A Primer on D.C.'s Tenant Opportunity To Purchase Law

By Jonathan K. Tycko

Tenants who live in the District of Columbia have various rights that are triggered when their landlord decides to sell the building in which they live. These rights arise under the D.C. Rental Housing Conversion and Sale Act, D.C. Code §§ 42-3404.01 *et seq.* (the "Sale Act"), and in particular under Subchapter IV of the Sale Act, which is generally referred to as the Tenant Opportunity To Purchase – or TOPA – law.

Although TOPA is a highly-specialized law that traditionally has been the domain of real estate attorneys, trial lawyers who practice in the District should have at least a general familiarity with TOPA. TOPA rights are often extremely valuable, but can easily be lost if tenants do not take certain specific actions within fairly short time-frames. Since many of your clients are likely tenants, and may ask you questions about TOPA-related issues, it is important for you to at least be able to "issue spot" and to give basic TOPA advice. In addition, TOPA has generated significant amounts of litigation, some of which has been very high-stakes. In matters that result in litigation, tenants need good, aggressive litigators on their side, and these are matters that plaintiff-side trial lawyers are well suited to handle.

This primer is divided into four parts. Part I explains the basic concept behind TOPA, and how TOPA works to the advantage of tenants. Part II addresses the sometimes perplexing question of when a property is "sold" – and thus the tenants' rights triggered – under TOPA. Part III explains the procedures that tenants must follow to protect their rights when they receive an "offer of sale" from the owner of their property. Finally, Part IV discusses the remedies that are potentially available to tenants if the owners of their property sell the property without first making an "offer of sale" to the tenants.

I. What Is TOPA, And How Does It Work To The Advantage Of Tenants?

The original TOPA law was enacted as part of the Sale Act in 1980, and has been amended several times since then. The Sale Act, as a whole, is intended primarily to accomplish two goals: (1) to reduce the impact of displacement of tenants that can occur when neighborhoods experience gentrification; and (2) to encourage tenants to become homeowners. These goals are accomplished by providing tenants with various rights when apartment buildings are either converted into condominiums or sold to new owners, and through those rights providing tenants with significant bargaining power that can be converted into various benefits that prevent, or alleviate the effects of, displacement.

TOPA applies to all "housing accommodations." A "housing accommodation" is defined as "a structure in the District of Columbia containing 1 or more rental units and the appurtenant land." D.C. Code § 42-3401.03(10). Thus, TOPA applies to essentially all tenants in the District, even those renting single-family houses or condominium units.

When the owner of a housing accommodation decides to sell, the tenants get first crack at buying the accommodation. TOPA provides that "[b]efore an owner of a housing accommodation may sell the accommodation . . . the owner shall give the tenant an opportunity to purchase the accommodation at a price and terms which represent a bona fide offer of sale." D.C. Code § 42-3404.02(a). A "bona fide offer of sale" means, in essence, an offer to sell the accommodation to the tenants at the same price and on the same terms that the owner would offer to a third-party. *See* D.C. Code § 42-3404.05. Indeed, if the owner already has entered into a contract to sell the accommodation to a third-party, then the tenants have a "right of first refusal" with respect to that contract, D.C. Code § 42-3404.08, meaning the absolute right to step into the shoes of the third-party, and to purchase the accommodation on the terms set forth in the third-party contract.

The owner must make the offer of sale in writing, and a copy of that offer of sale must be delivered to each of the tenants. In addition, the offer of sale must be posted in the common areas of the building, and a copy must be delivered to DCRA. The offer of sale must inform the tenants if the owner has already entered into a contract with a third-party for the sale of the accommodation. *See* D.C. Code § 42-3404.03.

To perfect their TOPA rights, tenants who receive an offer of sale from an owner must take various steps, and must do so within some very tight time-lines. These steps are outlined in Part III below.

In recent years, multi-unit apartment buildings have sold for anywhere between $50,000 and $150,000 per unit, depending on location and quality of the building. So, by way of example, a 100 unit apartment building could be sold for anywhere from $5 million to $15 million. Tenants often receive offers of sale with purchase prices in this range. The question tenants often first ask is "how could we possibly afford to purchase our building?"

