"Governed by New York Law"? Considering the Impact of New York State Law in Bankruptcy Matters

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GOVERNED BY NEW YORK LAW? CONSIDERING THE IMPACT OF NEW YORK STATE LAW IN BANKRUPTCY MATTERS

17th Annual New York City Bankruptcy Conference, May 14, 2015

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Uniform Business and Business-Related Laws Eschewed by New York

Act	Purpose/Description[1]	Year of NCCUSL Approval	No. of Jurisdictions to Enact[2]
Arbitration Act	Updates 1956 version to reflect developments in arbitration law, which became an increasingly utilized method of alternative dispute resolution since the time of the original Uniform Arbitration Act.	2000	18[3]
Declaratory Judgments Act	Authorizes courts to adjudicate actual controversies concerning legal rights and duties even though traditional remedies for damages or equitable relief are not available.	1922	42
Electronic Transactions Act	Establishes the legal equivalence of electronic records and signatures with paper writings and manually-signed signatures.	1999	49
Entity Transactions Act, Model	Allows conversion of one kind of business organization to another, or the merger of two or more business organizations into one organization.	2007	6[4]
Federal Lien Registration Act	Provides for the registration of federal liens by procedures consistent with normal recording of mortgages in local real property records and with the normal filing of security interests in personal property	1978	38
Foreign Money Claims Act	Simplifies international business by allowing courts in the US to accept or render judgments valued in foreign currency.	1989	22
Fraudulent Transfer Act[5]	Provides a creditor with the means to reach assets a	1984	45[6]

[1] Descriptions are as stated by the National Conference of Commissioners on Uniform State Laws (NCCUSL); some descriptions were edited by the authors.
[2] Jurisdictions includes the 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands.
[3] In Pennsylvania, H.B. 34, which would codify the Arbitration Act, was referred to the Judiciary Committee. West Virginia's S.B. 37 passed the state Senate.
[4] In Idaho, S.B. 1025, a bill to enact the Model Entity Transactions, Limited Liability Company, Limited Partnership, Partnership, and Voidable Transaction (formerly Fraudulent Transfer) Acts, has passed in the state's Senate.

Act	Purpose/Description[1]	Year of NCCUSL Approval	No. of Jurisdictions to Enact[2]
	debtor has transferred to another person to keep them from being used to satisfy a debt.		
Limited Liability Company Act	Permits the formation of limited liability companies (LLCs), which provide the owners with the advantages of both corporate-type limited liability and partnership tax treatment.	1996	12[7]
Limited Partnership Act	Provides a more flexible and stable basis for the organization of limited partnerships, helping states stimulate new partnership business ventures.	2001	19[8]
Partnership Act	Modernizes the Uniform Partnership Act of 1914, adopted in every state except Louisiana. It also establishes a partnership as a separate legal entity, and not merely as an aggregate of partners.	1997	39[9]
Prudent Investor Act	Revamps rules that now govern the actions of trustees, who are required to pursue an investment strategy taking into account such factors as risk and return.	1994	43
Registered Agents Act, Model	Provides states with one registration procedure for registered agents no matter the kind of business entity represented by the agent, simplifying registration procedures by providing one registered agent database in each state.	2006	11
Securities Act	Provides basic investor protection from securities fraud, complementing the federal Securities and Exchange Act.	2002	18
Trade Secrets Act	Provides a legal framework for improved trade secret	1985	50

[5] The Fraudulent Transfer Act is now known as the Voidable Transactions Act. The NCCUSL approved the name change in 2014.
[6] In Kentucky, S.B. 204, a bill to enact the Fraudulent Transfer Act, was introduced but has not yet been referred to committee.
[7] This Act has been introduced in Idaho (S.B. 1025), New Mexico (H.B. 228), North Dakota (H.B. 1136), and Washington (S.B. 5030), all of which have been referred to committee.
[8] In Mississippi, S.B. 2310 has been sent to the Governor for signature. The Act is pending in Idaho; see *supra*, note 1.
[9] The Act is pending in Idaho; see *supra*, note 1.

Act	Purpose/Description[1]	Year of NCCUSL Approval	No. of Jurisdictions to Enact[2]
	protection for industry.		
UCC-3, Negotiable Instruments	Updates provisions of the UCC dealing with payment by checks and other paper instruments to provide essential rules for the new technologies and practices in payment systems.	1990	52

New York State Assembly
Uniform Laws Enacted on December 17, 2014

Act	Purpose/Description	Year Approved by NCCUSL
UCC-1, General Provisions	Amends Article 1 to harmonize with ongoing UCC projects and recent revisions.	2001
UCC-7, Documents of Title	Updates Article 7 to provide a framework for the further development of electronic documents of title, and to update the article for modern times in light of state, federal and international developments.	2003
UCC-9 Amendments, Secured Transactions	Responds to filing issues and addresses other matters that have arisen in practice since the 1998 version of Article 9 including to provide greater guidance as to the name of an individual debtor to be provided on a financing statement.	2010

17th Annual New York City Bankruptcy Conference: "Governed by New York Law"? Considering the Impact of New York State Law in Bankruptcy Matters

UPA, RUPA and the Unfinished Business Doctrine

By: David M. Posner and Gianfranco Finizio[1]

I. Overview of UPA and RUPA

The Uniform Partnership Act (UPA) provided a blanket set of rules governing all aspects of a general partnership, including a partner's withdrawal, in the absence of a partnership agreement. The UPA's provisions governing a partner's withdrawal are modeled on aggregate theory with respect to the partnership. The departure of any partner from the partnership marked the legal end of that partnership and the partnership assets were sold with any surplus distributed to the partners regardless of the event that caused the dissolution. At first, because of UPA's aggregate basis, some courts prohibited a buyout and required a forced sale of assets following dissolution of the partnership. In some jurisdictions that adopted UPA, a common law solution to the liquidation provision developed that permitted the remaining partners to buyout the withdrawing partner's interest.

In 1992, the Conference proposed a Revised Uniform Partnership Act (RUPA) to replace UPA. RUPA contains many of the same provisions as UPA, however, it proceeds from a different theoretical underpinning. RUPA is premised upon an entity theory. Under this theory there are two distinct paths for partnership to follow when a partner leaves the partnership - dissociation and dissolution. Certain events, such as death of a partner, trigger RUPA's

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[1] David M. Posner is a Partner and Gianfranco Finizio is an associate at Otterbourg P.C.

dissociation provisions; the partnership does not dissolve. Instead, the partnership must buyout the deceased partner's interest and continue the partnership business. Under the dissolution scenario which is triggered by certain events, including in the case of a partnership-at-will, the express will of a partner to withdraw, the partnership begins the winding-up process, during which the assets of the partnership are sold.

RUPA made other significant changes with respect to the dissolution of a partnership and winding up of partnership affairs. Under UPA, if a partner withdraws from the partnership, an event occurs that ends the partnership, the partners agree to end the partnership, or any of a number of situations occurs, the partnership dissolves. Dissolution resulted in the end of the partnership's business, a wind up of the affairs of the business, and the partnership property being sold. Partnership agreements, even before the enactment of the RUPA, often provided a method whereby the withdrawing partner's interests are purchased and the partnership continued. In the absence of such an agreement, the remaining partners could continue the partnership's business, but the resulting business is considered a completely new partnership. RUPA altered this practice. As noted above, RUPA introduced dissociation, whereby the remaining partners can purchase the interests of the dissociating partner and continue partnership business and the business need not be considered a completely new partnership.

When a partnership is winding up as the result of a dissolution, both UPA and RUPA restrict the participation of partners who have wrongfully caused the dissolution of the partnership or have wrongfully dissociated from the partnership from participating in the winding up process. The most significant part of the winding up process is the liquidation of partnership assets and payment of partnership creditors. When the assets are liquidated, creditors who are not also partners are generally paid first. If a partner is also a creditor of the partnership, he or she is then reimbursed. Once each of the creditors is reimbursed, partners may recover their capital contributions. If assets remain, then all of the partners will receive their share, in accordance with a partnership agreement or according to the provisions of the UPA or the RUPA.

The following states have adopted the RUPA: Alabama, Alaska, Arizona, Arkansas, California, Colorado, Delaware, District of Columbia, Florida, Hawaii, Idaho, Illinois, Iowa, Kansas, Kentucky, Maine, Maryland, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Jersey, New Mexico, North Dakota, Oklahoma, Oregon, Puerto Rico, South Dakota (substantially similar), Tennessee, Texas (substantially similar), US Virgin Islands, Vermont, Virginia, and Washington. Connecticut, West Virginia, and Wyoming adopted the 1992 or 1994 version. Here are the states that have not adopted RUPA (Louisiana never adopted UPA at all): Georgia, Indiana, Massachusetts, Michigan, Mississippi, New Hampshire, **New York**, North Carolina, Ohio, Pennsylvania, Rhode Island, and Wisconsin.

II. Outline of UPA and RUPA Issues Effecting General Partnerships

1. General Partnerships are governed by UPA or RUPA – these are the default rules which can be varied by agreement of the partners, however, taxation and liability rules cannot be varied by the written partnership agreement

2. There is unlimited liability for the general partners hence the ultimate evolution of Limited Liability Partnerships

3. No double taxation in a partnership for the general partners

General Partners

1. General partners are co-owners this distinguishes a partnership from mere agency relationship. All general partners each have power to control the partnership unless the partnership agreement provides otherwise or delineates powers and duties.

2. UPA V. RUPA: created a shift as noted above from an aggregate to entity theory (RUPA § 501)

a. UPA: considered partnership to be separate individuals who were aggregated for purposes of the partnership

b. RUPA: evolved toward an entity theory, however, some issues such as taxes and tax liability still follow an aggregate theory

c. Under UPA § 25 partners are co-owners as "tenants in partnership." RUPA abolishes the notion of tenants in partnership in favor of the entity theory

(i) UPA § 25 – "tenant in partnership"; equal right to possess specific partnership property for partnership purposes but no right to possess it for non- partnership purposes without consent of partners; an individual partner cannot assign her right in specific property, rather she can only assign interest in partnership property considered as a whole, the right to a portion of the partnership's profits

(ii) A partner's interest in his share of the profits and surplus. UPA § 26

(iii) Assignment. The assignee is limited to share of profits and surplus. Any rights with respect to control or other duties of the assigning partner assignor does not transfer to assignee. As such, any assignment is limited to distributions. UPA § 27

(iv) A garnishment a partner's share of the profits and surplus is permitted and is a form of involuntary assignment. UPA § 28

d. Under RUPA § 501, a partner is not a co-owner of partnership property and has no interest in partnership property. This does away with UPA § 25(1)'s concept of "tenants in partnership" and reflects adoption of the entity theory. Unlike UPA, partnership property is owned by the entity and not by the individual partners.

(i) Assignment is the same as under the UPA. A partner can assign/transfer interest, but limited to partner's share of profits and losses plus the right to receive distributions. RUPA §§ 502, 503.

(ii) Garnishment or other involuntary assignments are permitted. RUPA § 504 is the same as under the UPA.

3. <u>Express v. Implied General Partners</u>

a. A partnership is an association of two or more persons to carry on as co-owners of a business for profit. UPA § 6(a), RUPA codified judicial interpretation of UPA, and clarified that this is regardless of whether the parties evidence an intent to form a partnership RUPA § 202(a)

b. A written partnership agreement evidences an express partnership

c. An implied/informal partnership exists if there is:

(i) Sharing profits versus sharing of gross returns to the partnership and partnership liabilities. RUPA terms such an arrangement a presumption of partnership (§ 202(c)(3)), UPA terms it prima facie evidence of the existence of partnership.

(ii) Shared control; and

(iii) Joint ownership

4. <u>Property</u>

a. All property originally brought into the partnership or subsequently acquired by purchase or otherwise, on account of partnership, is partnership property (UPA § 8(1))

b. Unless contrary intention appears, partnership property acquired with partnership funds is partnership property (UPA § 8(2))

c. RUPA §§ 203, 204 provisions provide the same as a and b above.

5. Authority and decision-making

a. Equality of control in decision-making unless otherwise agreed. Unanimous vote required for the admission of a new partner unless the partnership agreement provides otherwise

b. By virtue of status as partner, you have apparent authority in ordinary course of business transactions with respect to "business of the kind carried on by the partnership." RUPA § 301(1) and UPA § 9(1).

c. Apparent authority exists as long as it is within daily business of the partnership. Every partner is an agent of the partnership for business purposes and every act of one partner which is apparently for the business binds the partnership, unless the partner so acting has no authority to act for the partnership in the particular matter, and the person with whom he is dealing has knowledge of the fact that he has no such authority. UPA § 9(1) and RUPA § 301(1).

d. If actions are not in ordinary course of business, then the acts of the partner only bind the partnership if such acts were authorized by the other partners. RUPA § 301(2)

e. Under RUPA § 303, 304 the partnership can file a statement with the secretary of state that either provides for specified authority or delineates the limits of partner authority

6. Relationship between power and profits

a. UPA § 18 and RUPA § 401 are essentially the same

b. Each partner has total equality in profits and losses, regardless of their initial capital contribution (unless modified by the partnership agreement) (RUPA § 401(b)), and total equality in management and conduct of business (RUPA § 401(f)).

c. Under RUPA § 401, a dissociated partner has no actual authority to bind the partnership but in certain circumstances may still have apparent authority to do so. RUPA § 30.

7. Creditors' rights against partners and partnership

a. The majority rule under UPA is that a creditor can simultaneously go after partnership assets and partners' assets.

b. The minority rule under UPA is that a creditor has to exhaust partnership assets first and only then afterwards go after the individual assets.

c. RUPA § 306 adopted this UPA minority rule. You can simultaneously go against both partners individually but in enforcing a judgment you have to exhaust partnership assets first. § 307(d)

8. Dissociation and dissolution (discussed above)

a. UPA. A dissolution is triggered when partner leaves the partnership. UPA § 29, 31 – dissolution is a change in relation of partners caused by any partner ceasing to be associated in carrying on of the business and is distinguished from winding up

(i) UPA § 38 – when one partner leaves it triggers a winding up unless partnership agreement provides otherwise

b. RUPA added the dissociation option. RUPA §§ 601-701 governs dissociation, RUPA § 801-802 governs dissolution

(i) RUPA § 601. A dissociation occurs when a partner leaves, dies or transfers his interests

(A) RUPA § 701. A dissociation with no winding up (§ 603) requires a buyout by the partnership of dissociating partner's interest

(B) RUPA § 801. A dissociation with a winding up (§ 603) is a dissolution and is otherwise similar to UPA.

c. Comment to RUPA 601.

(i) An entirely new concept dissociation is used in RUPA in lieu of the UPA term dissolution to denote the change in the relationship caused by a partner ceasing to be part of carrying on of business. Dissolution is retained but with an entirely different meaning.

(ii) RUPA § 801 identifies the situations in which the dissociation of a partner causes the winding up of a business. RUPA § 701 provides that in all other situations there is a buyout of the partner's interest rather than a winding up of the partnership business. In those other situations, the partnership entity continues, unaffected by the partner's dissociation.

(iii) A dissociated partner remains a partner for some purposes and still has some residual rights, duties, powers and liabilities.

(iv) Deceased partner's interest will pass to his estate and be bought out under RUPA § 701.

d. Under both UPA and RUPA:

(i) A partner may withdraw even if partnership agreement says you cannot withdraw. RUPA § 602, the same concept is implicit in UPA § 31(2).

(ii) Upon dissociation or dissolution under RUPA or dissolution under UPA a partner's right to participate in management terminates as does the partner's duty not to compete

(A) If dissociating partner takes any clients of firm with him in ongoing transactions, she must account to the partnership for fees collected on those transactions

e. RUPA § 701 requires buyout of dissociated partner's interest at buyout price specified in partnership agreement or § 701(b) the partner's proportionate share of the liquidation value of the partnership

(i) RUPA § 703 provides that a dissociated partner may still be liable for partnership obligation incurred before dissociation, but not obligations incurred after dissociation. The dissociated partner may make agreement with partnership and partnership creditors to be released from liability. RUPA § 702(b) also provides that a partner can be liable for damage caused to partnership after dissociation

(ii) RUPA § 702(a) provides that a dissociated partnership may still be liable for former partner's acts for up to two years if third party reasonably assumed dissociated partner was still a partner, unless it makes it clear that partner is no longer part of partnership. This can be accomplished by a notice of dissociation or other constructive notice to third parties. See RUPA § 704. Apparent Authority of a dissociated partner continues for three years under RUPA § 702(a) (§ 301).

III. Unfinished Business Doctrine Case Law Summary

"Clients are not merchandise. Lawyers are not tradesmen."[2]

Issue: How to apply the "unfinished business" doctrine to law firms that dissolve and/or file for bankruptcy.

[2] Cohen v. Lord, Day & Lord, 75 N.Y. 2s 95, 98 (1989)

The Unfinished Business Doctrine: The doctrine was originally set forth in a California case – *Jewel v. Boxer* ("Jewel").[3] The doctrine provides that, "profits arising from work begun by former partners of dissolved law firms are a partnership asset that must be finished for the benefit of the dissolved partnership, absent an agreement to the contrary."[4]

Jewel v. Boxer: This case first applied the unfinished business doctrine in the context of a dissolved law firm. In Jewel, a four-partner law firm voluntarily dissolved into two two-partner law firms. The Jewel court held that "in the absence of a partnership agreement, the Uniform Partnership Act requires that attorney fees received on cases in progress upon dissolution of law partnership are to be shared by the former partners according to their right to fees in the former partnership, regardless of which former partner provides legal services in the case after the dissolution."[5] Importantly, the Jewel court emphasized that law firm partners may include in a partnership agreement provisions for the completion of unfinished business. These are typically known as "Jewel waivers". As a result, many law firms have amended their partnership agreements to include Jewel waivers providing that the law firm has waived its right to any income derived post-dissolution for unfinished business matters.

Heller Ehrman LLP: In 2008, Heller Ehrman LLP ("Heller") encountered troubles after more than 50 partners left the firm, which then caused the collapse of merger talks with a major law firm. On September 25, 2008, the firm confirmed its dissolution would occur on November 28, 2008. The dissolution plan that was adopted contained a Jewel waiver purporting to waive any rights Heller may have to seek payment for legal fees generated on non-contingency matters after the departure of a Heller attorney. On December 28, 2008, Heller filed for chapter 11 protection in the Northern District of California. Thereafter, Heller's bankruptcy estate sued

[3] 203 Cal. Rptr. 13 (Cal. Ct. App. 1 Dist. 1984)
[4] Geron v. Seyfath Shaw (In re Thelen), 24 N.Y.3d 16, 28 (2014)
[5] 203 Cal. Rptr. at 15

various law firms (including, among others, Jones Day, Foley & Lardner LLP and Davis, Wright, Tremaine, LLP) alleging that under *Jewel v. Boxer*, the Heller estate had property rights in the unfinished hourly matters pending at the time the former Heller lawyers joined their respective new firms. The lawsuits were grounded in a fraudulent transfer theory with respect to Heller's property rights in those unfinished hourly matters. In a written ruling granting summary judgment for the defendant law firms, the District Court ruled that *Jewel v. Boxer* is not controlling, and found that a dissolved law firm cannot assert a property interest in hourly matters pending at the time of its dissolution.[6] The matter is currently being briefed at the 9th Circuit and oral arguments are anticipated to occur in approximately 6 to 9 months.

Howery LLP: On March 9, 2011, after the departure of more than 60 attorneys and rumors of failed merger talks with a major law firm, Howery LLP ("Howery") announced that it would dissolve effective March 15, 2011. Immediately prior to the dissolution, Howery adopted a Jewel waiver so as to protect partners from the potential claw back of fees for unfinished business matters. In June 2011, Howery's chapter 11 proceeding was initiated in the Bankruptcy Court for the Northern District of California (the bankruptcy proceeding was originally commenced as an involuntary chapter 7, but it was later converted to a voluntary case under chapter 11). Thereafter, the Howery estate commenced proceedings against numerous law firms seeking a turnover of profits derived from those firms relating to the unfinished business of Howery. The defendant law firms moved to dismiss the actions in light of the recent authority from California (i.e., Heller Ehrman LLP) and New York (i.e., Thelen/Coudert), but the court declined to dismiss the actions on the grounds that the Howery partnership was governed by District of Columbia law, not New York law or California law. The Bankruptcy Court

[6] Heller Ehrman LLP v. Davis, Wright, Tremaine, LLP, No. 14-01236, 2014 WL 2609743 (N.D. Cal. June 11, 2014).

ultimately held in favor of the Howery estate on an unjust enrichment theory, ruling that those claims could proceed. The Court declined to determine how much of those profits would be "just" to return to the estate and reserved that issue for trial. In the meantime, the District Court agreed to hear an interim appeal on the matter. Final briefs for the appeal were filed earlier this week and oral argument is expected in the near term.

Thelen LLP: On October 28, 2008, the partners of Thelen LLP ("Thelen") voted to dissolve the firm due to, among other things, profitability and liquidity issues. In connection with the dissolution, the partners amended their partnership agreement to include a Jewel waiver. Following the dissolution, eleven (11) Thelen partners joined Seyfarth Shaw, LLP ("Seyfarth") and transferred the unfinished client matters to Seyfarth, which billed those clients for its services on an hourly basis. On September 17, 2009, Thelen filed for chapter 7 protection in the Southern District of New York. Thereafter, the chapter 7 trustee initiated an adversary proceeding against Seyfarth seeking to avoid the Jewel waiver as a constructive fraudulent transfer. The chapter 7 trustee argued that the unfinished matters should have been included in Thelen's bankruptcy estate but were fraudulent transferred to Seyfarth without consideration. Seyfath argued that under New York law, a partnership does not retain any property interest in pending hourly matters upon a firm's dissolution. The District Court agreed with Seyfarth and held that "recognizing a property right in unfinished hourly fee matters would conflict with New York's strong public policy in favor of client autonomy and attorney mobility" and "would result in an unjust windfall for the Thelen estate . . . ."[7] On appeal, the New York Court of Appeals addressed the question of whether New York law treats a dissolved law firm's unfinished hourly fee matters as its property. The Court of Appeals decision is discussed below.

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[7] In re Thelen 736 F.3d 213, 218 (2d Cir. 2013)

Coudert Brothers LLP: On August 16, 2005, following a failed effort to merge with another law firm, Coudert Brothers LLP ("Coudert") dissolved pursuant to the terms of its partnership agreement. Prior to the dissolution, Coudert amended its partnership agreement to permit it to sell the firm's assets to other law firms to maximize value, wind down business in an orderly fashion and maintain client continuity. In connection with this amendment, former Coudert partners joined other law firms, which firms were retained by Coudert's former clients to complete unfinished legal matters (a majority of which were complete by the new firms on an hourly basis). On September 22, 2006, Coudert filed for chapter 11 protection in the Southern District of New York. During the chapter 11 case, Development Specialists, Inc. ("DSI"), as administrator of the estate, commenced thirteen (13) adversary proceeds against the law firms that had hired former Coudert partners on the theory that the defendant law firms were liable to Coudert for any profits derived from completing the unfinished client matters that the former Coudert partners brought to their new firms. The District Court agreed with DSI and held that the unfinished matters were presumed to be Coudert's assets on the date of dissolution. Like in Thelen, the decision was appealed to the New York Court of Appeals.

Thelen/Coudert New York Court of Appeals: In a landmark decision dated July 1, 2014, the New York Court of Appeals concluded that under New York's partnership law, no law firm has a property interest in future hourly legal fees because they are "too contingent in nature and speculative to create a present or future property interest."[8] New York law and public policy reasons are weaved throughout the decision with an emphasis on the policy that legal clients have a right to terminate an attorney-client relationship at any time and upon such termination, the client has an obligation only to compensate the former attorney for work that was completed.

[8] 24 N.Y.3d at 28

As it currently stands, this decision is the "last word" on the unfinished business doctrine in New York.

2014 WL 2609743
United States District Court,
N.D. California.

Heller Ehrman LLP, Plaintiff,
v.
Davis, Wright, Tremaine, LLP, Defendant.
Heller Ehrman LLP, Plaintiff,
v.
Jones Day, Defendant.
Heller Ehrman LLP, Plaintiff,
v.
Foley & Lartner LLP, Defendant.
Heller Ehrman LLP, Plaintiff,
v.
Orrick, Herrington & Sutcliffe LLP, Defendant.

Nos. C 14–01236 CRB, C 14–01237 CRB, C 14–01238 CRB, C 14–01239 CRB | Signed June 11, 2014

Synopsis

Background: Trustee of bankruptcy estate of dissolved law partnership brought fraudulent transfer proceeding to set aside "*Jewel* waiver" executed by firm upon its dissolution, and to compel law firms to which its former partners had moved, and which were retained by firm's former clients to continue the legal representation on hourly fee matters, to account to firm for its alleged property interest in these hourly fee matters at time it was dissolved. Parties cross-moved for summary judgment.

[Holding:] The District Court, Charles R. Breyer, J., held that law firm which had been dissolved had no property interest in hourly fee matters pending at time of its dissolution, for which law firm's former partners had any duty to account.

Summary judgment for defendants.

West Headnotes (7)

[1] **Attorney and Client**
Client fees

Under California law, law firm which had been dissolved when creditors' termination of their financial support rendered it impossible for firm to continue to provide legal services in ongoing matters had no property interest in hourly fee matters pending at time of its dissolution, for which law firm's former partners had any duty to account when, following firm's dissolution, they accepted employment with other firms, and clients hired these other firms to continue representing clients in these hourly fee matters; former partners had no duty to account for fees thereafter earned by these new firms, pursuant to new fees agreements between firms and clients, entirely as result of firms' investment of their own time and labor.

3 Cases that cite this headnote

[2] **Attorney and Client**
Property of firm
Attorney and Client
The relation in general

Law firm never owns its client matters; client always owns the matter, and the most that law firm can be said to have is expectation of future business.

Cases that cite this headnote

[3] **Attorney and Client**
Property of firm

Under California law, professional law partnerships do not have "good will" asset; rather, good will, in sense of expectation of future business, is personal and confidential and attaches to the individual partners of firm.

Cases that cite this headnote

[4] **Attorney and Client**
Property of firm

Under California law, professional law partnership's good will, in sense of the firm's reputation, is not an asset to which a property interest attaches.

Cases that cite this headnote

[5] **Attorney and Client**
Act of parties
Under California law, client's power to discharge attorney, with or without cause, is absolute.

Cases that cite this headnote

[6] **Attorney and Client**
Premature Termination of Relation
Under California law, when client exercises the unilateral right to discharge his or her attorney, the discharged attorney has a right only to quantum meruit recovery for the value of work already done on matter.

Cases that cite this headnote

[7] **Attorney and Client**
Dissolution, Settlement, and Accounting
Client matters in which bankrupt law partnership had been retained to represent clients ceased to be partnership business, and became partnership business of new firms that clients retained to carry on the representation, when clients terminated the debtor firm upon its dissolution and retained new, third-party counsel.

Cases that cite this headnote

Attorneys and Law Firms

Christopher Daniel Sullivan, Diamond McCarthy LLP, Melissa Lor, Schnader Harrison Segal and Lewis, San Francisco, CA, for Plaintiff.

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ORDER RE SUMMARY JUDGMENT

CHARLES R. BREYER, UNITED STATES DISTRICT JUDGE

I. INTRODUCTION

***1** A law firm—and its attorneys—do not own the matters on which they perform their legal services. Their clients do. A client, for whatever reason, may summarily discharge counsel and hire someone else. At that point, the client owes fees only for services performed to the date of discharge, and his former lawyer must, even if fees are in dispute, cease working on the matter and immediately cooperate in the transfer of files to new counsel.

[1] It is in this context that the Court is asked to address a question of first impression: namely, whether a law firm—which has been dissolved by virtue of creditors terminating their financial support, thus rendering it impossible to continue to provide legal services in ongoing matters—is entitled to assert a property interest in hourly fee matters pending at the time of its dissolution.

This issue was presented to the Bankruptcy Court, which this Court reviews de novo. *SeeExecutive Benefits Insurance Agency v. Arkison,* —— U.S. ——, 134 S.Ct. 2165, ——, —— L.Ed.2d —— (2014) citing *Stern v. Marshall,* ——U.S. ——, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011). In doing so, the Court concludes that under the facts presented here, neither law, equity, nor policy recognizes a law firm's property interest in hourly fee matters. [1] First, as to the law, the Court finds that *Jewel v. Boxer,* 156 Cal.App.3d 171, 203 Cal.Rptr. 13 (1984), an intermediate state appellate court decision, is not controlling under these facts and that no California Supreme Court decision supports such a result. [2] Second, the equities clearly favor the Defendants (third-party law firms which earned the compensation paid to them) over Heller (which received full payment for its services). And finally, considering the policies favoring the primacy of the rights of clients over those of lawyers, it is essential to provide a market for legal services that is unencumbered by quarrelsome claims of disgruntled attorneys and their creditors. While this Court distinguishes *Jewel v. Boxer* on its facts, it is also of the opinion that the California Supreme Court would likely hold that hourly fee matters are not partnership property and therefore are not "unfinished business" subject to any duty to account. [3]

1 Nothing in this Order is intended to address the fiduciary duties of law partners to one another—they are not the

parties who have been sued. Nor does this Order address matters which Heller Ehrman LLP was handling on a contingency basis.

2 Only one California Supreme Court case cites Jewel. *SeeHoward v. Babcock,* 6 Cal.4th 409, 424 n. 8, 25 Cal.Rptr.2d 80, 863 P.2d 150 (1993) (citing Jewel in a string cite in a footnote for a proposition which is not material to this case). *Howard* was decided before the Revised Uniform Partnership Act ("RUPA") took effect in 1999. *See*Cal. Corp.Code § 16111(b).

3 As Judge Pauley of the Southern District of New York noted, "... there is good reason to believe that the highest courts of New York and California would decline to follow *[Jewel].*" *Geron v. Robinson & Cole LLP,* 476 B.R. 732, 745 (S.D.N.Y.2012).

***2** Now before the Court are cross motions for summary judgment in a long-running bankruptcy dispute. These four actions arise from the bankruptcy of a large law firm: Heller Ehrman LLP. Heller's bankruptcy estate claims the profits earned by the law firms that Heller's former clients retained to work on hourly fee matters. Heller, because of its bankruptcy and dissolution, could no longer do that work. The question these cases present is whether hourly fee matters pending when a law firm dissolves are the property of that firm. More specifically, these cases require the Court to consider whether Heller's bankruptcy Trustee has a claim against third-party law firms that hired former Heller lawyers, representing former Heller clients in hourly fee matters. The answer to both questions is no.

Heller's bankruptcy Trustee ("Trustee") filed multiple adversary proceedings against various law firms, including Davis, Wright, Tremaine LLP; Orrick, Herrington & Sutcliffe LLP; Foley & Lardner LLP; and Jones Day ("Defendants") which Heller's former Shareholders joined. Many of the initial lawsuits settled, but four defendant law firms challenged the Trustee's claims to their profits earned from former Heller clients. For the reasons set forth below, the Court finds that the Trustee does not have a property interest in profits Defendants earned working on hourly fee matters which Heller had once handled, and therefore enters JUDGMENT in favor of Defendants and against the Trustee.

II. BACKGROUND

As to the questions of (1) whether hourly fee matters pending when a law firm dissolves are the property of that firm and (2) whether Heller's bankruptcy Trustee has a claim against third-party law firms representing Heller's former clients in hourly fee matters, the relevant facts are undisputed.

Heller was a global law firm with approximately 700 lawyers until its dissolution in 2008. Heller was structured as a limited liability corporation composed of eight partners, all of which were professional corporations (the "Heller PCs"). The shareholders of the Heller PCs (the "Shareholders") provided legal services to Heller's clients. Heller relied on a $35 million revolving line of credit from Bank of America to finance its operations. In September 2008, Bank of America declared Heller to be in default and seized control of the firm's bank accounts. Unable to continue their business, the Heller PCs voted to dissolve the firm in accordance with a dissolution plan written by a group of Shareholders. The dissolution plan included a "Jewel Waiver" which purported to waive any rights and claims under the doctrine of *Jewel v. Boxer* to seek payment of legal fees generated after the departure date of any lawyer or group of lawyers with respect to non-contingency/ nonsuccess fee matters only. Heller notified its clients that as of October 31, 2008, it would no longer be able to provide legal services. Heller filed its Chapter 11 bankruptcy case in December 2008. [4]

4 The parties acknowledged at the June 5, 2014, motion hearing that these facts are not in dispute.

The Trustee's adversary proceedings against Defendants and other law firms allege that Heller's estate is entitled to recover profits associated with pending hourly matters because the "Jewel Waiver" was a constructively fraudulent transfer or an actual fraudulent transfer of Heller's property under the Bankruptcy Code or under the California Uniform Fraudulent Transfer Act. 11 U.S.C. § 548; Cal. Civ.Code § 3439 et seq. The Trustee has not sued the individual Shareholders. *In re Heller Ehrman LLP,* 2013 WL 951706 at *1–2 (Bankr.N.D.Cal. Mar. 11, 2013).

At the hearings in Bankruptcy Court, the Trustee made several significant concessions which the Bankruptcy Court described in detail:

> At both hearings on the MSJs, [the Trustee's] counsel conceded that if a Shareholder had left Heller prior to the dissolution and had taken unfinished business, Heller could not pursue recovery of profits earned by that Shareholder following his or her departure, absent some breach of fiduciary duty. In particular, at the hearing on October 15, the [bankruptcy & court asked [the Trustee's] counsel whether a partner who took a big case would have to

account for it. [The Trustee's] counsel stated the duty to account arose upon dissolution, but not before, unless the departing attorney breached a fiduciary duty to the firm:

*3 THE COURT: How about if there wasn't a dissolution?

MR. SULLIVAN: If he breached his fiduciary duty.

THE COURT: How about if he just walked out the door and stole the client, took the client with him? You know, the documents, the way I interpret it, said, as I stated earlier this afternoon, the client is a client of the firm.

....

THE COURT: So if Mr. X or Ms. Y leaves and nobody cares, that's fine. But if somebody goes out the door with a big fat case, did Heller or didn't it have the right to pursue that attorney predissolution?

MR. SULLIVAN: Not in the absence of a breach of fiduciary duty.

THE COURT: But was that itself a breach of duty?

MR. SULLIVAN: No

While [the Trustee's] counsel was not as direct on this issue at the November hearing, he did not deny that a Shareholder who left Heller prior to the dissolution, in the absence of a breach of duty, would not have to account for unfinished business taken to another firm. Moreover, he acknowledged and did not dispute Defendants' allegation that prior to its dissolution, Heller had never sued a former Shareholder under a *Jewel* theory to recover the profits earned on such unfinished business. Thus, only as a result of Heller's dissolution were departing Shareholders burdened with a duty to account for unfinished business taken from the firm. The Jewel Waiver purported to eliminate that duty to account, freeing the Shareholders to keep profits earned on unfinished business.

Finally, *counsel for [the Trustee] also acknowledged that a law firm that took unfinished business from Heller without a Shareholder concurrently joining it would have no exposure under [the Trustee's] fraudulent transfer theories.*

Id. at *3–4 (emphasis added) (citations omitted).

The only Defendants in these cases are the third-party law firms that provided services to Heller's former clients under new fee agreements once Heller dissolved. The Trustee seeks to recover a portion of the fees paid to these third parties.

III. LEGAL STANDARD

The Court shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(a). An issue is "genuine" only if there is a sufficient evidentiary basis on which a reasonable fact finder could find for the nonmoving party, and a dispute is "material" only if it could affect the outcome of the suit under governing law. *SeeAnderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 248–49, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). The burden is on the moving party to demonstrate that there is no genuine dispute with respect to any material fact and that it is entitled to judgment as a matter of law. *Celotex Corp. v. Catrett,* 477 U.S. 317, 323, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). A court must view the evidence in the light most favorable to the non-moving party and draw all justifiable inferences in its favor. *Anderson,* 477 U.S. at 255, 106 S.Ct. 2505. "Where the record taken as a whole could not lead a rational trier of fact to find for the non-moving party, there is no 'genuine issue for trial.' " *Matsushita Elec. Indus. Co. v. Zenith Radio,* 475 U.S. 574, 587, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986). It is agreed that this Court must apply California law in its analysis of whether the bankruptcy estate held a property interest in the pending hourly matters at the time of the dissolution. *See generallyErie R. Co. v. Tompkins,* 304 U.S. 64, 78, 58 S.Ct. 817, 82 L.Ed. 1188 (1938). If Heller had no property interest in Defendants' fees, then summary judgment must be granted in favor of the Defendants.

