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The *Delaware Law Review* (ISSN 1097-1874) is devoted to the publication of scholarly articles on legal subjects and issues, with a particular focus on Delaware law. With this issue, the Delaware State Bar Association is changing the focus of the law review format to provide an overview of recent developments in case law and legislature that impacts Delaware practitioners. This shift in the focus of the publication is in keeping with the ever-evolving role of the Delaware State Bar Association to remain relevant to the bar as a practical resource.

The Delaware State Bar Association expresses it gratitude and appreciation to Danielle Gibbs for 4 years of exemplary service as Editor-in-Chief of the *Delaware Law Review*. Alisa E. Moen is the incoming Editor-in Chief. She is a partner at Blank Rome LLP and currently serves as the firm's Corporate Litigation Vice Practice Group Leader.*

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DELAWARE LAW REVIEW

KEY DECISIONS OF 2012 IN DELAWARE CORPORATE AND ALTERNATIVE ENTITY LAW

Bruce L. Silverstein, Kathaleen St. J. McCormick and Tammy L. Mercer*

I. CORPORATE LAW

A. Transactions Involving Controlling Stockholders

In *Americas Mining Corp. v. Theriault* ("*Southern Peru*"),[1] the Delaware Supreme Court affirmed the Court of Chancery's post-trial judgment of more than $1.3 billion in damages (plus in excess of $600 million in pre- and post-judgment interest) against a controlling stockholder and its affiliates on the controlled corporation's board of directors. In affirming the judgment, the Delaware Supreme Court established a new rule that the burden of proving the "entire fairness" of "a transaction involving self-dealing by a controlling shareholder" will remain with defendants at trial where the record does not permit a pretrial determination that the burden should be shifted to the plaintiff(s).[2] The *Southern Peru* ruling does not address, much less answer, the related question of whether the standard of judicial review at trial will be "entire fairness" or "business judgment" in non-control situations where (i) one or more directors is self-interested or lacks independence, and (ii) a pretrial determination cannot be reached on the question of the proper standard of judicial review.

Southern Peru arose out of a merger transaction by which Southern Copper Corporation ("Southern Peru") acquired a 99.15% interest in Minera México, S.A. de C.V. ("Minera") from Southern Peru's controlling stockholder, Grupo México, S.A.B. de C.V. ("Grupo Mexico"), which indirectly owned an absolute majority of Southern Peru's voting shares.[3] In consideration of the merger, Grupo Mexico (through a wholly owned subsidiary) acquired 67.2 million shares of Southern Peru stock.[4] The challenged transaction was not subject to a vote of a majority of Southern Peru's minority stockholders.[5] The merger was, however, negotiated on behalf of Southern Peru by a four-member special committee of outside directors over a period of eight months.[6] While accepting that the members of the special committee

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1. 51 A.3d 1213 (Del. 2012) (hereinafter *Southern Peru).*

2. *Id.* at 1241-42.

3. *Id.* at 1218-19.

4. *Id.* at 1219.

5. *See id.* at 1228.

6. *See id.* at 1219.

were disinterested and independent (even though one member of the committee was not optimally suited to serve on the committee due to a different form of conflict),[7] the Court of Chancery found that the special committee members had a "controlled mindset" that prevented them from functioning in an independent manner.[8] Accordingly, the court required the defendants to carry the burden of proof on the issue of entire fairness.[9]

In affirming the Court of Chancery's ruling, the Delaware Supreme Court rejected the defendants' contention that the trial court erred by failing to make a pre-trial determination of which party bore the burden of proof respecting the question of entire fairness.[10] The Supreme Court acknowledged the nature of this inquiry is necessarily fact intensive, and a post-trial determination concerning burden shifting creates "practical problems" because it requires defendants to litigate as if they bore the burden of proof during trial.[11] Nonetheless, the Supreme Court rejected the defendants' argument that this approach would deter corporations from using protective devices. In this regard, the Supreme Court observed that the procedural benefit of burden shifting is a "modest" one,[12] and that the real benefit of a well-functioning special committee is that it is persuasive evidence of a fair process.[13] The Supreme Court explained that "[a] fair process usually results in a fair price," and that "the proponents of an interested transaction will continue to be incentivized to put a fair dealing process in place that promotes judicial confidence in the entire fairness of the transaction price."[14]

The Supreme Court separately affirmed the trial court's determination that the special committee did not function with sufficient independence to earn a shift in the burden in this particular case, in any event.[15] Relatedly, the Supreme Court approvingly quoted the following observation of the Court of Chancery:

> A close look at *Tremont* suggests that the [burden shifting] inquiry must focus on how the special committee actually negotiated the deal — was it "well functioning" — rather than just how the committee was set up. The test, therefore, seems to contemplate a look back at the substance, and efficacy, of the special committee's negotiations, rather than just a look at the composition and mandate of the special committee.[16]

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7. *See id.* at 1232.

8. *Id.* at 1245.

9. *Id.* at 1242. On the merits, the Court of Chancery determined that Grupo Mexico's interest in Minera was worth $2.4 billion, and that the 67.2 million shares of Southern Peru stock "paid" to Grupo Mexico were worth $3.7 billion. *Id*. at 1218. Both "values" were contested at trial. *See id*. at 1250-51. The Court of Chancery determined the value of Grupo Mexico's interest in Minera using a form of "fair value" analysis akin to that employed in a statutory appraisal action. *See id*. at 1250. Because the shares of Southern Peru were publicly traded, the Court of Chancery used their trading price to determine the amount paid to Grupo Mexico. *See id.* at 1250 n.62.

10. *Id.* at 1239-44.

11. *Southern Peru, 51 A.3d* at 1241.

12. *Id.* at 1242.

13. *Id.* at 1243.

14. *Id.*

15. *Id.* at 1241-43.

16. *Id.* at 1240-41 (quoting the Court of Chancery opinion) (citations omitted).

In *Frank v. Elgamal*,[17] Vice Chancellor Noble denied a motion to dismiss a claim challenging a merger in which four stockholders of the target corporation — consisting of the CEO, COO, and two non-director officers — collectively held 71.19% of the company's common stock and received different consideration from that paid to the public stockholders, including equity in the acquiror.[18] The plaintiffs alleged that these four stockholders constituted a "control group" and argued that their receipt of disparate consideration implicated the "entire fairness" standard under *Kahn v. Lynch Communication Systems, Inc*.[19] The Court of Chancery agreed that the entire fairness standard applied, but did so under *In re John Q. Hammons Hotels, Inc. Shareholder Litigation*,[20] and not *Kahn*.[21] The distinction between the two cases — and the doctrines they establish — is that (i) under *Kahn* the use of a special committee and a majority of the minority vote will not eliminate fairness scrutiny (although either will shift to the burden of proving fairness to the plaintiffs), whereas (ii) under *Hammons*, the use of both prophylactics will eliminate "entire fairness" scrutiny and the business judgment rule will be applicable.[22]

The transaction challenged in *Frank* was a merger through which American Surgical Holdings, Inc. ("American Surgical") was acquired by Great Point Partners I, L.P. ("Great Point") for $2.87 in cash per share of common stock.[23] When the board of American Surgical approved the merger, all members of the alleged control group (a) agreed to vote for the merger, (b) exchanged some, but not all, of their common stock in American Surgical (17.4% of the outstanding common stock) for preferred stock representing 14.9% of the equity of Great Point, and (c) signed employment agreements with the corporation surviving the merger.[24] The merger was ***not*** subject to a "majority-of-the-minority" vote requirement.[25] Accordingly, absent a termination of the merger agreement in advance of a stockholder vote, the voting agreements assured stockholder approval of the merger.[26]

In denying the defendants' motion to dismiss the complaint, the Court of Chancery determined that the plaintiffs' allegations were sufficient to support an inference that the stockholders who received disparate treatment in the merger were a "control group."[27] Accordingly, because the merger was not conditioned on a vote of a majority of the minority stockholders, the court held that the merger would be judged by the "entire fairness" standard if the plaintiffs later established that the alleged control group was, in fact, a control group.[28] Although the outcome in *Frank* favored the stockholder

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17. C.A. No. 6120-VCN, 2012 Del. Ch. LEXIS 62 (Del. Ch. Mar. 30, 2012).

18. *Id.* at *3, 8-9.

19. 638 A.2d 1110 (Del. 1994) (cited at 2012 Del. Ch. LEXIS 62, at *24).

20. C.A. No. 758-CC, 2009 Del. Ch. LEXIS 174 (Del. Ch. Oct. 2, 2009) (hereinafter *Hammons).*

21. *Frank,* 2012 Del. Ch. LEXIS 62, at *25-26.

22. *Id.*

23. *Id.* at *6.

24. *Id.* at *8-9.

25. *Id.* at *33.

26. *Id.* at *33-38.

27. *See id.* at *26-29.

28. *See id.* at *26.

plaintiffs in that particular case, the court's application of *Hammons* is a divergence from *Kahn* that permits a merger in which a controlling stockholder (or control group) receives disparate treatment to receive business judgment protection if appropriate procedural safeguards are employed. The Delaware Supreme Court has yet to address this specific legal issue.

In *In re Delphi Financial Group Shareholder Litigation*,[29] Vice Chancellor Glasscock found that the plaintiffs had established a probability of proving that a controlling stockholder committed a breach of fiduciary duty by insisting that super-voting stock receive greater per-share merger consideration than ordinary voting stock where (i) the company's certificate of incorporation required equal treatment of the two classes of stock in a merger,[30] (ii) the merger was conditioned on an amendment to the certificate of incorporation that would eliminate the equal treatment provision,[31] and (iii) the proposed charter amendment and merger were negotiated by a special committee of disinterested and independent directors and conditioned on a vote of a majority of the minority public stockholders.[32] Nonetheless, the court declined to grant a preliminary injunction against the proposed transaction on the grounds that the stockholders could be made whole in a post-merger damages proceeding.[33] Thereafter, Delphi agreed to pay an additional $49 million to the public stockholders.[34]

In *Delphi*, Tokio Marine Holdings, Inc. ("Tokio") made an offer to acquire Delphi Financial Group, Inc. ("Delphi") in an all-cash, third party merger.[35] Delphi had two classes of common stock: (i) Class A shares, which had one vote per share, and (ii) Class B shares, which had ten votes per share.[36] The certificate of incorporation provided that the Class B shares were convertible into Class A shares on the sale of the company and would receive the same consideration in the sale as the Class A shares.[37] Robert Rosenkranz ("Rosenkranz") was Delphi's founder, Chairman, and CEO.[38] Additionally, although Rosenkranz owned less than 13% of Delphi's equity, he controlled 49.9% of the vote — largely through the Class B shares, which were owned exclusively by Rosenkranz and his affiliates.[39]

In 2011, Tokio contacted Rosenkranz about the possible acquisition of Delphi.[40] Rosenkranz negotiated with Tokio, and Tokio offered $45 per share, which was a 106% premium over the market price of the Class A shares.[41] After

29. C.A. No. 7144-VCG, 2012 Del. Ch. LEXIS 45 (Del. Ch. Mar. 6, 2012).

30. *Id.* at *42.

31. *Id.* at *52.

32. *See id.* at *4-5, 52

33. *Id.* at *7, 73, 74.

34. *See* Transcript at 7-8, *In re* Delphi Fin. Grp. S'holder Litig., C.A. No. 7144-VCG (Del. Ch. July 31, 2012) (hereinafter *Delphi* Trans.); Order at 3, 6, *In re* Delphi Fin. Grp. S'holder Litig., C.A. No. 7144-VCG (Del. Ch. July 31, 2012) (hereinafter *Delphi* Order).

35. *See Delphi,* 2012 Del. Ch. LEXIS 45, at *3-4.

36. *Id.* at *3.

37. *Id.* at *12.

38. *Id.* at *8.

39. *Id.* at *10-11.

40. *Id.* at *15.

41. *Id.* at *20.

those negotiations, Rosenkranz informed Delphi's board of directors (the "Delphi Board") that he would not vote for a sale at $45 per share, but that he was willing to vote for a merger that provided greater consideration for his Class B shares.[42] The Delphi Board established a special committee to negotiate with Rosenkranz over the price he would accept for the Class B shares.[43] After originally demanding $59 per share, Rosenkranz and the special committee ultimately agreed upon $53.875 for the Class B shares.[44] At the same time, Rosenkranz further negotiated with Tokio for a per share price to be paid to all stockholders without a differential.[45] Tokio agreed to pay $46 per share.[46] Delphi then informed Tokio that the aggregate amount of the consideration should be allocated $53.875 for the Class B and $44.875 for the Class A.[47] The merger was conditioned upon a majority of Class A shares held by the public (and not Rosenkranz or his affiliates) being voted in favor of both (i) an amendment to the certificate of incorporation allowing the Class A shares and Class B shares to receive different consideration in a merger, and (ii) a post-amendment merger.[48] During the negotiation of the merger, Rosenkranz also discussed with Tokio either continuing certain terminable contracts that Delphi had with a Rosenkranz affiliate or Tokio actually purchasing the affiliate from Rosenkranz.[49] The Court found (preliminarily) that no agreement was reached, but that Rosenkranz expected to complete an agreement with Tokio shortly after the merger closed.[50]

In considering a motion for a preliminary injunction against the proposed merger, the Court "assume[d]" (but did not determine) that the *Hammons* rubric applied.[51] Despite the use of both a special committee and a majority of minority vote, however, the Court determined that the plaintiffs established a probability of success that "in negotiating for disparate consideration and only agreeing to support the merger if he received it, Rosenkranz violated duties to the stockholders."[52] The court did not identify the specific "duties" it found Rosenkranz likely to have violated.

In *In re Synthes, Inc. Shareholder Litigation*,[53] Chancellor Strine dismissed a complaint arising out of the acquisition of Synthes, Inc. ("Synthes") by an unaffiliated third party in which the same consideration was paid to all stockholders of Synthes, including Synthes's founder, CEO, and alleged controlling shareholder, Hansjoerg Wyss ("Wyss"). In so doing, the court rejected the plaintiffs' effort to state a claim that Wyss was self-interested in the merger on account of an alleged

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42. *Id.* at *20, *29.

43. *Id.* at *20-23.

44. *Id.* at *30-31.

45. *Id.* at *28-30.

46. *Id.* at *30.

47. *Id.* at *32.

48. *Id.* at *33.

49. *Id.* at *34-36.

50. *Id.* at *35.

51. *Id.* at *43 n.57.

52. *Id.* at *61.

53. 50 A.3d 1022, 1031, 1046 (Del. Ch. 2012).

need for liquidity.[54] The court found, among other things, that the complaint was devoid of any well-pleaded allegations that would support an inference that Wyss had conflicting interests with the common stockholders sufficient to "justify invocation of the entire fairness standard."[55]

The litigation in *Synthes* arose out of a merger by which Johnson and Johnson Company ("J&J") acquired Synthes for blended consideration consisting of 65% stock and 35% cash.[56] Although Wyss received the same consideration as all other holders of common stock, the plaintiffs alleged that Wyss "received liquidity benefits [in the J&J transaction] that were not shared equally with the rest of the stockholders and colored his decision to support the Merger."[57] The plaintiffs also argued that this alleged need for liquidity caused Wyss "to supposedly improperly reject further consideration of [another bid]" in which Wyss would be required to rollover shares.[58] The court assumed, for the purpose of considering the defendants' dismissal motion, that Wyss was a controlling stockholder and that he was actively involved in negotiating the merger, and focused its analysis on the question of whether Wyss had a disabling conflict giving rise to heightened scrutiny.[59]

In rejecting the plaintiffs' invocation of the entire fairness standard of review, the court applied the general rule that a controller's need for liquidity does not create a conflict of interest sufficient to give rise to scrutiny under the entire fairness standard except under "very narrow circumstances" that were not pleaded by the plaintiffs.[60] The court also observed that Wyss had no obligation to consider an alternative that would have required him to roll over shares to his detriment but to the minority shareholders' benefit, and that Delaware law does not "impose on controlling stockholders a duty to engage in self-sacrifice for the benefit of minority shareholders."[61]

B. Transactions Involving *"Revlon"* Scrutiny

In *In re El Paso Corp. Shareholder Litigation*,[62] Chancellor Strine determined that the stockholder plaintiffs established a probability of proving the process that led to an agreement by which El Paso Corp. ("El Paso") would be acquired by Kinder Morgan, Inc. ("Kinder") was tainted by questionable negotiating decisions and conflicts of interest on the part of El Paso's CEO and investment banker. Nonetheless, the court declined to grant a preliminary injunction that would have delayed or prevented a vote by the stockholders of El Paso, because (i) there was no rival bidder for El Paso that the merger agreement was precluding, and (ii) the merger represented a substantial premium over market and the El Paso stockholders "may find [it] desirable in current market conditions, despite the disturbing behavior that led to its final

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54. *Id.* at 1034-38.

55. *Id.* at 1031.

56. *Id.* at 1024.

57. *Id.* at 1034.

58. *Id.* at 1029 n.27, 1034.

59. *Id.* at 1034.

60. *Id.* at 1035, 1036.

61. *Id.* at 1040.

62. 41 A.3d 432 (Del. Ch. 2012).

terms."[63] The parties ultimately agreed to terms of a settlement, which was approved by the court, whereby the defendants paid $110 million in consideration of a global release of the plaintiffs' claims pertaining to the challenged transaction.[64]

In concluding that the plaintiffs had established a probability of success on their claims under *Revlon*, the court reaffirmed that:

> [*Revlon*] does not exist as a license for courts to second-guess reasonable, but arguable, questions of business judgment in the change of control context, but to ensure that the directors take reasonable steps to obtain the highest value reasonably attainable and that their actions are not compromised by impermissible considerations, such as self-interest.[65]

The court observed that the plaintiffs had succeeded in implicating "the core animating principle of *Revlon*"[66] by demonstrating that the "debatable tactical decisions were motivated not by a principled evaluation of the risks and benefits to the company's stockholders, but by a fiduciary's consideration of his own financial or other personal self-interests."[67]

Specifically, the court found that the following facts, among others, demonstrated that the plaintiffs were likely to succeed in proving that the transaction was motivated by a fiduciary's self-interest: *First*, Goldman Sachs was conflicted with respect to the transaction because it owned approximately 19% of Kinder (valued at approximately $4 billion), controlled two seats on Kinder's board of directors, and had placed two senior Goldman Sachs principals in those seats.[68] These conflicts were only partially disclosed to El Paso's board of directors (the "El Paso Board").[69] *Second*, Morgan Stanley, which was retained by El Paso as an adjunct to Goldman Sachs to advise exclusively on a sale of the company to Kinder, was constrained in several ways that compromised its ability to give independent advice on that deal.[70] *Third*, El Paso's CEO was conflicted because he was interested in acquiring El Paso's E&P business from Kinder in connection with the sale of El Paso,[71] this conflict was not disclosed to the El Paso Board, which had relied on the CEO to conduct the negotiations with Kinder,[72] and the CEO made proposals at levels below those authorized by the El Paso Board when negotiating with Kinder.[73] *Fourth*, Goldman Sachs reduced its valuation of the spin-off alternative after Kinder made its

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63. *Id.* at 434-35.

64. *See* Stipulation and Agreement of Settlement, *In re* El Paso Corp. S'holder Litig., C.A. No. 6949-CS (Del. Ch. Sept. 7, 2012); Final Order and Judgment, *In re* El Paso Corp. S'holder Litig., *C.A. No. 6949-CS (Del. Ch. Dec. 3, 2012).*

65. *El Paso*, 41 A.3d at 439.

66. *Id.*

67. *Id.*

68. *Id.* at 440.

69. *Id.* at 434.

70. *Id.* at 442.

71. *Id.* at 443-44.

72. *Id.*

73. *Id.* at 445.

acquisition proposal.[74] *Finally*, the merger agreement could not be terminated if a favorable bid emerged for only one of El Paso's two main businesses, which the Court concluded was a valuable alternative to the merger, and the termination fee was high when measured against only the portion of El Paso's business that Kinder intended to retain, making a competing offer by another party with a similar interest "very expensive."[75]

In the *Synthes* decision (discussed *supra* Section I.A), Chancellor Strine dismissed the complaint, in part on the grounds that *Revlon* scrutiny did not apply to a 65% stock, 35% cash deal.[76] The plaintiffs alleged that *Revlon* applied because the stockholders received mixed consideration of 65% J&J stock and 35% cash for their stock, and that this blended consideration represented their last chance to receive a premium for their shares.[77] The court observed this transaction did not result in a change of control because, post-merger, the stockholders would hold shares in a company whose shares are held in a large, fluid market.[78] The Court further observed that outcome was compelled by the Delaware Supreme Court in *In re Santa Fe Pacific Corp. Shareholder Litigation*,[79] in which "the Supreme Court held that a merger transaction involving nearly equivalent consideration of 67% stock and 33% cash did not trigger *Revlon* review when there was no basis to infer that the stock portion of that consideration was stock in a controlled company."[80]

C. *"Caremark"* Claims

In two cases in 2012, the Court of Chancery considered various "oversight" claims – commonly known as "*Caremark*" claims – that directors knowingly caused or consciously permitted the corporation to violate positive law, or failed utterly to attempt to establish a reporting system or other oversight mechanism to monitor the corporation's legal compliance.[81] Such claims were first recognized by the Court of Chancery in *In re Caremark International Inc. Derivative Litigation*,[82] and were subsequently recognized and further developed by the Delaware Supreme Court in *Stone v. Ritter*.[83]

In *South*, Vice Chancellor Laster determined that the plaintiffs were unsuccessful in pleading a *Caremark* claim. The plaintiffs' complaint in *South* was filed in response to Hecla Mining Company's ("Hecla") issuance of a press release announcing that it was lowering its projections for silver production and in response to the United States Mine Safety and

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74. *See id*. at 441.

75. *Id.* at 445.

76. *Synthes,* 50 A.3d at 1047-48.

77. *Id.* at 1047.

78. *Id.* at 1047-48.

79. 669 A.2d 59, 71 (Del. 1995).

80. 50 A.3d at 1048.

81. *See* South v. Baker, C.A. No. 7294-VCL, 2012 Del. Ch. LEXIS 229 (Del. Ch. Sept. 25, 2012) (hereinafter *South*); and La. Mun. Police Emps.' Ret. Sys. v. Lennar Corp., C.A. No. 7314-VCG, 2012 Del. Ch. LEXIS 230 (Del. Ch. Oct. 5, 2012) (hereinafter *Lennar*).

82. 698 A.2d 959 (Del. Ch. 1996).

83. 911 A.2d 362 (Del. 2006).

Health Administration's issuance of "a press release noting that Hecla had been cited for numerous safety violations."[84] The complaint alleged that a series of safety incidents at Hecla's Lucky Friday mine in northern Idaho constituted "red flags" for the board.[85] In dismissing the complaint, the court observed that the plaintiffs failed to cite any positive law that the board consciously violated or facts from which such a decision could be inferred,[86] failed to indicated that the Lucky Friday incidents were connected, that the board was informed of such incidents, or whether the board responded to such information,[87] and failed to allege facts from which the court could infer a sustained or systematic failure.[88] To the contrary, the plaintiffs alleged that the Hecla board formed a Safety Committee of outside board members, which affirmatively refuted allegations of a systemic failure.[89]

The Court of Chancery dismissed the complaint in *South* pursuant to Rule 23.1 with prejudice and without leave to amend.[90] However, the court made the dismissal of the complaint with prejudice only as to the named plaintiffs, and expressly noted that the dismissal would not have preclusive effect on "the efforts of more diligent stockholders to investigate potential claims and, if warranted, file suit."[91] Additionally, the court observed that Delaware courts have "admonished stockholders repeatedly to use Section 220 of the General Coropration Law,[92] to obtain books and records and investigate their claims before filing suit,"[93] and the court criticized the plaintiffs' hasty filing and failure to make a "deliberate and thorough pre-suit investigation."[94]

Vice Chancellor Glasscock's decision in *Lennar*, however, demonstrates that not all efforts to use Section 220 to investigate *Caremark* claims will succeed. In *Lennar*, the court declined to order an inspection of books and records for the asserted purpose of investigating putative *Caremark* claims on the grounds that the plaintiff did not provide a "credible basis" for investigating such a claim.[95] The two bases for investigation proffered by the plaintiff, and which the court found to be insufficient, were (a) past lawsuits concerning the missclassification of employees to avoid paying overtime, and (b) two news articles reporting that Lennar is one of many companies being investigated by the Department of Labor.[96]

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84. *South,* 2012 Del. Ch. LEXIS 229, at *1.

85. *Id.* at *35-40.

86. *Id.* at *33.

87. *Id.* at *35.

88. *Id.* at *40.

89. *Id.* at *40.

90. *Id.* at *5.

91. *Id.* at *5, 42-45.

92. Del. Code Ann. tit. 8, § 220.

93. *South*, 2012 Del. Ch. LEXIS 229, at *2.

94. *Id.* at *2-5, 61.

95. *Id.* at *2.

96. *See id.* at *4-14.

D. Confidentiality Agreements And Standstill Agreements

1. Confidentiality Agreements

In *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*,[97] the Delaware Supreme Court affirmed a decision by the Court of Chancery, enjoining Martin Marietta Materials, Inc. ("Martin") from pursuing an unsolicited effort to acquire Vulcan Materials Company ("Vulcan") for a period of four months, based on a post-trial determination that Martin had violated two confidentiality agreements with Vulcan, prohibiting Martin from disclosing certain non-public information obtained from Vulcan during prior, failed discussions pertaining to a potential consensual business combination. After Vulcan ended the consensual negotiations, Martin launched an unsolicited exchange offer and concurrently filed suit in the Court of Chancery to obtain a declaration that Martin did not breach the non-disclosure agreements in connection with its exchange offer.[98] Vulcan counterclaimed for breach of the agreements.[99] The Court of Chancery held that Martin violated the non-disclosure agreements by impermissibly disclosing non-public information obtained from the prior consensual negotiations, and enjoined the hostile takeover bid for a four month period.[100]

On appeal, the Delaware Supreme Court reviewed the lower court's interpretation of the relevant contracts *de novo*.[101] In addition, the Supreme Court rejected Martin's argument that the Court of Chancery erroneously converted the relevant confidentiality agreements into standstill agreements, holding that while it is undisputed that the agreements at issue were "true confidentiality agreements, not standstill agreements," which did not "categorically preclude Martin from making a hostile takeover bid for Vulcan[,] [w]hat they did was preclude Martin from using and disclosing Vulcan's confidential, nonpublic information except insofar as the agreements themselves permitted."[102]

In so holding, the Delaware Supreme Court defined the contents and purposes of these respective forms of agreements, observing that

> Standstill agreements and confidentiality agreements are qualitatively different. A standstill agreement expressly prohibits specific conduct by a contracting party to acquire control of the other contracting party. Typically, a standstill agreement will prohibit a hostile bid in any form, including a hostile tender offer to acquire stock control of the other contracting party and/or a proxy contest to replace all or some of its directors. Standstill prohibitions do not require, or in any way depend upon, a contracting party's use or disclosure of the other party's confidential, nonpublic information. Rather, a standstill agreement is intended to protect a contracting party against hostile takeover behavior, as distinguished from the unauthorized use or disclosure of the other party's confidential nonpublic information.
>
> A confidentiality agreement, in contrast, is intended and structured to prevent a contracting party from using and disclosing the other party's confidential, nonpublic information except as permitted by the

97. No. 254, 2012, 2012 Del. LEXIS 342 (Del. July 10, 2012).

98. *Id.* at *21.

99. *Id.*

100. *Id.* at *22-24, 50-51.

101. *Id.* at *25.

102. *Id.* at *31.

