resolving disputed issues of fact by the application of accounting principles, and that the accounting firm shall not have the final authority to make any binding decisions as to issues of law." *See also Peco Logistics, LLC v. Walnut Investment Partners, L.P.*, 2015 WL 9488249 (Del. Ch. 2015) (Bouchard, C.), in which the Delaware Chancery Court refused to second-guess the valuation of an expert in connection with a put when the LLC Agreement clearly required that the expert's determination would be binding (but none of the parties appears to have argued that there was de facto arbitration).

[93]Steven H. Reisberg, *What Is Expert Determination? The Secret Alternative to Arbitration*, 250 N.Y. L.J. (Dec. 13, 2013). *See also* New York City Bar Report, *supra* note 92; Steven Skulnik, *Purchase Price Adjustment Determinations in the US*, Prac. Law (Thomson Reuters web site, Apr. 9, 2015), *available at* http://us.practicallaw.com/2-604-0249 ("[C]ourts in states that recognize the distinction between arbitration and expert determinations generally hold that the parties opted for expert determination, and not arbitration, if the agreement [includes certain provisions limiting the expert's role (e.g., the expert is limited to determining only the amount of loss)].").

[94]For further discussion of what is arbitration and the consequent application of potentially "unpredictable stan-

dards," *see* Scott Seidman & Molly Honoré, *When Is an Appraisal Provision in a Contract an "Arbitration Agreement?,"* 34 Litig. J. 8 (Spring 2015). *See also* Skulnik, *supra* note 93, which indicates that consequences (of having or not having a deemed arbitration agreement under the FAA) may include different levels of formality imposed on the process (e.g., whether to decide matter only on the evidence submitted) and different standards for review (e.g., courts may have "greater discretion in reviewing the merits of an expert determination when compared to arbitration awards"), and which provides a Sample Clause that highlights in bold key language to avoid arbitration: "**acting as experts and not arbitrators**." It is ironic that if the partners want the accountants' determination to be final, and the provision is respected as an expert determination (and not found to be an agreement to arbitrate), then the parties may have greater appeal rights than they would under the default rules of the FAA.

[95]Alternatively, if the partners would prefer state law treatment of an expert determination in a state where the relevant law is sufficiently developed, they might make absolutely clear that they intend an expert determination and not an arbitration. But query whether such a clear statement of intent would trump precedential federal rulings in the relevant Circuit finding that a final and binding expert determination constitutes an arbitration?

[96]It was previously noted that caution must be exercised when requiring actual payments *by the partnership* in connection with a hypothetical sale. This admonition applies to the creation of reserves by the partnership. For example, if there is all-asset pricing and the reserve is funded by existing reserves that were part of all the assets originally priced, the selling partner may not be funding any portion of the reserve without an appropriate adjustment.

[97]*See supra* note 73. Of course, it is possible to give this option to either partner or only to one partner (e.g., the majority owner) and to limit or expand the circumstances under which it may be exercised. For example, if the partners want to encourage one another to accept the determination of the accountants, then the right to switch to a property sale might not be available to a partner who disagrees with the accountants' determination.

[98]The distribution to the partners may be non-taxable (I.R.C. § 731(a)(1)), although each partner will end with an adjusted basis in the undivided interest it receives equal to the partnership's adjusted basis in that interest, but not more than the adjusted basis in its partnership interest (I.R.C. § 732(a)). (But the distribution might be taxable if it involves so-called "hot assets" (i.e., unrealized receivables or substantially appreciated inventory under I.R.C. § 751(b)) or previously contributed property with so-called "built-in gain or loss" under I.R.C. § 704(c)(1)(B) or 737.)

[99]In at least one state, namely California, the sale of a partnership interest may trigger a transfer tax based upon a deemed sale of the *entire* Property, rather than just the selling partner's proportionate share. *See supra* note 44. Indeed, if the Property is in California, then the transfer tax payable for the sale of a partnership interest is either 0% or 100% of the transfer tax payable for the sale of the entire Property. If the distribution of undivided interests is exempt from transfer tax, then the only applicable transfer tax would be a transfer tax payable on the selling partner's sale of its undivided interest in the Property (i.e., a *proportionate* amount of the transfer tax payable in connection with a sale of the *entire* Property). Thus, if a majority partner is the selling partner, then the transfer tax payable under this alternative structure may be less than the transfer tax payable upon the sale of its partnership interest!

[100]To obtain this benefit, the sale would be limited to an undivided interest in the *Project* (rather than *all assets* of the partnership), and the partners would have an actual liquidation following the sale to the purchasing partner rather than the hypothetical liquidation discussed in Section 3 below.

[101]*See, e.g.*, 6 Del. C. §§ 17-607, 18-607; Harris Ominsky, Real Estate Lore, Ch. 65 (Limited Partners May Have To Refund Distributions), at 399 (A.B.A. 2006).

[102]How should such a reduction work in conjunction with adjustments to account for hypothetical closing costs? For example, if the gross value is reduced by 0.5% to account for the savings resulting from not paying a brokerage commission, should only 99.5% of the price for the sold parcel here be deducted?

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