IV. DISCUSSION

A. Law

*4 The Trustee asserts that under California law as set forth in *Jewel v. Boxer,* the estate has a property interest in pending hourly matters. In *Jewel,* the California Court of Appeal considered the voluntary dissolution of a four-person firm after its partners split into groups of two and formed new firms. 156 Cal.App.3d at 174–75, 203 Cal.Rptr. 13. "[E]ach former partner sent a letter to each client whose case he had handled for the old firm, announcing the dissolution." *Id.* at 175, 203 Cal.Rptr. 13. The letter included "a substitution of attorney form, which was executed and returned by each client retaining the attorney who had handled the case for the old firm." *Id.* Significantly, "[t]he new firms represented the clients under fee agreements entered into between the client and the old firm." *Id.* (emphasis added). The court held that, under those facts, the former partners violated their "fiduciary duty not to take any action with respect to unfinished partnership business for personal gain." *Id.* at 178–79, 203 Cal.Rptr. 13. In essence, the court found that the new firms had earned profits which, in equity, belonged to the dissolving partnership because the departing partners had appropriated work for themselves that could have been performed on behalf of the dissolved firm.

Jewel is different from the cases here for five key, related reasons. First, the dissolution of the firm at issue in *Jewel* was voluntary, while Heller's dissolution was forced when Bank of America withdrew the firm's line of credit. This is significant because the partners in *Jewel* could have, but chose not to, finish representing their clients as or on behalf of the old firm. Here, Heller lacked the financial ability to continue providing legal services to its clients, leaving clients with ongoing matters no choice but to seek new counsel and Heller Shareholders no choice but to seek new employment. Second, in *Jewel*, "[t]he new firms represented the clients under fee agreements entered into between the client and the old firm." *Id.* at 175, 203 Cal.Rptr. 13. Here, the clients signed new retainer agreements with the new firms. Third, in *Jewel*, the new firms consisted entirely of partners from the old firms: one firm with four partners had become two firms with two partners each. Here, Defendants are preexisting third-party firms that provided substantively new representation, requiring significant resources, personnel, capital, and services well beyond the capacity of either Heller or its individual Shareholders. Where in *Jewel*, the departed partners continued to have fiduciary duties to each other and the old firm, here, the third-party firms never owed any duty, fiduciary or otherwise, to the dissolved firm. Fourth, *Jewel* treated hourly fee matters and contingency fee matters as indistinguishable. Here, there are no contingency fee cases at issue. Finally, *Jewel* was decided in 1984 and thus applied the Uniform Partnership Act (the "UPA") which the materially different Revised Uniform Partnership Act (the "RUPA") has since superseded. The RUPA, which applies after 1999 to all California partnerships, allows partners to obtain "reasonable compensation" for helping to wind up partnership business, Cal. Corp.Code § 16401(h), and thus undermines the legal foundation on which *Jewel* rests.

The RUPA's impact on *Jewel* is significant. Section 404(b)(3) of the RUPA provides that a partner must "refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership." Cal. Corp.Code § 16404(b)(3). As the drafters of the RUPA explained, this language means that "[t]he duty not to compete ... does not extend to winding up the business, as do the other loyalty rules. Thus, a partner is free to compete immediately upon an event of dissolution...." RUPA § 404 cmt. 2. Therefore, unlike in *Jewel,* if a former Heller Shareholder signed a new retainer agreement with a former Heller client, this would not violate the "fiduciary duty not to take any action with respect to unfinished partnership business for personal gain." *Jewel,* 156 Cal.App.3d at 178–79, 203 Cal.Rptr. 13. Consequently there is no provision of the RUPA that gives the dissolved firm the right to demand an accounting for profits earned by its former partner under a new retainer agreement with a client. Moreover, here, the new retainer agreements were not even signed between former Heller clients and former Heller Shareholders but rather between the clients and new, third-party firms.

***5** Although *Jewel* has been cited in dozens of cases from California and beyond, "courts have cited *Jewel* reflexively and uncritically," that is, without much analysis or consideration of the changes in law firm practice or law. *Geron,* 476 B.R. at 739 n. 2. The California Supreme Court has not ruled on the issue now before the Court, nor do any published California cases decided under the RUPA cite *Jewel* for its unfinished business rule. Thus, California law is unsettled on the question of whether a law firm may assert a property interest in hourly fee matters pending at the time of its dissolution. Absent clear authority from California courts, the Court next turns to the equities. [5]

5 Because Jewel does not apply, the Court need not reach the issue of whether the "Jewel Waiver" at issue here was valid or constituted a fraudulent transfer. Nor does the Court reach the issue of whether Heller was unable to pay its bills as they became due and was thus insolvent at the time of the "Jewel Waiver."

B. Equity

A bedrock of the commercial legal profession is that lawyers expect to be paid for services they provide to their clients, and clients expect to pay the firm that employs the lawyers who provide their services. Balancing the equities, it is simple enough to conclude that the firms that did the work should keep the fees. [6] And, of course, the fees that Heller earned through its labor prior to dissolution have been paid or are not at issue here. The fees at issue here were generated by Defendants' labor, not Heller's. So in terms of fairness, the

Trustee cannot argue that the Defendants have received a windfall—they did the work.

6 At the motion hearing, the Trustee was right to emphasize that equitable considerations also weigh in favor of Heller's creditors, many of whom are former Heller Shareholders and employees. Heller's dissolution and its outstanding debt to its dedicated Shareholders and employees is lamentable. However, it does not, in and of itself, justify taking away from Defendants that which they earned through their labor and investment absent a clear direction from the California Supreme Court that this is a property interest, the recognition of which would further advance the public policy goals of bankruptcy law.

The Trustee argues instead that the former Heller Shareholders had a fiduciary duty to account to Heller's estate for profits their new firms earned from work on former Heller matters. However, the fiduciary duty to account is limited to partnership property. Cal. Corp. Code § 16404(b)(1). If the profits Defendants earned are not derived from Heller partnership property, then there is no duty to account. A few basic principals demonstrate why the equities do not favor finding a property interest here.

[2] [3] [4] A law firm never owns its client matters. The client always owns the matter, and the most the law firm can be said to have is an *expectation* of future business. At the motion hearing the Trustee was unable to articulate a basis for calculating the value of this expected future business. The Trustee suggested that the value at issue here is "good will," which does not ordinarily appear on law firm balance sheets which are on a modified cash basis. In California, and beyond, professional law partnerships do not have a "good will" asset. *SeeLyon v. Lyon,* 246 Cal.App.2d 519, 526, 54 Cal.Rptr. 829 (1966).[7] "The 'good will' which plaintiff claims—the expectation of future business—is personal and confidential and attaches to the individual partners of the firm, thus, no monetary value can be attributed to it and there is nothing to sell." *Id.* The good will the Trustee discussed may be real in one sense: certainly a firm's reputation is a crucial part of its ability to obtain work. However, good will is not an asset to which a property interest attaches. Moreover, Heller's bankruptcy did much to undermine the firm's otherwise stellar reputation and to eviscerate any reasonable expectation of future business.

7 State supreme courts from Wyoming and Iowa have favorably cited *Lyon* for this proposition. *SeeSmith, Keller & Assocs. v. Dorr & Assocs.,* 875 P.2d 1258, 1265 n. 5 (Wyo.1994); *Bump v. Stewart, Wimer & Bump, P.C.,* 336 N.W.2d 731, 736 (Iowa 1983). For example, "[t]he accepted rule has recognized that professional partnerships do not have a *goodwill* asset. This rule is consistent with the position that a client's files belong to the client, and the professional partnership may not withhold the files to restrict the client's access to other providers." *Smith, Keller & Assocs.,* 875 P.2d at 1265 n. 5 (emphasis in original) (internal citations omitted).

***6 [5] [6] [7]** Obviously, the expectation of future business—if it is "good will"—would disappear as soon as either (1) the client removes business, which it can do at will, or (2) the law firm ceases to be able to perform the work to generate those expected future profits. "It has long been recognized in [California] that the client's power to discharge an attorney, with or without cause, is absolute." *Fracasse v. Brent,* 6 Cal.3d 784, 790, 100 Cal.Rptr. 385, 494 P.2d 9 (1972). When a client exercises "the unilateral right to discharge his or her attorney," the party discharged "only has a right to quantum meruit recovery" for the value of work already done on the matter. *Jalali v. Root,* 109 Cal.App.4th 1768, 1777, 1 Cal.Rptr.3d 689 (2003). Here, the client matters at issue ceased to be Heller's partnership business and became the Defendants' partnership business when the clients terminated Heller and retained new, third-party counsel.

The Trustee conceded as much before the Bankruptcy Court. As the Bankruptcy Court explained, the Trustee "did not deny that a Shareholder who left Heller prior to the dissolution, in the absence of a breach of duty, would not have to account for unfinished business taken to another firm." *In re Heller Ehrman LLP,* 2013 WL 951706, at *4. The Trustee further "acknowledged and did not dispute Defendants' allegation that prior to its dissolution, Heller had never sued a former Shareholder under a *Jewel* theory to recover the profits earned on such unfinished business." *Id.* Thus, according to the Trustee, "only as a result of Heller's dissolution were departing Shareholders burdened with a duty to account for unfinished business taken from the firm." *Id.*

It is unclear why the duties, rights, and property interests at stake here should be different simply because Heller dissolved. To the extent dissolution does change the lay of the land, it should do so in favor of Defendants as a matter of equity. Heller ceased to be able to represent its clients, leaving them with no choice but to seek representation elsewhere. Defendants came to the rescue of these clients and provided them with legal services on ongoing matters.

The former Heller clients negotiated and signed entirely new retainer agreements with third-party firms. And those firms provided substantively new representation, requiring significant resources, personnel, capital, and services well beyond the capacity of either Heller or its individual Shareholders.

The plight of Heller's former staff and creditors is, as in all bankruptcies, deplorable. However, Defendants did the work that generated the fees at issue here. With the Defendants those fees should stay. The equities favor Defendants.

C. Policy

Public policy considerations also support the Court's ruling. The Trustee argued at the motion hearing that the two policy reasons articulated by *Jewel* apply here. First, *Jewel* explained that preventing extra compensation to law partnerships "prevents partners from competing for the most remunerative cases during the life of the partnership in anticipation that they might retain those cases should the partnership dissolve." *Jewel,* 156 Cal.App.3d at 179, 203 Cal.Rptr. 13. Second, the *Jewel* holding "discourages former partners from scrambling to take physical possession of files and seeking personal gain by soliciting a firm's existing clients upon dissolution." *Id.* Based on the detailed discussion of these policy issues during the motion hearing, the Court concludes that they are not at play here.

The profits to which the Trustee asserts a claim are not those of the former Heller Shareholders themselves, but rather those of the new, third-party firms. Thus, any benefit or incentive for the former Heller Shareholders is not directly at issue. Further, the former Heller clients chose to sign new retainer agreements with third-party firms. The decision to retain new counsel was not instigated by "physical possession of files" but rather by Heller's inability to provide further representation. Nor could the Trustee provide the Court with a workable definition of "winding up" or "unfinished business." The Court agrees that Heller should bill and be paid for the time its lawyers spent filing motions for continuances, noticing parties and courts that it was withdrawing as counsel, packing up and shipping client files back to the clients or to new counsel, and getting new counsel up to speed on pending matters. That is what winding up unfinished business entails when a firm dissolves in the context of a bankruptcy.[8] But the Trustee suggests that Heller's estate is entitled to a share of all profits earned even on litigation lasting long after Heller ceased to function, into the indefinite future perpetuating the inequity over time. Legal matters have a way of dragging on,[9] even in this century. Public policy cannot favor such an outcome.

8 To the extent that the Trustee argues that "winding up" entails further substantive legal work on pending matters, the RUPA allows partners to obtain "reasonable compensation" for helping to wind up partnership business. Cal. Corp.Code § 16401(h). Authorizing wind-up compensation does not create a property interest. It simply permits lawyers to continue to work on pending matters and be compensated.

9 *See* Charles Dickens, *Bleak House* (1853) (describing the fictional legal case of *Jarndyce v. Jarndyce,* which dragged on for generations).

***7** Nor could the Trustee direct the Court to any concrete evidence that either of the two policy factors articulated in *Jewel* came into play during Heller's dissolution. That Defendants, in hiring former Heller Shareholders, considered those Shareholders' book of business is to be expected and hardly speaks to unruly competition within Heller. In fact, the Trustee's position would create a perverse incentive in the context of a firm struggling to avoid dissolution. The Trustee's rule would incentivize partners of a struggling firm to jump ship at the first sign of trouble to avoid the kind of suit Defendants now find themselves in, even if that would destabilize an otherwise viable firm.

Moreover, the Trustee would have this Court prevent third-party firms from earning a profit on hourly fee matters formerly handled by Heller simply because those firms hired former Heller Shareholders. Such a holding would discourage third-party firms from hiring former partners of dissolved firms and discourage third-party firms from accepting new clients formerly represented by dissolved firms. It is not in the public interest to make it more difficult for partners leaving a struggling firm to find new employment, or to limit the representation choices a client has available, by establishing a rule that prevents third-party firms from earning a profit off of labor and capital investment they make in a matter previously handled by a dissolved firm.[10] *SeeIn re Thelen LLP,* 736 F.3d 213, 223 (2d Cir.2013) ("the [unfinished business] doctrine may discourage other law firms from accepting lawyers and client engagements from a dissolved law firm for fear that a substantial portion of the resulting profits may be turned over to the dissolved law firm or its creditors."). Law firms accepting a new client, even for an hourly-fee matter, must be prepared to invest considerable resources: attorney salaries; malpractice insurance; administrative support; research fees; document preparation; space allocation; opportunity costs; and so on. No firm can be expected to contribute those resources if they are not entitled to retain the corresponding profits. Here, the Trustee asks this Court to deprive Defendants of profits earned off of Defendants' labor and capital investment. Public policy weighs strongly against such an outcome. *SeeIn re Thelen LLP,* 736 F.3d at 222–23 (discussing policy arguments against treating hourly fee matters as partnership property including (1) the nature of the attorney-client relationship, (2) economic consequences and perverse incentives, (3) rules of professional conduct,[11] and (4) distinctions between contingency and hourly fee matters).

10 If, as here, clients would like to choose third-party firms with some familiarity with the matters by virtue of having hired former Heller Shareholders, the Trustee's argument is that those third-party firms would not be able to earn a profit on their labor or investment. Thus, the Trustee's position would all but force former Heller clients to retain new counsel with no connection to Heller or their matters.

11 Defendants argue that the Trustee's position would lead to a fee sharing arrangement prohibited by Rule 1–320 of the California Rules of Professional Ethics. The Court need not address this argument.

V. CONCLUSION

Finding no justification, legal or otherwise, for creating a property interest in pending hourly matters, the Court GRANTS summary judgment in favor of Defendants and against Plaintiff.

IT IS SO ORDERED.

Parallel Citations

71 Collier Bankr.Cas.2d 1437

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24 N.Y.3d 16
Court of Appeals of New York.

In re THELEN LLP.
Yann Geron, as Chapter 7 Trustee of
the Estate of Thelen LLP, Appellant,
v.
Seyfarth Shaw LLP, Respondent.
In re Coudert Brothers LLP, Debtor.
Development Specialists,
Inc., Respondent–Appellant,
K & L Gates LLP et al., Appellants–Respondents,
Akin Gump Strauss Hauer & Feld
LLP, et al., Appellants–Respondents.

July 1, 2014.

Synopsis
Background: In first of two cases containing identical questions certified to the Court of Appeals of New York, trustee of Chapter 7 estate of dissolved law partnership brought adversary proceeding against firms to which debtor's attorneys departed, seeking to recover, on fraudulent transfer theory, value of pending hourly fee matters that attorneys brought with them to these new firms. The United States District Court for the Southern District of New York, William H. Pauley III, J., 476 B.R. 732, granted firm's motion for judgment on the pleadings, and sua sponte certified its order for interlocutory appeal. Trustee appealed. Agreeing that New York law governed the parties' dispute, the Court of Appeals, Gerard E. Lynch, Circuit Judge, 736 F.3d 213, certified to the Court of Appeals of New York two unresolved questions regarding the applicability and scope of the "unfinished business doctrine." In second case, administrator for Chapter 11 estate of dissolved law partnership brought adversary proceedings against firms that had hired debtor's former partners, seeking to recover profits that former partners earned while completing debtor's client matters that were pending but uncompleted on date of debtor's dissolution. Following withdrawal of the reference, 462 B.R. 457, law firms moved for summary judgment, and administrator cross-moved for declaration that unfinished client matters were debtor's property on date of its dissolution. The United States District Court for the Southern District of New York, Colleen McMahon, J., 477 B.R. 318, ruled that under New York law, as predicted by the court, all client matters pending on date of dissolution were assets of law partnership. After leave to appeal was granted, firms appealed, and the Court of Appeals certified the same two questions asked in the first case.

[Holding:] The Court of Appeals of New York, Read, J., held that under New York law, a dissolved law firm's pending hourly fee matters are not partnership "property" or "unfinished business" within the meaning of the Partnership Law.

Certified question answered.

West Headnotes (10)

[1] **Attorney and Client**
Client fees

Dissolved law firm's pending hourly fee matters are not "partnership property" or "unfinished business" within meaning of Partnership Law; a law firm does not own a client or an engagement, and is only entitled to be paid for services actually rendered. McKinney's Partnership Law §§ 4(4), 12, 40(6), 66(1)(a).

4 Cases that cite this headnote

[2] **Attorney and Client**
Dissolution, Settlement, and Accounting

"Unfinished business doctrine" generally provides that profits arising from work begun by former partners of dissolved law firms are a partnership asset that must be finished for the benefit of the dissolved partnership, absent an agreement to the contrary.

Cases that cite this headnote

[3] **Attorney and Client**
Dissolution, Settlement, and Accounting

Unfinished business doctrine rests on the legal principle that because departing partners owe a fiduciary duty to the dissolved firm and their former partners to account for benefits obtained from use of partnership property in winding up the partnership's business, they may not be separately compensated.

1 Cases that cite this headnote

[4] **Partnership**
Control and disposition of partnership property

New York Partnership Law does not define property but, rather, supplies default rules for how a partnership upon dissolution divides property as elsewhere defined in state law. McKinney's Partnership Law § 1 et seq.

Cases that cite this headnote

[5] **Attorney and Client**
Act of parties

Attorney and Client
Premature Termination of Relation

Clients have always enjoyed the unqualified right to terminate the attorney-client relationship at any time, without any obligation other than to compensate the attorney for the fair and reasonable value of the completed services.

Cases that cite this headnote

[6] **Attorney and Client**
Property of firm

No law firm has a property interest in future hourly legal fees because they are too contingent in nature and speculative to create a present or future property interest, given the client's unfettered right to hire and fire counsel.

3 Cases that cite this headnote

[7] **Partnership**
Partnership Property

Purpose of the Uniform Partnership Act (UPA) is to harmonize partners' duties regarding partnership property, not to delineate the scope of such property. McKinney's Partnership Law § 1 et seq.

Cases that cite this headnote

[8] **Attorney and Client**
The relation in general

Client's legal matter belongs to the client, not the lawyer.

Cases that cite this headnote

[9] **Attorney and Client**
Dissolution, Settlement, and Accounting

Attorney and Client
Act of parties

Contracts between a law firm and a client cannot contemplate survival of the law firm's dissolution without impermissibly infringing the client's right to terminate an attorney at will.

Cases that cite this headnote

[10] **Attorney and Client**
Act of parties

New York has a strong public policy encouraging client choice and, concomitantly, attorney mobility.

Cases that cite this headnote

Attorneys and Law Firms

*****535** Rich Michaelson Magaliff Moser, LLP, New York City (Howard P. Magaliff of counsel), for appellant in the first above-entitled proceeding.

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McCarter & English, LLP, New York City (David J. Adler, Joseph R. Scholz and Eduardo Glas of counsel), for respondent-appellant in the second above-entitled proceeding.

Kaye Scholer LLP, New York City (James M. Catterson and Margaret A. Rogers of counsel), DLA Piper LLP (US) (Joshua S. Sprague of counsel), Hogan Lovells US LLP (Scott W. Reynolds of counsel), Mayer Brown LLP (Michael O. Ware of counsel), Schulte Roth & Zabel LLP (Michael L. Cook and David M. Hillman of counsel), Drinker Biddle & Reath LLP (Michael P. Pompeo of counsel), Holland & Knight LLP (Barbara R. Parlin of counsel), Proskauer Rose LLP (Steven E. Obus of counsel), Sutherland Asbill & Brennan LLP (Robert D. Own of counsel), Venable LLP (Lawrence H. Cooke II of counsel), Weil, Gotshal & Manges LLP (Mindy J. Spector and Michael F. Walsh of counsel), and Willkie Farr & Gallagher LLP (John C. Longmire and Stephen Greiner of counsel), amici curiae in the first above-entitled proceeding.

Diamond McCarthy LLP, New York City (Allen B. Diamond, Howard Ressler and Andrew B. Ryan of counsel), for Alan M. Jacobs, Liquidating Trustee for Dewey & LeBoef Liquidation Trust, Diamond McCarthy LLP, Dallas, Texas (Andrew B. Ryan, James D. Sheppard and Michael Fishel of counsel), for Allan B. Diamond, Chapter 11 Trustee for Howrey LLP, and Greenfield Sullivan, San Francisco, California (Christopher D. Sullivan of counsel), for Michael Burkhart, Plan Administrator for Heller Ehrman LLP Liquidating Trust, amici curiae in the first above-entitled proceeding.

Glenn Lau–Kee, New York State Bar Association, Albany, Damian Schaible, The Association of the Bar of the City of New York, New York City, and Barbara Moses, New York County Lawyers' Association, for New York State Bar Association and others, amici curiae in the first and second above-entitled proceedings.

Keker & Van Nest LLP, San Francisco, California (Steven A. Hirsch and John C. Bostic of counsel), and Lawrence E. Zabinski, Chicago, Illinois, and Daniel J. Donnelly, for Attorneys' Liability Assurance Society, Inc., amicus curiae in the first and second above-entitled proceedings.

***22 OPINION OF THE COURT**

READ, J.

******1 [1] **266** The United States Court of Appeals for the Second Circuit has asked us two questions relating to "whether, for purposes of administering [a] ... related bankruptcy, New York law treats a dissolved law firm's pending hourly fee matters as its property" (*In re: Thelen LLP [GERON v. seyfaRth shaw Llp*], 736 F.3D 213, 216 [2d cir.2013]). we hoLd that pending hourly fee matters are not partnership ****267 ***537** " property" or "unfinished business" within the meaning of New York's Partnership Law. A law firm does not own a client or an engagement, and is only entitled to be paid for services actually rendered.

***23 I.**

Thelen

On October 28, 2008, the partners of the law firm Thelen LLP (Thelen) voted to dissolve the firm, which was insolvent. In carrying out the dissolution, Thelen's partners adopted the Fourth Amended and Restated Limited Liability Partnership Agreement ("Fourth Partnership Agreement") and a written Plan of Dissolution. The Fourth Partnership Agreement provided that it was governed by California law and, unlike its predecessor agreements, included an "Unfinished Business Waiver." The waiver recited that

> "[n]either the Partners nor the Partnership shall have any claim

> or entitlement to clients, cases or matters ongoing at the time of the dissolution of the Partnership other than the entitlement for collection of amounts due for work performed by the Partners and other Partnership personnel prior to their departure from the Partnership. The provisions of this [section] are intended to expressly waive, opt out of and be in lieu of any rights any Partner of the Partnership may have to 'unfinished business' of the Partnership, as the term is defined in *Jewel v. Boxer,* 156 Cal.App.3d 171 [203 Cal.Rptr. 13] (Cal.App. 1 Dist.1984), or as otherwise might be provided in the absence of this provision through the interpretation of the [California Uniform Partnership Act of 1994, as amended]."

This kind of waiver is referred to as a "*Jewel* Waiver," after *Jewel v. Boxer,* 156 Cal.App.3d 171, 203 Cal.Rptr. 13 (Cal.Ct.App.1984), the intermediate appellate court case that inspired it. Applying the Uniform Partnership Act (UPA), the *Jewel* court held that, absent an agreement to the contrary, profits derived from a law firm's unfinished business are owed to the former partners in proportion to their partnership interests. The Thelen partnership adopted the waiver with the

> "hope that, [it would] serve as an inducement to encourage partners to move their clients to other law firms and to move Associates and Staff with them, the effect of which will be to reduce expenses to the Partnership, and to assure that client matters are attended to in the most efficient and effective ***24** manner possible, and to help ensure collection of existing accounts receivable and unbilled time with respect to such clients."

******2** Following Thelen's dissolution, 11 Thelen partners joined Seyfarth Shaw LLP (Seyfarth)—10 in its New York office and one in California. The former Thelen partners transferred unfinished matters to Seyfarth, which billed clients for their services. On September 18, 2009, Thelen filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York.

After his appointment as the Chapter 7 trustee of Thelen's bankruptcy estate, Yann Geron (Geron) commenced an adversary proceeding against Seyfarth in the United States District Court for the Southern District of New York. Geron sought to avoid the "Unfinished Business Waiver" as a constructive fraudulent transfer under 11 USC §§ 544 and 548(a)(1)(B) and California state law, and to recover the value of Thelen's unfinished business for the benefit of the estate's creditors. On the assumption that pending hourly matters ****268** *****538** were among a law firm's assets, Geron argued that Thelen's partners fraudulently transferred those assets to individual partners without consideration when they adopted the "Unfinished Business Waiver" on the eve of dissolution.

Seyfarth moved for judgment on the pleadings, arguing that New York rather than California law defined whether it received any "property interest." In a decision dated September 4, 2012, the District Court Judge first agreed with Seyfarth that New York law governed. He then concluded that under New York law, the "unfinished business doctrine" does not apply to a dissolving law firm's pending hourly fee matters, and that a partnership does not retain any property interest in such matters upon the firm's dissolution. In the Judge's view, to rule otherwise would "conflict[ ] with New York's strong public policy in favor of client autonomy and attorney mobility" (*In re Thelen LLP* [*Geron v. Seyfarth Shaw LLP*], 476 B.R. 732, 742–743 [S.D.N.Y.2012]); and "result in an unjust windfall for the Thelen estate, as 'compensating a former partner out of that fee would reduce the compensation of the attorneys performing the work' " (*id.* at 740, quoting *Sheresky v. Sheresky Aronson Mayefsky & Sloan, LLP,* 35 Misc.3d 1201[A], 2011 WL 7574999 [Sup.Ct.N.Y. County 2011]). He further observed that "[s]uch an expansion of the [unfinished business] doctrine would violate ***25** New York's public policy against restrictions on the practice of law" and "clash directly with New York's Rules of Professional Conduct"; specifically, the rule generally forbidding fee splitting (*id.* at 740). Accordingly, the Judge granted Seyfarth's motion for judgment on the pleadings. The Judge sua sponte certified his order for interlocutory appeal (*id.* at 745–746).

By decision dated November 15, 2013, the Second Circuit agreed with the District Court that New York law governed the parties' dispute, and asked us to answer two unresolved questions of New York law regarding the applicability and scope of the "unfinished business doctrine"; specifically,

> ****3 "Under New York law, is a client matter that is billed on an hourly basis the property of a law firm, such that, upon dissolution and in related bankruptcy proceedings, the law firm is entitled to the profit earned on such matters as the 'unfinished business' of the firm?
>
> "If so, how does New York law define a 'client matter' for purposes of the unfinished business doctrine and what proportion of the profit derived from an ongoing hourly matter may the new law firm retain?" (736 F.3d at 225).

Coudert

On August 16, 2005, the law firm Coudert Brothers LLP (Coudert) dissolved in accordance with the terms of its partnership agreement. That same day, the equity partners adopted a "Special Authorization," whereby the equity partners authorized

> "the Executive Board ... to take such actions as it may deem necessary and appropriate, including, without limitation, the granting of waivers, notwithstanding any provisions to the contrary in the Partnership Agreement ..., in order to:
>
> "a. ... sell all or substantially all of the assets of ... the Firm to other firms or service providers, in order to maximize the value of the Firm's assets and business;
>
> "b. wind down the business of the Firm with a view to continuing the provision of legal services to clients and the orderly transition of client matters ***26** to other firms or service providers, in order to maximize the value of the Firm's ****269** *****539** assets and business to the extent practicable."

Coudert partners were subsequently hired by several different firms. As of the date of the firm's dissolution, there remained between Coudert and its clients partly performed contracts for the provision of legal services. When former Coudert partners joined other firms, those firms were retained by Coudert's former clients to conclude these unfinished legal matters. The client matters were completed by the new firms on an hourly basis, with only two exceptions.

In September 2006, Coudert filed for protection from its creditors pursuant to Chapter 11 of the Bankruptcy Code. Developmental Specialists, Inc. (DSI), as administrator of Coudert's bankruptcy estate, brought 13 separate adversary proceedings against the firms that had hired the former Coudert partners. These lawsuits were premised on the unfinished business doctrine. More specifically, DSI argued that the defendant firms were liable to Coudert for any profits derived from completing the client matters that the former Coudert partners brought to those firms. The firms moved for summary judgment, arguing that the unfinished business doctrine did not apply to matters billed on an hourly basis. DSI cross-moved for a declaration that the unfinished client matters were Coudert's property on the day it dissolved.

In a decision dated May 24, 2012, the District Court denied the firms' motion for summary judgment and granted DSI's cross-motion. The Judge agreed with DSI that

> "[u]nder the Partnership Law, the Client Matters are presumed to be Coudert's assets on the Dissolution Date. While the Coudert Partnership Agreement could have provided otherwise, it does not; on the contrary, it confirms the statutory presumption, as does the text of the Special Authorization adopted by the partners who voted to dissolve the firm. In the absence of any evidence that Coudert's partners intended to exclude pending but uncompleted client representations from the firm's assets, DSI is entitled to a declaration that the Client Matters were Coudert assets on the Dissolution Date. Because they are Coudert assets, the Former Coudert Partners are obligated to account for any profits they earned while winding the Client Matters up at ***27** the Firms" (*Development Specialists, Inc. v. Akin Gump Strauss Hauer & Feld LLP*, 477 B.R. 318, 326 [S.D.N.Y.2012]).

****4 Upon the District Court's certification, the law firms appealed. By order dated December 2, 2013, the Second Circuit certified the same two questions asked in *Thelen* (*In re Coudert Bros. LLP*, 2013 WL 9363394, 2013 U.S.App.LEXIS 26016).

II.

The Role of the Partnership Law

Geron and DSI (collectively, the trustees) base their claims principally on the unfinished business doctrine as originally articulated and applied by the *Jewel* court in the context of a law firm dissolution. The doctrine derives from an interpretation of various provisions of the Partnership Law; primarily, sections 12, 40(6) (the so-called "no compensation" rule), 43(1) (the so-called "duty to account") and 66(1)(a). [1] The trustees also rely on **270 ***540 Partnership Law § 4(4), which directs that the statute "shall be so interpreted and construed as to effect its general purpose to make uniform the law of those states which enact it."

1 Section 12(1) provides that "[a]ll property originally brought into the partnership stock or subsequently acquired, by purchase or otherwise, on account of the partnership is partnership property"; section 12(2), that "[u]nless the contrary intention appears, property acquired with partnership funds is partnership property."
Section 40(6) provides that "[n]o partner is entitled to remuneration for acting in the partnership business, except that a surviving partner is entitled to reasonable compensation for his services in winding up the partnership affairs."
Section 43(1) specifies that "[e]very partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property."
Section 66(1)(a) specifies that "[a]fter dissolution a partner can bind the partnership ... [b]y any act appropriate for winding up partnership affairs or completing transactions unfinished at dissolution."

[2] **[3]** The legislature enacted the Partnership Law in 1919, thereby adopting the UPA, which was approved and recommended to the states by the Conference of Commissioners on Uniform State Laws in 1914. Prior to the Conference's approval and recommendation for adoption of the Revised Uniform Partnership Act (RUPA) in 1994, the UPA had been enacted in every state except *28 Louisiana. Generally speaking, the unfinished business doctrine provides that profits arising from work begun by former partners of dissolved law firms are a partnership asset that must be finished for the benefit of the dissolved partnership, absent an agreement to the contrary. The doctrine rests on the legal principle that because departing partners owe a fiduciary duty to the dissolved firm and their former partners to account for benefits obtained from use of partnership property in winding up the partnership's business, they may not be separately compensated. This rule has been applied by courts in other jurisdictions to both contingent and hourly matters. [2]

2 It is not entirely clear to what extent the post-dissolution attorney fees at issue in *Jewel* were for hourly or contingency fee matters.

[4] Importantly, though, the Partnership Law does not define property; rather, it supplies default rules for how a partnership upon dissolution *divides* property as elsewhere defined in state law. As a result, the Partnership Law itself has nothing to say about whether a law firm's "client matters" are partnership property. When discussing what constitutes "property," we have explained that the

> ****5 "*expectation of any continued or future business is too contingent in nature and speculative to create a present or future property interest.* Although property is often described as a 'bundle of rights,' or 'sticks,' with relational aspects ...*the ability to terminate the relationship at any time without penalty ... cannot support a finding that a transferrable property right existed* " (*Verizon New England, Inc. v. Transcom Enhanced Servs., Inc.,* 21 N.Y.3d 66, 72, 967 N.Y.S.2d 883, 990 N.E.2d 121 (2013) [emphases added]).

[5] **[6]** **[7]** In New York, clients have always enjoyed the "unqualified right to terminate the attorney-client relationship at any time" without any obligation other than to compensate the attorney for "the fair and reasonable value of the *completed services* " (*In re Cooperman,* 83 N.Y.2d 465, 473, 611 N.Y.S.2d 465, 633 N.E.2d 1069 [1994] [emphasis added]). In short, no law firm has a property interest in future hourly legal fees because they are "too contingent in nature and speculative to create a present or future property interest" (**271 ***541 *Verizon New England,* 21 N.Y.3d at 72, 967 N.Y.S.2d 883, 990 N.E.2d 121), given the client's unfettered right to hire and fire counsel. Because client matters are not partnership property, the trustees' reliance on Partnership Law § 4(4) is misplaced. As the District Court Judge in *Geron* *29 pointed out, "[t]he purpose of [the] UPA is to harmonize partners' duties regarding partnership property, *not to delineate the scope of such property* " (*Geron,* 476 B.R. at 742 [emphasis added]).

The Contingency Fee Cases

Moreover, contrary to the trustees' contentions, New York courts have never suggested that a law firm owns anything with respect to a client matter other than yet-unpaid compensation for legal services already provided. Appellate Division decisions dealing with unfinished business claims in the context of contingency fee arrangements uniformly conclude that the dissolved partnership is entitled only to the "value" of its services (*see Grant v. Heit,* 263 A.D.2d 388, 389, 693 N.Y.S.2d 564 [1st Dept.1999]; *Shandell v. Katz,* 217 A.D.2d 472, 473, 629 N.Y.S.2d 437 [1st Dept.1995]; *DelCasino v. Koeppel,* 207 A.D.2d 374, 374, 615 N.Y.S.2d 454 [2d Dept.1994]; *Dwyer v. Nicholson,* 193 A.D.2d 70, 73, 602 N.Y.S.2d 144 [2d Dept.1993]; *Kirsch v. Leventhal,* 181 A.D.2d 222, 586 N.Y.S.2d 330 [3d Dept.1992] [Levine, J.]).

[8] The Appellate Division has occasionally referred to a contingency fee case as an "asset" subject to distribution (*see e.g. Shandell,* 217 A.D.2d at 473, 629 N.Y.S.2d 437; *Kirsch,* 181 A.D.2d at 225, 586 N.Y.S.2d 330). But as then-Justice Levine stressed in *Kirsch,* a former partner "is only entitled to 'the *value* of his interest at the date of dissolution ... with interest' " (*id.* at 226, 586 N.Y.S.2d 330, *quoting*Partnership Law § 73; *see also Santalucia v. Sebright Transp., Inc.,* 232 F.3d 293, 298 [2d Cir.2000] ["(I)n a case where a lawyer departs from a dissolved partnership and takes with him a contingent fee case which he then litigates to settlement, the dissolved firm is entitled only to the value of the case at the date of dissolution, with interest. Stated conversely, the lawyer must remit to his former firm the settlement value, less that amount attributable to the lawyer's efforts after the firm's dissolution" (*citing Kirsch,* 181 A.D.2d at 225–226, 586 N.Y.S.2d 330)]). The trustees have not cited any New York case in which the law firm was awarded the client matter itself, or any fee not earned by the law firm's own work. This is hardly surprising since, as already discussed, a client's legal matter belongs to the client, not the lawyer.

