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ONEONONE

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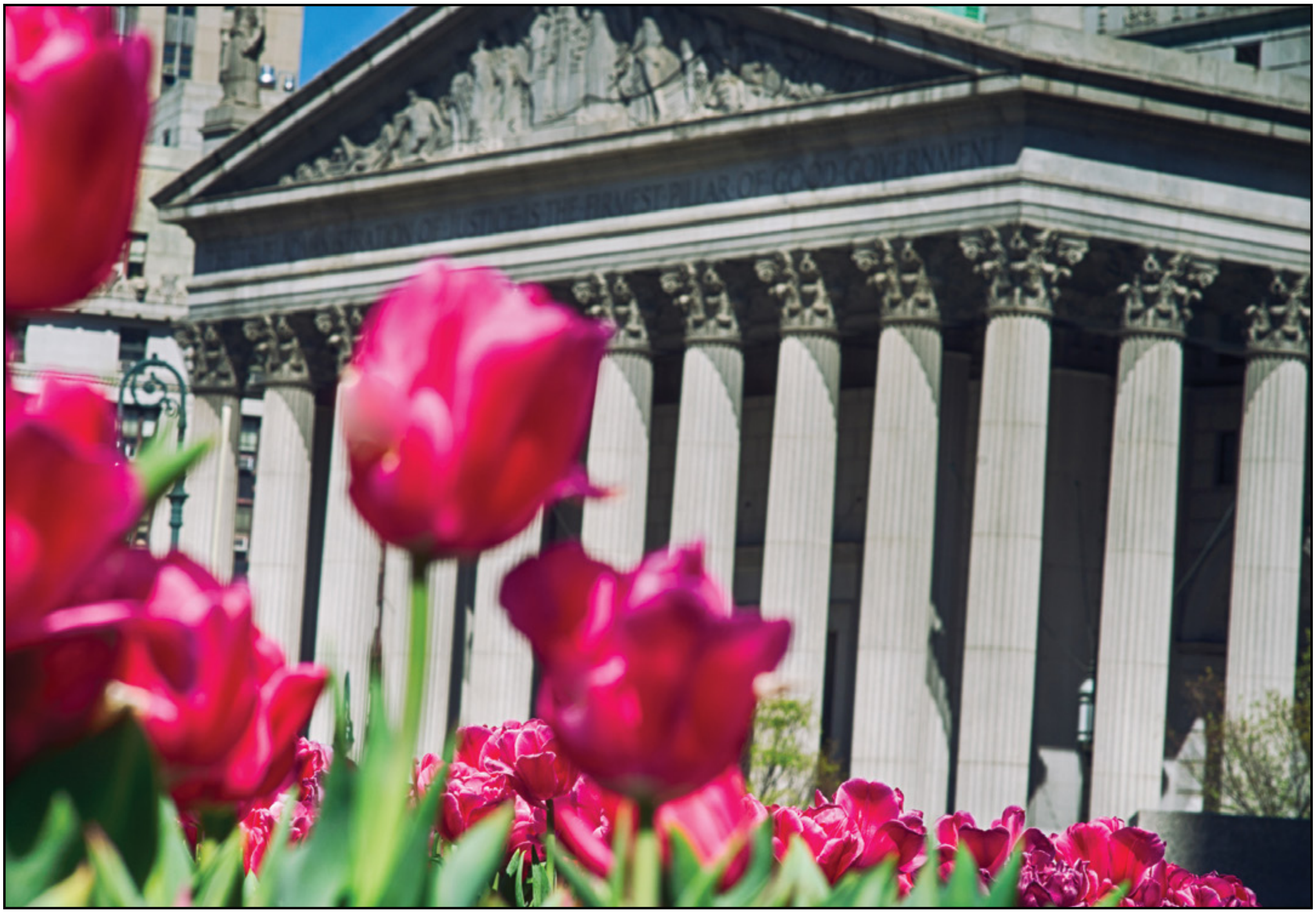

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Message from the Chair

Joel E. Abramson

Welcome to the spring edition of *One on One*, the General Practice Section's quarterly publication that provides Section members and all readers with current developments in the diverse areas of the law in which we practice, as well as Ethics Opinions which pertain to all lawyers, regardless of the nature of their practice.

To those of you who attended the Section's program at the 2018 NYSBA Annual Meeting, thank you. It was sold out and the attendees received solid Continuing Legal Education in the areas of Ethics, the CPLR, and "Hot Tips from the Experts." This year, the agenda included "Loose Lips and Emailing Lawyers: The Ethics or Protecting Client Confidences," "Hot Tips from the Experts," as well as updates on the CPLR and the NYS Lawyers' Fund for Client Protection.

There seemed to be great fanfare for the "Loose Lips" presentation. It reviewed rapidly emerging and evolving issues of attorney-client confidentiality with a special focus on internet and e-mail security. As always, we welcomed Timothy J. O'Sullivan from the New York State Lawyers' Fund for Client Protection in Albany to update our Section on the work of the fund.

If you did not attend, you missed a very meaningful program. Please try to make every effort to attend in 2019.

Beyond keeping Section members well informed in diverse areas of substantive law, the Section hopes to advance an initiative to improve the conditions under which Section members and the overall legal community practice law.

I would like to thank each one of you for your membership and support of this Section of ours. Many of us are in solo or small firm practice, but even for large firm or corporate practitioners, it is so important to reach outside of the four walls of our practice, whatever it may be, and connect with other members of our profession; learn from each other; encourage each other in our professional development; and make some great friends along the way.

One of the best ways to learn and make some friends is with NYSBA's new private, online professional communities. Communities have the ability to function just like the basic listserve; but with far greater additional technical capabilities (don't worry—it's easy to use, and you can use it through email like the listserve, if you like)! I encourage you to go to www.nysba.org/HowDoI to check out more information about Communities. For your participation in this, I thank you. I look forward to continuing my involvement in the General Practice Section for a long time to come, not just as an "extra" tacked onto my already busy life as an attorney—but as an integral part of it.

Please feel free to submit to *One on One* articles pertaining to such subjects as professional liability (legal malpractice), professional discipline, the practitioner/court system relationship, and managing a law office.

As always, your comments, criticisms, and suggestions are invited. The General Practice Section is here to serve your needs, so please contact the editors or me if there are any changes or recommendations for *One on One* or General Practice Section programs and activities which you would like to see implemented.

Lastly, if any readers are not already members of the General Practice Section, please join us; please join the General Practice Section.

Joel E. Abramson

Message from the Co-Editors

Richard Klass

As the Co-Editors of *One on One*, we endeavor to provide our members and readers with a great selection of topical articles on issues affecting the varying and diverse areas of law in which our General Practice Section members practice. As always, our journal provides the most recent New York ethics opinions.

This issue, we are pleased to offer you the following articles, which we hope will be found very helpful and informative:

Justice, Justice, Shall Thou Pursue: Martin Minkowitz, *One on One*'s editor, provides a quote that motivates us to represent our clients with zeal while avoiding dilatory conduct.

An Overview of the New York Rules of Professional Conduct in the Context of Mediation: Marcy Einhorn starts with an Abraham Lincoln quote and reminds us how the NY rules come from the need to reduce costs for both sides.

Promissory Estoppel and the Statute of Frauds in New York: Mary Eaton, Sameer Advani and Patricia O. Haynes remark on a Court of Appeals case that departs from prior guidance and the Restatement (Second) of Contracts by estopping the invocation of the statute of frauds if there is "unconscionable injury".

A Litigator's Guide to the Management of New York Limited Liability Companies: Michael J. Firestone presents a legal and practical understanding of how NY LLCs are managed and officer duties must be discharged.

Recent Trends in New York Partnership Law—Written, Oral, and Implied Partnerships, Fiduciary Duties, and Remedies: Gerard V. Mantese and Emily S. Fields compare real life and Hollywood examples of potential partnership formations to explain the NY rules.

Martin Minkowitz

How Do You Spell P-A-I-D F-A-M-I-L-Y L-E-A-V-E? An Exploration of New York's Paid Family Leave Act: Theresa Rusnak highlights some key areas of confusion and concern that may stand in the way of the smooth administration of the new law.

The Law is Boring Enough: Stephen Donaldson breaks down "legal speak" phrases and encourages less boring legal writing by giving some best practices.

Article Submission

The General Practice Section encourages its members to participate on its committees and to share their knowledge with others, especially by contributing articles to an upcoming issue of *One on One*.

Your contributions benefit the entire membership. Articles should be submitted in a Word document. Please feel free to contact either Martin Minkowitz at mminkowitz@stroock.com (212-806-5600), Richard Klass at richklass@courtstreetlaw.com (718-643-6063), or Matthew Bobrow at matthew.bobrow@law.nyls.edu (908-610-5536) to discuss ideas for articles.

We have reinstated the "Letter to the Editor" as a way for our readership to express their personal views in our journal. Please address these submissions to matthew.bobrow@law.nyls.edu.

Sincerely,
Martin Minkowitz
Richard Klass
Matthew Bobrow
Co-Editors

Justice, Justice, Shall Thou Pursue

By Martin Minkowitz

"You shall not commit a perversion of justice." "Do not act perversely in judgment."[1] This quote, and well known to us all, has been interpreted to mean that one who delays the rendering of judgment in order to aggravate one of the litigants is considered as one who acts perversely.

It is the professional and ethical obligation of a lawyer to represent his client with zeal, putting forth all within his or her skill to do what is necessary to win, within the bounds of the law. If an adjournment of a proceeding in the case is necessary or beneficial to the client, the attorney should seek to obtain such an adjournment or postponement.

Is it possible that in that pursuit a line can be crossed? That justice (or a case) delayed is a perversion of the judicial system that officers of the court are obligated to avoid? Should we challenge success? A successful representation, after all, is the purpose of the retention. Lawyers are not engaged to lose.

Actually, I understand the position that it can be beneficial if cases can be caught in a judicial system that drags along so that judgement does not come for months, or, in some cases, years. How can that be permitted? Weren't we taught that "justice delayed is justice denied." What happened to that? Just a "cliché?" The issue raises a lot of questions and there can be a lot of finger pointing. There are the lawyers who need to represent their clients to the best of their ability. There are the judges and court administration staff who have an obligation to ensure the confidence and trust of the public in the true administration of justice. There are the government lawyers (state and county prosecutors) who also are trusted by the public for the true administration of justice in the courts.

I remember fearing the ire of a judge if I walked into a court room five minutes late. Yet there are lawyers who believe the justice for their clients lies in a justice system which is "tied up in knots." For some "muddled memories" or witnesses who are no longer available to testify are the best ways to win cases. So they are tardy and just excuse themselves because they believe they are performing appropriately.

The worst offender is the one who causes delay for personal reasons. The lawyer who is too busy, has too many cases, too little time, just overwhelmed, or is only a sole practitioner and needs more help and time, or just does it because he can get away with it. That has happened to every lawyer, on both sides, but if it is a method of practice, a common routine and used as an excuse, it is not appropriate even if it should potentially and incidentally be beneficial to the client. Don't accept the engagement if you don't have enough time to do it properly. Too many balls in the air will most certainly cause one or more to drop. If you answer "Ready," mean it.

While a win is still a win, I must hold to my conviction that dilatory conduct should not be sanctioned as anyone's appropriate method of practice. "A lawyer shall act with reasonable diligence and promptness in representing a client and is not bound to press for every advantage that might be realized for a client."[2] For those lawyers who have forgotten, or never knew, a lawyer acts frivolously when his or her "conduct has no reasonable purpose other than to delay or prolong the resolution of litigation."[3]

"Dilatory tactics bring the administration of justice into disrepute."[4] If the reasonable purpose is alleged to be to avert the witnesses' loss of memory or death, then the burden is on the court administration, including the judiciary, to abate this abuse. What helps one side is detrimental to the other, and the system must be the guardian of the pursuit of justice for both sides.

Endnotes

1. LEVITICUS 19:15.
2. NY Rules of Professional Conduct, Rule 1.3 (a) and Comment [1].
3. *Id.*, Rule 3.1 (2).
4. *Id.*, Rule 3.2 Comment.

Martin Minkowitz is counsel to Stroock & Stroock & Lavan LLP and practices in the area of Insurance and Workers' Compensation regulation, and an adjunct professor at Brooklyn Law School.

The Law Is Boring Enough

By Stephen Donaldson

There isn't much about practicing law that one could call exciting. I'm sure at least one attorney reading this will disagree and rattle off a list of things he or she considers exhilarating when it comes to the law. I imagine trial work can be quite thrilling at times, although as I sit here writing this, I'm thinking of your average Joe Schmo attorney (like me), not Gerry Spence.

I will admit working as a lawyer has its moments of intellectual stimulation. But in the grand scheme of a professional life, reading a statute is about as much fun as reading the prescribing information that comes with a bottle of antibiotics. I'll be the first attorney to admit that, upon pulling up a statute that is more than a paragraph long, my first thought is, *"Really? They expect me to read all of this?"*

Let's face it. The law is dry. After walking out of a deposition, you ever see a bunch of lawyers giving each other chest bumps and letting out war cries? *"Yeah, baby! That's what I'm talking about!"*

Nope.

It's a challenge to consider this profession stimulating when almost every sentence in every piece of writing requires a footnote. And that's even more true when it comes to the Internal Revenue Code. You ever have trouble sleeping at night, break out section 1 of the IRC and try making sense of that lovely piece of literary genius. I guarantee you'll be fast asleep within five minutes.

So why, as attorneys, do we continue to keep the law as boring as humanly possible? Why do we continue to use phrases like "annexed hereto" in every affirmation we draft? Why do intelligent, self-respecting attorneys choose to use the phrase *nunc pro tunc* in their writings when *retroactive* will suffice?

Pick up almost every legal publication in the world and the writing is about as exciting as getting sued for malpractice. I understand that many documents we draft as attorneys must include specific language because, otherwise, they'll get bounced out of court.

But when you've got the freedom to roam with your writing, for the sake of your readers, hit us with your best literary shot. Write the way you talk rather than writing the way you think something should be written because you're an attorney. Yes, a big part of your job is mitigating risk for your clients, but doing a good job managing risk shouldn't depend on writing that has the same effect on your readers as an elephant tranquilizer.

So how can you do your part to make the legal writing world a better place? It's much easier than you think.

First, can we all agree to breakup with words like *thereinafter* and *hereinbefore*? No other profession in the world uses these words and all of those other professions seem to be doing just fine, so why do lawyers cling to these relics the way millennials cling to their phones?

Second, in his book *On Writing,* Stephen King wrote, "I believe the road to hell is paved with adverbs, and I will shout it from the rooftops." When someone much more talented and more successful than I am gives advice, I listen, so since the day I was admitted, I promised myself I would never, ever allow myself to submit a court document or write an email to anyone with the phrase *woefully inadequate*. However, I see that foolish phrase in emails and court documents everywhere I look. To my attorney colleagues, do you think writing, "The defendant's pleadings are *woefully inadequate*," is really going to swing a court's decision in your direction compared to writing, "The pleadings are inadequate?"

"But when you've got the freedom to roam with your writing, for the sake of your readers, hit us with your best literary shot. Write the way you talk rather than writing the way you think something should be written because you're an attorney."

Stephen King is a better writer than I and likely a better writer than almost anyone reading this piece and he advises the rest of us mortals to be wary of adverbs. Therefore, leave the adverbs; bring the cannoli.

Third, if summarizing decisions, can we further agree to stop referring to parties by their procedural positions, e.g., petitioner, respondent, etc.? I understand that's who they are from a procedural perspective, but trying to digest such writing can drive a reader nuts and we can all do better. For example, if the petitioner is a hospital and

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> *"So for the sake of the sanity of your beloved colleagues in this esteemed profession, let's drop the legal speak, refer to parties by their names, and write in the first person."*

respondent is a patient, why not refer to them as hospital and patient to make your readers' lives a bit easier? A respondent is nameless, faceless party. A patient is someone to whom we might be able to relate, so for the sake of giving something to help your reader reach the end of your piece, give these people names.

This last one is something that I'm advocating for but I have a nagging suspicion that I may shoot myself in the foot by recommending we try to write in the first person. I don't know if there's anything in our state or local codes that forbids submitting papers written in the first person (I've looked but have yet to find any relevant provisions), which is why I say I might end up shooting myself in the foot. And I've mentioned this is past publications: specifically, why write *Your Affirmant* when *I* gets the job done?

When drafting affirmations of legal services after appearing in special proceedings, I always write, "I visited the alleged incapacitated person on December 12 . . ." When I first started practicing, I did the whole, "Your affirmant visited . . . " thing and just could not bear to submit papers that read that way. Doing so made me feel like a big, fat phony—as if I was sitting at a typewriter wearing a sawtooth blazer with elbow patches while smoking a pipe lecturing students on the nobility of practicing law. That's just not me, so I can't bring myself to write in the third person.

And I've yet to have a paper bounced for writing in the first person. Again, I could be wrong, but writing *I* just feels so much more right compared to *your affirmant*.

So for the sake of the sanity of your beloved colleagues in this esteemed profession, let's drop the legal speak, refer to parties by their names, and write in the first person. I know, it's a lot to ask, but it's like exercising. Getting to the gym is the hardest part. Once you're there, the rest is easy.

How Do You Spell P-A-I-D F-A-M-I-L-Y L-E-A-V-E? An Exploration of New York's Paid Family Leave Act

By Theresa Rusnak

In April 2016, Governor Andrew Cuomo signed into law the Paid Family Leave Act (PFL or the Act), which will provide paid family leave to New York employees. Employers covered by the New York State Disability and Workers' Compensation Laws will have to comply with the Act.

After two sets of proposed regulations were released and submitted for public comment, the Workers' Compensation Board issued final regulations on PFL on July 19. 2017.[1]

Even with the final regulations, it is difficult to predict exactly how PFL will impact New York's employees and employers. However, large-scale change is inevitable. From conflicts and overlap with other laws, such as the federal Family and Medical Leave Act (FMLA) and New York Disability laws, to questions about insurance implementation, arbitration or collective bargaining, the Act will add a new layer of complexity to the already complex process of administering the myriad employee leave and benefit laws that govern the workplace. This article provides an overview of the Act, and highlights some of the key areas of confusion and concern that may stand in the way of the smooth administration of the new law.

Perplexing Phased-in Implementation

PFL has two main facets: amount of leave and payment during that leave. Each will be implemented in a series of phases, gradually increasing from January 1, 2018 to January 1, 2021.

Starting in 2018, an employee will be eligible for up to eight weeks of PFL,[2] which will be paid at 50 percent of the employee's average weekly wage[3] or 50 percent of the state average weekly wage (SAWW). The Department of Labor adjusts the SAWW yearly, each year on March 31. The current SAWW is $1,305.92.[4] Using that number, the maximum weekly payment for an employee taking leave in 2018 would be roughly $650. However, once that amount increases on March 31, 2018 (and each year thereafter), the maximum benefit level will increase as well.

In 2019, an employee will be eligible for up to 10 weeks of leave,[5] paid at 55 percent of the employee's average weekly wage rate or the SAWW, whichever is less.[6] For 2020, the 10 weeks will remain constant, but the percentage of weekly wage will increase to 60 percent.[7] Finally, in or after 2021, an employee will have 12 weeks[8] available at 67 percent of their average weekly wage or SAWW, whichever is less.[9]

Abundant Available Leave

Employees will be able to use PFL in three situations: 1) to bond with a new child, 2) to care for a family member with a serious health condition,[10] and 3) to address a military exigency.[11]

PFL can be taken after the birth, adoption or foster placement of a child in the home.[12] The purpose of the leave is to bond with the new child, and can be taken by any parent regardless of gender. The leave can be taken up to one year after the child's birth or placement.[13] Since PFL will be available January 1, 2018, leave can be taken for children that were born or placed in 2017.[14]

PFL also provides leave for employees to care for a family member with a serious health condition.[15] "Serious health condition" has the same definition under PFL as under FMLA, [16] but the definition of "family member" differs. FMLA defines "family member" as a parent, spouse or child, while PFL expands this to also include grandparents, grandchildren and domestic partners. Like under FMLA, however, an employee taking leave under PFL to care for a family member must do so within a reasonable geographical proximity to that family member.[17] Notably, there are no restrictions on employees traveling to the family member to fulfill this requirement.

Interesting Insurance Implications

Unlike FMLA, which is administered by employers, PFL is administered primarily through disability insurance carriers. Existing disability carriers in the state are required to cover the PFL under the Act starting in January 1, 2017.[18] Employers that are covered by a disability insurance policy will automatically be covered for the purposes of PFL starting on the first of the year, whether or not the employer has paid additional premiums for this purpose.

As the primary administrator, the insurance carrier will determine whether an employee receives PFL. The carrier will receive an employee's request for leave[19] and appropriate paperwork certifying the need for the leave

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This article originally appeared in the Fall 2017 issue of the *Labor and Employment Law Journal*, a publication of the Labor and Employment Law Section. It was written before the effective date of the Act.

and then make the decision regarding the grant of the leave. With the primary responsibility for requests and certifications placed on the insurance carrier, the regulations largely remove the employer from the leave process. This creates a challenging situation for employers who must manage staffing and attendance, but have not role in approving the leave. Notably, the insurance carrier has 18 days to approve or deny a benefit—long after the time off has already been taken, in many circumstances. It becomes even more challenging and confusing when FMLA is also involved. The regulations provide that when PFL is taken for a reason covered by FMLA, the two types of leave will run concurrently.[20] However, because the employer, and not the insurance carrier, administers FMLA, there may be times when the two entities differ regarding the necessity of the leave, creating confusion for the employee.

"Since the final regulations have been released, insurance companies, employers and employees can begin to prepare in earnest for Paid Family Leave..."

Diverse Days Off

Employees can take their available PFL leave on an intermittent basis, with a single day being the shortest possible increment of leave time.[21] For each day of intermittent leave, an employee must provide notice to the employer that the leave will be taken.[22] When an employee does not provide notice, the carrier or self-insured employer can withhold payment until the employee submits a request for payment together with the date of leave, as long as it is within thirty days of the leave.[23] As noted above, the insurance carrier has 18 days to approve or deny the request.[24] Interestingly, the lack of appropriate notice does not expose the employee to permanent repercussions. It does not prevent the employee from taking the leave, nor does it allow the employer to discipline the employee for doing so. In fact, it does not even permanently withhold payment for those days taken. This leaves the employer and the insurance carrier with little recourse when notice requirements are not followed, which will be felt most acutely in cases of intermittent leave.

Flummoxing FMLA Issues

PFL and FMLA can be taken concurrently, provided that the reason for taking the leave applies to both laws. However, even when the qualifying reason applies, there are several practical problems that can arise.

First, the qualification dates for some employees may differ for PFL and FMLA, which could prevent the two types of leave from running together. A full-time employee becomes eligible for PFL leave after 26 weeks of work, with no minimum hours requirement.[25] However, employees only become eligible for FMLA after 12 months and 1,250 hours of work.[26] When a new employee takes PFL, the employee may not yet be eligible for FMLA.

Second, differences in look-back periods between the two laws could prevent PFL and FMLA from running concurrently, and also result in employees taking back-to-back leave. PFL is provided on a rotating 52-week look-back period.[27] However, FMLA can be provided using a variety of methods: calendar year, fiscal year, date from first leave and/or rolling basis.[28] Given these different methods, it is possible that an employee might be entitled to first take joint PFL/FMLA leave, and then take FMLA again within the same short period of time. For example, think of an employer who gives FMLA leave based on the calendar year 12-month period, starting on January 1 of each year. An employee of that employer then takes in late November joint PFL and FMLA leaves to care for a child with a serious health condition. However, come January 1, the PFL leave is exhausted and cannot be taken again for another 52 weeks, but the FMLA leave is renewed and can be taken again. In this situation, an employee could end up taking 24 weeks of consecutive leave, between the two laws.