> agreement. In that respect it is qualitatively distinguishable from a prohibition that precludes a party categorically from engaging in specified hostile takeover activity. Thus, a confidentiality agreement will not typically preclude a contracting party from making a hostile bid to acquire control of the other party, so long as the bid does not involve the use or disclosure of the other party's confidential, non-public information. A confidentiality agreement is intended to protect a contracting party's non-public information, not its corporate ownership and control.[103]

2. "Don't Ask, Don't Waive" Standstill Agreements

In two bench decisions, and separately in the context of approving a class action settlement, the Court of Chancery considered the enforceability of agreements that prohibit counterparties from requesting a waiver to make a topping bid – which agreements colloquially have come to be known as "Don't Ask, Don't Waive" standstill agreements.[104]

In *Ancestry.com*, a challenge to the target company's enforcement of the "Don't Ask" aspect of its standstill agreements was mooted when the target's board waived the restriction in advance of a preliminary injunction hearing. While declining to delay the stockholders' consideration of the proposed transaction, Chancellor Strine ordered that the transaction could proceed only so long as the defendants promptly disclosed to the stockholders that potential bidders had been contractually restricted from making a topping bid prior to the waiver.[105] Notwithstanding the fact that the substantive issue of the validity of the challenged standstill agreement had been mooted by its waiver, the Chancellor volunteered his view that the plaintiffs would have had a probability of success on the merits of their substantive challenge to the use of the standstill agreement prior to its waiver.[106] The Chancellor was careful to note, however, that he was not endorsing any *per se* rule of invalidity or breach of fiduciary duty, and that his views were specific to the facts of the case before him. As the Chancellor explained in his bench ruling:

> I'm not prepared to rule out that they can't be used for value-maximizing purposes. But the value-maximizing purpose has to be to allow the seller as a well-motivated seller to use it as a gavel, to impress upon the people that it has brought into the process the fact that the process is meaningful; that if you're creating an auction, there is really an end to the auction for those who participate. And therefore, you should bid your fullest because if you win, you have the confidence of knowing you actually won that auction at least against the other people in the process.[107]

A few weeks earlier, in a bench ruling in *Complete Genomics*, Vice Chancellor Laster preliminarily enjoined a target company from enforcing a standstill agreement that prevented the counter-party from requesting (even in a non-public manner) a waiver of restrictions preventing it from making a superior offer to a merger transaction the target company's

103. *Id.* at *28-30 (footnotes omitted).

104. *See* Transcript, *In re* Ancestry.com Inc. S'holder Litig., C.A. No. 7988-CS (Del. Ch. Dec. 17, 2012) (hereinafter *Ancestry.com* Trans.*);* Transcript*, In re* Complete Genomics, Inc., C.A. No. 7888-VCL (Del. Ch. Nov. 27, 2012) (hereinafter *Complete Genomics* Trans.*); In re* Celera Corp. S'holder Litig., C.A. No. 6304-VCP, 2012 Del. Ch. LEXIS 66 (Del. Ch. Mar. 23, 2012), *rev'd sub nom. on other grounds,* 59 A.3d 418 (Del. 2012).

105. *Ancestry.com* Trans. at 20-34.

106. *Id.* at 25-26.

107. *Id.* at 23.

board had approved (subject to stockholder approval).[108] The court did so on the grounds that the contractual agreement compromised the ongoing fiduciary duty of the target board's directors to evaluate competing offers, disclose material information, and make meaningful merger recommendations to the stockholders.[109] Although Chancellor Strine later explained in *Ancestry.com* that he did not view Vice Chancellor Laster's bench ruling in *Complete Genomics* to establish a per se rule of invalidity,[110] the bench ruling in *Complete Genomics* is not qualified by reference to specific facts, and appears to apply to all standstill agreements that purport to restrict the counter-party from requesting a waiver from the target company, even in a non-public manner.[111]

Similarly, in *Celera*, Vice Chancellor Parsons approved a contested class action settlement in part on the grounds that (i) obtaining a waiver of the standstill agreements constituted a therapeutic benefit to the class, and (ii) the plaintiffs' claims challenging the standstill agreements were colorable because such an agreement "arguably emasculates whatever protections the … fiduciary out otherwise could have provided."[112]

It is notable that the merger agreements in the cases considered by the Court of Chancery have authorized the target companies to release counter-parties to the standstill agreements from the contractual constraints imposed by the agreements if it were necessary to do so for the members of the target's board of directors to comply with their fiduciary duties. It does not appear that the Delaware courts have yet been called upon to determine (i) whether the standstill agreements are enforceable in the absence of such a "fiduciary out," or (ii) whether it would be a breach of fiduciary duty for a target board to agreed to a merger covenant that does not include a "fiduciary out" for a standstill agreement.

E. "Opt-Out" Rights In Class Action Litigation

In *BVF Partners, L.P. v. New Orleans Employees Retirement System*,[113] the Delaware Supreme Court held that the Court of Chancery committed reversible error in refusing to permit a discretionary opt-out right in connection with certification of a class and approval of a settlement in stockholder litigation that challenged a two-step transaction by which Quest Diagnostics Corporation ("Quest") acquired Celera Corporation ("Celera") for $8 per share in cash.[114] The settlement was opposed by BVF Partners L.P. ("BVF"), which (i) held approximately 25% of Celera's shares at the time of the challenged merger, (ii) believed the transaction substantially undervalued Celera by failing to properly value Celera's passive royalties in certain pharmaceuticals being developed by other companies, and (iii) sought to "opt-out" of the

108. *Complete Genomics* Trans. at 13.

109. *Id.* at 18. A few weeks earlier in that same matter, the Court declined to issue a preliminary injunction against the target company's enforcement of standstill agreements with other counter-parties, which precluded the counter-parties only from making public bids for the company, but did not preclude the counter-parties from making non-public bids. *See* Transcript, *In re* Complete Genomics, Inc., C.A. No. 7888-VCL (Del. Ch. Nov. 9, 2012). The court did so on the ground that the challenge was "unripe in that no real litigable concrete dispute has been presented" because it did not appear that there was any restricted party that wished to bid, but was being prevented from doing so by the challenged standstill agreement. *See id*. at 5. Despite denying the requested injunction, the court did require that the defendant board provide the plaintiffs with prompt notice if any party to a standstill agreement were to make a non-public request to be released from the agreement. *See id.*

110. *See Ancestry.com* Trans. at 22.

111. *See Complete Genomics* Trans. at 18.

112. *Celera*, 2012 Del. Ch. LEXIS 66, at *81-82.

113. 59 A.3d 418 (Del. 2012).

114. *See id.* at 423, 426.

proposed class to pursue what BVF claimed to be substantial damages claims against the defendants (and others).[115] The Court of Chancery overruled BVF's objections, certified a non-opt-out class pursuant to Rule 23(b)(2) with New Orleans Employees' Retirement System ("NOERS") as the class representative, and approved the settlement.[116] The Delaware Supreme Court affirmed the Court of Chancery's certification of the class and of NOERS as the class representative, but reversed the lower court's refusal to grant a discretionary opt-out right.[117] In view of the opt-out decision, the Delaware Supreme Court declined to rule on the fairness of the settlement, which BVF had also challenged.[118]

The stockholder suits challenging the merger in *Celera* were filed by NOERS and various other stockholders that held ownership interests in Celera that were relatively insubstantial in relation to BVF's stock ownership.[119] The suits were brought on behalf a proposed class consisting of all persons (other than the defendants) who owned stock in Celera from the date of the announcement of the proposed merger through the merger's consummation.[120] As such, the class definition included BVF.

A few weeks after the stockholder suits were commenced, the parties entered into a Memorandum of Understanding, by which the plaintiffs agreed to withdraw their motion for a preliminary injunction and work towards entering into a formal Settlement Agreement that would release the claims of the proposed class in consideration of the defendants' agreement to provide various "therapeutic benefits."[121] The proposed settlement did not provide for any increase in the merger consideration.

Four days before the merger closed, NOERS sold all of its Celera stock on the secondary market.[122] The parties entered into a formal settlement agreement four months after the merger closed, and the Court of Chancery scheduled a hearing on the questions of class certification and approval of the proposed settlement for a few months later.[123] The Court of Chancery's decision on class certification and approval of the proposed settlement was filed on March 23, 2012 – nearly a year after the challenged merger had closed.

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115. *See id.* at 426-28. In connection with its opposition to the settlement, BVF also identified an error in the valuation analysis of Celera's financial advisor — pertaining to the drug royalties — which BVF claimed to have had a material impact on the financial advisor's fairness opinion. *See id.* at 424-25.

116. *See id.* at 428.

117. *See id.*

118. *See id.*

119. *See id.* at 426-27.

120. *See id.* at 427.

121. Specifically, the defendants agreed (i) to reduce the termination fee from 3.5% to 2.3% of the transaction value, (ii) to waive standstill agreements that precluded potential competing bidders from making a Superior Offer for Celera, (iii) to extend the tender offer by seven days, and (iv) to issue supplemental disclosures regarding the investment banker's financial analysis and the transaction history. *See id. at 426.*

122. *See id.* at 426-27, 430.

123. *See id.* at 427.

On appeal, the Delaware Supreme Court concluded that the Court of Chancery erred by certifying the class without providing a discretionary opt-out right.[124] The Supreme Court held that the Court of Chancery did not err in certifying the class pursuant to Rule 23(b)(2), observing that "Delaware courts 'repeatedly have held that actions challenging the propriety of director conduct in carrying out corporate transactions are properly certifiable under both subdivisions (b)(1) and (b)(2).'"[125] The Delaware Supreme Court further observed that a "Rule 23(b)(2) class may seek monetary damages in addition to declaratory or injunctive relief, so long as the claim for equitable relief predominants [sic]."[126] The Supreme Court held, however, that the Court of Chancery committed reversible erred by denying BVF's request for a discretionary opt-out right under the circumstances of this case.[127] As the Supreme Court explained:

> [The Court of Chancery] could not deny a discretionary opt-out right where the policy favoring a global settlement was outweighed by due process concerns. Here, the class representative was "barely" adequate, the objector was a significant shareholder prepared independently to prosecute a clearly identified and supportable claim for substantial money damages, and the only claims realistically being settled at the time of the certification hearing nearly a year after the merger were for money damages. Under these particular facts and circumstances, the Court of Chancery had to provide an opt-out right.[128]

F. Attorneys' Fees In Derivative Litigation

Another notable aspect of the Delaware Supreme Court's decision in *Southern Peru* (discussed *supra* Section I.A) is the affirmance of the Court of Chancery's award of more than $300 million in attorneys' fees to plaintiffs' counsel. In so doing, the Delaware Supreme Court declined the defendants' argument for a cap or mandatory range on attorneys' fees in megafund cases,[129] and endorsed the Court of Chancery's reasoning that the award "creates healthy incentive for plaintiff's lawyers to actually seek real achievement for the companies that they represent in derivative actions and the classes that they represent in class actions."[130]

In affirming the Court of Chancery's fee award, the Delaware Supreme Court rejected the defendants' argument that the Court of Chancery erred in its application of the factors for awarding attorneys' fees set forth in *Sugarland Industries, Inc. v. Thomas*.[131] Specifically, the defendants argued that the trial court erred by ascribing "dispositive weight" to the benefit achieved by the litigation, and by failing to apply a "declining percentage" concept by which the percentage fee awarded decreases as the size of the common fund created by the litigation increases.[132] The Supreme Court concluded

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124. *Id.* at 433.

125. *Id.* at 432-33 (quoting *In re* Cox Radio, Inc. S'holders Litig., C.A. No. 4461-VCP, 2010 Del. Ch. LEXIS 102, at *28 (Del. Ch. May 6, 2010)).

126. *Id.* at 432-33.

127. *Id.* at 433.

128. *Id.* at 436.

129. *See Southern Peru,* 51 A.3d at 1252-63.

130. *Id.* at 1252 (quoting the Court of Chancery opinion).

131. 420 A.2d 142 (Del. 1980).

132. *Southern Peru,* 51 A.3d at 1252, 1258.

that the Court of Chancery had, in fact, applied the declining percentage concept by awarding 15% of the common fund as opposed to the 22.5% requested.[133] The Delaware Supreme Court also "decline[d] to impose either a cap or the mandatory use of any particular range of percentages for determining attorneys' fees in megafund cases."[134]

In a rare dissenting opinion, Justice Berger disagreed with the majority's affirmance of the attorneys' fee award (but concurred with the majority's decision on the "merits" aspect of the appeal).[135] According to the dissent, the trial court's analysis "focused on the perceived need to incentivize plaintiffs' lawyers to take cases to trial," and gave the impression that "the fundamental test for reasonableness is whether the fee is setting a good incentive, and that the only basis for reducing the fee would be envy."[136] Justice Berger wrote that such analysis "is not a decision based on *Sugarland*."[137]

In an equally rare move, Grupo Mexico moved for reargument of the Delaware Supreme Court's already en banc decision.[138] In its reargument motion, Grupo Mexico argued that

> the relevant "benefit achieved" for calculating attorneys' fees in a derivative case, against a majority stockholder and other defendants, is properly defined as the entire judgment paid to the corporation, or, in this case, 19% of the entire judgment paid to the corporation, because the majority stockholder defendant owns 81% of the corporation that will receive the judgment.[139]

The Delaware Supreme Court summarily denied the reargument motion, holding both (i) that Grupo Mexico waived the argument by failing to raise it before the Court of Chancery, and (ii) that Grupo Mexico's "look through" argument for attorneys' fees was without substantive merit, in any event.[140] Specifically, the court observed that "[i]n this case, the corporation was harmed and the total recovery is awarded to the corporation, … not 'nominally' but actually,"[141] and that "Delaware law does not analyze the 'benefit achieved' for the corporation in a derivative action, against a majority stockholder and others, as if it were a class action recovery for minority stockholders only."[142]

The Court of Chancery's decision approving attorneys' fees in *Delphi* (discussed *supra* Section I.A) also is notable. There, Vice Chancellor Glasscock awarded the plaintiffs' counsel $12 million of a $49 million settlement fund created after the Court of Chancery determined (on a preliminary injunction record) that the plaintiffs had a reasonable probability of success, but denied the injunction on other grounds.[143] In approving the fee award, the court observed:

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133. *Id.* at 1258-59.

134. *Id.* at 1261.

135. *Id.* at 1263.

136. *Id.*

137. *Id.*

138. *See* Ams. Mining Corp. v. Theriault, No. 29, 2012, 2012 Del. LEXIS 520, at *2 (Del. Sept. 21, 2012).

139. *Id.*

140. *Id.* at *3-4.

141. *Id.* at *5.

142. *Id.* at *7.

143. *Delphi* Trans. at 11-12.

> When addressing corporate benefit doctrine fee requests where the benefit is intangible, such as where there has been an additional disclosure made as a result of litigation, the Court … may apply the *Sugarland* factors with apparent precision[,] but is always acting on really nothing more than intuition or basing its decision on some prior decision which was rendered by that judge based on intuition. It is substantially different in this case because of the result, the hard monetary result that was achieved for the stockholders.[144]

More recently, in the *El Paso* litigation (discussed *supra* Section I.B) — which also involved the denial of a preliminary injunction despite a finding that the plaintiffs had a reasonable probability of success — the plaintiffs' counsel were awarded $26 million of a $110 million settlement fund.[145]

II. ALTERNATIVE ENTITY LAW

A. "Default" Fiduciary Duties In Limited Liability Companies

In *Gatz Properties, LLC v. Auriga Capital Corporation*,[146] the Delaware Supreme Court made crystal clear that "the question remains open" whether the Delaware Limited Liability Company Act (the "Act") imposes "default" fiduciary duties upon managers and controllers of a Limited Liability Company (a "LLC") organized under the Act, where the members of the LLC have not specifically contracted that such duties will not apply.[147] The Supreme Court made this pronouncement in the course of affirming Chancellor Strine's decision in *Auriga Capital Corporation v. Gatz Properties, LLC*,[148] in which the Chancellor determined that Gatz Properties, LLC ("Gatz") — the manager of Peconic Bay, LLC ("Peconic") (an LLC organized under the Act) — had violated certain fiduciary duties that were expressly imposed by the terms of Peconic's Limited Liability Company Agreement.[149] The Chancellor's decision separately held that Gatz was subject to certain "default" fiduciary duties.[150] While stopping short of formally vacating this aspect of the lower court's decision, the Delaware Supreme Court wrote that "the [lower] court's statutory pronouncements must be regarded as dictum without any precedential value."[151]

A few weeks after the Delaware Supreme Court decided *Gatz*, Vice Chancellor Laster decided *Feeley v. NHAOCG, LLC*,[152] which partially denied a motion to dismiss certain counterclaims that were based, among other things, on alleged

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144. *Id.* at 10.

145. *Id.* at 10.

146. 59 A.3d 1206 (Del. 2012).

147. *Id.* at 1218-20 & n.62.

148. 40 A.3d 839 (Del. Ch. 2012).

149. *See Gatz*, 40 A.3d at 859.

150. *See id.* at 849-56.

151. *Gatz,* 59 A.3d 1218.

152. C.A. No. 7304-VCL, 2012 Del. Ch. LEXIS 274 (Del. Ch. Nov. 28, 2012).

violations of "default" fiduciary duties by the manager of a Delaware LLC. In sustaining the plaintiffs' right to pursue its claims for violation of default fiduciary duties, the Court of Chancery relied, among other things, on the Chancellor's decision in *Auriga Capital Corporation*.[153] In so doing, the court expressly acknowledged the Delaware Supreme Court's opinion in *Gatz*, and wrote:

> Although the Delaware Supreme Court determined that the Chancellor should not have reached the question of default fiduciary duties, his explanation of the rationale for imposing default fiduciary duties remains persuasive, at least to me. In citing the Chancellor's discussion I do not treat it as precedential, but rather afford his views the same weight as a law review article, a form of authority the Delaware Supreme Court often cites.[154]

Definitive resolution of the issue will need to await the Delaware Supreme Court's next opportunity to address the question or action by the Delaware legislature to amend the LLC Act.

B. Contractual "Special Approval" Provisions In Limited Partnership Agreements

In at least four opinions, the Court of Chancery explored the effect of a "Special Approval" provision in a limited partnership agreement of a publicly held master limited partnership. In all but one of the cases, the Court of Chancery dismissed all claims against the defendants because the use of the Special Approval process, and the related "conclusive presumption" of good faith created by the receipt of a fairness opinion. All of the dismissals were appealed to the Delaware Supreme Court.

1. *Gerber v. Enterprise Products Holdings, LLC*

The first "Special Approval" case decided in 2012 was *Gerber v. Enterprise Products Holdings, LLC*,[155] which was decided by Vice Chancellor Noble. *Gerber* involved a challenge to two conflict transactions (a sale of assets and a merger) involving Enterprise GP Holdings, L.P. ("EPE"). The Court of Chancery held that the challenged transactions were protected from judicial scrutiny for fairness, good faith or fiduciary breach because they were approved in accordance with certain terms of EPE's limited partnership agreement (the "EPE LPA"), which specified that any alleged conflict transactions would be:

> deemed approved by all Partners, and shall not constitute a breach of this Agreement or of any agreement contemplated herein or therein, or of any duty stated or implied by law or equity if the resolution or course of action in respect of such conflict of interest is … approved by Special Approval.[156]

"Special Approval" was defined in the EPE LPA as approval by a committee of three or more directors meeting the independence requirements of the Securities and Exchange Act and the New York Stock Exchange.[157] In the case of

153. *Id.* at *21-26.

154. *Id.* at *25.

155. C.A. No. 5989-VCN, 2012 Del. Ch. LEXIS 5 (Del. Ch. Jan. 6, 2012).

156. *Id.* at *30-31 (modifications in original).

157. *Id.* at *32-33.

the challenged transactions, the Special Approval process was utilized and the independent committee relied upon the opinion of an independent financial advisor.[158]

Prior to the two transactions challenged in *Gerber*, EPE and Enterprise Products Partners, L.P ("Enterprise Products") were in a two-tier limited partnership structure, the entirety of which was controlled, indirectly, by Dan Duncan ("Duncan"). Specifically, Duncan owned and controlled Dan Duncan LLC ("Duncan"), which owned or controlled Enterprise Products Holding, LLC (the "General Partner"), which was EPE's general partner. In turn, EPE owned and controlled Enterprise Products GP, LLC, which Enterprise Products' general partner.[159]

The first transaction challenged in *Gerber* was EPE's sale of its ownership interest in Texas Eastern Products Pipeline Company, LLC ("Teppco") to Enterprise Products (the "Teppco Sale"). The Teppco Sale was considered by the Audit, Conflict, and Governance Committee (the "ACG Committee") of the board of General Partner (the "Board"). The ACG Committee hired Morgan Stanley & Co. ("Morgan Stanley") to render an opinion regarding the fairness of the Teppco Sale, and Morgan Stanley opined that the Teppco Sale was fair from a financial point of view.[160] The ACG Committee and the Board thereafter approved the Teppco Sale.[161]

The second transaction challenged in *Gerber* involved a merger of EPE and Enterprise Products (the "Enterprise Merger").[162] In considering the Enterprise Merger, the ACG Committee met with Morgan Stanley and its legal advisors to discuss the actions involved in the Teppco Sale and a prior transaction involving Teppco – both of which had led to separate claims against Duncan and related entities (collectively the "Teppco Claims"). Following this discussion, EPE and Enterprise Products eventually agreed on terms for the Enterprise Merger. Morgan Stanley opined that the terms of the Enterprise Merger were fair to the holders of EPE's LP units, but EPE never obtained any separate valuation of the Teppco Claims.[163]

The plaintiff in *Gerber* challenged both the Teppco Sale and the Enterprise Merger. The plaintiff named Duncan and his various affiliated and controlled entities as defendants. The plaintiff alleged, among other things, that the defendants breached their express and implied duties under the EPE LPA by causing EPE (i) to undertake the Teppco Sale and (ii) to enter into the Enterprise Merger without valuing the Teppco Claims.[164] The defendants moved to dismiss the plaintiff's complaint, and the Court granted the motion.

In support of its dismissal of the complaint in *Gerber*, the court found that the EPE LPA displaced common law fiduciary duties in connection with the approval of any transaction involving a conflict of interest, and that the plaintiff could not sustain his breach of fiduciary duty claims against any defendant because the Teppco Sale and the Enterprise Merger both had been approved by the "Special Approval" process in the EPE LPA.[165] The court also addressed the

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158. *Id.* at *36-37, 58.

159. *Id.* at *4.

160. *Id.* at *6-7.

161. *Id.* at *7.

162. *Id.* at *7-8.

163. *Id.* at *8-9.

164. *Id.* at *10-11.

165. *Id.* at *37, 58.

plaintiff's claim for an alleged breach of the implied covenant of good faith and fair dealing. The court observed that the implied covenant is a contractual duty that binds only the named parties to the EPE LPA.[166] Because General Partner was the only defendant that was a party to the EPE LPA, the court rejected the plaintiff's claim as to all defendants other than General Partner.[167] As to General Partner, the court held the implied covenant required that General Partner act in good faith when it exercised its contractually-conferred discretion to utilize the Special Approval process.[168] The court concluded that the complaint could fairly be read to allege a claim that General Partner acted in bad faith when it elected to use the Special Approval process.[169] Nonetheless, the EPE LPA directly addressed the issue of "good faith" — providing that General Partner was entitled to a conclusive presumption of good faith if General Partner took any act in reliance upon the opinion of an expert.[170] Because the ACG Committee relied upon an opinion from Morgan Stanley, the court held that General Partner was entitled to a conclusive presumption that it acted in good faith in utilizing the Special Approval process.[171] In so doing, the court acknowledged that it was the ACG Committee, and not General Partner, that had relied upon the Morgan Stanley opinion. The court reasoned, however, as follows:

> [It would be] unreasonable … for the Court to infer that although an independent subset of the Board relied upon a fairness opinion, the entity that the Board manages did not rely upon that opinion. Thus, the only reasonable interpretation of the well-pled facts is that [General Partner] relied upon [t]the 2009 Morgan Stanley Fairness Opinion in deciding whether to use the Special Approval process to take advantage of the contractual duty limitations provided by Section 7.9(a).[172]

In a footnote, the court addressed the question of how a section of the EPE LPA could preclude a claim for a breach of the implied covenant when the Delaware Limited Partnerships Act provides that a partnership agreement may not eliminate the implied covenant of good faith and fair dealing.[173] The court reasoned that (i) the implied covenant is a "gap-filler" that comes into play only where there is a gap in the contract, and (ii) there was no gap in the contract with respect to the AGC Committee's ability to rely on the opinion of an expert because the parties had expressly addressed the issue in the EPE LPA.[174]

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166. *Id*. at *40.

167. *Id*.

168. *Id*. at *44-45.

169. *Id*. at *45.

170. *Id*. at *46-47.

171. *Id*. at *48.

172. *Id*. at *47-48.

173. *Id*. at *41 n.46.

174. *Id*. at *50-51 & n.58.

2. *In Re K-Sea Transportation Partners L.P. Unitholders Litigation*

The next case to raise similar issues was *In re K-Sea Transportation Partners L.P. Unitholders Litigation*,[175] which was decided by Vice Chancellor Parsons. *K-Sea* involved an unaffiliated third-party acquisition of K-Sea Transportation Partners, L.P. ("K-Sea") in which K-Sea's general partner ("K-Sea GP") received disparate consideration from that received by K-Sea's common unitholders.[176] Specifically, the common unitholders received $8.15 in cash per unit,[177] while K-Sea GP received a separate cash payment of $18 million for certain IDRs held exclusively by K-Sea GP.[178] On account of the differential consideration in the merger, K-Sea GP formed a conflicts committee to review and make a recommendation regarding the merger.[179] The members of the conflicts committee met the requirements imposed on them by K-Sea's limited partnership agreement (the "K-Sea LPA") in that none of them held an ownership interest in the limited partnership or any affiliated entity other than common units.[180] Each member of the conflicts committee did, however, subsequently receive 15,000 "phantom" partnership units, which entitled the holder to one common unit (or its cash equivalent) upon vesting — which occurred immediately upon a change of control.[181] Thus, if the merger occurred, each member of the conflicts committee would receive 15,000 partnership units (or their cash equivalent). The conflicts committee hired a financial advisor ("Stifel") to opine on the fairness of the merger.[182] Stifel opined that the $8.15 per share being paid to the holders of the common unitholders was fair. Stifel did not opine on the fairness of the $18 million payment to the general partner.[183] After the conflicts committee passed on fairness of the merger, the full board of K-Sea GP approved the transaction.

The plaintiffs, certain common unitholders of K-Sea, challenged the transaction. The plaintiffs alleged that K-Sea GP, certain of its affiliates, and the directors of K-Sea GP had breached the K-Sea LPA and their fiduciary duties in approving the merger.[184] The plaintiffs specifically argued that (1) the conflicts committee and the board had breached their fiduciary duties by not evaluating the fairness of the $18 million payment to K-Sea GP, and (2) K-Sea GP and the board had breached their duties by relying on the approval of a conflicts committee that was tainted by their ownership of the phantom units.[185] The defendants moved to dismiss, and the Court of Chancery granted the motion.

175. C.A. No. 6301-VCP, 2012 Del. Ch. LEXIS 67 (Del. Ch. Apr. 4, 2012).

176. *Id.* at *6.

177. *Id.* at *8.

178. *Id.* at *6.

179. *Id.*

180. *Id*. at *7.

181. *Id.*

182. *Id.* at *7-8.

183. *Id.* at *8.

184. *Id.* at *3.

185. *Id*.