******6** And notably, these cases have involved disputes between a dissolved partnership and a departing partner, not outside third parties. In this context, statements that contingency fee cases are "assets" of the partnership subject to distribution simply means that, as between the departing partner and the partnership, the partnership is entitled to an accounting for the value ***30** of the cases as of the date of the dissolution. *Kirsch, Shandell* and other Appellate Division decisions involving contingency fee arrangements do not suggest that law firms own their clients' legal matters, or have a property interest in work performed by former partners at their new firms.

Stem v. Warren

The trustees rely heavily on our decision in *Stem v. Warren,* 227 N.Y. 538, 125 N.E. 811 (1920), as did the District Court Judge in *DSI.*But *Stem* involved claims for breach of fiduciary duty; we did not hold "that executory contracts to perform professional services are partnership assets unless a contrary intention appears" (*DSI,* 477 B.R. at 333), or define unfinished client engagements as partnership property.

*****542 **272** In *Stem,* one architectural partnership (Reed & Stem) entered into an agreement with another architectural partnership (Warren & Wetmore) for the purpose of "secur[ing] a contract for architectural services in the construction of the Grand Central Station and buildings in connection therewith" (*Stem,* 227 N.Y. at 542, 125 N.E. 811). The agreement stated that the partnerships would "share and share alike as firms and not as individuals the profits and losses" (*id.* at 543, 125 N.E. 811). On the same day, the joint venture entered into a separate contract with the railroad company agreeing, among other things, to jointly act as architects for the company. It was the clear intent of the parties that the contract was to be performed notwithstanding the death of Reed, the "executive head" of the joint venture, if this should occur; that is, the agreement between the partnerships contemplated that the joint venture would survive either partnership's dissolution and that the contract with the railroad company would be performed by the survivors.

The joint venture worked on the Grand Central Station project for over seven years before Reed died. The trial court found that, without consent from Reed's surviving partner or his estate, Wetmore sent the railroad company a proposed new contract that was, in substance, the same as the joint venture's existing contract, except that Warren & Wetmore was named as sole architects. The railroad company immediately terminated its contract with the joint venture and entered into the new, identical contract exclusively with Warren & Wetmore.

******7** Stem, the surviving partner, filed suit to recover one half of the profits on two separate projects of the joint venture: the ***31** work performed pursuant to the joint venture agreement and the contract with the railroad regarding Grand Central Station; and the work performed on what became the Biltmore Hotel, for which the joint venture had prepared preliminary plans prior to Reed's death. We determined that "the firm of Warren & Wetmore are to be held accountable to the plaintiff" for the profits from work on Grand Central Station (*id.* at 547, 125 N.E. 811), but denied Stem compensation from the Biltmore project for anything other than the value of the actual work performed (the preliminary plans) by the joint venture before the dissolution.

[9] Thus, *Stem* is not a case that defines what makes up the partnership property or "assets"; it is a breach-of-fiduciary duty case in which one joint venturer underhandedly cut a surviving joint venturer out of a contract expressly intended (including by the client) to survive dissolution. We specifically held that as a result of Wetmore's "breach of duty," Warren & Wetmore was liable to account to the joint venture for the usurped opportunity. We recited that the railroad contract was intended to survive Reed's death [3] and, from that, concluded that the surviving members of the joint venture had a duty to complete the contract for the joint venture's benefit. *Stem* does not hold that the joint venture "owned" the railroad contract to the exclusion of others; rather, we decided that Stem's former joint venturers (Warren & Wetmore) did not have the right to exclude him from the contract. Certainly, if the railroad had terminated its contract with the joint venture and hired a new, unrelated firm, nothing in *****543** ****273** *Stem* suggests that Stem could have pursued the new firm to recover a percentage of its profits.

3 By contrast, contracts between a law firm and a client cannot contemplate survival of the law firm's dissolution without impermissibly infringing the client's right to terminate an attorney at will (*see Demov, Morris, Levin & Shein v. Glantz,* 53 N.Y.2d 553, 556, 444 N.Y.S.2d 55, 428 N.E.2d 387 [1981]).

Public Policy Considerations

Treating a dissolved firm's pending hourly fee matters as partnership property, as the trustees urge, would have numerous perverse effects, and conflicts with basic principles that govern the attorney-client relationship under New York law and the Rules of Professional Conduct. By allowing former partners of a dissolved firm to profit from work they do not perform, all at the expense of a former partner and his new firm, the trustees' approach creates an "unjust ***32** windfall," as remarked upon by the District Court Judge in *Geron,* 476 B.R. at 740.

Next, because the trustees disclaim any basis for recovery of profits from the pending client matters of a former partner who leaves a troubled law firm *before* dissolution, their approach would encourage partners to get out the door, with clients in tow, before it is too late, rather than remain and work to bolster the firm's prospects. Obviously, this run-on-the-bank mentality makes the turnaround of a struggling firm less likely.

******8** And attorneys who wait too long are placed in a very difficult position. They might advise their clients that they can no longer afford to represent them, a major inconvenience for the clients and a practical restriction on a client's right to choose counsel. Or, more likely, these attorneys would simply find it difficult to secure a position in a new law firm because any profits from their work for existing clients would be due their old law firms, not their new employers.

The trustees answer that clients do not care whether they pay one law firm or another, so long as their legal affairs are handled properly, and that requiring law firms to forfeit the fees earned by their lawyers' efforts has no impact on attorneys or clients. We disagree for the reasons already mentioned. Additionally, clients might worry that their hourly fee matters are not getting as much attention as they deserve if the law firm is prevented from profiting from its work on them. The notion that law firms will hire departing partners or accept client engagements without the promise of compensation ignores commonsense and marketplace realities. Followed to its logical conclusion, the trustees' approach would cause clients, lawyers and law firms to suffer, all without producing the sought-after financial rewards for the estates of bankrupt firms.

[10] Ultimately, what the trustees ask us to endorse conflicts with New York's strong public policy encouraging client choice and, concomitantly, attorney mobility. In *Cohen v. Lord, Day & Lord,* 75 N.Y.2d 95, 96, 551 N.Y.S.2d 157, 550 N.E.2d 410 (1989), the partnership agreement provided that a departing partner forfeited his right to departure compensation if he practiced law in competition with his former firm. The lower court held that the provision was a "valid ... financial disincentive to competition and did not prevent plaintiff from practicing law in New York or in any other jurisdiction" (*id.* at 97, 551 N.Y.S.2d 157, 550 N.E.2d 410 [internal quotation marks omitted]).

We reversed, holding that these financial penalties impermissibly interfered with clients' choice of counsel—i.e., "[t]he ***33** forfeiture-for-competition provision would functionally and realistically discourage and foreclose a withdrawing partner from serving clients who might wish to continue to be represented by the withdrawing lawyer and would thus interfere with the client's choice of counsel" (*id.* at 98, 551 N.Y.S.2d 157, 550 N.E.2d 410). In ****274** *****544** this regard, we quoted approvingly from an opinion of the New York County Lawyers' Association issued in 1943, which stressed that

> "[c]lients are not merchandise. Lawyers are not tradesmen. They have nothing to sell but personal service. An attempt, therefore, to barter in clients, would appear to be inconsistent with the best concepts of our professional status" (*id.* at 98, 551 N.Y.S.2d 157, 550 N.E.2d 410; *see also Denburg v. Parker Chapin Flattau & Klimpl,* 82 N.Y.2d 375, 381, 604 N.Y.S.2d 900, 624 N.E.2d 995 [1993] [finding unacceptable a provision in a partnership agreement that "improperly deter(red) competition and thus impinge(d) upon clients' choice of counsel" by creating an incentive for a partner changing firms to discourage a Parker Chapin client from coming along]).

******9** Finally, the trustees seek to entice us to hold in their favor on the ground that a law firm may always avoid the unfinished business doctrine by placing a well-crafted *Jewel* waiver in the partnership agreement. This suggestion fails to consider the possibility that classifying clients' pending hourly fee matters as firm property may lead to untoward unintended consequences. For example, the trustees, as noted before, limit their sought-after recoveries to client matters that remain unresolved as of the date of a law firm's dissolution. As Seyfarth pointed out, though, if a client's pending matter is partnership property, why doesn't every lawyer whose clients follow him to a new firm breach fiduciary duties owed his former law firm and partners? In the end, the trustees' theory simply does not comport with our profession's traditions and the commercial realities of the practice of law today, a deficiency beyond the capacity of a *Jewel* waiver to cure.

Accordingly, the first certified question should be answered in the negative, and the second certified question should not be answered as it is unnecessary to do so.

Chief Judge LIPPMAN and Judges GRAFFEO, SMITH, PIGOTT, RIVERA and ABDUS–SALAAM concur.

***34** In Each Case: Following certification of questions by the United States Court of Appeals for the Second Circuit and acceptance of the questions by this Court pursuant to section 500.27 of this Court's Rules of Practice, and after hearing argument by counsel for the parties and consideration of the briefs and the record submitted, first question answered in the negative and second question not answered as unnecessary.

Parallel Citations

24 N.Y.3d 16, 20 N.E.3d 264, 995 N.Y.S.2d 534, 2014 WL 2931526 (N.Y.), 2014 N.Y. Slip Op. 04879

End of Document

477 B.R. 318
United States District Court,
S.D. New York.

DEVELOPMENT SPECIALISTS, INC.,
in its capacity as Plan Administrator
for Coudert Brothers LLP, Plaintiff,
v.
AKIN GUMP STRAUSS HAUER
& FELD LLP, Defendant.
Development Specialists, Inc., in its capacity as Plan Administrator for Coudert Brothers LLP, Plaintiff,
v.
Arent Fox LLP, Defendant.
Development Specialists, Inc., in its capacity as Plan Administrator for Coudert Brothers LLP, Plaintiff,
v.
Dorsey & Whitney LLP, Defendant.
Development Specialists, Inc., in its capacity as Plan Administrator for Coudert Brothers LLP, Plaintiff,
v.
Duane Morris LLP, Defendant.
Development Specialists, Inc., in its capacity as Plan Administrator for Coudert Brothers LLP, Plaintiff,
v.
Jones Day, Defendant.
Development Specialists, Inc., in its capacity as Plan Administrator for Coudert Brothers LLP, Plaintiff,
v.
Jones Day and Scott Jones, Defendants.
Development Specialists, Inc., in its capacity as Plan Administrator for Coudert Brothers LLP, Plaintiff,
v.
Jones Day and Geoffrey De Foestraets, Defendants.
Development Specialists, Inc., in its capacity as Plan Administrator for Coudert Brothers LLP, Plaintiff,
v.
Jones Day and Jingzhou Tao, Defendants.
Development Specialists, Inc., in its capacity as Plan Administrator for Coudert Brothers LLP, Plaintiff,
v.
K & L Gates LLP, Defendant.
Development Specialists, Inc., in its capacity as Plan Administrator for Coudert Brothers LLP, Plaintiff,
v.
Morrison & Foerster LLP, Defendant.
Development Specialists, Inc., in its capacity as Plan Administrator for Coudert Brothers LLP, Plaintiff,
v.
Sheppard Mullin Richter &
Hampton LLP, Defendant.
Development Specialists, Inc., in its capacity as Plan Administrator for Coudert Brothers LLP, Plaintiff,
v.
DLA Piper (US) LLP, Defendant.
Development Specialists, Inc., in its capacity as Plan Administrator for Coudert Brothers LLP, Plaintiff,
v.
Dechert LLP, Defendant.

Nos. 11 civ. 5994 (CM), 11 civ. 5973 (CM), 11 civ. 5995 (CM), 11 civ. 5969 (CM), 11 civ. 5974 (CM), 11 civ. 5972 (CM), 11 civ. 5968 (CM), 11 civ. 5970 (CM), 11 civ. 5993 (CM), 11 civ. 5985 (CM), 11 civ. 5971 (CM), 11 civ. 5983 (CM), 11 civ. 5984 (CM). | May 24, 2012.

Synopsis

Background: Administrator for Chapter 11 estate of debtor-former law partnership brought action against 10 firms to recover profits that debtor's former partners earned while completing debtor's client matters that were pending but uncompleted on date of debtor's dissolution, asserting claims for accounting, turnover, unjust enrichment, and conversion. Following withdrawal of the reference, 462 B.R. 457, law firms moved for summary judgment, and administrator cross-moved for declaration that unfinished client matters were debtor's property on date of its dissolution.

Holdings: The District Court, McMahon, J., held that:

[1] under New York law, as predicted by court, all client matters pending on the date of dissolution are assets of law partnership, regardless of how partnership was to be compensated for the work;

[2] client matters that remained unfinished as of debtor's dissolution were partnership property for which former partners who brought them to conclusion had duty to account; and

[3] factual issues precluded summary judgment for firms on claims for accounting.

Motions granted in part and denied in part.

West Headnotes (19)

[1] **Partnership**
Continuance of Partnership for Purposes of Winding Up

Under New York law, partnership's dissolution is not termination, and, instead, the partnership "continues" in existence until the winding up of its affairs is completed.

Cases that cite this headnote

[2] **Partnership**
As to fiduciary relation of partners

Partnership
Continuance of Partnership for Purposes of Winding Up

Under New York law, following partnership's dissolution, former partners generally do not owe fiduciary duties either to one another or to the dissolved firm, although they have a continuing duty to each other as they wind up the partnership's affairs, including winding up the partnership's unfinished business. N.Y.McKinney's Partnership Law § 43(1).

Cases that cite this headnote

[3] **Partnership**
Continuance of Partnership for Purposes of Winding Up

Under New York law, continuing duty owed to one another by former partners of dissolved partnership as they wind up partnership's affairs, including winding up partnership's unfinished business, devolves on all partners at the moment of dissolution, whether they remain behind to wind up partnership's business or leave partnership and wind up the business elsewhere. N.Y.McKinney's Partnership Law § 43(1).

Cases that cite this headnote

[4] **Partnership**
Control and disposition of partnership property

Under New York law, if a former partner of a dissolved partnership makes use of a partnership asset, or partnership property, she has a fiduciary duty to account to her former partners for any benefit that she derives from it, and this includes the business of the partnership. N.Y.McKinney's Partnership Law § 43(1).

Cases that cite this headnote

[5] **Attorney and Client**
Dissolution, Settlement, and Accounting

Rule that, after dissolution, each former partner of law partnership is free to practice law individually, and has the right to accept retainers from persons who had been clients of the firm, must be qualified to recognize a former partner's duty to account for his use of partnership property after dissolution.

Cases that cite this headnote

[6] **Partnership**
Control and disposition of partnership property

Partnership property remains partnership property, dissolution notwithstanding, under New York law, and a former partner of the dissolved firm must account for any benefit he derives from his use of a partnership asset, even if he is not among the winding up partners charged with winding up the firm's affairs.

Cases that cite this headnote

[7] **Attorney and Client**
Dissolution, Settlement, and Accounting

Under New York law, as predicted by federal district court, all client matters pending on the date of dissolution are assets of law partnership, regardless of how partnership was to be compensated for the work. N.Y.McKinney's Partnership Law § 43.

Cases that cite this headnote

[8] **Partnership**
Engaging in Other Business

It is a general principle of partnership law that partners are expected to devote their efforts to the partnership business, not to individual endeavors.

Cases that cite this headnote

[9] **Attorney and Client**
Property of firm

Under New York law, all executory contracts for the provision of client services by a law partnership are presumed to belong to the partnership, rather than individual partners.

Cases that cite this headnote

[10] **Partnership**
Status of partnership after dissolution in general

Under New York law, the general rule, known as the "unfinished business doctrine," is that the business of a partnership that is unfinished on the date that the partnership dissolves is an asset of the partnership, and must be concluded for the benefit of the dissolved partnership.

3 Cases that cite this headnote

[11] **Attorney and Client**
Client fees

Under New York law, new business that is contracted for and undertaken only after a law partnership dissolves, even business from a client of the dissolved firm, is not an asset of the dissolved firm, since a partnership has no more than an expectation of obtaining future business from a client, and therefore the partner who conducts the business and collects the resulting fee owes no duty to his former partners to account for any profit he may earn.

1 Cases that cite this headnote

[12] **Attorney and Client**
Property of firm

Partnership
Contracting new obligations in general

Under New York law, even an executory contract that is terminable at will by the client can be a partnership asset, notwithstanding the uncertainty that it will ever be fully performed.

Cases that cite this headnote

[13] **Partnership**
Performance of contracts of partnership

Fact that, under New York law, an executory contract, terminable at will, can be a partnership asset does not mean that every executory contract necessarily must be such an asset, and if the parties indicate a contrary intent, that will control.

Cases that cite this headnote

[14] **Attorney and Client**
Alteration in membership or business

To the extent that restrictive covenants keep lawyers from representing particular clients, they are inconsistent with unfettered client choice, and so are void as violative of New York public policy, and this is so whether the restrictive covenant takes the form of an outright ban on practice or simply creates a financial disincentive for the lawyer to continue representing his clients of his former firm.

Cases that cite this headnote

[15] **Attorney and Client**
Client fees

Under New York law, as predicted by federal district court, when law partnership dissolves, both ongoing hourly billed cases and ongoing contingency fee cases are "unfinished business" assets of partnership subject to distribution, unless a contrary intention appears in partnership agreement. N.Y.McKinney's Partnership Law § 43.

Cases that cite this headnote

[16] **Attorney and Client**
Dissolution, Settlement, and Accounting

Under New York law, provision of law partnership's partnership agreement indicating that equity partners at time of partnership's dissolution were entitled to receive designated payments from partnership as though they had withdrawn involuntarily on day preceding dissolution did not waive partnership's right to participate in profits that former partners earned post-dissolution on client matters that remained unfinished as of dissolution, or operate to settle all accounts between partnership and former partners, but instead simply described amount of money which former partners who remained partners on dissolution date were entitled to collect from partnership, or its estate, in dissolution process, overriding state statute setting default rule for settling accounts with partners who withdrew after dissolution. N.Y.McKinney's Partnership Law § 73.

1 Cases that cite this headnote

[17] **Attorney and Client**
Dissolution, Settlement, and Accounting

Partnership agreement of dissolved law partnership did not provide for client matters that were billed on hourly basis to be treated other than as partnership assets, and instead specifically stated that all property of partnership belonged to partnership, rather than its individual partners, and therefore, under New York law, client matters that remained unfinished as of partnership's dissolution were partnership property and former partners who brought them to conclusion had duty to account for profits earned in doing so. N.Y.McKinney's Partnership Law § 43.

2 Cases that cite this headnote

[18] **Bankruptcy**
Judgment or Order

Material issues of fact existed as to value of pending client matters of Chapter 11 debtor-law partnership on date of debtor's dissolution, amount of post-dissolution profits attributable to former partners' "use" of client matters for which former partners had duty to account under New York law, and amount of post-dissolution profits that could be attributed to former partners' post-dissolution efforts, skills, and diligence in completing client matters that had to be deducted from profits, precluding summary judgment for law firms, at which debtor's former partners completed debtor's client matters, on claims for accounting by administrator for Chapter 11 estate. N.Y.McKinney's Partnership Law § 43.

1 Cases that cite this headnote

[19] **Attorney and Client**
Dissolution, Settlement, and Accounting

Law firms joined by former partners for dissolved debtor-law partnership were jointly liable with former partners for an accounting with respect to former partners' completion of debtor's client matters and fees earned thereon, making it unnecessary to join former partners individually in action commenced by administrator for Chapter 11 estate to recover profits earned by firms while completing debtor's client matters. Fed.Rules Civ.Proc.Rule 19, 28 U.S.C.A.

2 Cases that cite this headnote

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DECISION AND ORDER DENYING GRANTING IN PART AND DENYING IN PART DEFENDANTS' MOTIONS FOR SUMMARY JUDGMENT, AND GRANTING PLAINTIFF'S CROSS–MOTION FOR A DECLARATION

McMAHON, District Judge.

I. INTRODUCTION

Plaintiff Development Specialists Inc. ("DSI"), in its role as administrator of the bankruptcy estate of the dissolved law firm Coudert Brothers LLP ("Coudert") brought this suit against ten law firms—Defendants Akin Gump Strauss Hauer & Feld LLP, Arent Fox LLP, Dorsey & Whitney LLP, Duane Morris LLP, Jones Day, K & L Gates LLP, Morrison & Foerster LLP, Sheppard Mullin Richter & Hampton LLP, DLA Piper (US) LLP, and Dechert LLP (the "Firms" herein) —to recover from the Firms profits that former Coudert partners earned while completing client matters of Coudert that were pending but uncompleted on the date of its dissolution.

Presently before the Court are the Firms' motions for summary judgment dismissing the complaint, and DSI's cross-motion for a declaration that the unfinished client matters were Coudert's property on the day it dissolved. For the reasons discussed below, the Firms' motions are granted in part and denied in part, and DSI's cross-motion is granted.

II. BACKGROUND

The following facts are undisputed, unless otherwise noted.

323** ***A. Facts

Coudert is a law partnership first organized in 1853. (*See e.g.,* DSI's 56.1 (Jones Day) ¶ 1; Jones Day's Resp. 56.1 ¶ 1.) Although it is presently dissolved, it maintains a legal existence, because it is not yet "terminated." *See infra.*

At all times relevant to this case, Coudert operated under a written partnership agreement, last amended December 30, 2004 (the "Coudert Partnership Agreement"). (*See, e.g.,* DSI's 56.1 (Jones Day) ¶ 2 (citing Keefe Decl. ¶ 7, Ex. A (Coudert Partnership Agreement, or CPA in citations); Jones Day's Resp. 56.1 ¶ 2.)) It includes several provisions relevant to these motions, which are addressed further below.

In accordance with the terms of Article 10 of the Coudert Partnership Agreement, Coudert dissolved on August 16, 2005 (the "Dissolution Date"). (DSI's 56.1 (Jones Day) ¶¶ 8–9; Jones Day's Resp. 56.1 ¶¶ 8–9.) On the Dissolution Date, the equity partners adopted a "Special Authorization," which provides, as relevant, the following:

> The Equity Partners ... hereby authorize the Executive Board ... to take such actions as it may deem necessary and appropriate, including, without limitation, the granting of waivers, notwithstanding any provisions to the contrary in the Partnership Agreement ..., in order to:
>
> a..... sell all or substantially all of the assets of ... the Firm to other firms or service providers, in order to maximize the value of the Firm's assets and business;
>
> b. wind down the business of the Firm with a view to continuing the provision of legal services to clients and the orderly transition of client matters to other firms or service providers, in order to maximize the value of the Firm's assets and business to the extent possible ....

(Keefe Decl., Ex. A, at 76.)

Some of Coudert partners who were with the Firm on the Dissolution Date were subsequently hired by the Defendant Firms. (*See, e.g.,* Akin Gump 56.1 ¶ 3; Sheppard Mullin 56.1 ¶ 4; Arent Fox 56.1 ¶ 3; DLA Piper ¶ 3; Morrison & Foerster 56.1 ¶ 3; Dechert 56.1 ¶ 3; Dorsey & Whitney ¶ 3; K & L Gates 56.1 ¶ 4; Duane Morris 56.1 ¶ 3.) They are referred to herein as the "Former Coudert Partners." [1]

1 DSI appears to disclaim any "unfinished business" recovery based on the actions of partners who left Coudert prior to the Dissolution Date. (*See, e.g.,* DSI's 56.1 Resp. (Duane Morris) ¶ 3; DSI's 56.1 Resp. (Jones Day) ¶ 8; DSI's Opp. Br. at 19 n. 14.)

On the Dissolution Date, there remained, between Coudert and its clients, partly performed contracts for the provision of legal services. These matters were part of the "business of the Firm" that the Executive Board was authorized to "wind down." When the Former Coudert Partners joined the Firms, the Firms were retained by Coudert's (former) clients to conclude some of the legal matters left unfinished by Coudert on the Dissolution Date. (*See, e.g.,* Sheppard Mullin 56.1 ¶ 5; Arent Fox 56.1 ¶ 4; DLA Piper 56.1 ¶ 4; Morrison & Foerster 56.1 ¶ 4; Dechert 56.1 ¶ 4; Dorsey & Whitney 56.1 ¶ 3; K & L Gates 56.1 ¶ 5; Duane Morris 56.1 ¶ 4; Jones Day 56.1 ¶ 4.) These are referred to herein as the "Client Matters." [2]

2 Defendant Akin Gump submits an affidavit attesting that it was retained by former Coudert clients only on "new" legal matters, wholly unrelated to the Client Matters, i.e., those on which Coudert was retained before the Dissolution Date. (*See* Akin Gump 56.1 ¶ 4; *cf.* Jones Day 56.1 ¶ 8.) If this fact were established, Akin Gump would be entitled to judgment as a matter of law. However, this is a pre-discovery motion for summary judgment on a discrete legal issue and DSI has taken no discovery. It should be allowed to do so before I dismiss the claim against Akin Gump's on this particular ground.

***324** The Firms completed the Client Matters. The Firms submitted testimony that they billed all of the Client Matters (with two exceptions) on an hourly basis. (*See, e.g.,* Akin Gump 56.1 ¶ 5; Sheppard Mullin 56.1 ¶¶ 6–7; Arent Fox 56.1 ¶ 5; DLA Piper 56.1 ¶ 5–6; Morrison & Foerster 56.1 ¶ 5; Dechert 56.1 ¶¶ 5–6; Dorsey & Whitney 56.1 ¶¶ 4–5; K & L Gates ¶ 5; Duane Morris 56.1 ¶¶ 5–6; Jones Day 56.1 ¶ 5; *but see* DLA Piper 56.1 ¶ 7 (acknowledging "incentive fee" matter); Jones Day 56.1 ¶ 7 (acknowledging "flat fee" matter).) The Court assumes, for purposes of this motion, that this is true. The complaint does not reveal whether Coudert billed the Client Matters on an hourly basis, though I would be surprised to learn otherwise.

The record does not reveal the extent of any profits gained (or losses sustained) by the Firms while completing the Client Matters.

B. Prior proceedings

Coudert filed for Chapter 11 bankruptcy in this District in September 2006. *See In re Coudert Bros. LLP (Retired Partners),* 2011 WL 5593147, at *1 (S.D.N.Y. Sept. 23, 2011). On August 27, 2008, the Bankruptcy Court entered an order confirming the First Amended Liquidation Plan. (*See* Adler Decl. Ex. 1.) That plan became effective on September 8, 2008, and DSI was appointed as Plan Administrator of the Coudert bankruptcy estate. In that role, DSI is empowered to act on behalf of the Coudert bankruptcy estate.

The procedural path from the interposition of DSI's claims in this matter as adversary proceedings in the Bankruptcy Court to the decision on this motion is convoluted. For additional background, see this Court's prior orders in these (and related) matters. *See Development Specialists, Inc. v. Orrick, Herrington & Sutcliffe, LLP,* 2011 WL 6780600 (S.D.N.Y. Dec. 23, 2011); *Development Specialists, Inc. v. Akin Gump Strauss Hauer & Feld LLP,* 462 B.R. 457 (S.D.N.Y.2011) ("*DSI v. Firms*" herein). Insofar as is relevant here, DSI brought thirteen separate adversary proceedings against the Firms, premised on the "unfinished business doctrine;" it argued that the Firms are liable to Coudert for any profits derived from completing the Client Matters that the Former Coudert Partners brought to the Firms. The complaints lodged claims under New York law and Federal bankruptcy law for an accounting, turnover, unjust enrichment, and conversion. (Huene Decl., Exs. A–M); *see generally DSI v. Firms,* 462 B.R. at 460–62.

The Firms moved to dismiss the complaints, arguing primarily that the unfinished business doctrine on which DSI relied did not apply to the Client Matters, because they were billed by the hour rather than taken on contingency. An all day hearing was held on the motions on July 31, 2009. On August 7, 2009 the Bankruptcy Court (Drain, J.) denied the motions to dismiss in a bench ruling.

Judge Drain acknowledged that the application of the unfinished business doctrine to non-contingency cases had not been addressed by the New York Court of Appeals. Given a lack of clarity regarding the doctrine generally, Judge Drain observed, "If I had the power, this would be a case for certification to the New York Court of Appeals; however, the New York Constitution precludes that course except for requests by the Second Circuit."

***325** Nevertheless, relying on authority from other jurisdictions—which, like New York, base their partnership law on the Uniform Partnership Act ("UPA")—Judge Drain concluded that New York's highest court, if faced with the issue, would conclude that the unfinished business rule applies both to contingency fee matters and to non-contingency (billable hours) matters. He rejected the Firms' argument that the unfinished business doctrine is essentially a form of quantum meruit. Rather, Judge Drain found that liability for profits realized from unfinished business follows from a partner's continuing duties to her former firm. (*See generally* Adler Decl. Ex. 5.)

In late 2009 and early 2010, the Firms filed answers to DSI's complaints.

An amended bench ruling superseded the original decision in January 2010. After it was entered, the Firms moved for direct certification of the issue to the Second Circuit Court of Appeals under 28 U.S.C. § 158(d)(2), on the basis that New York law on the issues raised was unsettled. Judge Drain denied the motion, and the Honorable Victor Marrero, of this Court, subsequently denied the Firms' motion for leave to appeal Judge's Drain's non-final order denying the motion to dismiss the complaints, concluding that, "Although the application of the unfinished business doctrine to hourly fee matters is a matter of first impression in New York, that alone does not mean that the question is a 'difficult' one." *See generally In re Coudert Bros. LLP Law Firm Adversary Proceedings,* 447 B.R. 706 (S.D.N.Y.2011).

In the wake of the United States Supreme Court's decision in *Stern v. Marshall,* — U.S. ——, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011), the Firms moved to withdraw the reference to the Bankruptcy Court. I granted that motion last September, because Judge Drain will not be able to make a final ruling in this case, and little discovery had been taken. *See generally DSI v. Firms,* 462 B.R. at 457.

The parties have subsequently filed the cross-motions for summary judgment on the discrete issue of whether the unfinished business rule applies to the Client Matters that are the subject of DSI's complaints.

III. DISCUSSION

A. Summary judgment standard

A party is entitled to summary judgment when there is no "genuine issue of material fact" and the undisputed facts warrant judgment for the moving party as a matter of law. Fed.R.Civ.P. 56; *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). On a motion for summary judgment, the court must view the record in the light most favorable to the nonmoving party and draw all reasonable inferences in its favor. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,* 475 U.S. 574, 587, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986). Whether any disputed issue of fact exists is for the Court to determine. *Balderman v. U.S. Veterans Admin.,* 870 F.2d 57, 60 (2d Cir.1989). The moving party has the initial burden of demonstrating the absence of a disputed issue of material fact. *Celotex v. Catrett,* 477 U.S. 317, 323, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986).

Once the motion for summary judgment is properly made, the burden shifts to the non-moving party, to "set forth specific facts showing that there is a genuine issue for trial." *Anderson,* 477 U.S. at 250, 106 S.Ct. 2505. The nonmovant "may not rely on conclusory allegations or unsubstantiated speculation," *Scotto v. Almenas,* 143 F.3d 105, 114 (2d Cir.1998), but must support the existence of an alleged dispute with specific citation to the record materials, Fed.R.Civ.P. 56(c).

***326** While the Court must view the record "in the light most favorable to the non-moving party," *Leberman v. John Blair & Co.,* 880 F.2d 1555, 1559 (2d Cir.1989) (citations omitted), and "resolve all ambiguities and draw all reasonable inferences in favor of the party against whom summary judgment is sought," *Heyman v. Commerce and Indus. Ins. Co.,* 524 F.2d 1317, 1320 (2d Cir.1975) (citations omitted), the non-moving party nevertheless "must do more than simply show that there is some metaphysical doubt as to the material facts." *Matsushita Elec.,* 475 U.S. at 586, 106 S.Ct. 1348 (citations omitted).

Finally, not every disputed factual issue is material in light of the substantive law that governs the case. "Only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment." *Anderson,* 477 U.S. at 248, 106 S.Ct. 2505.

B. Syllabus

The cross-motions raise two separate issues

Issue 1 : Were the pending but incomplete Client Matters among Coudert's "assets" on the Dissolution Date? If they were, then the Former Coudert Partners have a duty to account to Coudert for any post-dissolution profits attributable to the use of those assets. The Firms move for summary judgment, arguing that Coudert had no property interest in the Client Matters on and after the Dissolution Date, because the clients were billed by the hour and the payment to firm was not subject to any contingency. DSI cross-moves for a declaration that the Client Matters were Coudert assets because they were "unfinished business" of the firm on the Dissolution Date.

Answer : Although the New York Court of Appeals has not addressed this precise issue, I believe that it would conclude that the method by which the Client Matters were billed does not alter the nature of Coudert's property interest in them. Under the Partnership Law, the Client Matters are presumed to be Coudert's assets on the Dissolution Date. While the Coudert Partnership Agreement could have provided otherwise, it does not; on the contrary, it confirms the statutory presumption, as does the text of the Special Authorization adopted by the partners who voted to dissolve the firm. In the absence of any evidence that Coudert's partners intended to exclude pending but uncompleted client representations from the firm's assets, DSI is entitled to a declaration that the Client Matters were Coudert assets on the Dissolution Date. Because they are Coudert assets, the Former Coudert Partners are obligated to account for any profits they earned while winding the Client Matters up at the Firms.

Issue 2 : Assuming the Client Matters were Coudert assets on the Dissolution Date, are the Firms nevertheless entitled to summary judgment because the Client Matters had no value as a matter of law? The Firms' fall-back argument for summary judgment is that Coudert's interest in the Client Matters is limited to the value of its pre-dissolution services. These actions should be dismissed, they contend, because, as a matter of law, the value of the post-dissolution "efforts, skill and diligence" of the Former Coudert Partners equals the fees paid for legal services performed at the new Firms. Thus, the extent of the Former Partners' duty to account for their post-dissolution effort in finishing the matters is zero, and the Estate's only interest lies in collecting receivables for work on the Client Matters performed at Coudert prior to dissolution.

Answer : It cannot be said as a matter of law or of undisputed fact that the Client ***327** Matters did not generate any profit that will have to be remitted to Coudert's bankruptcy estate. The issue needs to be tried.

Result : DSI's cross-motion is granted and the Firms' motions are denied. However, the Firms are entitled to summary judgment dismissing DSI's claims for turnover, unjust enrichment and conversion. The rights and duties of the parties will be finally settled in an accounting-the traditional remedy for resolving monetary disputes among former partners.

IV. GENERAL PRINCIPLES OF NEW YORK PARTNERSHIP LAW

The law of partnerships in New York is codified in the New York Partnership Law, itself a codification the Uniform Partnership Act ("UPA"), see McKinney's New York Partnership Law ("Partnership Law") § 1 (1919), and reflected in judicial decisions before and after its enactment.

"The Partnership Law's provisions are, for the most part, default requirements that come into play in the absence of an agreement." *Ederer v. Gursky,* 9 N.Y.3d 514, 526, 851 N.Y.S.2d 108, 881 N.E.2d 204 (2007). Significantly for our case, the Coudert Partnership Agreement expressly incorporates the Partnership Law's default rules. (CPA Art. 10(a).)

"A partnership is an association of two or more persons to carry on as co-owners a business for profit ..." Partnership Law § 10(1). Joint ownership of the business and sharing and the profits and losses of the business are the key indicia of a partnership. *Id.* § 11. Jointly owned "partnership property" includes "All property originally brought into the partnership stock or subsequently acquired, by purchase or otherwise," and, "Unless the contrary intention appears, property acquired with partnership funds." *Id.* § 12. Partners are presumed to devote all of their efforts to the partnership business, and are entitled to no compensation for doing so beyond their proportional interest in the profits the business generates. *Id.* § 40(6). Partners owe one another, and the partnership, fiduciary duties, including the duty to account for any benefit a partner derives from his use of partnership property. *Id.* § 43.

Under the Partnership Law, a partnership can dissolve for several different reasons. Among them is an agreement by the partners to dissolve, the death of a partner, or the decision of a partner to withdraw. *See* Partnership Law § 62; *see also Vollgraff v. Block,* 117 Misc.2d 489, 492, 458 N.Y.S.2d 437 (Sup.Ct.1982) (citing *Matter of Silverberg (Schwartz),* 81 A.D.2d 640, 438 N.Y.S.2d 143 (2d Dep't 1981)).