Absence of Arbitration Remedies

Disputes regarding the grant or denial of PFL are submitted to arbitration.[29] However, as of right now, the remedies for incorrectly granted or incorrectly denied leave are unclear. For example, suppose an employee is denied leave by the carrier, and the employee appeals. Then, the arbitrator decides in favor of the employee getting the leave. It is likely that in between those two decisions, a number of days or weeks may have gone by, and the time the employee requested for the leave is long since passed. Given the time delay, does the employee in the example take leave right after the arbitrator's decision? Is the employee in some way compensated or the carrier/employer punished for the leave that he could have taken at the appropriate time but did not? The opposite situation is also possible: the carrier grants leave and the employer (if the employer indeed has such a right), disputes that decision and proceeds to arbitration. During that time, the employee takes the leave he requested. Then, at arbitration, the arbitrator denies the leave. What are the consequences for the carrier and employer? The only provision in the regulations regarding remedies mandates that arbitration awards be paid to the prevailing party within 10 days of the filing of the decision before beginning to accrue interest.[30]

Furthermore, it is worth mentioning that the section on arbitration in the final regulations does not have a provision detailing the parties that can appeal a decision regarding a claim for benefits. Within the arbitration section as a whole, the insurance carrier, self-insured employer, and employee are mentioned as various parties. However, employers that are not self-insured are not explicitly included as a party that may file for arbitration. Interestingly, the Board received a comment on this topic after the releases of the first set of proposed regulations, and in response stated that there was nothing in the regulations prohibiting an employer from making an appeal.[31] However, the Board declined to change either the second set of proposed regulations or the final regulations to include the employer, leaving the right to arbitration for employers likely, but not guaranteed.[32]

Muddled Mandatory Subjects of Collective Bargaining

PFL will need to be administered in many workplaces where unions represent employees and collective bargaining agreements are in place.

Perhaps the main issue with PFL and collective bargaining is which, if any, parts of the Act are mandatory subjects of bargaining. Generally, employers and unions cannot collectively bargain to replace an existing law. However, within the law itself, there may be discretionary provisions that are mandatory subjects of bargaining.[33] At this time, it is not clear what the National Labor Relations Board or the New York Public Employment Relations Board would consider to be a discretionary provision of the PFL.

For employers that already have collective bargaining agreements in place, the regulations state that the only way a collectively bargained agreement can supplant the statutory leave requirement is if the agreement provides leave benefits "at least as favorable" as those under the Act.[34] The regulations further elucidate that benefits may be deemed "at least as favorable" if: "the aggregate benefits…are equivalent to or greater than the family leave benefits" and the "cash family leave benefits meet the minimum requirements under subdivision (e)."[35] Based on this loose definition, it is unlikely that many, if any, currently collectively bargained agreements would meet this standard, leaving the employer required to implement the insured benefit with all the protections of the Act. This is an area of the law that will have to be developed through arbitrations and court cases, and will therefore take time to be fully explored.

Intricate Interactions with Other Paid Leave Policies

PFL, along with interacting with FMLA, will also have to share space with employer-provided paid leave policies, such as paid time off and paid vacation.

The regulations state that an employer can offer the employee the option to use paid leave before using PFL, but the employer does not have to offer this option, and cannot mandate it.[36] If the employer offers the option, and the employee exercises it, the leaves will run concurrently. In that situation, the employee would be paid the employee's full salary for the vacation time, before finishing the rest of the leave with PFL pay. For those days that overlap, the employer can request reimbursement from the carrier to defray some of the cost.[37]

However, the analysis becomes more complicated when employers are also subject to FMLA. The regulations provide that an employee's accrued paid leave can be applied against the PFL time "in accordance with the provisions of the FMLA."[38] Under FMLA, an employer can mandate that an employee use paid time off or vacation days concurrently with the FMLA leave.[39] Yet, FMLA also provides that employers cannot have their vacation or paid time off policies run concurrently with other types of *paid* leave, such as disability or workers' compensation.[40] There is an argument that PFL is similar to disability and worker's compensation, because it is paid leave that is not paid by the employer. If this is the case, then PFL could not run concurrently. The regulations have an internal contradiction in this regard.

Likely Levels of Employee Contributions

Although PFL coverage can be funded by employees, employers can choose to bear the cost of PFL.[41] In this situation, employees would maintain the same rights to leave and benefits as employees that do contribute. If an employer initially covers the cost of PFL, but then decides to use employee contributions, it may do so. However, the regulations prohibit an employer from retroactively charging its employees for past coverage costs.

However, if an employer does decide to collect contributions from its employees, these contributions will be in the form of weekly deductions from employee paychecks.[42] This money is then remitted by the employer to the insurance carrier (or is maintained by a self-insured employer) to cover the cost of benefits.

On June 1, 2017, the New York State Department of Financial Services set the maximum employee contribution at 0.126% of an employee's average weekly wage, up to and not exceeding 0.126% of the SAWW.[43] Using the 2016 SAWW, the maximum deduction is $1.65 per week for 2018. Both the annual maximum deduction and the statewide average weekly wage change every year. The insurance premium is set at the same exact amount per employee, with the intent that the payroll deduction will exactly match the premium payment. Employers may begin to collect these deductions at any time, [44] but all surplus deductions must be returned to employees.[45]

Your Plan for Full-Time and Part-Time Employees

PFL covers both full-time and part-time employees. An employee is considered full-time when he or she works more than 20 hours a week, and part-time when he or she works less than 20 hours a week.[46] Full-time employees become eligible for leave after 26 consecutive weeks of work.[47] These part-time employees will become eligible to take PFL after working 175 days preceding the first full day the leave begins.[48] There is no minimum hours requirement that either or full or part-time employees must meet before becoming eligible.

Some seasonal or part-time employees may waive PFL coverage. An employer must give its qualifying employees the waiver option, although the employee chooses whether to use it.[49] A temporary or seasonal employee, one who will not even meet the 175 days of working within a 52-week period, can sign a waiver exempting them from coverage.[50] Notably, this is not the same as mandating that an employee who does not work 175 days in a 52-week period looking back from the date of the leave cannot receive PFL. If that were the case, the 175-day coverage would be mathematically impossible for part-time employees. Therefore, if the employee desires PFL after 175 days of working for the employer, the leave must be granted, regardless of how many of those 175 days were within a 52-week look-back period.

Lateral Link to Disability Laws

PFL is intended to complement existing statutory disability benefits, providing benefits for leaves that would not be covered under the state's Disability Benefits Law. Since they are intended for different purposes, the two types of benefits cannot be collected at the same time.[51] However, there is a combined limitation for the two types of leaves: no more than 26 weeks of combined PFL and disability leave can be taken in a 52 week period.[52]

While the two types of leaves are for distinct purposes, they will come together in the maternity leave situation, creating the opportunity for birth mothers to take lengthy partially-paid maternity leaves. A birth mother typically takes six to eight weeks of disability leave for her own recovery. Since this time is for her own disability, it can be taken under the Disability Benefits Law without using any PFL time. Once that period of disability ends, the woman can take advantage of her eight (and eventually 12) week PFL benefit, ultimately creating a maternity leave of as much as 18-20 weeks when the leave is fully implemented. (If the employer is also covered by the federal FMLA, the FMLA leave will run concurrently for the first 12 weeks, since FMLA can be used concurrently with both DBL and PFL.) This would make the average time off after giving birth about 17 weeks, for New York women after the year 2021.

Exceptional Exemptions

Generally speaking, PFL broadly applies to any private New York State employer[53] with more than one employee, and those who are covered by the Workers' Compensation Law.[54] Significantly, public employers are not covered. The Workers' Compensation Law defines "public employer" as the state, a political subdivision of the state, a public authority, or any other government agency or instrumentality thereof.[55] These employers can opt into PFL coverage (as many have done for disability coverage) but are not required to do so.

However, certain types of employees, even if they are employed by covered employers, are exempt from the law and employers need not provide PFL (or DBL) coverage. This includes livery driver, black car driver, farm laborer, ministers, and jockeys.[56] Independent contractors are also not covered.

There is yet another category of employees that are excluded from the law: "person[s] engaged in a professional or teaching capacity in or for a religious, charitable, or educational institution."[57] As the language states, this exemption only applies to those teachers and professionals working for those three types of entities. Moreover, the definition of professionals may be narrowly drawn to include learned and creative professionals, as it is under the wage and hour laws.[58]

This exception could have several ramifications. First, these institutions may be already optionally covering their professionals and teachers under the disability law, even though the law does not technically require them to do so. If this is the case, the institution may decide take a second look at that coverage before adding PFL.

However, even if the institutions elect to discontinue coverage for their professionals and teachers, they will still have to purchase it for the rest of their employees that do not work in those capacities. As noted above, the exemption only applies to "a person engaged in a professional or teaching capacity," which means it does not apply to all the other employees that these institutions routinely and necessarily employ. This could lead to a confusing situation where some employees have the right to take substantially more leave than others.

Finally, many of these professionals and teachers may be represented by unions, which surely will have strong opinions on whether the disability coverage should be discontinued or not, and whether those professionals should be covered by PFL. This decision will certainly be subject to mandatory bargaining.

Abstract Notice Announcements

The PFL regulations set forth a number of notice requirements, both for employees and employers. On the employee side, the notice requirements are the same as under FMLA: "an employee must provide the employer with at least 30 days advance notice before leave is to begin if the qualifying event is foreseeable."[59] If the leave is foreseeable, and the employee does not provide adequate notice, the carrier may file a partial denial of the family leave claim for a period of up to 30 days from the date the notice is provided. If, however, "30 days advance notice is not practicable…notice must be given as soon as practicable."[60] This also applies to each individual day or period of days taken for intermittent leave.[61] The employee must inform the employer of the dates of the leave, or risk the carrier withholding payment. The regulations provide that an employer can waive the 30-day notice requirement, but are silent on whether the intermittent notice requirement can be waived.[62] The content of the notice shall be "sufficient" to "make the employer aware of the qualifying event and the anticipated timing and duration of the leave."[63]

An employer must also provide an employee with several types of notices. First, employers must notify their employees of their rights under PFL. The regulations obligate an employer to place a poster in the workplace, as well as inform their employees through a handbook or separately written policy.[64] Furthermore, when an employee initially notifies the employer that he or she seeks leave, the employee "need not expressly assert rights under PFL or even mention family leave."[65] The regulations place the burden on the employer to seek further information from the employee to determine whether paid family leave is being sought by the employee.

Moreover, employers are also required to inform employees when their PFL leave has been concurrently designated as FMLA leave.[66] If an employer fails to provide this notice, it loses the right to have the leave run concurrently with FMLA.[67] On the other hand, if an employer designates FMLA leave for a reason also covered by PFL, informs the employee of this, and the employee still declines to apply for payment, the leave period will counted against the employee's maximum leave duration.[68]

Vexing Variations for Self-Insured Employers

Employees also have the option to self-insure their employees for PFL, but must have done so by September 30, 2017.[69] Employers who have not previously self-insured for disability leave must apply to the Chair of the Workers' Compensation Board for approval.[70]

Self-insured employers must follow all of the same regulations as insurance carriers, including the same criteria for determining whether leave should be granted or appealed. Self-insured employers must file annual reports to the Workers' Compensation Board, which include information on the number of eligible employees, the amount of covered payrolls, the number of employees who received benefits, the amount of benefits paid, the amount of employee contributions, and the estimate amount of employee contributions in the upcoming year.[71]

Self-insured employers are required to deposit into a Workers' Compensation fund in an amount that will be determined by the Chair of the Workers' Compensation Board. Self-insured employers will likely have to obtain lines of credit from a bank or surety company in order to be able to make these deposits.[72] The regulations set forth minimum deposit requirements for self-insured employers, ranging from a $10,000 deposit for employers with fewer than eight employees to a $50,000 deposit for employers with 2965 employees or more.[73]

Effective Employer Penalties

The regulations set forth a penalty structure for non-compliant employers. Particularly, if an employer does not provide coverage under the Act, "a penalty shall be imposed on the employer, not in excess of a sum equal to one-half a per centum of the employer's weekly payroll for the period of such failure, and a further sum not in excess of 500 dollars."[74] Penalties are also imposed for employers that discriminate or retaliate against employees for using PFL, under Section 120 of the Workers' Compensation Law.[75] Penalties are reviewable by the Bureau of Compliance of the Workers' Compensation Board upon the employer's request within three days of the date of the penalty.[76]

Since the final regulations have been released, insurance companies, employers and employees can begin to prepare in earnest for Paid Family Leave to begin in a few months. For insurance companies, this will consist of crafting PFL policies and adding them as a rider to existing DBL policies. Employers, in turn, will have PFL riders automatically added to their DBL policies, but must take steps to ensure payroll deductions are properly taken, craft new PFL policies, revise existing leave policies, and refine their internal leave and attendance-tracking processes to account for the added complexity of the PFL benefits. Although no one can exactly predict PFL's overall impact, every party affected by the regulations should begin to consider how they will be affected. This is as "simple" as remembering how to spell P-A-I-D F-A-M-I-L-Y L-E-A-V-E.

Endnotes

1. The regulations are available at the New York State Workers' Compensation website, at http://www.wcb.ny.gov/PFL/pfl-regs-text-revised.jsp.
2. Paid Family Leave Act Regulations, Laws, Regulations and Decisions: Workers' Compensation Board § 358-3.1(e)(3)(i).
3. *See id*. § 358-3.1 (e)(2)(i). Average weekly wage is calculated by determining the average wage of the eight weeks of employment immediately preceding the first week of the leave. *See id*. § 355.9(a)(2).
4. *See* New York State Average Weekly Wage, Workers' Compensation Law § 2(16), available at https://labor.ny.gov/stats/avg_wkly_wage.shtm.
5. *See supra* note 2, § 358-3.1 (e)(3)(ii).

6. *See id*. at § 358-3.1 (e)(2)(ii).
7. *See id*. at § 358-3.1 (e)(2)(iii).
8. *See id*. at § 358-3.1 (e)(3)(iii).
9. *See id*. at § 358-3.1 (e)(2)(iv).
10. PFL is not available for an employee to care for his or her own serious health condition. *See id*. § 380-2.5(g)(4).
11. *See id*. at § 380-2.3.
12. *See id*. at § 380-2.2.
13. *See id*. at § 380-2.2(b).
14. *See id*. at § 380-2.7.
15. *See id*. at § 380-2.1.
16. It is an "illness, injury, impairment, or physical or mental condition that involves: inpatient care in a hospital, hospice or residential health care facility; or continuing treatment or continuing supervision by a health care provider." *Id*. § 355.9(a)(16).
17. *See id*. § 380.2.1(a).
18. *See id*. at § 380-7.1; § 380-7.7.
19. New York has released a form, called PFL-1, for this purpose. However, the form does not have to be used, and a carrier must accept all forms of reasonable requests for leave. See id. § 380-5.1.
20. The employer must designate the leave as FMLA before it can run concurrently with PFL. *See id*. § 2.5(g)(1).
21. *See id*. at § 380-2.5(g)(5).
22. *See id*. at § 380-3.1(c).
23. *See id*. at § 380-4.1(b).
24. *See id*.
25. *See id*. § 380-2.5. For employees whose "nature of the employment" includes breaks, such as semester breaks, the period of 26 consecutive weeks will be tolled during those periods of absence. *Id*. § 380-2.5(a)(3).
26. *The Family and Medical Leave Act*, United States Department of Labor, Wage and Hour Division, available at https://www.dol.gov/whd/regs/compliance/1421.htm.
27. *See supra* note 2, § 355.9(a)(8).
28. Fact Sheet #28H: 12-month period under the Family and Medical Leave Act (FMLA), United States Department of Labor, available at https://www.dol.gov/whd/regs/compliance/whdfs28h.pdf.
29. *See generally supra* note 2, § 380-9.
30. See *supra* note 2, § 380-5.4(f)
31. Comments were submitted to the Workers' Compensation Board noting this discrepancy: "The Board received a comment stating that the employer should have the ability to appeal a decision. There is nothing in the regulations as written that prohibits an employer from filing for arbitration regarding a paid family leave claim." *See* Assessment of Public Comment, Paid Family Leave, available at http://www.wcb.ny.gov/PFL/pfl-assessment-public-comment.jsp.
32. *See id*.
33. This is the case with FMLA, where provisions of the law have been held to be subjects of collective bargaining, such as notice requirements (*Woodman v. Miesel Sysco Food Serv. Co.*, 254 Mich. App. 159, fn 7 (Mich. Ct. App. Nov. 26, 2002)) and arbitration (*14 Penn Plaza LLC v. Pyett*, 129 S.Ct. 1456, 1469 (2009)).
34. *See supra* note 2, at § 380-2.9.
35. *Id*. at § 358-3.1(d)(1) & (2). Subdivision (e) sets forth the provisions on amount of leave (eight to twelve weeks) and payment for the leave (50 percent to 67 percent of the employee's weekly wages, up to the state-wide average weekly wage) on an increasing scale.
36. *See id*. at § 380-6.2(a). "The actual reimbursement amount may be computed after family leave is complete." *Id*.
37. *See id*.
38. *Id*. at § 380-6.2(c).
39. 29 C.F.R. §§ 825.207(b).
40. 29 C.F.R. § 825.207(d): "Because leave pursuant to a disability benefit plan is not unpaid, the provision for substitution of the employee's accrued paid leave is inapplicable, and neither the employee nor the employer may require the substitution of paid leave." *Id*.
41. *See supra* note 2, at § 380-361.1(g).
42. *See id*. at § 380-2.4(d).
43. *Decision on Premium Rate for Family Leave Benefits and Maximum Employee Contribution for Coverage Beginning January 1, 2018*, New York State Department of Financial Services, available at http://www.dfs.ny.gov/insurance/r_other/dec_prem_rate_flb_06012017.pdf.
44. *See supra* note 2, at § 380-2.4(d).
45. *See id*. at § 380-7.2(b)(3).
46. *See id*. at § 380-2.5(a) and (b).
47. *See id*. at § 380-2.5(a)(1).
48. *See id*. at § 380-2.5(b).
49. *See id*. at § 380-2.6(a).
50. *See supra* note 2, at § 380-2.6. The employer cannot mandate that a temporary or seasonal employee waive PFL; the employee must make the decision. *See id*.
51. *See id*. at § 380-2.4(c). Interestingly, although days taken off for vacation or other paid time off count towards the 52 week eligibility period for PFL, time on disability leave does not. *See id*. § 380-2.5 (e).
52. *See id*. at § 380-2.5(f).
53. This includes employers headquartered outside of New York, but who have employees who work in the state and are required to be covered under New York disability laws.
54. 12 N.Y.C.R.R. §355.4(a).
55. N.Y. Work Comp L. § 212-B (2016)
56. *See supra* note 2. at § 355.2(c)(8), (9) & (10).
57. *Id*. 355.2(c)(4).
58. *Fact Sheet #17D: Exemption for Professional Employees Under the Fair Labor Standards Act (FLSA)*, United States Department of Labor, https://www.dol.gov/whd /overtime/fs17d_professional.pdf.
59. *See supra* note 2 at § 380-3.1(a).
60. *Id*.
61. *See id*. at § 380-3.1(c).
62. This may have implications for collective bargaining as well; if the notice requirements can be waived, this suggests that they are a discretionary subject under the Act, and may therefore be subject to bargaining.
63. *See supra* note 2, § 380-3.2(a).
64. *See id*. at § 380-7.2 (e); Section 380-7.2 (a)(1) and (2).
65. *See id*. at § 380-3.2(b).
66. *See id*. at § 380-2.5(g)(1).
67. *See id*. at § 380-2.5(g)(2).
68. *See id*. at § 380-2.5(g)(3).
69. *See id*. at § 361.1(f).
70. *See id*. at § 361.1 (a).
71. *See id*. at § 361.4(a) & (b).
72. These institutions also have to follow the PFL regulations. *See id*. at § 361.3 (c) & (d).
73. *See id*. at § 376.1(c).
74. *Id*. at § 380-7.2(d).
75. *See id*. at § 380-8.2.
76. *See id*. at § 380-7.9.

Recent Trends in New York Partnership Law–Written, Oral, and Implied Partnerships, Fiduciary Duties, and Remedies

By Gerard V. Mantese and Emily S. Fields

> CAMERON: We'd love for you to work with us, Mark. I mean, we need a gifted programmer who's creative.
>
> TYLER: And we know you've been taking it in the shins.
>
> DIVYA: The women's groups are ready to declare a Fatwa, and this could help rehabilitate your image.
>
> MARK: Wow. You'd do that for me?
>
> DIVYA: We'd like to with you.
>
> CAMERON: Our first programmer graduated and went to work at Google. Our second programmer just got overwhelmed with school work. We would need you to build the site and write the code and we'll provide . . .
>
> MARK: I'm in.
>
> CAMERON: — the money. What?
>
> MARK: I'm in.
>
> TYLER: Awesome.[1]

In this scene from the film *The Social Network*, several students discuss forming a business relationship to create a social networking website. Despite this alleged agreement, Mark Zuckerberg, "Mark," allegedly delays working on their project to secretly create his own website, Facebook. Mark's website becomes wildly successful, and he excludes Cameron, Tyler, and Divya from its profits.[2]

Was this enough to form a partnership? New York law defines a partnership as "an association of two or more persons to carry on as co-owners a business for profit."[3] Partnerships may be formed by express, written agreements, which clearly identify and define the roles, rights, and duties of the parties. They also may be formed by oral agreement. Or, partnerships may be implied from the parties' conduct, even if the parties have never used the word "partner" or "partnership" to describe their relationship. Partnerships give rise to strict fiduciary duties.[4] Under the Partnership Law, partners are accountable to one another as fiduciaries.[5] The requirements for partnership formation permit courts to find that a partnership exists from the nature of the parties' relationship and therefore subject partners to liability for breach of fiduciary duties. In fact, parties may be subject to liability for breaching duties they may not necessarily know they owed to the other partners. Thus, it is important to understand the factors that courts analyze to determine whether a partnership exists.

Partnership Factors

New York courts examine four factors to determine whether a partnership exists. The presence or absence of a single factor is not dispositive.[6] Rather, courts will look at the entirety of the parties' relationship.[7] They look at the parties' intent (express or implied), whether the parties had joint control and management of the business, whether the parties shared in the profits and losses, and whether the parties combined their knowledge, skill, or property in their endeavors.[8]

In *Yuen v. Branigan*, the New York Supreme Court applied the partnership factors and held that the plaintiff pled sufficient facts as to the existence of an oral partnership agreement to defeat the defendants' motion for summary judgment.[9] The plaintiff sued for breach of fiduciary duties among other things, alleging that he entered into an oral partnership agreement with the defendants to operate a hedge fund.[10] Under the alleged agreement, the plaintiff became a "partner" of the hedge fund and received an equity interest.[11] The court noted several indicia of a partnership, including the defendants' holding the plaintiff out to the world as a partner,[12] the plaintiff's vested equity interest,[13] and the plaintiff's role as head of trading of defendants' hedge fund, which required the plaintiff's knowledge and skill.[14]

Similarly, in *Koether v. Sherry*, the plaintiff sufficiently pled the existence of a partnership to avoid summary judgment.[15] In *Koether*, the plaintiff alleged that he and the defendant agreed to use their shared expertise to develop a business and share in its profits.[16] The Kings County Supreme Court determined that the plaintiff adequately pled shared profits and losses (the essential element of a partnership), which was supported by documentary ev-

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idence.[17] The plaintiff also produced sufficient evidence to establish that he and the defendant jointly managed the business. This evidence included emails in which the parties discussed employee compensation and profit-maximizing strategies.[18] Given the parties' joint efforts to establish and manage the business over the course of their relationship, the court found that the plaintiff sufficiently alleged the existence of a partnership, giving rise to fiduciary duties.[19]

Fiduciary Duties

In *Meinhard v. Salmon*, Chief Judge Benjamin Cardozo elegantly described the fiduciary duties that partners owe one another, a standard which is still applied nearly 90 years later. Judge Cardozo wrote that,

> Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.[20]

"In New York, partnerships may be formed without express agreements and may even be implied from conduct."

Courts will enforce these duties with "uncompromising rigidity."[21] Partners owe their partners fiduciary duties, and courts take this obligation seriously. New York courts hold shareholders of closely held corporations,[22] managers of LLCs,[23] and trustees[24] to the same standard of fiduciary duties. Shareholders of closely held corporations, LLC managers, trustees, and partners owe strict fiduciary duties to the shareholders, members, beneficiaries, and partners of their respective enterprises.

Partners, and other fiduciaries, are obligated to act in the interests of their partners (rather than in their own interests) and with good faith, due care, and undivided loyalty, among other things.[25] They are required to make full disclosures of material facts, such as conflicts of interest and divided loyalty.[26] Under Partnership Law § 43, each partner is required to account to the partnership for any benefit received in any transactions connected with the partnership.[27]

This standard of conduct applies to partners regardless of how the partnership was formed. Therefore, parties who may be unaware that they are indeed partners of a partnership will also be held to this strict standard of conduct.

Breach of Fiduciary Duties

To establish a breach of fiduciary duty, the plaintiff must show that a fiduciary relationship existed, that the other party breached such duty, and that such wrongful conduct caused the plaintiff damage.[28] Therefore, if the plaintiff can establish an oral or implied partnership, the defendant is subject to liability for any misconduct that injured the plaintiff.