In dismissing the complaint, the court first examined the effect of an exculpatory provision in the K-Sea LPA, which stated: "Notwithstanding anything to the contrary set forth in this Agreement, no Indemnitee shall be liable for monetary damages to the Partnership [or] the Limited Partners … for losses sustained or liabilities incurred as a result of an act or omission if such Indemnitee acted in good faith."[186] Based on this provision of the K-Sea LPA, the court determined that the plaintiffs' claim could survive dismissal only if the plaintiffs had pled facts showing that the "[d]efendants both (1) breached the [K-Sea] LPA or a fiduciary duty and (2) in doing so, acted in bad faith."[187]

In assessing whether the complaint stated a viable claim that the defendants had breached the K-Sea LPA, the court observed that the challenged transaction was a merger and that the K-Sea LPA set forth a procedure for approval of merger that required (1) the consent of K-Sea GP, and (2) an affirmative vote by a majority of the holders of K-Sea common units.[188] There was no dispute that the second requirement had been satisfied.[189] As to the first requirement, the court found that the K-Sea LPA placed no limits on K-Sea GP's consent, except to exercise its "discretion."[190] In that regard, the court observed that K-Sea LPA expressly provided that K-Sea GP was entitled to "consider only such interests and factors as it desires and shall have no duty or obligation to give any consideration to any interest of, or factors affecting, the Partnership [or] any Limited Partner" when exercising discretion under the K-Sea LPA.[191] Based on this contractual language, the court rejected the plaintiffs' argument that the merger must be "fair and reasonable" to the limited partners.[192]

The court also considered whether K-Sea GP's contractual duty to consent was "constrained by any other default or fiduciary duty."[193] In that regard, the court found that the K-Sea LPA displaced any such duties with a provision that required only that K-Sea GP not "exercise its discretion in a manner inconsistent with the best interests of the Partnership as a whole."[194] The court held that this "narrower" duty required only that K-Sea GP not act in bad faith.[195] With respect to the question of bad faith, the court observed that the K-Sea LPA provided that K-Sea GP was entitled to a conclusive presumption of good faith when it acted in reliance upon the professional opinion of an expert, and concluded that the conflicts committee's reliance on Stifel's report immunized K-Sea GP from a finding that it had breached the express contractual obligation to act in good faith or that it had breached the implied covenant of good faith and fair dealing.[196]

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186. *Id.* at *17 (modifications in original).

187. *Id.* at *18.

188. *Id.* at *19.

189. *Id.* at *20.

190. *Id.* at *21.

191. *Id.* at *20 (modification in original).

192. *Id.* at *21.

193. *Id.* at *22.

194. *Id.* at *22-23.

195. *Id.* at *23.

196. *Id.* at *31-32. Notably, the court reached this decision (in reliance upon the K-Sea LPA) despite its acknowledgment that the well pleaded allegations of the complaint supported a reasonable inference that K-Sea GP "failed to act in good faith" in approving the merger. *Id.* at *29-30. The allegations that supported this inference included that the "K-Sea Board caused K-Sea GP to refuse to consent to any transaction until [the acquirer] offered a separate payment of $18 million for K-Sea GP's IDRs" and "that the K-Sea board incentivized the otherwise independent members of the Conflicts Committee to approve the Merger Agreement by granting on the eve of negotiations phantom units, which would vest upon a change of control." *Id.* at *30.

3. *In Re Encore Energy Partners LP Unitholder Litigation*

In re Encore Energy Partners LP Unitholder Litigation,[197] also decided by Vice Chancellor Parsons, was the next case involving "Special Approval" provisions. *Encore* arose from the merger of Vanguard Natural Resources, LLC ("Vanguard") and Encore Energy Partners LP ("Encore") – the general partner of which ("Encore GP") was controlled by Vanguard.[198] After Vanguard proposed the merger, Encore GP formed a conflicts committee of independent directors with broad authority to consider the proposed merger and to negotiate on behalf of Encore.[199] The pertinent provision of Encore's Limited Partnership Agreement (the "Encore LPA") provided that approval of the merger "by a majority of the members of the Conflicts Committee acting in good faith" would constitute "Special Approval" such that "any resolution or course of action by [Encore GP] or its Affiliates … shall be permitted and deemed approved by all Partners, and shall not constitute a breach of [the Encore LPA] … or of any duty stated or implied by law or equity …."[200] A determination made in "good faith" was further defined in the Encore LPA as a determination that an actor believes to be "in the best interests of the Partnership."[201]

The conflicts committee retained experienced legal and financial advisors, and conducted due diligence for approximately six weeks following Vanguard's offer.[202] Then, the conflicts committee countered Vanguard's initial offer by proposing a higher exchange ratio.[203] Vanguard ultimately agreed to the conflicts committee's counter offer of a higher exchange ratio, and the conflicts committee thereafter approved the merger.

The plaintiffs, certain unitholders of Encore, challenged the transaction. The plaintiffs named Encore GP, Vanguard, and the directors of Encore GP as defendants.[204] The plaintiffs alleged that the defendants breached the Encore LPA and the implied covenant of good faith and fair dealing by proposing and approving the merger.[205] Among other things, the plaintiffs alleged that Vanguard planned to propose a merger with Encore months before Vanguard actually proposed the merger, and that Vanguard monitored the spread between Vanguard and Encore's respective trading prices to seize upon an exchange ratio favorable to Vanguard.[206] The plaintiffs also alleged that Vanguard made public announcements and released pessimistic forecasts designed to drive down Encore's trading price.[207] The plaintiffs claimed the conflicts

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197. C.A. No. 6347-VCP, 2012 Del. Ch. LEXIS 214 (Del. Ch. Aug. 31, 2012).

198. *Id*. at *2.

199. *Id*. at *12-14.

200. *Id*. at *31.

201. *Id*. at *33.

202. *Id*. at *13-15.

203. *Id*. at *16.

204. *Id*. at *4-5.

205. *Id*. at *25.

206. *Id*. at *11, 24-25.

207. *Id*. at *7-11.

committee's counter-offer was indefensibly low, and that the ultimate deal was less valuable to Encore's unitholders than the initial offer because of the increase in the spread in the company's respective trading prices over the course of negotiations.[208] The plaintiffs' sole claim alleged that "Defendants breached their contractual duties to Plaintiffs … by proposing, approving and consummating a transaction that was not fair or reasonable and was undertaken in bad faith."[209]

The Court of Chancery concluded that the only applicable duties would be those expressly set forth in the Encore LPA, which effectively eliminated any fiduciary duties that are legally capable of being waived.[210] In relevant part, the Encore LPA replaced any default duties with an express contractual duty to act in good faith when conducting the "Special Approval" process. The court concluded that the relevant contractual provision required the plaintiffs to allege that the defendants acted "in a matter they subjectively believed was *not* in the best interest of [the company] and its unitholders."[211]

The court held that the plaintiffs had not stated a claim for subjective bad faith. The court observed that the plaintiffs' allegations boiled down to a claim that the conflicts committee "ran a shoddy negotiation process."[212] The court concluded, however, that the complaint lacked allegations of "sufficient facts from which one reasonably could infer that the members of the conflicts committee subjectively believed they were acting contrary to the Partnership's interests by giving Special Approval to the Merger."[213]

The court also addressed the plaintiffs' claim that the defendants had breached the implied covenant of good faith and fair dealing. Pursuant to the terms of the Encore LPA, Encore GP was entitled to a conclusive presumption that it acted in good faith for conduct taken in reliance on the opinion of a financial advisor, and the plaintiffs' allegations supported the inference that Encore GP had relied upon the opinion of its financial advisors in connection with the challenged merger.[214] The court observed that "good faith" as used in the Encore LPA for the purpose of the conclusive presumption is at least as broad as ("and likely broader" than) the "good faith" standard applied under the implied covenant.[215] Thus, the plaintiffs could not plead a breach of the implied covenant because the defendants were entitled to the conclusive presumption of good faith set forth in the limited partnership agreement.[216] The court also observed that the plaintiffs' claim failed for the further reason that the complaint did not contain allegations from which the court could infer that the defendants' actions frustrated the plaintiffs' reasonable expectations arising out of the contract.[217]

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208. *Id.* at *21.

209. *Id.* at *22.

210. *Id*. at *30.

211. *Id*. at *33 (emphasis in original).

212. *Id*. at *41.

213. *Id*. at *41.

214. *Id*. at *55-57.

215. *Id*. at *57 n.107.

216. *Id*. at *57-58.

217. *Id*. at *49-51.

4. *Brinckerhoff V. El Paso Pipeline GP Company*

The final case is *Brinckerhoff v. El Paso Pipeline GP Company*,[218] which Chancellor Strine decided from the bench following oral argument.[219] The challenged transaction in *Brinckerhoff* was a conflict transaction involving (i) El Paso Pipeline Partners, LP ("El Paso"), which was a publicly traded master limited partnership, and (ii) El Paso Corporation ("EPC"), which was the controller of El Paso's general partner.[220] In the challenged transaction, El Paso had agreed to acquire EPC's 51% interest in two other entities. El Paso's limited partnership agreement (the "El Paso LPA") eliminated any common law fiduciary duties and displaced those duties with contractual duties.[221] Specifically, the El Paso LPA provided four methods for obtaining approval of a transaction involving a conflict of interest.[222] If one of those four methods was employed, the El Paso LPA provided that the transaction "shall be permitted and deemed approved by all partners, and … shall not constitute a breach of [the El Paso LPA]."[223] For the challenged transaction, the defendants had elected to utilize the Special Approval method that required "approval by a majority of [the members of] the conflicts committee acting in good faith."[224] The El Paso LPA also created a rebuttable presumption that the conflicts committee acted in good faith.[225] Another provision of the El Paso LPA separately provided a conclusive presumption of good faith for acts taken by the general partner in reliance on the opinion of an independent expert.[226]

Among other things, the plaintiff alleged that (i) El Paso paid a grossly unfair price for the assets at issue, and (ii) critical information was omitted or not considered by the conflicts committee and its advisors in granting Special Approval – including information about contemporaneous and comparable transactions, and EPC's refusal to exercise a right of first refusal it held as to certain of the same assets. Based on these allegations, the plaintiff argued that he had rebutted the presumption of good faith created by the Special Approval process employed to approve the challenged transaction. The defendants argued that the plaintiff's allegations were insufficient to create an inference of bad faith sufficient to overcome the contractual rebuttable presumption of good faith resulting from the use of a conflicts committee. The defendants also argued that they were entitled to a conclusive presumption of good faith because the conflicts committee had obtained the opinion of an independent financial advisor.

The Court of Chancery held that the plaintiff had pleaded facts that, if true, would support a claim that the "[conflicts] committee consciously approved a transaction that it believed was unduly favorable to the parent at the expense

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218. Transcript, C.A. No. 7141-CS (Del. Ch. Oct. 26, 2012).

219. Before announcing his ruling, the Chancellor offered the following words of caution: "People now are putting too much stock in bench rulings. People who are not from Delaware used to never even see them, and now they trade as some sort of samizdat literature, as if they are published opinions or something. They're not, but they're important to the exercise of justice …." *Id.* at 52.

220. *Id.* at 5.

221. *Id.* at 6.

222. *Id.* at 7.

223. *Id.*

224. *Id.*

225. *Id.* at 7.

226. *Id.* at 34-35.

of the interest the committee was charged to protect."[227] These facts included the conflicts committee's failure to consider "a contemporaneous transaction in the same asset space involving the parent, a transaction that the pricing terms of which create[d] an inference of fairly gross price mismatching," and the fact that the parent "eschew[ed] the option" to buy into the same space as that was being sold to El Paso.[228] The court further observed:

> [T]he conflicts committee and its financial advisor, if they were doing their job, would have known of these inconvenient facts. The absence of any candid dealing with them and explanation of why they're distinct, and the pricing of the transaction at a multiple that the plaintiffs plead was exceedingly disparate, does to my mind create a pleading stage inference.[229]

The court also rejected the defendants' argument that the conclusive presumption of good faith applied because the conflicts committee had relied upon an independent financial advisor. The court questioned whether the El Paso LPA could be read to give a general partner the benefit of a contractual conclusive presumption of good faith in circumstances where a flawed conflicts committee process had failed to sustain the defendants' reliance upon a contractual rebuttable presumption of good faith.[230] In this regard, the court found the El Paso LPA to be ambiguous as to whether both contractual presumptions could apply at the same time, and observed that such ambiguities are "not read in favor of a party seeking exculpation or the narrowing of default duties that would otherwise exist …."[231] According to the court, "when [the limited partnership agreement] says that the conflict committee acts under a particular standard, that's the standard; and that the general partner is benefited for this reason."[232] The unstated implication of this statement appears to be that the court was not prepared to permit the general partner to obtain the benefit of a Special Approval process that was not formally employed in the challenged transaction — even if the facts might arguably have supported the employment of that process.

C. Implied Covenant Of Good Faith And Fair Dealing

In 2012, the Court of Chancery also clarified the scope of the implied covenant of good faith and fair dealing in the governing agreements of alternative entities. As set forth above, a number of the alternative entity cases involved claims for breach of the implied covenant of good faith and fair dealing. In a few of those cases, the court confirmed that a claim for breach of the implied covenant and fair dealing is not a substitute for a claim for breach of fiduciary duty.[233]

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227. *Id*. at 56.

228. *Id*. at 56-57.

229. *Id*. at 8.

230. *Id*. at 15-17.

231. *Id*. at 55.

232. *Id*.

233. *See*, *e.g.*, *Encore*, 2012 Del. Ch. LEXIS 214, at *46 (holding that the implied covenant "is not a 'free floating duty' or 'a substitute for fiduciary duty analysis'"); *Gatz*, 40 A.3d at 854 (observing that "[a] generalized 'fairness' inquiry under the guise of an 'implied covenant' review is an invitation to, at best, reinvent what already exists in another less candid guise, or worse, to inject

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In *ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC*,[234] the court further explained the difference between an implied covenant analysis and a fiduciary duty analysis.

In *ASB*, Vice Chancellor Laster held that the plaintiff, which was a party to an LLC agreement, was entitled to an award of fees pursuant to a contractual provision that awarded attorney's fees to a prevailing party in any action to "enforce the provisions of [the LLC Agreement]."[235] The defendant asserted that the LLC Agreement did not entitle the plaintiff to collect attorney's fees for defending counterclaims asserting breach of fiduciary duty and breach of the implied covenant of good faith and fair dealing. The court rejected the defendant's arguments, holding that the defendant's breach of fiduciary duty claim arose from a provision in the applicable LLC agreement and that the claim was one to enforce the terms of the LLC agreement.

As to the defendants' counterclaim for breach of the implied covenant of good faith and fair dealing, the court held that "[n]otwithstanding the covenant's potentially misleading moniker and decisional references to a culpable mental state, a claim for breach of the implied covenant is a contract claim …."[236] The court explained, in great detail, how a claim for a breach of the implied covenant of good faith and fair dealing differs from a "tort claim" for breach of fiduciary duty. The court reasoned that there is a temporal component that is "critical" to each claim.[237] In a breach of fiduciary duty claim, the "court examines the parties as situated at the time of the wrong."[238] The court considers "whether the defendant owed the plaintiff a duty" and "whether the duty was breached."[239] The court may consider historical events to inform its analysis, "but liability depends on the parties' relationship when the alleged breach occurred, not on the relationship as it existed in the past."[240] By contrast, an implied covenant claim "looks to the past."[241] In an implied covenant analysis, the court asks "what the parties would have agreed to themselves had they considered the issue in their original bargaining positions at the time of contracting."[242] The parties' relationship at the time of the wrong is less important in an implied covenant analysis. As such, the "fair dealing" component of an implied covenant analysis is not akin to a "fair dealing" analysis in an entire fairness review. Fair dealing in an implied covenant analysis is a "commitment to deal 'fairly' in the

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unpredictability into both entity and contract law, by untethering judicial review from the well-understood frameworks that traditionally apply in those domains").

234. 50 A.3d 434 (Del. Ch. 2012).

235. *Id*. at 439.

236. *Id*. at 444-45.

237. *Id*. at 440.

238. *Id*.

239. *Id*.

240. *Id*.

241. *Id*.

242. *Id*.

sense of consistently with the terms of the parties' agreement …."[243] And, good faith in an implied covenant analysis is loyalty to the "scope, purpose, and terms" of the agreement, not loyalty to the counterparty to the agreement.[244]

The court noted that the temporal focus applies "equally to a party's discretionary rights" under a contract.[245] Thus, in situations where the implied covenant requires that a party exercise discretion reasonably, "what is 'arbitrary' or 'unreasonable'—or conversely 'reasonable'—depends on the parties' original contractual expectations, not a 'free-floating' duty applied at the time of the wrong."[246]

Finally, the court also dispelled any notion that a culpable mental state is required to prove a claim for the implied covenant of good faith and fair dealing. The court traced this notion through historical cases,[247] and showed that proving fraud was only "one way of establishing a breach of the implied covenant, but not the only way."[248] The court held, "[i] ncorporating a mental state or other tort-like concepts assists in measuring when a defendant's conduct passes beyond what the contracting parties would have agreed to in their original bargaining positions. It does not convert a breach of the implied covenant into a tort."[249]

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243. *Id*.

244. *Id*.

245. *Id*. at 441.

246. *Id*. at 441-42.

247. *Id*. at 442-45.

248. *Id*. at 444.

249. *Id*.

DEVELOPMENTS IN DELAWARE HEALTH LAW: ADDRESSING PRESCRIPTION DRUG ABUSE

Nathan Trexler*

In 2012, developments impacting Delaware health care providers, patients, and the delivery of health care in the state have highlighted the efforts to address prescription drug abuse. This article summarizes the principal health law developments aimed at curbing the growing prescription drug abuse problem: the launch of the Delaware Prescription Monitoring Program and the Board of Medical Licensure and Discipline's Regulation 18, addressing the standards for prescribing controlled substances for the treatment of pain.

Prescription drug abuse, specifically of opioids and other controlled substances, in Delaware has been covered widely in news media,[1] and the growing epidemic continues to have a devastating impact on the entire country.[2] Second only to marijuana, prescription painkillers are now considered the most abused drugs by youth in the United States.[3] And there is no denying that prescriptions for opioids have increased dramatically; between 1997 and 2007 the use of prescription opioids increased more than four times,[4] and "[t]he rate of death from drug overdose in the United States has more than doubled since 1999 impelled largely by an increase in overdoses involving prescribed substances, especially opioid analgesics."[5] Yet, "[p]aradoxically, there are simultaneous pressures to increase opioid prescribing for the benefit of individual patients and to reduce it for the sake of public health."[6]

Delaware health care providers sit at the center of these debates over detecting drug abuse and diversion and promoting sound prescribing. In providing controlled substances therapy to patients, providers must become cognizant of new requirements of the Delaware Prescription Monitoring Program and Board of Medical Licensure and Discipline Regulation 18.

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1. Chris Barrish & Daniel Sato, *Prescription Drug Abuse: An Epidemic of Painkillers*, Delaware News Journal (2011), *available at* http://www.delawareonline.com/section/NEWS1111/Pill-Abuse.

2. Jeanmarie Perrone & Lewis S. Nelson, *Medication Reconciliation for Controlled Substances—An "Ideal" Prescription-Drug Monitoring Program*, 366 N Eng. J. Med. 2341, 2341 (2012).

3. Shoshana Walter, *Meager Participation Hobbles Drug Oversight*, N.Y. Times (April 8, 2012) at A23A, *available at* http://www.nytimes.com/2012/04/08/us/poor-participation-hobbles-californias-drug-oversight.html?pagewanted=all&_r=0.

4. Centers for Disease Control and Prevention, *CDC Grand Rounds: Prescription Drug Overdoses—A U.S. Epidemic*, Morbidity & Mortality Wkly. Rep., Jan. 13, 2012, at 10. Some have reported that the Joint Commission's pain management standards, which went into effect for accredited facilities in 2001 and recognized patients' rights to the appropriate assessment and management of pain, among other factors, has led to a "liberalization" of opioid prescribing for pain management. Perrone & Nelson, *supra* note 2 at 2341. "In this new model, physicians, dentists, and nurse practitioners – rather than drug cartels and street dealers – play prominent roles in escalating drug use." *Id.*

5. Leonard J. Paulozzi et al., *A History of Being Prescribed Controlled Substances and Risk of Drug Overdose Death*, 13 Pain Med. 87, 88 (2012).

6. Perrone & Nelson, *supra* note 2 at 2341.

I. THE DELAWARE PRESCRIPTION MONITORING PROGRAM

The Prescription Monitoring Program ("PMP") is a product of the Delaware Prescription Monitoring Act (the "Act"), signed by Governor Markell in 2010.[7] The PMP was launched in August 2012 "as a means to promote public health and welfare and to detect the illegal use of controlled substances" and to address the dual purposes of "reducing misuse and diversion of controlled substances in the State while promoting improved professional practice and patient care."[8] The PMP allows key stakeholders to monitor the prescribing and dispensing of all Schedule II, III, IV and V controlled substances and to research the prescribing and dispensing of drugs of concern.[9] Importantly, the "PMP shall not interfere with the legal use of a controlled substance or drug of concern."[10]

The core of the PMP is a database, accessed via a public website.[11] The Act authorizes the Office of Controlled Substances ("OCS"), within the Department of State's Division of Professional Regulation, to establish and maintain the PMP. The PMP serves to trace the path of a controlled substance, wherein dispensers and prescribers are required to access the PMP website to report and monitor information about the prescribing and dispensing of controlled substances. Members of law enforcement are permitted to access the PMP website to investigate illegal activity.

A. Stakeholder Requirements

The first key stakeholder in the program is the "prescriber" of controlled substances. A "prescriber" is defined by the Act as "a licensed health care professional with the authority to write and issue prescriptions" with certain exceptions.[12] Exempted from the Act's requirements, however, is a prescriber—or other authorized person—who "administers" a controlled substance or drug upon the lawful order of a prescriber. "Administer" is defined as "the direct application of a drug to the body of a patient by injection, inhalation, ingestion, or any other means."[13] Also exempt from the Act's requirements is a prescriber—or other authorized person—who *causes* the administration of such a substance for immediate relief from an

7. 77 Del. Laws 396 (2010). As of October 2012, forty-two states had operational prescription monitoring programs, and eight states had enacted legislation establishing a prescription monitoring program. *Status of Prescription Drug Monitoring Programs*, Alliance of States with Prescription Monitoring Programs (Oct. 17, 2012), *at* http://www.pmpalliance.org/pdf/pmp_status_map_2012.pdf. Research regarding the effectiveness of such programs is still limited, but a recent Canadian study of prescription monitoring programs reported a sizable decrease in the number of inappropriate prescriptions for opioids and benzodiazepines in British Columbia. Pamela Lewis Dolan, *Study Quantifies Drug Monitoring Database's Effect on Opioid Prescriptions*, Am. Med.ical News (Sept. 20, 2012), *at* http://www.ama-assn.org/amednews/2012/09/17/bisf0920.htm.

8. Del. Code Ann. tit. 16, § 4798(a) (2011).

9. *Id.* § 4798(c). This article focuses on the prescribing of controlled substances in medical treatment. "Drugs of concern" are defined as those other than controlled substances to be defined by the Delaware Office of Controlled Substances by rule that "demonstrate a potential for abuse or diversion." *Id.* § 4798(b)(7). At the time of publication, no rules have been promulgated defining such drugs.

10. *Id.* §4798(c).

11. The PMP Web address is pmp.delaware.gov.

12. *Id.* § 4798(b)(9).

13. *Id.* § 4798(b)(1).

acute condition in the provision of emergency care. Thus, an emergency department prescriber who provides a controlled substance to a patient for immediate self-administration in providing emergency care is not subject to the requirements of the Act. Similarly, a prescriber "who prescribes up to a 72-hour supply of a controlled substance for on call services or emergency care" is exempt from the Act's requirements. Finally, a veterinarian who prescribes for veterinary services is not subject to the requirements of the Act.[14]

If a prescriber is subject to the Act, he or she is required, under certain circumstances, to take certain actions before writing and issuing a prescription for a controlled substance.[15] If the prescriber has a "reasonable belief that the patient may be seeking the controlled substance, in whole or in part, for any reason other than the treatment of an existing medical condition," the prescriber—or another person authorized by the prescriber—must obtain a utilization report regarding that patient from the PMP database.[16] The utilization report, a collection of the data submitted by dispensers to the PMP, will provide the patient's prescription history for the preceding twelve months. The prescriber must review the utilization report and, based upon the information contained therein assess whether the prescription sought is "necessary" for the treatment of the patient.[17]

In the event that a prescriber is unable to access the database to obtain the prescription information by electronic means—perhaps because the prescriber does not utilize a computer or internet connection in his or her office—the OCS may grant a waiver to the prescriber, relieving him or her from the Act's requirements.[18] Any such prescriber must obtain a waiver from the OCS on an annual basis until such prescriber is able to access the prescription information by electronic means. Once the prescriber writes and issues a prescription to a patient, the dispenser must enter the prescription information into the PMP when the patient seeks to fill the prescription.

The Act defines "dispenser" as a person authorized by the State to dispense or distribute controlled substances or drugs of concern to the ultimate user, with certain exceptions.[19] To "dispense" means to interpret, evaluate, and implement a prescription, including the preparation and delivery of the drug to a patient or his or her agent for administration to, or use by, the patient.[20] "Distribute" is defined as the delivery of a drug other than by administering or dispensing.[21] A health care facility pharmacy is not subject to the Act's requirements when it dispenses or distributes controlled substances for inpatient care or for immediate use by an emergency department , or when dispensing up to a seventy-two-hour supply at the time of discharge.[22]

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14. *Id.* § 4798(b)(9).

15. Certain prescribers are also subject to the Board of Medical Licensure and Discipline Regulation 18, which describes the standards of prescribing controlled substances for the treatment of pain. For a discussion of the requirements of Regulation 18, see *infra* Section II.

16. Del. Code Ann. tit. 16, § 4798(e).

17. *Id.*

18. *Id.* § 4798(f).

19. *Id.* § 4798(b)(4).

20. *Id.* § 4798(b)(3).

21. *Id.* § 4798(b)(5).

22. Basically, "dispensers" under the Act include retail pharmacies, non-resident pharmacies who operate in other states but ship, mail, or deliver a controlled substance to a patient in Delaware, and controlled substance registrants who dispense controlled substances, including samples.

For every controlled substance prescription dispensed or otherwise distributed, the dispenser shall submit certain information into the electronic PMP database.[23] The information required to be submitted includes: (1) the pharmacy name; (2) the dispenser's DEA registration number; (3) the date the drug was dispensed; (4) the prescription number from the prescriber; (5) whether the prescription is new or a refill; (6) the national drug code for the drug dispensed; (7) the quantity dispensed; (8) the approximate number of days supplied; (9) the patient's name and date of birth; (10) the patient's address; (11) the prescriber's DEA registration number and name; and (12) the date the prescription was issued by the prescriber.[24] The data is submitted pursuant to the Dispenser's Implementation Guide.[25] Waivers similar to those granted to prescribers are not available to dispensers.

For those with a basic familiarity with the Health Insurance Portability and Accountability Act of 1996 ("HIPAA")—which by most accounts is everyone who has ever been to a health care provider and signed a medical record privacy policy—it is evident that the information described above includes protected health information.[26] The Act makes clear that this prescription information is not subject to open records laws or otherwise subject to disclosure, unless provided for by the Act.[27] The OCS is responsible for ensuring that privacy and confidentiality is maintained in the collection, transmission, and maintenance of the information in the PMP.[28]

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23. *Id.* § 4798(d). Where a controlled substance is needed for bona fide research, the OCS may not require dispensers to submit information any more frequently than that required for controlled substance prescriptions. *Id.*

24. *Id.*

25. *Dispenser's Implementation Guide*, Del. Div. of Prof'l Regulation Prescription Monitoring Program (March 2012), http://dpr.delaware.gov/boards/controlledsubstances/pmp/documents/DE%20PDMP_Dispensers%20Implementation%20Guide.pdf.