[1] However, "Dissolution is not termination." *Scholastic, Inc. v. Harris,* 259 F.3d 73, 85 (2d Cir.2001) (citing

Partnership Law §§ 60, 61). Instead the partnership "continues" in existence until the "winding up" of its affairs is completed. This case concerns the duties of the partners to each other while the firm is in this liminal state.

[2] Post-dissolution, former partners generally do not owe fiduciary duties either to one another or to the dissolved firm. But there is an important exception: they have a continuing duty to each other as they wind up the partnership's affairs, including winding up the partnership's unfinished business. *See, e.g., Ajettix Inc. v. Raub,* 9 Misc.3d 908, 912, 804 N.Y.S.2d 580 (Sup.Ct.2005) ("[O]n dissolution, partners owe a continuing fiduciary duty to one another with respect to dealings effecting the winding up of the partnership *and the preservation of the partnership assets.*") (emphasis added); *see also King v. Leighton,* 100 N.Y. 386, 3 N.E. 594 (1885).

***328 [3] [4]** This duty devolves on *all* partners at the moment of dissolution, whether they remain behind to wind up the firm's business (as Coudert's Executive Board did), or leave their former firm and wind up the business elsewhere. *Compare Stem v. Warren,* 227 N.Y. 538, 125 N.E. 811 (1920) (post-dissolution liability of winding up partner), *with Rhein v. Peeso,* 194 A.D. 274, 185 N.Y.S. 150 (1st Dep't 1920) (post-dissolution liability of departing partner); *see also Shandell v. Katz,* 217 A.D.2d 472, 629 N.Y.S.2d 437 (1st Dep't 1995) (departing law partner); *Murov v. Ades,* 12 A.D.3d 654, 786 N.Y.S.2d 79 (2d Dep't 2004) (same). In either case, if a former partner makes use of a "partnership asset," or "partnership property," she has a fiduciary duty to account to her former partners for any benefit that she derives from it. That includes the business of the partnership. As the Supreme Court put it in *Denver v. Roane,* 99 U.S. 355, 358, 25 L.Ed. 476 (1878):

> Having jointly undertaken the business intrusted to the partnership, *all the parties* were under obligation to conduct it *to the end.* This duty they owed to the clients and to each other. *And as to the unfinished business remaining with the firm on [the date of dissolution], the duty continued.* (emphases added).

This duty is codified in section 43 Partnership Law, which says that, "Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property." Partnership Law § 43(1).

Partnership Law § 73 is part of the Article of the Partnership Law that deals with dissolution. It provides that, if the winding up partners do not immediately settle accounts with a partner who dies or withdraws from the partnership upon dissolution, they have a duty to account for the departing partner's percentage interest in the partnership property as of the date of dissolution. Moreover, the departing partner, or his estate, is entitled either to interest on the amount of his share of the partnership property, running from the date of dissolution, or, "in lieu of interest, the profits attributable to the use [by the winding up partner] of [the departing partner's] right in the property of the dissolved partnership...." *Id.* § 73; *see also Kirsch,* 181 A.D.2d at 225, 586 N.Y.S.2d 330.

The Appellate Division First Department has said that Partnership Law § 73 is determinative of the "departing" partner's duty to his dissolved firm. *See Shandell,* 217 A.D.2d at 473, 629 N.Y.S.2d 437. However, that is not really correct. "It is to be observed that [New York at Partnership Law § 73] is substantially an enactment of the common law rule governing *the rights of retiring partners or representatives of deceased partners* where the business is continued after the retirement or death of a partner." 2 A.L.R.2d 1084, *Construction and application of § 42 of Uniform Partnership Act as to rights of parties where business is continued after a partner retires or dies,* § 1 (emphasis added).[3] Thus, the Second Circuit has recognized that, "Section 73 is *not* the source of the duty of a lawyer to account to his former partners." (Emphasis added). Rather, "The source of the duty is the fiduciary relationship of trust and confidence that partners have from time immemorial shared with one another." *Santalucia,* 232 F.3d at 300. That duty is the same whether it runs from the winding up ***329** partners to the departing partner, or the departing partner to the winding up partner. Partnership Law § 73 remains relevant only as a means to measure of what is owed to a former partner on dissolution, and even then can be trumped by a partnership agreement—as it is in the case of Coudert. *See infra.*

3 Partnership Law § 73 is New York's enactment of § 42 of the UPA.

[5] [6] So the oft-stated rule that, "After dissolution, each former partner is free to practice law individually, and has the right to accept retainers from persons who had been clients of the firm," *Silverberg,* 81 A.D.2d at 641, 438 N.Y.S.2d 143 (citing *Talley v. Lamb,* 100 N.Y.S.2d 112 (Sup.Ct. New York County 1950)) must be qualified to recognize a former partner's duty to account for his use of partnership property after dissolution. This qualification is so implicit in the nature of a partnership that it should go without saying. A departing partner is not free to walk out of his firm's office carrying a Jackson Pollack painting he ripped off the wall of the reception area, simply because the firm has dissolved. Partnership property remains partnership property, dissolution notwithstanding, and a former partner of the dissolved firm must account for any benefit he derives from his use of a partnership asset, even if he is not among the "winding up partners" charged with winding up the firm's affairs.

The duty to account under the unfinished business doctrine is *not* based on principles of quantum meruit—the dissolved firm's equitable claim for compensation for the value of work actually performed prior to dissolution. With the exception of *Aurnou v. Greenspan,* 161 A.D.2d 438, 555 N.Y.S.2d 356 (1st Dep't 1990)—which was subsequently repudiated by the very court that decided it—the New York courts have uniformly rejected quantum meruit as the analytical basis for the duty to account for profits yielded by business unfinished when a law firm dissolves. *Kirsch,* 181 A.D.2d at 225–26, 586 N.Y.S.2d 330 (rejecting *Aurnou*); *Dwyer v. Nicholson,* 193 A.D.2d 70, 73, 602 N.Y.S.2d 144 (2d Dep't 1993) (same); *Shandell,* 217 A.D.2d at 473, 629 N.Y.S.2d 437 (same); *see also DelCasino v. Koeppel,* 207 A.D.2d 374, 615 N.Y.S.2d 454 (2d Dep't 1994); *Grant v. Heit,* 263 A.D.2d 388, 693 N.Y.S.2d 564 (1st Dep't 1999). The Second Circuit, whose decisions bind this Court, also rejected the quantum meruit argument; in *Santalucia,* the court reversed a District Court's reliance on a quantum meruit measure in a case involving a departed attorney's duty to account to his former firm. *Santalucia,* 232 F.3d at 297–98.

Moreover, the quantum meruit rationale has been almost universally rejected in other UPA jurisdictions. *See, e.g., Jewel v. Boxer,* 156 Cal.App.3d 171, 177, 203 Cal.Rptr. 13 (Cal.Ct.App.1984) (collecting cases); *Sufrin v. Hosier,* 896 F.Supp. 766, 769–70 (N.D.Ill.1995) (applying Illinois law, rejecting quantum meruit rationale). Partnership Law § 4(4) instructs New York courts to adopt interpretations of its provisions that conform to other UPA states, so were there no New York precedent addressing the question, the presumption of uniformity with other state's interpretations would point to the same result.

The question that naturally arises is whether the partner is entitled to deduct from the net profits "reasonable compensation" for her post-dissolution efforts before remitting the balance to her former partners for division. The answer at common law was simple: no. *See, e.g., King,* 100 N.Y. at 393–95, 3 N.E. 594. The Supreme Court gave the common law rule as follows: "[W]here partnerships are equal, as was true in the present case, and there is no stipulation in the partnership agreement ***330** for compensation to a surviving partner for settling up the partnership business, he is entitled to no compensation." *Denver v. Roane,* 99 U.S. 355, 358, 25 L.Ed. 476 (1878). The same is true under the statutory scheme. New York's Partnership Law codifies the "no compensation rule" in § 40(6): "No partner is entitled to remuneration for acting in the partnership business, except that a surviving partner is entitled to reasonable compensation for his services in winding up the partnership affairs." The Legislature elected to modify the no compensation rule only where dissolution of the partnership was caused by death, which is the only time there can be a "surviving" partner; a partner who winds up business on dissolution for any reason other than death is not a surviving partner, so the modification is not applicable here. *See, e.g., Geist v. Burnstine,* 19 N.Y.S.2d 76, 77 (1st Dep't 1940); *see also Beckman,* 579 A.2d at 640 (collecting cases).

Notwithstanding the text of the Partnership Law, New York courts have found a way to avoid the harshest application of the no compensation rule—at least in the limited context of "unfinished business" claims arising out of contingent fee legal representations. They have done so, not by rejecting the rule outright, but by reducing the profits for which a former partner must account by an amount that reflects the value of his post-dissolution "efforts, skill, and diligence" in concluding the matter. *See, e.g., Kirsch,* 181 A.D.2d at 226, 586 N.Y.S.2d 330; *Murov,* 12 A.D.3d at 656, 786 N.Y.S.2d 79. The Second Circuit has adopted this approach. *Santalucia,* 232 F.3d at 298. The New York Court of Appeals has never considered whether what I will call the "*Kirsch* rule" runs afoul of the "no compensation" rule codified in Partnership Law § 40(6).

Finally, the Partnership Law does not distinguish between law partnerships and other kinds of partnerships. To the contrary, its provisions are applicable generally to partnerships engaged in any business or profession. Partnership Law § 2 (" 'Business' includes *every* trade, occupation, or profession.") (emphasis added).

The provisions of the Partnership Law just discussed may appear dated, or even downright quaint, to observers of the kind of sophisticated corporate law practice that was carried on at Coudert. In the context of the "mega—firm" model-divisions among classes of partners, client hoarding, and mercenary lateral hiring—one could argue that the law's presumption that partners are mutual owners of all of a law firm's business, and that all contribute to its success and so are entitled to share in the profits, no longer reflects the reality of practice.[4] Many partners at such firms no longer view their "book of business" as an asset of the firm, but as a jealously guarded piece of personal property. *See, e.g.,* Mark Harris, *Why More Firms Will Go the Way of Dewey & LeBoeuf,* Forbes (May 8, 2012) ("The portability of the partner's 'book' has weakened the bonds that hold firms together and threatens the identity of the law firm as we know it.") (available at http:// www.forbes. com/sites/forbesleadershipforum/2012/05/08/ why-more-lawfirms-will-go-the-way-of-dewey-leboeuf/). Such a view undermines the conclusion that such client matters really ***331** are property of the firm, as well as the premises of the no compensation rule. But the Partnership Law says otherwise.

4 *See, e.g.,* Paul M. Barrett, Law Firms' White Shoes Blues, Businessweek (April 18, 2012) ("In a business increasingly characterized by fierce bidding for talent and high-level defections, many successful attorneys jealously hoard clients and keep an eye on the American Lawyer numbers to see whether they ought to take their 'book of business' elsewhere. Under these circumstances, client loyalty at many firms has deteriorated.") (available at www.businessweek.com/ printer/articles/21004-law-firms-white-shoe-blues).

Furthermore, the statute only sets default rules. With few exceptions (one of which will be explored below), partners are free to vary these rules by partnership agreement. The mega-firm is not the only model for a law partnership (or any partnership), so the law's assumptions about the nature of partnership, as codified in the statute and reflected in the numerous decisions interpreting it, should not be set aside in the absence of an explicit agreement among partners that they wish to operate under different rules. If law firms like Coudert need an alternative set of assumptions to survive in a new marketplace, they are free to provide for one in their partnership agreements. Given their resources and sophistication, it is far more equitable to ask them to draft any special rules they want to follow than it is to add a gloss to the statute applicable to the far more numerous, and undoubtedly less sophisticated, partnerships the affairs of which are governed by the Partnership Law. In the absence of special rules, the Couderts of this world are bound by the "quaint" practices of yore.

With these principles in mind, I turn to the issues presented by the cross-motions.

V. ANALYSIS OF THE ISSUES

A. The Client Matters Were Coudert Assets on the Dissolution Date

1. *The New York Court of Appeals would not distinguish among unfinished business according to how it is billed*

[7] I conclude that the New York Court of Appeals would, if confronted with the issue, conclude that all client matters pending on the date of dissolution are assets of the firm-regardless of how the firm was to be compensated for the work.

a. *Nature of a partnership and partnership property*

[8] Every partnership is an association of people to conduct business as co-owners in the hope of making a profit. It is a general principle of partnership law that partners are expected to devote their efforts to the partnership business, not to individual endeavors. Thus, the presumption *must* be that the firm's business belongs to the firm, and not to any individual partner.

The alternative would be that, even while the firm was in active operation, client matters—i.e., the firm's business—would presumptively be, *not* firm property, but the personal property of individual partners (most likely, whatever partner originated the client representation). This alternative leads to results that are contrary to the most basic provisions of the Partnership Law. Indeed, such an arrangement would not fit within the definition of a "partnership at all," because the business would not be carried on by "co-owners." *See* Partnership Law § 10 ("A partnership is an association of two or more persons to carry on *as co-owners* a business for profit.") (emphasis added).

Of course, many law firms do make efforts to reward business origination by allocating different profit shares to different partners (as Coudert did), by awarding payment in the nature of "bonuses" to unusually productive partners, or even (as we read in the news) by guaranteeing particular partners a certain quantum of compensation. But this result is not achieved by making individual partners the owners of client matters they originate, with no duty to account to anybody but themselves. Assuming that such an ownership structure could be bargained for, it would ***332** not be a "partnership" as the law envisions a partnership; and, as detailed below, the Coudert partners did not bargain for such an arrangement.

[9] All executory contracts for the provision of client services by a partnership are presumed to belong to the partnership, rather than individual partners. "A law partnership not only possesses fixed assets in the form of typewriters, bookcases, etc., *it possesses assets in the form of cases and legal matters." Matter of Lester (Berman),* 61 A.D.2d 935, 936, 403 N.Y.S.2d 33 (1st Dep't 1978) (emphasis added). For that reason alone, their status as assets should not depend on how the client pays the firm. The payment on the contract could be upfront, on completion, intermittent, or any combination thereof.

b. ***As a general rule, the unfinished business of a professional partnership is an asset of the partnership unless a contrary intention appears.***

[10] The general rule is that the business of a partnership that is unfinished on the date the partnership dissolves is an asset of the partnership, and must be concluded for the benefit of the dissolved partnership. *Stem v. Warren,* 227 N.Y. 538, 125 N.E. 811 (1920). This rule is often referred to as the "unfinished business doctrine."

"Unfinished business" must be distinguished from "finished business"-business that has been completed prior to dissolution (the merger done and documented; the lawsuit tried to verdict or settled). If a firm has finished a piece of business but has not collected its fee, in whole or in part, the resulting receivable is, obviously, an asset of the firm. If the firm liquidates, the fee has to be collected for the benefit of the members of the firm in liquidation. *Jackson v. Hunt Hill & Betts,* 7 N.Y.2d 180, 183, 196 N.Y.S.2d 647, 164 N.E.2d 681 (1959).

[11] "New business" is an entirely new contract or engagement to do a piece of work. New business that is contracted for and undertaken only after a partnership dissolves—even business from a client of the dissolved firm —is not an asset of the dissolved firm, because a partnership has no more than an expectation of obtaining future business from a client. For that reason, the attorney who conducts the business and collects the resulting fee owes no duty to his former partners to account for any profit he may earn. *Stem,* 227 N.Y. at 550, 125 N.E. 811; *see also Conolly v. Thuillez,* 26 A.D.3d 720, 723, 810 N.Y.S.2d 239 (3d Dep't 2006); *In re Brobeck, Phleger & Harrison LLP,* 408 B.R. 318, 333 (Bankr.N.D.Cal.2009) (applying California law). Retainers from former clients on new matters—even matters, like appeals, that are related to finished representations—have been treated as "new" business and are not subject to the duty to account. *See, e.g., Talley,* 100 N.Y.S.2d at 117–18 (no duty to account for fees earned on appeals from matters originally handled as partnership business). [5]

5 This rule explains why, as alluded to in a previous footnote, Defendant Akin Gump would be entitled to summary judgment if there were no dispute of genuine fact that it only represented former Coudert clients on "new" matters, unrelated to matters pending but uncompleted by Coudert on the Dissolution Date. As noted, DSI will have an opportunity, through discovery, to explore whether Akin Gump's factual assertion is correct.

Between "finished business" and "new business" lies unfinished business: executory contracts to perform services, begun but not fully performed by the partnership on the date of its dissolution. Unfinished business is presumptively treated as a partnership asset subject to distribution.

***333** **[12]** The fact that a contract is executory does not mean that it cannot be considered an asset of a professional partnership. Even an executory contract that is terminable at will by the client (which is true of all contracts to provide legal representation, as a matter of public policy) can be a partnership asset, notwithstanding the uncertainty that it will ever be fully performed. *See King,* 100 N.Y. at 393, 3 N.E. 594 ("[T]he executors of a deceased partner were entitled to the profits made upon contracts pending, unperformed at the death of their testator, and thereafter completed."); *see also Stem,* 227 N.Y. at 544, 125 N.E. 811 (executory contract for architectural services, terminable at will, was partnership asset); *see also Santalucia,* 232 F.3d at 297–99 (unfinished legal representations can be valuable partnership asset).

[13] However, the fact that an executory contract, terminable at will, *can* be a partnership asset does not mean that every executory contract necessarily *must* be such an asset. If the parties indicate a contrary intent, that will control. *See Dawson v. White & Case,* 88 N.Y.2d 666, 671, 649 N.Y.S.2d 364, 672 N.E.2d 589 (1996) ("[T]he partners are free to exclude particular items from the class of distributable partnership property, and such an agreement will be enforced in an accounting proceeding."); *see also Stem,* 227 N.Y. at 546–47, 125 N.E. 811.

The New York Court of Appeals has squarely held, in the context of professional services partnerships other than law firms, that executory contracts to perform professional services are partnership assets unless a contrary "intention" appears. That was the rule applied in *Stem v. Warren,* 227 N.Y. 538, 125 N.E. 811 (1920). There, two architecture firms—Reed and Stem ("RS") and Warren and Wetmore ("WW")—became partners for the purpose of planning and overseeing construction of Grand Central Station. The resulting partnership ("RS & WW") entered a contract with the New York Central and Hudson River Railroad Company (the "Railroad") to do that work. *Id.* at 543–44, 125 N.E. 811. The contract was terminable at will by the Railroad-albeit with provision for payment for work completed. *Id.* at 544, 125 N.E. 811.

RS & WW performed work under the contract for some years, until November 12, 1911, when Reed (of RS) died, thereby dissolving the partnership. Following his death, Wetmore (of WW) contacted the Railroad and asked it to retain WW to finish the work on the Station. The Railroad agreed. It entered a contract with WW, effective December 19, 1911, and terminated the contract with RS & WW effective December 31, 1911. The Railroad paid RS & WW for all services rendered through the date of termination, so the partnership had recovered the full value of its pre-dissolution services, and had no outstanding accounts receivable from the Railroad at that point. *Id.* at 545, 125 N.E. 811. WW subsequently completed work on the Station and was paid under the terms of its contract with the Railroad.

Even though RS & WW had been paid in full for the value of services provided prior to dissolution, Reed's estate sued WW for an accounting of all profits WW earned on the contract after RS & WW dissolved. The Estate prevailed. The New York Court of Appeals held that, when Reed died, RS & WW dissolved, and all the surviving partners were immediately vested with ownership of RS & WW's property for the purpose of winding up the partnership's affairs. The Railroad contract was considered to be the partnership's asset on dissolution—"The most valuable asset of such partnership was the contract between it and the railroad company," ***334** *Stem,* 227 N.Y. at 546–47, 125 N.E. 811—and WW was "required to account for all profits it earned for completing the business after dissolution. The Court held:

> Upon the death of Mr. Reed it was the duty of the survivors of the firms to take possession of the firm's assets, perform the contract, extinguish the firm's liabilities, and close its business for the interest of all parties concerned, and the representatives of Reed were entitled to share in the profits of all unfinished business though subsequently completed.

Id. at 547, 125 N.E. 811.

The fact that the Railroad could have terminated the contract at will did not compel the conclusion that the contract was not "property" of the partnership. Similarly, the fact that RS & WW had been fully compensated for its pre-dissolution efforts, and that no accounts receivable from the Railroad were outstanding on the dissolution date, did not mitigate WW's obligation to account for all post-dissolution profits earned from finishing the work on the Grand Central Terminal. The contract for services was an asset of the partnership, and because it was an asset of the partnership, the benefits it yielded to former partners after dissolution belonged to the dissolved partnership. *See also Rhein,* 194 A.D. at 274, 185 N.Y.S. 150 (executory contract, payment due on completion, was an asset of a dental partnership on the date of dissolution); *Shandell,* 217 A.D.2d at 472, 629 N.Y.S.2d 437 (executory contract, payment contingent on success, is an asset of a law partnership on the date of dissolution, unless partners agree otherwise).

Other federal courts in this Circuit have looked to the parties intent to determine whether an executory contract should be treated as partnership property—although Judge Cogan on the Eastern District explained:

> There is surprisingly little New York authority on how a court is to determine what property is within or without a partnership. Perhaps that is because whether one looks to the Uniform Partnership Act ... or the common law, the question of whether a particular asset is partnership property is resolved by the fundamental contractual

interpretation exercise of determining the parties' intent. As one treatise has summarized the law:

> The question whether or not personal property owned or acquired by a partner has been contributed by him or her to the firm so as to become partnership property depends on the intention of the parties as revealed by their conduct; by the provisions of the partnership agreement or agreement preliminary thereto; by the terms of written instruments relative to the transfer of the property to or for use of the firm; by entries in the firm books; and by the use of the property in the firm business, although the mere fact that property is used in the firm business will not of itself show that it is firm property.

Sriraman v. Patel, 761 F.Supp.2d 7, 18 (E.D.N.Y.2011) (citing *The John E. Enright,* 40 F.2d 588, 590 (2d Cir.1930); *In re Amy,* 21 F.2d 301, 303 (2d Cir.1927); *Altman v. Altman,* 271 A.D. 884, 67 N.Y.S.2d 119 (2d Dep't 1946); 68 C.J.S. Partnership § 107 (2010)) (other citations omitted). None of these cases distinguishes between executory contracts to provide services where the partners bill by the hour and executory contracts where partnership compensation is contingent on results: the same intent-based rule applies to all kinds of business.

***335** So unless the Firms can suggest a meaningful distinction between law partnerships and other partnerships, or a meaningful difference between legal business that is billed by the hour versus handled on contingency, I can predict with reasonable certainty that the New York Court of Appeals would find that the Client Matters in this case were Coudert's property in the absence of an agreement to the contrary.

c. *The rule that makes business unfinished at dissolution an asset of the partnership has been applied, in New York and elsewhere, to law firms that handled cases on contingency*

The three New York Appellate Divisions that have addressed this issue, as well as the United States Court of Appeals for the Second Circuit (whose decisions on state law bind me), have applied the general rule that executory contracts are partnership assets in the absence of an agreement to the contrary to law partnerships—but always in the context of cases involving contingency fee cases.

In *Kirsch v. Leventhal,* 181 A.D.2d 222, 586 N.Y.S.2d 330 (3d Dep't 1992), the Appellate Division, Third Department discussed the rule in the context of a law firm that dissolved in the middle of a contingency fee case. The court recognized that whether the law partners intended that the matter be classified as a partnership asset was an issue of fact. If the evidence revealed that the partners so intended, however, "the case would have constituted unfinished business of the firm to be evaluated as of the date of dissolution in determining the value of plaintiff s partnership interest." *Id.* at 224, 586 N.Y.S.2d 330; *see also Shandell v. Katz,* 217 A.D.2d 472, 629 N.Y.S.2d 437 (1st Dep't 1995); *DelCasino v. Koeppel,* 207 A.D.2d 374, 615 N.Y.S.2d 454 (2d Dep't 1994); *Santalucia,* 232 F.3d at 294.

Courts in other UPA jurisdictions have also concluded that unfinished legal representations where payment to the lawyers is contingent on recovery by the client are "unfinished business" assets of the retained law partnership upon dissolution, completion of which by any former partner gives rise to a duty to account, as long the partners intended that result. *Jewel v. Boxer,* 156 Cal.App.3d 171, 174, 203 Cal.Rptr. 13 (Cal.App. 1st Dist.1984), an intermediate appellate case from California, is often cited as the leading case for this proposition under the UPA:

> [I]n the absence of a partnership agreement, the Uniform Partnership Act requires that attorneys' fees received on cases in progress upon dissolution of a law partnership are to be shared by the former partners according to their right to fees in the former partnership, regardless of which former partner provides legal services in the case after the dissolution.

Id.; see also Sullivan, Bodney & Hammond v. Bodney, 16 Kan.App.2d 208, 210–11, 820 P.2d 1248 (Kan.App.1991) (collecting cases); *Beckman v. Farmer,* 579 A.2d 618, 636 (D.C.App.1990) (collecting cases); *LaFond v. Sweeney,* —— P.3d ——, ——, 2012 WL 503655, at *1 (Colo.App. Feb. 16, 2012). The same rule was applied by the United States Supreme Court in at least one pre-*Erie* case, *Denver v. Roane,* 99 U.S. 355, 358, 25 L.Ed. 476 (1858), which cited *Caldwell v. Leiber,* 7 Paige Ch. 483 (N.Y.1839), a New York case, as authority. *See also Consaul v. Cummings,* 222 U.S. 262, 32 S.Ct. 83, 56 L.Ed. 192 (1911).

If the partners do not specify whether a particular representation is intended to be an asset of the partnership subject to distribution on dissolution, courts treat their silence as signifying an intention that it ***336** should: "In the absence of an agreement to the contrary, pending contingency fee cases of a dissolved partnership are assets subject to distribution." *Murov,* 12 A.D.3d at 655, 786 N.Y.S.2d 79; *see also Conolly,* 26 A.D.3d at 720, 810 N.Y.S.2d 239 (same); *Liddle, Robinson & Shoemaker v. Shoemaker,* 304 A.D.2d 436, 441, 758 N.Y.S.2d 628 (1st Dep't 2003) (same); *Gottlieb v. Greco,* 298 A.D.2d 300, 749 N.Y.S.2d 19 (1st Dep't 2002) (same); *Grant,* 263 A.D.2d at 388, 693 N.Y.S.2d 564 (same); *McDonald,* 233 A.D.2d at 22 (same); *Shandell,* 217 A.D.2d at 472, 629 N.Y.S.2d 437; *DelCasino,* 207 A.D.2d at 374, 615 N.Y.S.2d 454 (same); *Dwyer,* 193 A.D.2d at 70, 602 N.Y.S.2d 144 (same); *Kirsch,* 181 A.D.2d at 222, 586 N.Y.S.2d 330 (same). The Second Circuit has embraced this rule where the client matter was handled on contingency. *Santalucia,* 232 F.3d at 295.

d. *Courts in other UPA jurisdictions have applied the same rule where law firms handle cases on a non-contingency basis.*

Every court in a UPA jurisdiction that has considered the precise question posed here has concluded that billable hours matters are partnership assets in the absence of any expressed intention that they should be treated otherwise.

> On the basis of the[ ] principles [of the UPA], every other court confronted with this issue of division of post-dissolution proceeds of a law partnership has held that pending cases, regardless of whether they are hourly-fee cases or contingent-fee matters, are unfinished business requiring winding up after dissolution, and are therefore assets of the partnership subject to post-dissolution distribution.

In re Labrum & Doak, LLP, 227 B.R. 391, 408 (Bankr.E.D.Pa.1998) (citing cases from California, Pennsylvania and the District of Columbia). The fact that New York courts must harmonize their rulings with those of other UPA jurisdictions by statute, Partnership Law § 4(4), is powerful reason to conclude that the New York Court of Appeals would reach the same result.

For example, in *Rothman v. Dolin,* an intermediate appellate court in California applied the *Jewel* rule to cases billed by the hour. 20 Cal.App.4th 755, 24 Cal.Rptr.2d 571 (Cal.Ct.App.1993). Noting that

> *Jewel* never explicitly limited the application of the unfinished business doctrine to contingency fee matters, the court ruled: the policy reasons for the rule announced in *Jewel* ... apply with equal force to both contingency and hourly rate cases. Indeed, according different treatment to hourly rate and contingency fee cases would lead to the prospect of attorneys shunning contingency fee cases in anticipation of a possible dissolution of the law firm, and scrambling to get the hourly rate cases rather than the contingency fee cases upon dissolution.

Id. at 758, 24 Cal.Rptr.2d 571; *id.* at 759, 24 Cal.Rptr.2d 571 ("That one matter is to be compensated at an hourly rate and another on a contingency basis is of no consequence in determining whether a matter is unfinished business."); *see also In re Brobeck,* 408 B.R. at 333 (applying Pennsylvania law).

The District Court for the District of Columbia reached the same result in *Robinson v. Nussbaum,* 11 F.Supp.2d 1 (D.D.C.1997). The District of Columbia Court of Appeals had previously ruled, in the context of contingency fee cases, that unfinished client representations are partnership assets, use of which by one former partner renders her liable to account to her former partners. *Beckman v. Farmer,* ***337** 579 A.2d 618, 636 (D.C.1990). In *Robinson,* the court found no reason to distinguish between hourly billed and contingent fee cases for the purposes of this doctrine:

> The crux of the *Beckman* opinion fully supports this conclusion. There the Court of Appeals explained that its holding stemmed from two fundamental principles of partnership law. First, dissolution of a law partnership does not terminate existing contracts with its clients. And second, former partners who honor these

> existing contracts do so as fiduciaries for the benefit of the former partnership. From these principles, the court concluded that work performed after dissolution to resolve pending cases is conducted for the benefit of the dissolved law partnership. The nature of the underlying contractual relationship between the dissolved partnership and its client does not alter the legal status of a dissolved partnership nor does it change the fiduciary duties each partner must honor towards another. They remain the same regardless of how an attorney agrees to be compensated by his clients.

Robinson, 11 F.Supp.2d at 6.

e. *The Firms' proposed distinctions do not lead to a contrary result*

Despite the considerations discussed above, the Firms argue that the New York Court of Appeals would distinguish between legal business billed by the hour and legal business paid on contingency, and would conclude that the former were not subject to the unfinished business rule. I find their arguments unpersuasive.

i. No future expectancy (quantum meruit)

The Firms first argue that there are real differences between contingency fee cases and matters that are billed by the hour, and assert that those differences make the treatment of former upon dissolution of a partnership inapplicable to the latter. They argue that the dissolved partnership's interest in a pending billable hours matter is (or ought to be) limited to the extent of the firm's receivables (billed or yet to be billed) for services rendered prior to dissolution.

I cannot quarrel with the proposition that contingency and billable hour matters are different in critical respects. When a firm takes a case on contingency, it in effect wagers that the cost of completing the matter (lawyer effort and overhead) will be reimbursed and more upon completion. Were a law firm that was retained on contingency to dissolve in the middle of the representation, the dissolved firm would have expended something (perhaps much) in pursuit of the client's goals, and received nothing in return. By contrast, when a case is billed by the hour, the firm is compensated on a periodic basis for work already performed; the only risk the firm runs is the risk that the client will ignore its contractual obligation to pay bills upon receipt. There is no risk that the firm will not be compensated for its time, effort and overhead based on the result of the case. So (assuming the client is not a deadbeat), if the firm dissolves while the matter remains pending, it either has been paid or can obtain payment for all work theretofore performed.

The Firms argue that this difference makes it inappropriate to treat billable hours cases as assets of a law firm that handled work on this basis. In effect, they assert that an engagement to represent a client in a matter—to defend a corporation in a shareholder suit, say, or to prepare documents and provide tax advice in connection with some corporate transaction—does not give rise to a single contract, but rather a series of "mini-contracts," each one corresponding to a new billing period. ***338** "Unfinished business," they argue, effectively becomes "finished business" with the submission of each periodic invoice. To put their argument in practical terms, if it were the practice of a law firm to bill its clients on the first day of every month, then when the firm dissolved on May 15(1) all work done prior to the issuance of the May 1 invoice would be "finished business;" (2) work performed in May but not yet billed would be "unfinished business" (and so subject to the unfinished business rule); while (3) work performed elsewhere by former members of the dissolved firm, during what would have been subsequent billings periods (June, July, August), would be "new business," and so would not subject the former partners to any duty to account.

But the Firms' argument conflates a law firm's rights against its clients—which may differ according to how the matters is billed—and the rights of former partners among themselves, including the right to demand an accounting from any partner who derives a benefit from exploiting a partnership asset. As the cases that reject the quantum meruit rationale for the duty to account make clear (see page 17, supra), these rights are entirely distinct.

The unfinished business doctrine does not exist to assure that a law firm is paid for the value of work it has performed prior to dissolution. It exists to settle accounts among partners upon dissolution of their business. The fact that the client agreed to make payments for services rendered by giving his lawyer a percentage of any winnings realized as opposed to paying him by the hour does not alter the fundamental proposition, codified in Partnership Law § 43, that every partner must account to her former partners for profits realized from the use of what was, on the date of dissolution, a partnership asset.

Furthermore, while law firms have a variety of ways to collect from clients when they dissolve before being paid (or fully paid) for matters handled prior to dissolution, those remedies exist separate and apart from the fiduciary responsibility of the former partners *inter se,* and the measure of recovery they offer attorneys is not the same as the measure of the former partners' duty to each other in dissolution. For example: if a matter was handled on contingency, the law allows the firm to recover for the value of services already rendered in any of three ways, one which is bringing a plenary action in quantum meruit. *Schneider, Kleinick, Weitz, Damashek & Shoot v. City of New York,* 302 A.D.2d 183, 186, 754 N.Y.S.2d 220 (1st Dep't 2002). [6] But the fact that the firm can sue its client in quantum meruit does not limit the rights of its former partners as among themselves to the quantum meruit value of their former firm's services; as should by now be apparent, as among the former partners the duty to account runs to all profits earned by whatever partner finishes the business that the dissolved firm started. Profit is generally greater than the value of services rendered (quantum meruit). Similarly, if the matter was billed by the hour, the law gives the firm a right to sue for payment under the doctrine of account stated. *See, e.g., Lapidus & Associates, LLP v. Elizabeth Street, Inc.,* 92 A.D.3d 405, 405–06, 937 N.Y.S.2d 227 (1st Dep't 2012). But an account stated includes payment for overhead as well as profit, and the Partnership Law provides that, as among former partners, the duty to account is limited to profits. Were this Court to embrace what is, in effect, a rule that measures a former partner's duty to account under Partnership Law § 43 to the value of the account ***339** stated in billable hours cases, it would seriously undermine the reasoning that undergirds cases like *Kirsch* and *Santalucia* in the contingency fee context.

6 The other two are the retaining lien and the charging lien. See Judiciary Law § 475.

The Firms' argument would also run afoul of the New York Court of Appeals' ruling in *Stem,* the facts of which were discussed at length above. There, the dissolved professional partnership was fully compensated for all work done prior to its dissolution; no accounts receivable were outstanding. Nevertheless, the surviving partners were accountable to the dissolved firm (and to the estate of the partner whose demise effected the dissolution) for the profit they realized on the job that the dissolved partnership had originally contracted to perform. If the Firms had suggested a principled reason why law firms should be treated differently than architectural firms, I would evaluate it, but they do not; and off the top of my head I can think of none. The Partnership Law certainly does not treat law partnerships any differently than other partnerships. The only idea that suggests itself is that contracts for legal representation must always be terminable at will, so lawyers are not entitled to expectancy damages if a client decides to change lawyers in the middle of a representation. I know of no reason why contracts for architectural services must be terminable at will, but in *Stem* the contract with the Railroad *was* terminable at will. So terminability and the unavailability of expectancy damages do not seem to be differences that makes a difference.

In any event, the factual premise that undergirds the novel mini-contracts theory is a false one. When a client retains a law firm to represent it in a particular matter, it is not entering into a contract analogous to a month to month lease for its services, but into a contract to provide services, either generally (the classic arrangement of placing a firm "on retainer," which has all but disappeared) or in connection with a particular identified matter or matters. The fact that bills are rendered and payment is obtained periodically, rather than when the matter is entirely concluded, simply reflects the arrangement the parties made about when and how compensation would be received—which is one (and only one) term of the contract between them.