In *Frame v. Maynard*, the First Department held that the defendant breached fiduciary duties owed to the plaintiffs (his partners) when he failed to fully disclose information material to a specific transaction.[29] The defendant offered to acquire the plaintiffs' partnership interests in a particular piece of property for roughly $850,000.[30] The plaintiffs accepted the offer.[31] However, the defendant failed to fully disclose the actual value of the property at issue, which he recently had appraised for over $2 million.[32] The court found it "beyond dispute" that such a disclosure would have influenced the plaintiffs' decision to accept the offer, and so the defendant's failure to disclose constituted a breach of fiduciary duties.[33]

In *Pokoik v. Pokoik* (involving an LLC), the First Department held that the defendant breached fiduciary duties owed to the plaintiff.[34] The parties had entered into a settlement agreement, under which the plaintiff agreed to make payments of $2.2 million to certain properties in which they had an interest.[35] The company's accountant informed the defendant, the managing member of the LLC, that the transactions would result in a $750,000 tax liability.[36] To avoid a negative effect on himself, the defendant placed the entire tax burden on the plaintiff's shoulders.[37] The defendant did so without informing the plaintiff about the tax liability or that the plaintiff was the only member shouldering the burden.[38] The court determined that the defendant breached duties owed to the plaintiff.[39]

In another New York case, *Huang v. Sy*, the Second Department reaffirmed the lower court's holding that the defendant breached fiduciary duties.[40] The defendant engaged in self-dealing by making payments out of the partnership's funds to himself and entities he alone controlled, without obtaining consent from his partners.[41] The court found "no basis to disturb the Supreme Court's determination."[42]

Remedies for Breach

A breach of the fiduciary duties owed pursuant to Partnership Law § 43 is one of the events that triggers an innocent partner's right to an accounting. Partnership Law § 44 affords each partner the right to an accounting if: (1) he is excluded from partnership business or property; (2) he has such a right under an agreement; (3) his partner has violated § 43; or (4) the situation otherwise renders an accounting just and equitable.[43] In fact, the court may order a party to account for a breach of fiduciary duties where the relationship between the parties was never reduced to a writing, or even labeled a partnership.

Damages for breach of fiduciary duties include disgorgement of profits earned from the breach and damages from lost opportunities caused by the misconduct.[44] The court may award appreciation damages where the breach is the result of serious misconduct.[45] If possible, property transferred in a transaction that gives rise to a breach of fiduciary duties must be returned.[46] The court may also award interest for a breach of fiduciary duties.[47]

In *Frame v. Maynard*, the court ordered the defendant to disgorge the plaintiffs' share of the profits the defendant earned from the subject transaction, with interest.[48] The *Huang* plaintiffs were entitled to be restored to the position they were in before they joined the venture, with interest.[49]

Conclusion

In New York, partnerships may be formed without express agreements and may even be implied from conduct. Regardless of how the partnership is formed, the partners owe one another stringent fiduciary duties. Those in breach may be ordered to disgorge profits and pay damages for lost profits, among other remedies. It is imperative that parties engaged in business transactions understand the factors that courts analyze to determine whether a partnership in fact exists, as partnership duties are rigid and exacting.

Endnotes

1. The Social Network (Sony Pictures 2010).
2. Miguel Helft, *Court Upholds Facebook Settlement With Twins*, N.Y. Times, April 11, 2011, http://www.nytimes.com/2011/04/12/technology/12facebook.html.
3. N.Y. P'ship Law § 10(1).
4. *Meinhard v. Salmon*, 249 N.Y. 458, 463-64 (1928).
5. N.Y. P'ship Law § 43.
6. *Fasolo v. Scarafile*, 120 A.D.3d 929, 930; 991 N.Y.S.2d 820 (N.Y. App. Div. 4th Dep't 2014).
7. *Id.*
8. *Hammond v. Smith*, 151 A.D.3d 1896, 1897; 57 N.Y.S.3d 832 (N.Y. App. Div. 4th Dep't 2017), *citing Griffith Energy Inc v. Evans*, 85 A.D.3d 1564; 925 N.Y.S.2d 282 (N.Y. App. Div. 4th Dep't 2011).
9. *Yuen v. Branigan*, 2015 NY Misc LEXIS 3252, at *26 (Sup. Ct. New York Co. 2015).
10. *Yuen*, 2015 NY Misc LEXIS 3252, at *1-2.
11. *Yuen*, 2015 NY Misc LEXIS 3252, at *4-5.
12. *Id.* at *25-26.
13. *Id.* at *26.
14. *Id.*
15. *Koether v. Sherry*, 40 Misc 3d 1237(A); 977 N.Y.S.3d 667 (Sup. Ct. Kings Co. 2013).
16. *Id.*
17. *Id.*
18. *Id.*
19. *Id.*
20. *Meinhard v. Salmon*, 249 N.Y. 458, 463-64 (1928).
21. *Id.* at 464.
22. *Brunetti v. Musallam*, 11 A.D.3d 280, 280; 783 N.Y.S.2d 347 (N.Y. App. Div. 1st Dep't 2004) ("The relationship between shareholders in a close corporation, vis-à-vis each other, is akin to that between partners and imposes a high degree of fidelity and good faith.").
23. *Kalikow v. Shalik*, 43 Misc. 3d 817, 824-25; 986 N.Y.S.2d 762 (Sup. Ct. Nassau Co. 2014) ("A partner, and by analogy, a [minority managing] member of a limited liability company, has a fiduciary obligation to others in the partnership or [LLC]…").
24. *Carbone v. Betz*, 101 A.D.3d 866, 868; 955 N.Y.S.2d 209 (N.Y. App. Div. 2d Dep't 2012).
25. *RSSM CPA LLP v. Bell*, 2017 N.Y. Misc LEXIS 40, at *31; 2017 NY Slip Op. 30020(U) (Sup. Ct. New York Co. 2017).
26. *Dubbs v. Stribling & Assocs.*, 96 N.Y.2d 337, 340; 752 N.E.2d 850 (2001).
27. N.Y. P'ship Law § 43(1).
28. *Pokoik v. Pokoik*, 115 A.D.3d 428, 429; 982 N.Y.S.2d 67 (N.Y. App. Div. 1st Dep't 2014).
29. *Frame v. Maynard*, 83 A.D.3d 599; 922 N.Y.S.2d 48 (N.Y. App. Div. 1st Dep't 2011).
30. *Id.* at 601.
31. *Id.*
32. *Id.* at 602.
33. *Id.*
34. *Pokoik v. Pokoik*, 115 A.D.3d 428; 982 N.Y.S.2d 67 (N.Y. App. Div. 1st Dep't 2014).
35. *Id.* at 429.
36. *Id.* at 429-30.
37. *Id.*
38. *Id.* at 430.
39. *Id.* at 432.
40. *Huang v. Sy*, 62 A.D.3d 660, 661; 878 N.Y.S.2d 398 (N.Y. App. Div. 2d Dep't 2009).
41. *Id.* at 661
42. *Id.*
43. N.Y. P'Ship Law § 44.
44. *Herman v. Herman*, 2017 NY Misc LEXIS 1862, at *8-9; 2017 NY Slip Op. 31034(U) (Sup. Ct. New York Co. 2017), citing *105 E Second St. Assoc v. Bobrow*, 175 A.D.3d 746, 746-47; 573 N.Y.S.2d 503 (N.Y. App. Div. 1st Dep't 1991).
45. *Id.*
46. *Id.* at * 9, citing *In re Estate of Rothko*, 43 N.Y.2d 305, 322; 372 N.E.2d 291 (1977).
47. *Id.* at *9.
48. *Frame v. Maynard*, 107 A.D.3d 582; 969 N.Y.S.2d 6 (N.Y. App. Div. 1st Dep't 2013).
49. *Huang v. Sy*, 18 Misc. 3d 1141(A); 859 N.Y.S.2d 903 (Sup. Ct. Queens Co. 2008), *aff'd*, *Huang v. Sy*, 62 A.D.3d 660; 878 N.Y.S.2d 398 (N.Y. App. Div. 2d Dep't 2009).

A Litigator's Guide to the Management of New York Limited Liability Companies

By Michael J. Firestone

I. INTRODUCTION

Since the adoption of the New York Limited Liability Company Law (the "LLC Law") in 1994, the limited liability company (LLC) has become the most popular type of entity for organizing privately owned businesses in New York. While New York-based commercial litigators generally do not advise their clients on the formation of LLCs and the various tax and corporate law issues that are involved in their operation, they are often called upon to represent parties in disputes concerning the extent of the LLC manager's (or majority member's) right to control the business and operations of the LLC, the manager's fiduciary duties to the LLC and its members, and the minority members' rights to consent or oppose certain business decisions. Litigators should therefore be conversant in the basic statutes and case law applicable to the management of New York LLCs.

This article has two purposes. First, to provide litigators with both a legal and practical understanding of how New York LLCs are managed. Second, to outline the LLC manager's fiduciary duties under New York law and to examine the limits placed on managers as a result of those duties, as well as those areas where the duties can be carved back or even eliminated.

II. DETERMINING HOW AN LLC IS MANAGED

A. The Management Framework

Three sources provide the framework under which an LLC is managed: (i) the LLC Law; (ii) the LLC's articles of organization; and (iii) the LLC's operating agreement.

1. The LLC Law

The LLC Law covers, among other things, the process by which an LLC is formed and dissolved, the rights of members and the processes by which the LLC is managed, and the rules applicable to mergers. Many provisions of the LLC Law only apply to the extent they are not overridden by the articles of organization or the operating agreement. Thus, the LLC Law constitutes a set of "default" rules applicable only where the members fail to agree otherwise in writing, or where their written agreement fails to address an issue otherwise covered by the LLC Law.

2. The Articles of Organization

An LLC is formed by filing articles of organization with the New York secretary of state. Pursuant to § 203(e) of the LLC Law, the articles of organization must provide basic information regarding the LLC, such as its name and a designation of the New York Secretary of State as the agent of the LLC upon whom process may be served.

The articles of organization are relevant to the management analysis in two respects. First, Section 203(e)(7) of the LLC Law states that the articles of organization shall set forth:

> Any other provisions, not inconsistent with law, that the members elect to include in the articles of organization for the regulation of the internal affairs of the limited liability company, including, but not limited to, (A) the business purpose for which the Company is formed, (B) a statement of whether there are limitations on the authority of members or managers or a class or classes thereof to bind the limited liability company and (C) any provisions that are required or permitted to be included in the operating agreement of the limited liability company pursuant to section four hundred seventeen of this chapter.

In practice, most articles of organization include only the bare minimum required by § 203(e), with provisions concerning the internal governance of the LLC set forth in the operating agreement. This results from two factors. First, the articles of organization is a public document (while the operating agreement is a private contract), and LLC members have no reason to make public their internal business arrangements. Second, the articles of organization must be filed in order to form an LLC, while the operating agreement can be executed at a later date. The LLC may need to be formed quickly (particularly if there is a pressing business opportunity), in which case the members will draft a bare-bones articles of organization and put off negotiating and drafting an operating agreement until a later date.[1] Nevertheless, because the members are permitted to include management provisions in the articles of organization, it is imperative that the articles be reviewed whenever analyzing the management of an LLC. Indeed, even a bare-bones articles of organization will often include, at the very least, an indemnification provision.

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Second, § 401(a) of the LLC Law states as follows:

> Unless the articles of organization provides for management of the limited liability company by a manager or managers or a class or classes of managers, management of the limited liability company shall be vested in its members... subject to any provisions in the articles of organization or the operating agreement...

Based on this language, the LLC Law implicitly requires the articles of organization to state whether the LLC is managed by a manager or by its members.[2]

3. The Operating Agreement

Section 417 of the LLC Law states that the members of an LLC

> shall adopt a written operating agreement that contains any provisions not inconsistent with law or its articles of organization regarding (i) the business of the limited liability company, (ii) the conduct of its affairs and (iii) the rights, powers, preferences, limitations or responsibilities of its members, managers, employees or agents, as the case may be.

The LLC Law defines an "operating agreement" as "any written agreement of the members concerning the business of a limited liability company and the conduct of its affairs..."[3] As one New York court has said, the operating agreement is the "primary document defining the rights of members, the duties of managers and the financial arrangements of the limited liability company."[4] Thus, the operating agreement is a contract among the members reflecting how they want the LLC to be run.

Whenever it is necessary to understand the management of an LLC, the starting point is the operating agreement. Operating agreements vary depending on the nature of the LLC's business and the relationship among the members. While there are virtually unlimited ways in which to structure management, operating agreements are generally designed to vest managerial authority with the member who has the most equity in the LLC, and/or the highest degree of expertise in the business being run.

B. Management of the LLC by a Manager

In managing an LLC with multiple members, it is most efficient for one person, known as a manager, to be responsible for the LLC's day-to-day operations and most of its significant business decisions.[5] In practice, the manager is often a member with a significant ownership interest in the LLC, though she need not be a member if the articles of organization and/or operating agreement so provides.[6] The manager only has "such responsibilities accorded to him or her by the members as provided in the operating agreement."[7] Thus, an operating agreement must identify the manager by name and describe the scope of the manager's authority, either by (i) identifying a set of specific acts for which the manager is responsible and can authorize on her own, while leaving all other actions to the consent of the members or (ii) granting the manager sole and exclusive authority to make all decisions, and then carving out a series of specific exceptions for which member consent is required.[8]

A good operating agreement should provide the manager and the members with certainty about their respective roles, and leave no ambiguity regarding those areas over which the manager has authority. For example, the operating agreement might provide that the manager has sole and exclusive authority to make all decisions with respect to the LLC's business and operations, except that members holding a majority of the membership interests must approve any decision to amend the operating agreement, sell all or substantially all of the LLC's assets, or commence a bankruptcy proceeding. By contrast, a poorly written operating agreement might provide that the manager has sole and exclusive authority to manage the LLC except that all members must approve "major decisions" without defining the term. This language is vague, and may lead to clash between the manager and the members over which sorts of decisions are "major" and which are not.

An LLC may have more than one manager or multiple "classes" of managers. If multiple managers are designated, the operating agreement should state whether all managers must agree for an action to be taken, whether only a majority of managers are required, or whether each manager may act on his or her own. Similarly, if the LLC has "classes" of managers, the operating agreement will identify those business decisions over which each class may exercise control.[9] To the extent there are multiple

"The LLC Law defines an 'operating agreement' as 'any written agreement of the members concerning the business of a limited liability company and the conduct of its affairs...'"

managers, the operating agreement should include some mechanism for resolving a deadlock between them.

There are various ways in which the members can structure the authority of the manager under the operating agreement. Indeed, as one New York court aptly said, "one of the beauties of the LLC is that members can specifically and explicitly determine how their company is to be run."[10] The following four scenarios demonstrate a variety of management structures that are available for a manager-managed LLC; they are by no means exhaustive, but rather illustrative of the flexibility afforded by the LLC form.

1. Scenario 1: The Real Estate Investment, Case 1

In this scenario, the LLC has three members. Member A owns 60 percent of the LLC's equity, and Members B and C each own 20 percent. The LLC's sole asset is a valuable commercial property. Member A is in the business of real estate management, while Members B and C are longtime acquaintances of Member A whom he invited to participate in the investment but who have no prior experience investing in or managing a commercial real estate property or participating in the management of an LLC. The operating agreement provides that Member A is the managing member, with absolute discretion to make all decisions relating to the business and operations of the LLC, except that Members B and C must consent to a decision to sell the existing property, acquire a new property, or take on new debt.

The operating agreement recognizes that Member A, as the owner of more than half of the LLC, is entitled to make nearly all management decisions. From the perspective of the LLC members, this is sensible because Member A has experience in the real estate industry while they do not. At the same time, while Members B and C have no say over the day-to-day running of the business (e.g., creating a budget, hiring building employees and service providers, negotiating leases, etc.), Member A cannot fundamentally alter the nature of the investment without first obtaining the other members' consent to do so.

2. Scenario 2: The Real Estate Investment, Case 2

The LLC has three members, A, B and C, each of whom own one-third of the membership interests, and all three of whom are experienced real estate investors. The LLC owns an apartment building. At least two of the three members must approve all major management decisions, including but not limited to the building's annual budget, the hiring of any employees or contractors, the refinancing of the mortgage, a sale of the building, and any lease for more than 2,000 square feet. Member A is the manager of the LLC, but the operating agreement limits his authority to overseeing the building's daily operations and executing the decisions of the members. The operating agreement authorizes Member A to hire his wholly owned management company to manage operations at the building, for which the management company will receive market-rate compensation.

Here, Members A, B and C all have equal interests in the property and significant experience with real estate. The operating agreement therefore provides for "majority rule." In return for serving as manager and carrying out the members' decision, Member A has the right to receive compensation that is not available to Members B and C.

3. Scenario 3: The Service Business

The LLC has two members, each of whom owns 50% of the LLC. The LLC's sole asset is a public relations firm. The members are longtime friends and colleagues who worked together for many years before opening their business. The operating agreement provides that Members A and B are both managing members who must agree in order for any decision to be made. In the event that they cannot reach agreement, the operating agreement requires that they enter into mediation. If mediation fails, the LLC is required to be dissolved.

Here, the members are equal investors and each has the particular knowledge required for the running of the business. Moreover, the members have already built a relationship based on trust and mutual respect from years of working together. Thus, they are comfortable sharing management rights and anticipate that they will either not have fundamental disagreements or they are confident that such disagreements can be amicably resolved. At the same time, the operating agreement recognizes that relationships change, and that a time may come when the members cannot resolve a deadlock on their own. The operating agreement therefore provides a mechanism for dispute resolution and, if it becomes necessary because of an unresolvable deadlock, the orderly dissolution of the business without either member having to commence a judicial proceeding.

4. Scenario 4: The Equity Investment

The LLC has 18 members. Seventeen of the LLC members are a mix of individuals, other LLCs, and trusts (the "Minority Investors"). The Minority Investors each own various amounts of equity ranging from 20 percent to 2 percent. The 18th member is another LLC which acts as manager (the "Manager LLC") and owns 0.01 percent of the LLC's membership interests. The LLC's operating agreement provides that the Manager LLC has the sole and absolute right to manage the LLC, while the Minority Investors have no rights whatsoever to participate in the management of the LLC. The Manager LLC is run by its three members, A, B, and C (the "Managers"), at least two of whom must consent to any decision. If at any time there are fewer than three Managers, the remaining two must appoint a third so that there cannot be a deadlock among them as to management decisions.

The Managers are all partners at a private equity firm and have experience in the aerospace industry. The LLC's sole asset is a controlling interest in a privately held corporation (the "Corporation") that is in the business of manufacturing jet engine components. Through its controlling interest, the LLC appoints a majority of the Corporation's directors and its key officers, and has consent rights over certain major business decisions. In return for managing the LLC and its investment in the Corporation, the Manager LLC is paid a management fee by the LLC, as well as a share of profits if the Corporation hits certain profitability targets.

Here, the Minority Investors have all of the equity and no control over management, while the Managers have control over management and essentially no equity, but an incentive to run a profitable business. This makes sense, as the LLC is essentially an investment vehicle for the Minority Investors, who are relying on the business acumen of the Managers to successfully navigate a unique and highly sophisticated investment. In order to reassure the Minority Investors that their investment will function smoothly, the operating agreement provides mechanisms to prevent a deadlock among the Managers.

C. Management of the LLC Where No Operating Agreement Exists

Section 417(a) of the LLC Law provides that LLC members "shall adopt a written operating agreement."[11] Courts have nevertheless interpreted this provision of the LLC Law to mean that even where the members do not adopt an operating agreement, an LLC maintains its corporate character as a limited liability entity and may conduct business as such.[12] In such circumstances, however, the LLC is governed solely by the provisions of the LLC Law.[13] Similarly, even if an operating agreement exists but is silent with respect to certain issues that are addressed by the LLC Law, the LLC Law, where applicable, applies to those areas.[14]

Allowing the LLC to be governed by the LLC Law rather than the operating agreement carries significant implications for the management of the LLC. Article IV of the LLC Law, which concerns management of the LLC, contains various provisions, discussed below, that may be at odds with how the members want or expect their business to be run. These provisions may all be altered or removed by the members in an operating agreement.[15] Thus, to the extent there is no operating agreement, or the operating agreement is silent on certain issues, the following rules will apply to the management of the LLC.

1. Management by Members

In the absence of an operating agreement, Section 401(a) of the LLC Law vests management of a limited liability company in the LLC's members. Additionally, Section 401(b) deems any member exercising "management powers or responsibilities" to be a manager subject to all of a manager's duties and liabilities under the law. To illustrate the problems which may result in an LLC governed by the default rules of Section 401(b), consider *Laugh Factory, Inc. v. Basciano*, 608 F. Supp. 2d 549 (S.D.N.Y. 2009), a federal case applying New York law. There, two entities—Laugh Factory Inc. ("Laugh Factory") and 300 West 43 Street Realty, Inc. ("300 West")—formed an LLC for the purpose of operating a comedy club. The club was located in a Manhattan building controlled by 300 West's sole shareholder. The members never entered into an operating agreement. The members ultimately sued each other for various claims, including one by Laugh Factory that 300 West breached its fiduciary duties to the LLC. 300 West argued that it was not the manager and therefore owed no fiduciary duties to Laugh Factory. On motion for summary judgment, the Court held that there was sufficient evidence that employees of 300 West had handled many of the LLC's operations, such as bookkeeping and obtaining a liquor license for the comedy club. To the extent "that in so doing they were acting on behalf of [300 West]...there is evidence that could support a finding that [300 West]...was a managing member of the" LLC under Section 401 and that 300 West "accordingly owed—and potentially breached—a fiduciary duty to the other member."[16]

2. Voting Rights of Members

When entering into an operating agreement, the members can designate certain decisions that must be must be consented to by all or any percentage of the members, as opposed to actions which may be authorized on the manager's sole authority. In the absence of an operating agreement covering these issues, however, §§ 402(c) and (d) reserve to the members holding a majority of the membership interests the right to consent to certain key management decisions, regardless of whether the LLC is managed by a manager. Those decisions include:[17]

- admitting new members;
- incurring debt other than in the ordinary course of business;
- adopting, amending, restating or revoking the articles of organization or operating agreement;
- dissolving the LLC;
- selling, leasing, exchanging, mortgaging, pledging or transferring all or substantially all of the LLC's assets; and
- merging or consolidating the LLC with or into another LLC.[18]

While it is desirable for members to consider which decisions require member consent rather than rely on the items listed in § 402, members still need to be careful about which decisions they cede to managers and which they retain for themselves. *Ahmed v. Fulton Street Brothers Realty*, LLC, 107 A.D.3d 832 (2d Dep't. 2013), concerned an LLC with three members: Yasser Lewis, Wilfred Ward, and Latuit Ward. Lewis, who owned a 38 percent interest in the LLC, was the managing member; the Wards together owned the remaining 62 percent. The members entered into an operating agreement which went beyond the provisions of § 402(d) by providing that the managing member could make decisions concerning the sale or disposition of the LLC's property without obtaining the other members' consent.

Apparently unbeknownst to the Wards, Lewis authorized the transfer of a property owned by the LLC to a different LLC that was also managed by Lewis. One month later, the Wards voted to remove Lewis as managing member and simultaneously authorized the LLC to enter into a contract to sell to a different purchaser the same property that Lewis had previously purported to transfer. The Wards then learned of Lewis's prior transfer of the property, and they sought to unwind the first contract and enforce the second. The Court, however, declined to reverse the original transfer authorized by Lewis because the members had specifically drafted the operating agreement to override Section 402 by providing Lewis—the owner of only 38% of the equity—with the authority to make those decisions on his own.[19]

3. Indemnification

Indemnification provisions allow a manager to be indemnified by the LLC for certain claims for which the manager is found liable and to advance funds to pay for his legal expenses. Indemnification and advancement are generally unavailable, however, if a court finds that the manager acted in bad faith or engaged in willful misconduct or breached the operating agreement. (Very often, the manager is required to provide an undertaking to the LLC by which he agrees to repay the LLC if it is determined that he had no right to advancement.) As managers are often personally exposed to increased litigation risk from disgruntled members, the right of indemnification is seen as a necessary prerequisite for managers to do their job effectively.

Indemnification provisions are either "permissive" or "mandatory." A permissive provision allows, but does not require, the LLC to indemnify the manager and advance his legal fees. A mandatory provision, on the other hand, obligates the LLC to do so. The members are free to include in the operating agreement a permissive or mandatory provision. If the operating agreement is silent and the LLC Law controls, however, then indemnification is permissive only. Specifically, § 420 of the LLC Law states as follows:

> Subject to the standards and restrictions, if any, set forth in its operating agreement, a limited liability company may, and shall have the power to, indemnify and hold harmless, and advance expenses to, any member, manager or other person...from and against any and all claims and demands whatsoever...