26. Protected health information is "individually identifiable health information" that is transmitted and/or maintained in electronic media or in any other form or medium, with certain exceptions not relevant to this article. 45 C.F.R. § 160.103 (2007). "Individually identifiable health information" includes demographic information collected from an individual created or received by a health care provider (and other covered entities) that "[r]elates to the past, present, or future physical or mental health or condition of an individual; the provision of health care to an individual; or the past, present, or future payment for the provision of health care to an individual" and that identifies the individual or may where there is a reasonable basis to believe it may be used to identify the individual. *Id.*

27. Del. Code Ann. tit. 16, § 4798(h). While this is not an article discussing the intricacies of HIPAA, it is worth briefly mentioning the interplay of the PMP and HIPAA's Privacy Rule. Prescribers and dispensers are covered entities under HIPAA, and the Act may require these individuals to transmit protected health information to the PMP. This may appear to conflict with HIPAA regulations, which generally limit the circumstances in which, and to what extent, such information can be disclosed. *See* 45 C.F.R. § 164.502. HIPAA expressly preempts contrary state law, unless an exception applies. 45 C.F.R. § 160.203. For example, the Secretary of the United States Department of Health and Human Services may find that the state law is necessary to prevent health care fraud and abuse or for purposes of "serving a compelling need related to public health, safety, or welfare." *Id.* § 160.203(a)(1). Most importantly, perhaps, the Secretary may find that the state law's principal purpose is "the regulation of the … distribution, dispensing, or other control of any controlled substances." *Id.* § 160.203(a)(2). Exceptions also exist that do not require a prior determination of the Secretary, including where a state law provides for "the conduct of public health surveillance, investigation, or intervention." *Id.* § 160.203(c). If an exception does not apply, the HIPAA privacy rules apply, though it is likely that disclosures under the Act will comply with HIPAA requirements.

28. Del. Code Ann. tit. 16, § 4798(i).

B. The Use And Disclosure Of Prescription Information

In exercising its authority to ensure the integrity of the program and to further its stated goals, the OCS is required to make certain disclosures and is authorized to make others. For example, the OCS has an affirmative duty to notify appropriate law enforcement officials or professional licensure, certification, or regulatory agencies whenever it has reasonable cause to believe that a dispenser or prescriber has breached professional standards, or knows of a violation of law—be it patient abuse or diversion of controlled substances or otherwise.[29] The professional standards of every health care profession are either established by statute or promulgated by that profession's licensing or certification authority. Presumably, the OCS must have a basic familiarity with those standards in order to refer dispensers or prescribers to the appropriate regulatory agency.[30] For example, it is considered unprofessional conduct for a physician to use, distribute, or issue a prescription for a dangerous or narcotic drug, other than for therapeutic or diagnostic purposes.[31] In addition to the required reports to professional regulators, the OCS may also provide data at the request of a designated representative of any professional regulating board or commission who is involved "in a bona fide specific investigation involving a designated person,"[32] or at the request of the Division of Professional regulation for purposes of administering and enforcing the Act.[33]

The OCS may also honor other requests to provide PMP data. For example, the OCS may honor requests by prescribers or dispensers who request such reports pursuant to their own obligations under the Act, as long as the prescriber or dispenser requesting information first certifies that the information is requested for the purpose of providing medical or pharmaceutical treatment to a bona fide patient.[34] Naturally, the OCS may provide data to an individual who requests his or her own PMP information.[35] Certain qualified personnel can also obtain PMP data reports for bona fide research or educational purposes, but the OCS must delete or redact any information that would reasonably identify a specific recipient of a substance, and the information may only be released pursuant to a written agreement.[36] The OCS may also provide data reports regarding Medicaid recipients to the Delaware Department of Health and Social Services ("HSS").[37] There are no stated limits regarding an HHS request for such information.

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29. *Id.* § 4798(i)(1).

30. For example, physicians' professional standards are found at Chapter 17 of Title 24 of the Delaware Code and are further defined by regulations promulgated by the Board of Medical Licensure and Discipline at Chapter 17 of Title 24 of the Delaware Administrative Code. Pharmacists' professional standards are found at Chapter 25 of Title 24 of the Delaware Code and are further defined by regulations promulgated by the Board of Pharmacy at Chapter 25 of Title 24 of the Delaware Administrative Code.

31. Del. Code Ann. tit. 24, § 1731(b)(6) (2011).

32. Del. Code Ann. tit. 16, § 4798(i)(2)(c). It is interesting to note here, that the professional boards cannot go on fishing expeditions by utilizing PMP data. They must first initiate a bona fide and specific investigation.

33. *Id.* § 4798(i)(2)(g).

34. *Id.* § 4798(i)(2)(a).

35. *Id.* § 4798(i)(2)(b). Prescribers and dispensers, however, are not permitted to release PMP data to patients because the reports that a prescriber or dispenser can obtain will contain confidential information about the prescriber and dispenser.

36. *Id.* § 4798(i)(2)(h).

37. *Id.* § 4798(i)(2)(e).

Finally, the OCS may release information to a local, state, or federal law enforcement or prosecutorial office administering, investigating, or enforcing controlled substances laws.[38] The requester, however, must be involved in a "bona fide specific drug-related investigation in which a report of suspected criminal activity involving controlled substances by an identified suspect has been made."[39] Furthermore, the information must be "relevant and material" to the investigation and limited to the "extent reasonably practicable in light of the purpose for which the information is sought."[40] The OCS shall include identifying information only if non-identifying information cannot be used.

C. Penalties And Immunity

The Act provides penalties for failure to comply with its requirements and for the misuse of the program. A dispenser who fails to submit the information required under the Act is subject to discipline by the Board of Pharmacy pursuant to Chapter 25 of Title 24 of the Delaware Code.[41] The same is true if a dispenser knowingly submits incorrect prescription information. A dispenser alleged to have violated the Act is entitled to a hearing, and if found to have violated this provision, is subject to disciplinary sanctions ranging from a letter of reprimand to a revocation of his or her license.[42]

Any person authorized to have prescription information pursuant to the Act—including dispensers, prescribers, licensing Board personnel, patients, and State personnel—who knowingly discloses the information without authorization under the Act is guilty of a class G felony and, upon conviction, shall be fined not more than $10,000, imprisoned not more than two years, or both.[43] Any person authorized to have prescription information pursuant to the Act who intentionally uses the information in furtherance of a crime is guilty of a class E felony and, upon conviction, is subject to a fine not more than $10,000, imprisonment for not more than five years, or both.[44] Finally, any person not authorized to have prescription information pursuant to the Act and who obtains such information fraudulently is guilty of a class E felony.[45] Such person shall be fined not more than $10,000, imprisoned not more than five years, or both.[46]

There is no express penalty in the Act for a prescriber's failure to obtain a utilization report. However, a physician prescriber commits unprofessional conduct if he or she engages in any "dishonorable, unethical, or other conduct likely to deceive, defraud, or harm the public."[47] Likewise, a dentist prescriber is subject to disciplinary sanctions if he or she has

38. The OCS may also provide a report to a properly convened grand jury pursuant to a subpoena. *Id.* § 4798(2)(f).

39. *Id.* § 4798(i)(2)(d). Like professional boards and commissions, law enforcement cannot use the PMP to fish for illegal activity.

40. *Id.*

41. *Id.* § 4798(m).

42. Del. Code Ann. tit. 24, § 2516 (2007).

43. Del. Code Ann. tit. 16, § 4798(n).

44. *Id.* § 4798(o).

45. *Id.* § 4798(p).

46. *Id.*

47. *Id.* § 1731(b)(3).

"practiced dentistry … in an incompetent or grossly negligent manner."[48] Thus, an argument can be made that if such prescribers fail to request a utilization report where there is a *reasonable belief* that the patient may be seeking controlled substances for reasons other than the treatment of a medical condition, the prescribers may be subject to professional disciplinary action. For a physician, the argument would be that in failing to request a utilization report, he or she engaged in conduct that is likely to harm the public. For a dentist, the argument would be that in failing to request a utilization report, he or she engaged in the practice of dentistry in an incompetent or grossly negligent manner. While there are immunity provisions contained in the Act, they would not apply to such circumstances.

The Act's immunity provisions address distinct acts or omissions. Under section 4798(g), a court of competent jurisdiction must first make a finding of gross negligence, malice or criminal intent before any prescriber, dispenser, or other person or entity in proper possession of information pursuant to the Act, can be subject to civil liability, administrative action or other legal or equitable relief for any of the following: (1) furnishing information pursuant to the Act; (2) receiving, using or relying on, or not using or relying on, information received pursuant to the Act; (3) failing to furnish information to the OCS; (4) providing factually incorrect information to the OCS; and (5) circumstances where the OCS released information to the wrong person or entity. Note that these immunity provisions would not seem to apply to the prescribers described in the above hypotheticals regarding the prescribers' failure to obtain a utilization report where there is a reasonable belief of abuse or diversion of controlled substances because receiving and being in possession of the information is a prerequisite to immunity. Whether this result was intended by the drafters of the statute is unclear. Nevertheless, it appears that a prescriber's professional board potentially could take disciplinary action if the prescriber failed to obtain a report in violation of the Act, without any court first having made a finding of gross negligence, malice or criminal intent.

D. Implications For Health Care Providers

The Act has many implications for health care providers, especially as the PMP's requirements relate to providers' other legal and ethical duties.

First, as described above, a prescriber must request a utilization report prior to prescribing a controlled substance where the prescriber has a reasonable belief that the patient may be seeking the controlled substance for any reason other than valid treatment purposes. For some prescribers, particularly those familiar with prescribing controlled substances for the treatment of pain and physicians subject to Board of Medical Licensure and Discipline Regulation 18,[49] there are a number of mechanisms to assist the prescriber in detecting any potential abuse or diversion of controlled substances. For those who do not prescribe such substances with any regularity, however, it may not be clear whether their belief of abuse or diversion is reasonable. If this becomes a difficult question for providers, will the default position be to request the utilization report? Is it "gross negligence" to request a utilization report as a default, even if there is no reasonable belief of abuse or diversion? While controlled substances have a recognized benefit in the treatment of pain, as acknowledged by the General Assembly and the Federation of State Medical Boards,[50] will providers wary of the process simply refuse to

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48. *Id.* § 1128(2).

49. For a discussion on the standards set forth in Regulation 18, see *infra* Section I.B.

50. Federation of State Medical Boards of the United States, Inc., *Model Policy for the Use of Controlled Substances for the Treatment of Pain* (2004), *at* http://www.fsmb.org/pdf/2004_grpol_controlled_substances.pdf.

issue such prescriptions? And how would such a refusal implicate health care providers' ethical obligations? These questions may remain unanswered for some time.

Second, prescribers are directed to review the utilization report, if requested, to assess whether the prescription for the controlled substance is "necessary." Presumably, this allows some degree of flexibility in the provider's medical decision-making. Can a controlled substance prescription still be "necessary" even if the utilization report indicates drug abuse by showing that the patient received controlled substances from another prescriber at the same time? Simply stopping prescriptions of controlled substances may be inappropriate and at odds with the standard of care, which may require the patient to be slowly tapered from the drugs.[51] Furthermore, every physician is ethically prohibited from abandoning his or her patient, and patient abandonment may give rise to a claim for malpractice. Abandonment generally occurs where the provider unilaterally severs the treatment relationship with the patient, without providing reasonable notice, at a time when the patient still requires medical attention. Care should be taken in ending a treatment relationship with a patient believed to be abusing controlled substances.

Third, most health care professionals in Delaware have legal obligations—imposed by statute or regulation—that require the reporting of other health care professionals who may be engaging in unprofessional conduct. All health care providers and health care facilities must report physicians—any person certified and registered to practice medicine—when the reporting provider reasonably believes that the physician is or may be guilty of unprofessional conduct.[52] In practice this means a dentist prescriber and any dispenser who, upon obtaining and reviewing prescription information under the Act, believes a physician prescriber has engaged in unprofessional conduct[53] must report that prescriber to the Division of Professional Regulation. However, a physician prescriber has no duty to report a dentist prescriber or a dispenser. Dentist prescribers have an affirmative duty to report, in addition to physician prescribers, other dental prescribers and dispensers when the reporter reasonably believes that the person engaged in conduct that would constitute grounds for disciplinary action.[54] The recognition of these duties is important for one reason: if any of these key stakeholders fails to report when required, they are subject to substantial fines and potential disciplinary sanctions.[55] Thus, the required actions under the PMP may necessitate further action with regard to reporting unprofessional conduct.

Also of concern to providers may be the impact of the PMP where patients may "doctor shop" across state lines for controlled substances. In areas close to state borders, including much of Delaware, interstate collaboration may be essential to the program's effectiveness in these areas. An interstate network has been created to allow interstate sharing of PMP information, but it is currently operational in only ten states, excluding Delaware and its neighboring states.[56]

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51. "[A]t discharge, you must consider how the patient will tolerate discontinuation without harm, and, in cases involving such drugs as opioids, benzodiazepines, anticonvulsants, and antidepressants, and others, safe discontinuation may require a tapering schedule." Scott M. Fishman, Responsible Opioid Prescribing: A Physician's Guide 77 (2007).

52. Del. Code Ann. tit. 24, § 1731A (2010).

53. Again, it is unprofessional conduct for a physician prescriber to use, distribute, or issue a prescription for a dangerous or narcotic drug, other than for therapeutic or diagnostic purposes. *Id.* § 1731(b)(6).

54. *Id.* § 1131A(a).

55. The Board of Medical Licensure and Discipline has "the authority to impose a fine, not to exceed $10,000 for the first violation, and not to exceed $50,000 for any subsequent violation, on any person, any healthcare provider, any healthcare institution, and the Medical Society of Delaware for violation" of the duty to report. *Id.* § 1731A(i). Furthermore, it is unprofessional conduct for a physician who willfully fails to report under section 1731A, subjecting that physician to a range of disciplinary sanctions. Any dentist who fails to report pursuant to title 24, section 1131A of the Delaware Code is subject to disciplinary sanctions. *Id.* § 1128(15).

56. *NABP PMP InterConnect*, National Association of Boards of Pharmacy, *at* http://www.nabp.net/programs/pmp-interconnect/nabp-pmp-interconnect.

II. BOARD OF MEDICAL LICENSURE AND DISCIPLINE REGULATION 18

The Delaware Board of Medical Licensure and Discipline ("BMLD") also took an important step to curb prescription drug abuse when it promulgated Regulation 18, Use of Controlled Substances for the Treatment of Pain, in February 2012.[57] While the regulation's primary focus is the treatment of chronic pain, it "may be applicable to prescribing controlled substances for the treatment of acute pain when clinically appropriate."[58] For purposes of this article, reference will only be made to the treatment of chronic pain. The regulation's stated purpose reinforces the State's recognition that "[t]he diagnosis and treatment of pain is integral to the practice of medicine" and that controlled substances may play an important role in pain treatment:

> The principles of quality medical practice dictate that citizens of Delaware have access to appropriate and effective pain relief. The appropriate application of up-to-date knowledge and treatment modalities can serve to improve the quality of life for those patients who suffer from pain as well as reduce the morbidity and costs associated with untreated or inappropriately treated pain.
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> …
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> The Board recognizes that controlled substances including opioid analgesics may be essential in the treatment of acute pain due to trauma or surgery and chronic pain, whether due to cancer or non-cancer origins.[59]

With this in mind, the regulation was developed to define the specific requirements for the treatment of pain with controlled substances, in order "to alleviate licensed practitioners' uncertainty, to encourage better pain management, and to minimize practices that deviate from the appropriate standard of care and lead to abuse and diversion."[60] Thus, much like the legislative purpose behind the PMP, the regulation was promulgated with the hope of curbing inappropriate use of controlled substances while not burdening proper utilization of such drugs in medical treatment. In fact, the BMLD believes that the regulation will help ease licensed practitioners' fears of investigation or sanction by setting better standards

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57. 15 Del. Reg. Regs. 1184 (Feb. 01, 2012) *amended by* 16 Del. Reg. Regs. 651 (Dec. 01, 2012). The amendments to the regulation in December 2012 addressed concerns regarding the regulation's applicability to use of controlled substances for the treatment of acute pain. 16 Del. Reg. Regs. 651, at 651. The amendment clarified the focus of the regulation, which was the use of controlled substances for the treatment of chronic pain. *Id.* The amendments also allowed the BMLD discretion to utilize clinical practice guidelines and the use of expert review for disciplinary matters involving pain treatment with controlled substances. *Id.* The text of the final regulation is found at 24 Del. Admin. Code 1700 § 18.0 (2013). The BMLD's statutory authority to promulgate regulations is found at Del. Code Ann. tit. 24, § 1713(a)(12).

58. 24 Del. Admin. Code 1700 § 18.0. "Acute pain" is defined as "the normal, predicted physiological response to a noxious chemical thermal or mechanical stimulus and typically associated with invasive procedures, trauma and disease" and is generally limited in duration. *Id.* § 18.10.1. "Chronic pain" is defined as "a state in which pain persists beyond the usual course of an acute disease or healing of an injury, or that may or may not be associated with an acute or chronic pathologic process that causes continuous or intermittent pain over months or years." *Id.* § 18.10.3.

59. *Id.* § 18.0. The BMLD adopted the Federation of State Medical Board's "Model Policy for the Use of Controlled Substances for the Treatment of Pain," which can be found at http://www.fsmb.org/pdf/2004_grpol_controlled_substances.pdf.

60. 24 Del. Admin. Code 1700 § 18.0.

for such treatment.[61] To be clear, the BMLD will consider inappropriate treatment to be a departure of the standards of medical practice and will investigate complaints pursuant to its regulatory authority.

Regulation 18 provides both the standards practitioners must follow in the treatment of chronic pain with controlled substances and the standards to which the BMLD must adhere in reviewing the appropriateness of such treatment. Each will be addressed in turn. First, it is important to note that the BMLD exercises regulatory authority in this regard only over certain health care providers, or those subject to the Medical Practice Act, including physicians and physician assistants (hereinafter, "practitioner(s)").[62]

Turning to the standards of treatment, the BMLD first set forth some primary overarching requirements for practitioners. First, "[a]ppropriate pain management is the treating practitioner's responsibility," so practitioners must obtain education regarding assessing pain and the effective methods of pain treatment.[63] Most importantly, in regard to that education, practitioners should understand that "tolerance and physical dependence are normal consequences of sustained use of opioid analgesics and alone are not the same as addiction."[64] Patient pain should be properly assessed, in accordance with current clinical practice guidelines, and practitioners should use both pharmacologic and non-pharmacologic treatment modalities according to his or her judgment in accordance with current knowledge and scientific research. The quantity and frequency of doses of controlled substances must be adjusted according to the intensity and duration of pain, as well as treatment outcomes.[65] In addition to these more general requirements, there are six main requirements for the treatment of chronic pain with controlled substances: (1) evaluation; (2) the treatment plan; (3) informed consent; (4) the treatment agreement; (5) periodic review; (6) and consultation. In addition, Regulation 18 addresses standards for medical record documentation.

When evaluating a chronic pain patient, the practitioner must obtain a medical history and conduct a physical examination, which should be documented in the medical records. The practitioner's evaluation must document the etiology, nature and intensity of pain, any current and past treatments for pain, and any underlying or coexisting diseases or conditions. In addition, the evaluation must document the effect the pain has had on the patient's physical and psychological function, including whether the patient has a history of substance abuse. Finally, there must be present one or more recognized medical indications for treatment with controlled substances.[66]

The treatment plan is a written document stating the goals and objectives that will be used to determine treatment success. Such goals may be complete or partial pain relief, or improved physical function. The plan shall indicate any planned diagnostic evaluations or treatments, as well as whether alternative treatment modalities or rehabilitation programs

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61. While the regulation is broad in its scope, it only applies to the licensed practitioners over whom it exercises licensing and regulatory authority. This includes physicians, but excludes other potential prescribers of controlled substances, such as dentists.

62. Del. Code Ann. tit. 24, ch. 17.

63. 24 Del. Admin. Code 1700 § 18.0.

64. *Id.* "Tolerance" is defined by the regulation as "a physiologic state resulting from regular use of a drug in which an increased dosage is needed to produce a specific effect, or a reduced effect is observed with a constant dose over time." *Id.* § 18.10.9. "Physical dependence" is defined as "a state of adaptation that is manifested by drug class-specific signs and symptoms that can be produced by abrupt cessation, rapid dose reduction, decreasing blood level of the drug, and/or administration of an antagonist." *Id.* § 18.10.6.

65. *Id.* § 18.0.

66. *Id.* § 18.1.1.

are indicated and necessary. Most importantly, after treatment begins with controlled substances, the practitioner must review the effectiveness of treatment and adjust the drug therapy to suit the continuing medical needs of the patient.[67]

Informed consent is a basic tenet of medical practice and a well-settled risk area for health care providers.[68] Regulation 18 specifically requires the practitioner to explain the risks and benefits of the use of controlled substances to the patient, or to someone with decision-making capacity for the patient if the patient lacks such capacity.[69]

The treatment agreement often stands at the center of these treatment relationships. Like any effective treatment, it requires a plan agreed upon by patient and practitioner. Regulation 18 imposes additional safeguards that must be included in agreements for the treatment of chronic pain with controlled substances, but *only if* the patient is "at high risk for medication abuse or has a history of substance abuse." As a matter of course, however, it is not always easy to detect a history of substance abuse, unless the patient is forthcoming with such information. If an agreement is required, it must include certain patient responsibilities. First, the patient must agree to random urine/serum medication level screening.[70] The patient must also agree to receive prescriptions only from the individual practitioner and only from one pharmacy when possible. The agreement shall also list the number and frequency of prescription refills and the reasons for which the treatment with controlled substances may be discontinued by the practitioner, such as violation of the agreement.[71]

Practitioners treating chronic pain patients with controlled substances must periodically review the course of the treatment, documenting any new information regarding the cause and source of the pain and any changes in the patient's health. At a minimum, the review must include an evaluation of whether controlled substances therapy should continue or be modified based on the practitioner's evaluation of the patient's progress toward the goals and objectives contained in the original treatment plan. Further, the periodic review must document an evaluation of whether the patient is having a satisfactory response to the treatment, as perhaps indicated by decreased pain, increased levels of function, or an improvement in quality of life. The hallmark of such evaluations is objective evidence of patient function, but the regulation notes that information from family members or caregivers should be considered in determining how the patient has been responding to controlled substances treatment. Finally, if the patient's progress is unsatisfactory, the periodic review must document the practitioner's assessment of the appropriateness of continuing the course of treatment and the consideration of alternative therapeutic modalities.[72]

The final of the six core standards is consultation. At any point during treatment, the practitioner must be prepared to refer the patient for additional evaluation and treatment to other health care providers in order to meet the treatment objectives contained in the treatment plan. The regulation states that "[s]pecial attention must be given to those patients with pain who are at risk for medication misuse, abuse or diversion." In addition to patients with a history of substance abuse, patients with co-morbid psychiatric disorders require extra care and may require consultation with or referral to

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67. *Id.* § 18.2.

68. *See, e.g.*, Spencer v. Goodill, 17 A.3d 552 (Del. 2011).

69. 24 Del. Admin. Code 1700 § 18.3.

70. "Some physicians may feel uncomfortable with the mistrust implied by such confrontational approaches and may find that a highly functional [PMP] readily alerts its users to signs of aberrant drug-procurement behavior." Perrone & Nelson, *supra* note 2, at 2341. Still, when a treatment agreement is required under the regulation, urine drug screens are a mandated component of that agreement. 24 Del. Admin. Code 1700 § 18.4.

71. *Id.* Again, as stated *supra*, practitioners should be cognizant of patient abandonment.

72. *Id.* § 18.5.

experts familiar with treating such patients. The regulation affirmatively requires practitioners who "regularly treat" such patients to educate themselves about the current standards of care in the treatment of such patients.[73]

As stated above, in addition to the six core standards, Regulation 18 requires the practitioner to keep accurate and complete medical records. The medical records of a chronic pain patient being treated with controlled substances must include: (1) a history and physical examination; (2) diagnostic, therapeutic and laboratory results; (3) evaluations and consultations; (4) documentation of etiology of pain; (5) treatment goals; (6) a documented discussion of the risks and benefits of the use of controlled substances; (7) informed consent; (8) all treatments; (9) all medications, include the date, type, dosage and quantity prescribed; (10) patient instructions and agreements; and (11) documented results of periodic review.[74] All medical records must be current and maintained in an accessible manner. Thus, for each visit, a practitioner should include documentation appropriate for the level of care, including: (1) an interim history and physical examination; (2) a record of the patient's vital signs, as clinically appropriate; (3) an assessment of patient progress; and (4) the medication plan.

Turning to the standards under which the BMLD shall review the care provided by practitioners in the treatment of chronic pain patients, "practitioners should not fear disciplinary action from the [BMLD] for ordering, prescribing, dispensing or administering controlled substances … for a legitimate medical purpose and in the course of professional practice."[75] Such treatment must be based on sound clinical judgment, and the documentation addressed above is crucial to demonstrating that clinical judgment.

In reviewing treatment for pain with controlled substances, the BMLD may refer to current clinical practice guidelines and may utilize experts in the field. The validity of the treatment will be judged based upon the practitioner's documentation, and not solely on the quantity and duration of medication prescribed.[76] Every allegation of inappropriate treatment will be evaluated on an individual basis. A practitioner will be subject to discipline for violating Regulation 18 unless the contemporaneous medical records "document reasonable cause for deviation" from the regulations. Finally, the practitioner's treatment with controlled substances "will be evaluated to a great extent by the outcome of pain treatment, recognizing that some types of pain cannot be completely relieved, and by taking into account whether the drug used is appropriate for the diagnosis, as well as improvement in patient functioning and/or quality of life."[77]

The effectiveness of the rule in decreasing controlled substances abuse and diversion, its application in disciplinary proceedings, and its relationship with the operation of the PMP will be revealed over time. In the meantime, providers and their attorneys should view these developments as safeguards in safely prescribing to a sensitive patient population, and should work to ease any administrative hurdles encountered when attempting to comply with the new legal requirements.

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73. *Id.* § 18.6.

74. *Id.* § 18.7.

75. *Id.* § 18.0.

76. The quantity and duration of medication prescribed is exactly the type of information contained in the PMP. Such information may garner attention from regulators, but only medical record documentation will tell the whole story.

77. *Id.*

LAW FIRM DISSOLUTIONS: WHEN THE MUSIC STOPS, DOES ANYONE NEED TO ACCOUNT FOR ANY UNFINISHED BUSINESS?

Michael D. DeBaecke* and Victoria A. Guilfoyle**

It is a fact. Some law firms fail. The dissolution and resulting bankruptcy of Dewey & Leboeuf LLP in 2012 is only the latest of several large law firm failures to occur in the last decade.[1] The prolonged and generationally unprecedented global economic challenges of the "Great Recession" faced by all manner of businesses in recent years has spawned even more intense than normal competition among law firms. Legal commentators and pundits have predicted additional law firm failures in coming years.[2]

Law firm dissolutions and their related bankruptcies present many interesting academic and practical issues for judges and practitioners. But perhaps no law firm dissolution/bankruptcy issue has garnered more recent attention in legal circles than the unfinished business doctrine. Broadly speaking, the unfinished business doctrine provides for post-dissolution profits arising from the work of former partners at new firms on matters that began at the dissolved firm to be deemed property of the old firm's estate and to be available to pay creditors of the old firm.[3] Application of the unfinished business doctrine carries real consequences for the dissolved law firms and their bankruptcy estates; for the recoveries obtained by secured and unsecured creditors; for the former partners of the failed law firms who thought they had moved their books of business to their new firms; and for the new firms that find themselves (perhaps years later) addressing demands for payment relating to the business that came with their new partners.[4]

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1. *See, e.g.,* Brobeck, Phleger & Harrison LLP (2003); Altheimer & Gray (2003); Coudert Brothers LLP (2005); Heller Ehrman LLP (2008); Thelen LLP (2008); Thacher Proffitt & Wood LLP (2008); Wolf Block LLP (2009); Howrey LLP (2011); and Yoss LLP (2011).