It is true that the United State Supreme Court suggested over a century ago that a law partner who winds up the business of a dissolved firm might owe his former partners a different duty when the firm handled cases on a billable hours basis rather than on contingency:

> there is a suggestion in *Denver v. Roane,* that there may be "a different rule in cases of winding up partnerships between lawyers and other professional men, where the profits of the firm are the result solely of professional skill and labor."
>
> This point is not involved, and on it no ruling is made, because we are not dealing with questions between the administrator of the deceased and the surviving member of an ordinary law partnership, where the latter conducts to a conclusion the business of the firm, *under circumstances where there may be a right from time to time to call on the*

> *client for compensation for the value of services rendered, and even though the case is finally lost.* Here the agreement related solely to litigation in which compensation was for success, and not for the value of services rendered. Such payment was to be *in solido,* and the partners agreed that the fees should be divided *in solido.*

Consaul v. Cummings, 222 U.S. 262, 271, 32 S.Ct. 83, 56 L.Ed. 192 (1911) (internal citation omitted) (emphasis added). However, the Court quite explicitly did not ***340** decide the matter. And when the Partnership Law was adopted some years later, its draftsmen did not accept the High Court's invitation either to treat law partnerships differently than other partnerships, or to draw a distinction between professional services contracts where services are billed as rendered rather than being dependent on the matter's outcome.

Furthermore, *Consaul* says nothing at all about whether client matters that are billed by the hour are or are not assets of the law firm that is retained to handle them; if anything, it suggests that they are assets, because a partner's duty to account (which is what the court was discussing) would not be triggered otherwise.

ii. New York public policy would lead the Court of Appeals to apply the rules differently than other UPA states have

The Firms argue that the Court of Appeals would not follow the other UPA jurisdictions, which have concluded that client matters billed by the hour are presumptively partnership assets, because the imposition of a duty to account on former law partners who finish such client matters would be contrary to New York public policy. This is by far the Firms' most powerful argument. However, it, too, fails in the end.

The Firms rely on New York's strong commitment to the policy of client choice of attorneys. They argue that the Court of Appeals would reject application of the unfinished business doctrine to billable hours matters because it would lead to a financial disincentive to an attorney's continued representation of her client. Other UPA jurisdictions have acknowledged that a policy favoring unfettered client choice of counsel might indeed conflict with the application of the unfinished business doctrine; but in the end, all but one of those states have concluded that the unfinished business doctrine does not run afoul of this public policy. *See Jewel,* 156 Cal.App.3d at 178, 203 Cal.Rptr. 13; *Resnick v. Kaplan,* 49 Md.App. 499, 509, 434 A.2d 582 (1981); *Ellerby v. Spiezer,* 138 Ill.App.3d 77, 81, 92 Ill.Dec. 602, 485 N.E.2d 413 (1985); but *see Welman v. Parker,* 328 S.W.3d 451, 457 (Mo.App. S.D.2010) (application of the unfinished business doctrine and no compensation rule to law partnership "would unduly impinge upon the client's perceived freedom to change attorneys without cause and could have a chilling effect upon the choice of that option by the client"); *see also Comment, Winding Up Dissolved Law Partnerships: The No–Compensation Rule and Client Choice,* 73 Cal. L.Rev. 1598 (1985). New York, however, has gone further than other jurisdictions to protect client autonomy and attorney mobility. That, say the Firms, argues for a different answer to the question.

It is true that New York goes out of its way to protect a client's right to select counsel of its choosing. Most conspicuously, New York courts have overridden the usual rule that partners may arrange their internal affairs as they please by refusing to enforce provisions in partnership agreements that might create a financial disincentive for a partner to continue representing a client of his former firm. For example, in *Cohen v. Lord, Day & Lord,* 75 N.Y.2d 95, 96, 551 N.Y.S.2d 157, 550 N.E.2d 410 (1989), the Court of Appeals held:

> A law firm partnership agreement which conditions payment of earned but uncollected partnership revenues upon a withdrawing partner's obligation to refrain from the practice of law in competition with the former law firm restricts the practice of law in violation of [New York Rules of Professional Conduct 5.6] and is unenforceable in these circumstances as against public policy.

***341** Cohen had been a partner with the firm Lord, Day & Lord, for nearly 20 years. He signed the firm's partnership agreement, which gave a withdrawing partner a departure payment equal to the partner's interest in accounts receivable and fees earned but unbilled on the date of withdrawal, payable over three years. However, this payment would be forfeited if the partner entered into competition with the firm after withdrawal. *Id.* at 97, 551 N.Y.S.2d 157, 550 N.E.2d 410. A partner who continued to practice law in any state or other jurisdiction where Lord, Day & Lord maintained an office or in any contiguous jurisdiction, was entitled only to a settling of his capital account. Cohen went into practice elsewhere after leaving Lord Day, and sued his former firm for the full departure payment. The firm raised this forfeiture provision as a defense.

The Court of Appeals ruled that the forfeiture provision was void as contrary to public policy—not because it was harmful to the lawyer, but because it might have proven harmful to a client. Because "The forfeiture-for-competition provision would functionally and realistically discourage and foreclose a withdrawing partner from serving clients who might wish to continue to be represented by the withdrawing lawyer and would thus interfere with the client's choice of counsel," the Court held that it ran afoul of the provision of the professional ethics rules (now embodied in Rule 5.6) that prohibits restraints on the practice of law. *Cohen,* 75 N.Y.2d at 98, 551 N.Y.S.2d 157, 550 N.E.2d 410. [7]

7 Under Rule 5.6, "A lawyer shall not participate in offering or making ... a partnership ... agreement that restricts the right of a lawyer to practice after termination of the relationship, except an agreement concerning benefits upon retirement."

The Court of Appeals explained that "The purpose of the rule is to ensure that the public has the choice of counsel." It discussed several ethics opinions, including one from the New York County Lawyer's Association, that had concluded such agreements were unethical, because: "Clients are not merchandise. Lawyers are not tradesmen. They have nothing to sell but personal service. An attempt, therefore, to barter in clients, would appear to be inconsistent with the best concepts of our professional status." *Cohen,* 75 N.Y.2d at 98, 551 N.Y.S.2d 157, 550 N.E.2d 410.

[14] Therefore, to the extent that restrictive covenants keep lawyers from representing particular clients, they are inconsistent with unfettered client choice, and so are void as violative of New York public policy. This is so whether the restrictive covenant takes the form of an outright ban on practice or simply creates a financial disincentive for the lawyer to continue representing his clients of his former firm, as did the forfeiture provision at issue in *Cohen. Id.* at 99–100, 551 N.Y.S.2d 157, 550 N.E.2d 410 (relying on *Matter of Silverberg (Schwartz),* 75 A.D.2d 817, 819, 427 N.Y.S.2d 480 (2d Dep't 1980)). The Court of Appeals rejected the notion, espoused in the dissent, that a financial disincentive for the withdrawing lawyer to continue a representation is irrelevant to the client's free exercise of choice. *Cohen,* 75 N.Y.2d at 99, 551 N.Y.S.2d 157, 550 N.E.2d 410; *compare id.* at 107–08, 551 N.Y.S.2d 157, 550 N.E.2d 410 (Hancock, J., dissenting).

The Firms argue that the application of the unfinished business doctrine [8] where cases are billed by the hour will create the ***342** same sort of "financial disincentive" for the former partners of dissolved firms to continue representing their clients that the New York Court of Appeals condemned in *Cohen.* Specifically, when a partner realizes that he and his new firm will be required to perform 100% of the ongoing work, but will have to account for his profit and share a large percentage of it with his former partners, he will prefer to withdraw from the representation—even though his client at the former firm may wish him to continue.

8 The Firms' argument is equally applicable to the application of the "no compensation rule," which is discussed further below. It is no more persuasive in that context.

This argument has been made before, and has been rejected by most UPA jurisdictions. For example, the California Supreme Court has observed:

> in some respects, the "no-compensation rule" of partnership law, whereby departing partners are compensated for winding up the unfinished business of the partnership according to their partnership interest, may be just as much a disincentive on the withdrawing partner to continue to represent clients of the firm as an anticompetitive penalty.

Howard v. Babcock, 6 Cal.4th 409, 424 n. 8, 25 Cal.Rptr.2d 80, 863 P.2d 150 (1993). Yet in *Jewel* the California appellate court reasoned that:

> the right of a client to the attorney of one's choice and the rights and duties as between partners with respect to income from unfinished business are distinct and do not offend one another. Once the client's fee is paid to an attorney, it is of no concern to the client how that fee is allocated among the attorney and his or her former partners.

156 Cal.App.3d at 178, 203 Cal.Rptr. 13. However, that plainly is not the law in New York; that very argument (that it is all the same to the client how the fee gets divided once it is paid) was made by Judge Hancock in dissent, 75 N.Y.2d

at 107–08, 551 N.Y.S.2d 157, 550 N.E.2d 410 (Hancock, J., dissenting), and rejected by the majority in *Cohen,* 75 N.Y.2d at 99–100, 551 N.Y.S.2d 157, 550 N.E.2d 410.

The strongest case for the Firms' position is, ironically, one they fail to cite—*Denburg v. Parker Chapin Flattau & Klimpl,* 82 N.Y.2d 375, 604 N.Y.S.2d 900, 624 N.E.2d 995 (1993). There, the New York Court of Appeals struck down, as an illegitimate financial disincentive to the practice of law, a provision of a partnership agreement that required a departing partner who competed against her former firm to pay the firm the greater of (i) 12.5% of the firm's profits allocated to the partner over the two previous years or (ii) 12.5% of the annual bills by the new firm to former Parker Chapin clients over the ensuing two years. The Court of Appeals believed that this requirement illegally infringed on a client's right to choose to give her business to a new firm:

> As we made clear [in *Cohen*], restrictions on the practice of law, which include "financial disincentives" against competition as well as outright prohibitions, are objectionable primarily because they interfere with the client's choice of counsel: a clause that penalizes a competing attorney by requiring forfeiture of income could "functionally and realistically discourage" a withdrawing partner from serving clients who might wish to be represented by that lawyer.

Id. at 380, 604 N.Y.S.2d 900, 624 N.E.2d 995 (quoting *Cohen,* 75 N.Y.2d at 98, 551 N.Y.S.2d 157, 550 N.E.2d 410). The Court observed that the forfeiture provision created a disincentive for a departing partner to continue representing a client of his former firm, even if the client preferred to retain her, because retaining a client of the former firm required a forfeiture of a portion of profits for work done subsequent to her departure from Parker Chapin. *Denburg,* ***343** 82 N.Y.2d at 381, 604 N.Y.S.2d 900, 624 N.E.2d 995.

Denburg helps the Firms in a couple of ways. First, along it with *Cohen,* it supports the proposition that, under New York law, *any* financial disincentive to a lawyer's continuing to represent a client impinges on that client's ability to select counsel of his choice.

But more important is the similarity between the financial disincentive found repugnant to public policy in *Denburg* and the practical effect of the unfinished business doctrine and no compensation rule in these cases. In *Denburg,* if a departing partner competed against her former firm by continuing to represent a client whose business once had been the property of the firm, she was obligated to share her fees with her former partners. Here, if DSI prevails, a withdrawing partner who completed an unfinished Coudert representation at a new firm will have to share 100% of the profits realized on that representation with her former Coudert partners.

However, the matter is not quite so simple.

First, *Denburg* and *Cohen* are not dissolution cases; they involve the withdrawal of one partner from a partnership that continued in business rather than winding up. The rules for partnerships in dissolution are very different, and significantly are set by statute. *See* Partnership Law Art. 6 (Dissolution and Winding Up). When a partnership does not dissolve despite the death or withdrawal of a partner, as was the case in *Denburg* and *Cohen,* the default provisions of the Partnership Law are not implicated. It would be difficult indeed to conclude that the Partnership Law provisions that impose and measure the duty of partners to wind up existing firm business for the benefit of the dissolved firm, adopted as they were by the Legislature, violate public policy. *See* Partnership Law §§ 40(6), 43(1), 73.

Second, *Denburg* and *Cohen* involved situations where a partner was competing with his or her former partners for the custom of the same client. Here there is no question of competition—only of whether the Former Coudert Partners have a continuing duty to account for profits earned on business that originated at Coudert—which has gone out of business—and must be finished elsewhere.

Third, *Cohen* has nothing to do with the unfinished business doctrine, and *Denburg* does not specifically address unfinished business. The fee-sharing provision in the Parker Chapin partnership agreement required the departing partner to share profits earned on *new* business from former clients of Parker Chapin—in effect, treating the *client,* not the *matter,* as the firm's property. Therefore, even if it had arisen in the context of dissolution, *Denburg* could be read as holding only that a provision that required a departing attorney to share fees on *new business* involving her former firm's clients was contrary to public policy, because it restricted the client *even after* any unfinished representation was wound up.

Accounting for profits earned on unfinished business, on this reading, would simply be an unexceptional application of the Partnership Law.[9]

9 Unfortunately, it is not clear from the Court of Appeals' opinion whether the partnership agreement's non-competition provision was meant to apply only to new business.

For all these reasons, it would be unwise to extrapolate too much from *Denburg* and *Cohen.*

Ultimately, the reason I do not believe *Denburg* or *Cohen* mandates the result argued for by the Firms is that accounting for profits in a contingent fee case creates exactly the same type of financial disincentive ***344** for a former partner to finish business begun at a former firm. But the "financial disincentive" rationale underlying *Cohen* and *Denburg* has never been held by a New York court to undermine the unfinished business rule in contingent fee cases post-dissolution. This argues strongly in favor of restricting the rule of the non-competition cases to situations where lawyers and their former firms are in fact competing for new business from the same client.

It is significant that the Second Circuit never mentioned *Cohen* or *Denburg,* or any other non-competition case, in *Santalucia v. Sebright Transp., Inc.,* 232 F.3d 293 (2d Cir.2000), where it adopted the Appellate Division rule that contingency fee cases pending on the date of dissolution are partnership assets subject to distribution in the absence of a contrary agreement. There, a dissolved law firm sued its departed partner, Premo, to account for profits he earned winding up one of the contingency fee cases that was pending at the firm on the day it dissolved. District Judge Hurd limited the firm to a quantum meruit recovery for the value of its pre-dissolution work. He was reversed on appeal.

> To date, the New York Court of Appeals has not addressed the more specific issue of when and to what extent a lawyer has a fiduciary duty to account to a dissolved firm for the contingent fee cases that he took with him. However, New York's Appellate Division has confronted the problem on several occasions. Those cases now uniformly hold that, "absent an agreement to the contrary, pending contingent fee cases of a dissolved partnership are assets subject to distribution."

Id. at 297–98 (citations omitted). The Second Circuit expressed no concern that permitting the dissolved firm to participate in Premo's post-dissolution earnings might impinge on his client's right to an unfettered choice of counsel.

The Firms will undoubtedly argue that *Santalucia* should not be extended to the billable hours context. But there is no logical reason why, as a public policy matter, the rule ought not be the same for any pending legal representation that remains unfinished when the law firm handling it dissolves—regardless of how it is billed. Where the presumed deterrent effect on the client's ability to retain the lawyer of his choice is exactly the same, no matter how the case is billed, it makes no sense to hold that imposing on a former partner the duty to account for profit realized on a billable hours case that originated at her now-dissolved law firm violates public policy, but imposing the identical duty when the case was handled on contingency does not. The desire to protect client choice in selecting counsel may well augur for adopting a rule that *no* unfinished legal representation is an asset of a dissolved law partnership (as opposed to any other type of professional services partnership). But as long as *Santalucia* remains good law in this Circuit—and I suspect that it will until the New York Court of Appeals finally weighs in on this issue—I am not free to embrace such a rule.

[15] Thus, I believe that if faced with the issue, the New York Court of Appeals would apply the same rule to hourly billed cases as its Appellate Divisions apply to contingency fee cases: they are unfinished business assets subject to distribution unless a contrary intention appears.

2. *The Coudert Partnership Agreement does not indicate a contrary intention*

The Coudert Partnership Agreement does not suggest that client representations billed by the hour should not be ***345** treated as Coudert's assets. On the contrary, it specifically states that all the property of the firm belongs to the firm, not the individual partners. Article 8(i) sets forth the nature of each partner's interest in Coudert:

> The property of the Partnership belongs to the Partnership, and not to the Partners, and a Partner has no individual property rights in any specific assets of the Partnership. Rather, each Partner's interest in the Partnership property is his or her share in the surplus after the Partnership debts are paid and the Partnership

> accounts are settled and the rights of the Partners are adjusted between themselves.

(CPA Art. 8(i).) The Agreement does not specify that the Client Matters are *not* property of Coudert, so under *Stem* and *Shandell,* they are property of the firm.

If there were any doubt that Coudert partners thought their client matters were firm property, the Special Authorization that the partners passed to allow the Executive Board to wind up the firm dispels it:

> The Equity Partners ... hereby authorize the Executive Board ... to take such actions as it may deem necessary and appropriate, including, without limitation, the granting of waivers, notwithstanding any provisions to the contrary in the Partnership Agreement ..., in order to:
>
> a..... sell all or substantially all of the assets of ... the Firm to other firms or service providers, in order to maximize the value of the Firm's assets *and business;*
>
> b. wind down the business of the Firm with a view to continuing the provision of legal services to clients and the orderly transition of client matters to other firms or service providers, *in order to maximize the value of the Firm's assets and business to the extent possible ....*

(Keefe Decl., Ex. A, at 76 (emphasis added).) The winding up partners are specifically instructed "to maximize the value of [Coudert's] assets and business" by "transition[ing]" to other firms the "continuing ... provision of legal services to clients." Plainly, the drafters of this authorization thought that client matters were firm business for which provision needed to be made—for the clients, and to maximize their value to Coudert in dissolution. The language of the Authorization does not distinguish between contingency and billable matters, which is hardly surprising, since and informed observers of the New York City big firm market would be surprised if Coudert had a large book of contingency business.

Thus, the Coudert Partnership Agreement and the Special Authorization only confirm the law's presumption that executory contracts to perform legal services are property of the partnership, for which partners who bring them to a conclusion upon dissolution have a duty to account.

Neither does the Coudert Partnership Agreement do anything to forestall the application of the default rules of the Partnership Law, including the duty to account for profits earned on unfinished business after dissolution. In fact, the Coudert Partnership Agreement *calls explicitly for the application of the Partnership Law's default dissolution rules if the firm dissolves:*

> (a). Dissolution. The Partnership may only be dissolved and wound up by an affirmative vote of a Super Majority of the Executive Board ... and an affirmative vote of the Equity Partners.... Such dissolution and winding up, *and the rights of the Partners in connection therewith,* shall be governed by the provisions of the Act.

***346** (CPA Art. 10(a) (emphasis added).) Article 1 defines the "Act" as the New York Partnership Law. (CPA Art. 1.)

[16] The Firms point to the second sentence of Article 10(b) of the Coudert Partnership Agreement, which provides:

> In the case of any persons who shall have been Equity Partners at the time of such termination or dissolution of the Partnership ... each such person shall be entitled to receive from the Partnership ... "those payments provided for pursuant to Article 6(k) and Article 11 ... as though such person had Withdrawn involuntarily upon the day preceding such termination or dissolution of the Partnership."

(CPA Art. 10(b) (paragraph break added).) This provision says that any Coudert partner still with the firm on the date it dissolves is entitled to certain payments, and explains how those payments will be calculated (as though the partner had withdrawn the day before dissolution). It says nothing about assets, unfinished business, or the firm's right to an account from those partners if unfinished client business is finished by a former partner after dissolution.

The Firms argue that this provision either waives Coudert's right to participate in the profits the Former Coudert Partners earned post-dissolution, or operates to settle all of the accounts between the Former Coudert Partners and Coudert —much as the continuation provisions of Articles 3 and 11 would have if Coudert had not dissolved. But I do not read this sentence to do either. It only describes the amount of money to which former Coudert partners who remained partners on the Dissolution Date are entitled to collect from the firm (or its Estate) in the dissolution process—nothing more. I thus read it to override Partnership Law § 73, which sets the default rule for settling accounts with partners who withdraw after dissolution. Interpreting this sentence otherwise than in accordance with the plain meaning of its words would undermine the applicability of the Partnership Law to Coudert's dissolution process "and the rights of the Partners in connection therewith," in direct contradiction of the Coudert Partnership Agreement. (*See* CPA Art. 10(a).)

[17] Thus, because the Client Matters belonged to Coudert on the Dissolution Date, and because the Coudert Partnership calls for the application of the Partnership Law to determine the post-dissolution rights of the partners, the Former Coudert Partners have a duty to account for profits they earned completing the Client Matters at the Firms. If Coudert had wished it otherwise, the firm could have drafted its Partnership Agreement differently. It did not. As a result, DSI is entitled to a declaration that the Client Matters were Coudert's property on the Dissolution Date.

B. The Only Way to Decide Whether the Unfinished Business Has Value Is to Have an Accounting.

As a fall back, the Firms argue that they are entitled to summary judgment even if the Client Matters are assets, because those assets have no value. They argue that all the post-dissolution profits to which Coudert might otherwise be entitled are attributable to the Former Coudert Partners' post-dissolution "efforts, skill and diligence"—which, when deducted from the fees earned by the Firms, leaves nothing of the fees they were paid for handling the Client Matters to remit to Coudert.

That is not at all apparent.

As a general matter, a partner making his accounting may deduct expenses from gross fees and remit the net fees, i.e., ***347** profits, to his former partners for division. As discussed above, under the no compensation rule, "expenses" are not supposed to include compensation for the partner's post-dissolution efforts—however extraordinary those efforts may be. Other UPA states enforce this rule rigidly, even when the result is harsh—as, for example, when a departing partner takes a matter from the dissolving firm shortly after its inception and achieves an extraordinary result almost entirely through his efforts at a new firm. *See, e.g., Ellerby,* 138 Ill.App.3d at 83, 92 Ill.Dec. 602, 485 N.E.2d 413; *In re Labrum,* 227 B.R. at 418–19 (applying Pennsylvania law); *see also LaFond,* —— P.3d at ——, 2012 WL 503655, at *10.

In an apparent effort to ameliorate so "unfair" as result, New York cases that discuss the unfinished business doctrine in the context of law firm contingency fee cases calculate expenses differently than do courts in other UFA jurisdictions. Cases like as *Kirsch* and *Shandell* do not allow the former firm to participate in any "value" the case yields as a result of the accounting partner's post-dissolution "efforts, skill and diligence." Their rationale is that, under Partnership Law § 73, any such additional "value" is not "attributable" to the accounting partner's "use" of the partnership property, but solely to the former partner's own efforts. *See* Partnership Law § 73 (entitling a deceased or retiring partner to "an amount equal to the value of his interest in the dissolved partnership with interest, or, at his option ... in lieu of interest, *the profits attributable to the use of his right in the property of the dissolved partnership.*") (emphasis added). This rule —which has so far only been applied in the context of law partnerships—in effect treats the value of the partner's "effort, skill and diligence" as an expense that can be added to the deduction from overhead, not as compensation to the partner. The *Kirsch* rule has been applied by three of the four Appellate Divisions, and by the Second Circuit in *Santalucia,* 232 F.3d at 293; *see also Shandell,* 217 A.D.2d at 472, 629 N.Y.S.2d 437 (1st Dep't); *Murov,* 12 A.D.3d 654, 786 N.Y.S.2d 79 (2d Dep't); *Kirsch,* 181 A.D.2d at 222, 586 N.Y.S.2d 330 (3d Dept).

The New York Court of Appeals has never addressed whether this deduction is or is not consistent with the Partnership Law's "no compensation" rule. I question whether that court, if squarely confronted with the issue, would endorse the result reached by the intermediate appellate courts. As far as I can discern, the distinction between profits "attributable" to the "use" of a firm asset and profits attributable to the accounting partner's "post-dissolution efforts, skill and diligence" is non-existent. Imagine a law partnership consisting of Abbey and Bob. They agree to dissolve. Because they are both alive, neither is a "surviving partner" entitled to extra compensation under Partnership § 40(6). *See Geist,* 19 N.Y.S.2d at 76. Only one case is pending on the date of dissolution. Abbey completes it, thereby winding up the business of the old partnership. Bob demands an accounting for his share of the profits. Applying *Kirsch,* Abbey gets to withhold from the gross fees (1) her expenses in winding up the case, and (2) an amount representing her "effort, skill and diligence" in winding up the business. But Abbey's retention of the latter amount, to reward her post-dissolution efforts, runs directly contrary to the rule that governed in cases like *Stem, Rhein,* and *Geist.* In *Rhein* the court spoke plainly: the departing partner was required to remit the contracted fee, less his expenses, *without any compensation for his post-dissolution efforts, skill and diligence.*

Rhein involved a dental partnership, not a law firm, but it is hard to see why ***348** dentists, or architects, or the lawyers that were denied reasonable compensation in *Geist,* should be treated differently (and worse) than lawyers are under the Partnership Law. [10] How else, other than by expending her "efforts" to bring it to a successful conclusion, could Abbey have "used" an unfinished client matter that properly belong to the firm of Abbey and Bob? Assets like client matters do not yield profits simply by sitting on the shelf, so trying to distinguish between "using" a firm asset to generate profits, and putting "efforts, skill and diligence" into generating those profits makes little sense. The distinction appears to be purely semantic—a clever way of exempting law practice from the common law and UPA "no compensation" rule, despite the evident intent of the Legislature not to do so.

10 Except, of course, that lawyers write the rules.

Moreover, when determining the "value" of an unfinished contingent fee case as of the date of dissolution—as the court must, in order to determine Bob's entitlement to share in the settlement proceeds—courts following *Kirsch* and *Santalucia* are required to examine factors that make Bob's recovery depend on quantum meruit, rather than the partnership law's presumption that a partner is entitled to his or her contractual share of the profits in the partnership business. *Grant,* 263 A.D.2d at 389, 693 N.Y.S.2d 564 ("the Referee must evaluate *the efforts undertaken by the former law firm prior to dissolution date,* or any other relevant evidence to form a conclusion as to the value of these cases to the law firm on the dissolution date.") (emphasis added). To the extent that the New York rule calls for Bob to get the net fees less the value of Amy's efforts, Bob's recovery will invariably approximate what he would recover under quantum meruit principles—notwithstanding the ostensible "rejection" by the New York appellate courts of quantum meruit as the measure of a former partner's right to recovery from whatever partner finishes a matter pending upon dissolution.

The result in cases like *Kirsch* and *Shandell* eviscerates the "no compensation" rule. In fact, the "efforts, skill and diligence" rule appears to read that provision right out of the statute, in contravention of the Legislature's intent, as plainly expressed in Partnership Law § 40(6). Furthermore, the case on which *Kirsch* relies—*Bader v. Cox,* 701 S.W.2d 677 (Tex.App.1985), involved what was considered a "surviving" partner, who is therefore expressly entitled to compensation under the UPA's modification of the no compensation rule. *Bader,* in turn, relies on *Timmermann v. Timmermann,* 272 Or. 613, 538 P.2d 1254 (1975) (en banc), which appears to embrace the rule that *any* partner who winds up firm business is entitled to compensation, even if she was not forced to do so by the death of her partner. But in New York and elsewhere, Partnership Law § 40(6) has been interpreted to allow compensation only to partners who wind up the partnership affairs following dissolution caused by death. *See Geist,* 19 N.Y.S.2d at 76. So *Kirsch* (which did not involve a dissolution caused by death) looks to me like it rests on a misapplication or misunderstanding of Partnership Law § 40(6), because in that case, where two living partners agreed to go their separate ways, there was no "surviving" partner.

Finally, the great weight of authority in UPA jurisdictions is against the *Kirsch* rule. *See, e.g., Ellerby,* 138 Ill.App.3d at 83, 92 Ill.Dec. 602, 485 N.E.2d 413 ("[P]rior to the distribution of any profits, each partner is entitled to be reimbursed for the reasonable and necessary overhead expenses attributable to winding up the partnership's ***349** business," and nothing more); *Jewel,* 156 Cal.App.3d at 180, 203 Cal.Rptr. 13 ("Under the provisions of the Uniform Partnership Act, the former partners will be entitled to reimbursement for reasonable overhead expenses (*excluding partners' salaries*) attributable to the production of post-dissolution partnership income.") (emphasis added); *In re Labrum,* 227 B.R. at 418–19 (same) (applying Pennsylvania law); *see also LaFond,* — P.3d at ——, 2012 WL 503655, at *10 ("The great majority of states have concluded that contingent fees ultimately generated from cases that were pending at the time of dissolution of a law firm must be divided among the former law partners according to the fee-sharing arrangement that was in place when the firm dissolved."); *but cf. Bader v. Cox,* 701 S.W.2d 677 (Tex.App.1985) (embracing "efforts, skill and diligence" rationale).

For all these reasons, I entertain serious doubts whether the New York Court of Appeals would adopt the rationale of cases like *Kirsch* and *Shandell,* either in the contingency fee context or in the billable hours context.

The Second Circuit, however, has applied the rule, to a law firm, in the contingency fee context, *Santalucia, supra.* This court is bound by that decision. For the reasons discussed at length at pages 330–31 to 344 above, I can see no justification for imposing a different and harsher rule in a billable hours case than in a contingency case. In fact, adopting the rule in the billable hours context undermines even more clearly the purported repudiation of the quantum meruit rationale for unfinished business cases.

Thus, while I doubt whether the New York Court of Appeals would apply *Kirsch* in *either* context, I feel constrained to apply *Santalucia* to billable hours cases as well. The situation needs sorting out, but that is ultimately a job for the New York Court of Appeals.

[18] Applying the rule set forth in *Santalucia* does not, however, obviate the need for a trial. Disputed issues of fact remain concerning both the "value" of the Client Matters on the Dissolution Date, which will be determined, at least in part, by valuing the Formers Coudert Partners' post-dissolution efforts, skill and diligence.

Lest there be any doubt: this Court cannot blithely assume that the profits attributable to the Former Coudert Partners' post-dissolution "efforts, skill and diligence" are equal to the profits realized by the Firms for completing the Client Matters. One only need to look to *Santalucia* itself to reach this conclusion. After reversing Judge Hurd on the application of quantum meruit to the valuation question, the Second Circuit did not direct that he enter a judgment of zero in favor on the dissolved law partnership; it remanded so that Judge Hurd could make findings of fact about both the value of the wrongful death case on the date of dissolution and the departing partner's post dissolution "efforts, skill and diligence." *Id.* at 299–300.

This Court is currently in no position to make factual findings about any of the following: the value of the Client Matters on the Dissolution Date; the amount of post-dissolution profits (amounts collected minus expenses incurred) attributable to the Former Coudert Partners' "use" of the Client Matters, for which the Former Coudert Partners have a duty to account; or the amount of the post-dissolution profits that can be attributed to the Former Coudert Partners' post-dissolution "efforts, skill and diligence," which I must deduct from the profits as directed by *Santalucia.* Resolving those issues raises new questions ***350** that go far beyond the bounds of this opinion, including the following:

(1) The Partnership Law requires the departing partner to account for profits he realizes from the use of the dissolved firm's unfinished business. Is that measured by his share of the new firm's profit on the matter, or by the entire profit realized on the matter?

(2) What constitutes a deductible "expense" or "overhead" at the new firm? What portion of the new Firm's realized fee is profit and what is expense (which will entail dissection of billing rates to tease out the profit factor from the cost factor)?

(3) How does one value the Former Coudert Partner's contribution of "effort, skill and diligence" to the matter?

I am disinclined to ruminate on these issues; I look forward to the thorny task of resolving them.

C. Disposition of summary judgment motions

DSI's cross-motion for summary judgment seeks a declaration that the Client Matters were Coudert's property on the Dissolution Date, as a matter of law. DSI has demonstrated its entitlement the declaration it seeks, as a matter of law. The Firms have failed to adduce evidence creating a disputed issue of fact concerning the parties' intent. Thus, DSI's cross-motion for a declaration to the effect that the Client Matters were Coudert property on the Dissolution Date, triggering the Former Coudert Partners' duty to account, is GRANTED.

[19] The Firms' motions for summary judgment dismissing the complaints are DENIED as to the claims for an accounting. The Former Coudert Partners' duty to account to Coudert arose as they completed the Client Matters and earned fees thereon, and these actions were within the scope of the business of the Firms they joined. Thus, the Firms are jointly liable for an accounting, and there is no need to join the Former Coudert Partners individually under Federal Rule of Civil Procedure 19.

The Firms' motions are GRANTED as to DSI's remaining claims, which are dismissed, without prejudice, as duplicative and unnecessary. All the rights and obligations of the parties will be settled in an accounting proceeding. No basis for damages beyond remitting of the profits, less deductions, has been identified either in the pleadings our on the record of this motion. Should discovery reveal such a basis, DSI can move to have its remaining claims reinstated.

As noted above, Defendant Akin Gump avers that it has only represented former Coudert clients on new business, unrelated to any unfinished business. It is free to move for summary judgment once DSI has had discovery on the issue.

D. Certification

I have received some indication that the Firms will want to move for certification and an interlocutory appeal under 28 U.S.C. § 1292. They are ordered to do so within 10 days. DSI's response due 7 days thereafter. I will not need reply papers.

As the foregoing no doubt demonstrates, I respectfully disagree with my distinguished colleague, the Hon. Victor Marrero—who denied an interlocutory appeal from Judge Drain's order denying the Firms' motion to dismiss, *In re Coudert Bros. LLP Law Firm Adversary Proceedings,* 447 B.R. 706 (S.D.N.Y.2011)—about the complexity and difficulty of the issues involved in this case. The Firms' motion should explain why the current, and very different, posture of the case as it stands before me should lead me to analyze the ***351** remaining statutory elements differently than Judge Marrero.

VI. CONCLUSION

The Clerk of Court is directed remove the following open motions from the Court's list of pending matters: 11 Civ. 5968 (ECF #s 13, 22); 11 Civ. 5969 (ECF #s 15, 24); 11 Civ. 5970 (ECF #s 13, 22); 11 Civ. 5971 (ECF #s 14, 23); 11 Civ. 5972 (ECF #s 13, 23); 11 Civ. 5973 (ECF #s 14, 25); 11 Civ. 5974 (ECF #s 14, 24); 11 Civ. 5983 (ECF #s 19, 28); 11 Civ. 5984 (ECF #s 15, 24); 11 Civ. 5985 (ECF #s 13, 21); 11 Civ. 5993 (ECF #s 12, 21); 11 Civ. 5994 (ECF #s 15, 25); 11 Civ. 5995 (ECF #s 13, 22).

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476 B.R. 732
United States District Court,
S.D. New York.

Yann GERON, as Chapter 7
Trustee of Thelen LLP, Plaintiff,
v.
ROBINSON & COLE LLP, et al., Defendants.
Yann Geron, as Chapter 7
Trustee of Thelen LLP, Plaintiff,
v.
Seyfarth Shaw LLP, et al., Defendants.

Nos. 11 Civ. 8967, 12 Civ. 1364. | Sept. 4, 2012.

Synopsis
Background: Trustee of Chapter 7 estate of dissolved law partnership brought ad

versary proceeding against firms to which debtor's attorneys departed, seeking to recover, on fraudulent transfer theory, the value of pending hourly fee matters that attorneys brought with them to these new firms. Defendants moved to dismiss trustee's complaint or for judgment on pleadings.

Holdings: The District Court, William H. Pauley, III, J., held that:

[1] New York law governed determination of whether, and to what extent, a dissolved law firm had interest in pending hourly fee matters, such that its execution of waiver of its rights therein was in the nature of fraudulent prepetition transfer avoidable by trustee;

[2] under New York law as predicted by federal district court judge in that state, dissolved law firm's pending hourly fee matters are not partnership assets;

[3] assuming that pending hourly fee matters were "assets" of bankrupt law firm at time of its dissolution roughly one year prior to petition date, firm fraudulently transferred those assets when, without firm's receipt of any consideration in exchange, its partners adopted a so-called *Jewel* waiver on eve of dissolution; and

[4] whether firm had interest in pending hourly fee matters under California law could not be determined on motion to dismiss.

Granted in part and denied in part.

West Headnotes (21)

[1] **Contracts**
Legal remedies and proceedings
Law firm to which attorneys in bankrupt law partnership moved, not being party to the debtor's fourth partnership agreement, was not bound by choice-of-law provision in that agreement, in fraudulent transfer proceeding brought by Chapter 7 trustee, seeking to capture pending hourly fee matters which departing attorneys brought to this new firm for distribution as assets of estate. 11 U.S.C.A. § 548.

Cases that cite this headnote

[2] **Contracts**
Legal remedies and proceedings
Contractual choice-of-law-provision governs only causes of action sounding in contract, not those sounding in tort.

Cases that cite this headnote

[3] **Contracts**
Legal remedies and proceedings
Fraudulent Conveyances
Nature and Form of Remedy
Fraudulent transfer claims sound in tort, so as not to be subject to contractual choice-of-law provision.