(emphasis added).

Permissive indemnification provisions can be problematic. For example, assume that the LLC has three members. Although the LLC does not have an operating agreement, one of the members owns 70 percent of membership interests and in practice acts as the LLC's manager. The manager is the subject of a derivative lawsuit brought by the other members alleging that he breached his fiduciary duties. The manager is now faced with a dilemma. Under the LLC Law, he may authorize the LLC to advance his litigation expenses. However, the members purporting to sue him derivatively on behalf of the LLC may seek to oppose his doing so. If the members cannot find a way to resolve this among themselves, the manager may need to litigate his right to have his fees advanced by the LLC. Importantly, "fees on fees," i.e., legal fees spent by the manager seeking to establish his right to advancement, are only covered by an indemnification provision that specifically provides for such fees.[20] As Section 420 does not specifically cover "fees on fees," the costs of litigation related to advancement will not be covered by § 420.[21] Additionally, note that the LLC may indemnify "any person," such as a third-party professional or employee.

4. Agency

An LLC is only capable of acting through its agents. To avoid internal conflict and confusion, most LLCs designate the manager as the sole agent in the operating agreement. Members may, however, determine otherwise and are free to designate any or all of the members as agents as well. So long as the members appropriately coordinate their actions, having multiple agents can be efficient, particularly if papers need to be signed and the manager is not available to do so. If the members do not designate an agent in the operating agreement, however, then the default rule under § 412 of the LLC Law will apply.

Under § 412(b)(1) and (2), if the LLC is managed by a manager, then the manager is deemed an agent of the LLC and no other member may act as the LLC's agent unless he or she has been delegated such authority by the manager. Section 412(b)(2) carves out an exception by noting that a manager cannot bind the LLC if in fact he has no authority to act for the LLC in the particular matter and the person with whom he or she is dealing knows that the manager has no such authority.

Under § 412(a), if the LLC is managed by its members, then every member is deemed to be an agent of the LLC, except in a situation where the member in fact has no authority to act for the LLC in the particular matter and the person with whom he is dealing knows that the member has no such authority.

Sections 412(c) and (d) provide two additional rules relating to agency: First, the act of a manager or member that is not "apparently" for the purpose of carrying on the LLC's business "in the usual way" does not bind the LLC unless it was specifically authorized by the LLC.[22] Second, to the extent the member or manager is restricted in some way, either in the operating agreement or in any other form of agreement, and the manager purports to bind the LLC in contravention of such restriction, the LLC will not be bound so long as the person on the other side of the transaction was aware of the restriction.[23]

5. Multiple Managers

Where the operating agreement provides for multiple managers but does not indicate how they are to make decisions collectively, Section 408(b) provides that the managers will manage the LLC by affirmative vote of the majority of the managers.

6. Qualifications of Managers

Under Section 410, unless otherwise stated in the operating agreement, a manager may, but need not be, a member of the LLC.

7. Compensation of Managers

Many operating agreements expressly prohibit the managers from receiving compensation.[24] If the operating agreement does not include language prohibiting manager compensation, the LLC Law controls, and the manager is authorized to fix her own compensation.[25]

8. Election, Removal, and Resignation of Managers

In a manager-managed LLC, the operating agreement will often state that a manager serves until death, incapacity, or withdrawal as a member. The operating agreement may also discuss the circumstances under which a manager may be removed from office by the members, whether the manager has the right to resign, and the manner in which a successor manager is selected. If these matters are not covered in the operating agreement, the LLC Law will fill in the gaps as follows: First, Section 413(a) requires that the members are to vote annually on the election of a manager, who must receive the support of a majority-in-interest of the members. Second, Section 414 provides that a majority in interest of the members may remove a manager with or without cause. Third, Section 415 provides that the manager may resign at any time.

> *"Indemnification provisions allow a manager to be indemnified by the LLC for certain claims for which the manager is found liable and to advance funds to pay for his legal expenses."*

III. THE MANAGER'S STANDARD OF CONDUCT

A. The Business Judgment Rule

In making decisions on behalf of the LLC, under New York case law, the manager is protected by the familiar business judgment rule applicable to corporate officers and directors.[26] The business judgment rule bars judicial inquiry into actions of managers "taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes."[27] Thus, if a manager's decision is challenged in a legal proceeding, the court will presume that he or she acted within his or her business judgment and will not overturn such decision unless it can be shown that the decision was made in bad faith or tainted by fraud.[28] Additionally, a manager is not protected by the business judgment rule to the extent that he or she has a financial interest in the transaction at issue.[29] The defense of the business judgment rule is key, particularly if the manager takes actions which are unpopular with members. For example, a manager may determine not to make distributions or to issue capital calls. These decisions are generally disfavored by members, who may allege that decisions are being made by the manager in order to oppress them and are in breach of his or her fiduciary duties. Yet, so long as the manager's decision merits the presumption of the business judgment rule, the court will uphold his or her decision. Indeed, "[s]o long as the managing member does not run afoul of his contractual and fiduciary obligations, his business decisions cannot be questioned, either by non-managing members or the court."[30]

B. The Manager's Fiduciary Duty

Managers and members, who exercise management powers or responsibilities pursuant to § 401(b), owe fiduciary duties of loyalty and care to the LLC and its members. Specifically, § 409(a) of the LLC Law provides that a "manager shall perform his or her duties as a manager... in good faith and with that degree of care that an ordinarily prudent person in a like position would use under similar circumstances."[31] The duty of loyalty requires the manager to refrain from using his or her position to gain a financial or other advantage that is not shared with the members.[32] Thus, courts have held that the duty of loyalty requires the manager to avoid situations in which his "personal interest possibly conflicts with the interest of those owed a fiduciary duty."[33] Courts have also held that the duty of loyalty requires a manager to disclose all material facts involving the LLC to members.[34] While little has been said regarding the duty of care in the context of an LLC, in the case of corporate directors, the duty has been defined as requiring the fiduciary "to act in an informed and 'reasonably diligent' basis in 'considering material information.'"[35]

C. Contractual Limitations on Fiduciary Duties

While managers owe fiduciary duties to the LLC and its members under the LLC Law, the extent of those duties exist within the terms of the operating agreement. Thus, "when a member complains that his rights were violated based on traditional notions of equity and corporate fair play, courts must be wary not to lose sight of the nature of the LLC and provide members with rights they did not bargain for and, in many cases, expressly disclaimed."[36] In particular, members may agree in the operating agreement to "prospectively waive" certain potential future breaches of the manager's fiduciary duties. They may also grant the manager the right to enter into interested transactions or pursue business opportunities that compete with the LLC. Taken together, members have broad authority to limit the manager's fiduciary duties, should they choose to do so.

Under New York law, the LLC members have the right to prospectively waive the manager's duty of care, but not the duty of loyalty. Specifically, Section 417(a) of the LLC Law provides that the operating agreement,

> may set forth a provision eliminating or limiting the personal liability of managers to the limited liability company or its members for damages for any breach of duty in such capacity, ***provided that no such provision shall eliminate or limit***:
>
> (1) the liability of any manager if a judgment or other final adjudication adverse to him or establishes that his or her acts or omissions were in ***bad faith or involved intentional misconduct or a knowing violation of law or that he or she personally gained in fact a financial advantage to which he or she was not legally entitled***...[37]

Notwithstanding § 417(a)(1), there are circumstances in which even certain aspects of the duty of loyalty can be waived as well. For example, members often include in the operating agreement a provision allowing the manager to authorize a market-rate transaction between the LLC and an entity in which the manager has a financial interest, or to invest in a business that competes with the LLC without having to share profits with the other members. While New York courts have not examined these provisions in the specific context of § 417, they are widespread and presumed to be valid.[38]

The notion of how far members can go in circumscribing the duty of loyalty was explored by the Appellate Division, First Department and the New York Court of Appeals in the *Pappas v. Tzolis* decisions. That case concerned Vrahos LLC, formed by three members, Pappas, Ifantopolous and Tzolis, for the purpose of entering into a long-term lease of a building located in Manhattan.[39] The LLC's operating agreement included a clause providing that "any member may engage in business ventures and investments of any nature whatsoever, whether or not in competition with the LLC, without obligation of any kind to the LLC or to the other Members."[40] The operating agreement also granted Tzolis an option to enter into a sublease with the LLC, which could only be exercised if Tzolis made certain payments to the LLC. Tzolis exercised the sublease option, but failed to make the required payments. He explained to Pappas and Ifantopolous that rather than make the payments and keep the sublease, he preferred to buy them out of LLC and take over the prime lease. The other members agreed with this plan, and Tzolis bought them out for a total of $1.5 million. In connection with the buyout, Pappas and Ifantopolous executed a "certificate" which provided that:

> Each of the undersigned Sellers, in connection with their respective assignments to Steve Tzolis of their membership interests in Vrahos LLC, has performed their own due diligence in connection with such assignments. Each of the undersigned Sellers has engaged its own legal counsel, and is not relying on any representation by Steve Tzolis or any of his agents or representatives, except as set forth in the assignments and other documents delivered to the undersigned Sellers today. Further, each of the undersigned Sellers agrees that Steve Tzolis has no fiduciary duty to the undersigned Sellers in connection with such assignments.[41]

Six months after buying out Pappas and Ifantopolous, Tzolis assigned the lease to a third party for $17.5 million. Pappas and Ifantopolous claimed that Tzolis had begun negotiating the assignment of the lease prior to the time that the parties agreed to the buyout, and they alleged causes of action for, among other things, breach of fiduciary duty for failure to disclose such negotiations. Tzolis moved to dismiss, arguing that he did not owe Pappas and Ifantopolous a fiduciary duty because of the clause in the operating agreement and the certificate. The trial court granted Tzolis's motion, which was reversed on appeal. The Appellate Division held that the operating agreement,

> may have permitted Tzolis to pursue a business opportunity unrelated to Vrahos for his exclusive benefit, without having to disclose it to plaintiffs or otherwise present it first to Vrahos. However, we find that the provision does not 'clearly' permit Tzolis to engage in behavior such as that alleged here, which was to surreptitiously engineer the lucrative sale of *the sole asset owned by Vrahos* without informing his fellow owners of that entity.[42]

The Appellate Division also held that the certificate did not waive Tzolis's fiduciary duty, holding that Tzolis "had an overriding duty to disclose his dealings with [the third party]...to plaintiffs before they assigned their interests in Vrahos to him."[43]

The Appellate Division's decision was reversed by the Court of Appeals.[44] The Court of Appeals did not address the clause in the operating agreement permitting Tzolis to engage in competitive business ventures, but instead, the court focused on the certificate. It found that plaintiffs were "sophisticated businessmen represented by counsel," and that by the time of the buyout "the relationship between the parties was not one of trust" such that "reliance on Tzolis's representations as a fiduciary would not have been reasonable."[45] In light of these facts, the Court found that Tzolis did not owe a fiduciary duty to plaintiffs because of the certificate. In reaching this conclusion, the Court relied on its prior decision in *Centro Empresarial Cempresa S.A. v. America Movil S.A.B. de C.V.*, where it held that:

> "A sophisticated principal is able to release his fiduciary from claims—at least where the fiduciary relationship is no longer one of unquestioning trust—so long as the principal understands that the fiduciary is acting in his own interest and the release is knowingly entered in to"...The test, in essence, is whether, given the nature of the parties' relationship at the time of the release, the principal is aware of information about the fiduciary that would make reliance on the fiduciary unreasonable.[46]

The Court of Appeals' decision in *Pappas* and Section 417(a) are in some degree of conflict, and it remains to be seen whether the New York legislature will follow Delaware and simply allow LLC members to prospectively waive the duty of loyalty. For now, however, two things are clear: First, for a manager to argue successfully that members waived their duty of loyalty, the relationship of trust between the manager and the members must have broken down, perhaps irretrievably.[47] Second, although the Court of Appeals reversed the Appellate Division, the former said nothing about the latter's consideration of the operating agreement provision allowing the manager to engage in competitive enterprises. Thus, even where the member may enter into a business venture in competition with the LLC, courts will not view this clause as providing the interested member with a blank check to cheat the other members out of the profits from their joint venture.

D. The Manager's Right to Rely on Experts

Recognizing that managers often must rely on third parties in order to reach business decisions, Section 409(b) of the LLC Law provides that a manager,

> shall be entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, in each case prepared or presented by:
>
> (1) one or more agents or employees of the limited liability company;
>
> (2) counsel, public accountants or other persons as to matters that the manager believes to be within such person's professional or expert competence; or
>
> (3) a class of managers of which he or she is not a member, duly designated in accordance with the operating agreement of the limited liability company as to matters within its designated authority, which class the manager believes to merit confidence, so long as in so relying he or she shall be acting in good faith and with such degree of care, but he or she shall not be considered to be acting in good faith if he or she has knowledge concerning the matter in question that would cause such reliance to be unwarranted.[48]

To the extent the manager complies with § 409(b), he or she "shall have no liability by reason of being or having been a manager of the limited liability company."[49]

This Section was examined by the Appellate Division, First Department, in *Pokoik v. Pokoik*. In that case, Gary Pokoik, the managing member, and Leon Pokoik, the non-managing member, had previously settled a dispute by having Leon pay $2.2 million to multiple LLCs from which it was alleged that Leon had misappropriated funds for his personal use.[50] Gary and Leon knew that the $2.2 million was less than the full amounts at issue in their dispute and that any discrepancy between the amount paid by Leon and the actual amounts allegedly misappropriated would be written off by the LLCs.[51] After Leon made the payments, Gary was informed by the LLCs' accountants that there was a $750,000 discrepancy between what had been misappropriated and what had been repaid, and that under the tax law, the properties would have to account for such funds. Gary was advised by the accountants to account for such discrepancy by writing down Leon's capital accounts, on the grounds that any discrepancy was a likely result of Leon's actions.[52] Gary followed this advice and also failed to inform Leon of the accountants' recommendation.[53] As a result of the reduction in his capital accounts, Leon stopped receiving distributions.

Leon argued that Gary breached his fiduciary duty by reducing Leon's capital accounts and denying him distributions, while leaving the capital accounts of all other members untouched. Gary argued that he had relied on the advice of the LLCs' accountants in determining to reduce Leon's capital accounts, and he was, therefore, not liable for breach under § 409(b). Gary moved for summary judgment on that basis. The trial court denied Gary's motion, finding that the reasons for writing down Leon's capital account and whether Gary had acted in bad faith or actually relied on the accountants were factual matters that could only be resolved at trial.[54] On appeal, the First Department affirmed the trial court's order on the grounds that Gary did not act in good faith. Specifically, the First Department found that:

> Gary had an interest in reducing plaintiff's capital accounts, as opposed to charging certain amounts to the LLCs, because the latter course of action would ultimately have had a negative financial impact on Gary. These failures to make truthful and complete disclosures...and Gary's conflict in choosing to burden only plaintiff and not all the LLCs members, including himself, does not show "undivided and undiluted loyalty."[55]

Pokoik is a problematic decision because there is no indication that the advice that Gary received from the accountants was wrong. Thus, how does a manager reconcile the need to follow accurate expert advice with his obligation to treat all members fairly when they are in conflict? The court gave no guidance on that issue. However, at the time they entered into the settlement, Gary and Leon knew that there would be a discrepancy, but failed to address it. They should have consulted with their accountants and resolved how to account for the discrepancy at the time of the settlement, rather than putting off the issue to the future. By failing to do so, they created a situation in which they had no written agreement to guide the manager's decision. A comprehensive agreement—either a settlement or operating agreement—is always preferable to relying on the manager's discretion, particularly where, as here, there has been a breakdown in trust between the manager and the member.[56]

E. Allowing the Manager to Enter Into Interested Transactions

Although managers must avoid any potential or actual conflicts of interest with the LLC, they are not prohibited from transacting business with the LLC, so long as certain requirements are met. As discussed above, the operating agreement may permit the manager to authorize interested transactions, subject to various conditions (e.g., that the amount paid by the LLC be the equivalent of what it would pay an independent third party for same work). To the extent that the operating agreement is silent on this issue, § 411 of the LLC Law provides a mechanism for "cleansing" an interested transaction between the LLC and a third party affiliated with the manager. Section 411 is one of the more complicated sections of the LLC Law, but it can be boiled down to a few key points:[57]

- If there is more than one manager, so long as all material facts related to manager's interest in the transaction are disclosed in good faith to the disinterested managers, the transaction can be authorized by the consent of a majority of the disinterested managers, or if that is an insufficient number of votes to constitute an act of the managers under the operating agreement, by the unanimous consent of all disinterested managers; or
- If the interested manager is the sole manager, so long as all material facts related to manager's interest in the transaction are disclosed in good faith to the members, the interested transaction can be authorized by consent of the members; but
- If there was no disclosure or if the manager's vote was required to approve the transaction, the transaction may be avoided unless the interested manager establishes that it was fair and reasonable to the LLC as of the time that it was approved.

Thus, whenever § 411 is applicable, it is necessary for the manager to make full disclosure and obtain consent from either the disinterested managers, if any, or the members. As establishing the fairness of the transaction presents the manager with a difficult and potentially costly litigation burden, the best practice is to seek consent before entering into the transaction. Importantly, the LLC Law makes it clear that members are free to include "additional restrictions on contracts and transactions between a limited liability company and its managers" in the operating agreement, and it may even provide that all such transactions "shall be void or voidable by the limited liability company."[58]

Wilcke v. Seaport Lofts is the sole case interpreting § 411.[59] There, the two managers owned 40.9 percent of the LLC's membership interests.[60] An entity, in which the two managers and three other members had financial interests, sought to purchase the LLC's sole asset for $5 million. Two other members, the Wilckes, sought to purchase the same asset for $4.8 million. The operating agreement required that two-thirds of the membership interests approve a sale of the asset. A total of 72.4 percent of the membership interests voted in favor of selling the asset to the entity in which the managers' had a financial interest. The court noted that because the vote of the *interested* managers owning 40.9 percent of the membership interests was necessary to achieve a two-thirds majority and approval of the transaction under the operating agreement, it was "incumbent upon the interested parties to establish affirmatively that the transaction was fair and reasonable to the limited liability company at the time it was approved."[61] Importantly, the court found that the transaction was "fair and reasonable," based on an independent appraisal of the properties which were the subject of the transaction.[62]

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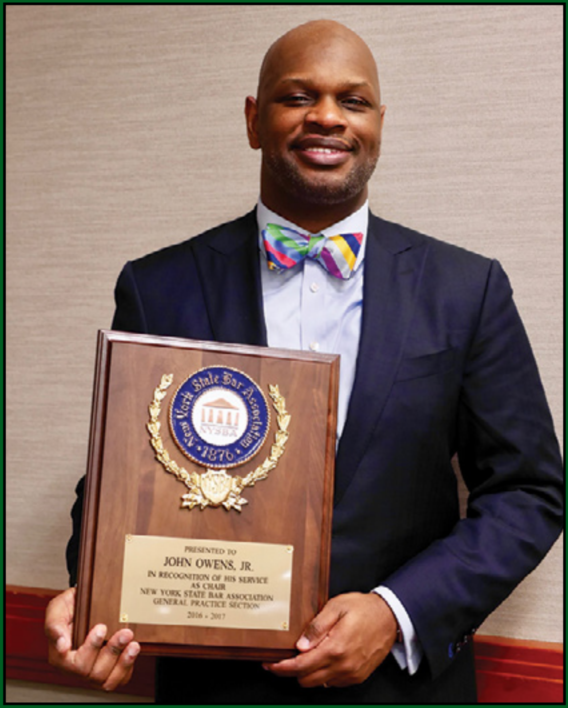
Annual Meeting 2018

On January 23, 2018, the General Practice Section held its annual meeting at the New York Hilton Midtown. Attendance at the annual meeting was tremendous, with a sold-out morning session.

The first segment was an update on the CPLR by Burton N. Lipshie, Esq., managing attorney of the litigation practice group at Stroock & Stroock & Lavan LLP and an adjunct professor. Prof. Lipshie provided attendees with a comprehensive guide on all of the cases throughout the prior year which changed or enhanced various CPLR sections and case law. In particular, he updated the group on the development of case law surrounding personal jurisdiction and electronic discovery.

The Committee on Professional Ethics hosted an excellent program titled "Loose Lips and Emailing Lawyers: The Ethics of Protecting Client Confidences." The program focused on the rapidly emerging and evolving issues of attorney-client confidentiality with a special focus on internet and email security. Speakers at the session included Justice Karen K. Peters, former presiding Justice of the Appellate Division, Third Department; Timothy J. O'Sullivan, Esq., New York State Lawyers' Fund for Client Protection; William K. Rashbaum, *The New York Times*; Jonathan Stribling-Uss, Constitutional Communication; and Michael Ross as moderator.

Finally, the GP Section received its annual "Hot Tips" from various speakers. The topics were: "I Got Bloomed! (Don't let your client say this about you): Keeping Client Confidences and Loyalties After the Attorney-Client Relationship has Terminated," presented by Richard A. Klass; Estate Taxes and Portability, presented by Ash Ahluwalia; Social Security Filing Strategies under the New Rules, presented by Bruce D. Steiner; and Minimizing the Financial Exploitation of the Elderly, presented by Dwayne Weissman.



Former Section Chair John Owens Jr. was recognized for his service to the Section as Chair.

Owens, O'Neill Receive GP Section Awards at AM

At right, Paul J. O'Neill Jr. was presented with the General Practice Section Award in recognition of outstanding and innovative service to the GP Section for the improvement of the daily practice of law for general practitioners in New York State.

Litigator's Guide to LLCs

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IV. CONCLUSION

In advising a client who is an LLC manager or member concerning a dispute related to the management of the LLC, it is imperative that early on in the representation, the litigator gain a comprehensive understanding of how the LLC is managed and the extent of the manager's fiduciary duties. This requires (i) an in-depth reading of the operating agreement, (ii) a review of the articles of organization, (iii) determining whether any of the LLC Law's default rules are in effect, and (iv) consulting relevant case law. Doing so will allow the litigator to identify those areas where the manager or the members have leverage over each other in any dispute and will inform the litigation strategy going forward.