The answer to that question is complicated in practice, and varies from property to property. But, in general, the ability of tenants to exercise their TOPA rights flows from two other provisions. First, TOPA rights are "assignable," *see* D.C. Code § 42-3404.06, meaning that tenants can sell or assign their rights to third-parties. Second, under the provisions of the Sale Act that govern conversions of apartment buildings

into condominiums or cooperatives, such conversions may occur only if a majority of the tenants vote in favor of conversion at a tenant election. *See* D.C. Code § 42-3404.03. Thus, instead of pooling their own money to purchase the building, tenants more frequently "assign" their purchase rights to a third-party developer. In exchange, the third-party developer agrees to pay the purchase price.

In the agreement between the tenants and the third-party developer, the tenants may also agree to vote in favor of conversion of the building into a condominium or cooperative. Because properties are often worth substantial more as condominiums or cooperatives than as pure rental properties, this agreement by the tenants to permit conversion creates an increase in the value of the building. It is that increased value that attracts third-party developers to deal with the tenants, and that provides the capital for various other concessions that the third-party developers may make to the tenants.

By way of example, a particular building may be worth $5 million as a rental property, but $7 million as a condominium. By agreeing to vote in favor of condominium conversion, the tenants create $2 million in additional value. They can negotiate to recapture a portion of that added value through various concessions by the third-party developer. These concessions often include at least some of the following: (1) an agreement by the developer to upgrade the building; (2) an agreement by the developer to permit tenants to purchase individual units at below-market prices; (3) an agreement by the developer to pay cash to tenants who prefer to move out of the property; and/or (4) an agreement by the developer to permit existing tenants to remain in the property as tenants at certain agreed-upon – and typically below-market – rents.

Through the mechanisms of assignment and conversion, and the bargaining power that they provide to tenants, TOPA avoids displacement by allowing tenants to negotiate to remain in their buildings. Because tenants often end up remaining in their buildings as owners of condominium or cooperative units, TOPA also has the effect of shifting the tenants into home ownership. And for those tenants who choose not to remain in their buildings, TOPA at least offers the possibility that those tenants will be paid some substantial amount of cash when they move out, thereby alleviating the financial impact of displacement and, in some cases, providing those tenants with the financial resources to purchase a home somewhere else. In this way, TOPA serves its twin goals of reducing the impact of displacement, and of encouraging home ownership.

II. What Is A "Sale" That Triggers Tenants' TOPA Rights?

A tenant's TOPA rights, including the right to receive an "offer of sale," are triggered only when a "sale" of the housing accommodation occurs. When the Sale Act was first enacted in 1980, the term "sale" was left undefined. And although both the courts and the City Council have attempted to provide at least partial definitions since then, the exact meaning of the term remains subject to dispute in some circumstances. This lack of definition has provided owners seeking to circumvent TOPA with the opportunity to structure creative transaction that they claim are not "sales." Much of the TOPA litigation over the years has focused on this issue, with tenants and tenants associations challenging transactions that occurred without advance notice to the tenants.

In the late-1990s and early 2000s, a favorite avoidance technique used by owners was a type of transaction that became known in the real estate industry as a "95-5 sale." In this type of transaction, the old owner would transfer a 95% tenancy-in-common title interest to the new owner. The old owner and new owner would simultaneously enter into a side-agreement, typically called a "Tenants-In-Common Agreement" or "Co-Ownership Agreement," that allocated all or almost all of the income, liabilities and management responsibilities to the new owner. Thus, essentially all of the economic value of ownership was transferred to the new owner, while the old owner retained only a *de minimus* and economically meaningless title interest. The tenants would not learn of the transaction until after it occurred, and at no point in the process would "offers of sale" be delivered to the tenants. A variation on this type of transaction involved the transfer of a majority (sometimes as much as 99.9%) of the ownership interests in a corporation or limited liability company that, in turn, held title to the housing accommodation.