1 Cases that cite this headnote

[4] **Bankruptcy**
Effect of state laws in general
In absence of any binding contractual choice-of-law provision, district court had to apply

choice-of-law rules of state in which it sat to determine which state's law governed the purported property interests at issue in fraudulent transfer avoidance proceeding. 11 U.S.C.A. § 548.

Cases that cite this headnote

[5] **Action**
What law governs

Under New York choice-of-law rules, courts first examine whether actual conflict exists between the laws of the jurisdictions involved, and if there is such a conflict, then courts conduct an "interest analysis" and apply law of the jurisdiction having the greatest interest in litigation.

Cases that cite this headnote

[6] **Action**
What law governs

When ascertaining, for choice-of-law purposes, which state has the greatest interest in pending litigation, New York courts undertake a two-pronged inquiry, determining: (1) what are the significant contacts and in which jurisdiction they are located; and (2) whether purpose of law at issue is to regulate conduct or allocate loss.

Cases that cite this headnote

[7] **Bankruptcy**
Transfer fraudulent as to partnership or individual creditors

New York law governed determination of whether, and to what extent, a dissolved law firm had interest in pending hourly fee matters, such that its execution of waiver of its rights therein was in the nature of fraudulent prepetition transfer avoidable by trustee of its Chapter 7 estate; while law firm was California limited liability partnership, majority of its former partners who moved to defendant firm and took these pending hourly fee matters with them were licensed to practice in New York, alleged fraudulent transfer occurred in New York, and partnership had filed its Chapter 7 petition in the Southern District of New York, so that New York had greater interest in controversy. 11 U.S.C.A. § 548.

4 Cases that cite this headnote

[8] **Torts**
What law governs

When regulation of conduct is at issue, state where the alleged tort took place has greater interest in controversy, for purposes of application of New York choice-of-law rules.

Cases that cite this headnote

[9] **Federal Courts**
State or Federal Laws as Rules of Decision; Erie Doctrine

When presented with state law issue, it is federal court's task to ascertain what the state law is, not what it ought to be.

Cases that cite this headnote

[10] **Federal Courts**
Anticipating or predicting state decision

Without guidance from state's highest court, federal court confronted with state law question must predict how state's highest court would resolve that question.

Cases that cite this headnote

[11] **Attorney and Client**
Client fees

Under New York law, absent agreement to the contrary, pending contingent fee cases of dissolved law partnership are partnership assets subject to distribution.

1 Cases that cite this headnote

[12] **Federal Courts**
Inferior courts

Federal Courts
Anticipating or predicting state decision

While not binding authority, New York trial court's interpretation of New York law is entitled to great weight, when federal court attempts to predict how the New York Court of Appeals would rule on unresolved state law issue.

2 Cases that cite this headnote

[13] **Attorney and Client**
Client fees

Under New York law as predicted by federal district court judge in that state, dissolved law firm's pending hourly fee matters are not partnership assets.

6 Cases that cite this headnote

[14] **Statutes**
Conflict

When confronted with two apparently conflicting statutes, New York courts adopt any fair construction that yields a reasonable field of operation for both statutes.

Cases that cite this headnote

[15] **Attorney and Client**
Standards, canons, or codes of conduct

While New York Rules of Professional Conduct lack the force of law, New York courts interpret other laws to harmonize with them where possible. N.Y.Rules of Prof.Conduct, Rule 1.1 et seq.

Cases that cite this headnote

[16] **Attorney and Client**
Client fees

While New York law deems deem pending contingency fee matters to be assets of dissolved law firm, dissolved firm has no cognizable property interest in fee, where successful settlement of pending contingent fee case post-dissolution is due to surviving partner's post-dissolution efforts, skill and diligence.

Cases that cite this headnote

[17] **Attorney and Client**
Client fees

Under New York law, when lawyer departs from dissolved law partnership and takes with him a contingent fee case which he then litigates to settlement, dissolved firm is entitled only to the value of case on date of dissolution, with interest.

1 Cases that cite this headnote

[18] **Attorney and Client**
Client fees

Bankruptcy
Pleading

Allegations in complaint filed by trustee of Chapter 7 estate of dissolved law partnership, that firm's partners, at same time that they agreed to dissolve firm, also adopted an amended partnership agreement that, for no consideration, purported to waive partnership's interest in pending cases except to extent of any fees already earned in those cases at time of dissolution, without making any attempt to distinguish between pending contingent fee matters, in which the dissolved partnership had interest under New York law, and pending hourly fee matters, in which, as predicted by district court, firm had no such interest, did not state a plausible claim for avoidance of waiver as fraudulent transfer. 11 U.S.C.A. § 548.

3 Cases that cite this headnote

[19] **Bankruptcy**
Transfer fraudulent as to partnership or individual creditors

Assuming that pending hourly fee matters were "assets" of bankrupt law firm at time of its dissolution roughly one year prior to petition date, firm fraudulently transferred those assets when, without firm's receipt of any consideration in exchange, its partners adopted a so-called *Jewel* waiver on eve of dissolution, pursuant to which they purported to waive partnership's interest in pending cases, except to extent of any fees already earned in those cases at time of dissolution. 11 U.S.C.A. § 548.

Cases that cite this headnote

[20] **Attorney and Client**
Client fees

Under California law, dissolved law partnership may have interest in pending hourly fee matters that exist at time of dissolution, but only to extent that these matters generate fees in excess of reasonable compensation for services rendered by attorneys in winding up such unfinished partnership business. West's Ann.Cal.Corp. Code § 16401(h).

2 Cases that cite this headnote

[21] **Bankruptcy**
Proceedings

Whether compensation received by departing partners in dissolved law firm for winding up unfinished partnership business by prosecuting pending hourly fee matters to conclusion exceeded reasonable compensation for such services, such that firm's gratuitous, prepetition waiver of any interest in these pending matters had deprived it of valuable interest in property that otherwise would have been included in Chapter 7 estate, and that trustee could recover as fraudulent transfer, could not be determined on motion to dismiss fraudulent transfer complaint, without a more fully developed record. 11 U.S.C.A. § 548.

1 Cases that cite this headnote

Attorneys and Law Firms

***735** Howard P. Magaliff, Esq., DiConza Traurig Magaliff LLP, New York, NY, for Plaintiff.

Christopher J. Major, Esq., Meister Seelig & Fein LLP, New York, NY, for Robinson & Cole LLP.

Robert W. Dremluk, Esq., Seyfarth Shaw LLP, New York, NY.

Thomas Feher, Esq., Thompson Hine LLP, Cleveland, OH, for Seyfarth Shaw LLP.

MEMORANDUM & ORDER

WILLIAM H. PAULEY III, District Judge.

These actions arise from an alarming phenomenon—the bankruptcy of a major law firm. The pursuit of pending hourly fee matters as assets of the estate has become a recurring feature of such bankruptcies. But this concept of law firm "property" collides with the essence of the attorney-client relationship. That relationship springs from agency law, not property law. The client is the principal, the attorney is the agent, and the relationship is terminable at will. The question presented is whether a dissolved law firm's pending hourly fee matters are nevertheless its property.

***736** Plaintiff Yann Geron (the "Trustee"), the Chapter 7 trustee of the bankruptcy estate of former law firm Thelen LLP ("Thelen"), brings fraudulent transfer and accounting and turnover claims against Defendants Seyfarth Shaw LLP ("Seyfarth Shaw") and Robinson & Cole LLP ("Robinson & Cole"). Through these claims, the Trustee seeks to recover profits from work that former Thelen partners performed after they joined those two law firms. Seyfarth Shaw moves for judgment on the pleadings under Federal Rule of Civil Procedure 12(c), and Robinson & Cole moves to dismiss all claims against it under Federal Rule of Civil Procedure 12(b)(6). For the following reasons, Seyfarth Shaw's motion is granted in its entirety and Robinson & Cole's motion is denied. Further, this Court *sua sponte* certifies this order for interlocutory appeal.

BACKGROUND

Until its dissolution in late 2008, Thelen was a registered limited liability partnership governed by California law, (Voluntary Petition ("Pet.") at 1, *In re Thelen LLP,* Case No. 09–15631 (Bankr.S.D.N.Y.).) On October 28, 2008—in the midst of the global financial crisis—Thelen's partners voted to dissolve the firm. (Complaint against Robinson & Cole and Partner Does, dated Sept. 14, 2011 ("RC Compl.") ¶ 20; Complaint against Seyfarth Shaw and Partner Does, dated Sept. 14, 2011 ("SS Compl.") ¶ 20.) At the same time, Thelen's partners adopted the Fourth Amended and Restated Limited Liability Partnership Agreement (the "Fourth Partnership Agreement"), which was also governed by California law. (RC Compl. ¶ 20; SS Compl. ¶ 20.) In connection with the Fourth Partnership Agreement, Thelen's partners voted to wind up Thelen's business under a written Plan of Dissolution. (RC Compl. ¶ 21; SS Compl. ¶ 21.) At the time of its dissolution, Thelen was insolvent. (RC Compl. ¶¶ 23, 28–29; SS Compl. ¶¶ 23, 28–29.)

Unlike Thelen's previous partnership agreements, the Fourth Partnership Agreement incorporated a so-called *Jewel* Waiver. (RC Compl. ¶ 34; SS Compl. ¶ 34.) Specifically, it provides:

> Neither the Partners nor the Partnership shall have any claim or entitlement to clients, cases or matters ongoing at the time of dissolution of the Partnership other than the entitlement for collection of amounts due for work performed by the Partners and other Partnership personnel prior to their departure from the Partnership. The provisions of this [section] are intended to expressly waive, opt out of and be in lieu of any rights any Partner or the Partnership may have to "unfinished business" of the Partnership, as the term is defined in *Jewel v. Boxer,* 156 Cal.App.3d 171 [203 Cal.Rptr. 13] (Cal.App. 1 Dist.1984), or as otherwise might be provided in the absence of this provision through the interpretation or application of the [California Uniform Partnership Act of 1994, as amended].

(RC Compl. ¶ 34; SS Compl. ¶ 34.)

On September 18, 2009, Thelen filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. At that time, Thelen indicated that it "has been domiciled or has had a residence, principal place of business, or principal assets" in the Southern District of New York. (Pet. at 2.) After the Trustee was appointed, he instituted adversary proceedings against Seyfarth Shaw, Robinson & Cole, and several former Thelen partners. The Trustee contends that Thelen's adoption of the *Jewel* ***737** Waiver in its Fourth Partnership Agreement constituted a fraudulent transfer by Thelen. The Trustee now seeks to avoid the fraudulent transfer of Thelen's unfinished business, recover its value, and require Defendants to account for and turn over the profits generated from that work.

DISCUSSION

I. *Legal Standard*

Courts evaluate motions for judgment on the pleadings under the same standard as motions to dismiss for failure to state a claim. *See Bank of N.Y. v. First Millennium, Inc.,* 607 F.3d 905, 922 (2d Cir.2010). "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' " *Ashcroft v. Iqbal,* 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009) (quoting *Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007)). To determine plausibility, courts follow a "two-pronged approach." *Iqbal,* 556 U.S. at 679, 129 S.Ct. 1937. "First, although 'a court must accept as true all of the allegations contained in a complaint,' that 'tenet' 'is inapplicable to legal conclusions,' and '[t]hreadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice.' " *Harris v. Mills,* 572 F.3d 66, 72 (2d Cir.2009) (alteration in original) (quoting *Iqbal,* 556 U.S. at 678, 129 S.Ct. 1937). Second, a court determines "whether the 'well-pleaded factual allegations,' assumed to be true, 'plausibly give rise to an entitlement to relief' " *Hayden v. Paterson,* 594 F.3d 150, 161 (2d Cir.2010) (quoting *Iqbal,* 556 U.S. at 679, 129 S.Ct. 1937). A court's "consideration [on a motion to dismiss] is limited to facts stated on the face of the complaint, in documents appended to the complaint or incorporated in the complaint by reference, and to matters of which judicial notice may be taken." *Allen v. WestPoint–Pepperell Inc.,* 945 F.2d 40, 44 (2d Cir.1991).

II. *Choice of Law*

To prevail on its claims against Seyfarth Shaw, the Trustee must demonstrate that Thelen had an interest in "property." *See* 11 U.S.C. §§ 542, 544, 548, 550; *see also* Cal. Civ.Code §§ 3439.04–3439.07. According to the Trustee, Thelen's partners transferred "property" to Seyfarth Shaw and Robinson & Cole when they executed the *Jewel* Waiver. The parties agree that California law defines any "property interest" that Robinson & Cole received.[1] However, the Trustee and Seyfarth Shaw dispute whether California law or New York law defines any "property interest" received by Seyfarth Shaw.

1 Robinson & Cole is based in Connecticut, (RC Compl. ¶ 4), but the parties do not contend that Connecticut law governs the "property interest" at issue. Because the parties agree that California law applies and they did not brief applicable Connecticut law, this Court declines to consider whether Connecticut law applies. *See Julio & Sons Co. v. Travelers Cas. & Sur. Co. of Am.,* 591 F.Supp.2d 651, 656 n. 3 (S.D.N.Y.2008).

[1] [2] [3] As a preliminary matter, this Court rejects the Trustee's contention that California law applies because Thelen's Fourth Partnership Agreement contained a choice-of-law provision to that effect. Because Seyfarth Shaw was not a party to the Fourth Partnership Agreement, it cannot be bound by that agreement. *See Int'l Customs Assocs., Inc. v. Ford Motor Co.,* 893 F.Supp. 1251, 1255 (S.D.N.Y.1995) (citing *Abraham Zion Corp. v. Lebow,* 761 F.2d 93, 103 (2d Cir.1985)). Further, "a contractual choice-of-law-provision governs only a cause of action sounding in contract, not one sounding in tort[.]" ***738** *Drenis v. Haligiannis,* 452 F.Supp.2d 418, 425–26 (S.D.N.Y.2006). Fraudulent transfer claims sound in tort. *See Drenis,* 452 F.Supp.2d at 418. Accordingly, Seyfarth Shaw is not bound by the agreement's choice-of-law provision.

[4] [5] In the absence of a binding contractual choice-of-law provision, this Court applies the choice-of-law rules of New York to determine which state's law governs the purported property interest at issue. *See In re Gaston & Snow,* 243 F.3d 599, 600–01, 607 (2d Cir.2001). Thus, this Court first examines whether an actual conflict exists between the laws of the jurisdiction involved. *See Paradigm BioDevices, Inc. v. Viscogliosi Bros., LLC,* 842 F.Supp.2d 661, 665 (S.D.N.Y.2012). If there is such a conflict, this Court conducts an "interest analysis," and applies the "law of the jurisdiction having the greatest interest in the litigation[.]" *Istim, Inc. v. Chemical Bank,* 78 N.Y.2d 342, 347, 575 N.Y.S.2d 796, 581 N.E.2d 1042 (1991) (quoting *Schultz v. Boy Scouts of Am., Inc.,* 65 N.Y.2d 189, 197, 491 N.Y.S.2d 90, 480 N.E.2d 679 (1985)) (internal quotation marks omitted).

[6] For the reasons described below, the existence and scope of a dissolved law firm's property interest in pending hourly fee matters vary under New York and California law. This Court therefore examines the competing interests of New York and California in this action. In ascertaining the state with the greatest interest, this Court undertakes a two-pronged inquiry, determining "(1) what are the significant contacts and in which jurisdiction are they located; and, (2) whether the purpose of the law [at issue] is to regulate conduct or allocate loss." *Padula v. Lilarn Props. Corp.,* 84 N.Y.2d 519, 521, 620 N.Y.S.2d 310, 644 N.E.2d 1001 (1994) (citation omitted).

[7] [8] Here, the majority of the significant contacts occurred in New York. The Trustee does not dispute that the majority of the former Thelen partners who moved to Seyfarth Shaw are licensed to practice law in New York. Moreover, Thelen filed its Chapter 7 petition in the Southern District of New York, indicating that it "has been domiciled or has had a residence, principal place of business, or principal assets" in the Southern District of New York. (Pet. at 2.) In view of these contacts, Thelen's status as a California limited liability partnership is inconsequential. *See El Cid, Ltd. v. N.J. Zinc Co.,* 575 F.Supp. 1513, 1518–19 (S.D.N.Y.1983). And where, as here, regulation of conduct is at issue, the state where the alleged tort took place has the greater interest. *See GFL Advantage Fund, Ltd. v. Colkitt,* No. 03 Civ. 1256 (JSM), 2003 WL 21459716, at *3 (S.D.N.Y. June 24, 2003); *see also Roselink Investors, L.L.C. v. Shenkman,* 386 F.Supp.2d 209, 225 (S.D.N.Y.2004) ("A fraudulent conveyance statute is conduct regulating rather than loss allocating." (internal citation and quotation marks omitted)). Here, the alleged tort occurred in New York. Accordingly, New York has the greatest interest in this litigation, and New York law defines the property interest—if any—that Seyfarth Shaw received.

III. *Unfinished Business Under New York Law*

[9] [10] To prevail on its claims against Seyfarth Shaw, the Trustee must demonstrate that Seyfarth Shaw received a property interest of Thelen's. To that end, the Trustee seeks to recover Thelen's purported ownership interest in profits from its former clients' hourly fee matters that were pending when Thelen dissolved. The Trustee also seeks to recover profits from pending contingency fee matters. In opposing these claims, Seyfarth Shaw contends that New York law does not recognize ***739** a law firm's property interest in pending hourly fee matters. It is this Court's task "to ascertain what the state law is, not what it ought to be." *Klaxon Co. v. Stentor Elec. Mfg. Co.,* 313 U.S. 487, 497, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941). Accordingly, without guidance from the state's highest court, this Court must "predict how the New York Court of Appeals would resolve the question [.]" *Amerex Grp., Inc. v. Lexington Ins. Co.,* 678 F.3d 193, 200 (2d Cir.2012) (quoting *Highland Capital Mgmt. LP v. Schneider,* 460 F.3d 308, 316 (2d Cir.2006)) (internal quotation marks omitted).

The Trustee bases his claims on the "unfinished business doctrine," which is "[t]he general rule that the business of a partnership that is unfinished on the date the partnership dissolves is an asset of the partnership, and must be concluded for the benefit of the dissolved partnership." *Dev. Specialists, Inc. v. Akin Gump Strauss Hauer & Feld LLP,* 477 B.R. 318, 2012 WL 1918705, at *11 (S.D.N.Y. May 24, 2012) ("*DSI* ") (citing *Stem v. Warren,* 227 N.Y. 538, 125 N.E. 811 (1920)). The seminal case applying this doctrine to law partnerships is *Jewel v. Boxer,* 156 Cal.App.3d 171, 179, 203 Cal.Rptr. 13 (Cal.App. 1 Dist.1984), where the court noted that "each former partner has a duty to wind up and complete the unfinished business of the dissolved partnership."[2] The court also observed that "[t]he Uniform Partnership Act unequivocally prohibits extra compensation for postdissolution services, with a single exception for surviving partners." *Jewel,* 156 Cal.App.3d at 176–77, 203 Cal.Rptr. 13 (citing Cal. Corp.Code § 15018(f) (since repealed)). Applying this "no compensation" rule, the court in *Jewel* held that "absent a contrary agreement, any income generated through the winding up of unfinished business is allocated to the former partners according to their respective interests in the partnership." *Jewel,* 156 Cal.App.3d at 176, 203 Cal.Rptr. 13. New York's Partnership Law is a codification of the Uniform Partnership Act ("UPA"), and the "no compensation" rule applies in New York. *See DSI,* 477 B.R. at 327, 2012 WL 1918705, at *5 (citing N.Y. P'ship Law § 1); *see also* N.Y. P'ship Law § 40(6). After *Jewel,* some courts have characterized a dissolved law firm's unfinished business as a "partnership asset." *See, e.g., In re Brobeck, Phleger & Harrison LLP,* 408 B.R. 318, 333 (Bankr.N.D.Cal.2009). The question here is whether New York law sanctions the expansion of such a rule to a dissolved law firm's pending hourly fee matters.

2 *Jewel* involved a four-partner law firm handling principally personal injury and workers' compensation cases that dissolved in 1977. Thereafter, the partners split into two two-partner law firms, with clients retaining the attorney who handled their matter at the old firm. Because they had no written partnership agreement, the partners disputed the allocation of attorneys' fees from these cases. Reversing the trial court, an intermediate appellate court concluded that the profits from this "unfinished business" were owed to the former partners in proportion to their partnership interests. *Jewel,* 156 Cal.App.3d at 174–76, 203 Cal.Rptr. 13. Over the last three decades, courts have cited *Jewel* reflexively and uncritically. Thus, from modest beginnings in a dispute involving a small Alameda County general practice firm, the *Jewel* doctrine has grown to ensnare some of the largest law firms in the United States.

[11] Under New York law, it is well settled that "[a]bsent an agreement to the contrary, pending *contingent fee cases* of a dissolved partnership are assets subject to distribution." *Santalucia v. Sebright Transp., Inc.,* 232 F.3d 293, 297 (2d Cir.2000) (emphasis added). But New York courts have not expanded the unfinished business doctrine to reach pending hourly fee matters. Rather, the only New York ***740** court to consider whether a debtor law firm possesses a property interest in its unfinished hourly fee matters concluded that it does not. In *Sheresky v. Sheresky Aronson Mayefsky & Sloan, LLP,* 35 Misc.3d 1201(A), 2011 WL 7574999, at *5 (N.Y.Sup.Ct. Sept. 13, 2011), the state court declined to expand the unfinished business doctrine to pending hourly fee matters, reasoning that "[i]t is logical to distinguish between contingency fee arrangements and cases which are billed on the basis of hourly work." Citing the New York Rules of Professional Conduct, the court refused "to recognize a cause of action for unfinished business for hourly fee cases which has, hitherto, not been recognized by the New York courts." *Sheresky,* 2011 WL 7574999, at *6.

[12] **[13]** Although *Sheresky* is not binding authority, a New York trial court's interpretation of New York law is entitled to "great weight." *In re Brooklyn Navy Yard Asbestos Litig.,* 971 F.2d 831, 850 (2d Cir.1992) (internal quotation marks omitted). And this Court finds *Sheresky* persuasive. Unlike in the contingency fee context, applying the unfinished business doctrine to pending hourly fee matters would result in an unjust windfall for the Thelen estate, as "compensating a former partner out of that fee would reduce the compensation of the attorneys performing the work." *Sheresky,* 2011 WL 7574999, at *5. Such an expansion of the doctrine would violate New York's public policy against restrictions on the practice of law. *See Cohen v. Lord, Day & Lord,* 75 N.Y.2d 95, 96, 551 N.Y.S.2d 157, 550 N.E.2d 410 (1989). Indeed, recognizing a property interest in pending hourly fee matters would clash directly with New York's Rules of Professional Conduct, which state:

> A lawyer shall not divide a fee for legal services with another lawyer who is not associated in the same firm unless: (1) the division is in proportion to the services performed by each lawyer or, by a writing given to the client, each lawyers assumes joint responsibility for the representation; (2) the client

> agrees to the employment of the other lawyer after a full disclosure that a division of fees will be made, including the share each lawyer will receive, and the client's agreement is confirmed in writing; and (3) the total fee is not excessive.

22 NYCRR 1200.0, DR 1.5(g).

[14] **[15]** When confronted with two apparently conflicting statutes, New York courts adopt "any fair construction" that yields "a reasonable field of operation for both statutes." *Cnty. of St. Lawrence v. Shah,* 95 A.D.3d 1548, 945 N.Y.S.2d 443, 446 (3d Dep't 2012) (quoting *Con. Edison Co. of N.Y., Inc. v. Dep't of Envtl. Conservation,* 71 N.Y.2d 186, 195, 524 N.Y.S.2d 409, 519 N.E.2d 320 (1988)) (internal quotation marks and alteration omitted). Although the Rules of Professional Conduct lack the force of law, *cf. Niesig v. Team I,* 76 N.Y.2d 363, 369, 559 N.Y.S.2d 493, 558 N.E.2d 1030 (1990), New York courts interpret other laws to harmonize with them where possible. *See Sheresky,* 2011 WL 7574999, at *5.

[16] **[17]** Further, recognizing a property interest in pending hourly fee matters would contravene New York law's treatment of post-dissolution contingency fee matters. Although New York cases deem pending contingency fee matters to be "assets" of a dissolved firm, they hold that a dissolved firm has "no cognizable property interest in [a] fee" where the "successful settlement of a pending contingent fee case post-dissolution is due to a surviving partner's post-dissolution efforts, skill and diligence [.]" *Santalucia,* 232 F.3d at 298 (quoting *Shandell v. Katz,* 217 A.D.2d 472, 629 N.Y.S.2d 437, 439 (1st Dep't 1995)) (internal quotation marks omitted). ***741** "Thus, in a case where a lawyer departs from a dissolved partnership and takes with him a contingent fee case which he then litigates to settlement, the dissolved firm is entitled only to the value of the case at the date of dissolution, with interest." *Santalucia,* 232 F.3d at 298 (citing *Kirsch v. Leventhal,* 181 A.D.2d 222, 586 N.Y.S.2d 330, 333 (3d Dep't 1992)). In an hourly fee case, unlike a contingency fee case, all post-dissolution fees that a lawyer earns are due to that lawyer's "post-dissolution efforts, skill and diligence[.]" *Shandell,* 629 N.Y.S.2d at 439 (quoting *Kirsch,* 586 N.Y.S.2d at 333) (internal quotation marks omitted). Accordingly, New York law does not recognize a debtor law firm's property interest in pending hourly fee matters.

And recognizing such a property interest would have bizarre consequences. If such an interest exists, it becomes property of the estate upon the filing of a bankruptcy petition. *See* 11 U.S.C. § 541. It would appear, then, that the Bankruptcy Code empowers a debtor law firm to sell its pending hourly fee matters to the highest bidder. *See* 11 U.S.C. § 363 ("The trustee, after notice and hearing, may use, sell, or lease ... property of the estate [.]"). When this Court asked the Trustee whether a debtor firm could auction off its pending matters, the Trustee was unable to answer definitively. (Hearing Transcript, dated July 31, 2012 ("Hr'g Tr.") at 31 (12 Civ. 1364, ECF No. 17).) And the Trustee's reticence is understandable, as allowing such a sale of "property" is inconsistent with a client's right to choose attorneys. *See Demov, Morris, Levin & Shein v. Glantz,* 53 N.Y.2d 553, 556, 444 N.Y.S.2d 55, 428 N.E.2d 387 (1981) ("[It is] well rooted in our jurisprudence [ ] that a client may at any time, with or without cause, discharge an attorney [.]"). Similarly, under the Trustee's interpretation of the unfinished business doctrine, it is unclear whether a client who discharges a debtor law firm and transfers his case to a new firm violates the automatic stay. *See* 11 U.S.C. § 362 (prohibiting "any act to obtain possession of property of the estate ... or to exercise control over the property of the estate").

These unworkable results militate powerfully against extending the unfinished business doctrine to hourly fee matters. Perhaps for this reason, New York courts have endeavored to cabin the doctrine, holding that "[r]etainers from former clients on new matters—even matters, like appeals, that are related to finished representations—... [are] 'new business' and not subject to the duty to account." *DSI,* 477 B.R. at 332, 2012 WL 1918705, at *11 (citing *Talley v. Lamb,* 100 N.Y.S.2d 112, 117–18 (N.Y.Sup.Ct.1950)). Given this background, characterizing unfinished hourly fee matters as "property" makes little sense.

In arguing that pending hourly fee matters are nevertheless Thelen property, the Trustee relies heavily on *Stem v. Warren,* 227 N.Y. 538, 125 N.E. 811 (1920), a hoary case involving architecture partnerships. According to the Trustee, *Stem* stands for the proposition that a partnership's executory contracts may be partnership property even if they are terminable at will. But the Trustee's reading of the case is overbroad. Rather, "under *Stem,* if an executory contract with a third party contemplates that it should survive dissolution, it remains a joint venture asset and the co-venturers have an obligation to perform with the concomitant right to its benefits." *Scholastic, Inc. v. Harris,* 259 F.3d 73, 89 (2d

Cir.2001). Here, Thelen's hourly fee matters cannot have contemplated post-dissolution survival without infringing a client's right to terminate an attorney at will. *See* ***742** *Demov, Morris, Levin & Shein,* 53 N.Y.2d at 556, 444 N.Y.S.2d 55, 428 N.E.2d 387. Although the contract in *Stem* was, by its terms, terminable at will, *see* 227 N.Y. at 544, 125 N.E. 811, contracts for legal services are categorically different from architecture contracts. Clients repose "ultimate trust and confidence" in their attorneys. *In re Cooperman,* 83 N.Y.2d 465, 472, 611 N.Y.S.2d 465, 633 N.E.2d 1069 (1994). "The attorney's obligations, therefore, transcend those prevailing in the commercial market place," and "[t]he contract under which an attorney is employed by a client has peculiar and distinctive features[.]" *Cooperman,* 83 N.Y.2d at 472–73, 611 N.Y.S.2d 465, 633 N.E.2d 1069 (quoting *Martin v. Camp,* 219 N.Y. 170, 172, 114 N.E. 46 (1916)) (internal quotation marks and citations omitted).

A pending client matter is not an ordinary article of commerce. Contrary to *DSI,* an hourly fee matter is not akin to "a Jackson Pollack [sic] painting" that a departing attorney "rip[s] off the wall of the reception area [.]" *DSI,* 477 B.R. at 329, 2012 WL 1918705, at *7. The client, not the attorney, moves a matter to a new firm. Thus, the attorney-client relationship is unique, and applying *Stem* to hourly fee legal service contracts would undermine it. New York law does not countenance such a result. *See Sheresky,* 2011 WL 7574999, at *5–6. In *Cohen,* the New York Court of Appeals drew on an ethics opinion from the New York County Lawyers' Association to emphasize New York's commitment to client autonomy: "Clients are not merchandise. Lawyers are not tradesmen.... An attempt, therefore, to barter in clients, would appear to be inconsistent with the best concepts of our professional status." *Cohen,* 75 N.Y.2d at 98, 551 N.Y.S.2d 157, 550 N.E.2d 410 (internal quotation marks omitted). This policy applies just as forcefully to client matters.

The Trustee also cites cases from other jurisdictions for the proposition that "every other court confronted with this issue ... has held that pending cases, regardless of whether they are hourly-fee cases or contingent-fee matters [are] ... assets of the partnership subject to post-dissolution distribution." *In re Labrum & Doak, LLP,* 227 B.R. 391, 408 (Bankr.E.D.Pa.1998) (citing *Sufrin v. Hosier,* 896 F.Supp. 766, 769 (N.D.Ill.1995)). But the cases on which the Trustee relies do not represent a consensus view. *See Sheresky,* 2011 WL 7574999, at *5–*6. In *DSI,* the district court nonetheless gave substantial weight to these decisions on the ground that "New York courts must harmonize their rulings with those of other UPA jurisdictions by statute[.]" *DSI,* 477 B.R. at 336, 2012 WL 1918705, at *15 (citing N.Y. P'ship Law § 4(4)). This Court respectfully disagrees.

The purpose of UPA is to harmonize partners' duties regarding partnership property, not to delineate the scope of such property. *See Welman v. Parker,* 328 S.W.3d 451, 458 (Mo.Ct.App.2010) (explaining that state common law, and not the Uniform Partnership Law, determines "which party is entitled to the contingent fee"); *see also DSI,* 477 B.R. at 334, 2012 WL 198705, at *13 ("There is surprisingly little New York authority on how a court is to determine what property is within or without a partnership.") (quoting *Sriraman v. Patel,* 761 F.Supp.2d 7, 18 (E.D.N.Y.2011)); *cf. Butner v. United States,* 440 U.S. 48, 55, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979) ("[T]here is no reason why [property] interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding."). The Trustee identifies no provision of UPA that addresses whether pending hourly fee matters are partnership property. And, for the reasons discussed above, recognizing a property right in unfinished hourly fee matters conflicts with New York's strong public policy in ***743** favor of client autonomy and attorney mobility. *See Cohen,* 75 N.Y.2d at 98, 551 N.Y.S.2d 157, 550 N.E.2d 410; *see also Denburg v. Parker Chapin Flattau & Klimpl,* 82 N.Y.2d 375, 381–82, 604 N.Y.S.2d 900, 624 N.E.2d 995 (1993). Accordingly, the Trustee's contention that the court in *Sheresky,* 2011 WL 7574999, at *6, failed to engage in the requisite analysis of out-of-state case law is without merit. (Hr'g Tr. at 28.) To the extent that the out-of-state cases suggest a result that is irreconcilable with New York policy, they are not reliable indicators of New York law.

[18] Thus, under New York law, a dissolved law firm's pending hourly fee matters are not partnership assets. And because the Trustee's complaint against Seyfarth Shaw fails to distinguish between pending contingency fee matters and hourly fee matters, the complaint is deficient. *See Iqbal,* 556 U.S. at 678, 129 S.Ct. 1937. Accordingly, Seyfarth Shaw's motion for judgment on the pleadings is granted, and the Trustee's claims against Seyfarth Shaw are dismissed. If the Trustee intends to pursue claims against Seyfarth Shaw regarding Thelen's pending contingency fee matters, the Trustee must amend his complaint.

IV. *Unfinished Business under California Law*

In contrast to Seyfarth Shaw, Robinson & Cole concedes for the purposes of its motion to dismiss that California law governs any property interest that it received. Robinson & Cole argues that, notwithstanding *Jewel* and the cases following it, California law no longer recognizes a dissolved law firm's property right in its pending hourly fee matters. Robinson & Cole also maintains that, even assuming the existence of such a property interest, the interest was never transferred to Robinson & Cole. The Trustee responds that California law recognizes pending hourly fee matters as assets, and that Thelen transferred those assets to Robinson & Cole when its partners executed the *Jewel* Waiver.

[19] Assuming that pending hourly fee matters are "assets," Thelen fraudulently transferred those assets when its partners adopted the *Jewel* Waiver on the eve of dissolution without consideration. *See In re Heller Ehrman LLP,* No. 08–32514DM, 2011 WL 1539796, at *5 (Bankr.N.D.Cal. April 22, 2011); *see also* 11 U.S.C. § 101(54) (a "transfer" is "each mode, direct or indirect, ... of disposing of or parting with—(i) property; or (ii) an interest in property"). Under section 550(a) of the Bankruptcy Code, the Trustee may recover the value of fraudulently transferred property from "(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or (2) any immediate or mediate transferee of such initial transferee." 11 U.S.C. § 550(a). And when Thelen's former partners brought pending matters to Robinson & Cole, they transferred that "property" to their new firm. Thus—assuming that pending hourly fee matters are "property"—Robinson & Cole may be liable as an "immediate or mediate transferee" of those assets. *See* 11 U.S.C. § 550(a)(1). That Robinson & Cole owes no fiduciary duties to Thelen is irrelevant to its status as a transferee. *See Brobeck,* 408 B.R. at 339 n. 31

[20] The central question, then, is whether California law recognizes a dissolved law firm's pending hourly fee matters as partnership assets. In *Jewel* and the cases following it, California courts held that such matters were, indeed, assets of a dissolving firm. *See Jewel,* 156 Cal.App.3d at 176, 203 Cal.Rptr. 13; *see also* ***744** *Rothman v. Dolin,* 20 Cal.App.4th 755, 758–59, 24 Cal.Rptr.2d 571 (Cal.App. 2 Dist.1993). And *Jewel* applies to registered limited liability partnerships like Thelen. *See Fox v. Abrams,* 163 Cal.App.3d 610, 616, 210 Cal.Rptr. 260 (Cal.App. 2 Dist.1985) (extending the *Jewel* doctrine to the dissolution of a law corporation because *Jewel* "was not based solely on partnership law but also cited 'sound policy reasons' for its decision"). However, Robinson & Cole argues that California's enactment of the Revised Uniform Partnership Act ("RUPA") in 1994 abrogated the *Jewel* doctrine. *Jewel* and its progeny relied on UPA's "no compensation" rule. *See Jewel,* 156 Cal.App.3d at 176–77, 203 Cal.Rptr. 13; *see also Rothman,* 20 Cal.App.4th at 757, 24 Cal.Rptr.2d 571. But RUPA abolished the "no compensation" rule, providing instead that a partner is entitled to "reasonable compensation for services rendered in winding up the business of the partnership." Cal. Corp.Code § 16401(h).