2. *See, e.g.*, Steven J. Harper, The Lawyer Bubble: A Profession in Crisis (2013); Debra Cassens Weiss, *Law Firm Consultant Predicts 'Absolutely' More Layoffs and as Many as Five BigLaw Dissolutions*, ABA Journal, Sept. 6, 2012, *at* http://www.abajournal.com/news/article/consultant_predicts_absolutely_more_layoffs_and_as_many_as_five_biglaw_diss/; Jay Adkisson, *Howrey: When the Sinking Ship Seeks the Cheese Back From the Fleeing Rats,* Forbes, Aug. 1, 2012, *at* http://www.forbes.com/sites/jayadkisson/2012/08/01/howrey-when-the-sinking-ship-seeks-the-cheese-back-from-the-fleeing-rats/.

3. Application of the unfinished business doctrine is not limited to law firm failures. The doctrine has been applied in other types of partnership failures. *See, e.g.,* King v. Leighton*,* 3 N.E. 594, 598 (N.Y. 1885) (construction firm); Stem v. Warren, 125 N.E. 811, 813 (N.Y. 1920) (architecture firm); Rhein v. Peeso, 185 N.Y.S. 150 (N.Y. App. Div. 1920) (dental firm).

4. Several significant settlements of unfinished business claims have been inked in recent law firm bankruptcy cases. *See, e.g.,* Order Pursuant to Section 105(a) of the Bankruptcy Code and Bankruptcy Rule 9019(a) Approving the Settlement Agreement among the Debtor, Paul Hastings LLP and Certain Former Partners, In re Dewey & Leboeuf, No. 12-12321 (Bankr. S.D. N.Y. Apr. 1, 2013) (approving a settlement that provided, in part, for (i) payments to the estate in the aggregate amount of $1.586 million on account of unfinished business claims and (ii) releases of over $41 million in claims against the estate); Order Granting Motion by Liquidating Debtor for (1) Approval of Settlement of Claims against Covington & Burling LLP and IP Shareholder Defendants under Bankruptcy Rule 9019; (2) for a Finding of Good Faith Settlement under Cal. Code Civ. P. § 877; and (3) Leave to File Second Amended Complaint, In re Heller Ehrman LLP, No. 08-32514 (Bankr. N.D. Cal. Aug. 15, 2011) (approving a settlement that provided, in part, for payments to the estate in the aggregate amount of $4.996 million on account of unfinished business claims); Order Pursuant to Rule 9019 of the Federal Rules of Bankruptcy Procedure Authorizing and Approving a Settlement Agreement Between

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This article delves into the unfinished business doctrine as applied in law firm dissolutions, including a detailed discussion of recent competing decisions issued in 2012 by two district court judges in the Southern District of New York.[5] Those courts reached opposite conclusions on whether the unfinished business doctrine applies under New York law to hourly fee matters pending upon the dissolution of a law firm.

I. THE UNFINISHED BUSINESS DOCTRINE UNDER APPLICABLE STATE PARTNERSHIP LAW

Questions concerning application of the unfinished business doctrine in law firm dissolutions arise under a familiar fact pattern. A departing partner of a dissolved law firm joins a new firm. The departing partner asks a client she had been performing work for at the dissolved firm whether the client wishes to move its pending matter to the partner's new firm. The client agrees and the new firm then enters into an agreement with the client to handle the pending matter (i.e. the unfinished business). The new firm and its new partner provide services to complete the pending matter and receive payment for those services from the client. Thereafter, the dissolved former firm (or its bankruptcy estate) and/or former partners at the dissolved firm demand that the new firm and the departed partner turnover at least the profits received from the completion of the unfinished business.

"Unfinished business" has been defined as "executory contracts to perform services, begun but not fully performed by the partnership on the date of its dissolution."[6] Unfinished business is not to be confused with "finished business" or "new business", neither of which falls under application of the unfinished business doctrine.[7] According to at least one court, "[u]nfinished business exists until it is finished, and therefore the [t]rustee, if entitled, can recover any realized [u]nfinished [b]usiness profits no matter when such business was or is concluded."[8] The unfinished business doctrine

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the Plan Administrator and Baker & McKenzie LLP, Dev. Specialists, Inc., in its capacity as Plan Administrator for Coudert Brothers LLP v. Baker & McKenzie LLP, No. 09-1150 (Bankr. S.D. N.Y. Aug. 20, 2010) (approving a settlement that provided, in part, for (i) payments to the estate in the aggregate amount of $6.65 million on account of unfinished business claims and (ii) an agreement to share approximately $17 million in contingent fees).

5. Dev. Specialists, Inc. v. Akin Gump Strauss Hauer & Feld LLP (In re Coudert Bros. LLP), 480 B.R. 145 (S.D. N.Y. 2012) (hereafter, "*Coudert Bros*."); Geron v. Robinson & Cole LLP (In re Thelen LLP), 476 B.R. 732 (S.D. N.Y. 2012) (hereafter, "*Thelen*").

6. *Coudert Bros*., 480 B.R. at 161. *See* Greenspan v. Orrick, Herrington & Sutcliffe LLP (In re Brobeck, Phleger & Harrison LLP), 408 B.R. 318, 333 (Bankr. N.D. Cal. 2009) (hereafter, "*Brobeck*") ("Under California law, the unfinished business of a law partnership is any business covered by retainer agreements between the firm and its clients for the performance of partnership services that existed at the time of dissolution.")

7. "Finished business" is "business that has been completed prior to dissolution (the merger done and documented; the lawsuit tried to verdict or settled)." *Coudert Bros*., 480 B.R. at 160. "New business" is an entirely new engagement entered into with a dissolved firm's former client that followed a former partner to the new firm. *Id*. at 160-61; *see also Brobeck*, 408 B.R. at 333 ("However, a critical distinction exists between 'unfinished business,' which remains a partnership asset and for which each partner has a fiduciary duty to complete, and 'new' business which is not a partnership asset and may follow the individual partner.")

8. *Brobeck*, 408 B.R. at 332 n.15 (rejecting time period limit on recovery as argued by the defendant firms and attorneys); *compare* Official Comm. of Unsecured Creditors v. Ashdale (In re Labrum & Doak, LLP), 227 B.R. 391, 396 (Bankr. E.D. Pa. 1998) (hereafter, "*Labrum & Doak*") (creditors' committee voluntarily limited unfinished business claims to fees collected by former partners and their new firms on unfinished business in the one year period following dissolution of debtor law firm).

rests on the legal principle that, absent an enforceable agreement stating otherwise, a departing partner owes a fiduciary duty to the dissolved firm and her former partners to account for benefits obtained from use of partnership property in winding up the business of the partnership.[9]

Well-drafted partnership agreements generally address (i) whether unfinished business constitutes a partnership asset and (ii) whether, upon dissolution, partners owe a duty to account for unfinished business. The partnership agreement should govern resolution of the issues, provided the provisions themselves are not subject to attack under laws such as applicable state or federal fraudulent transfer statutes. But, in the absence of controlling partnership agreement provisions, the questions of whether (i) unfinished business constitutes property of the partnership's bankruptcy estate and, if so, (ii) former partners owe a fiduciary duty to account to their dissolved firm and former partners for profits relating to unfinished business, are largely controlled by applicable state law, particularly applicable state partnership statutes.

A discussion of applicable state law begins with the Uniform Partnership Act of 1914 ("UPA"). The UPA has been adopted by every state, except Louisiana.[10] Subsequent revisions to the UPA, commonly referred to as "RUPA" or the Revised Uniform Partnership Act, have been adopted by thirty-seven states, including Delaware and California, but excluding New York and Pennsylvania.[11]

According to the states' codifications of UPA or RUPA, partnership property refers to all property, whether real, personal or mixed, tangible or intangible, or any interest held therein, that is owned by the partnership.[12] Under the laws of most states, *in the absence of an express provision to the contrary in the applicable partnership agreement,* a partner owes a fiduciary duty of loyalty to account to the partnership and her former partners with respect to any property, profit or benefit obtained in the conduct or winding up of partnership business.[13]

Importantly, application of the unfinished business doctrine to law firms has not been limited to firms formed under state *partnership* laws. The doctrine has been applied in dissolutions of law firms formed as professional corporations,

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9. The unfinished business doctrine has been applied in the context of law firm dissolutions. It does not appear to have been applied in a situation where a partner simply leaves her solvent operating law firm, joins a new firm while her old firm continues operating, and then clients of the old firm engage her at the new firm to continue working on the client's pending matters. *See, e.g., Coudert Bros*., 480 B.R. at 151, n.1; Heller Ehrman LLP v. Jones Day (In re Heller Ehrman LLP), No. 10-3221, 2013 Bankr. LEXIS 889, at *12-15 (Bankr. N.D. Cal. Mar. 11, 2013) (hereafter, "*Heller 2013*").

Unfinished business claims in the context of a law firm's dissolution are not the only possible claims against departing partners. *See, e.g.,* Trustee's Motion, Pursuant to Bankruptcy Rule 9019, for an Order (A) Approving Settlement Agreements with Certain Former Partners of the Debtor; (B) Finding that Such Settlements are in Good Faith; and (C) Barring Certain Claims against Settling Partners, In re Thelen, LLP, No. 09-15631 (Bankr. S.D. N.Y. Sept. 28, 2011) (describing claims against former partners, including claims related to alleged overcompensation received by the partners in violation of the relevant partnership agreements, unpaid capital contribution requirements, and unpaid loans or other advances made by the debtor law firm on behalf of the partners for a variety of reasons, including payment of health insurance and other personal expenses).

10. *See* Uniformlaws.org, Legislative Fact Sheet – Partnership Act, at http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Partnership Act (last visited Apr. 18, 2013).

11. *Id.*; *see also* Delaware Revised Uniform Partnership Act, DEL. CODE ANN. tit. 6, ch. 15 (2005 and Supp. 2012) ("DRUPA"); California Revised Uniform Partnership Act of 1994, Cal. Corp. Code §§ 16100-16962 (2006 and Supp. 2013) ("CRUPA").

12. *See, e.g.*, DRUPA § 15-101(17); CRUPA § 16101(15).

13. *See, e.g.*, DRUPA § 15-404(b)(1)("A partner's duty of loyalty to the partnership and the other partners is limited to the following: (1) to account to the partnership and hold as trustee for it any property, profit or benefit derived by the partner in the conduct or winding up of the partnership business or affairs or derived from a use by the partner of partnership property, including the appropriation of a partnership opportunity;…"); CRUPA § 16404(b)(1) (substantially similar).

limited liability companies, and even in a case involving a "hybrid" limited liability partnership.[14] Moreover, "dissolution" does not equate to "termination".[15] A dissolved law firm continues in existence until its affairs are "wound up."[16]

II. CASE LAW DEVELOPMENT OF THE UNFINISHED BUSINESS DOCTRINE

It is well-settled in many states that, absent contrary provisions in a partnership agreement, the unfinished business doctrine applies to *contingency fee* matters pending upon dissolution of a law firm.[17] Absent an agreement to the contrary, partners who take with them to their new places of employment contingency fee cases they were handling at the time of their old firm's dissolution likely will have a duty to account to the old firm for at least a portion of the fees received from those contingency cases.[18]

Several courts recently have wrestled with the question of whether, in the absence of an enforceable agreement among the former partners, the unfinished business doctrine applies to *hourly fee* matters pending with the dissolved firm at the time of its dissolution. These hourly fee matters typically get moved by the clients to a new firm in conjunction with the new firm's hiring of the responsible partner. The new firm receives fees as a result of work performed on the hourly fee matters. Then the questions become whether the former partner or new firm must account for the fees received and if so, whether reasonable compensation for the "efforts, skill and diligence" utilized to obtain such fees may be deducted to reduce the amount owed to the dissolved firm. State and federal courts across the country have been asked to decide these questions in the context of law firm dissolutions. They are not all reaching the same conclusions.

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14. *See, e.g.*, Santalucia v. Sebright Transp., Inc., 232 F.3d 293, 299 (2d Cir. 2000) (hereafter, "*Santalucia*") (applying unfinished business doctrine to law firm practicing as professional corporation formed under New York law) (citations omitted); Sufrin v. Hosier, 896 F. Supp. 766 (N.D. Ill. 1995) (applying unfinished business doctrine to law firm practicing as professional corporation formed under Illinois law); Heller Ehrman LLP v. Arnold & Porter LLP (In re Heller Ehrman LLP), No. 10-3203, 2011 Bankr. LEXIS 1497, at *6-12 (Bankr. N.D. Cal. Apr. 22, 2011) (hereafter, "*Heller 2011*") (applying unfinished business doctrine where debtor law firm was a California limited liability partnership, managing general partner was a California professional corporation, remaining partners consisted of several other professional corporations incorporated in California and other states, and the individual attorney partners were members of the various professional corporations); *id.* at *7 ("Even though the court agrees that RUPA is inapplicable, it disagrees with Defendant's contention that – absent the Jewel waiver – the Shareholders had no duty to account for profits from unfinished business."); Rothman v. Dolin, 24 Cal. Rptr. 2d 571, 572 n.3 (Cal. Ct. App. 1993) (unfinished business doctrine applies to professional law corporations formed under California law); Fox v. Abrams, 210 Cal. Rptr. 260, 265 (Cal. Ct. App. 1985) (same).

15. *Coudert Bros.,* 480 B.R. at 155 ("Dissolution is not termination.") (quoting Scholastic, Inc. v. Harris, 259 F.3d 73, 85 (2d Cir. 2001) (citing New York Partnership Law §§ 60, 61)).

16. *Coudert Bros.,* 480 B.R. at 155-56 ("Instead, the partnership 'continues' in existence until the 'winding up' of its affairs is completed.")

17. *Id.* at 163-64 (collecting cases).

18. *See, e.g., Santalucia*, 232 F.3d at 298 (applying New York law) ("Thus, in a case where a lawyer departs from a dissolved partnership and takes with him a contingent fee case which he then litigates to settlement, the dissolved firm is entitled only to the value of the case at the date of dissolution, with interest…. Stated conversely, the lawyer must remit to his former firm the settlement value, less that amount attributable to the lawyer's efforts after the firm's dissolution.") (citations omitted).

A. *Jewel v. Boxer*

Now to the case law. *Jewel v. Boxer*[19] is the seminal unfinished business doctrine case dealing with law firms. In *Jewel*, a four-partner California law firm dissolved in 1977. Two of the partners (Messrs. Jewel and Leary) formed one new firm, and the other two partners (Messrs. Boxer and Elkind) formed another new firm. At their dissolved firm, the former partners had no written partnership agreement and no agreement allocating fees from active cases upon dissolution.[20] At the time of dissolution, the old firm was handling various types of cases, apparently with an emphasis on personal injury and workers compensation cases.[21] When the new firms were formed, the respective partners at the new firms were hired by the clients whose cases were handled by such partners at the old firm.[22]

Several years later, a dispute arose as to the proper allocation of attorneys' fees received by the new firms from completion of the old firm's cases that remained open at the time of dissolution. Following a bench trial, the court allocated post-dissolution income to the old and new firms on a *quantum meruit* basis.[23] In a somewhat Byzantine process, the court first determined the former partners' respective partnership interests in income of the old firm: 30% for Jewel, 27% for Boxer, 27% for Elkind, and 16% for Leary. The court then allocated the disputed fees between the old firm and new firms according to three factors: "the time spent by each firm in the handling of each case, the source of each case (always the old firm), and, in the personal injury contingency fee cases, the result achieved by the new firm."[24] The trial judge assigned values to each of the three factors, with the values depending on items such as when a case settled or if it was tried, and the amount of time expended on the case before and after dissolution.[25] The court found that Messrs. Boxer and Elkind owed the old firm more than double what Messrs. Jewel and Leary owed the old firm. Notwithstanding, Messrs. Jewel and Leary appealed to challenge the trial court's allocation of post-dissolution fees.

The appellate court reversed. In so doing it applied California partnership law[26] to hold that (a) a dissolved partnership continues until unfinished partnership business is wound up, and (b) absent a contrary agreement, any income generated through the winding up of unfinished business is allocated to the former partners according to their respective

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19. Jewel v. Boxer, 203 Cal. Rptr. 13 (Cal. Ct. App. 1984).

20. *Id.* at 15.

21. The *Jewel* opinion is somewhat unclear whether the old firm at the time of dissolution handled all contingency fee matters, or a mix of some contingent fee matters and some hourly fee matters. The opinion appears to suggest that at least most of the old firm's matters were of the contingent fee variety. *See id.* at 15-16; see also Rothman v. Dolin, 24 Cal. Rptr. 2d 571, 572-73 (Cal. Ct. App. 1993) (noting lack of clarity from the Jewel and Fox opinions as to the kinds of client matters pending at the time of respective dissolutions, but concluding that unfinished business consisted of all types of matters in progress at time of dissolution).

22. *Jewel*, 203 Cal. Rptr. at 16.

23. "Quantum meruit" is Latin for "as much as he deserved." Black's Law Dictionary 1276 (8th ed. 2004).

24. *Jewel*, 203 Cal. Rptr. at 16.

25. *Id.*

26. When the *Jewel* decision issued in 1984, California had adopted the UPA. *See* Cal. Corp. Code §§ 15001-15058 (1995). California subsequently adopted revisions to the UPA. As of January 1, 1999, CRUPA governed all California partnerships, thus replacing the former UPA in its entirety. *See Brobeck*, 408 B.R. 318, 325, n.2 (Bankr. N.D. Cal. 2009) (citing CRUPA §16111).

interests in the dissolved partnership at the time of dissolution.[27] Further, the appellate court ruled that this manner of allocation should be utilized regardless of which former partner and new firm provided the actual legal services subsequent to the dissolution.[28] The *quantum meruit* approach adopted by the trial court was rejected based upon the plain language of the UPA and the decisions of several other courts interpreting the relevant UPA provisions.[29]

Importantly, the *Jewel* court relied upon the UPA and case law to hold that "no partner (except a surviving partner) is entitled to extra compensation for services rendered in completing unfinished business."[30] The court found the UPA contained no special exception for law firms and lawyers from the "no extra compensation" rule set forth in the UPA.[31] And in invoking the "no extra compensation" rule, the *Jewel* court explained the "sound policy reasons" supporting application of the rule to law partnerships.[32] The "no extra compensation" rule, however, does not mean that a new firm bears all of the expenses incurred in generation of the post-dissolution revenue on unfinished matters.[33] Rather, "[u]nder the provisions of the Uniform Partnership Act, the former partners will be entitled to reimbursement for reasonable overhead expenses

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27. *Jewel*, 203 Cal. Rptr. at 19.

28. *Id.* at 15-17.

29. *Id.* at 17 (citing Resnick v. Kaplan, 434 A.2d 582, 587 (Md. 1981); Frates v. Nichols, 167 So.2d 77, 81 (Fla. Dist. Ct. App. 1964); Kreutzer v. Wallace, 342 So.2d 981, 982-83 (Fla. Dist. Ct. App. 1977)).

30. *Jewel*, 203 Cal. Rptr. at 16 (citing Cal. Corp. Code, § 15018(f) (1995)). Section 15018(f) under the California UPA stated as follows: "No partner is entitled to remuneration for acting in the partnership business, except that a surviving partner is entitled to reasonable compensation for his services in winding up the partnership affairs."

In footnote 2 of its opinion, the *Jewel* court defined "extra compensation" as "receipt by a former partner of the dissolved partnership of an amount of compensation which is greater than would have been received as the former partner's share of the dissolved partnership." This has changed in California. Under CRUPA, a departing partner became entitled to deduct overhead expenses and reasonable compensation from the fees generated from winding up the unfinished business of the partnership. CRUPA §16401(h) (2006). *See Brobeck*, 408 B.R. at 327, n.4 (CRUPA has changed the *Jewel* "no extra compensation" rule for post-dissolution windup activities; now, partners are allowed "reasonable compensation" for services rendered in winding up partnership business); s*ee also id.* at 333 ("What constitutes unfinished business must be determined on the date of dissolution of the partnership, not based on events occurring thereafter…. Absent an agreement to the contrary, partnership assets include attorneys fees received by the partnership for cases in progress at dissolution, and such fees, *minus overhead and reasonable compensation*, must be shared among all partners in accordance with the ownership interest of each, regardless of which partner performs the services for winding up purposes.") (emphasis added) .

31. *Jewel*, 203 Cal. Rptr. at 17 ("[t]he definition of 'business' in the Uniform Partnership Act as including 'every trade, occupation, or profession' (Corp. Code, §15002) precludes an exception for law partnerships"); *Coudert Bros.*, 480 B.R. 145, 158 (S.D. N.Y. 2012) (the New York Partnership Law applies to partnerships engaged in any business or profession).

32. *Jewel*, 203 Cal. Rptr. at 18:

> The rule prevents partners from competing for the most remunerative cases during the life of the partnership in anticipation that they might retain those cases should the partnership dissolve. It also discourages former partners from scrambling to take physical possession of files and seeking personal gain by soliciting a firm's existing clients upon dissolution…. On balance, the allocation of fees according to each partner's interest in the former partnership should not work an undue hardship as to any partner where each partner completes work on the partnership's cases which are active upon its dissolution.

33. *Id.* at 19-20 ("A reimbursement of reasonable and necessary overhead expenses attributable to the winding up of partnership business is certainly an equitable result."). But this does not mean that gross income from the subject matters gets reduced by partners' compensation, which is not included as part of the overhead expenses. *Id.* at 19.

(excluding partners' salaries) attributable to the production of postdissolution partnership income; in other words, it is *net* postdissolution income, not gross income, that is to be allocated to the former partners."[34]

The *Jewel* court also discussed whether the results that flowed from its rulings would be unjust or would somehow cause undue hardship for some former partners. It concluded that application of the "no extra compensation" rule would not lead to unjust results, primarily because of "two basic fiduciary duties owed between the former partners: First, each former partner has a duty to wind up and complete the unfinished business of the dissolved partnership …. Second, no former partner may take any action with respect to unfinished business which leads to purely personal gain."[35]

On an issue addressed in many cases decided after *Jewel*, the *Jewel* court distinguished between a client's absolute right to choice of counsel on the one hand, and the rights and duties owed by former partners to each other with respect to income from unfinished business on the other hand. The court held that these two rights were independent and distinct, and a client's right to counsel of her choice should have no impact on allocation of fees collected on the client's matter among the former partners of a dissolved firm.[36]

Finally, perhaps in its most practical takeaway advice, the *Jewel* court noted that all of the uncertainty surrounding application of the UPA to the dissolution of the old firm could have been avoided by a written partnership agreement containing provisions addressing with specificity the completion and allocation of unfinished business upon dissolution.[37]

Courts in California and from around the country have followed *Jewel*, particularly in cases involving contingent fee matters, but also in some cases involving hourly fee matters.[38] It must be noted, however, that at least one court has questioned whether the reasoning of *Jewel* remains fully intact given California's subsequent adoption of CRUPA.[39]

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34. *Id.* (italics in original) (citing Cal. Corp. Code §15015(b) (1995)).

35. *Id.*

36. *Id.* at 17; *see also Coudert Bros*., 480 B.R. at 168-69. *But see Thelen*, 476 B.R. 732, 742-43 (Bankr. S.D. N.Y. 2012); Welman v. Parker, 328 S.W.3d 451, 457 (Mo. Ct. App. 2010) (in case involving disputed contingent fee, court held that dissolved firm was entitled only to recover the reasonable value of services provided prior to the dissolution; court reasoned that client's absolute right to choose counsel, including right to be represented by withdrawing partner at her new firm, would be impermissibly and adversely impacted by a conclusion that the contingent fee remained the property of the dissolved partnership). The reasoning utilized in *Welman* has its critics. *See* LaFond v. Sweeney, No. 10CA2005, 2012 Colo. App. LEXIS 242 (Colo. Ct. App. Feb. 16, 2012); Huber v. Etkin, 58 A.3d 772 (Pa. Super. Ct. 2012).

37. *Jewel*, 203 Cal. Rptr. at 19 ("The former partners must bear the consequences of their failure to provide for dissolution in a partnership agreement.")

38. Labrum & Doak, 227 B.R. 391, 408-09 (Bankr. E.D. Pa. 1998) (applying Pennsylvania UPA to hold that post-dissolution income received on hourly fee cases pending at time of dissolution constituted property of the estate; court found that partnership agreement did not address allocation of fees and costs in the event of dissolution) (collecting cases); Huber v. Etkin, 58 A.3d at 780 (holding that under Pennsylvania UPA, contingency fees from cases pending at time of dissolution but not realized until after dissolution are assets of dissolved firm)(collecting state cases); Rothman v. Dolin, 24 Cal. Rptr. 2d 571, 573 (Cal. Ct. App. 1993) (holding under California law that unfinished business consists of contingent and hourly fee matters not yet completed at time of dissolution); *Brobeck*, 408 B.R. 318, 333 (Bankr. N.D. Cal. 2009) (unfinished business of law firm includes all matters in progress when firm dissolves, regardless of whether hourly fee or contingency fee matters); *id.* at 333, n.20 (expressly rejecting Defendants' argument that hourly rate matters are not included within CRUPA definition of unfinished business); Sufrin v. Hosier, 896 F. Supp. 766, 769 (N.D. Ill. 1995) (holding under Illinois law that dissolved firm's contingent fee matters in progress at time of dissolution constituted firm assets that must be shared according to formula agreed to by former partners, notwithstanding fact that only one of the two partners worked to complete client matters after dissolution); *LaFond v. Sweeney*, 2012 Colo. App. LEXIS 242 at *7 (holding under Colorado law that because two lawyers agreed to share firm's profits equally, each was entitled to equal share of contingent fee obtained by one of them after dissolution; pursuant to Colorado LLC Act, attorney who obtained fee was not entitled to extra compensation for winding up case).

39. *Thelen*, 476 B.R. 732, 739 (S.D. N.Y. 2012) (noting that the *Jewel* court's adoption of the "no extra compensation"

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B. The Southern District Of New York Split On Whether Hourly Fee Matters Constitute Unfinished Business Of A Dissolved Partnership

In 2012, two district court judges in the Southern District of New York addressed head-on whether hourly fee matters pending upon a law firm's dissolution constitute property of the partnership (and its estate)[40] and therefore, constitute unfinished business subject to an accounting by the former partners and their new firms, absent a contrary and enforceable agreement.

Judge Colleen McMahon addressed the issue under New York law in the Coudert Brothers LLP ("Coudert Brothers") bankruptcy case. Judge William H. Pauley III, in turn, addressed the issue under New York and California law in the Thelen LLP bankruptcy case. The two judges reached conflicting decisions under New York law, and the Second Circuit has accepted interlocutory appeals of both decisions under New York law. A detailed discussion of the two district court decisions follows.

1. *Coudert Bros.*

After more than 150 years of providing legal services, Coudert Brothers dissolved in August 2005. In September 2006 Coudert Brothers filed for Chapter 11 bankruptcy in the United States Bankruptcy Court for the Southern District of New York.