Endnotes

1. Delaying entry into the operating agreement until after the LLC is formed often leads to problems down the road, particularly if the members are ultimately unable to agree on the management of the business. *See infra*, n. 10,
2. *See* § 2.3(a), *infra*.
3. LLC Law § 102(u).
4. *Willoughby Rehabilitation & Health Care Ctr., LLC v. Webster*, 13 Misc. 3d 1230(A) at *3 (Nassau Sup. 2006).
5. As an alternative to manager-managed LLCs, the LLC may be managed by its members. In member-managed LLCs, the operating agreement will often provide that the members will make decisions by majority or supermajority vote. Control of the LLC will follow the member or members who hold sufficient membership interests to affect the outcome of a vote of the members. Generally speaking, a member-managed LLC will have one member who owns more than a majority of the membership interests and therefore is a manager by default (even if he is not identified as such in the operating agreement) and who will be subject to all duties and responsibilities of a manager (including fiduciary duties, as discussed below), even though he may need to obtain member consent for certain key business decision. *See* LLC Law § 401(b).
6. *See* LLC Law § 410(a).
7. LLC Law § 408(a).
8. In addition to management by managers, some LLCs are managed by officers and a board of directors appointed by the members. In those instances, the officer plays the same role as the manager and the board provides a mechanism by which members may grant or withhold their consent to certain acts of the officers.
9. *See* LLC Law § 419(a).
10. *Barry v. Clermont York Associates LLC*, 50 Misc. 3d 1203(A), *13 (N.Y. Sup. 2015).
11. Although not the subject of this essay, it should be noted that the Appellate Division, First Department recently interpreted the LLC Law to provide that an operating agreement need not be agreed to by all members, but rather may be adopted by a vote of a majority in interest of the members. *See Shapiro v. Ettenson*, 146 A.D.3d 650 (1st Dep't 2017).
12. *See In re Eight of Swords, LLC*, 96 A.D.3d 839 (2d Dep't 2012). *See also Spires v. Castlerine*, 4 Misc. 3d 428, 431 (Monr. Sup. 2004) (noting that there "is no provision in the Limited Liability Company Law imposing any type of penalty or punishment for failing to adopt a written operating agreement. The statute does not require an operating agreement prior to the formation" of the LLC.").
13. *See In re Eight of Swords*, LLC, 96 A.D.3d at 839.
14. *See In re 1545 Ocean Avenue, LLC*, 72 A.D.3d 121, 129 (2d Dep't 2010).
15. Sections 409 and 411 of the LLC Law, which concerns the fiduciary duties of managers, are discussed separately.
16. *Laugh Factory*, 608 F. Supp. 2d at 562.
17. The term "majority in interest of the members" is defined by the LLC Law as "the members whose aggregate share of the current profits of the limited liability company constitutes more than one-half of the aggregate of such shares of all members." LLC Law § 102(o).
18. It should be noted that Section 402(c), which includes the first three bullet points listed above, states that a vote "of a majority in interest" is required, while Section 402(d), which includes the last three bullet points listed above, states that a vote of "at least a majority in interest" is required. It is not clear why the legislature separately listed the acts described in Sections 402(c) and 402(d) or why it decided to differentiate between "a majority in interest" and "at least a majority in interest." *See* Miller, Meredith R. (2015), *The New York Limited Liability Company Law at Twenty: Past, Present & Future*, Touro Law Review, Vol. 31: No. 3, Article 9, at 406-07. Available at: http://digitalcommons.tourolaw.edu/lawreview/vol31/iss3/9.
19. See *Ahmed*, 107 A.D.3d at 833. While not discussed in the opinion, the fact that Lewis failed to disclose and seek ratification from the other members to transfer the property to a different LLC with which he was affiliated could itself constitute a breach of the managing member's fiduciary duty to the other members and could be voided unless the transfer is found to be "entirely fair" to the LLC. *See infra*, § 3.5.
20. *See 546-552 W. 146th St. LLC v. Arfa*, 99 A.D.3d 117, 121 (1st Dep't 2012).
21. *See id.*
22. *See* LLC Law § 412(c).
23. *See* LLC Law § 412(d).
24. Distributions of cash to the members from the LLC are generally not considered "compensation," though some operating agreements will include language specifically prohibiting compensation of members, except for distributions.
25. *See* NY LLC Law § 411(e). As discussed below, a manager's decision to pay himself compensation must be guided by his fiduciary duties to the LLC and the members (i.e., a grossly inflated compensation package may be considered a breach of duty).
26. *See Barry*, 50 Misc. 3d at *10 (*citing Levandusky v. One Fifth Avenue Apt. Corp.*, 75 N.Y.2d 530 (1990)).
27. *Auerbach v. Bennett*, 47 N.Y. 2d 619, 629 (1979).
28. *Id.* at 631. *See also Shapiro v. Rockville Country Club*, 22 A.D.3d 657, 658 (2d Dep't 2005) ("In reviewing the reasonableness of the directors' actions, 'absent claims of fraud, self-dealing, unconscionability or other misconduct, the court should apply the business judgment rule . . .'") (internal citations omitted).
29. *See Wolf v. Rand*, 258 A.D.2d 401, 404 (1st Dep't 1999) ("the business judgment rule does not protect corporate officials who engage in fraud or self-dealing or corporate fiduciaries when they make decisions affected by inherent conflict or interest") (internal citations omitted).
30. *Barry*, 50 Misc. 3d at *12.
31. The language employed by LLC Law § 409(a) is identical to Section 717(a) of the New York Business Corporation Law (BCL), which imposes similar duties of loyalty and care on corporate directors. *See* BCL § 717(a) ("A director shall perform his duties

as a director. . .in good faith and with that degree of care which an ordinarily prudent person in a like position use under similar circumstances.”).

32. *See Higgins v. New York Stock Exchange, Inc*., 10 Misc. 3d 257, 278 (N.Y. Sup. 2005) (“The fiduciary duty of loyalty imposes on corporate directors an obligation not to ‘assume and engage in the promotion of personal interests which are incompatible with the superior interests of their corporation. . .as [directors] owe [the corporation] their undivided and unqualified loyalty.’”) (citations omitted).

33. *Pokoik v. Pokoik*, 115 A.D.3d 428, 429 (1st Dep’t 2014) (*quoting Birnbaum v. Birnbaum*, 73 N.Y.2d 461, 466 (1989)).

34. *Salm v. Feldstein*, 20 A.D.3d 469, 470 (2d Dep’t 2005). The LLC Law does not contain an affirmative obligation to make regular reports of material business matters to the members, although some operating agreements may require such reporting. Rather, the duty to disclose is activated when the manager is engaged in an interested transaction or seeks member consent to act on behalf of the LLC.

35. *Higgins*, 10 Misc. 3d at 283.

36. *Barry*, 50 Misc. 3d at *13.

37. In 2004, Delaware amended its LLC statute to allow LLC members to prospectively waive the duty of loyalty in addition to the duty of care. *See* DEL. CODE ANN, Title 6, § 18-1101(c) (“To the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) to a limited liability company or another member or manager. . .the member’s or manager’s or other person’s duties may be expanded or restricted or eliminated by provisions in the limited liability company operating agreement, provided, that the limited liability company agreement may not eliminate the contractual covenant or good faith and fair dealing.”). The New York legislature has not followed suit with a similar amendment to the LLC Law. *See generally* Graves, Jack and Davydan, Yelena (2015), *Fiduciary Duties of LLC Managers: Are They Subject to Prospective Waiver Under the New York LLC Statute?*, Touro Law Review, Vol. 31: No. 3, Article 11. Available at: http://digitalcommons.tourolaw.edu/lawreview/vol31/iss3/11.

38. Even if no such provision is extant in the operating agreement, the members may vote to approve an interested transaction that would otherwise be in breach of the duty of loyalty, so long as all material facts are disclosed. *See* LLC Law § 411, discussed *infra*, § 3.5.

39. *Pappas v. Tzolis*, 87 A.D.3d 889 (1st Dep’t 2011).

40. *Id*. at 889-890.

41. *Id*. at 890.

42. *Id*. at 892-93 (emphasis in original).

43. *Id*. at 894.

44. *Pappas v. Tzolis*, 20 N.Y.3d 228 (2012).

45. *Id*. at 233. In particular, the Court of Appeals noted that there had been “numerous business disputes,” that plaintiffs’ affidavits portrayed Tzolis as “uncooperative and intransigent,” and that the relationship between Tzolis and plaintiffs had become “antagonistic.”

46. *Centro Empresarial Cempresa S.A. v. America Movil S.A.B. de C.V*., 17 N.Y. 3d 269, 278 (2011).

47. *See DeBenedictus v. Malta*, 140 A.D. 3d 438, 439 (1st Dep’t 2016) (citing *Pappas* and holding that managing member could only claim that he owed no fiduciary duty where there is no longer a relationship of trust). *See also McGuire v. Huntress*, 83 A.D.2d 1418, 1420 (4th Dep’t 2011) (managing member owed continuing fiduciary duty to disclose a pending offer to the members, even though members had orally agreed to be bought out by managing member).

48. LLC Law § 409(b).

49. LLC Law § 409(c).

50. *Pokoik v. Pokoik*, 115 A.D.3d 429 (1st Dep’t 2014). *See also Pokoik v. Pokoik*, 2013 WL 373432 (N.Y. Sup. Jan. 21, 2013).

51. *See Pokoik*, 115 A.D.3d at 429.

52. *See id.*

53. *See id.*

54. *See Pokoik*, 2013 WL 373432.

55. *Pokoik*, 115 A.D.3d at 430 (*quoting Birnbaum v. Birnbaum*, 73 N.Y.2d 461,466 (1989)).

56. It seems that the Court was concerned by Gary’s failure to disclose to Leon that he had been advised to reduce Leon’s capital accounts by the LLC’s accountants. While simply disclosing the accountants’ advice to Leon would not, by itself, have resolved the dispute between Gary and Leon, the failure to disclose made Gary look as if he had something to hide. While this is pure conjecture on the author’s part, it is possible that disclosing the advice to Leon would have made it easier for Gary to later argue that he perceived there to be nothing wrong with the advice he received from the accountants. Failing to disclose that advice, by contrast, made it look as if Gary knew that he should not reduce Leon’s capital accounts.

57. The relevant text of the statute is too lengthy to reproduce in this essay.

58. LLC Law § 411(d).

59. The 1st Department’s opinion does not provide significant factual detail. The facts of the case are drawn from the parties’ appellate briefs.

60. *Wilcke v. Seaport Lofts*, 45 A.D.3d 447 (1st Dep’t 2007).

61. *Wilcke*, 45 A.D.3d at 447, *citing* LLC Law § 411(b).

62. *Wilcke*, 45 A.D.3d at 448.

Promissory Estoppel and the Statute of Frauds in New York

By Mary Eaton, Sameer Advani and Patricia O. Haynes

I. Introduction

On June 29, 2017, the New York Court of Appeals recognized for the first time that a defendant may be estopped from invoking the statute of frauds as a defense to a breach of contract claim where the elements of promissory estoppel are met and enforcing the statute would inflict an "unconscionable injury" on the plaintiff.[1] All four departments of the Appellate Division have long recognized promissory estoppel as an equitable exception to the statute of frauds.[2] The Court of Appeals' insistence that a plaintiff must prove "unconscionable injury" before invoking the exception, however, may make it practically impossible for plaintiffs to raise the exception successfully. The Court's decision is a departure from the more lenient standard articulated in the Restatement (Second) of Contracts and adopted by several other states, and serves as the latest reminder that New York's policy of requiring a writing for certain contracts will continue to be strictly enforced.

II. *In re Hennel*

In *In re Hennel*, the promisees, two brothers, sought to enforce an obligation against the estate of the promisor, their deceased grandfather.[3] The decedent had promised his grandsons that they would inherit his property free of a mortgage.[4] The promise was memorialized in the decedent's 2006 will, which provided that the mortgage on the property would be satisfied from the assets of his estate upon his death.[5] But in 2008, the decedent executed a new will, which revoked the prior will and made no mention of satisfying the mortgage.[6] The decedent orally assured his grandsons that, despite the revocation of the prior will, they would still take the property unencumbered by the mortgage upon his death.[7] In reliance on this promise, the grandsons carried out management and maintenance responsibilities for the property.[8]

After the decedent died, the will was probated, and the grandsons brought claims against the decedent's estate based on the decedent's oral promise to pay the outstanding balance of the mortgage on the property.[9] Unless the decedent's oral promise was enforced, the grandsons would be obligated to pay $85,000 on a mortgage of the property, which was valued at $235,000. Decedent's widow, the executor of his estate, argued that the grandsons' claims were barred by the statute of frauds because the decedent never gave up, in writing, his right to revoke the provision of the 2006 will which promised that his estate would satisfy the mortgage.[10] The Appellate Division, affirming a judgment by the Surrogate Court, held that the doctrine of promissory estoppel obligated the estate to honor the decedent's oral promise to satisfy the mortgage out of the estate's assets.[11] The court held that, while "promissory estoppel is generally unavailable to bar a statute of frauds defense," it should be recognized when applying the statute would be unconscionable.[12] The grandsons agreed to maintain and manage the property during the decedent's lifetime, which enabled him to retain the financial benefits of the property without attending to the concomitant responsibilities, on the understanding that the mortgage would be paid in full upon his death.[13] The court found that to deprive the grandsons of the consideration for which they bargained after they cared for the property in reliance on their grandfather's promise was "so strong and manifest [an inequality] as to shock the conscience and confound the judgment of any [person] of common sense" and "would wreak an unconscionable result."[14] Two judges dissented from the Third Department's decision, finding that the grandsons had not satisfied their "heavy burden" in demonstrating that promissory estoppel should be used to bar application of the statute of frauds.[15] The dissenters argued that the property the grandsons inherited still maintained substantial value and that "[i]f the mere fact that a promisee sustained a loss of any degree is found sufficient, without more, to invoke the doctrine of promissory estoppel, the requirement of unconscionability will have no meaning, and the policy objectives served by the statute of frauds will then be severely undermined."[16]

The Court of Appeals reversed. While recognizing that promissory estoppel is available as an equitable exception to the statute of frauds, the Court noted that it was limited to those "rare cases" where the party invoking it will suffer "unconscionable injury" if the promise is not enforced.[17] The Court concluded that the injury that the grandsons suffered may have been "unfair," but it was not unconscionable.[18] Due to the property's value, the Court noted, the grandsons could have easily sold the property and paid off the mortgage in full with the proceeds. The fact that the mortgage cut into their profits by a significant amount did not rise to the level of unconscionability, as they still received some value from the property. [19]

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III. Promissory Estoppel as an Equitable Exception to the Statute of Frauds

Prior to *Hennel*, the Court of Appeals had recognized two other exceptions to the statute of frauds, namely part performance and equitable estoppel.[20] The part performance exception provides an avenue of relief for plaintiffs who begin performing their obligations under an oral promise, but "only if the plaintiff's actions can be characterized as unequivocally referable to the agreement alleged."[21] A party may establish equitable estoppel by demonstrating "(1) conduct which is calculated to convey the impression that the facts are otherwise than, and inconsistent with, those which the party subsequently attempts to assert; (2) intent that such conduct (representation) will be acted upon; and (3) knowledge, actual or constructive, of the true facts."[22] Promissory estoppel, on the other hand, requires "a clear and unambiguous promise, reasonable and foreseeable reliance on the promise, and an injury sustained from the promisee's reliance."[23] Promissory and equitable estoppel differ in that "promissory estoppel is based on a promise regarding the promisor's future conduct," whereas "equitable estoppel is based on a misrepresentation of an existing fact."[24] In addition to proving the elements of each estoppel, a party seeking to avoid the statute of frauds must also prove "unconscionable injury."[25]

Hennel not only represents the first instance in which the Court of Appeals has explicitly recognized promissory estoppel as an equitable exception to a statute of frauds defense, it marks a clear departure from the Court's prior rulings on this issue.[26] In *Farash v. Sykes Datatronics*,[27] for example, the Court cited with approval the Restatement provision that recognizes promissory estoppel as an exception to the statute of frauds. There, the Court ruled that the statute of frauds did not bar plaintiff's claim on a quasi-contract restitution theory despite the statute precluding plaintiff's breach of contract claims.[28] The Court did not explicitly mention "promissory estoppel," however, although the dissent in that case accused the majority of recognizing a promissory estoppel cause of action *sub silentio*.[29] A year later, in *Cohen v. Brown, Harris, and Stevens*, the Court actually held that "the doctrine of promissory estoppel may not be used to preclude the raising of the Statute of Frauds as an affirmative defense to the enforcement of an oral lease."[30]

In contrast, lower appellate courts in the state have shown less resistance to recognizing promissory estoppel as an equitable exception to the statute of frauds, though those courts have uniformly acknowledged that its application is limited to cases where "the circumstances [are] such as to render it unconscionable to deny" the oral promise on which the promisee has relied.[31] The courts have also noted that the question of "whether the circumstances are so egregious as to render it unconscionable to invoke the Statute of Frauds" generally cannot be determined on the pleadings and must "await full determination of the facts upon trial."[32]

The recognition of promissory estoppel as an equitable exception to the statute of frauds is also consistent with the Restatement (Second) of Contracts. Section 139 of the Restatement provides that a promise reasonably expected to induce reliance "is enforceable notwithstanding the Statute of Frauds if injustice can be avoided only by enforcement of the promise."[33] While this principle has, as noted above, been regularly applied by the courts in New York and elsewhere, it represents a relatively novel evolution of the doctrine from its traditional use by courts as a means to bind parties to an agreement that lacked consideration where the promisee detrimentally relied on the promise.[34] Indeed, Section 139 did not appear in the First Restatement, and there was no suggestion otherwise that promissory estoppel could operate as an exception to the statute of frauds.[35] It was not until the Second Restatement that the alternative use of promissory estoppel to avoid the statute of frauds was acknowledged, though the drafters noted that this newer use would likely be more limited. Comment b to Section 139 specifically observed that "the requirement of consideration is more easily displaced than the requirement of a writing."[36] As discussed below, however, the stringent "unconscionable injury" requirement that the New York Court of Appeals adopted in *Hennel* makes the doctrine's potential use more restrictive than even the Restatement contemplated, and it is also a different standard than that adopted by some other jurisdictions.

"Hennel *not only represents the first instance in which the Court of Appeals has explicitly recognized promissory estoppel as an equitable exception to a statute of frauds defense, it marks a clear departure from the Court's prior rulings on this issue."*

IV. The "Unconscionable Injury" Requirement

In *Hennel*, the Court of Appeals required a showing of "unconscionable injury" but recognized that "cases where the party attempting to avoid the statute of frauds will suffer unconscionable injury will be rare."[37] In so doing, the Court of Appeals struck a balance between permitting exceptions to the statute of frauds but limiting those exceptions to ensure that the statute of frauds does not become obsolete.[38] Under the particular facts of the *Hennel* case, the grandsons were required to absorb a financial injury equal to 40% of the value that they thought they bargained for, an injury the court did not find to be "unconscionable." Borrowing from the analogous doctrine of unconscionable contracts, the Court explained that "unconscionable" in the context of avoiding the statute of frauds required an injury "so inequitable and egregious as to shock the conscience and confound the judgment of any person of common sense."[39]

In setting this high bar, the Court openly acknowledged that it had imposed an injury requirement more stringent than the Restatement, which requires that a failure to enforce an oral agreement would work an "injustice."[40] Under the Restatement, the following are listed as factors to be considered when determining whether "injustice" exists such that the statute of frauds will not be enforced: (1) "the availability and adequacy of other remedies, particularly cancellation and restitution," (2) "the definite and substantial character of the action or forbearance in relation to the remedy sought," (3) "the extent to which the action or forbearance corroborates evidence of the making and terms of the promise, or the making and terms are otherwise established by clear and convincing evidence," (4) "the reasonableness of the action or forbearance," and (5) "the extent to which the action or forbearance was foreseeable by the promisor."[41]

By focusing solely on the unconscionability of the "injury," the Court appears not to have given weight to any of the other Restatement factors. Some of those factors, particularly the extent to which the injured party's forbearance corroborates evidence of the promise, may actually have more relevance than the severity of a party's injury to the policy underlying the statute of frauds, which is "to guard against the peril of perjury; to prevent the enforcement of unfounded claims."[42] Arguably, if one were to focus on the statute's rationale, "whether the promisee's reliance provides sufficient evidence of the existence of the terms of a contract so that the statute of frauds has been satisfied,"[43] should be given equal, if not more, weight than the extent of the party's injury.

Another complicating aspect of the Court of Appeals' focus on the "unconscionable *injury*" is that it overlooks analyzing the unconscionability *of the agreement itself*. When unconscionability is used to invalidate an agreement, courts typically consider both the circumstances surrounding the agreement's formation as well as the results that obtain if the agreement is not enforced.[44] That is, a finding of unconscionability may turn on the process by which the parties came to the agreement (e.g., coercive negotiation tactics) and/or the substance of the agreement itself (e.g., usurious interest rates). Even some of the Appellate Division cases decided before *Hennel* that recognized promissory estoppel as an equitable exception to the statute of frauds did not appear to singularly focus, as the Court of Appeals did, on the plaintiff's injury. For example, language in some cases refer to a defendant's unconscionable "conduct"[45] or unconscionable "circumstances"[46] or state that promissory estoppel will preclude application of the statute only to avoid an unconscionable "result."[47] To be sure, an egregious injury to a plaintiff may qualify as an unconscionable result or circumstance, but the Court's primary emphasis on "unconscionable injury" certainly appears to narrow the application of those terms. It is unclear how the Court's injury-centric inquiry fits in to the traditional unconscionability analysis or why the process by which an agreement was entered into was not considered in the *Hennel* case.

In addition to applying a more stringent standard than the Restatement (and possibly narrowing the doctrine's application in New York), the Court of Appeals' "unconscionable injury" requirement also differs from the standard adopted in some other jurisdictions. Courts in a number of other states apply the Restatement standard faithfully.[48] In certain states, such as Massachusetts, courts may flexibly apply the equitable exception whenever the elements of promissory estoppel are satisfied.[49] In *Barrie-Chivan v. Lepler*, for example, a Massachusetts appeals court held that the statute of frauds did not bar a plaintiff's claim for loan repayment against a defendant who testified at trial that he orally agreed to the loan.[50] The court held that "[p]romissory estoppel is an equitable doctrine, and judges are to apply it flexibly to avoid injustice," and concluded that permitting a defendant to bar recovery in those circumstances would "work a harsh injustice."[51] In Delaware, courts require a showing of "manifest injustice" in addition to the elements of promissory estoppel when a party is seeking to circumvent the statute of frauds. Delaware courts cite to both the Restatement factors and also case law requiring unconscionable injury when determining whether "manifest injustice" exists.[52] And in California, the state's highest court adopted a rule that promissory estoppel may preclude application of the statute of frauds where *either* unconscionable injury results from refusing to enforce the oral contract or one party to the agreement would be unjustly enriched.[53]

In contrast, certain jurisdictions appear to take an even more restrictive approach than New York does. In Texas, for example, "[f]or promissory estoppel to create an exception to the statute of frauds, there must have been a promise to sign a written contract which had been prepared and which would satisfy the requirements of the statute of frauds."[54] Furthermore, "[a] promise to prepare a written contract is insufficient. The defendant must have promised to sign a particular agreement which was in writing at the time."[55] The Supreme Court of Ohio has gone so far as to "decline to recognize [promissory estoppel] as an exception to the statute of frauds even when the promise to execute an agreement is fraudulent or misleading," but has allowed the use of promissory estoppel as an equitable remedy available to permit a plaintiff to at least recover reliance damages.[56]

New York's rule that promissory estoppel may be an exception to the statute of frauds only when a plaintiff can show an "unconscionable injury" is just one of a variety of ways that courts analyze whether to enforce the statute. As some commentators have observed, "The cases in the last forty years reflect many different approaches—not 'A' major new approach"[57] to this issue, and litigants should therefore be sure to research a particular jurisdiction's rules carefully before raising the promissory estoppel exception.

The Court of Appeals' ruling in *In re Hennel* adds to the list of equitable exceptions that litigants may raise when the statute of frauds would otherwise bar a party from enforcing an agreement. However, despite the Court's recognition of the exception, the high evidentiary showing required to prove an "unconscionable injury" makes it unlikely that many litigants will successfully raise the exception and prevent enforcement of the statute of frauds. The "unconscionable injury" requirement is more stringent than the standard articulated in the Restatement (Second) of Contracts and signals a different approach than that used in other jurisdictions.