A number of these transactions subsequently were challenged by tenants associations. The first case to make its way through the courts was brought in 2002 by the Twin Towers Plaza Tenants Association, which represented two large high-rise apartment buildings in Southwest. In 2003, Judge Melvin Wright issued a ruling in which he held that the 95-5 transaction was a "sale," and that the tenants' TOPA rights had been violated. On appeal, however, the Court of Appeals reversed. In *Twin Towers Plaza Tenants Ass'n, Inc. v. Capitol Park Associates, L.P.*, 894 A.2d 1113 (D.C. 2006), the Court applied a two-part definition of "sale." Drawing from *West End Tenants Ass'n v. George Washington Univ.*, 640 A.2d 718, 727-28 (D.C. 1994), the Court defined "sale" as a transfer "from one person to another for a consideration of value, implying the passing of the general and absolute title." *Id.* (quoting Blacks Law Dictionary 1337 (6th ed. 1990)). The Court reasoned that a transfer of a 95% interest in title did not meet this definition because it did not result in a transfer of "absolute title" or an "absolute transfer." *Twin Towers Plaza*, 894 A.2d at 1118-1120. Thus, to be a "sale" under the *Twin Towers Plaza* definition, a transaction

must involve both (1) a transfer of "absolute title," and (2) an exchange of "consideration of value."

The prevalence of 95-5 transactions also led to legislative activity. In 2005, D.C. Law 16-15, the "Rental Housing Conversion and Sale Amendment Act of 2005," was enacted (largely due to the efforts of Councilmember Jim Graham), and became effective on July 22, 2005. The intent of the law was to stop the practice of 95-5 transactions, and to create a more functional definition of sale, focusing on the economic realities of the particular transactions. Thus, despite the holding of *Twin Towers Plaza*, 95-5 style transaction are now considered "sales," if they occurred after July 22, 2005. Under the 2005 amendments, a "sale" includes "[t]he transfer of an ownership interest in a corporation, partnership, limited liability company, association, trust or other entity which owns an accommodation as it sole or principal asset, which, in effect, results in the transfer of the accommodation[.]" D.C. Code § 42-3404.02(c). In addition, the 2005 amendments added a new provision intended to discourage the type of hyper-technical interpretation seen in *Twin Towers Plaza*; that new provision states that "[t]he applicability of this chapter, and rights created hereunder, shall be determined by examining the substance of the transaction or series of transactions," and that "[a] step transaction or other device entered into or employed for the purpose of avoiding the obligation to comply with the requirements of this chapter shall be construed in accordance with the substance of the transaction." D.C. Code § 42-3405.03b(b).

III. What Should Tenants Do If They Receive An "Offer Of Sale"?

If the tenants of a housing accommodation receive an offer of sale, they must take various steps to preserve their right to purchase the accommodation. The specific steps, and the deadlines for those steps, vary depending on the number of units in the accommodation. *See* D.C. Code §§ 42-3402.09 (single-family accommodations), 42-3402.10 (accommodations with 2-4 units), 42-3402.11 (accommodations with 5 or more units). Most important to bear in mind is that certain of the deadlines come very quickly, and cannot be extended. So, tenants need to act (and potentially need legal advice) almost immediately upon receiving an offer of sale.

Tenants who live in housing accommodations with five or more units (in other words, the larger and more valuable properties) have the most complex process. In a building with five or more units, an offer of sale does not give any individual tenant the right to purchase the building. Instead, it gives the tenants – as a group – the right to form a "tenant organization" (which often is also called a "tenant association") which can then negotiate with the owner to purchase the building. *See* D.C. Code § 42-3404.11. When the tenants receive an offer of sale, they must form an appropriate tenant organization, and take certain other actions, within 45 days:

1. Form A Non-Profit Corporation. At least three tenants must agree to act as "incorporators" and must file Articles Of Incorporation with the Department of Consumer and Regulatory Affairs ("DCRA"). The Articles Of Incorporation will name the tenants who will serve as the initial Board of Directors of the non-profit corporation. Typically, the Board of Directors must include at least three persons, but can be larger if the tenants want a larger Board. The Board of Directors is the group that has responsibility for running and making decision for the tenant organization.

2. Adopt Bylaws and Appoint Officers. After the Articles Of Incorporation are filed, the Board Of Directors must hold its first meeting, called the "organizational meeting." At the organizational meeting, the Board Of Directors must take at least two actions. First, the Board Of Directors must adopt a set of bylaws. Second, the Board of Directors must appoint the initial officers of the non-profit corporation; typically, these include a president, treasurer and secretary.

3. Sign-Up A Majority Of The Tenants. To have the right to negotiate to purchase a building in response to an offer of sale, a tenant organization must represent a majority of the occupied units in the building. *See* D.C. Code § 42-3401.03(18). Employees of the owner who live in the building, and tenants who have lived in the building for less than 90 days, are not counted for this purpose. *Id.* Typically, a tenant organization will ask a representative of each of the units to sign a membership form, indicating that he or she has joined the tenant organization.