Robinson & Cole's argument is persuasive. In applying the unfinished business doctrine to law partnerships, *Jewel* relied expressly on UPA's "no compensation" rule, reasoning that "[t]he Uniform Partnership Act unequivocally prohibits extra compensation for postdissolution services, with a single exception for surviving partners." *Jewel,* 156 Cal.App.3d at 176–77, 203 Cal.Rptr. 13. But RUPA transformed the law on which *Jewel* relied and eroded the theoretical underpinnings of the *Jewel* doctrine. Because RUPA entitles partners of a dissolving firm to "reasonable compensation for services rendered in winding up the business of the partnership," Cal. Corp.Code § 16401(h), there is no basis to require Thelen's former partners to remit all profits earned from former Thelen matters to the Thelen estate. [3]

3 This Court declines to address Robinson & Cole's argument—raised only in a footnote—that the Trustee fails adequately to allege Thelen's insolvency at the time of the *Jewel* Waiver. *See Bryant Park Capital, Inc. v. Jelco Ventures,* No. 05 Civ. 8702(GEL), 2007 WL 2119486, at *1 (S.D.N.Y. July 23, 2007) (declining to consider argument raised only in footnote).

[21] Nevertheless, the former Thelen partners' post-RUPA entitlement to "reasonable compensation" does not necessarily mean that Robinson & Cole did not receive Thelen "assets." The question of "reasonable compensation" is fact-intensive, and this Court cannot, on a motion to dismiss, determine whether the former Thelen partners are entitled to retain all profits earned from pending hourly fee matters. Robinson & Cole cites *Jacobson v. Wikholm,* 29 Cal.2d 24, 30–31, 172 P.2d 878 (1946), for the proposition that "reasonable compensation" includes profits resulting from a partner's post-dissolution skill and effort, except to the extent that those profits result from the use of the dissolved partnership's capital. Yet, notwithstanding *Jacobson,* the fact-bound "reasonable compensation" inquiry may not be resolved on a motion to dismiss. *See Anderson News, L.L.C. v. Am. Media, Inc.,* 680 F.3d 162, 185 (2d Cir.2012) ("Fact-specific questions cannot be resolved on the pleadings." (internal alterations, quotation marks, and citations omitted)). Thus, Robinson & Cole's liability turns on the extent to which the former Thelen partners received remuneration beyond "reasonable compensation." This question can only be resolved on a more fully developed record.

In arguing that dismissal of the claims against it is warranted, Robinson & Cole advances many of the same policy arguments proffered by Seyfarth Shaw. But these arguments are less persuasive in the context of California law because California ***745** courts have rejected them. *See Fox,* 163 Cal.App.3d at 616, 210 Cal.Rptr. 260 (discussing "sound policy reasons" supporting *Jewel* doctrine); *see also Jewel,* 156 Cal.App.3d at 179, 203 Cal.Rptr. 13. And New York's commitment to attorney mobility appears to be stronger than California's. *Compare Cohen,* 75 N.Y.2d at 98, 551 N.Y.S.2d 157, 550 N.E.2d 410, *with Howard v. Babcock,* 6 Cal.4th 409, 422–23, 25 Cal.Rptr.2d 80, 863 P.2d 150 (1993) (declining to follow *Cohen*).

In sum, RUPA's "reasonable compensation" rule undermines the *Jewel* doctrine, which applied the older "no compensation" rule. Nevertheless, California law may still recognize a dissolving firm's pending hourly fee matters as "assets." Specifically, to the extent that Robinson & Cole earned profits from former Thelen matters exceeding "reasonable compensation," California law dictates that those profits belong to Thelen. Accordingly, Robinson & Cole's motion to dismiss the Trustee's claims is denied.

V. *Interlocutory Appeal*

A district court may certify an order for interlocutory appeal if "the district judge 'is under the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal may materially advance the ultimate termination of the litigation.' " *United States v. Culbertson,* 598 F.3d 40, 45 (2d Cir.2010) (quoting 28 U.S.C. § 1292(b)). The question whether a dissolved law firm's pending hourly fee matters are partnership assets under New York law and California law is controlling. And "reversal of [this] opinion, even though not resulting in dismissal, could significantly affect the conduct the action[.]" *Primavera Familienstifung v. Askin,* 139 F.Supp.2d 567, 570 (S.D.N.Y.2001).

These issues impact a large number of cases, and they present substantial grounds for difference of opinion. The *DSI* court recently certified its decision for interlocutory appeal, and that decision implicates many of the controlling issues in this Memorandum & Order. *See Dev. Specialists, Inc. v. Akin Gump Strauss Hauer & Feld LLP,* Nos. 11 Civ. 5994 (CM), *et seq.,* 2012 WL 2952929, at *7–8 (S.D.N.Y. July 18, 2012). Further, certification of these questions to the New York Court of Appeals and the California Supreme Court may be warranted because those high courts have "not squarely addressed" the issues, and the scope of the unfinished business doctrine is of great importance to both the legal profession and clients. *Joseph v. Athanasopoulos,* 648 F.3d 58, 67 (2d Cir.2011) (quoting *10 Ellicott Square Court Corp. v. Mountain Valley Indem. Co.,* 634 F.3d 112, 125–26 (2d Cir.2011)). Notwithstanding its humble beginnings, some lower courts have applied the *Jewel* doctrine expansively, with untoward consequences for the bar and clients. In this Court's view, there is good reason to believe that the highest courts of New York and California would decline to follow suit. In these circumstances, "the prompt resolution" of these issues on appeal will promote judicial economy and doctrinal clarity. *Mohawk Indus., Inc. v. Carpenter,* 558 U.S. 100, 130 S.Ct. 599, 607, 175 L.Ed.2d 458 (2009). Accordingly, this Court *sua sponte* certifies this order for interlocutory appeal.

CONCLUSION

For the foregoing reasons, Seyfarth Shaw LLP's motion for judgment on the pleadings is granted, and Robinson & Cole LLP's motion to dismiss is denied. This Court certifies this order for interlocutory appeal pursuant to 28 U.S.C. § 1292(b). Any party seeking leave for the Court of Appeals to hear an interlocutory appeal ***746** shall direct its application to the Court of Appeals within ten days. *See* 28 U.S.C. 1292(b). This Court hereby stays all proceedings in the district court pending a decision on certification from the Court of Appeals.

The Clerk of the Court is directed to file this Memorandum & Order in both 11 Civ. 8967 and 12 Civ. 1364. The Clerk of the Court is further directed to terminate the motions pending at ECF No. 13 in 11 Civ. 8967 and ECF No. 9 in 12 Civ. 1364.

Parallel Citations

56 Bankr.Ct.Dec. 269

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17th Annual New York City Bankruptcy Conference: "Governed by New York Law"? Considering the Impact of New York State Law in Bankruptcy Matters

My Firm Folded and My Capital is Gone; What Next?: Disgorging Partner Compensation in *Dewey* and *Thelen*

By Evan C. Hollander, Jonathan W. Hughes, and Dana Yankowitz Elliott[1]

Introduction

The collapse of a business is traumatic for any owner-operator. They worry about their employees, damage to their reputations, and may well face an uncertain financial future. If the business was operated as a corporation, the failure of the company may have a devastating impact on the owner-operator, but she will not likely be compelled to repay compensation she received as an officer of the company prior to the filing. The same is not true for members of a partnership. Depending upon the jurisdiction of their firm's formation and the provisions of their partnership agreements, even those partners who have generated revenues far in excess of their earnings may find themselves obligated to repay all compensation that they received months, or even years, prior to their firm's failure.

Two recent bankruptcy cases out of the Southern District of New York shine a light on the harsh realities that partners face when their firms fail. The *Dewey & LeBoeuf LLP* case involved the failure of a New York limited liability partnership. In that case, the court applied unique features of New York insolvency and debtor-creditor law to recover all of the distributions made to the defendant former partners for more than three years prior to the filing. In contrast, the *Thelen LLP* case involved the failure of a California limited liability partnership. There, the court applied a contractual analysis of the partnership agreement to recover all

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distributions made to defendant-former partners in excess of the firm's net income during its last year of operation. While both decisions were unwelcome news for law firm partners, the *Dewey* decision and its grounding in uniquely harsh New York state law exposes partners to much greater risks than the *Thelen* decision.

The *Dewey* Opinion

In May 2012, Dewey filed for chapter 11 protection in the United States Bankruptcy Court for the Southern District of New York (Judge Martin Glenn). The firm's liquidation plan contained a settlement under which about 400 former partners contributed approximately $71.5 million dollars to settle potential claims to disgorge prepetition distributions made to them. After the plan had been confirmed, the trustee pursued claims against those partners who refused to settle and sought to recover all distributions made to those former partners within three years prior to the bankruptcy filing.[2]

On October 29, 2014, Judge Glenn granted summary judgment in favor of the trustee on two critical issues. First, he held that New York Debtor and Creditor Law (NYDCL) § 277(a) applies to the partners of a New York limited liability partnership, establishing the trustee's right to pursue recovery of *all* partner distributions made while the partnership was insolvent, allegedly dating back to January 2009. Second, he overruled the former partners' principal defense, holding that the partners' legal and business generation services cannot qualify as "reasonably equivalent value" for purposes of Bankruptcy Code § 548(a)(1)(B)(i) to offset that recovery.[3]

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2 The clawback period in *Dewey* was limited to a little over three years because the Dewey Trustee established an insolvency date of January 2009. However, because New York Civil Practice Law and Rules § 213 has a six-year look-back period, it is possible that a member of a New York partnership could be at risk of avoidance for up to six years of distributions.

3 *See* 518 B.R. 766, 785–88(Bankr. S.D.N.Y. 2014).

NYDCL § 277(a) states that every transfer made by an insolvent partnership to its partners is subject to avoidance, without exception. NYDCL § 277(b), on the other hand, deals with transfers made by an insolvent partnership to entities *other than* partners, and provides that such transfers are not subject to avoidance as long as the partnership received "fair consideration" from the transferee. The *Dewey* court noted that unlike many other provisions of NYDCL, the term "partner" as used in § 277(a) did not contain a "carve-out" for LLP partners, and thus concluded that § 277(a)'s strict liability standard applied to all transfers made to Dewey's former partners after the firm became insolvent without allowing any offset for their services to the partnership.

New York is in the minority of states that still has in effect the Uniform Fraudulent Conveyance Act (UFCA), from which NYDCL § 277 derives. Most states have adopted the more "modern" Uniform Fraudulent Transfer Act (UFTA). Unlike the UFCA, the UFTA does not contain a special provision like § 277(a) that specifically covers transfers made by a partnership to its partners. Rather, the UFTA contains a single provision applicable to all types of transferees (including partners) that provides that transfers made by an insolvent transferor are avoidable only if the transferor did not receive "reasonably equivalent value" in exchange for the property transferred. Thus, in a UFTA jurisdiction, a transfer made by an insolvent partnership to any party, including a partner, may not be avoided if the transferee provided value to the transferor that was reasonably equivalent to the value of the property received by the transferee.[4]

While the UFTA provides that a transfer may not be avoided if the transferee provided "reasonably equivalent value," it does not address whether a former partner's services to a

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4 At least some of the remaining UFCA states, such as Maryland, have achieved the same result by affirmatively amending their version of § 277(a) to allow partners to prove "fair consideration," instead of by eliminating their UFCA equivalent of § 277(a).

partnership constitute "reasonably equivalent value". The answer to that question depends on whether the state has, like New York, retained the pre-World War I era Uniform Partnership Act (UPA) with its draconian "no compensation rule," or, has adopted the mid-1990s Revised Uniform Partnership Act (RUPA) with its "reasonable compensation rule."

After ruling that the distributions were avoidable under the strict liability provisions of NYDCL § 277(a), the *Dewey* court went on to conclude that the distributions were also subject to avoidance under the constructive fraudulent transfer provisions of Bankruptcy Code §548(a)(1)(B). Like the UFTA, Bankruptcy Code § 548(a)(1)(B)(i) provides that a transfer by an insolvent entity is not avoidable if the transferor received reasonably equivalent value in exchange for the transferred property.

The former Dewey partners argued that the trustee was not entitled to summary judgment under § 548(a)(1)(B)(i) because they were entitled to a factual hearing on the question whether the services they had provided to the firm constituted reasonably equivalent value. The court said no, holding that New York's "no compensation rule" precluded the former Dewey partners from establishing a reasonably equivalent value defense. Embodied in New York Partnership Law § 40(6), this rule states that absent an agreement to the contrary, "[n]o partner is entitled to remuneration for acting in the partnership business, except that a surviving partner is entitled to reasonable compensation for his services in winding up the partnership affairs."

The *Thelen* Opinions

In October 2008, Thelen LLP filed for chapter 11 protection in the United States Bankruptcy Court for the Southern District of New York (Judge Allan L. Gropper). The trustee brought adversary proceedings seeking to disgorge prepetition compensation payments made to various partners of the defunct California limited liability partnership under both breach of contract and fraudulent transfer theories. The parties agreed to present the fraudulent transfer issues first. As California has adopted RUPA, Judge Gropper was not confronted with a "no compensation rule" and thus had no trouble denying the trustee's motion for summary judgment on the issue of "reasonably equivalent value."[5]

On November 20, 2014, Judge Gropper addressed the breach of contract causes of action in the adversary proceedings, particularly whether the former partners were entitled to retain draws that were paid as advances on partnership income, to the extent that those draws were subsequently determined to have exceeded the partners' allocable share of net income for the applicable year. Turning to the partnership agreement, Judge Gropper noted that it provided that partners would from time to time be entitled to receive draws on their allocable share of the projected net income of the firm, with a "true-up" to be determined in connection with a calculation of the firm's final net income at the end of each year. Concluding that under the partnership agreement, partners were entitled only to their share of the firm's profits, Judge Gropper granted the trustee's motion for summary judgment on the breach of contract claim and compelled the partners to repay any compensation received over the course of 2008 in excess of their allocable share of net income for the year.[6]

Conclusion

Both the *Dewey* and *Thelen* opinions are bad news for law firm partners, but to varying degrees. The *Dewey* opinion is firmly grounded in statutory law and thus the only relief for members of New York partnerships may be through the appellate or the legislative process. As the *Thelen* opinion was based on contract law, it leaves open the prospect that in a jurisdiction

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5 *See* Geron v. Fontana (*In re* Thelen LLP), Ch. 11 Case No. 09-15631, Adv. No. 11-02648, 2014 WL 2178156, at *7 (Bankr. S.D.N.Y. May 23, 2014).

6 *See* Geron v. Fontana (*In re* Thelen LLP), 520 B.R. 388, 398 (Bankr. S.D.N.Y. 2014).

that has adopted the UFTA, the harsh result in that case might be avoided through careful drafting of the applicable partnership agreement to provide, for example, that upon a liquidation, partners may retain compensation received in an amount equal to the greater of their share of net income or the reasonable equivalent of their services (as determined under applicable law).

17th Annual New York City Bankruptcy Conference: "Governed by New York Law"? Considering the Impact of New York State Law in Bankruptcy Matters

Why Lawyers Need to Pay More Attention to the Distinctions Between Veil-Piercing and Alter-Ego Theories

By Evan C. Hollander and Dana Yankowitz Elliott[1]

Introduction

Outside of the bankruptcy context, there is little practical need to focus on the distinctions between corporate veil-piercing and alter-ego causes of action because the practical implications of each ruling are the same: The plaintiff is able to reach the assets of another entity in addition to those of the defendant when seeking to satisfy its judgment. The litigants, and by extension their lawyers, often pay little attention to whether the basis for the judgment was the vicarious liability of the third party (as in the case of a veil-piercing determination) or a finding that the third party and the defendant were in reality the same entity (as in the case of an alter-ego determination). New York bankruptcy cases have consistently shown, however, that these two separate theories of liability have significantly different implications for an individual debtor who has been the target of a veil-piercing or an alter-ego claim.

Veil Piercing vs. Alter Ego

A determination authorizing a plaintiff to pierce a corporate veil will result in a principal or an affiliate of the defendant being vicariously liable for the defendant's obligations to the plaintiff. In order to establish a veil-piercing claim, a plaintiff must prove that the principal or affiliate of the defendant exercised complete domination over the defendant with respect to the transaction at issue, and that the domination was used to commit a fraud or wrong that resulted in injury to the plaintiff. A finding that a principal or an affiliate was the defendant's alter ego will

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result in the defendant and its alter ego being treated as a single entity. In order to prevail on an alter-ego claim, a plaintiff must establish that there was such a unity of interest and control between the defendant and the other entity that they cannot really be said to be two separate entities. *See Rohmer Assoc., Inc. v. Rohmer*, 830 N.Y.S.2d 356, at *1 (App. Div. 2007). An alter-ego determination does not make one entity vicariously liable for the debts of another. Rather, it results in the disregarding the separateness of the entities as a legal fiction and treats them as one in the same entity.

Where the target of a veil-piercing claim has become a debtor in a bankruptcy proceeding, a court may conclude that the automatic stay of § 362 of the Bankruptcy Code enjoins the prosecution of state court litigation against the debtor's affiliate. This is because a liability ruling against the debtor's affiliate could have an adverse impact on property of the estate if a basis for piercing the debtor's corporate veil is established. Cases have shown that where a plaintiff has asserted claims against a primary obligor as well as veil-piercing claims against the obligor's principal or affiliate, it is not sufficient to merely sever the claims and proceed solely against the primary obligor if the principal or affiliate subsequently commences a bankruptcy proceeding. Plaintiffs who proceed in this manner run the risk that the bankruptcy court will conclude that prosecution of the state court litigation against the primary obligor was in violation of the automatic stay. This may result in a determination that any liability ruling rendered after the principal or affiliate's filing is void *ab initio*, notwithstanding the time and expense expended litigating the state court proceeding against the primary obligor to judgment.[2] Therefore, plaintiff's counsel would be well advised to not only seek severance of the claims

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2 *See Mokuba N.Y. LLC v. Pitts (In re Pitts)*, 2009 WL 4807615 (Bankr. E.D.N.Y. Dec. 8, 2009) (finding that post-petition state court proceedings might be a violation of the stay and the judgment void *ab initio* if plaintiffs were to successfully pierce the corporate veil, because the judgment against the non-debtors would have an immediate, adverse effect on the debtor).

against the principal or affiliate upon the bankruptcy filing, but to also seek an order of the bankruptcy court modifying the automatic stay prior to continuing with the state court litigation against the primary obligor.

While the continuation of litigation against a primary obligor also implicates the automatic stay where an alter-ego claim has been asserted against a principal or an affiliate that has commenced a bankruptcy proceeding, the stay is not implicated on the basis that a liability ruling against the primary obligor could have an indirect adverse impact on the debtor's estate, but rather, on the basis that if an alter-ego determination is made, the assets of the primary obligor will become part of the debtor's bankruptcy estate. Unlike a veil-piercing determination, however, where a debtor-principal is an individual, a finding that the debtor was the alter ego of the primary obligor may subject to scrutiny the debtor's actions in connection with the operation of the primary obligor when the court considers the debtor's entitlement to a discharge under § 523(a) (which excepts from discharge certain debts of an individual debtor) and § 727(a) (which provides for a complete denial of a discharge where an individual debtor has engaged in certain types of inappropriate conduct) of the Bankruptcy Code.[3]

The Cases

In re Pitts

In *Mokuba N.Y. LLC v. Pitts (In re Pitts)*[4] plaintiffs sued in New York state court an individual and several corporations of which he was the sole director, agent, shareholder and principal. Plaintiffs' claims were based on fraud, breach of contract, breach of express and

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3 *See Adler v. Ng (In re Adler)*, 518 B.R. 228 (E.D.N.Y. 2014). Only individual debtors may receive a discharge. *See* § 727(a)(1). The provisions of § 523(a) and § 727(a) are also applicable to individual debtors in chapter 11. *See* §§ 1141(d)(2) and (d)(3)(C).

4 2009 WL 4807615 (Bankr. E.D.N.Y. Dec. 8, 2009).

implied warranty, and breach of the covenant of good faith and fair dealing. Plaintiffs' complaint included allegations that the individual had controlled the corporate defendants and disregarded their corporate identities, and requested that their corporate identities be merged for purposes of their liabilities, that their corporate veils be pierced, and that the individual be held liable for the corporate defendants' acts. Plaintiffs filed a motion for a default judgment in state court. Shortly thereafter, the individual filed a petition under chapter 7 of the Bankruptcy Code. The state court determined that the automatic stay prohibited the plaintiffs from proceeding against the individual and entered a default judgment as to all issues of liability against the corporate defendants. The state court made no findings that the individual-debtor had participated in any fraud or was responsible as a matter of law for the corporate defendants' actions.

In the individual's bankruptcy case, plaintiffs filed a nondischargeability action seeking to have certain debts owed by the debtor deemed nondischargeable pursuant to Bankruptcy Code § 523(a)(2)(A), and moved for summary judgment. The debtor then moved to have the state court judgment entered against the corporate defendants deemed void *ab initio*, arguing that the automatic stay applied to the actions against the corporate defendants and that therefore the plaintiffs' actions in state court constituted a willful violation of the stay imposed by § 362(a)(1).

The bankruptcy court denied the debtor's motion, holding that the state court had correctly concluded that the automatic stay did not apply to the corporate defendants. The bankruptcy court found that as there had been no determination on the issues of veil-piercing or alter-ego theories of liability between the debtor and the corporate defendants, the state court judgment had no impact on the individual debtor or his bankruptcy estate. Therefore, plaintiffs did not commit a willful violation of the stay by continuing to participate in the state court action after the debtor filed for bankruptcy, and should not be liable for sanctions.

However, the bankruptcy court went on to consider the debtor's argument that even if there was no willful stay violation, the stay should nonetheless prohibit plaintiffs from using the state court judgment in the adversary proceeding. The bankruptcy court held that if it were to ultimately rule that cause existed to pierce the corporate veil of the corporate defendants, the post-petition proceedings in state court might be deemed to have violated the stay rendering the state court judgment void *ab initio*. The court thus reasoned because if plaintiffs were successful in piercing the corporate veil, the state court judgment against the corporate defendants would have an immediate, adverse effect on the debtor.

In re Adler

As in *Pitts*, the plaintiffs in *Adler v. Ng (In re Adler)* sued in New York state court an individual and the corporations he owned and controlled. Plaintiffs asserted claims based on fraud, breach of contract, and corporate veil-piercing. The individual subsequently filed for chapter 7 protection. The state court stayed the case against the individual but proceeded against the corporate defendants and entered judgment against them after trial on the merits.

In the debtor's bankruptcy case, plaintiffs filed a nondischargeability action pursuant to Bankruptcy Code §§ 523(a)(2)(A), (a)(4), and (a)(6), and objected to the debtor's discharge pursuant to §§ 727(a)(2), (a)(3), (a)(4)(A), and (a)(5). The bankruptcy court granted plaintiffs' summary judgment motion, giving collateral estoppel effect to the state court judgment, finding that the debtor's debt was nondischargeable, and denying the debtor's discharge. The debtor appealed, and the district court reversed and remanded, holding that the state court judgment was not entitled to preclusive effect in the adversary proceeding because the claims against the debtor had been severed, and there were genuine issues of fact as to the debtor's omissions on his schedules and statements.[5] On remand, the bankruptcy court found that the corporate veil should be pierced and held the debtor liable for the corporate defendants' obligations.[6] In a separate decision, the bankruptcy court held that the automatic stay applied retroactively to the state court judgment against the corporations because once the corporate veil had been pierced, the liability determination against the corporations had resulted in an adverse impact on the debtor's estate.[7] Thus, the bankruptcy court ruled that the state court judgment violated the stay and was void *ab initio*. In that opinion the court also concluded that the debtor was the alter ego of the corporate defendants and that therefore the separateness of the entities should be disregarded. As a result of the alter-ego determination, the court considered the debtor's conduct in the operation of the corporations when considering whether the debtor was entitled to a discharge under § 727(a). Finding that in connection with the operation of the business the debtor had concealed property, failed to justify inadequate corporate records, failed to explain the loss of assets, and made a false oath and account, the court denied the debtor a discharge under § 727(a). The plaintiffs appealed the court's determination that the state court liability ruling was void *ab initio*, and the debtor appealed the ruling denying him a discharge.

The district court denied both appeals, affirming the bankruptcy court's decision on both counts.[8] The district court found that the bankruptcy court had not erred in ruling that the state court liability determination was void *ab initio* or in ruling that the alter-ego determination made

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5 395 B.R. 827 (E.D.N.Y. 2008).

6 467 B.R. 279 (Bankr. E.D.N.Y. 2012).

7 494 B.R. 43 (Bankr. E.D.N.Y. 2013).

8 518 B.R. 228 (E.D.N.Y. 2014).

the debtor's actions in connection with operation of the corporations subject to scrutiny in determining whether the debtor was entitled to a discharge.

In re Mihalatos

As in both *Pitts* and *Adler*, the plaintiffs in *Agai v. Mihalatos (In re Mihalatos)*[9] sued an individual and a corporation of which he was an owner, in New York state court, alleging breach of contract. After trial, the state court entered judgment against both the individual and the corporate defendant. Plaintiffs then commenced post-judgment proceedings in state court to pierce the corporate veil between the individual and the corporate defendant. Before judgment was rendered in the state court post-judgment proceeding, the individual defendant commenced a chapter 7 case. Plaintiffs sought relief from the automatic stay to proceed with the veil piercing claim in the post judgment proceeding. The individual defendant, now a debtor, did not object to the lifting of the stay, and did not raise any opposition in the state court proceeding thinking that it was unnecessary as he was already personally liable on the corporate judgment.

After the state court granted summary judgment on the post-judgment veil piecing claim, the plaintiff's moved in the individual's chapter 7 case for an order denying the debtor a discharge pursuant to Bankruptcy Code §§ 727(a)(3), (a)(4)(A), and (a)(5). Plaintiffs asserted that as a result of the veil piercing determination in the state court proceeding, the debtor's bad acts in connection with the operation of his business could now be considered when determining the debtor's entitlement to a discharge.

The bankruptcy court denied plaintiffs' summary judgment motion, stating that while the allegations in the state court complaint were compelling, he was not prepared to find on

[9] 2015 WL 996977 (Bankr. E.D.N.Y. Mar. 3, 2015).

summary judgment that the state court clearly made the required "alter ego" finding or that it was implicit in the [state court] holding."

Conclusion

These cases make clear that corporate veil-piercing and a finding of alter ego are distinct doctrines and may have very different consequences in an individual debtor's bankruptcy case. As explained in *Adler* and *Mihalatos*, where a veil-piercing allegation is made between a debtor and a non-debtor corporate entity, a bankruptcy court may hold that a state court action against the non-debtor is subject to the automatic stay, because a liability ruling against the non-debtor could have an adverse impact on the debtor's estate. Where an alter-ego allegation is made, a bankruptcy court may conclude that an action against a non-debtor is stayed because an alter-ego determination would render the non-debtor's assets part of the bankruptcy estate. Moreover, when the debtor is an individual, an alter-ego determination will subject to scrutiny the debtor's actions in connection with the operation of the non-debtor when the court considers the debtor's entitlement to a discharge.

In Pari Delicto, Wagoner and New York Law on Imputation: A Good Defense Beats a Good Offense Every Time

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When a corporate bankruptcy involves pre-petition misconduct by the debtor's officers, directors or shareholders, the creditors' recovery often will depend on the outcome of litigation against deep pocketed third parties -- lawyers, accountants, lenders, underwriters, bankers and other advisors -- who may be said to have been involved with or otherwise aided and abetted such misconduct. The litigation usually is brought by a creditors' committee, a chapter 11 trustee or a post-confirmation litigation trustee, and the causes of action asserted typically will include common law claims such as negligence, malpractice, fraud or aiding and abetting a breach of fiduciary duty.

Who wins? Of course, the particular facts and circumstances underlying the claims will be key, but so will the forum and applicable law, in particular, whether New York's law on *in pari delicto* and/or the Second Circuit's related *Wagoner* rule of standing applies.

In Pari Delicto and *Wagoner* Defined

The common law equitable defense of *in pari delicto* derives from the Latin maxim *in pari delicto potior est conditio defendentis*, "in a case of equal or mutual fault. . . the position of the [defending] party . . . is the better one." *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 306 (1985). "The defense is grounded on two premises: first, that courts should not lend their good offices to mediating disputes among wrongdoers; and second, that denying judicial relief to an admitted wrongdoer is an effective means of deterring illegality." *Bateman Eichler*, 472 U.S. at 306; *Kirschner v. KPMG LLP*, 15 N.Y.3d 446, 464 (NY 2010). As the New York Court of Appeals explained long ago, "no Court should be required to serve as paymaster of the wages of crime, or referee between thieves. Therefore, the law will not extend its aid to either of the parties or listen to their complaints against each other, but will leave them where their own acts have placed them." *Kirschner*, 15 N.Y.3d at 464, *quoting Stone v. Freeman*, 298 N.Y. 268, 271 (NY 1948).

The Supreme Court has described the traditional formulation of *in pari delicto* as being "narrowly limited to situations where the plaintiff truly bore at least substantially equal responsibility for his injury. . .for there may be, and often are, very different degrees in their guilt." *Bateman Eichler*, 472 U.S. at 306-307. Public policy considerations also might preclude the defense in some cases, notwithstanding that the plaintiff bore substantial fault for his injury. *Id.*; *see also Official Committee of Unsecured Creditors of Allegheny Health Educ. and Research Foundation v. PriceWaterhouseCoopers, LLP,* 605 Pa. 269, 294-298 (Pa. 2010); *FDIC v. O'Melveny & Myers,* 61 F.3d 17, 19 (9th Cir. 1995).

For example, in *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134 (1968), *overruled on other grounds, Copperweld Corp. v. Independence Tube Corp,* 467 U.S. 752 (1984), the Supreme Court indicated that it was inappropriate to invoke broad common law remedies such as *in pari delicto* as a barrier to relief where a private suit under federal law serves important public purposes. Similarly, in *Bateman Eichler* and subsequently in *Pinter v. Dahl*, 486 U.S. 622 (1988), the Supreme Court found that, in the context of an action under the federal securities laws, the *in pari delicto* defense would not apply unless: (i) the plaintiff is an active, voluntary participant in the unlawful activity that is the subject of the suit; and (ii) preclusion of the plaintiff's suit does not offend the underlying statutory policies. Other courts have rejected application of *in pari delicto* when the plaintiff was a subsequently appointed representative seeking recovery on behalf of creditors or innocent shareholders and the evidence demonstrated that the defendant was negligent in its actions or had colluded with the corporation's management. *See, e.g., In re Phar-Mor, Inc. Sec. Litig.*, 900 F. Supp. 784, 787 (W.D. Pa. 1995); *Welt v. Sirmans*, 3 F. Supp. 2d 1396, 1402-1403 (S.D. Fla. 1997); *NCP Litigation Trust v. KPMG LLP*, 187 N.J. 353 (NJ 2006); *Allegheny Health*, 605 Pa. at 306-307.

By contrast, courts in New York consistently have held that "the principle that a wrongdoer should not profit from his own misconduct is so strong . . . the defense applies even in difficult cases and should not be weakened by exceptions." *Kirschner*, 15 N.Y.3d at 464; *McConnell v. Commonwealth Pictures Corp.*, 7 N.Y.2d 465, 470 (NY 1960); *Saratoga County Bank v. King*, 44 N.Y. 87, 94 (NY 1870).

In pari delicto is an affirmative defense in New York state courts.[1] Among other things, this means that the burden of pleading and proving that the plaintiff is *in pari delicto* rests with the defendant. *Kirschner*, 15 N.Y.3d at 478 (dissent, explaining operation of rule). Although the defense may be and often is asserted as the basis for a motion to dismiss, the facts supporting the defense must be clear on the face of the complaint, or the presumption of truth afforded to a plaintiff's allegations on a pre-answer motion will preclude dismissal at the outset. In that case, the defendant may be subject to costly and time consuming discovery and additional motion practice, or even a

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[1] This is also true in other states. *See, e.g., Allegheny Health*, 605 Pa. at 294-295 (describing *in pari delicto* as a "defense"); *NCP Litigation Trust*, 187 N.J. at 366-367 (same).

trial. The threat of discovery, motion practice and a trial often results in a costly settlement for the third party defendant.

In *Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114 (2d Cir. 1991), the Second Circuit converted the *in pari delicto* defense into a "prudential rule of standing." *See Hosking v. TPG Capital Management, L.P. (In re Hellas Telecommunications (Luxembourg) II SCA)*, 2015 WL 373647, *28 (Bankr. S.D.N.Y. Jan. 29, 2015). Prudential limits on standing are judicially imposed "self-limits on the exercise of jurisdiction" by the federal courts, which, among other things, can only hear cases or controversies in which the plaintiff asserts an injury that is fairly traceable to the defendant's purportedly unlawful conduct and which injury is likely to be redressed by the requested relief. *Silverman v. Meister Seelig & Fein, LLP (In re Agape World, Inc.)*, 467 B.R. 556, 573 (Bankr. E.D.N.Y. Feb. 21, 2012).

Under the *Wagoner* construct, a party who participated in the misconduct that gives rise to a claim does not even have standing to pursue the claim, thereby placing the burden of pleading and proving standing on the plaintiff rather than the defendant. Since *Wagoner*, federal courts in the Second Circuit have routinely dismissed common law claims on the basis that the plaintiff, or the party whose claim is being asserted, was involved in the underlying misconduct and thus did not have standing to sue. *See, e.g., BC Liquidating, LLC v. Weinstein (In re BC Funding, LLC)*, 519 B.R. 394 (Bankr. E.D.N.Y. Oct. 31, 2014); *O'Connell v. Penson Financial Services, Inc. (In re Arbco Capital Mgmt., LLP)*, 498 B.R. 32 (Bankr. S.D.N.Y. Sept. 26, 2013). Federal courts applying other states' law on *in pari delicto* do not necessarily follow the *Wagoner* construct. *See, e.g., Harrison v. New Jersey Community Bank (In re Jesup & Lamont,* *Inc.),* 507 B.R. 452, 475-476 (Bankr. S.D.N.Y. Mar. 26, 2014) (denying motion to dismiss aiding and abetting claim premised based on *Wagoner* because it was not clear from face of complaint that New York law applied); *Adelphia Recovery Trust v. Bank of America, N.A.,* 2010 WL 3452374 (S.D.N.Y. 2010) (applying Pennsylvania law, denying motion to dismiss based on *in pari delicto*); *CarrAmerica Realty Corp. v. Nvidia Corp.,* 302 Fed. Appx. 514, 516 (9th Cir. Nov. 25, 2008) (declining to follow *Wagoner* rule); *In re Senior Cottages of Am., LLC*, 482 F.3d 997, 1003 (8th Cir. 2007) (*Wagoner* criticized for analyzing *in pari delicto* as rule of standing); *Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., Inc.,* 267 F.3d 340, 346-47 (3d Cir. 2001), *citing In re Dublin Secs., Inc.*, 133 F.3d 377, 380 (6th Cir. 1997) (standing should be analyzed separately from defenses such as *in pari delicto*).

Imputation and the Adverse Interest Exception

The *in pari delicto* defense assumes that the plaintiff has committed some wrongdoing relevant to the subject of the action. This is a relatively straightforward analysis when the plaintiff is an individual and also is the person whose actions are *in pari delicto*. When the plaintiff is a corporation, or a party suing on behalf of a corporation, application of the defense requires resort to the laws of agency, and particularly the rules of imputation, because a corporation only can act through its officers, directors and employees.[2]

It is well-settled that the conduct of managers (*i.e.* officers and directors) acting within the scope of their employment is imputed to the corporation. *See, e.g., Wight v. BankAmerica Corp.*, 219 F.3d 79, 87 (2d Cir. 2000) (applying New York law). This is

[2] It also should be noted that the *in pari delicto* defense does not apply in actions by a corporation for breach of fiduciary against its officers and directors, which actions typically are authorized by statute. *See, e.g.*, N.Y. Bus. Corp. L. § 720.

true irrespective of whether the agent "acts less than admirably, exhibits poor business judgment or commits fraud." *Kirschner*, 15 N.Y. 3d at 465. Following this rule, the *in pari delicto* defense and *Wagoner* standing rule will bar a corporation's action against a third party arising out of misconduct involving its own managers acting on its behalf because such misconduct is imputed to the corporation. *See, e.g., The Mediators, Inc. v. Manney (In re Mediators, Inc.)*, 105 F.3d 822, 827 (2d Cir. 1997) (*in pari delicto* barred action by creditors' committee asserting debtor's claims against third party bank).