Endnotes

1. *In re Hennel*, 2017 N.Y. Slip Op. 05266 at * 6 (June 29, 2017).
2. *Castellotti v. Free*, 138 A.D.3d 198, 27 N.Y.S.3d 507 (1st Dep't 2016); *Carvel Corp. v. Nicolini*, 144 A.D.2d 611, 535 N.Y.S.2d 379 (2d Dep't 1988); *Bernard v. Langan Porsche Audi*, 143 A.D.2d 495, 532 N.Y.S.2d 599 (3d Dep't 1988); *Buddman Distribs. v. Labatt Importers*, 91 A.D.2d 838, 459 N.Y.S.2d 395 (4th Dep't 1982).
3. *In re Hennel*, 2017 N.Y. Slip Op. 05266 at * 2.
4. *Id.*
5. *Id.*
6. *Id.* at *3.
7. *Id.*
8. *Id.*
9. *Id.*
10. *In re Estate of Hennel,* 133 A.D.3d 1120, 1122, 20 N.Y.S.3d 460, 463 (3d Dep't 2015); *see also Aaron v. Aaron*, 64 A.D.3d 1103,1104, 882 N.Y.S.2d 776 (3d Dep't 2009) ("[A] contract to make a testamentary provision . . . must be in writing and subscribed by the party to be charged with its performance.").
11. *Id.* at 1121.
12. *Id.* at 1123.
13. *Id.*
14. *Id.*
15. *Id.* at 1124 (Garry, J.P., dissenting).
16. *Id.* (internal quotation marks omitted).
17. *In re Hennel*, 2017 NY Slip Op 05266 at * 2.
18. *Id.*
19. *Id.* at *8-9.
20. *See id.* (citing *Am. Bartenders Sch. v. 105 Madison Co.,* 59 N.Y.2d 716, 718, 463 N.Y.S.2d 424 (1983) (describing the equitable exceptions of equitable estoppel and part performance); *Anostario v. Vicinanzo*, 59 N.Y.2d 662, 664, 463 N.Y.S.2d 409, 410 (1983) (recognizing part performance as an exception to the statute of frauds); *Wooley v. Stewart*, 222 N.Y. 347, 350-51 (1918) (describing equitable estoppel as a defense to the statute of frauds)).
21. *Anostario*, 59 N.Y.2d at 664 (internal quotation marks omitted).
22. *Health-Loom Corp. v. Soho Plaza Corp.*, 272 A.D.2d 179, 181, 709 N.Y.S.2d 165, 168 (1st Dep't 2009).
23. *Williams v. Eason*, 49 A.D.3d 866, 868, 854 N.Y.S.2d 477 (2d Dep't 2008).
24. *Glasshouse Sys., Inc. v. Int'l Bus. Mach. Corp.*, 750 F. Supp. 2d 516, 525 (E.D. Pa. 2009) (interpreting New York law).
25. *See In re Hennel*, 2017 N.Y. Slip Op. 05266 at * 5-6 (holding that "where the elements of promissory estoppel are established, and the injury to the party who acted in reliance on the oral promise is so great that enforcement of the statute of frauds would be unconscionable, the promisor should be estopped from reliance on the statute of frauds"); *Am. Bartenders Sch.*, 59 N.Y.2d at 718 ("[t]he purpose of invoking the doctrine [of equitable estoppel] is to prevent the infliction of unconscionable injury and loss upon one who has relied on the promise of another").
26. *In re Hennel*, 2017 N.Y. Slip Op. 05266 at * 4-5.
27. 59 N.Y.2d 500, 465 N.Y.S.2d 917 (1983).
28. *Id.* at 504.
29. *Id.* at 511 (Jasen, J., dissenting).
30. 64 N.Y.2d 728, 731, 485 N.Y.S.2d 745, 747 (1984).
31. *Swerdloff v. Mobil Oil Corp.*, 74 A.D.2d 258, 263, 427 N.Y.S.2d 266, 269 (2d Dep't 1980); *see also Tribune Print Co. v. 263 Ninth Ave. Realty*, 88 A.D.2d 877, 879, 452 N.Y.S.2d 590, 593 (1st Dep't 1982) (finding that, in New York, a cause of action based on promissory estoppel "is reserved for a limited class of cases based on unusual circumstances . . .").
32. *Buddman Distribs,* 91 A.D.2d at 839.
33. Restatement (Second) of Contracts § 139.
34. *See* David G. Esptein, Ryan D. Starbird, & Joshua C. Vincent, *Reliance on Oral Promises: Statute of Frauds And "Promissory Estoppel*," 42 Texas Tech L. Rev. 914, 941 (2010) (stating that courts have started applying "promissory estoppel" as an exception to the statute of frauds starting about 40 years ago, but that it has been used to find liability based on detrimental reliance on a promise without consideration for more than 75 years).
35. *See* Restatement (Second) of Contracts § 90 ("A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promise or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires."); *See also* Esptein, Starbird, & Vincent, *supra* note 34, at 916-926, 937 (chronicling the history behind promissory estoppel as a doctrine enforcing agreements that lacked consideration in which one party detrimentally relied on the promise and stating that the § 139 was not in the First Restatement).
36. Restatement (Second) of Contracts § 139, Cmt. b.
37. *In re Hennel*, 2017 N.Y. Slip Op. 05266 at * 8.
38. *Id.* (finding that the statute of frauds would be "severely undermined" if a court were to prohibit its application whenever some "unfairness").
39. *Id.* (internal quotation marks omitted).
40. *Id.* at * 6 n.3 ("[t]o the extent the Restatement (Second) of Contracts §139 permits circumvention of the statute of frauds where mere 'injustice' not rising to the level of unconscionability would result,

we decline to adopt it.”).

41. Restatement (Second) of Contracts § 139(2) (1981).

42. *In re Hennel*, 2017 N.Y. Slip Op. 05266 at * 5.

43. Esptein, Starbird, & Vincent, *supra* note 34, at 941-42.

44. *Gillman v. Chase Manhattan Bank, N.A.*, 73 N.Y.2d 1, 10, 537 N.Y.S.2d 787, 791 (“A determination of unconscionability generally requires a showing that the contract was both procedurally and substantively unconscionable when made—i.e., “some showing of an ‘absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party.’”).

45. *Bernard*, 143 A.D.2d at 496 ([d]efendant’s *conduct* here was not so egregious or unconscionable as to invoke the doctrine of promissory estoppel) (emphasis added).

46. *Swerdloff*, 74 A.D.2d at 263 (requiring that “‘the *circumstances* [be] such as to render it unconscionable to deny’ the oral promise upon which the promisee has relied” for promissory estoppel to preclude application of the statute of frauds”) (emphasis added).

47. *Carvel Corp.*, 144 A.D.2d at 612 (stating that use of promissory estoppel “to preclude a party from asserting the Statute of Frauds . . . is properly reserved for that limited class of action where the *result* of enforcing the contract would be so egregious as to render unconscionable the Statute of Frauds”) (emphasis added); *but see Castellotti*, 138 A.D.3d at 204 (“If a contract is barred by the statue of frauds, a promissory estoppel claim is viable in the limited set of circumstances where unconscionable *injury* results from the reliance placed on the alleged promise.”) (emphasis added).

48. *See, e.g.*, *Walker v. Ireton*, 221 Kan. 314, 322, 559 P.2d 340, 346 (1977) (“In our judgment [the Restatement is a] clear and direct statement[] of the principles of law to be applied in determining whether or not an oral contract should be removed from the application of the statute of frauds and enforced by a court on equitable principles.”); *McIntosh v. Murphy*, 52 Haw. 29, 36, 469 P.2d 177, 181 (1970) (listing and applying the Restatement factors).

49. *See Maffei v. Roman Catholic Archbishop of Boston*, 449 Mass. 235, 255 n.30, 867 N.E.2d 300, 318 n.30 (2007) (“[e]stoppel may prevail against a Statute of Frauds defense where the litigant claiming estoppel proves: (1.) A representation or conduct amounting to a representation intended to induce a course of conduct on the part of the person to whom the representation is made. (2.) An act or omission resulting from the representation, whether actual or by conduct. . . . (3.) Detriment to such person as a consequence of the act or omission.”); *Barrie-Chivian v. Lepler*, 87 Mass.App. Ct. 683, 685-686, 34 N.E.3d 769, 771 (2015) (noting case law in the state holding that when the elements of promissory estoppel are present, courts may flexibly apply the doctrine to avoid injustice by circumventing the statute of frauds).

50. 87 Mass. App. Ct. at 686.

51. *Id.*

52. *See CBA Collections Servs., Ltd. v. Potter, Cross, & Leonard P.A.*, 1996 WL 527214 at *7 (Del. Super. Ct., Aug. 14, 1996).

53. *Monarco v. Lo Greco*, 35 Cal.2d 621, 625, 220 P.2d 737, 741 (1950).

54. *Stiedl v. BSI Fin. Servs.*, 2017 WL 1290132 at *8 (S.D. Tex. 2013) (internal citations omitted) (applying Texas law).

55. *Id.*

56. *Olympic Holding Co., LLC v. ACE Ltd.*, 122 Ohio St. 3d 89, 96, 909 N.E.2d 93, 100 (2009).

57. Epstein, Starbird, & Vincent, *supra* note 34, at 937.

An Overview of the New York Rules of Professional Conduct in the Context of Mediation

By Marcy Einhorn

> *Discourage litigation. Persuade your neighbors to compromise whenever you can. Point out to them how the nominal winner is often a real loser—in fees, and expenses, and waste of time*. Abraham Lincoln (circa 1850)

In the spirit of Honest Abe, New York again celebrated Mediation Settlement Day on October 18 this year with a host of activities designed to promote mediation as a means of resolving disputes without going to court.

According to the New York State Court website, "Mediation is an efficient, user-friendly means for resolving conflicts and disputes. Instead of asking a judge to make a decision in court, parties in conflict meet with a trained mediator who helps them communicate with one another and if possible, reach an agreement that satisfies everyone."[1]

A recent survey of New York litigators reveals, surprisingly perhaps, that this group of attorneys is almost 90 percent behind the use of mediation as a means of resolving disputes.[2] Here, we'll take a look behind that rosy endorsement to see what litigators like and don't like about mediation in order to gain a better understanding of the obstacles to the mediation of disputes. Next, this article will discuss some of the Rules of Professional Conduct that are relevant to attorneys who mediate. Finally, the article will discuss the ethical obligation of truthfulness to third parties as a standard of conduct in the mediation context.

The first priority of an advocate in mediation is always to further the client's goals and interests.[3] Although volumes could be written on the ways and means of meeting a client's objectives, suffice it to say here that the Rules give some general guidance, but leave the specifics to the individual practitioner, to implement in their infinite wisdom as a professional.[4]

With respect to the favorability of mediation as a means of resolving disputes, participants in the State Bar's recent survey pointed to the success rate of mediation, the speed in which a resolution can be reached, the cost savings, the focus on resolution and the emphasis on realistic expectations as some of the reasons why they favored mediation.[5] To give a complete picture, participants in the survey also responded to questions about what they disliked about mediation. Top of the list were flaws in the process, followed by the lack of commitment to settle on the part of the attorneys or the parties, the low success rate, the effect it had on delaying resolution, the cost, the push for everyone to give up something in order to settle, and overly aggressive mediators.[6] It is worth noting that a high percentage of the attorneys surveyed said that even when mediation was not successful, there were several other beneficial effects that made mediation worthwhile including the opportunity to understand and assess the strengths and weaknesses of your own and your adversary's case, the chance to start a process that could ultimately lead to a settlement, the exchange of information without formal discovery, the "reality testing" of your position that mediation provides, and the opportunity to "lower the emotional temperature" of a dispute.[7]

Likes and dislikes aside, mediation raises a unique set of ethical issues that advocates are not likely to confront in litigation. While the rules regarding confidentiality,[8] your role as an advisor,[9] and truthfulness in relation to third parties[10] apply to professional conduct regardless of the forum in which a dispute is heard, there are no Rules of Professional Conduct that specifically address the ethics involved in mediating disputes. In fact, a close reading of the Rules makes it quite clear that the Rules regarding conduct in a dispute apply to disputes pending before a tribunal,[11] and mediators are not included in the definition of what constitutes a tribunal under the Rules.[12]

The obligation of truthfulness to third parties is of particular concern in the mediation setting. This issue was addressed in an ethical opinion issued by the ABA Standing Committee on Ethics and Professional Responsibility.[13] There it was stated that certain statements are considered to be "nonactionable hyperbole," are merely a reflection of the speaker's state of mind, and are not to be considered misstatements of fact or law. In the case under consideration by the ABA Ethics Committee, a lawyer representing an employer in labor negotiations was found to have gone beyond mere puffery when he informed the union's lawyers that a particular employee benefit would cost an additional $100 per employee when the lawyer knew it would actual cost only $20 per employee.[14]

This distinction between "puffery" and misrepresentation is discussed in the Comments to New York Rule 4.1.

Marcy Einhorn is an experienced attorney who has undergone extensive training in mediation. She previously worked as a Court Attorney in the New York State Court system, drafting judges' opinions and supervising discovery conferences. She regularly serves as a Court Evaluator in guardianship proceedings, is a Hearing Officer in New York City administrative hearings, and was recently accepted onto the New York City Family Court panel of mediators.

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Although the Comments have not been officially adopted as part of the Rules, they do carry great weight within the profession.[15]

At least one writer asks whether the goals of representing a client in a mediation should be any different than the advocate's goals in a more adversarial setting, such as arbitration or litigation.[16] The author concludes that there are few "bright-line" differences between the ethical obligations of attorneys representing clients in mediations and those of attorneys in litigation.[17] However, when it comes to truthfulness, this author suggests that advocates may have an even higher duty when dealing with mediators since a crucial part of the process involves providing the mediator with accurate information so that the mediator can be effective in helping the parties to reach a workable solution to their dispute.[18] Failing this, a lawyer may not find himself or herself in violation of the Rules regarding truthfulness, but may violate Rule 1.1, which addresses the duty to provide competent representation.[19]

From a practical standpoint, mediator Alida Camp describes the problem with truthfulness, or a lack thereof, this way:

> Part of what is necessary for a successful mediation is information because it can persuade parties that they should be flexible in their proposals. Yet it can be difficult for counsel to impart information that they would rather keep in their back pockets for litigation or other reasons. Counsel's reluctance to provide facts or confirmation of impending actions that would have an impact on settlement conversations may be considered an impediment to continued talks, the cause of delay in productive talks, or leading the opposing party down the so-called primrose path. None of these outcomes furthers the mediation, leading to objections of bad faith or a disheartening reluctance to continue talking with accusations of being lied to once the truth emerges.[20]

Other than the mistrust that a lack of truthfulness can generate, misrepresentations that rise to the level of fraud[21] could actually impose a duty on opposing counsel to take affirmative steps to report such conduct, which would certainly muddy the waters for a possible settlement of the underlying dispute, to say the least.[22]

In conclusion, advocates in mediations need to be familiar with the same obligations that an advocate at an adversarial proceeding must know, with the added proviso that in a mediation advocates must be sure to keep their clients' goals and interests as a first priority while abiding by the ethical rules that apply to more adversarial proceedings.

Endnotes

1. https://www.nycourts.gov/ip/adr/MSD.shtml.
2. "Mediation: Through the Eyes of New York Litigators," Report of the Mediation Committee of the New York State Bar Association Dispute Resolution Section and The Alternative Dispute Resolution Committee of the New York City Bar Association, January 27, 2011, p. 4.
3. "Ethics for Lawyers Representing Clients in Mediations," John A. Sherrill, 6 Am. J. Mediation 29, 2012, p. 38. See, New York Rules of Professional Conduct, as amended through 1/1/17, Rule 1.2: SCOPE OF REPRESENTATION AND ALLOCATION OF AUTHORITY BETWEEN CLIENT AND LAWYER

   (a) Subject to the provisions herein, a lawyer shall abide by a client's decisions concerning the objectives of representation and, as required by Rule 1.4, shall consult with the client as to the means by which they are to be pursued. A lawyer shall abide by a client's decision whether to settle a matter.
4. *See* Comment (2) to Rule 1.2(a): [2] Clients normally defer to the special knowledge and skill of their lawyer with respect to the means to be used to accomplish their objectives, particularly with respect to technical, legal and tactical matters. On the other hand, lawyers usually defer to their clients regarding such questions as the expense to be incurred and concern for third persons who might be adversely affected. On occasion, however, a lawyer and a client may disagree about the means to be used to accomplish the client's objectives. Because of the varied nature of the matters about which a lawyer and client might disagree, and because the actions in question may implicate the interests of a tribunal or other persons, this Rule does not prescribe how such disagreements are to be resolved. Other law, however, may be applicable and should be consulted by the lawyer. The lawyer should also consult with the client and seek a mutually acceptable resolution of the disagreement. If such efforts are unavailing and the lawyer has a fundamental disagreement with the client, the lawyer may withdraw from the representation. See Rule 1.16(c)(4). Likewise, the client may resolve the disagreement by discharging the lawyer, in which case the lawyer must withdraw from the representation. See Rule 1.16(b)(3).
5. *Id.*
6. *Id.*
7. *Id.* at p. 6.
8. RULE 1.6: CONFIDENTIALITY OF INFORMATION:

   (a) A lawyer shall not knowingly reveal confidential information, as defined in this Rule, or use such information to the disadvantage of a client or for the advantage of the lawyer or a third person, …
9. RULE 2.1: ADVISOR:

   In representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social, psychological, and political factors that may be relevant to the client's situation.
10. RULE 4.1: TRUTHFULNESS IN STATEMENTS TO OTHERS:

    In the course of representing a client, a lawyer shall not knowingly make a false statement of fact or law to a third person.
11. RULE 3.3: CONDUCT BEFORE A TRIBUNAL:

    (a) A lawyer shall not knowingly:

    (1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer;

12. Rule 1.0: DEFINITION:

(w) "Tribunal" denotes a court, an arbitrator in an arbitration proceeding or a legislative body, administrative agency or other body acting in an adjudicative capacity. A legislative body, administrative agency or other body acts in an adjudicative capacity when a neutral official, after the presentation of evidence or legal argument by a party or parties, will render a legal judgment directly affecting a party's interests in a particular matter.

13. ABA Comm. on Ethics and Professional Responsibility, formal Op. 06-439 (2006).

14. See *Ethics for Counsel in the Business World*, James Q. Walker, PLI (2017).

15. See Comment to Rule 4.1: Statements of Fact [2] This Rule refers to statements of fact. Whether a particular statement should be regarded as one of fact can depend on the circumstances. Under generally accepted conventions in negotiation, certain types of statements ordinarily are not taken as statements of fact. Estimates of price or value placed on the subject of a transaction and a party's intentions as to an acceptable settlement of a claim are ordinarily in this category; so is the existence of an undisclosed principal, except where nondisclosure of the principal would constitute fraud. Lawyers should be mindful of their obligations under applicable law to avoid criminal and tortious misrepresentation.

16. *Ethics for Lawyers Representing Clients in Mediations, supra*, p. 29.

17. *Id.* at p. 38.

18. *Id.* at p. 34.

19. *Id.* See Rule 1.1: COMPETENCE:

(a) A lawyer should provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.

20. Alida Camp, ADR Offices of Alida Camp, alicampny@gmail.com.

21. Rule 8.4: MISCONDUCT:

A lawyer or law firm shall not:

(a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another;

(b) engage in illegal conduct that adversely reflects on the lawyer's honesty, trustworthiness or fitness as a lawyer;

(c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation;…

22. RULE 8.3: REPORTING PROFESSIONAL MISCONDUCT:

(a) A lawyer who knows that another lawyer has committed a violation of the Rules of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer shall report such knowledge to a tribunal or other authority empowered to investigate or act upon such violation.

New York State Bar Association Committee on Professional Ethics

Opinion 1142 (1/5/2018)

Topic: Delivering client file to client, maintenance of client files in electronic form

Digest: Where a lawyer keeps client files received in electronic form in that form and a former client requests a copy of the file in paper form, the lawyer must take reasonable measures to deliver the electronic documents in a form in which the client can access them, but the lawyer may charge the client the reasonable fees and expenses incurred in printing out and delivering a paper copy.

Rules: 1.15.

FACTS

1. The inquirer has a litigation practice in which most documents, such as discovery materials and transcripts, are received or generated in electronic form. The inquirer stores such documents in electronic form. In those instances in which the inquirer receives documents in hard-copy form, such as documents received from clients, he scans the documents and either returns the originals to the client or keeps them separate from the electronic file.

2. Generally, when a former client requests a copy of his or her file, the firm provides a link to a secure, password-protected cloud storage facility containing the client's file. One former client, who retained the firm to represent him in a criminal matter and who is now incarcerated, has requested that the firm send a printed copy of his electronic file to the former client's spouse. The inquirer states that it would be expensive to print out the electronic documents and send the printed copy to the client. The firm has no hard-copy documents for this client.

QUESTION

3. To what extent must a lawyer provide a former client with the client file in the form in which the client requests it?

4. Where a law firm maintains its client files in electronic form, can the lawyer charge the former client for the costs of printing and mailing a copy of the client file to the client?

OPINION

5. The principles that largely govern the answers to these questions have been set forth in a number of court and ethics opinions. First, except where original documents have particular evidentiary or similar value, a lawyer is not required to maintain the client file in any particular form. N.Y. State 940 ¶ 12 (2012) (except for "documents such as wills, deeds, contracts, and promissory notes" or other documents whose legal effect or evidentiary value may be impaired by destroying originals, "the Rules permit electronic copies to be kept in lieu of paper originals"); N.Y. County 725 (1998) ("[I]n some circumstances it may be appropriate for an attorney to record the contents of a client's file electronically or on microfilm instead of retaining the physical file, so long as the evidentiary value of such documents will not be unduly impaired by the method of storage."). *See also* N.Y. State 1020 ¶ 8 (2014) (a lawyer may use cloud-based data storage and sharing tools as long as the lawyer "takes reasonable steps to ensure that confidential information is not breached").

6. Second, it is well-established that, with some exceptions not relevant here, a former client is entitled to his or her client file. *Sage Realty Corp. v. Proskauer Rose Goetz & Mendelsohn*, 91 N.Y.2d 30, 37 (1997) (holding that a former client was presumptively entitled to both "end-product" documents and "work product materials, for the creation of which they paid during the course of the firm's representation"); N.Y. State 766 (2003) (overturning prior opinion in light of *Sage Realty* and concluding that "a former client is entitled to any document related to the representation unless substantial grounds exist to refuse access"). The lawyer's ethical obligation to deliver to the client the client file upon request derives from Rule 1.15(c)(4) of the New York Rules of Professional Conduct (the "Rules"), which requires a lawyer to "promptly . . . deliver to the client . . . as requested by the client . . . the funds, securities or other properties in the possession of the lawyer that the client . . . is entitled to receive." *See* N.Y. State 766.

7. Third, it is likewise well-established that a lawyer can generally charge a former client the reasonable fees and expenses of assembling and delivering to the former client those documents that the client is entitled to receive. *Sage Realty*, 91 N.Y.2d at 38 ("as a general proposition, unless a law firm has already been paid for assemblage and delivery of documents to the client, performing that function is properly chargeable to the client under customary fee schedules of the firm, or pursuant to the terms of any governing retainer agreement"). Where a lawyer gives a client the documents to which the client is entitled, the lawyer is generally entitled to retain a copy, but because the copy is for the lawyer's own protection and not to advance the client's interests, the lawyer must bear the costs of making that copy. N.Y. State 780 (2004) (finding that a lawyer generally has a "right to retain cop-

ies of the file in order to collect a fee or to defend against an accusation of wrongful conduct," but that the lawyer must pay for that copy).

8. Thus, it is clear that the inquirer must provide the client with a copy of his file, but we have not previously considered whether the lawyer must print out electronic documents if the client so requests. We conclude that where the client is unable to read electronic documents, the lawyer should make reasonable efforts to transmit the file in a form in which the client can access the documents. This conclusion is based on the premise that the property to which the client is entitled is not merely the physical medium on which the documents reside but the information contained thereon. Where a client is incarcerated, the client may not be permitted to receive a computer disk or drive containing the client file, or may not have the equipment to read the documents so they are usable in any further proceedings.

9. However, the lawyer is not obligated to pay the costs of printing out the documents. Rather, as the Court of Appeals concluded in *Sage Realty*, the costs of "assemblage and delivery of documents to the client" are properly chargeable to the client. 91 N.Y.2d at 38. The costs of preparing electronic documents for delivery to the client are analogous to the costs of assemblage of paper documents that were at issue in that case. *See* N.Y. City 2008-1 ("Although the Court of Appeals' *Sage Realty* decision principally related to paper documents, we do not see any principled reason why a lawyer's fees may not reflect the reasonable costs of retrieving electronic documents from their storage media and reviewing those documents to determine the client's right of access."). As in *Sage Realty*, however, a different answer on who pays for the printing might obtain where "the law firm has already been paid for" printing a copy of documents, as when a lawyer receives a transcript in hard copy form at a per-page fee that was charged to the client. Here, the inquirer states that there are no such hard copy documents for this client, so they are not the subject of his inquiry. Similarly, because the inquirer was retained by a paying client, we have no occasion to consider whether a different result might obtain where the lawyer was appointed by a court to represent an indigent client.

CONCLUSION

10. Where a lawyer keeps client files received in electronic form in that form and a former client requests a copy of the file in paper form, the lawyer must take reasonable measures to deliver the electronic documents in a form in which the client can access them. The lawyer may charge the client the reasonable fees and expenses incurred in printing out and delivering a paper copy.

(34-17)

Opinion 1143 (1/18/2018)

Topic: IOLA accounts; court appointed referee; deposit of third-party funds

Digest: An attorney who is appointed as a referee to conduct foreclosure sales pursuant to Part 36 of the Rules of the Chief Judge may deposit funds received from those sales into an IOLA account or special account maintained by the lawyer's firm or by the lawyer.

Rules: 1.15, 5.1.

FACTS

The inquirer is an attorney who is occasionally appointed as a referee to conduct foreclosure sales pursuant to Part 36 of the Rules of the Chief Judge (22 NYCRR Part 36). Most often, when the inquirer conducts these foreclosure sales, a bank representative is present at the sale to receive any sale proceeds, which are typically owed to a third party. At other times, no bank representative is present, so the sale proceeds are left in the possession of the inquirer.

The inquirer is a member of a law firm. The inquirer wishes to deposit the excess funds from foreclosure sales into the law firm's Interest on Lawyer Account ("IOLA"), but the inquirer's firm is reluctant to permit a deposit into the firm's IOLA account because only the inquirer, not the firm, was appointed as referee.

QUESTION

When an individual member of a law firm, and not the law firm itself, is appointed pursuant to 22 NYCRR Part 36 as a referee to conduct a foreclosure sale, may the attorney/referee deposit sale proceeds funds owed to a third party into the IOLA account of the individual attorney's law firm?