4. File The Application For Registration. After the non-profit corporation is incorporated and organized, it must then be "registered" with DCRA. The DCRA office that handles "registration" of tenant organizations is called the Condominium And Cooperative Conversion And Sales Branch. Forms for "registration" can be obtained from that office. The forms must be completed and filed within 45 days from the date the tenants received the offer of sale. *See* D.C. Code § 42-3404.11(1). If a tenant association already exists in the building at the time the tenants receive the offer of sale, and if the tenants wish to use that tenant association as their "tenant organization" for purposes of negotiating to purchase the building, then the deadline for registering is 30 days from the date that the tenants receive the offer of sale. *Id.*

5. Notify The Owner. A copy of the "registration" forms must be sent to the owner of the apartment building, along with a letter from the tenant organization expressing an interest in purchasing the building. *Id.*

The tenants must complete these five steps – and do so before the 45-day deadline – in order to preserve their right to purchase the building. This 45-day deadline is not subject

to extension (absent consent from the owner), and if the deadline is not met, then the owner is free to sell the property to a third-party without further negotiations with the tenants.

If the tenants are successful in taking these steps within 45-days, then additional deadlines are triggered. These include deadlines for negotiation of a contract of sale between the tenant organization and the owner of the accommodation (in accommodations with 5 or more units, a minimum of 120 days, *see* D.C. Code § 42-3404.11(2)), and deadlines for obtaining financing and going to closing on the sale of the accommodation (in accommodation with 5 or more units, a minimum of 120 additional days, subject to extensions up to 240 days, *see* D.C. Code § 42-3404.11(3)). Thus, the entire process of negotiating for the purchase of the accomodation, obtaining financing, and going to closing can take up to a full year after the tenant organization is organized.

IV. What Is The Remedy If A Building Or Unit Is Sold, And The Tenants Did Not Receive An "Offer Of Sale"?

Litigators often get the call when a building or unit is sold, and the tenants have *not* received offers of sale. In those circumstances, it may be necessary to bring a lawsuit against both the old owner and new owner, seeking to vindicate the tenants' TOPA rights.

The Sale Act explicitly authorizes private rights of action, and provides for fee-shifting. D.C. Code § 42-3405.03 states that an "aggrieved owner, tenant, or tenant organization may seek enforcement of any right or provision under this chapter through a civil action in law or equity, and, upon prevailing, may seek an award of costs and reasonable attorney fees."

Where the accommodation at issue has 5 or more units, the preferred plaintiff would be a tenant association that represents a majority of the occupied units, and thus qualifies as a "tenant organization." This avoids a potential "standing" defense that defendants often raise when the plaintiff is either an individual tenant, or a tenant association that represents less than a majority of the occupied units. Although individual tenants or tenant associations that represent less than a majority might arguably also have standing, the law on this issue is currently unsettled. *See Twin Towers Plaza*, 894 A.2d at 1116-17.

A lawsuit alleging TOPA violations may seek both injunctive relief (in the form of an unwinding of the sale, and a requirement that the tenants receive a right to exercise their TOPA rights, including the right of first refusal), and damages. Damages can be measured as the difference between the price paid by the third-party, and the value of the building to the tenants if they had been given an offer of sale and had been able to negotiate a deal with a third-party developer. This measure of damages may require expert testimony from an appraiser or other real estate expert.

One federal district court opinion held that damages are not an available remedy for TOPA violations, *see Redmond v. Birkel,* 797 F. Supp. 36 (D.D.C. 1992), but that holding was likely incorrect, and is not binding authority. A number of appeals now pending in the D.C. Court of Appeals raise this issue, and the Court of Appeals may, therefore, provide guidance on this issue in the near future.

When bringing a lawsuit on behalf of tenants for violations of their TOPA rights, other claims should also be considered. Those claims may include claims under the D.C. Consumer Protection Procedures Act, and common law claims for constructive fraud, conspiracy or aiding-and-abetting. In addition, where the defendants are small, closely-held corporations or limited liability companies, alter ego claims against the individual owners should be considered.

Jonathan K. Tycko is a partner with Tycko & Zavareei LLP. He frequently represents plaintiffs in various types of real estate related matters, and has represented numerous tenants and tenants associations in TOPA matters.

◆ ◆ ◆