The plan administrator (the "Plan Administrator") appointed pursuant to the Coudert Brothers' confirmed Chapter 11 plan filed thirteen separate adversary proceedings against ten law firms (the "Defendant Firms") premised, at least in part, on the unfinished business doctrine. The complaints asserted claims based on New York and federal bankruptcy law for an accounting, turnover, unjust enrichment, and conversion.[41]

Following a withdrawal of the reference of the adversary proceedings, the Defendant Firms filed motions for summary judgment. The Plan Administrator filed a cross-motion seeking a declaration that Coudert Brothers' unfinished

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rule was based on a since-repealed statute). As stated above, CRUPA changed the "no extra compensation" rule found in the California UPA. *See infra* note 30.

40. 11 U.S.C. §541(a) (under the Bankruptcy Code, property of the estate is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case"). Whether a debtor has any legal or equitable interest in property is determined by applicable state law. Butner v. United States, 440 U.S. 48, 55 (1979).

41. In response to the complaints, the Defendant Firms initially filed motions to dismiss. *See Coudert Bros.*, 480 B.R. at 153 (reciting procedural history). They argued, inter alia, that the unfinished business doctrine did not apply to non-contingency fee matters. The motions to dismiss were denied in a bench ruling by Judge Drain of the United States Bankruptcy Court for the Southern District of New York. *Id.* The Bankruptcy Court acknowledged that New York's highest court had not yet addressed the issue of whether the unfinished business doctrine applied to non-contingency matters. *Id.* The Bankruptcy Court concluded that, if the New York Court of Appeals was faced with this issue, it would find that the unfinished business doctrine applied to both contingency fee and non-contingency fee matters. *Id.*

After an amended bench ruling by the Bankruptcy Court, the Defendant Firms moved for direct certification to the Second Circuit Court of Appeals. Those motions were denied by the Bankruptcy Court. *Id.* The Defendant Firms then moved for leave to appeal the orders denying the motions to dismiss. Those motions were denied by the United States District Court for the Southern District of New York. *Id.* (citing In re Coudert Bros. LLP Law Firm Adversary Proceedings, 447 B.R. 706 (S.D. N.Y. 2011) (Marrero, J.)). The Defendant Firms were, however, successful in having the reference of the adversary proceedings withdrawn to the United States District Court for the Southern District of New York. *See Coudert Bros.*, 480 B.R. at 153, citing Dev. Specialists, Inc. v. Akin Gump Strauss Hauer & Feld LLP (In re Coudert Bros.), 462 B.R. 457 (S.D. N.Y. 2011) (McMahon, J.).

client matters constituted partnership assets on the date of dissolution.[42] In a lengthy decision, Judge McMahon addressed two primary issues.

First, Judge McMahon considered whether hourly fee matters pending at the time of dissolution constituted assets of the dissolved law firm under New York law (hereafter, "Issue No. 1"). Her answer, for the reasons discussed more fully below, was an unequivocal "Yes".[43]

Second, assuming arguendo that the hourly fee matters constituted partnership assets on the dissolution date, Judge McMahon addressed whether the Defendant Firms were entitled to summary judgment because the unfinished hourly fee matters had no value (hereafter, "Issue No. 2"). More specifically, the issue was whether the value of the post-dissolution efforts at the Defendant Firms to complete the hourly fee matters equaled the fees paid by the clients to the Defendant Firms for such matters, and therefore the hourly fee matters would not have generated any profit for distribution in accordance with the Coudert Brothers' partnership agreement. Judge McMahon held that the answer on Issue No. 2 required factual resolutions not appropriate for decision on summary judgment.[44]

The court, however, found that the Defendant Firms were entitled to summary judgment on the Plan Administrator's claims for turnover, unjust enrichment and conversion, thereby leaving a cause of action for an accounting, which is "the traditional remedy for resolving monetary disputes among former partners."[45]

a. The New York Partnership Law

As an initial matter, Judge McMahon discussed various sections of the New York Partnership Law (the "NYPL"). The NYPL is a codification of the UPA. The NYPL sets forth default rules that operate in the absence of a controlling provision in a partnership agreement.[46] Unlike the law firm in *Jewel*, Coudert Brothers had a written partnership agreement. And that agreement expressly incorporated the default rules of the NYPL.[47]

Judge McMahon explained that, pursuant to section 43 of the NYPL, "[p]artners owe one another, and the partnership, fiduciary duties, including the duty to account for any benefit a partner derives from his use of partnership property."[48] The NYPL also provides that, although a partnership may dissolve, the partnership continues until the

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42. *Coudert Bros.*, 480 B.R. at 151.

43. *Id.* at 154.

44. *Id.* at 155.

45. *Id.*

46. *Id.*

47. *Id.* at 155-56.

48. *Id.* at 156. Section 43(1) of the NYPL states:

> Every partner must account to the partnership for any benefit, and hold as trustee, for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.

See also Coudert Bros., 480 B.R. at 156 (quoting Denver v. Roane, 99 U.S. 355 (1878) ("Having jointly undertaken the business intrusted to the partnership, *all the parties* were under obligation to conduct it *to the end*. This duty they owed to the clients and to each other. *And as to the unfinished business remaining with the firm on [the date of dissolution], the duty continued*,") (emphasis added in *Coudert Bros.* opinion)). This duty described in *Roane* is codified in NYPL §43(1). *Coudert Bros.*, 480 B.R. at 156.

partnership's business is wound up.[49] Judge McMahon focused on partners' duties during the "winding up" phase. She found that partners owe fiduciary duties to one another while winding up partnership business, regardless of whether the partners remain with the dissolving firm during the windup or leave the dissolving firm and wind up the business at other firms.[50]

The court also discussed section 73 of the NYPL, which section is part of the Article of the NYPL that addresses dissolution. Section 73 provides that, if winding up partners do not immediately settle accounts with a partner who dies or withdraws from the partnership upon dissolution, the winding up partners have a duty to account for the departing partner's interest in the partnership as of the date of dissolution. It further provides that a partner who departs from a dissolving partnership is entitled to interest on his share of partnership property accruing from the date of dissolution, or, "in lieu of interest, the profits attributable to the use [by the winding up partner] of [the departing partner's] right in the property of the dissolved partnership …."[51]

Judge McMahon concluded that these NYPL provisions, read together, require a former partner to account for any post-dissolution use of partnership property.[52]

The *Coudert Bros.* court also reviewed the NYPL relating to the question of whether "the partner is entitled to deduct from the net profits 'reasonable compensation' for her post-dissolution efforts before remitting the balance to her former partners for division."[53] Judge McMahon noted that Section 40(6) of the NYPL codified the "no compensation" rule established under New York common law: "No partner is entitled to remuneration for acting in the partnership business, except that a surviving partner is entitled to reasonable compensation for his services in winding up the partnership affairs."[54]

Judge McMahon further noted that while "[t]he New York Court of Appeals has never considered whether what I will call the 'Kirsch rule' runs afoul of the 'no compensation' rule codified in Partnership Law §40(6)," the Second Circuit (in *Santalucia*) and several New York intermediate courts have ameliorated this rule, at least in the contingent fee context, by allowing a former partner to reduce the profits for which he must account "by an amount that reflects the value of his post-dissolution 'efforts, skill and diligence.'"[55] The *Coudert Bros.* court openly questioned whether the New York Court of Appeals would agree with the "reasonable compensation" approach adopted by these other courts.[56]

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49. *Id.*

50. *Id.*

51. *Id.* (quoting NYPL § 73). Judge McMahon noted the Second Circuit's view that "Section 73 is not the source of the duty of a lawyer to account to his former partners. The source of the duty is the fiduciary relationship of trust and confidence that partners have from time immemorial shared with one another." *Id.* at 157 (quoting *Santalucia*, 232 F.3d 293, 300 (2d Cir. 2000) (emphasis in original).

52. *Id.*

53. *Id.* at 158.

54. *Id.* at 158 (quoting NYPL § 40(6)). The "surviving partner" exception was not applicable because Coudert Brothers was not dissolved due to the death of any of its partners.

55. *Id.* at 159, 175-77; *see, e.g. Santalucia*, 232 F.3d at 298; Kirsch v. Leventhal, 586 N.Y.S.2d 330, 333 (N.Y. App. Div. 1992) (hereafter, "*Kirsch*") (court rejected quantum meruit approach to valuing former partner's share in contingent fee recovery relating to case pending at time of prior firm's dissolution; the *Kirsch* court held a quantum meruit approach was "inconsistent with the fiduciary duty of the partner in possession of the partnership business after dissolution [here, the defendant] to wind up the partnership's affairs and complete performance of any partnership service contracts for the benefit of all partners"; the *Kirsch* court found an issue of fact

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b. Issue No. 1 — Under New York Law, Hourly Fee Matters Constitute Assets Of A Dissolved Law Firm

Following its discussion of the NYPL, the *Coudert Bros.* court turned to analysis of Issue No. 1, i.e. whether under New York law pending hourly fee matters constituted partnership assets as of the date of dissolution. Judge McMahon reasoned that, due to the fundamental nature of a partnership, there is a presumption that a firm's business belongs to the firm and not to its individual partners.[57] Judge McMahon recited the general rule as holding that unfinished business (in the form of an executory contract) of a partnership on the date of dissolution is a partnership asset unless the parties indicate a contrary intent.[58]

In support of this "partnership asset" rule, the *Coudert Bros.* court relied on *Stem v. Warren*[59], a 1920 decision from the New York Court of Appeals. *Stem* involved two architecture firms, Reed and Stem ("RS") and Warren and Wetmore ("WW"). They formed a partnership ("RS & WW") to oversee the construction of Grand Central Station. RS & WW entered into a construction contract with the regional railroad company. That contract was terminable at will by the railroad but it included a provision requiring payment for completed work. After years of construction, one of the partners (Reed of RS) died and RS & WW dissolved. Wetmore negotiated with the railroad for his firm WW to complete the project. The railroad terminated the RS & WW contract and entered into a new contract with WW. The railroad paid RS & WW for all of the work it completed up to its dissolution.

Notwithstanding that RS & WW's contract was terminable at will and that RS & WW had been paid in full for its pre-dissolution work, Reed's estate successfully sued WW for an accounting for all profits WW received under its new contract with the railroad. The New York Court of Appeals explained that the railroad contract was RS & WW's most valuable asset and WW was required to account for any profits received while winding up RS & WW's business.[60]

Despite the fact that *Stem* did not involve a law partnership, the *Coudert Bros.* court viewed this decision as conclusive on the question presented (whether executory contracts to render legal services constituted partnership assets upon dissolution) because the NYPL does not treat law partnerships differently from other partnerships.[61]

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as to whether the contingency fee case at issue was a partnership asset; and, assuming the case constituted unfinished business of the dissolved firm, it needed to be "evaluated as of the date of dissolution in determining the value of plaintiff's partnership interest…"; finally, the *Kirsch* court quoted NYPL §73 (plaintiff entitled to "the value of his interest at the date of dissolution…with interest, or, at his option…in lieu of interest, the profits attributable to the use of his right in the property of the dissolved partnership") and stated that "[T]o the extent that the ultimate successful settlement of the *Geddes* case was due, as defendant avers, to her postdissolution efforts, skill and diligence, the firm's fee in the *Geddes* case proportionately would not be "'attributable to the use of [plaintiff's] right in the property of the dissolved partnership.'")

56. *Coudert Bros*., 480 B.R. at 175-77.

57. *Id.* at 159.

58. *Id.* at 161 (citing King v. Leighton, 3 N.E. 594, 600-01 (N.Y. 1885)); Stem v. Warren, 125 N.E. 811, 813 (N.Y. 1920); Dawson v. White & Case, 672 N.E. 2d 589, 592 (N.Y. 1996); Rhein v. Peeso, 185 N.Y.S. 150 (N.Y. App. Div. 1920); *Kirsch*, 586 N.Y.S.2d at 332.

59. Stem v. Warren, 125 N.E. 811 (N.Y. 1920).

60. *Coudert Bros*., 480 B.R. at 162 (citing *Stem*, 125 N.E. at 811-13).

61. *Id.* at 162-63, 167.

Judge McMahon explained that the question of whether an executory contract constitutes a partnership asset is controlled by the parties' intent, as evidenced by their conduct, the partnership agreement, the agreement with the client, the firm's accounting entries, etc.[62] Judge McMahon noted that none of the cited cases distinguished between hourly fee matters and contingent fee matters and ultimately concluded that the Defendant Firms had not suggested a "meaningful difference between legal business that is billed by the hour versus handled on contingency…"[63] Simply stated, she did not view the payment arrangement between the client and the firm as altering the general rule that executory contracts to provide legal services are partnership assets subject to distribution upon dissolution, absent a contrary intent of the parties.[64]

The *Coudert Bros.* court noted that prior New York intermediate appellate court decisions addressing whether executory contracts to provide legal services were partnership assets subject to distribution upon dissolution, had done so in the law firm context only with respect to contingent fee matters.[65] These courts had concluded that under New York law, contingent fee matters constituted property of the partnership subject to distribution upon dissolution. Courts in other UPA jurisdictions had reached the same conclusion under the applicable state law.[66] Furthermore, when partners do not specify whether a contingent matter is a firm asset subject to distribution upon dissolution, such silence has been construed to signify an intention it is a partnership asset.[67]

Due to (i) the absence of New York cases addressing Issue No. 1 in the context of billable hour representations, and (ii) the NYPL statutory requirement that New York courts harmonize their rulings with those of other UPA jurisdictions[68], the *Coudert Bros.* court examined decisions from other jurisdictions that had addressed Issue No. 1 with respect to hourly fee matters. It cited to several decisions concluding that hourly fee matters were partnership assets absent an express intention to the contrary.[69] One case cited by Judge McMahon explained as follows:

> The nature of the underlying contractual relationship between the dissolved partnership and its client does not alter the legal status of a dissolved partnership nor does it change the fiduciary duties each

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62. *Id.* at 163 (citing Sriraman v. Patel, 761 F. Supp.2d 7, 18 (E.D.N.Y. 2011)).

63. *Coudert Bros.*, 480 B.R. at 163, 165.

64. *Id.* at 166, 172-73.

65. *Kirsch*, 586 N.Y.S.2d 330, 332-33 (N.Y. App. Div. 1992); Shandell v. Katz, 629 N.Y.S.2d 437, 439 (N.Y. App. Div. 1993) (hereafter, "*Shandell*") (court rejected quantum meruit approach and held that contingent fee cases pending at time of dissolution are partnership assets subject to distribution); DelCasino v. Koeppel, 615 N.Y.S.2d 454 (N.Y. App. Div. 1994) (in dispute under shareholders' agreement, court held that "pending contingency fee cases constituted partnership assets subject to distribution upon dissolution"); *see also Santalucia*, 232 F.3d 293, 297-298 (2d Cir. 2000) (collecting New York intermediate appellate court decisions).

66. *Coudert Bros.*, 480 B.R. at 163-64 (collecting cases).

67. *Id.* at 164 (citations omitted).

68. *Id.* ("The fact that New York courts must harmonize their rulings with those of other UPA jurisdictions by statute, Partnership Law § 4(4), is powerful reason to conclude that the New York Court of Appeals would reach the same result."). Section 4(4) of the NYPL explains that "[T]his chapter shall be so interpreted and construed as to effect its general purpose to make uniform the law of those states which enact it."

69. *See, e.g., Coudert Bros.*, 480 B.R. at 164 (quoting Labrum & Doak, 227 B.R. 391, 408 (Bankr. E.D. Pa. 1998), which cites cases from California, Pennsylvania, and the District of Columbia).

partner must honor towards another. They remain the same regardless of how an attorney agrees to be compensated by his clients.[70]

Another case cited by the *Coudert Bros.* court set forth the policy rationale behind such a rule. "[A]ccording different treatment to hourly rate and contingency fee cases would lead to the prospect of attorneys shunning contingency fee cases in anticipation of a possible dissolution of the law firm, and scrambling to get the hourly rate cases rather than the contingency fee cases upon dissolution."[71] Judge McMahon concluded that the New York Court of Appeals would follow this policy rationale and reach the same result as the courts in the other UPA jurisdictions: hourly fee matters pending upon dissolution constituted partnership assets under New York law.[72]

With respect to Issue No. 1, the *Coudert Bros.* court was not convinced by the arguments raised by the Defendant Firms. First, the Defendant Firms argued that real differences existed between billable hour cases and contingency fee cases. For billable hour matters, the Defendant Firms argued that a dissolved partnership should only expect to be compensated for the services rendered prior to dissolution because the law firm receives periodic payments for work performed. Therefore, the argument goes, "unfinished business" becomes "finished business" after each periodic invoice is issued.[73]

Judge McMahon remained unpersuaded. She reasoned that the Defendant Firms were conflating two issues – a law firm's rights against its clients and the rights of former partners among themselves – and were taking a position that was contrary to the teachings of *Stem*. She concluded that a law firm's ability to collect from its clients had no bearing on every partner's duty to account to her former partners for profits realized from a partnership asset upon dissolution.[74]

Judge McMahon next addressed the Defendant Firms' argument, which she stated was their strongest, centered around New York's strong public policy in favor of a client's right to select counsel of its choosing.[75] Judge McMahon noted that New York courts have refused to uphold provisions in partnership agreements that created financial disincentives for a departing partner to continue representing clients of his old firm. In *Cohen v. Lord, Day & Lord*,[76] the New York Court of Appeals voided a partnership agreement provision providing for forfeiture of a withdrawing partner's post-withdrawal entitlement if that withdrawing partner competed with his old firm. New York's highest court found such provision to be contrary to the public policy of ensuring a client's unfettered right to choose counsel. The provision also ran afoul of the professional ethics rules prohibiting restraints on the practice of law.[77]

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70. *Coudert Bros.*, 480 B.R. at 165 (quoting Robinson v. Nussbaum, 11 F. Supp.2d 1, 6 (D.D.C. 1997)).

71. *Coudert Bros.*, 480 B.R. at 164-65 (quoting Rothman v. Dolin, 24 Cal. Rptr. 571 (Cal. Ct. App. 1993)).

72. *Coudert Bros.*, 480 B.R. at 164.

73. *Id.* at 165-66.

74. *Id.* at 166 ("every partner must account to her former partners for profits realized from the use of what was, on the date of dissolution, a partnership asset") (citing NYPL, §43). Although the United States Supreme Court implied in Consaul v. Cummings, 222 U.S. 262 (1911) that a partner's duty to her former partnership may differ when that partner winds up a contingency fee matter as opposed to a billable hour matter, the *Coudert Bros.* court noted that New York's legislature declined to make that distinction when it subsequently adopted the NYPL. *Coudert Bros.*, 480 B.R. at 168.

75. *Id.*

76. *See, e.g.*, Cohen v. Lord, Day & Lord, 550 N.E.2d 410, 411-12 (N.Y. 1989) (hereafter, "*Cohen*") (New York Court of Appeals held unenforceable as violative of public policy and New York's Disciplinary Rules a partnership agreement provision providing for forfeiture of compensation if departing partner competed with former firm after departure).

77. *Id.* at 411 ("the significant monetary penalty it exacts, if the withdrawing partner practices competitively with the

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The Defendant Firms argued that applying the unfinished business doctrine to billable hour representations similarly would impede client choice because a partner will be dissuaded from continuing to represent a client if that partner will have to share with his former partners a large percentage of the profit earned from work completed at his new firm. This, according to the Defendant Firms, would create the same sort of "financial disincentive" for the former partners to continue representing their former clients, as was rejected in *Cohen*.

Judge McMahon disagreed[78], and in doing so discussed at length but ultimately distinguished on several grounds a case she expressly noted was not cited by the Defendant Firms – *Denburg v. Parker Chapin Flattau & Klimpl*.[79] She observed that *Denburg* (as well as *Cohen*) were not law firm dissolution cases; rather, they involved one partner withdrawing from a partnership that continued to do business.[80] The statutes governing partnership dissolutions are not applicable in the context of a partner's withdrawal from an ongoing partnership. Judge McMahon also pointed out that elements of competition need not be considered in *Coudert Bros.* because, unlike the former firms in *Cohen* and *Denburg*, the Coudert Brothers law firm had ceased doing business.[81] And finally, the *Coudert Bros.* court noted that neither *Denburg* nor *Cohen* addressed the unfinished business doctrine.[82]

The *Coudert Bros.* court also relied upon an examination of the Coudert Brothers Partnership Agreement and Special Authorization to refute Issue No. 1 arguments raised by the Defendant Firms. The court concluded the Partnership Agreement lacked language providing that billable hour representations should be excluded from partnership assets. In fact, it contained express language stating that all property of the firm belonged to the partnership, not to the individual partners.[83] Judge McMahon also found that the Special Authorization, which was adopted by Coudert Brothers in con-

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former firm, constitutes an impermissible restriction on the practice of law. The forfeiture-for-competition provision would functionally and realistically discourage and foreclose a withdrawing partner from serving clients who might wish to continue to be represented by the withdrawing lawyer and would thus interfere with the client's choice of counsel."); *see also Coudert Bros*., 480 B.R. at 169, n.7 (quoting N.Y. Prof. Cond. R. 5.6) ("A lawyer shall not participate in offering or making…a partnership…agreement that restricts the right of a lawyer to practice after termination of the relationship, except an agreement concerning benefits upon retirement."). This rule is designed to protect a client's unfettered right to choose counsel. *Coudert Bros*., 480 B.R. at 169-70.

78. Importantly, Judge McMahon in *Coudert Bros*. and Judge Pauley in *Thelen* reached opposite conclusions on this argument. Judge McMahon was not persuaded that a client's unrestricted right to choose counsel would be adversely impacted by application of the unfinished business doctrine to hourly fee matters pending at the time of a firm's dissolution. Judge Pauley viewed it very differently.

79. Denburg v. Parker Chapin Flattau & Klimpl, 624 N.E.2d 995, 997-1002 (N.Y. 1993) (hereafter, "*Denburg*") (New York Court of Appeals rejected as an illegitimate "financial disincentive" to the practice of law, a partnership agreement provision requiring a departing partner who competed against her former firm to pay the former firm the greater of (i) 12.5% of the firm's profits allocated to the partner over the two previous years or (ii) 12.5% of the annual bills issued by the new firm to clients of the former firm over the next two years). *See Coudert Bros*., 480 B.R. at 170-72.

80. *Coudert Bros*., 480 B.R. at 171.

81. *Id.*

82. *Id.* at 171-72 (distinguishing *Denburg* as involving partnership agreement provision requiring departing partner to share profits earned on completely new business from former clients of the old firm). Judge McMahon also noted that neither *Cohen* nor *Denburg* were mentioned in *Santalucia*, which "adopted the Appellate Division rule that contingency fee cases pending on the date of dissolution are partnership assets subject to distribution in the absence of a contrary agreement." *Id.* at 173.

83. *Id.* Article 8(i) of the Coudert Brothers Partnership Agreement stated as follows:

> The property of the Partnership belongs to the Partnership, and not to the Partners, and a Partner has no individual property rights in any specific assets of the Partnership. Rather, each Partner's interest in the Partnership property

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nection with dissolution, emphasized the partners' understanding that pending client matters constituted firm property that must be transitioned to new firms in order to protect clients and to maximize the value of Coudert Brothers' assets and business.[84] And, the Partnership Agreement explicitly incorporated the NYPL's default rules governing dissolution, which rules included a partner's fiduciary duty to account for profits earned on use of partnership property (i.e. unfinished business).[85] Accordingly, Judge McMahon concluded that the former partners owed a duty to account for profits attributable to any unfinished business that was completed at the Defendant Firms.

Based upon all of the above, as to Issue No. 1, the *Coudert Bros.* court held in favor of the Plan Administrator that under New York law, pending hourly fee matters were firm assets on the dissolution date, subject to the former partners' duty to account.[86]

c. Issue No. 2 — Does The Value Of Post-Dissolution Efforts To Complete Hourly Fee Matters Factor In To Calculation Of Amounts Due To The Dissolved Firm?

After its analysis and conclusion on Issue No. 1, the *Coudert Bros.* court then tackled Issue No. 2. The Defendant Firms argued that even if the hourly fee matters were partnership assets, they remained entitled to summary judgment because those matters generated no profits at the Defendant Firms. The Defendant Firms argued that after deduction of the value attributable to their post-dissolution "efforts, skills and diligence", no profits were left for which to account.

As discussed above, some intermediate New York courts, as well as the Second Circuit in *Santalucia,* appear to have ameliorated the NYPL's "no extra compensation" rule.[87] Those courts have permitted former partners to include the

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is his or her share in the surplus after the Partnership debts are paid and the Partnership accounts are settled and the rights of the Partners are adjusted between themselves.

84. *Id.* The Special Authorization stated, in part, as follows:

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

(emphasis added).

85. *Id.* at 174. Article 10(a) of the Coudert Brothers Partnership Agreement stated as follows:

> Dissolution. The Partnership may only be dissolved and wound up by an affirmative vote of a Super Majority of the Executive Board … and an affirmative vote of the Equity Partners …. <u>Such dissolution and winding up, and the rights of the Partners in connection therewith, shall be governed by the provisions of the [New York Partnership Law]</u>.

(emphasis added). *See also Coudert Bros.*, 480 B.R. at 155-159 (discussing several sections of the NYPL).

86. *Id.* at 175.

87. Section 40(6) of the NYPL states : "No partner is entitled to remuneration for acting in the partnership business, except that a surviving partner is entitled to reasonable compensation for his services in winding up the partnership affairs."; *but see, e.g., Santalucia*, 232 F.3d 293, 298 (2d Cir. 2000) ("Thus, in a case where a lawyer departs from a dissolved partnership and takes

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value of their post-dissolution "efforts, skills and diligence" as an expense that may be deducted from gross fees collected. The New York Court of Appeals, however, has not addressed this issue. Judge McMahon expressed reluctance to conclude (in fact, she openly questioned) that the New York Court of Appeals would follow intermediate appellate court and Second Circuit precedent to permit former partners and their new firms to deduct the value of post-dissolution efforts and overhead expenses from the fees earned by completing unfinished business.[88] Nevertheless, Judge McMahon acknowledged that as a district court judge in the Southern District of New York, she was bound to follow the Second Circuit precedent in *Santalucia*, which permitted deduction for the value of post-dissolution "efforts, skills and diligence."[89]

Adhering to that precedent, however, did not obviate the need for a trial. The court noted that a number of issues, such as the value of the matters on the dissolution date, what constituted overhead expenses, and the value of the former partners' post-dissolution "efforts, skills and diligence", involved disputed facts. Judge McMahon welcomed "the thorny task" of resolving these factual issues.[90]

In accordance with a briefing schedule set by the court in its original decision on the pending summary judgment motions, the Defendant Firms filed motions for certification of an interlocutory appeal. On July 18, 2012, Judge McMahon amended her prior decision and order on the summary judgment motions to provide that her decision "involves controlling questions of law, as to which there exist substantial grounds for difference of opinion, and that an immediate appeal would materially advance the ultimate termination of these proceedings."[91] As such, the *Coudert Bros.* court certified its amended summary judgment order for interlocutory appeal pursuant to 28 U.S.C. §1292(b). By order dated December 18, 2012, the Second Circuit accepted the appeals and a cross-appeal.

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with him a contingent fee case which he then litigates to settlement, the dissolved firm is entitled only to the value of the case at the date of dissolution, with interest … Stated conversely, the lawyer must remit to his former firm the settlement value, less that amount attributable to the lawyer's efforts after the firm's dissolution.").

88. *Coudert Bros.*, 480 B.R. at 175-77 (recapping *Kirsch* line of authority as standing for proposition that a partner's "effort, skill and diligence" can be treated as an expense so as to increase the deduction for overhead, thereby reducing the profits generated from finishing a client's matter at the new firm; Judge McMahon opined that *Kirsch* "rests on a misapplication or misunderstanding of [NYPL] § 40(6)"). The *Kirsch* court did not expressly cite to or discuss section 40(6) of the NYPL. The *Kirsch* court primarily relied upon section 73 of the NYPL. Judge McMahon took issue with cases like *Kirsch* and *Shandell* because she believed that they "eviscerated" the "no compensation" rule set forth in NYPL §40(6). *See Coudert Bros.*, 480 B.R. at 176-77.