The presumption of imputation is premised upon the notion that the agent has disclosed all material facts to the corporation, such that the corporation is charged with the agent's knowledge. The rule is designed to encourage a principal to select honest agents. In New York, this presumption is rebutted only when the agent is acting entirely in his or her own interests *and adversely* to the interests of the corporation. *See, e.g., Center v. Hampton Affiliates*, 66 N.Y. 2d 782, 784 (NY 1985) (stating rule); *Kirschner*, 15 N.Y. 3d at 465. This is known as the adverse interest exception. Under this rule, a manager's misconduct will not be imputed to a corporation when the manager is defrauding the corporation in concert with a third party – under these circumstances, there can be no presumption that the manager has disclosed all material facts to the corporation, as disclosure would defeat the fraud. *Center*, 66 N.Y. 2d at 784.

Under New York law, the adverse interest exception is a "narrow one and applies only when the agent has totally abandoned the principal's interests." *The Mediators*, 105 F.3d at 827, *citing Center*, 66 N.Y.2d at 784-785. "Fraud on behalf of a corporation is not the same things as fraud against it. . . and when insiders defraud third parties for the corporation, the adverse interest exception is not pertinent." *Kirschner*, 15 N.Y. 3d at

468. As such, the misconduct of officers and directors acting in their official capacities will be imputed to the corporation, unless the corporation derived absolutely no benefit from those actions, and the actions benefited only the officer's or director's pecuniary interests. *Id.*; *Center*, 66 N.Y. 2d at 784-785; *O'Connell,* 498 B.R. at 46 (adverse interest exception does not apply if corporation received short term benefits from officer's fraud, even if it also suffered long term harm as a result).

The Sole Actor Rule

The adverse interest exception itself has an exception, known as the "sole actor rule." Under this rule, an agent's misconduct will be imputed to the corporation regardless of the fact that the agent was acting in his or her own interest and adversely to the corporation if "principal and its agent are indistinguishable, such as where the agent is a corporation's sole shareholder, or where the corporation bestows upon its agent unfettered control and allows the agent to operate without meaningful supervision with respect to a particular type of transaction." *Breeden v. Kirkpatrick & Lockhart, LLP*, 268 B.R. 704, 709 (S.D.N.Y. 2001), *aff'd*, 336 F.3d 94 (2d Cir. 2003); *see also The Mediators*, 105 F.3d at 827 (applying rule).

The sole actor rule negates the adverse interest exception, unless there is evidence that there was someone "involved in [debtor's] management who was ignorant of the ongoing fraud and could and would if advised of facts known to defendant have taken steps to bring the fraudulent conduct to an end." *Id.* at 710*, citing Wechsler v. Squadron, Ellenoff, Plesent & Sheinfeld, L.L.P.*, 212 B.R. 34, 36 (S.D.N.Y. 1997) (sole actor exception applies when there is no one else who could have stopped the agent's misconduct, but refusing to dismiss case before discovery on this issue).

In *Breeden*, the bankruptcy trustee of a corporation that was at the center of what was then the largest ever known Ponzi scheme (*i.e.*, pre-*Madoff*) commenced an action for damages against the corporation's former accountants and attorneys. The trustee's malpractice and breach of fiduciary duty claims were premised on the defendants' failure to report their suspicions about the fraud to innocent members of debtors' management. The District Court granted summary judgment in favor of defendants, because it found that management's misconduct had to be imputed to the debtors and hence to the trustee. While there was evidence that debtors had some "innocent" managers, the Court found that the only relevant decision-makers were the members of the Bennett family, all of whom were involved in and had knowledge of the Ponzi scheme. As such, the court found that the "innocent officers and directors the trustee has identified are irrelevant for the purposes of applying the [imputation defense]. . .[as] there is no evidence to suggest that any of these individuals either could have or would have stopped the fraud." *Breeden*, 268 B.R. at 712. As such, the trustee's action against the third party advisors was barred by the misconduct of the debtors' controlling insiders.

Imputation when a Bankruptcy Trustee is Appointed

The imputation analysis is more complicated when control of the plaintiff/corporation has been taken over by a bankruptcy or SIPA (Securities Investor Protection Act) trustee. Under the Bankruptcy Code and SIPA, the trustee or a duly appointed state representative is empowered to assert claims belonging to the bankrupt corporation, but any recovery usually goes to pay the claims of innocent creditors rather than back to the debtor or its shareholders. In such cases, the plaintiff trustee typically will argue that it should not be subject to a defense premised on the misconduct of the debtor's former insiders.

State law governs whether the *in pari delicto*/imputation defense will bar a claim by the receiver/trustee against third parties. *See O'Melveny & Myers v. FDIC*, 512 U.S. 79 (1994). Accordingly, if state law would impute the misconduct of the officers/directors to the corporation, then the bankruptcy or SIPA trustee likewise will be barred from asserting the corporation's claims against third-parties for damages arising out of such misconduct.

While some courts, including the Ninth Circuit (*FDIC v. O'Melveny & Myers,* 61 F.3d 17, 19 (9th Cir. 1995)), Pennsylvania (*Allegheny Health*, 605 Pa. at 306-307), and New Jersey (*NCP Litigation Trust*, 187 N.J. at 384-385), have created limited exceptions to the rule on imputation that permit claims against a third party professional by a trustee or receiver that would otherwise be barred if brought by the debtor company, New York courts have declined to make any such exceptions. Indeed, federal courts applying *Wagoner* have taken the rule a step further, finding that a bankruptcy trustee does not have *standing* to pursue a claim that would be barred by *in pari delicto* if brought by the debtor company. *See, e.g.*, *Breeden*, 268 B.R. at 709; *Hirsch v. Arthur Andersen & Co.*, 72 F.3d 1085 (2d Cir. 1995) (affirming dismissal of trustee's complaint for malpractice against third party accountant); *Goldin v. Primavera Familienstiftung, et al. (In re Granite Partners, L.P.)*, 194 B.R. 318, 328 (Bankr. S.D.N.Y. Apr. 9, 1996) (*in pari delicto* defense applied to bar trustee's claim against third-party brokers for mismanagement, waste and breach of fiduciary duty).

The New York Court of Appeals confirmed the absolute application of *in pari delicto* and the rules on imputation to bankruptcy/SIPA trustees in *Kirschner*. The underlying litigation in *Kirschner* arose out of the bankruptcy of REFCO, a large brokerage/clearing firm, which filing was triggered by a massive fraud perpetrated by the firm's president/chief executive officer and other insiders. The post-confirmation litigation trustee commenced litigation against various third parties, including law firms, underwriters and accountants on the ground that those parties aided and abetted the insider's fraud. *Kirschner*, 15 N.Y. 3d at 458-459. On defendants' motions to dismiss, the district court found that under *Wagoner*, the trustee did not have standing to pursue the claims because management's misconduct would be imputed to the debtor and hence to the trustee.

On appeal, the Second Circuit certified questions to the New York Court of Appeals concerning the rules on imputation and the adverse interest exception under New York law. The Second Circuit sought advice, among other things, as to whether "the adverse interest exception is satisfied by showing that the insiders intended to benefit themselves" and "whether the exception is available only where the insiders' misconduct has harmed the corporation." *Id.* at 462. Plaintiff trustee argued that filing bankruptcy should be deemed sufficient harm to the corporation to trigger the adverse interest exception, and that New York should broaden the exception on public policy grounds to permit recovery by innocent creditors and shareholders and make outside professionals bear the burden of negligence and misconduct in cases of corporate fraud. *Id.* at 469.

The New York Court of Appeals rejected these arguments, finding that a subsequent bankruptcy filing does not mean that the agent's actions were adverse to the company at the time they were committed. As a matter of policy, the court refused to shift the burden of supervising the activities of corporate officer/directors from the corporation and its shareholders to the third party professional (and its innocent shareholders/creditors), and found that as between insiders and outside professionals, in most cases insiders would be the more culpable for the fraud. Under the circumstances, it would be unfair to permit the creditors and innocent shareholders of the debtor to recover at the expense of the outside professional's innocent creditors and owners. It also found that changing the rules on imputation in such circumstances would not provide a greater deterrent to professional malfeasance than already exists.

Under the circumstances, the New York Court of Appeals refused to follow the approach taken in Pennsylvania and New Jersey and create an exception to the rules on imputation in cases involving a subsequently appointed and innocent official such as a bankruptcy trustee. *Id.* at 477. New York thus continues to apply the rules of imputation and the adverse interest exception strictly. The Second Circuit subsequently confirmed that the Court of Appeals' strict approach to imputation applied even in the case of a Ponzi scheme, when it affirmed the dismissal of state law claims against third party banks brought by the trustee in the notorious Madoff bankruptcy. *Picard v. JPMorgan Chase & Co., et al. (In re Bernard L. Madoff Investment Securities LLC),* 721 F.3d 54, 63-65 (2d Cir. 2013).

Conclusion

When balancing the interests of "innocent" creditors and shareholders of a bankrupt corporation against those of their former third party professionals, New York courts have come down squarely on the side of the professionals. In most cases, *In pari* *delicto*, *Wagoner*, and New York's strict rules on imputation and the adverse interest exception likely will bar a trustee in bankruptcy from asserting a claim belonging to the debtor against a third party arising out of misconduct in which an insider of the debtor participated. Generally, these rules do not apply when the claim is brought against a former officer, director or insider. They also do not apply when the claim at issue belongs to someone other than the debtor, such as an avoidance claim under state law or federal bankruptcy law, as such claims are brought on behalf of parties who were not *in pari delicto* with the defendant. In other states, the rules may be less strict, so third-party professionals have more risk of liability for negligence, malpractice or intentional actions taken in support of an insider's fraud.

Exemption	New York State[1]	Federal[2]
Homestead	House, condo, co-op or mobile home used as a residence Amount of exemption varies by county: • $150,000 in Kings, Queens, New York, Bronx, Richmond, Nassau, Suffolk, Rockland, Westchester and Putnam • $125,000 in Dutchess, Albany, Columbia, Orange, Saratoga and Ulster • $75,000 in all other NY counties	Principal place of residence (not including investment or rental properties) • Protection for up to $22,975 of home equity
Burial plot	Burial plot no larger than 1/4 acre with no building or structure (other than headstone or monument) on it	Burial plot for debtor or a dependent included as part of homestead exemption
Motor vehicle	$4,000 for one motor vehicle (or up to $10,000 if equipped for use by a disabled debtor) • Exemption not available if debt is owed for domestic support obligations or to the State of New York	$3,675 for one motor vehicle

[1] New York State exemptions are updated every three years, with the next update to occur in April 2015. New York law provides that a debtor may exempt $10,000 of total value in items listed under Civil Practice Law and Rules § 5205, plus additional exemptions for certain benefits and reparations/damages awards. If the claimed exemptions total less than $10,000, the debtor may use the remaining amount, or up to $5,000, whichever is less, to protect additional cash or the right to receive income tax refunds. Married couples who file a joint bankruptcy in New York may double the exemptions and claim the full exemption amount for any property actually owned by each spouse.

[2] Federal exemptions are also updated every three years, with the next update to occur in April 2016. Married debtors filing jointly may double the amount of each federal exemption. If a debtor's spouse does not file, the spouse is always defined as a dependent.

Jewelry/Art	A wedding ring; a watch, jewelry and art not exceeding one thousand dollars in value • Value of wedding ring is not capped (beyond aggregate personal property cap)	$1,550 for all jewelry that is held primarily for the personal, family or household use of the debtor or a dependent
Household goods, furnishings and appliances, clothes, health aids	Stoves and heating equipment for use in debtor's home and fuel for 120 days and "sewing machine with its appurtenances"; all clothes, furniture, one refrigerator, one radio, one television, one computer and associated equipment, one cell phone, crockery, tableware and cooking utensils "necessary" for the debtor and his/her family; all prescribed health aids and necessary medical and dental accessories	$575 in value of any individual item (up to $12,250 aggregate value) on household goods, furnishings and appliances, clothes, musical instruments Health aids if prescribed by medical professional (uncapped); if not specifically exempt as a health aid, could be included in the $12,250 exemption for household goods
Books and pictures	Religious texts, family pictures and portraits, and school books used by the debtor or his/her family, and other books, not exceeding $500 in value, kept and used as part of the family's or debtor's library	Included as part of household goods and furnishings ($575 per individual item and up to $12,250 aggregate value)
Church pew	A seat or pew occupied by the debtor or his/her family in a place of public worship	n/a
Domestic animals; food for animals and debtor	Domestic animals with the necessary food for those animals for 120 days (up to an aggregate value of $1,000 for such animals and food); all necessary food for the use of the debtor and family for 120 days Service animals are also exempt	Included as part of household goods and furnishings ($575 per individual item and up to $12,250 aggregate value), if held primarily for personal, family or household use of the debtor

Damages awards; reparations	Property or damages arising from the damage of exempt personal property, for up to one year after collection of proceeds (subject to $10,000 cap)	$22,975 for personal injury except pain and suffering or pecuniary loss; award for loss of future earnings needed for support; recovery for wrongful death of person debtor was a dependent of, if needed for support; and compensation received for being a crime victim
	Award under crime victim's reparation law; payment due to wrongful death of individual of whom debtor was a dependent, to the extent reasonably necessary for the support of debtor and any dependent of debtor; up to $7,500 for personal bodily injury; and compensation for loss of future earnings of debtor or individual of whom debtor is or was dependent, to the extent reasonably necessary for the support of debtor and any dependent of debtor • Exemption is in addition to $10,000 cap for personal property	
Spendthrift trust; college savings program trust fund payments	All property held in a spendthrift trust for a debtor if the trust was created by or proceeded from someone other than the debtor New York State college tuition savings program trust fund payments for the benefit of a minor or up to $10,000 of value if debtor owns the account	n/a
Military items	Uniforms, arms and equipment used in military service and pensions and awards for military service	Presumably included as part of household goods exemption

Pensions and public benefits	IRA, 401(k), Keogh, or other qualified retirement plan; social security, unemployment, disability, public assistance, workers' compensation or veteran's benefits (uncapped) • Tenant's rights under rent-stabilized lease are exempt (*Matter of Santiago-Monteverde*, 24 N.Y.3d 283 (N.Y. 2014); pending legislation would cap the exemption at $150,000)	Social security, unemployment benefits and compensation, veteran's benefits, public assistance, and disability or illness benefits; retirement accounts that are exempt from taxation • These items are fully exempt except that there is a cap of $1,245,475 on IRAs and Roth IRAs • The debtor's rights in an ERISA-qualified plan are not property of the estate and, therefore, do not require a claimed exemption (*Patterson v. Shumate*, 504 U.S. 753 (1992))
Wages and income	90% of income received within 60 days before bankruptcy filing; 90% of earnings from the sale of milk on debtor's farm; 100% of pay to a noncommissioned officer, private or musician in US or NY armed forces Court-ordered alimony, maintenance or child support $600 on deposit in a savings account	Alimony and child support in an amount "reasonably necessary" for the support of the debtor and any dependent of the debtor
Tools of the trade	Working tools and implements with a value up to $3,000 that are necessary for debtor's profession	$2,300 for tools of the trade, including implements and books, belonging to the debtor or a dependent

Insurance policies and payments	Non-tax deferred annuity contract benefits, up to $10,000, due to debtor if debtor purchased the contract within the six months prior to bankruptcy Cash surrender value of insurance policies	Any life insurance policies that have not matured except credit life insurance (not subject to value cap) $12,250 in loan value of life insurance policy, including the amount of any accrued dividend or interest, up to the $12,250 cap Life insurance payments needed for support under the life insurance policy of someone debtor was a dependent of
Security deposits	Security deposits being held for rental real estate or utilities	No specific exemption; could be included as part of wild card exemption if not required to be offset against creditor's claim
"Wild card" or general exemption	$1,000 of any personal property or cash if debtor does not use the homestead exemption	$1,225 plus $11,500 of any unused portion of debtor's homestead exemption to exempt any property owned by debtor

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This opinion is uncorrected and subject to revision before publication in the New York Reports.

No. 180
In the Matter of Mary Veronica Santiago-Monteverde.

Mary Veronica Santiago-Monteverde,
Appellant,
v.
John S. Pereira, &c.,
Respondent.

Ronald J. Mann, for appellant.
J. David Dantzler, Jr., for respondent.
Anisha S. Dasgupta, for amicus State of New York.
City of New York; New York State Senator Brad Hoylman et al.; New York City Bankruptcy Assistance Project et al., amici curiae.

ABDUS-SALAAM, J.:

The United States Court of Appeals for the Second Circuit has certified a question to this Court which requires us to resolve the following issue: May a bankruptcy debtor's interest in her rent-stabilized lease be exempted from her bankruptcy estate pursuant to New York State Debtor and Creditor Law section 282 (2) as a "local public assistance benefit?" We hold that section 282 (2) of the Debtor and Creditor Law (DCL) exempts a debtor-tenant's interest in a rent-stabilized lease.

I.

The debtor Mary Santiago-Monteverde has lived in her apartment at 199 E. 7th Street in Manhattan for over forty years. The apartment is rent-stabilized. After her husband died in June 2011, Santiago-Monteverde was unable to pay her credit card debts of approximately $23,000 and filed for Chapter 7 bankruptcy. During the pendency of the bankruptcy proceedings, she remained current on her rent obligations. She initially listed her apartment lease on Schedule G of her bankruptcy petition as a standard unexpired lease. Shortly thereafter, the owner of the apartment approached the bankruptcy trustee, respondent John S. Pereira, and offered to buy Santiago-Monteverde's interest in the lease. When the trustee advised her that he planned to accept the offer, she amended her filing to list the value of her lease on Schedule B as personal property exempt from the bankruptcy estate under DCL § 282 (2) as a "local public assistance benefit."

The Bankruptcy Court granted the trustee's motion to strike the claimed exemption on the ground that the value of the lease did not qualify as an exempt "local public assistance benefit" (In re Santiago-Monteverde, 466 BR 621, 622 [Bankr. SD NY 2012]). The court noted that Santiago-Monteverde's counsel did not dispute "that a rent-stabilized lease is the property of the estate and that the Trustee 'may assume or reject any executory contract or unexpired lease of the debtor'"(id., citing 11 USC § 365). The court reasoned that "the benefit of paying below market rent [ ] is not a 'public assistance benefit' that is entitled to any exemption in bankruptcy" and that the benefit "is a quirk of the regulatory scheme in the New York housing market, not an individual entitlement"(id. at 625).

The District Court affirmed the Bankruptcy Court(US Dist Ct, SD NY, 12 Civ 4238, Castel, J., 2012), holding that "the value in securing a lawful termination of the rent-stabilized lease . . . is a collateral consequence of the regulatory scheme and not a 'local public assistance benefit'" (id.).

On appeal to the Second Circuit, Santiago-Monteverde argued that "the lease (or its value) is a 'local public assistance benefit' because the value of the lease (in whole or in part) is traceable to the protections afforded to her under the [Rent Stabilization Code]" (747 F3d 153, 157 [2d Cir 2014]). Recognizing that this argument raises an open issue of New York law, the Second Circuit certified the following question to this Court: "Whether a debtor-tenant possesses a property interest in the protected value of her rent-stabilized lease that may be exempted from her bankruptcy estate pursuant to New York State

[DCL] Section 282 (2) as a 'local public assistance benefit'?" (id. at 158).

II.

The Bankruptcy Code authorizes a bankruptcy trustee to "assume or reject any . . . unexpired lease of the debtor" (11 USC § 365 [a]). As was noted by the Second Circuit, there is limited case law from both New York courts and bankruptcy courts holding that a trustee's authority under section 365 extends to rent-stabilized leases (see 187 Concourse Assocs. v Bunting, 175 Misc 2d 870 [Civ. Ct. 1997] and cases cited therein; see also In re Toldano, 299 BR 284, 292 [Bankr. SD NY 2003]; In re Stein, 282 BR 845 [Bankr. SD NY 2002]; In re Yasin, 179 BR 43, 49 [Bankr. SD NY 1995]). In this case, the debtor's counsel acknowledged at the hearing before the Bankruptcy Judge that a rent-stabilized lease is property of the estate and that the Trustee had the power to assume the lease pursuant to section 365 (466 BR 621, 622).

Section 522 (b) of the Bankruptcy Code permits the debtor to exempt certain property from the bankruptcy estate, and section 522 (d) provides a list of property that may be exempt. However, the Code also permits states to create their own list of exemptions, and New York has done so. DCL § 282 sets forth the permissible exemptions in personal bankruptcy. Debtors domiciled in New York have the option of choosing either the federal exemptions or New York exemptions (11 USC § 522 (b); DCL § 285).

DCL § 282 (2), entitled "Bankruptcy exemption for right to receive benefits" lists the following as exemptions:

> "The debtor's right to receive or the debtor's interest in: (a) a social security benefit, unemployment compensation or a local public assistance benefit; (b) a veterans' benefit; (c) a disability, illness, or unemployment benefit; (d) alimony, support, or separate maintenance, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor; and (e) all payments under a stock bonus, pension, profit sharing, or similar plan or contract on account of illness, disability, death, age, or length of service . . . "

When the rent-stabilization regulatory scheme is considered against the backdrop of the crucial role that it plays in the lives of New York residents, and the purpose and effect of the program, it is evident that a tenant's rights under a rent-stabilized lease are a local public assistance benefit.

The Legislature has concluded that rent stabilization is necessary to preserve affordable housing for low-income, working poor and middle class residents in New York City. As we said in Manocherian v Lenox Hill Hosp. (84 NY2d 385, 389 [1994]), "[t]he rent stabilization system began in 1969 to ameliorate, over time, the intractable housing emergency in the City of New York" due to a housing shortage which was caused by continued high demand and decreasing supply. We noted in Manocherian that "[b]y regulating rents and providing occupants with statutory rights to tenancy renewals under rent stabilization . . . the State intended to protect dwellers who could not compete in an overheated rental market, through no fault of their own" (id. at 389).

The New York City Administrative Code provides that the City Council "finds that a serious public emergency continues to exist in the housing of a considerable number of persons within the city of New York," and that "unless residential rents and evictions continue to be regulated and controlled, disruptive practices and abnormal conditions will produce serious threats to the public health, safety and general welfare" (Administrative Code of City of New York § 26-501).

The rent-stabilization program has all of the characteristics of a local public assistance benefit. It is plainly local in that it depends on periodic determinations by local authorities as to the continuing existence of an emergency in the particular jurisdiction. The program is public as it was enacted by the New York Legislature and implemented by legislative and administrative bodies at both the state and local level. Rent stabilization provides assistance to a specific segment of the population that could not afford to live in New York City without a rent regulatory scheme. And the regulatory framework provides benefits to a targeted group of tenants - it protects them from rent increases, requires owners to offer lease renewals and the right to continued occupancy, imposes strict eviction procedures, and grants succession rights for qualified family members.

The Trustee argues that the benefits of rent-stabilization are unlike the other exemptions listed in DCL § 282 (2), such as social security benefits, unemployment compensation, and alimony, support, or separate maintenance because those exemptions all involve periodic payments, while the rent-stabilization program does not involve payments to tenants. However, that argument ignores the reality of social programs such as food stamps, vouchers, medical care, discounted prescriptions, and the like, that do not involve payments to the recipients of the benefit. While many public assistance benefits are administered through programs that provide periodic cash payments, such payments are not a prerequisite to a benefit being in the nature of public assistance.

Furthermore, when the Legislature meant to refer only to "payments" in the DCL, it used that term. For example, in section 282 (2)(e), it exempted certain "payments" under pension and other plans. But it used the broader term "benefit" in section 282 (2)(a), indicating that benefits and payments are not the same. Likewise, the Legislature has demonstrated that the general term "public assistance" denotes more than cash payments. For example, the Social Services Law in effect when DCL § 282 (2)(a) was enacted provided that "public assistance and care includes home relief, veteran assistance, aid to dependent children, medical assistance for needy persons, institutional care for adults and child care granted at public expense" (Social Services Law § 2(18) [1982]). The current definition of public assistance is similar. Like other public assistance benefits exempted by New York law from a bankruptcy estate, the Rent Stabilization Law serves a select, defined group of New Yorkers who struggle, in this case, to afford suitable housing.

The Trustee also argues that the benefit of a rent-stabilized tenancy cannot be a public assistance benefit because it is not subsidized by the government, as are the other benefits of social security and unemployment compensation listed in DCL § 282 (2). However, the rent-stabilization program is an exceptional regulatory scheme that enables a specifically targeted group of tenants to maintain housing in New York City. This uncommon regulatory program reflects the legislative intent to create a benefit for certain individuals who fall below certain income or rent thresholds, based upon the Legislature's conclusion that there is a continuing housing emergency.

While the rent-stabilization laws do not provide a benefit *paid for* by the government, they do provide a benefit *conferred by* the government through regulation aimed at a population that the government deems in need of protection. Among other things, the Rent Stabilization Law caps legal rents. Although the population that benefits from rent-stabilization may not meet the requirements for New York City public housing programs or Section 8 assistance, the government, recognizing that housing protection is necessary to benefit a specific group of tenants, has created a public assistance benefit through a unique regulatory scheme applied to private owners of real property.

There are other public assistance benefits that are, at least in part, regulatory in form. Medicare is an example of a government program that is not solely the creature of a government subsidy. Although the government does, to some extent, contribute to the cost of medical care for Medicare recipients, it also sets the rates that can be charged by doctors. Medicare, like the rent-stabilization program is not strictly for the needy. It is a public assistance benefit that regulates what doctors can charge for services, while rent-stabilization is a public assistance benefit that regulates the rents property owners can charge protected tenants. While the classic examples of public assistance benefits may be solely government subsidized, or a mixture of subsidy and regulation as with Medicare, nothing prevents a targeted regulation from qualifying as a public assistance benefit. The rare regulatory scheme of rent-stabilization is such a benefit.

Finally, as was recently noted by the United States Supreme Court, exemptions serve the important purpose of protecting the debtor's essential needs (Clark v Rameker, 134 S Ct. 2242, 2247 [2014][internal quotation marks and citation omitted]). Affordable housing is an essential need. Mindful that exemption statutes are to be construed liberally in favor of debtors (In re Miller, 167 BR 782, 783 [SD NY 1994]), the certified question should be answered in accordance with this opinion.

Mary Veronica Santiago-Monteverde v John S. Periera
No. 180

SMITH, J.(dissenting):

I dissent, because the majority grossly misreads Debtor and Creditor Law § 282 (2).

"Public assistance" is a common synonym for "welfare." It refers, in ordinary speech, to government subsidies for the poor, whether paid in cash or in kind. The majority quotes a list of examples from former Social Services Law § 2 (18): "home relief, veteran assistance, aid to dependent children, medical assistance for needy persons, institutional care for adults and child care granted at public expense" (see majority op at 7). The current version of the statute adds "safety net assistance" (Social Services Law § 2 [18]). Neither list includes rent control or rent stabilization, though they have long been and still are prominent features of life in New York. Nor does the statutory list include any other regulatory program not involving a government subsidy. In fact, I do not think I have ever seen or heard the words "public assistance" used to refer to such a program before this case, and the majority cites no example of such a use.

Ignoring the generally accepted meaning of "public assistance," the majority chooses to interpret "public assistance benefits" in the Debtor and Creditor Law literally. The rent stabilization program is public, in the way that all government regulation is public; it "provides assistance to a specific segment of the population" that is in economic need; and it "provides benefits" to that same segment (majority op at 6). The same could be said of a great many programs -- e.g., minimum wage laws; antidiscrimination laws; workplace safety regulations -- that no one would think of calling "public assistance."

I would like to try asking every rent controlled or rent stabilized tenant in New York: "Do you receive public assistance?" I would be surprised to find even one (apart from those receiving government subsidies from other programs) who answered yes.

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Following certification of a question by the United States Court of Appeals for the Second Circuit and acceptance of the question by this Court pursuant to section 500.27 of this Court's Rules of Practice, and after hearing argument by counsel for the parties and consideration of the briefs and the record submitted, certified question answered in accordance with the opinion herein. Opinion by Judge Abdus-Salaam. Chief Judge Lippman and Judges Graffeo, Pigott and Rivera concur. Judge Smith dissents and votes to answer the certified question in the negative in an opinion in which Judge Read concurs.

Decided November 20, 2014

State Court Actions and Non-Dischargeability

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It is not uncommon for a judgment in a prior state court action against a defendant to lead to the defendant filing for bankruptcy. If the defendant is an individual,[1] depending on the type of action which was brought, a successful plaintiff may seek to have the amounts awarded in the state court judgment determined to be a non-dischargeable debt in the bankruptcy.[2] Section 1141(d)(6) of the Bankruptcy Code provides that confirmation of a plan does not discharge a debtor that is a corporation -

A. from any debt of a kind specified in paragraph (2)(A) or (2)(B) of Section 523(a) that is owed to a domestic governmental unit, or owed to a person as the result of an action filed under subchapter III of chapter 37 of title 31 or any similar state statute; or

B. For a tax or customs duty with respect to which debtor
   i. made a fraudulent return; or
   ii. willfully attempted in any manner to evade or to defeat such tax or such customs duty.

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[1] Section 1141(d)(2) of the Bankruptcy Code provides that a debtor who is an individual is not discharged from any debt excepted from discharge under Section 523. 11 U.S.C.§1141(d)(2)

[2] Section 523(a) of the Bankruptcy Code lists numerous debts that Congress has determined should be non-dischargeable, including, among others, debts (i) for certain taxes or customs duties, (ii) obtained by fraud, false pretenses or a false representation, (iii) for fraud or defalcation while acting in a fiduciary capacity, or for embezzlement or larceny, (iv) unscheduled debts unless creditor had actual knowledge, (v) for domestic support obligations, (vi) for willful and malicious injury to another or property of another, (vii) for certain governmental fines or penalties, (viii) for student loans unless failure to receive a discharge would result in undue hardship and (ix) for criminal restitution. Section 727(a) of the Bankruptcy Code lists numerous circumstances that could cause the Bankruptcy Court to deny the debtor a discharge, including, among others, if the debtor (i) transfers or hides property to defraud creditors, (ii) destroys or hides its books or records, (iii) commits perjury or fraud in connection with the bankruptcy case, (iv) cannot account for lost assets, (v) violates a court order, (vi) previously filed bankruptcy and received a discharge within a certain time frame, depending on the type of bankruptcy case, or (vii) fails to complete a course on personal financial management.

11 U.S.C. §1141(d)(6).[3] In such circumstances, a corporation which files Chapter 11 and confirms a plan will not be able to discharge those types of debts.

If a request is made under Section 523(a) or Section 727(a) of the Bankruptcy Code that a state court judgment be determined to be a non-dischargeable debt, the Bankruptcy Court must first determine if collateral estoppel or *res judicata* applies. Bankruptcy Courts have consistently held that an action pursuant to Section 523(a) or Section 727(a) is a cause of action arising under the Bankruptcy Code and thus, *res judicata* is not applicable.[4] *See Indo-Met Commodities, Inc. v. Wisell (In re Wisell)*, 494 B.R. 23, 35 (Bankr. E.D.N.Y. 2011).

The Bankruptcy Court must then determine if the state court made the factual and/or legal findings which would satisfy the requisite elements of Section 523(a) or Section 727(a), as applicable. If there is no opposition, then the court can consider the findings of the state court to be undisputed and collateral estoppel applies. However, the Bankruptcy Court still must undertake an independent analysis to determine whether those findings are sufficient to support granting the requested relief under Section 523(a) or Section 727(a) in the context of a summary judgment motion.

There are cases where Bankruptcy Courts located in New York have been unable to grant summary judgment under Section 523(a) or Section 727(a) based upon the record in the state court, and a trial before the Bankruptcy Court was then necessary. In *Z-Tex, Inc. v. Goldfarb (In*

[3] Subchapter III of Chapter 37 of title 31 covers liability for false claims.

[4] *Res judicata* is applicable where the claim sought to be precluded was necessarily decided and the party and the party against whom *res judicata* is being applied had a "full and fair opportunity" to litigate the issue in the prior proceeding. *Found v. Halperin (In re Halperin)*, 215 B.R. 321, 335 (Bankr. E.D.N.Y. 1997) (quoting *Conte v. Justice*, 996 F.2d 1398, 1400 (2d Cir. 1993)).

re Goldfarb), the New York Supreme Court entered a judgment for breach of contract which included punitive damages.[5] The plaintiffs in the state court action sought have the debt declared to be non-dischargeable under Sections 523(a)(2), 523(a)(4) and 523(a)(6) of the Bankruptcy Code.[6] The Bankruptcy Court held that the defendant in the state court action was precluded from relitigating whether the defendant obtained the property, services and credit of the plaintiffs upon and through fraudulent inducement. *Id.* While the Bankruptcy Court found that the state court decision contained findings sufficient to support granting of summary judgment under Section 523(a)(2)(A), the Bankruptcy Court held that, despite the state court's award of punitive damages, the state court had not determined that the assertions by the defendant were "materially false" as is required under Section 523(a)(2)(B), that the defendant took property from the plaintiffs "both wrongfully and with fraudulent intent" as is required under Section 523(a)(4) or that the defendants sustained a "malicious injury" as is required under Section 523(a)(6). *Id.* at *21-27. In *Wisell*, the Bankruptcy Court held that the state court findings and the award of punitive damages were not sufficient to grant non-dischargeability of the judgment under Section 523(a)(2)(A) on the basis of fraud because it was unclear whether the state court's finding of a fraudulent motive in the context of a punitive damage award is commensurate to fraud under Section 523(a)(2)(A). The Bankruptcy Court also noted that the state court did not make clear findings sufficient to establish actual fraudulent intent which is required for embezzlement and thus did not grant summary judgment under Section 523(a)(4). 494 B.R. at 37-38. The Bankruptcy Court held that the state court decision was a sufficient basis to grant non-

[5] No. 06-01275, 2006 Bankr. LEXIS 3364, at *15-16 (Bankr. S.D.N.Y. Dec. 5, 2006).

[6] Section 523(a)(2) provides an exception to discharge for liabilities for money, property, services or credit to the extent obtained by false pretenses, false representation or actual fraud. Section 523(a)(4) provides an exception to discharge for any debt for fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny. Section 523(a)(6) excepts from discharge any debt for willful and malicious injury by the debtor to another entity or the property of another entity.

dischargeability of the debt under Section 523(a)(2)(A) (the debt was obtained by false pretenses), Section 523(a)(4) (defalcation while acting in a fiduciary capacity) and Section 523(a)(6) (debt arising from willful and malicious injury by the debtor to another entity or the property of another debtor). *Id* at 35-42. In *Agai, 291 P, LLC and Summerfield Developers, Inc. v. Mihalatos (In re Mihalatos)*, the Bankruptcy Court held that an order of the New York Supreme Court piercing the corporate veil of Diontech Consulting, Inc. ("Diontech") should not be accorded *res judicata* on the issue that the defendant Diontech is the alter ego of debtor Mihalatos.[7] While veil piercing and alter ego are often used interchangeably, the Bankruptcy Court noted that veil piercing requires proof of a wrong or fraud as well as injury but, alter ego requires that the controlling principal and corporation be determined to be one and the same person. *Id.* The Bankruptcy Court denied summary judgment on the plaintiffs' request for denial of a discharge under Sections 727 (a)(3) (concealed, falsified or failed to keep records regarding the debtor's financial condition or business transactions), (a) (4) (A) (knowingly and fraudulently made a false oath or account) and (a) (5) (failed to explain satisfactorily any loss of assets or deficiency of assets to meet the debtor's liabilities) of the Bankruptcy Code since the issue of whether Diontech and Mihalatos were one and the same was never raised before or determined by the New York Supreme Court and thus, the record of the state court proceeding contained insufficient proof to support the denial of a discharge for Mihalatos. *Id.* at p. 2.

The Bankruptcy Court might be required have a trial on non-dischargeability of a state court judgment because no one had considered the fact that the defendant might file for bankruptcy after the judgment was obtained. Since bankruptcy counsel was not consulted during

[7] Memorandum Decision, Adversary Proceeding No. 8-13-08088-reg,(Docket No. 32, Bankr. E.D.N.Y. March 3, 2015). p. 9.

the course of the state court trial about what evidence should be put before the state court and what findings the state court should make in order for a Bankruptcy Court to grant non-dischargeability of the judgment, the state court judgment and record is often insufficient to support a finding of non-dischargeability under Section 523(a) or Section 727(a). Additionally, the causes of action brought under New York law in New York state court do not always neatly fit within the grounds for non-dischargeability set forth in Section 523(a) and Section 727(a) of the Bankruptcy Code. While the second difficulty cannot be easily remedied, occurrence of the first circumstances could be avoided or limited if state court trial attorneys were more cognizant of the likelihood of "round two" in the Bankruptcy Court and state court judges were then notified about that possibility and could issue judgments considering the findings needed for non-dischargeability.