OPINION

4. Rule 1.15(b)(1) of the N.Y. Rules of Professional Conduct (the "Rules"), which addresses the handling of client and third-party funds in the possession of an attorney, says in relevant part:

> A lawyer who is in possession of funds belonging to another person *incident to the lawyer's practice of law* shall maintain such funds in a banking institution within New York State. . . Such funds shall be maintained, in the lawyer's own name, or in the name of a firm of lawyers of which the lawyer is a member, or in the name of the lawyer or firm of lawyers by whom the lawyer is employed, in a *special account* or accounts, separate from any business or personal accounts of the

> lawyer or lawyer's firm, and separate from any accounts that the lawyer may maintain as executor, guardian, trustee or receiver, or in any other fiduciary capacity into such special account or accounts all funds held in escrow or otherwise entrusted to the lawyer or firm shall be deposited. [Emphasis added.]

5. An IOLA account is one such "special account." *See* Judiciary Law § 497. Our Committee opines only on ethical issues arising under the Rules and not on questions of law. Thus, we offer no view on whether the Judiciary Law, 22 NYCRR Part 36, or any other statute or rule relating to foreclosure sales, address the question presented. If so, then the requirements of law would govern. But if the law is not to the contrary, we see no reason under the Rules why the proceeds of a foreclosure sale belonging to a third party may not be placed into the IOLA account of the inquirer's law firm. (For convenience, we refer to trust accounts or escrow accounts as "special accounts" except when reference to IOLA accounts—a species of special accounts—is appropriate.)

6. By way of background, the appointment of a referee is usually set out in a judgment of sale entered following foreclosure. That judgment dictates the distribution of proceeds, which typically the referee computes. The referee cannot alter the terms of the judgment of foreclosure and sale. On the day of the sale, the referee announces the sale and reads its terms aloud. Following the sale, the referee is responsible for executing a referee's deed, obtaining the purchase deposit (or price), executing the memorandum of sale and the report of sale, calculating the final amount due, and distributing the funds in accordance with the judgment. Familiarity with these requirements is integral to service as a referee. Thus, although a person need not be a lawyer to act as a referee, courts often name lawyers to serve in that position.

7. Such service, in our view, is "incident to the lawyer's practice of law" within the meaning of Rule 1.15(a) even though non-lawyers are legally eligible to serve as foreclosure referees. The Rules may apply to a lawyer (or law firm) when engaged in activities that a non-lawyer may provide. We find support for this conclusion in our prior opinions applying the Rules to lawyers acting as referees in foreclosure matters. For instance, in N.Y. State 924 ¶¶ 4, 6 (2012) we concluded that an attorney could act as a referee in a mortgage foreclosure proceeding in which a client held a judgment on the mortgaged property, provided that the lawyer complied with the confidentiality provisions of Rules 1.6 and 1.8(b), as well as the conflicts provisions of Rules 1.7 and 1.9. Similarly, in N.Y. State 893 ¶ 5 (2011), we said that a prosecutor could accept appointment to a panel of foreclosure referees provided that the lawyer complied with the conflicts provisions of Rule 1.7. *Cf.* N.Y. State 979 (2013) (lawyers acting as mediators may be subject to the Rules). In light of the prevalence of lawyers appointed to referee foreclosure sales, we have no difficulty concluding that service as such is "incident to" the practice of law, and hence that Rule 1.15 applies.

8. It follows that a lawyer in possession of third-party funds yielded by the sale must assure their safekeeping in a special account segregated from the firm's own business or operating accounts. We know of no reason in the Rules why these funds may not be deposited into an IOLA account maintained by the firm of which the inquirer is a member if the funds qualify for deposit there under applicable laws and regulations. Rule 1.15(a) specifically says that funds so qualifying may be held in special accounts either "in the lawyer's own name, or in the name of a firm of lawyers of which the lawyer is a member." This means that, while the inquirer is not obligated to place the funds into a firm IOLA account, the inquirer is free to do so and the firm is free to accept them.

9. Alternatively, a lawyer in the inquirer's situation may set up a special account (including an IOLA account) in the lawyer's own name. We recognize that some law firms may have their own rules or agreements on such matters—for instance, a partnership provision prohibiting members of the firm from setting up special accounts in the lawyer's own name—but we have not been told of any such provision here. No ethics violation arises if a lawyer sets up a special account only in the lawyer/referee's name. But the inquirer need not do so if the firm will allow him to deposit the money into the firm's IOLA or other special account.

10. Under all circumstances a lawyer or law firm in possession of funds due a third party must maintain a special account to hold the third-party funds. Whichever course is selected, we note that, under Rule 5.1(a), the firm and its members are responsible to make "reasonable efforts to ensure that all lawyers in the firm conform" to the Rules, including proper maintenance of IOLA accounts and other special accounts.

CONCLUSION

11. An attorney who is appointed as a referee to conduct foreclosure sales, and who is in possession of funds belonging to a third party received from those sales, may ethically deposit funds into either the attorney's firm's IOLA account or into a special account set up by the attorney/referee individually. In any case, the attorney or the law firm must hold such third-party funds in a special account separate from the firm's business or operating account.

(27-17)

Opinion 1144 (1/29/2018)

Topic: Communications with client; withdrawal from representation of difficult client

Digest: A lawyer may place time and manner limitations on communications with a client provided the lawyer promptly informs and consults with the client on matters within the lawyer's duty of communication. If a breakdown occurs in communications between a lawyer and client such that representation cannot be carried out effectively, the lawyer may seek to withdraw from representing the client subject to any applicable rule of court.

Rules: Rules 1.2(a), 1.4, 1.16, 1.14.

FACTS

1. A court assigned the inquirer to represent an individual who has been charged with several criminal offenses. Prior to the inquirer's assignment, the client had been represented by a number of other lawyers. The client has unsuccessfully moved to have the inquirer relieved as counsel.

2. The client has ongoing mental health issues for which the client receives treatment. According to the inquirer, the client is physically intimidating, verbally abusive, and often non-responsive. The inquirer wishes to impose some restrictions on the time and manner in which the client may communicate with the lawyer, including limiting communications to scheduled appointments and written communications. If the client does not abide by these limits, or otherwise continues to disrupt communications, then the lawyer wishes to consider withdrawing from the representation.

QUESTIONS

3. May a lawyer place reasonable restrictions on the time and manner of communications between the lawyer and client? Under what circumstances may a lawyer withdraw from representation of a difficult client?

OPINION

4. The New York Rules of Professional Conduct (the "Rules"), in Rule 1.4, entitled "Communication," sets out a lawyer's obligations concerning communicating with clients. The Rule says:

> (a) A lawyer shall:
>
> (1) promptly inform the client of:
>
> (i) any decision or circumstance with respect to which the client's informed consent, as defined in Rule 1.0(j), is required by the Rules;
>
> (ii) any information required by court rule or other law to be communicated to a client; and
>
> (iii) material developments in the matter including settlement or plea offers.
>
> (2) reasonably consult with the client about the means by which the client's objectives are to be accomplished;
>
> (3) keep the client reasonably informed about the status of the matter;
>
> (4) promptly comply with a client's reasonable requests for information; and
>
> (5) consult with the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by these Rules or other law.
>
> (b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

5. Three core principles can be drawn from this Rule. First, a lawyer must keep the client apprised of material circumstances and developments in the matter. Second, a lawyer must comply with a client's reasonable requests for information. Third, a lawyer must reasonably consult with a client both about the means of accomplishing the client's objectives and about other decisions regarding the representation, some of which are within the client's province to decide. *See* Rule 1.2(a). On the first two of these—on developments in the matter and requests for information from the client—the lawyer must communicate promptly. Although a lawyer's obligations under this Rule are thus robust, neither Rule 1.4 nor other Rules prescribe a specific manner of communication, except when a Rule requires written instruments in specific circumstances, *see, e.g.,* Rule 1.5(b), (c), (d)(5) (governing legal fees); Rule 1.7(b) (governing informed consent to conflicts); Rule 1.8(a) (governing business transactions with clients).

6. Rule 1.4's obligation that a lawyer keep the client "reasonably informed about the status of the matter" can be fairly read to require a lawyer to use methods of communication that are effective, timely, and not unduly burdensome to the client, but the Rule does not prevent a lawyer from selecting the manner of communication. Rule 1.4(a)(4) specifically indicates that a lawyer need comply only with reasonable requests for information, thereby allowing lawyers the flexibility to curtail conversations or meetings that stray beyond the relevant substance of the representation. This provision expresses the Rule's recognition that some clients may thrust upon their lawyers burdensome, immaterial requests for information and that lawyers need not meet such unreasonable demands.

7. Similarly, Rule 1.4 does not prohibit a lawyer from controlling the timing of client communications. Other than the general requirement that developments in the case and responses to reasonable requests for information be "promptly" communicated, the Rule does not curtail a lawyer's discretion to schedule the specific timing of lawyer-client communications. Notably, Comment [4] to Rule 1.4 provides that when a prompt response to a client's reasonable request for information is not feasible, the lawyer (or a member of the lawyer's staff) should "acknowledge receipt of the request and advise the client when a response may be expected." That Comment is consistent with the notion that a lawyer—often balancing competing obligations—needs to have reasonable latitude to schedule the timing of client communications.

8. Consistent with the foregoing, we believe that the Rules do not prohibit a lawyer from responding to a challenging client by limiting the time and manner of communications with the client as long as the lawyer fulfills the substantive communicative requirements contained in Rule 1.4. *Cf.* N.Y. State 1124 (2017) (noting that no provision in the Rules mandates how lawyers must communicate with each other and that lawyers should work out between themselves the methods of communication that will best facilitate resolution of the matter at hand). Hence, a lawyer may limit communications to scheduled appointments or to some form of written transmission readily accessible to the client.

9. Whether and when a lawyer may seek to withdraw from representing a difficult client is controlled by Rule 1.16, which governs "declining or terminating representation." Rule 1.16(c) provides, in relevant part, that "except as stated in paragraph (d), a lawyer may withdraw from representing when, among other reasons, the "withdrawal can be accomplished without material adverse effects on the interests of the client," Rule 1.16(c)(1), "the client fails to cooperate in the representation or otherwise renders the representation unreasonably difficult for the lawyer to carry out the representation effectively, Rule 1.16(c)(7), or "the lawyer believes in good faith, in a matter before a tribunal, that the tribunal will find the existence of other good cause for withdrawal" Rule 1.16(c)(12). Rule 1.16(d), in turn, provides that "if permission for withdrawal from employment is required by the rules of a tribunal, a lawyer shall not withdraw from employment in a matter before that tribunal without its permission. When ordered to do so by a tribunal, a lawyer shall continue representation notwithstanding good cause for terminating the representation."

10. Because the inquirer has already appeared as counsel for the client in the pending matter, the inquirer may withdraw only with the permission of the tribunal. The reasons for permissive withdrawal in Rule 1.16(c) are disjunctive, so any one of the reasons set forth there may suffice. The most obvious candidate emerging from the facts—and thus the most apparent reason why the inquirer may seek permission for withdrawal from the tribunal—is whether the client's conduct will prevent the inquirer from "carry[ing] out the representation effectively" under Rule 1.16(c)(7). In most representations, and certainly in defending against a criminal prosecution, effective representation requires meaningful communication between a lawyer and client. If the client's verbal abuse and non-responsiveness result in a collapse of meaningful communication, then effective representation is almost certainly not possible. *See* Roy D. Simon & Nicole Hyland, *Simon's New York Rules of Professional Conduct Annotated*, 959 (2017) (noting, as examples of client conduct that make it unreasonably difficult to carry out representation effectively, "a client's constant calls to talk about the case or request information beyond what is fruitful or reasonable" and "a client's abusive or threatening communications to the lawyer"); *see also Cahill v. Donahoe*, 2014 WL 3339787 (W.D.N.Y. 2014) (granting motion to withdraw where "the attorney-client relationship is no longer productive and . . . the discord that has characterized their relationship over many months appears irreparable."). If an irreparable disintegration in communication has occurred, the inquirer may ask the court for permission to withdraw.

11. That the client here has mental health issues for which the client is receiving ongoing treatments makes it appropriate to mention Rule 1.14, which governs a lawyer's responsibilities to clients with diminished capacity. *See* N.Y. State 949 ¶ 20 (2012). Under Rule 1.14, a lawyer must "as far as reasonably possible" maintain a normal lawyer-client relationship. That a client suffers from mental illness does not diminish the lawyer's responsibility to treat the client attentively and with respect. Rule 1.14, Cmt. [2]. Rule 1.14 permits a lawyer to take protective action when the lawyer reasonably believes that the client is at risk of physical, financial, or other harm unless such action is taken. "Any condition that renders a client incapable of communicating or making a considered judgment on the client's own behalf casts additional responsibilities on the lawyer." Rule 1.14, Cmt. [1]. "Before considering what measures to undertake, lawyers must carefully evaluate each situation based on all of the facts and circumstances." N.Y. State 986 ¶ 12 (2013). In N.Y. State 986, we added (at ¶ 13):

> Any protective action taken by the lawyer should be limited to what is essential to carry out the representation. Thus, the lawyer may consult with family members, friends, other individuals, agencies or programs that have the ability to take action to protect the client. The Rule does not specify all of the potential protective actions that may be undertaken, but it makes clear that seeking the appointment of a guardian is the last resort, when no other protective action will protect the client's interests.

12. If the inquirer remains on the case, the inquirer will need to maintain a normal lawyer-client relationship "as far as reasonably possible," but, in evaluating the situation, the inquirer may conclude that protective actions are available to facilitate communication with the client so that the lawyer may enhance the prospect of effective representation.

CONCLUSION

13. A lawyer may place reasonable limitations on the timing and manner of client communications. When there is a breakdown of communications between a lawyer and client such that representation cannot be carried out effectively, the lawyer may seek to withdraw from representing the client.

(36-17)

Opinion 1145 (3/7/2018)

Topic: Litigation financing; conflicts of interest

Digest: Neither the lawyer nor the lawyer's firm may represent a client in litigation funded by a litigation financing company in which the lawyer is an investor.

Rules: 1.7; 1.8 (a), (e), (f) & (i), 1.10(a), (d)

FACTS

1. The inquirer is the managing partner of a law firm that represents plaintiffs in commercial litigation. The inquirer sometimes refers clients to a litigation financing company (the "Company") that provides money to the clients in exchange for a percentage of the prospective recovery.

2. The Company is structured as a limited partnership that privately raises money from qualified investors, among whom the inquirer seeks to be a direct and substantial one. The Company invests in a variety of lawsuits, including some brought by the inquirer's clients, and others brought by persons not represented by the inquirer. Investment decisions are made by a registered investment advisor. Neither the inquirer nor the inquirer's firm represents clients in their negotiations with the Company on the terms of the financing arrangements.

QUESTION

3. May a lawyer or the lawyer's firm represent a client in litigation funded by a litigation finance company in which the lawyer is an investor?

OPINION

4. The terms "alternative litigation finance" or "third-party litigation finance" refer to the funding of litigation activities by entities other than the parties themselves, their counsel, or other entities with a preexisting contractual relationship with one of the parties, such as an indemnitor or a liability insurer. These transactions are generally between a party to the litigation and a funding entity and involving an assignment of an interest in the proceeds from a cause of action. These activities have become increasingly prominent in recent years, leading to significant attention in the legal and popular press, scrutiny by state bar ethics committees, and scholarly commentary.

ABA Commission on Ethics 20/20, Informational Report to the House of Delegates (Dec. 2011) ("ABA Report") at 1 (footnotes omitted); *see also, e.g.*, Ethics Committee of the NYSBA Commercial and Federal Litigation Section, "Report on the Ethical Implications of Third-Party Litigation Funding" (2013); N.Y.C. Formal Op. 2011-2; A. Sebok, *Litigation Investment and Legal Ethics: What Are the Real Issues?*, 55 Canadian Bus. L. Journal 111 (2014).

5. In two previous opinions, we have considered issues arising from alternative litigation finance based on the former New York Code of Professional Responsibility (the "Code"). N.Y. State 769 (2003); N.Y. State 666 (1994). Both opinions analyzed issues of legal ethics but noted that this Committee does not opine on issues of law such as the legality of alternative litigation financing arrangements, and we repeat that caveat here. Here, we focus on the specific ethics issues presented in the inquiry; we do not revisit in any detail the ethical considerations applicable to alternative litigation financing generally.

6. In N.Y. State 666, we opined that a lawyer may ethically refer a client to a litigation financing company, while noting that the lawyer must be careful not to compromise confidentiality by disclosing information to the lending institution without the client's informed consent. In N.Y. State 769, we added that, subject to various limitations, a lawyer may ethically represent a client in negotiations with the litigation financing company and charge an additional fee for doing so. Both opinions also stated limitations relevant to the current inquiry that are set forth in the analysis below.

7. That the inquirer seeks to be a direct and substantial investor in the Company is of consequence. We do not address other situations, such as when a lawyer's investment occurs indirectly through intermediate entities, of which the lawyer may not even be aware.

8. The lawyer's proposed investment in the Company implicates at least four conflict-of-interest rules. We will first discuss two provisions—Rules 1.8(a) and 1.7(a)(2)—which the requisite disclosure and consent could potentially satisfy, and will then discuss two other provisions that we think preclude the proposed conduct in all circumstances.

9. Rule 1.8(a) of the New York Rules of Professional Conduct (the "Rules") sets forth requirements that must

be met when a lawyer enters into a business transaction with a client. This specific regulation, rather than the general conflicts provisions of Rule 1.7(a), governs the lawyer's conduct when a lawyer engages in a business transaction with a client. N.Y. State 1055 ¶ 13 (2015). Such a business transaction occurs when a client obtains funding from a source in which the lawyer has a financial interest, which funding will be used in part to pay the lawyer's fees. *See* N.Y. State 769 (citing the Code's predecessor to Rule 1.8(a) as one of bases for concluding that "the lawyer cannot own any interest in the financing institution"). The two other conditions to trigger Rule 1.8(a) are that the lawyer and client "have differing interests" in the transaction and that "the client expects the lawyer to exercise professional judgment therein for the protection of the client." Whether those circumstances are present will depend on the facts of particular cases. Here, we assume their presence, because the Company and the client have differing interests in the terms of the financing arrangements, *see* Rule 1.8, Cmt. [4C] (Rule 1.8(a) applies when lawyer obtains financial interest in client's claim except as Rules otherwise allow), and because the lawyer's financial stake in the Company could give rise to the client's reasonable expectation that the lawyer is exercising professional judgment on the client's behalf, *see* N.Y. State 769 ("an unsophisticated client may reasonably assume that by facilitating the transaction, the lawyer is also endorsing the entering into the proposed transaction and/or the terms thereof"); *cf.* N.Y. State 1055 n. 1 (2015) (client expectation likely when, for example, client has no other counsel, and the lawyer is acting for the client in the underlying matter).

10. When Rule 1.8(a) applies, then the transaction must be "fair and reasonable to the client." This is a fact-intensive inquiry, N.Y. State 913 ¶ 11 (2012), for which we lack data to opine. Assuming the inquirer satisfies this standard, then the inquirer may meet the other requirements of Rule 1.8(a) by complying with the obligations to make full disclosure in a writing, using language the client may reasonably understand, including the lawyer's role in the transaction; to advise the client, and to provide the client the opportunity, to seek independent legal counsel; and to obtain informed consent in a writing the client signs. Rule 1.8(a) (1) - (3).

11. If the client is not to be represented by the inquirer in the litigation, but rather by another lawyer in the inquirer's firm, the inquirer's financial interest would still give rise to a conflict by imputation. Rule 1.10(a) ("While lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by Rule 1.7, 1.8 or 1.9, except as otherwise provided therein."). Thus, even if the client is represented by another lawyer in the inquirer's firm, that representation, together with the inquirer's investment in the Company, would trigger the restrictions of Rule 1.8(a). But the imputed restriction could, in appropriate circumstances, be satisfied by informed consent and by meeting the other requirements of Rule 1.8(a)(1)–(3).

12. If the inquirer fully complies with Rule 1.8(a), then the inquirer must still abide by Rule 1.7(a) in connection with the ongoing representation of the client. N.Y. State 1139 ¶ 15 (2017). Rule 1.7(a)(2) provides that a lawyer shall not represent a client if a reasonable lawyer would conclude that "there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests," unless the affected client gives informed consent confirmed in writing. The inquirer's personal and financial interest in the Company could create such a risk. For instance, the Company may have an interest in expediting (or prolonging) the litigation to enhance the value of the Company's investment but which may not equate with the client's interests in going to trial (or reaching an early settlement). A continuing duty exists to protect the client from this risk. Nevertheless, in our view, this conflict may be adequately disclosed and waived under Rule 1.7(b) if the other requirements of Rule 1.7(b) are fulfilled. Rule 1.10 imputes this conflict to other lawyers in the inquirer's firm, but, like the underlying conflict, such an imputed conflict could be adequately disclosed and waived to allow the lawyer's firm to represent the client. *See* Rule 1.10(d).

13. There are, however, two other applicable Rules that informed consent cannot remedy. Rule 1.8(e) provides (subject to exceptions discussed below) as follows: "While representing a client in connection with contemplated or pending litigation, a lawyer shall not advance or guarantee financial assistance to the client." Underlying this Rule are two concerns: first, that such financial assistance "would encourage clients to pursue lawsuits that might not otherwise be brought," and second, that "such assistance gives lawyers too great a financial stake in the litigation." Rule 1.8, Cmt. [10].

14. The other provision (again subject to exceptions discussed below) is Rule 1.8(i): "A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client." This rule, too, "is designed to avoid giving the lawyer too great an interest in the representation. In addition, when the lawyer acquires an ownership interest in the subject of the representation, it will be more difficult for a client to discharge the lawyer if the client so desires." Rule 1.8, Cmt. [16].

15. We believe that the proposed conduct would violate both of these Rules. A violation of Rule 1.8(e) arises because the payments from the Company would constitute "financial assistance to the [inquirer's] client." We

recognize that the inquirer would not be the only investor in the Company, and that the inquirer's client would not be the only litigant funded by the Company, but these facts do not alter the reality that money from the inquirer would be paid as financial assistance to the inquirer's client. Nor does it matter that the money is routed first as an investment in a limited partnership and only thereafter as litigation funding. *See* Rule 8.4(a) (lawyer shall not violate the Rules "through the acts of another"); Phila. Op. 91-9 ("an attorney generally may not loan funds directly to a client, nor may an attorney indirectly do so through a finance company in which such attorney has an interest."); *cf*. Fla. Op. 00-3 (2002) ("an attorney may not indirectly loan funds to clients in connection with pending litigation through a nonprofit corporation funded by attorney contributions").

16. There are three exceptions to Rule 1.8(e) that allow limited assistance to clients in certain circumstances. Rule 1.8(e) (1) (advances of "court costs and expenses of litigation"), (2) (making such payments for indigent or pro bono clients) and (3) (making such payments in contingency matters). In those cases, the benefits of helping assure access to the courts outweigh the perils of such limited assistance. *See* Rule 1.8, Cmt. [10]. But even then, assistance is limited to "court costs directly related to litigation," such as "filing fees, expenses of investigation, medical diagnostic work connected with the matter under litigation and treatment necessary for the diagnosis, and the costs of obtaining and presenting evidence." Rule 1.8, Cmt. [9B]. Lawyers are never permitted to give litigation clients the more sweeping kinds of assistance—such as lawyer's fees billed on a non-contingency basis—that, under the inquiry, would apparently be provided by the Company. *See* N.Y. City 2011-2 (for commercial cases such as those at issue here, if the claim appears meritorious, "the financing company will advance amounts to cover attorneys' fees and the other costs of the litigation").

17. This result is consistent with our prior opinions, based on the Code, which indicated that the lawyer "cannot own an interest in the lending institution, as that would indirectly constitute a loan by the lawyer to the client." N.Y. State 666, *cited in* N.Y. State 769. Other jurisdictions agree. *See* N.J. Op. 691 (2001) (ethics rules do not prohibit lawyer from helping a client to obtain financial assistance from another "as long as the lawyer has no financial interest in the individual or entity which secures or provides that funding"); S.C. Op. 92-06 (approving attorney's interest in a loan company given that "the company would not make loans to the attorney's own clients"); Fla. Op. 00-3 (2002) ("The attorney shall not have any ownership interest in the funding company"); Phila. Op. 91-9 ("an attorney generally may not loan funds directly to a client, nor may an attorney indirectly do so through a finance company in which such attorney has an interest."); ABA Report at 16, 19-20 (alternative legal financing may be subject to non-waivable conflict rule prohibiting lawyer from "providing financial assistance to a client").