89. *Id.* at 177 ("Thus, while I doubt whether the New York Court of Appeals would apply *Kirsch* in either context, I feel constrained to apply *Santalucia* to billable hours cases as well. The situation needs sorting out, but that is ultimately a job for the New York Court of Appeals.") (emphasis in original). In *Santalucia*, the Second Circuit addressed an appeal challenging the apportionment of a contingent fee resulting from settlement of a wrongful death action. The United States District Court for the Northern District of New York awarded the dissolved law firm "a quantum meruit recovery – that is, a reasonable hourly fee multiplied by the number of hours it had devoted to the matter" before dissolution. *Santalucia*, 232 F.3d at 294. This resulted in a rather modest award for the dissolved firm, as compared to the amount awarded to the former partner based on his post-dissolution work. The Second Circuit, in vacating and remanding the case for further factual findings, concluded that under New York law, "absent an agreement to the contrary, a dissolving law firm is entitled to the value of the contingent fee at the time of dissolution." *Id.* at 294, 297-98 (emphasis added). The Second Circuit noted that while the New York Court of Appeals had not yet addressed the issue, its holding was consistent with several New York Appellate Division cases. *Id.* at 297-98 (citing and discussing, among others, *Shandell*, 629 N.Y.S.2d 437, 439 (N.Y. App. Div. 1995)).

90. *Id.* at 178.

91. *Id.* at 179.

2. *Thelen LLP*

Thelen LLP, a California limited liability partnership, dissolved in October 2008 and in September 2009 filed a Chapter 7 bankruptcy case in the Bankruptcy Court for the Southern District of New York. At the time of and in connection with the 2008 dissolution of their law firm, Thelen's partners adopted a Fourth Amended and Restated Limited Liability Partnership Agreement (the "Fourth Partnership Agreement"). The Fourth Partnership Agreement included a so-called *Jewel* Waiver:

> Neither the Partners nor the Partnership shall have any claim or entitlement to clients, cases or matters ongoing at the time of dissolution of the Partnership other than the entitlement for collection of amounts due for work performed by the Partners and other Partnership personnel prior to their departure from the Partnership. *The provisions of this [section] are intended to expressly waive, opt out of and be in lieu of any rights any Partner or the Partnership may have to "unfinished business" of the Partnership, as the term is defined in Jewel v. Boxer, 156 Cal. App. 3d 171 (Cal. App. 1 Dist. 1984), or as otherwise might be provided in the absence of this provision through the interpretation or application of the [California Uniform Partnership Act of 1994, as amended].*[92]

The Fourth Partnership Agreement also contained a California choice of law provision.

In two separate lawsuits filed in September 2011, the Thelen chapter 7 trustee sued two law firms (Seyfarth Shaw LLP and Robinson & Cole LLP) and several former partners who had joined those firms. The complaints alleged that Thelen's adoption of the *Jewel* Waiver constituted a fraudulent transfer of property, specifically a fraudulent transfer of the unfinished business of Thelen LLP at the time of its dissolution. Under bankruptcy and applicable state law, the trustee sought to avoid the alleged fraudulent transfer and to require the defendants to account for and turn over profits generated from the unfinished business.[93]

Seyfarth Shaw moved for judgment on the pleadings under Rule 12(c) of the Federal Rules of Civil Procedure. Robinson & Cole moved to dismiss under Federal Rule of Civil Procedure 12(b)(6).

For the reasons discussed below, the *Thelen* court found that hourly fee matters (i) were not property of a dissolved law firm under applicable New York law and (ii) were property of a dissolved law firm under applicable California law.

a. Choice Of Law Analysis — California Or New York Law?

At the outset, the *Thelen* court engaged in a choice of law analysis. First, the court held that the California choice of law provision in the Fourth Partnership Agreement was not binding or controlling because neither defendant was a party to that agreement.[94] In the absence of a binding contractual choice of law provision, the *Thelen* court applied New York choice of law rules to determine the governing state law.[95]

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92. *Thelen*, 476 B.R. 732, 736 (S.D. N.Y. 2012) (emphasis added).

93. *Id.* at 736-37.

94. The court also noted that a contractual choice of law provision only governs contract-based claims, not tort claims such as fraudulent transfer claims. *Id.* at 737-38 (citation omitted).

95. *Id.* at 738 (citing In re Gaston & Snow, 243 F.3d 599, 600-01, 607 (2d Cir. 2001)).

Under New York choice of law rules, Judge Pauley first examined whether a conflict existed between potentially applicable state substantive law (New York or California).[96] He concluded for the reasons expressed in his opinion that New York and California law conflicted as to the existence and scope of a dissolved law firm's property interest in pending hourly fee matters.[97] Because he found a conflict existed, Judge Pauley then conducted an "interest analysis," which led to application of the "law of the jurisdiction having the greatest interest in the litigation."[98] In ascertaining the state with the greatest interest, Judge Pauley undertook a "two-pronged inquiry, determining '(1) what are the significant contacts and in which jurisdiction are they located; and (2) whether the purpose of the law [at issue] is to regulate conduct or allocate loss.'"[99]

As to the action against Seyfarth Shaw (the "Seyfarth Shaw Action"), the *Thelen* court relied on several facts to conclude that the majority of significant contacts occurred in New York and therefore New York law applied to "define the property interest—if any—that Seyfarth Shaw received".[100] Most of the former partners that left Thelen to join Seyfarth Shaw were licensed to practice law in New York. Furthermore, the Thelen bankruptcy petition was filed in New York based upon Thelen having a domicile or a residence, principal place of business, or its principal assets in New York. Judge Pauley further relied on case law holding that where regulation of conduct is at issue, "the state where the alleged tort took place has the greater interest."[101] Judge Pauley found without elaboration that the alleged tort (the alleged fraudulent transfer of firm property resulting from adoption of the *Jewel* Waiver) occurred in New York.[102]

For its decision on the motion to dismiss filed in the action against Robinson & Cole (the "Robinson & Cole Action"), the *Thelen* court applied California law. The court simply noted that Robinson & Cole, a Connecticut based firm, and the plaintiff trustee agreed, at least for purposes of the motion to dismiss, that California law applied to the issue of whether Robinson & Cole received any "property interest" as a result of the Thelen LLP partners' adoption of the *Jewel* Waiver in the Fourth Partnership Agreement.[103]

b. Seyfarth Shaw Action - Hourly Fee Matters Do Not Constitute Assets Of A Dissolved Firm Under Applicable New York Law

After completing its choice of law analysis, the primary issue addressed by the *Thelen* court with respect to the Seyfarth Shaw Action was whether, under New York law, hourly fee matters pending at the time of dissolution constituted

96. *Id.* at 738 (citing Paradigm BioDevices, Inc. v. Viscogliosi Bros., LLC, 842 F.Supp. 2d 661, 665 (S.D. N.Y. 2012)).

97. *Id.* at 738.

98. *Id.* at 738 (quoting Istim, Inc. v. Chemical Bank, 581 N.E.2d 1042, 1044 (N.Y. 1991)).

99. *Id.* at 738 (quoting Padula v. Lilarn Props. Corp., 644 N.E.2d 1001, 1002 (N.Y. 1994)).

100. *Id.* at 738.

101. *Id.* at 738 (citing GFL Advantage Fund, Ltd. v. Colkitt, No. 03 Civ. 1256, 2003 WL 21459716, at *3 (S.D. N.Y. June 24, 2003), Roselink Investors, L.L.C. v. Shenkman, 386 F.Supp. 2d 209, 225 (S.D. N.Y. 2004)).

102. *Id.* at 738. Given the proliferation of law firms that have offices located around the country and in many cases, around the world, one can surmise that courts will wrestle with difficult choice of law issues in future unfinished business cases arising out of the dissolutions of large law firms.

103. *Id.* at 737, n.1 ("Because the parties agree that California law applies [to the "property interest" issue] and they did not brief applicable Connecticut law, this Court declines to consider whether Connecticut law applies.").

partnership assets, i.e. property of the estate. The answer was a resounding "No." Judge Pauley unequivocally held that "New York law does not recognize a debtor law firm's property interest in pending hourly fee matters."[104]

Judge Pauley began by noting that the New York Court of Appeals had not yet provided guidance on whether a law firm possessed a property interest in pending hourly fee matters.[105] Next, he discussed *Jewel v. Boxer*, the "seminal case" applying the unfinished business doctrine to law partnerships.[106]

Judge Pauley stated that "[u]nder New York law, it is well settled that 'absent an agreement to the contrary, pending contingent fee cases of a dissolved partnership are assets subject to distribution.'"[107] He further noted that New York courts had not extended the unfinished business doctrine to pending hourly fee matters, and that the only New York court to consider that issue declined to so extend the doctrine.[108] The *Thelen* court found the reasoning of *Sheresky* to be "persuasive."[109]

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104. *Id.* at 741.

105. *Id.* at 739 ("Accordingly, without guidance from the state's highest court, this Court must "predict how the New York Court of Appeals would resolve the question.") (quoting Amerex Group, Inc. v. Lexington Ins. Co., 678 F.3d 193, 200 (2d Cir. 2012)).

106. *Thelen* at 739; *see also id.* at 739, n.2 (observing that "[O]ver the last three decades, courts have cited Jewel reflexively and uncritically. Thus, from modest beginnings in a dispute involving a small Alameda County general practice firm, the Jewel doctrine has grown to ensnare some of the largest law firms in the United States.")

107. *Id.* at 739 (quoting *Santalucia*, 232 F.3d 293, 297 (2d Cir. 2000)).

108. *Thelen*, 476 B.R. at 739-740 (discussing Sheresky v. Sheresky Aronson Mayefsky & Sloan, LLP, No. 150178/10, 2011 WL 7574999 (N.Y. Sup. Ct. Sept. 13, 2011)) (hereafter, "Sheresky"). In *Sheresky*, the plaintiff was a former founding partner of a dissolved matrimonial firm. He sued his three former partners and their new law firm. The New York Supreme Court (a trial level court in New York) addressed the defendants' motion to dismiss all counts of the amended complaint, including a count for unfinished business.

The *Sheresky* court expressly addressed the issue of whether a cause of action for unfinished business relating to non-contingency fees was recognized under New York law. The *Sheresky* court concluded it was not, notwithstanding the Coudert Bros. bankruptcy court's denial of motions to dismiss filed by the named defendants and notwithstanding District Court Judge Victor Marrero's decision to "leave undisturbed" the Bankruptcy Court's ruling. *Id.* at *6 (citing In re Coudert Bros. LLP Law Firm Adversary Proceedings, 447 B.R. 706 (S.D. NY 2011) (denying defendants' motion for leave to file interlocutory appeal)).

The *Sheresky* court noted that prior New York decisions dealing with a claim for unfinished business all were in the contingent fee context and that the question of whether the unfinished business doctrine applied to hourly fee matters remained an open one in New York. And then the court reasoned:

> [i]t is logical to distinguish between contingency fee arrangements and cases which are billed on the basis of hourly work. A fee collected in a contingency fee case initiated by the former law firm may well result in a fee much greater than the amount of work expended by the lawyer or lawyers handling the case. In contrast, to the extent that compensation for the case is based solely on the amount of hourly work performed post-dissolution, compensating a former partner out of that fee would reduce the compensation of the attorneys performing the work.

Id. The *Sheresky* court also relied on New York Disciplinary Rule 1.5(g) dealing with division of fees between lawyers in different firms, in support of its decision to dismiss "a cause of action for unfinished business for hourly fee cases which has, hitherto, not been recognized by the New York courts." *Id.* at *6-7 (New York Disciplinary Rule 1.5(g) prohibits the sharing of fees among lawyers in different firms unless certain requirements are met. N.Y. Comp. Codes R. & Regs. tit. 22, § 1200.0 (2012)).

The *Sheresky* court pointed out that New York Disciplinary Rule 1.5(h) authorized payments to a lawyer formerly associated with a firm if such payments were made pursuant to a separation or retirement agreement. But the court noted that no such agreement was involved under the facts presented. *Id.* at *6.

The *Thelen* court relied fairly heavily on *Sheresky* in reaching its decision in the Seyfarth Shaw Action. It is unclear why the *Sheresky* opinion was not cited or discussed in *Coudert Bros.*

109. *Thelen*, 476 B.R. at 740 ("applying the unfinished business doctrine to pending hourly fee matters would result in an unjust windfall for the Thelen estate, as 'compensating a former partner out of that fee would reduce the compensation of the attorneys performing the work.'") (quoting *Sheresky*, 2011 WL 7574999 at *6).

The *Thelen* court expressly found as its main holding that an expansion of the unfinished business doctrine to pending hourly fee matters would "violate New York's public policy against restrictions on the practice of law."[110] It further found that such an expansion would "clash directly with New York's Rules of Professional Conduct", specifically Rule 1.5(g).[111]

The *Thelen* court also reasoned that recognition of pending hourly fee matters as a property interest would "contravene" the treatment of post-dissolution contingency fee matters under New York law.[112] A dissolved law firm is "entitled only to the value of the [contingent fee] case at the date of dissolution, with interest."[113] Because in an hourly fee case, "all post-dissolution fees that a lawyer earns are due to that lawyer's 'post-dissolution efforts, skill and diligence,'"[114] Judge Pauley reasoned that New York law "does not recognize a dissolved firm's property interest in pending hourly fee matters."[115]

Next, the *Thelen* court also noted what it described would be "bizarre consequences" and "unworkable results" as further support for its holding in the Seyfarth Shaw Action that pending hourly fee matters do not constitute property of a dissolved law firm under New York law. Judge Pauley observed that if pending hourly fee matters were recognized as property interests and therefore as property of the estate in a bankruptcy case, then a debtor law firm (or its appointed trustee) ought to be able to sell its pending hourly fee matters to a purchaser under section 363 of the Bankruptcy Code.[116] But, a sale of such "property" would be inconsistent with a client's unfettered right to choose counsel.[117] Judge Pauley

110. *Thelen*, 476 B.R. at 740 (citing *Cohen*, 550 N.E.2d 410 (N.Y. 1989)).

111. *Thelen*, 476 B.R. at 740 (quoting N.Y. Comp. Codes R. & Regs. tit. 22, § 1200.0, Rule 1.5(g)). Rule 1.5(g) of New York's Rules of Professional Conduct states as follows:

> A lawyer shall not divide a fee for legal services with another lawyer who is not associated in the same firm unless: (1) the division is in proportion to the services performed by each lawyer or, by a writing given to the client, each lawyer assumes joint responsibility for the representation; (2) the client agrees to the employment of the other lawyer after a full disclosure that a division of fees will be made, including the share each lawyer will receive, and the client's agreement is confirmed in writing; and (3) the total fee is not excessive.

112. *Id.*

113. *Id.* at 741 (quoting *Santalucia*, 232 F.2d 293, 298 (2d Cir. 2000)).

114. *Id.* (quoting *Shandell*, 629 N.Y.S.2d 437, 439 (N.Y. App. Div. 1993)).

115. *Id.*

116. *Id.* Section 363(b) of the Bankrupty Code provides that a trustee, after notice and a hearing, may "use, sell, or lease, other than in the ordinary course of business, property of the estate…."

117. *Id.* (citing Demov, Morris, Levin & Shein v. Glantz, 428 N.E.2d 387, 389 (N.Y. 1981)); *see also Thelen*, 476 B.R. at 742 ("Clients are not merchandise. Lawyers are not tradesmen…. An attempt, therefore, to barter in clients, would appear to be inconsistent with the best concepts of our professional status.") (quoting *Cohen*, 550 N.E.2d at 411 (N.Y. 1989)).

Regarding the "sale of property of the estate" issue raised in *Thelen*, Ruden McClosky P.A., a law firm based in Fort Lauderdale, Florida, filed a Chapter 11 bankruptcy case in November 2011 with the intent to sell substantially all of its assets to the law firm Greenspoon Marder, P.A. pursuant to a "stalking horse" asset purchase agreement (the "APA"). *See* Debtor's Motion for Entry of Order (A) Approving Competitive Bidding and Sale Procedures; (B) Approving Form and Manner of Notices; (C) Approving Form of Asset Purchase Agreement; (D) Scheduling Dates to Conduct Auction and Hearing to Consider Final Approval of Sale, Including Treatment of Executory Contracts and Unexpired Leases; (E) Authorizing Sale of Substantially All the Debtor's Assets Free and Clear of All Liens, Claims, Encumbrances and Interests; and (F) Granting Related Relief, In re Ruden McClosky P.A., No. 11-40603 (Bankr. S. D. Fla. Nov. 1, 2011) (hereafter, the "*Sale Motion*"). The APA, which was attached as Exhibit A to the Sale Motion, was subject to higher and better offers. A sale process established by the bankruptcy court did not yield any competing qualified offers and an order was entered approving the APA. Order (I) Authorizing the Sale of Substantially All of the Debtor's Assets Free and Clear of

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also questioned whether a client of a bankrupt dissolved firm that decided to exercise its unfettered right and transfer its hourly fee matter to another law firm would somehow be in violation of the automatic stay afforded debtors by section 362 of the Bankruptcy Code.[118]

Judge Pauley specifically addressed and distinguished the case of *Stem v. Warren*, a "hoary" case "heavily" relied upon by the plaintiff Thelen LLP trustee (and also a case that was heavily relied upon in the *Coudert Bros.* decision).[119] Judge Pauley wrote that "under *Stem*, if an executory contract with a third party contemplates that it should survive dissolution, it remains a joint venture asset and the co-venturers have an obligation to perform with the concomitant right to its benefits."[120] He contrasted that kind of contract with hourly fee matters serviced by law firms, reasoning that hourly fee matters cannot contemplate post-dissolution survival without infringing a client's right to terminate counsel at will.[121]

Judge Pauley espoused the view that contracts for legal services simply are different from other types of commercial contracts, such as the architecture contracts at issue in *Stem*. He disagreed with Judge McMahon's effort to analogize a contract for the provision of legal services to other "partnership property" such as a "Jackson Pollack" painting that might be removed from an office wall as a partner departs.[122] In the *Thelen* court's view, contracts for the provision of legal services and an attorney's obligations thereunder are "categorically different", "transcend those prevailing in the commercial market place…," and have "peculiar and distinctive features."[123] In essence, and directly contrary to the view espoused by Judge McMahon in *Coudert Bros.*, Judge Pauley viewed the attorney-client relationship as unique and believed that application of the unfinished business doctrine to hourly fee matters "would undermine it."[124]

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Liens, Claims, Encumbrances, and Other Interests; (II) Authorizing and Approving the Asset Purchase Agreement; (III) Approving Procedures and Rights Related to Assumption and Assignment of Certain Executory Contracts and Unexpired Leases; And (IV) Granting Related Relief, In re Ruden McClosky P.A., No. 11-40603 (Bankr. S. D. Fla. Nov. 30, 2011). In relevant part, paragraph 28.2 of the APA provided as follows:

> Buyer and Seller acknowledge and agree, that, notwithstanding any provision of this Agreement to the contrary, (i) nothing in this Agreement shall impair the rights of any existing or prior client of Seller to retain other counsel (other than Seller, Buyer or any attorney employed by Seller or Buyer), (ii) no client will be (or will deemed to be) "assigned", "conveyed" or "transferred" with, or in connection with, the conveyance of the Assets to Buyer at the Closing and (iii) no Asset will be conveyed to Buyer with respect to any client with respect to whom such conveyance may not be consummated in compliance with the Rules.

"Rules" was defined in the APA as the Rules of Professional Conduct promulgated by the Florida Bar. Among other Rules, Rule 4-1.17, pertaining to the sale of a law practice, was specifically addressed in paragraph 28.1 of the APA.

118. *Thelen*, 476 B.R. at 741.

119. *Id.* at 741-42. *See infra* pp. 11-12.

120. *Id.* at 741 (quoting Scholastic, Inc. v. Harris, 259 F.3d 73, 89 (2d Cir. 2001)).

121. *Id.* at 741 (citing *Demov, Morris, Levin & Shein*, 428 N.E.2d at 389).

122. *Id.* at 742 ("Contrary to [*Coudert Bros.*], an hourly fee matter is not akin to 'a Jackson Pollack [sic] painting' that a departing attorney 'rips off the wall of the reception area.'") (quoting *Coudert Bros.*, 480 B.R. 145, 157 (S.D. N.Y. 2012).

123. *Id.* at 742 (quoting In re Cooperman, 83 N.Y.2d 465, 472 (N.Y. 1994)).

124. *Id.* at 742 ("The client, not the attorney, moves a matter to a new firm. Thus, the attorney-client relationship is unique, and applying *Stem* to hourly fee legal service contracts would undermine it.")

The opening paragraph of the *Thelen* decision introduced what the court viewed as the competing interests at play:

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The *Thelen* court recognized that other courts had reached the opposite conclusion on the issue of whether pending hourly fee matters constitute partnership assets.[125] However, Judge Pauley "respectfully disagreed" with those courts and (perhaps unlike the *Coudert Bros.* court) did not feel constrained to rule under New York law as courts in other UPA jurisdictions have ruled under their own applicable law.[126] He found the NYPL (particularly section 4(4)) did not specify what property constituted property of a dissolved law firm, and it certainly did not specify that hourly fee matters constituted property of a dissolved law firm. Rather, what constituted partnership property under New York law remained an issue for the New York courts to decide.[127] Judge Pauley believed his ruling that pending hourly fee matters were not property of the dissolved law firm was consistent with New York's "strong public policy in favor of client autonomy and attorney mobility."[128]

As a result of its holding that under New York law, a dissolved law firm's pending hourly fee matters do not constitute partnership property, the *Thelen* court dismissed the Seyfarth Shaw Action. But the court gave plaintiff leave to amend his complaint to assert any claims against Seyfarth Shaw based upon pending contingency fee matters.[129]

c. Robinson & Cole Action — Hourly Fee Matters Constitute Assets Of A Dissolved Firm Under Applicable California Law

In ruling on the motion to dismiss filed in the Robinson & Cole Action, the *Thelen* court applied California law to determine that pending hourly fee matters constituted partnership assets at the time of a law firm's dissolution.

The court began by noting that California courts, including *Jewel*, have concluded a dissolved firm's pending hourly fee matters are partnership assets under California law. However, Judge Pauley suggested that because the *Jewel* court in reaching its conclusion relied on the "no extra compensation" rule under an old UPA provision that had since been abolished under the CRUPA, this conclusion now comes with "an asterisk."[130]

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

Id. at 735.

125. *Id.* at 742 (citations omitted).

126. *Id.*

127. *Id.* at 743.

128. *Id.* at 742-43 ("[R]ecognizing a property right in unfinished hourly fee matters conflicts with New York's strong public policy in favor of client autonomy and attorney mobility.") (citing *Cohen* , 550 N.E.2d 410, 411 (N.Y. 1989); *Denburg*, 624 N.E.2d 995, 999 (N.Y. 1993)). Although citing to *Denburg* in support of its decision, the *Thelen* court did not address the *Coudert Bros*. court's substantial effort to distinguish *Denburg.*

129. *Id.* at 743 (the original complaint did not distinguish between hourly fee and contingent fee matters).

130. *Id.* at 745 ("In sum, RUPA's 'reasonable compensation' rule undermines the Jewel doctrine, which applied the older 'no compensation' rule. Nevertheless, California law may still recognize a dissolving firm's pending hourly fee matters as 'assets.' Specifically, to the extent that Robinson & Cole earned profits from former Thelen matters exceeding 'reasonable compensation,' California law dictates that those profits belong to Thelen…"); *see also id.* at 744 ("But [CRUPA] transformed the law on which Jewel relied and

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The Robinson & Cole motion to dismiss was denied in large part because the question of "reasonable compensation", which in turn, would determine what profits, if any, were owed to the bankruptcy estate, was a fact-intensive one not subject to determination on a motion to dismiss.[131] The issue of whether the former Thelen LLP partners received monies in excess of "reasonable compensation" would need to be addressed on a "more fully developed record."[132]

The court also addressed whether Thelen LLP's adoption of the so-called *Jewel* Waiver shortly before dissolution constituted a fraudulent transfer of assets. Judge Pauley, after assuming arguendo that pending hourly fee matters were property of the partnership under California law, concluded that the law firm's adoption of the *Jewel* Waiver on the eve of dissolution and without consideration constituted a fraudulent transfer of partnership assets.[133] Therefore, under section 550(a)(2) of the Bankruptcy Code, he held the plaintiff could pursue recovery from Robinson & Cole as an "immediate or mediate transferee" of those assets.[134]

Sua sponte, the *Thelen* court certified its decision for an interlocutory appeal pursuant to 28 U.S.C. §1292(b). In doing so, Judge Pauley noted the *Coudert Bros.* court's recent certification of its decision for interlocutory appeal, found that the issues "present substantial grounds for difference of opinion", and posited that "certification of these questions to the New York Court of Appeals and the California Supreme Court may be warranted because those high courts have not 'squarely addressed' the issues, and the scope of the unfinished business doctrine is of great importance to both the legal profession and clients."[135]

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eroded the theoretical underpinnings of the Jewel doctrine. Because [CRUPA] entitles partners of a dissolving firm to "reasonable compensation for services rendered in winding up the business of the partnership," Cal. Corp. Code § 16401(h), there is no basis to require Thelen's former partners to remit all profits earned from former Thelen matters to the Thelen estate.")

131. *Id.* at 744 ("Thus, Robinson & Cole's liability turns on the extent to which the former Thelen partners received remuneration beyond 'reasonable compensation.'")

132. *Id.*

133. *Id.* at 743 (citing *Heller 2011*, No. 10-3203, 2011 Bankr. LEXIS 1497, at *15 (Bankr. N.D. Cal. Apr. 22, 2011)) (Jewel Waiver adopted in conjunction with plan of dissolution constituted a transfer of the firm's unfinished business and therefore, a transfer of the firm's property that may be subject to recovery)); *see also Brobeck*, 408 B.R. 318, 347 (Bankr. N.D. Cal. 2009) (same).

134. *Thelen*, 476 B.R. at 743; *see also Brobeck*, 408 B.R. at 339, n.31 (court rejected defendant firms' argument that plaintiff's claims must fail because there was no fiduciary or contractual relationship between the dissolved firm and the defendant firms; court found that while a fiduciary or contractual relationship may be necessary to succeed on an accounting or turnover claim, no such relationship was necessary for a successful fraudulent transfer claim; court found, without citing to any authority, that a trustee could recover from the defendant firms as immediate transferees of the former Brobeck partners, subject to any defenses available to the defendant firms under section 550(b)(1) of the Bankruptcy Code); *Heller 2011*, 2011 Bankr. LEXIS 1497 at *17 (same). The same bankruptcy judge (Judge Dennis Montali of the United States Bankruptcy Court for the Northern District of California) issued the *Brobeck* and two *Heller* opinions cited and discussed in this article. Judge Montali also presides over the pending Howrey LLP bankruptcy case.

135. *Thelen*, 476 B.R. at 745 (further commenting that certification to the highest courts in New York and California may be warranted because those courts have not "squarely addressed" the issues and suggesting that those high courts may not join with the "lower courts" that "have applied the Jewel doctrine expansively, with untoward consequences for the bar and clients.")

3. Waiting For The Second Circuit To Weigh In

The Second Circuit granted certification of the interlocutory appeals in *Coudert Bros.*, but only granted certification of the interlocutory appeal of the *Thelen* decision rendered in the Seyfarth Shaw Action.[136] Briefing now appears complete in the *Thelen* appeal.[137] Additional briefing is due in July 2013 in the *Coudert Bros.* appeals. It remains to be seen if the Second Circuit will certify the question of whether hourly fee matters constitute assets of a dissolved law firm to the New York Court of Appeals for decision.