18. The proposed conduct would also violate Rule 1.8(i). By providing money to the inquirer's client in exchange for a percentage of the prospective recovery, the Company would acquire a proprietary interest in the client's claim. The inquirer, as a part owner of the Company, would also acquire such an interest, which the rule prohibits except in the cases of "a lien authorized by law to secure the lawyer's fee or expenses," Rule 1.8(i)(1), or "a reasonable contingent fee in a civil case," Rule 1.8(i)(2). Neither of those exceptions would apply to the inquirer's financial stake in the Company. Even if a client is to compensate the inquirer by contingent fee, such a fee payment would be different from the percentage of a recovery that would ultimately be paid to the Company, and in part indirectly to the inquirer, in exchange for litigation financing. *See also* ABA Report at 16, 20 (alternative legal financing may be subject to non-waivable conflict rule prohibiting lawyer from "acquiring a proprietary interest in the client's cause of action").

19. As we have said, the imputation provisions of Rule 1.10(a) apply to violations of Rule 1.8. Thus, the preclusion of the proposed conduct by Rule 1.8(e) and Rule 1.8(i) would apply not only to clients whom the inquirer personally represents, but also to those represented by other lawyers associated in the inquirer's firm.

20. These restrictions are not subject to waiver. Rule 1.10(a) applies its imputation standard to any breach of Rule 1.7, 1.8, or 1.9, "except as otherwise provided therein." Rule 1.10(d) says that a "disqualification prescribed by this Rule [1.10(a)] may be waived by the affected client or former client under the conditions stated in Rule 1.7." In the context of prohibited transactions under Rule 1.8(e) or Rule 1.8(i), however, there is no negatively affected client or former client. The concept of waiver makes no sense. What is imputed is not a "disqualification," but rather an outright prohibition of the transaction in question. There are no informed-consent exceptions specific to Rules 1.8(e) and 1.8(i). Accordingly, the prohibitions of financial assistance to a client, and of acquiring a proprietary interest in the subject matter of litigation, are not subject to client waiver, and the same is true of those prohibitions as imputed.

CONCLUSION

21. Neither the lawyer nor the lawyer's firm may represent the client in a litigation funded by a company in which one of the firm's lawyers is an investor in the litigation financing company providing the funds.

(31-17)

Opinion 1146 (3/20/2018)

Modifies N.Y. State 808

Topic: Contingency fees: Paying fees in a criminal matter from personal injury settlement

Digest: A lawyer who represents a client in a personal injury matter and proposes to represent the client in a contemporaneous criminal defense matter and apply any funds recovered in the personal injury matter toward payment of legal fees in the criminal defense matter has a differing interest in any recovery in the personal injury matter and must satisfy the requirements of fairness, full disclosure and written consent set forth in Rule 1.8(a) to enter into the proposed retention.

Rules: 1.0(f), 1.0(j), 1.5(a), 1.8(a), 1.8(i)

FACTS

1. The inquirer's law firm represents clients in personal injury, criminal defense, and other matters. Occasionally, a client who has a personal injury case becomes involved in a criminal matter and asks that the firm represent the client in the criminal matter as well. Clients who are unable to pay in advance for the criminal defense sometimes propose to secure the payment of fees for the criminal representation against the prospective monetary recovery from the personal injury settlement, judgment, or award.

QUESTIONS

2. The inquirer poses three questions:

(a) Is it permissible for a client to pay fees for services rendered by the firm in criminal defense matters from a settlement, judgment, or award obtained by the firm on behalf of the client in the personal injury matter?

(b) Is it permissible to enter into a criminal retainer agreement with a current personal injury client which grants a lien against the client's potential personal injury award to cover fees earned on an hourly basis in the contemporaneous criminal representation?

(c) If it is not permissible to enter into a criminal defense retainer agreement which purports to create a lien against the personal injury recovery, is it nevertheless permissible to enter into a retainer agreement for the criminal defense matter, and to create a charging lien against the personal injury settlement, papers, or other materials or funds related to the personal injury case, should the client ultimately fail to pay the fees for the criminal defense case?

OPINION

3. We think the inquirer's first two questions pose the same issue, namely, whether the N.Y. Rules of Professional Conduct (the "Rules") permit the inquirer to enter into an agreement with a client to have fees for services rendered in the criminal defense matter paid out of, or secured by, the proceeds of any settlement, judgment, or award obtained in a personal injury matter in which the firm also represents the client. We assume the inquirer will have the client sign an engagement letter in the criminal defense matter that provides for billing the client at a fixed rate, hourly or otherwise, but provides, too, that fees for the criminal defense matter may be paid out of funds obtained in any recovery in the representation of the client in the personal injury matter, thus establishing an additional source for payment of the fees. This is analytically indistinguishable from a scenario in which the lawyer acquires a lien on any recovery obtained in the personal injury matter as security against payment of fees earned on an hourly basis in the contemporaneous criminal representation. In each instance, the proceeds of any recovery in the personal injury matter will be used to cover legal fees in the criminal defense matter only if the client is unable to cover those fees through the client's own personal funds. This arrangement therefore differs from an arrangement in which payment of legal fees in the criminal matter is contingent on the outcome of that matter, which is expressly prohibited by Rule 1.5(d)(1) (a lawyer "shall not enter into an arrangement for, charge or collect" a "contingent fee for representing a defendant in a criminal matter"). Here, payment in the criminal matter is not contingent on its outcome, and thus not the product of the lawyer's defense of the criminal matter.

4. Rule 1.8(i) permits a lawyer "to acquire a lien authorized by law" to secure payment of the lawyer's legal fees or expenses. This differs from the predecessor of the Rules, the N.Y. Code of Professional Responsibility (the "Code"), which in DR 5-103(A) allowed liens only if "granted by law." In N.Y. State 808 (2007), which was decided under the Code, we contrasted DR 5-103(A) with Rule 1.8(i) of the ABA Model Rules of Professional Conduct (the "Model Rules"), which permitted liens "authorized by law." This led us to conclude that, under the Code, a lawyer could not obtain a security interest in a client's claim when the lawyer represents the client in that claim. But the change from "granted" to "authorized" is of consequence. In explaining the Model Rules, ABA 02-247 said that, "[b]y use of the word 'authorized' in place of the word 'granted' under former [Model] Rule 1.8(j), Rule 1.8(i) is intended to permit any legally recognized lien to secure fees to be acquired in property that is the subject of litigation." The Comments to Rule 1.8 echo this same sentiment concerning New York's adoption of Rule 1.8(i): Although Rule 1.8(i) generally prohibits lawyers from acquiring a proprietary interest in the cause of action or subject matter of a litigation the lawyer is handling, the Rule excepts "liens granted by statute, [] originating in

common law and [] acquired by contract with the client." Rule 1.8, Cmt. [16]. Here, the inquirer proposes to enter into a contract with the client providing for a lien on recovery in the personal injury matter, which is permissible under the exception in Rule 1.8(i).

5. While a permitted exception to Rule 1.8(i), the inquirer's proposed arrangement for payment of fees in the criminal defense representation must abide by Rule 1.8(a), which governs business transactions with a client. *See* Rule 1.8, Cmt. [16] ("When a lawyer acquires by contract a security interest in property other than that recovered through the lawyer's efforts in the litigation, such an acquisition is a business or financial transaction with a client and is governed by the requirements of paragraph (a).") Rule 1.8(a) provides that "[a] lawyer shall not enter into a business transaction with a client if they have differing interests therein and if the client expects the lawyer to exercise professional judgment therein for the protection of the client" unless the transaction is "fair and reasonable" to the client, the terms are fully disclosed to the client in writing, the client is advised and given an opportunity to seek independent legal counsel, and the client gives informed consent in writing signed by the client.

6. "Differing interests" are defined to "include every interest that will adversely affect either the judgment or the loyalty of a lawyer to a client, whether it be a conflicting, inconsistent, diverse, or other interest." Rule 1.0(f). Here, the interests of the inquirer and the client will differ in connection with the inquirer's representation of the client in the personal injury action because the client and lawyer may have differing interests with respect to the amount of recovery sought and the risk analysis each would apply to obtaining it. For example, the lawyer may advise the client to reject a settlement that would otherwise be acceptable to the client because it is insufficient to cover costs in the criminal defense matter, or advise that the client accept a settlement that provides certainty in payment of the criminal defense costs rather than risk pursuing the case to trial when a credible chance exists of a larger recovery for the client at trial. *See* N.Y. State 1139 ¶ 9 (2017). In addition, we have previously observed that when a client has no other counsel in the matter and is an individual, and when the lawyer is responsible for client matters in the subject area—which is true here—it is more likely that the client will expect the lawyer to exercise professional judgment on the client's behalf. *See* N.Y. State 1055 n.1 (2015); *see also* ABA 11-458 (2011) (amendment to fee arrangements that involves a lawyer acquiring an interest in client property is subject to Model Rule 1.8(a)).

7. The lawyer must determine whether the transaction is "fair and reasonable" to the client. Rule 1.8(a)(1). Determining whether a transaction is "fair and reasonable" to the client requires a fact-specific inquiry of the facts ascertainable at the time. *See* N.Y. State 913 ¶¶ 11-12 (2012); *see also* N.Y. State 1139 ¶ 10; ABA 00-418 (2000). In addition, the lawyer must satisfy Rule 1.8(a)'s disclosure and consultation provisions, including assuring that the engagement letter in the criminal defense matter fully discloses the transaction in a manner that can be reasonably understood by the client; that the client provides informed written consent to the terms of the transaction (including the lawyer's role in the matter) after the lawyer has adequately explained the material risks of the proposed fee arrangement and reasonably available alternatives (*see* Rule 1.0(j)); and that the client has been advised to seek, and has been provided a reasonable opportunity to obtain, the advice of independent legal counsel regarding the proposed engagement. If all of the steps outlined above are taken, we see no ethical prohibition to the proposed fee arrangement.

8. The inquirer's third question—whether the law firm may enter into a retainer in the criminal defense matter that creates a charging lien against the personal injury case if the client fails to pay the fees in the criminal defense matter—is moot unless the inquirer is unable to comply with Rule 1.8(a). If compliance with Rule 1.8(a) is not possible, then the question whether a charging lien may be created against the recovery in the personal injury matter is an issue of law that is beyond the scope of this Committee. *See* N.Y. State Judiciary Law § 475.

CONCLUSION

9. A lawyer who represents a client in a personal injury matter and proposes to represent the client in a contemporaneous criminal defense matter and apply any funds recovered in the personal injury matter toward payment of legal fees in the criminal defense matter may do so provided that the lawyer complies with the Rule concerning business transactions with a client.

(38-17)

Opinion 1147 (3/23/2018)

Topic: Advertising: Use of "Esq." by a lawyer not admitted in New York

Digest: A lawyer not admitted to practice in New York may use the term "Esq." in connection with a non-legal business conducted in New York, provided that care is taken to avoid confusion about the lawyer's status. A lawyer who performs pro bono immigration services for a nonprofit organization may be described to clients and others as a lawyer, as long as all communications disclose the lawyer's jurisdictional and practice limitations.

Rules: 5.5, 7.5(a) 7.5(d), 8.4(b) & (c).

FACTS

1. The inquirer is admitted to practice law in California but not New York, where the inquirer currently resides. The inquirer works for a municipal agency in New York, but the scope of the inquirer's employment does not

involve the practice of law; the municipal agency employs a New York lawyer who acts as the agency's counsel. The inquirer would like to use the term "Esq." on business cards relating to the municipal employment.

2. In addition, the inquirer is a volunteer immigration lawyer for a non-profit organization, representing individuals in proceedings before the federal immigration court, an administrative agency. The inquirer has registered with the court and is identified as counsel on the court's forms when representing clients before the court. The inquirer advises these clients that the inquirer is not admitted to the practice of law in New York but is admitted in California.

QUESTIONS

3. The inquiry poses two questions:

a. May a lawyer not admitted in New York use the honorific "Esquire," more commonly abbreviated as "Esq.," on business cards that the lawyer uses as a municipal employee performing non-legal services?

b. When a lawyer not admitted in New York performs pro bono legal services to clients before a federal immigration tribunal, what disclosures of jurisdiction and subject matter limitations must the lawyer provide to clients?

OPINION

4. In N.Y. State 1089 (2016), we addressed whether a "retired lawyer" within the meaning of Section 118.1(g) of the Rules of the Chief Administrative Judge, 22 NYCRR § 118.1(g), may use the title "Esq." in performing legal services that Section 118.1(g) allows for someone so designated. There (in ¶ 4), we cited with approval N.Y. City 1994-5, which says:

> The title "esquire" does not legally designate an individual as a lawyer because it is not conferred in this country as an academic degree or license. It has, however, been adopted by lawyers by convention as a form of designation. Thus, one using the title in the United States is identifying himself or herself as a lawyer.

5. In the same opinion, we added (in ¶ 5), "that the term 'Esq.' does not have precisely the same connotation as, for example, 'Attorney-at-Law,'" and that, while lawyers acting in a non-legal capacity such as working for a nonprofit organization in administration or public relations could use the honorific "Esq." without qualification, a lawyer may not lead the recipient of the communication "to conclude that the lawyer was acting in a legal capacity." *Id*. Thus, when someone who is not admitted to practice law in New York uses the term "Esq." on a business card or otherwise, the question is whether the use of that abbreviation is misleading under Rule 8.4(c) of the N.Y. Rules of Professional Conduct (the "Rules"), prohibiting lawyers from engaging in "conduct involving dishonesty, fraud, deceit or misrepresentation."

6. We think the analysis in N.Y. State 1089 controls here. There, we noted that the retired lawyer remains a lawyer (although limited to performing unpaid legal work), and that while use of the term "Esq." is accurate, public perception must also be considered. A name on a business card containing solely a New York address and the honorific "Esq." could reasonably lead a member of the public to believe that the cardholder is a lawyer. A name on a business card with the honorific "Esq." but describing the person's position as one performing obviously non-legal services conveys a very different message. The issue, then, is not so much the use of "Esq."—provided the person is a lawyer—but the context in which the title appears. If the business transmits the message that the person is a lawyer but not performing legal services, then we see no reason under the Rules why the inquirer may not say as much. As long as the message is not misleading—as long as the lawyer who chooses to use the title takes care to avoid confusion and assure that the relevant audience is not misled to believe that the lawyer is acting as a lawyer—then we have no quarrel with its use on a business card.

7. The inquirer asks also if it is sufficient to explain to clients whom the inquirer represents as a volunteer immigration lawyer that the inquirer is admitted only in California and not in New York. Although we do not address questions of law, it has been our understanding that federal law permits a member in good standing of the bar of any state not under suspension or otherwise restricted in his or her practice of law to practice before federal immigration tribunals. *See* N.Y. State 863 ¶ 5 (2011).

8. In N.Y. State 863, applying the Rules to determine the disclosure that an attorney not admitted in New York must make, we said that a lawyer must note on letterhead and business cards that the lawyer is admitted to practice only in the state of admission, and that the lawyer's practice in New York is limited solely to immigration matters. We said, too, that prudence in that situation suggests that the lawyer add that the lawyer is "not licensed in New York State," in order to "avoid any possible confusion regarding whether the inquirer is or is not licensed in New York." *See id.* ¶ 14.

9. While the jurisdictional and subject matter limitations need not be included in an email signature block, nothing in an email or any communication may state or imply that the lawyer is admitted to practice in New York, because to do so would violate Rule 8.4(c), prohibiting a lawyer from engaging in misrepresentation. *Id*. ¶ 15.

CONCLUSION

10. A lawyer not admitted in New York may use the term "Esq." on business cards as long as the card does not

suggest that the lawyer is performing or qualified to perform legal services in this State. A lawyer may engage in a voluntary immigration practice with a nonprofit organization, and may refer to him or herself as a lawyer, provided that letterhead and business cards used in the practice fairly disclose applicable jurisdictional and subject matter limitations.

(37-17)

Opinion 1148 (4/2/2018)

Topic: Conflicts of interest: Former government lawyer in private practice in matters involving former government employer

Digest: A lawyer formerly employed by a county department to handle child support enforcement proceedings may, after termination of such employment, represent respondents in such proceedings, provided that the lawyer was not personally and substantially involved in the same matter while a government employee.

Rules: 1.0(j), 1.6, 1.9(a) & (c), 1.11(a) & (c).

FACTS

1. The inquirer is a New York lawyer formerly employed by a county social services agency (the "Department") within New York State. Among the duties of a county social services department are to assist "the state in the location of absent parents, establishment of paternity and enforcement and collection of support" obligations of legally responsible relatives to contribute for the support of their dependents. N.Y. Social Services Law § 111-c(1) (outlining Departmental duties). The Department employs an enforcement unit staffed, in part, by four or five attorneys, who seek to enforce alleged obligations to support dependents. We assume for our purposes that, in doing so, the attorneys represent the Department rather than individuals to whom the support payments may be owed.

2. The inquirer recently retired as one of the Department's enforcement unit attorneys, and has started a solo law firm in the same region. In this practice, the inquirer wishes to represent clients adverse to the Department, including opposing the Department's enforcement actions.

QUESTION

3. May an attorney, formerly employed by a county department of social services, represent clients opposing the efforts of the attorney's erstwhile government employer, including representing clients challenging support enforcement proceedings brought by that employer?

OPINION

4. This Committee's charter is limited to interpretation of the New York Rules of Professional Conduct (the "Rules") and does not extend to opining on issues of law, statutes, county ethics codes, or other regulations that may govern the duties of current or former government employees in their relations with their current or former government employers. Accordingly, here, we proceed without deciding that the inquirer's proposed representation conforms to any such limitation on the inquirer's proposed conduct.

5. Nothing in the Rules creates an absolute bar to a former government attorney's representation of a client in opposition to the attorney's former employer. Rule 1.11(a)(2) is the principal Rule governing conflicts that may be faced by a former government attorney. N.Y. State 1029 ¶ 9 (2014). Rule 1.11(a) provides in pertinent part that "a lawyer who has formerly served as a public officer or employee of the government . . . shall not represent a client in connection with a matter in which the lawyer participated personally and substantially as a public officer or employee, unless the appropriate government agency gives its informed consent, confirmed in writing, to the representation." Hence, Rule 1.11(a)(2) allows a former government attorney to represent private clients on matters in which the attorney did not participate "personally and substantially" while in government service.

6. The history of Rule 1.11(a)(2) makes "clear that the disqualification must be based on the lawyer's "personal participation to a significant extent." N.Y. State 748 (2001). "[T]hat a former government lawyer was counsel for the government in unrelated matters at the same time that the defendant's case was investigated or prosecuted is not enough to demonstrate personal and substantial participation under DR 9-101," the precursor to Rule 1.11(a)(2) in the N.Y. Code of Professional Responsibility (the "Code"), "or to require disqualification under that rule." *Id*. "Neither the Code, nor its goal of promoting public confidence require so limiting the practice of former government lawyers that they may not, following their return to private practice undertake work involving the types of matters in which they have gained particular expertise while in public service." N.Y. State 453 (1976).

7. The aims of Rule 1.11(a), a rule specific to onetime government lawyers, are akin to, but significantly differ from, those of Rule 1.9(a), a rule more generally regulating a lawyer's duty to former clients. The goals of Rule 1.9(a) include preventing a lawyer from "switching sides" and "improperly using confidential information of the former client," Rule 1.9, Cmts. [3] &[4], whereas Rule 1.11(a) is designed not only to protect the former government client but also to "prevent a lawyer from exploiting public office for the advantage of another client," Rule 1.11, Cmt. [3]. An additional and important concern of Rule 1.11(a), however, is to avoid an undue deterrent on lawyers serving in a public position without forever forgoing private practice in the legal area in which the lawyer served the government. Rule 1.11, Cmt. [3]; N.Y. State 1029 ¶ 10. For this reason, the test applicable to Rule 1.9 is qualitatively different from the test applicable to Rule 1.11.

8. To be sure, underlying each Rule is a protection of the former client's confidential information. A government

lawyer, like any lawyer, owes an ongoing duty to a former client to preserve the confidential information the lawyer garnered in the representation unless the former client releases the lawyer from that duty. Rule 1.11(a)(1) requires a lawyer who formerly served as a public officer or government employee to comply with Rule 1.9(c), which in turn provides that "a lawyer who has formerly represented a client in a matter" [in this case, a government or governmental agency] "shall not thereafter use confidential information of the former client protected by Rule 1.6 to the disadvantage of the former client" or reveal such information, in each case "except as these Rules would permit or require with respect to a current client." Among the exceptions in each Rule is the former client's "informed consent" within the meaning of Rule 1.0(j). Consistent with this proscription, Rule 1.11(a)(2) says that the government agency may consent if a former government attorney seeks to represent another party "in a matter in which the lawyer participated personally and substantially" while a government employee, subject always to the proscription in Rule 1.11(c) against the use of confidential government information against third persons, a ban that consent may not waive (and that is not an issue we address in this opinion).

9. Absent the former client's informed consent, the differing language of the two Rules reflects their different objectives. Rule 1.9(a) bars representation adverse to a former client "in the same or a substantially related matter" to the matter in which the lawyer previously represented a client. Rule 1.11(a) bars representation by a former government employee adverse to the former client only in the same specific matter as the matter in which the lawyer participated "personally and substantially" during the lawyer's government employment. As a result, the application of each Rule may diverge in practical ways. Solely by way of illustration, some courts apply Rule 1.9(a)'s "substantial relationship" test to disqualify lawyers who represented clients in specific types of matters. *See, e.g., Panebianco v. First Unum Life Ins. Co.,* 2005 U.S. Dist. LEXIS 7314 (S.D.N.Y. Apr. 27, 2005) (disqualifying law firm that represented former client in disability matters); *Lott v. Morgan Stanley Dean Witter & Co.,* 2004 U.S. Dist. Ct. LEXIS 25682 (S.D.N.Y. Dec. 23, 2004) (disqualifying law firm that represented former client in ERISA matters); *Mitchell v. Metro. Life Ins. Co.,* 2002 U.S. Dist. LEXIS 4675 (S.D.N.Y. Mar. 21, 2002) (disqualifying law firm that represented former client in discrimination matters). Without endorsing these decisions—disqualification to appear in court is a question of law, not ethics, and governed by judicial standards outside our purview—a theme running through the opinions, sometimes labeled the "playbook" approach, is not practicable in the context of former government lawyers. Many state and sub-state legal departments represent the government only in specific types of cases. To use this "playbook" approach in interpreting Rule 1.11(a) is to disregard both its purpose of encouraging public service and the different language that Rule 1.11(a) uses to assess whether a government lawyer is able to represent a client against the lawyer's former employer.

10. Otherwise put, Rule 1.11(a) ousts the application of Rule 1.9(a) in the context of government lawyers. Rule 1.9(a)'s "substantial relationship" may extend its reach to encompass matters that Rule 1.11(a)'s requirement of "personal and substantial" involvement in the specific matters was not intended to embrace. We do not negate the possibility that the two may overlap in some instances, but neither do we believe that the two are necessarily congruent. That each Rule uses different language, that Rule 1.11(a) is specific to government lawyers in contrast to Rule 1.9(a)'s general application, and that Rule 1.11(a) serves public purposes beyond those animating Rule 1.9(a), fortify this conclusion. We note, too, that the considerations for determining whether Rule 1.11(a) applies are materially narrower than those customarily applied in analysis of a Rule 1.9(a) conflict. *Compare* Rule 1.11, Cmt. 10 (factors to be used in determining whether two matters are the same include "the extent to which (i) the matters involve the same basic facts, (ii) the matters involve the same or related parties, and (iii) time has elapsed between the matters") *with* Rule 1.9, Cmts. [2] & [3] (setting forth additional factors to be considered in making a decision about whether a conflict exists).

11. Consequently, we conclude that a onetime government lawyer may represent clients adverse to the lawyer's former government employer unless that lawyer had a personal and substantial involvement in the same specific matter in which the lawyer now proposes to challenge the government's position. This conclusion rests on the assumptions (a) that the inquiring lawyer does not possess confidential information about the specific matter obtained during the inquirer's government service, and (b) that the inquiring lawyer does not otherwise possess confidential information about the specific matter which, owing to the lawyer's confidentiality obligations, the lawyer could not competently represent the client in resisting the government's action without violating the lawyer's ongoing duty of confidentiality, *see* N.Y. State 901 ¶ 10 (2011) (a lawyer possessing non-disclosable confidential information relating to existing representation must assess whether the lawyer reasonably believes that the lawyer may competently represent client). But merely knowing how the government agency usually handles such matters, untethered to personal and substantial involvement in or confidential information about the specific matter, is alone insufficient to prevent the former government lawyer from representing a private client against the lawyer's former government employer.

CONCLUSION

12. A lawyer formerly employed by a county department to handle child support enforcement proceedings may, after termination of such employment, represent respondents in such proceedings, provided that the lawyer was not personally and substantially involved in, and possesses no confidential information acquired about, the same specific matter while a government employee.

(32-17)

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