C. Has The Unfinished Business Doctrine Been Addressed By The Delaware Courts?

The Delaware Court of Chancery addressed whether a contingency fee received in 1985 by one of three former partners after dissolution of their law partnership constituted property of the dissolved law firm.[138] In *Wier*, the lead attorney (Mr. Wier) on a products liability suit against General Motors Corporation actually practiced with two law firms that dissolved prior to his receipt of the contingency fee at issue. Upon dissolution in 1982 of the law firm at which the contingency fee case originated, Mr. Wier formed a new law firm with two other partners and continued working on the case. That second law firm dissolved in 1983, without any written agreement regarding the apportionment of contingent fees relating to cases pending at the time of dissolution but not resolved until after dissolution.[139] Thereafter, Mr. Wier continued working on the case as a solo practitioner. The case settled in 1985 and a substantial attorney contingency fee was received by Mr. Wier.

There apparently was no dispute that the original dissolved law firm was entitled to a portion of the contingency fee based upon the terms of the agreement struck at the time of its dissolution by the former partners.[140] The issue addressed in *Wier* was whether the remaining portion of the contingency fee either constituted partnership property of the second dissolved law firm or the separate property of Mr. Wier.[141] The Court of Chancery held that because the intent of the former partners "determines what property will be considered partnership property as distinguished from separate property," a disputed question of fact required denial of the parties' cross-motions for summary judgment in

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136. By order dated January 16, 2013, the Second Circuit denied leave to appeal in the Robinson & Cole Action. The order merely stated: "Petitioner, through counsel, moves pursuant to 28 U.S.C. §1292(b) for leave to appeal an interlocutory order of the district court. Upon due consideration, it is hereby ORDERED that the motion is DENIED because an immediate appeal is unwarranted." Order Denying Motion for Leave to Appeal, Robinson & Cole LLP v. Yann Geron, as Chapter 7 Trustee of the Estate of Thelen LLP, No. 12-3708 (2d Cir. Jan. 16, 2013).

137. The Association of the Bar of the City of New York has filed an amicus brief supporting affirmance in favor of Seyfarth Shaw in the *Thelen* appeal.

138. Waserstein & Kreshtool v. Wier, No. 8990, 1989 Del Ch. LEXIS 148 (Del. Ch. 1989).

139. *Id.* at *6.

140. *Id.* at *3, *8.

141. *Id.* at *9 (citing several state court decisions, including Jewel v. Boxer, 203 Cal. Rptr. 13 (Cal. Ct. App. 1984) and Resnick v. Kaplan, 434 A.2d 582 (Md. 1981) for the proposition that "[I]f the Sellon case attorney fee, at the time of its receipt, was the property of [the dissolved firm], the plaintiffs would be entitled to share in the profits from the successful settlement of that litigation.")

favor of a trial.[142] The decision contained no discussion of whether Mr. Wier would be entitled to deduct the value of his post-dissolution "effort, skill, and diligence" should it be determined that the remaining portion of the contingency fee constituted property of the second dissolved firm.

The authors were unable to locate any Delaware court decisions addressing application of the unfinished business doctrine in a case involving hourly fee matters pending at the time of dissolution of a Delaware law firm.

III. THE TERMS OF THE APPLICABLE PARTNERSHIP AGREEMENT MATTER

In the absence of controlling partnership agreement provisions, the case law addressing application of the unfinished business doctrine in law firm dissolutions, particularly with respect to pending hourly fee matters, continues to develop. As a result, pure reliance on state court and federal court opinions in an effort to guide present decisions and predict future outcomes is less than optimal. Could a well-drafted partnership agreement governing the treatment of matters pending at the time of dissolution make a difference, assuming no fraudulent transfer issues? It appears the clear answer is "Yes" under any applicable state law, although the timing of adoption of the relevant partnership agreement provisions could prove significant. In *Jewel*, the court noted that the dispute between the former partners could have been avoided if they had executed a written agreement governing post-dissolution issues.[143] Numerous courts since *Jewel* have made similar observations.[144]

A recent Third Circuit case upheld the general principle that fees collected subsequent to the dissolution of the law firm that originated the underlying cases were the property of the former partners of the dissolved firm, to be distributed in accordance with their partnership interests set forth in their partnership agreement.[145] In that case, two medical

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142. *Wier*, 1989 Del Ch. LEXIS 148 at *10-13 (quoting 59A Am.Jur.2d Partnership § 354). The court found that intent of the former partners may be evidenced

> by their conduct, by the provisions of the copartnership agreement or agreement preliminary thereto, by the terms of written instruments, relative to the transfer of property to, or for the use of, the firm, by entries in the firm books, and by the use of the property in the firm business, although the mere fact that property is used in the firm business does not of itself show that it is firm property ordinarily, the question is one of fact depending on the particular circumstances involved in the case under consideration.

Id. at *10 (internal citation omitted).

143. *Jewel*, 203 Cal. Rptr. at 15 ("The absence of a written partnership agreement was an invitation to litigation upon a dissolution of the partnership.").

144. *See e.g. Coudert Bros*., 480 B.R. 145, 159 (S.D. N.Y. 2012) (explaining that if partners do not want to be subject to the default rules of the NYPL, they are free to agree to different rules explicitly set forth in their partnership agreement); *Id.* at 175 (same); Labrum & Doak, 227 B.R. 391, 412 (Bankr. E.D. Pa. 1998) ("the former partners must bear the consequences of their failure to provide for allocation of fees in their agreement" in event of dissolution); *Id.* at 415 (same); *Sheresky*, No. 150178/10, 2011 WL 7574999, *6 (N.Y. Sup. Ct. Sept. 13, 2011) ("Similarly, the partnership could have had a partnership agreement which established principles to be applied in case of dissolution; it did not."); *Wier*, 1989 Del. Ch. LEXIS 148 at *12-13 ("This entire dispute could have been avoided, of course, if the parties had made a specific agreement regarding the Sellon case attorney fees when the Kreshtool, Wier & Waserstein law firm was formed or when it was dissolved. Because they did not take that elementary precaution, the intent of the parties regarding the ownership of the Sellon case attorney fee is a disputed question of fact…"); compare Dwyer v. Nicholson, 602 N.Y.S.2d 144, 146-48 (N.Y. App. Div. 1993) (applying New York law, court found that because the partnership agreement provided only that "net income, cash and other deposits in partnership bank accounts, and accounts receivable" would be distributed among the partners upon dissolution, fees received on pending contingency cases would be excluded from post-dissolution distributions).

145. *See* Haymond v. Lundy, Nos. 03-3889, 04-1879, 2005 U.S. App. LEXIS 2223 (3d. Cir. Feb. 10, 2005).

malpractice cases were opened shortly before the dissolution of a medical malpractice and personal injury law firm (which had only two partners). Each partner started a separate firm post-dissolution, but ultimately only one of the new firms handled to conclusion both medical malpractice cases. The court held that, despite the fact that the other former partner did not perform additional work on either case, he remained entitled to share in the fees generated because the dissolved firm's partnership agreement explicitly provided for a 60/40 split of all such fees.[146] The terms of the applicable agreement clearly mattered.

In response to *Jewel* and to more recent court decisions emanating from several high profile law firm bankruptcy cases, presumably many law firms have undertaken a review of their own partnership agreements with respect to provisions applicable upon a dissolution of the firm.[147] While it must be acknowledged that one size will not fit all because no two law firms are exactly the same and the circumstances each face will almost certainly change over time, a thoughtful review and consideration of such provisions appears to be a prudent step.

Some firms, like the Thelen, Brobeck, and Heller Ehrman firms, have added so-called *Jewel* Waiver provisions to their partnership agreements expressly disclaiming any rights, claims, or entitlements to specified matters pending at the time of dissolution. The timing of the *Jewel* Waivers in those cases (added to the partnership agreements in connection with the agreed upon dissolutions), however, left them exposed to challenge under fraudulent transfer laws.[148]

For example, on March 11, 2013, Judge Montali issued a lengthy opinion in the *Heller Ehrman* bankruptcy case.[149] The opinion addressed whether Heller Ehrman's September 2008 adoption of a *Jewel* Waiver in its written dissolution plan constituted a fraudulent transfer of property of the dissolved firm.[150] Judge Montali concluded on summary judgment motions that it did.[151]

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146. *Id.*

147. *See, e.g.*, Jay Adkisson, Howrey: When the Sinking Ship Seeks the Cheese Back From the Fleeing Rats, Forbes, Aug. 1, 2012, at http://www.forbes.com/sites/jayadkisson/2012/08/01/howrey-when-the-sinking-ship-seeks-the-cheese-back-from-the-fleeing-rats/.

148. *Thelen*, 476 B.R. 732, 743 (S.D. N.Y. 2012); *Brobeck*, 408 B.R. 318, 338-347 (Bankr. N.D. Cal. 2009) (adoption of Jewel Waiver in conjunction with dissolution held on partial summary judgment to constitute constructive fraudulent transfer of debtor's property (the law firm's interest in profits from unfinished business) under section 548(a)(1)(B) of the Bankruptcy Code and Cal. Civ. Code §3439.05).

149. *See, e.g., Heller 2013*, No. 10-3221, 2013 Bankr. LEXIS 889 (Bankr. N.D. Cal. Mar. 11, 2013). In *Heller 2013*, Judge Montali addressed motions and cross-motions for summary judgment in four pending adversary proceedings filed by the Heller Ehrman plan administrator against the law firms of Jones Day, Davis Wright Tremaine LLP, Foley & Lardner LLP, and Orrick, Herrington & Sutcliffe, LLP, respectively. These lawsuits asserted claims for the recovery of profits earned by the defendant firms (each a new firm joined by former Heller Ehrman partners) on matters constituting the asserted unfinished business of Heller Ehrman. Many similar suits filed against other defendant law firms have been settled by the Heller Ehrman plan administrator.

150. The Heller Ehrman Jewel Waiver stated:

> As the Firm is no longer in a position to service its clients efficiently and as an inducement to encourage Shareholders to move their clients to other law firms and to move Associates and Staff with them, the effect of which will be to reduce expenses to the Firm-in-Dissolution, and to assure that client matters are attended to in the most efficient and effective manner possible, and to help ensure collection of existing accounts receivable and unbilled time with respect to such clients, the Firm-in-Dissolution will waive any rights and claims under the doctrine of *Jewel v. Boxer*, 156 Cal. App. 3d 171 (1984) [,] to seek payment of legal fees generated after the departure of any lawyer or group of lawyers with respect to non-contingency/non-success fee matters only and the Dissolution Committee is authorized to provide appropriate assurances to law firms that Shareholders may choose to join regarding this issue, provided, however, that the Firm-in-Dissolution reserves its right to seek indemnification from any such law firm with respect to actions taken after such matters are transferred to such law firms.

Heller 2013, 2013 Bankr. LEXIS 889 at *5-6 n. 3.

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As seen from above, assuming no fraudulent transfer issues, it appears that having well-drafted partnership agreement provisions governing dissolution (and the treatment of unfinished business in connection therewith) is a step in the right direction for all law firms. It very well may help the law firms of today and the future avoid the protracted and expensive litigation that so many firms and lawyers have found themselves embroiled in following a law firm dissolution and resulting bankruptcy.

IV. CONCLUSION

Whether the unfinished business doctrine applies to a dissolved firm's pending hourly fee matters completed by departing partners at their new firms remains a hotly contested issue. Significant dollars for many different constituencies can hang in the balance, particularly in cases involving failures of large law firms such as Dewey & Leboeuf.

It remains to be seen how the questions swirling around application of the unfinished business doctrine will be dealt with on both a legal and practical level. On the one hand, law firms possess the ability to craft governing provisions in their partnership agreements to clearly state whether the unfinished business doctrine will apply in the event of a dissolution, and to what extent. And state legislatures can address the issue head-on through the passage of revised or new state partnership laws. But neither is a permanent fix, because law firms and legislatures are not static. Partnership and statutory provisions that appear to make sense and pass muster one year may be changed in future years by different sets of people working under different sets of circumstances.

On the other hand, different courts have taken different approaches in analyzing the legal and policy rationales underlying application of the unfinished business doctrine to pending hourly fee matters. Highly-trained and experienced lawyers and judges have raised thoughtful and reasonable arguments on all sides of these multi-layered and important issues. Perhaps the Second Circuit (or the New York Court of Appeals via certification) will take the opportunities presented in the *Coudert Bros*. and *Thelen* appeals to provide some welcome guidance and clarity to this otherwise murky and evolving area of the law.

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151. *Id*. at *57. Judge Montali had addressed fraudulent transfer issues in his earlier Brobeck and Heller decisions. *See Brobeck*, 408 B.R. at 347 (partial summary judgment in favor of plaintiff as to liability on fraudulent transfer claim relating to Jewel Waiver; court found that former partners gave no value in exchange for the Jewel Waiver; court further found that former partners' new law firms were immediate transferees who had not asserted any good faith defenses under section 550(b) of the Bankruptcy Code; parties settled before a trial on the amount of damages); *Heller 2011*, No. 10-3203, 2011 Bankr. LEXIS 1497, at *17 (Bankr. N.D. Cal. Apr. 22, 2011) (on motion to dismiss, court found that defendant law firm that had hired former partners of the Heller Ehrman firm could be the subject of a fraudulent transfer claim relating to Heller Ehrman's execution of its Jewel Waiver; the court cited to its own Brobeck opinion as authority). In *Heller 2013* Judge Montali found on summary judgment that the Jewel Waiver met each of the four elements of a constructive fraud claim under section 548(a)(1)(B) of the Bankruptcy Code (or under Cal. Civ. Code §3439.05). The Jewel Waiver was a constructively fraudulent transfer of the property (i.e. unfinished business) of the dissolved Heller Ehrman firm. *Heller 2013*, 2013 Bankr. LEXIS 889 at *12 ("the critical transfer here is that which occurs when the Shareholder, having been the immediate transferee of the Jewel Waiver, joins the defendant law firm and brings along the unfinished business free of the duty to account.") ; *Id.* at *28-31 (same). Among other things, the *Heller 2013* court found that the former partners (the initial transferees) did not provide reasonably equivalent value in exchange for the Jewel Waiver. *Id.* at *20 ("[T]here is no evidence that any Shareholder would have refused to execute the Dissolution Agreement absent the Jewel Waiver.")

He also addressed whether the defendant firms had made a sufficient showing on any of their various asserted defenses to the constructive fraud claims. He found the defendant firms (subsequent transferees of the fraudulently transferred property) had failed to show a defense to liability under the safe harbor defenses of section 550(b)(1) of the Bankruptcy Code or otherwise. *Id.* at *31 ("Defendants have not shown that they provided value for the unencumbered unfinished business that they received.")

Judge Montali concluded *Heller 2013* by stating: "What remains, therefore, is proof at trial of the extent of Heller's damages, namely the amount earned by Defendants as profit on the unfinished business." *Id.* at *39.

RECENT DEVELOPMENTS IN LABOR AND EMPLOYMENT LAW

Allyson Britton DiRocco,* Timothy M. Holly,** Mary I. Akhimien*** and Jerry M. Cutler****

I. DISCRIMINATION UNDER TITLE VII OF THE CIVIL RIGHTS ACT OF 1964 AND DELAWARE DISCRIMINATION IN EMPLOYMENT ACT

In *Le v. City of Wilmington*, the United States Court of Appeals for the Third Circuit affirmed the United States District Court for the District of Delaware's grant of summary judgment for the defendant, City of Wilmington (the "City") in 2012.[1] Plaintiff Le T. Le ("Le"), a former employee of the City, brought an action against the City and City officials alleging copyright infringement, civil rights violations under Title VII of the Civil Rights Act of 1964 ("Title VII") and 42 U.S.C. § 1983, a claim under title 19, section711 of the Delaware Code, and a *prima facie* tort claim under Delaware law.

Le's employment with the City began when he was hired as an Information Analyst II in 2003. In this position, he provided support and technical assistance to users of the City's computer network. The City's Network Division consisted of Le, who was of Vietnamese descent, and two African American employees. The City terminated Le because it was experiencing several network system problems, and it determined that it would be more economical and efficient to outsource the Network Division functions to an outside vendor. All of the vendor's employees who performed the work formerly done by the Network Division were white.

Le alleged that the defendants discriminated against him on the basis of his race and/or ethnic background in violation of Title VII. The District Court analyzed whether Le could prove his claim of discrimination by presenting direct evidence as set forth in *Price Waterhouse v. Hopkins*,[2] or indirect evidence through the burden-shifting framework

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1. 736 F. Supp. 2d 842 (D. Del. 2010), *aff'd*, 2012 WL 1406462 (3d Cir. 2012).

2. 490 U.S. 228, 244-46 (1989).

of *McDonnell Douglas Corp. v. Green*.[3] Under *McDonnell Douglas*, "a plaintiff must first establish a *prima facie* case of discrimination by showing that: (1) he belongs to a protected class; (2) he suffered an adverse employment action; and (3) the circumstances of the adverse employment action give rise to an inference of unlawful discrimination such as might occur when a similarly situated person not of the protected class is treated differently."[4] If the plaintiff meets this burden and establishes a *prima facie* case, then the burden shifts to the employer to articulate a legitimate, nondiscriminatory reason for its treatment of the plaintiff. If the employer articulates such a reason, then the burden shifts back to the employee to demonstrate that the employer's reason is pre-textual.

Le contended that there was direct evidence of discrimination in the record. The Court noted that Le solely relied upon his own subjective beliefs that wrongdoing occurred, which was not sufficient to create a genuine issue of material fact and overcome summary judgment.[5] Le alleged that Joseph F. Capodanno, Jr. ("Capodanno") made a racially charged remark to an African American employee. The Court found that this alleged comment was made towards another individual who was of a different ethnic background than Le. Le also presented evidence that Capodanno had difficulty understanding Le's speech because of an accent. The Court noted that while discrimination based on an accent can be evidence of national origin discrimination, the employee's heavy accent or difficulty with spoken English can also be a legitimate basis for adverse employment action where effective communication skills are reasonably related to job performance.[6]

With respect to Le's claims concerning indirect evidence of discrimination, the defendants conceded that Le met the first two prongs of the *prima facie* test because he was of Vietnamese descent and his termination equated to adverse employment action. However, there was a dispute as to whether Le had established whether his termination gave rise to an inference of unlawful discrimination. The Court concluded that Le did not present sufficient evidence from which a reasonable fact finder could infer that Le was unlawfully discriminated against. It reasoned that although the Network Division (made up of minority employees) was replaced with consultants who happened to be white, the City did not interview or select the white individuals who came in to perform the work. Le contended that when African American employee Smith resigned, he was replaced by O'Donnell who is white, rather than Jones who was more qualified and African American. The Court held that Smith's replacement had nothing to do with Le because Le was three job levels below Smith.

The Court concluded that Le could not establish a *prima facie* case of discrimination; however, it nevertheless proceeded with the analysis under the burden-shifting framework. The City's reason for Le's termination was due to his inadequate performance. Le admitted that the City's network had various performance issues, including issues with server connections, the MUNIS software platform, connectivity problems with Outlook, as well as other problems. The Court held that Le's disagreement with the City as to the cause of these issues did not amount to pretext. Therefore, the Court granted summary judgment in favor of the defendants and dismissed Le's Title VII claim. Because the analysis for a Title VII claim is the same as state law claims under title 19, section 711 of the Delaware Code, the Court also dismissed the state law discrimination claim. The Court held that Le's *prima facie* tort claim under Delaware law was not recognized in the employment context.

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3. 411 U.S. 792, 793 (1973).

4. *Le*, 736 F. Supp. 2d at 754 (citing *McDonnell Douglas*, 411 U.S. at 802).

5. *Id*. at 854.

6. *Id.* at 855.

Le also alleged that the City violated the Copyright Act of 1976[7] , when it infringed the instant ticketing software application registered by Le with the Copyright Office (the "Work"), when the City used the application for its program to issue instant tickets for code violations. The District Court held that Le created the Work within the scope of his employment. Even if Le created the Work on his own time as he contended, he did so during his employment and without a specific written agreement from the City to the contrary. Therefore, the copyright on the Work belonged to the City.

The Court further held that the parties' conduct created in the City an implied and irrevocable license in the Work because: (1) Le was asked by the City to create the Work, (2) Le (with assistance of other City employees) created and delivered the Work, and (3) Le intended the Work to be used by the City. Le contended that he granted the City a revocable license, and that he exercised his right of revocation by removing the Work from the City's server; however, the Court rejected Le's contention because he was provided consideration. The Court granted summary judgment regarding Le's copyright infringement claims.

Le appealed the District Court's decision to the Court of Appeals of the Third Circuit, and on April 24, 2012, the Third Circuit affirmed the rulings below.[8]

II. RECENT CASE LAW DEVELOPMENTS RELATING TO THE WAGE PAYMENT AND COLLECTION ACT OF THE STATE OF DELAWARE

Due to the existence of employee-favorable remedies available in the Wage Payment and Collection Act of the State of Delaware ("WPCA"),[9] advocates, employees, and employers alike should make an effort to stay abreast of developments in that law. As the below, recent cases illustrate, the question of whether the WPCA applies and, if so, which remedies exist can sometimes be in debate.

A. Employees' Ability To Bring Claims For Unpaid Work During Meal Breaks

In *Bates v. Delaware Health Corp.*,[10] a putative class of certified nursing assistants alleged that they were forced to work through their half-hour lunch breaks, without pay, and that such time was never considered in determining whether overtime pay was due as a result of working hours over 40 in a workweek. Postured as a motion to dismiss for lack of subject matter jurisdiction, the motion was denied. In reaching this decision, the court considered, in part, whether the WPCA raised novel or complex issues of Delaware law. While the court found "there is an interesting legal issue about how Delaware's 'meal break' statute … should be interpreted, which would have some impact on the state law issues," the court denied the motion to dismiss based in large part on the fact that "Delaware has a fairly robust procedure for getting timely rulings on novel state law questions." More specifically, the court stated, "I believe the Delaware Supreme Court would accept and promptly decide a properly certified question."[11] The *Bates* decision does not specify the "interesting legal issue" of Delaware law. There might be at least two interesting legal issues.

7 17 U.S.C. §§ 101-122.

8. 2012 WL 1406462 (3d Cir. Apr. 24, 2012).

9. Del. Code Ann. tit.19, §§ 1101-1115

10. 2012 WL 2674601 (D. Del. July 5, 2012).

11. *Bates*, 2012 WL 2674601, at *2 (citing Del. Const. art. IV, § 11(8) and Sup. Ct. R. 41).

One interesting legal issue that might exist is whether Delaware's "meal break" statute requires only that employers allow a meal break (with a civil penalty for failing to do so) or whether it also dovetails with the WPCA to give employees a cause of action (and perhaps also liquidated damages and attorneys' fees) when employees work during what should have been unpaid meal breaks and are not paid for such work. Delaware's meal break law states, in part, "[a]n employer must allow an employee an unpaid meal break of at least 30 consecutive minutes, if the employee works 7½ or more consecutive hours. The meal break must be allowed some time after the first 2 hours of work and before the last 2 hours."[12] The "meal break" law further states, "[w]hoever violates this section shall be subject to a civil penalty of not less than $1,000 nor more than $5,000 for each violation."[13] Other than vaguely implying that an aggrieved employee may institute a "proceeding" and stating that "[j]urisdiction of violations of this subchapter shall be in any court of competent jurisdiction,"[14] the "meal break" statute otherwise is silent about how an aggrieved employee seeks relief (and for what) when s/he works through what should have been an unpaid meal break. The Delaware Supreme Court previously has held that where workmen's compensation benefits were due (under a statute other than WPCA) after proper demand therefor has been made, in order to give effect to the provisions of such statute, a claim for liquidated damages related to such a sum existed under WPCA.[15] It is possible that the same might be found true for any time worked during what should have been an unpaid meal break. Just as claims in the workmen's compensation context have come to be known as "*Huffman* claims," perhaps such claims in the meal break context will become known as "*Bates* claims."[16]

Another interesting legal issue might be whether an aggrieved employee has a cause of action in court for the "meal break" statute's applicable penalty. A penalty provision similar to that found in the "meal break" statute exists in the WPCA.[17] However, unlike the "meal break" statute, the WPCA also includes a "remedies of employees" section.[18] Although the remedies provision applies on its face only to "wages" and "liquidated damages," it has been applied to "benefits or wage supplements."[19] But due in part to there being "a clear statutory delineation between remedies afforded to an employee and civil penalties," the "remedies of employees" section of the WPCA has been held not to apply to the

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12. Del. Code Ann. tit. 19, § 707(a). Exceptions apply that should be considered , some of which are unclear and not tested in the courts,*e.g.,* "[o]nly 1 employee may perform the duties of a position.". A provision prohibiting retaliation also exists. *See* Del Code tit. 19, § 707(b).

13. Del. Code Ann. tit.19, § 707(c).

14. Del. Code Ann. tit.19, § 707(b), (c).

15. Nat'l Union Fire Ins. Co. v. McDougall, 877 A.2d 969 (Del. 2005) (citing Hoffman v. C.C. Oliphant & Son, Inc., 432 A.2d 1207 (Del. 1981)) (including as "wage" claim claims based on unpaid workers' compensation benefits due after proper demand therefor has been made in order to give effect to provisions of Del. Code tit. 19,§ 2357).

16. *Nat'l Union Fire Ins. Co.*, 877 A.2d at 971 ("[c]ivil actions filed under section 2357 to collect unpaid workers' compensation awards have been known as *'Huffman'* claims").

17. Del. Code Ann. tit. 19, § 1112(a) ("[a]ny employer who violates or fails to comply with any requirement of this chapter or any regulation published thereunder shall be deemed in violation of this chapter and shall be subject to a civil penalty of not less than $1,000 nor more than $5,000 for each such violation").

18. Del. Code Ann. tit. 19, § 1113 ("[a] civil action to recover unpaid wages and liquidated damages may be maintained in any court of competent jurisdiction").

19. Commons v. Green Giant Co., 394 A.2d 753 (Del. Super. 1978).

penalty provision of the WPCA.[20] Thus, the penalty identified in the WPCA simply is not a remedy afforded to aggrieved employees. Nonetheless, an open question is whether the lack of a "remedies of employees" section in the "meal break" law (and thus there no statutory delineation between the "meal break" statute's penalty provision and any remedy provision) is enough to distinguish the "meal law" from the WPCA for purposes of determining whether an employee has a private right of action against an employer for the civil penalty.[21]

Practicing attorneys in this field must stay tuned to learn whether the issues discussed above are resolved in the *Bates* litigation.

B. No Liquidated Damages For Wage Supplements

In *Hantman v. P/E, LTD.*, the Delaware Superior Court reaffirmed that the WPCA provides a cause of action to covered employees for both earned but unpaid "wages" and earned but unpaid "wage supplements."[22] The *Hantman* case also reaffirmed the more textually obvious issue that a civil action may be initiated to recover liquidated damages; and that a plaintiff who prevails in a WPCA action (for "wages" or "wage supplements") is entitled to "costs of the action, the necessary costs of prosecution, and reasonable attorney's fees" to be paid by the defendant. It is on the issue of liquidated damages that the *Hantman* case is noteworthy. The *Hantman* Court ruled that, because the liquidated damages provision of the WPCA applies to wages but not to wage supplements,[23] liquidated damages are not available on permanency awards, medical expert witness awards or attorney's fees for an administrative agency action before the Industrial Accident Board.

C. Reasons Why The WPCA Should Not Be Over-Applied

In *Klig v. Deloitte LLP*,[24] the Delaware Court of Chancery granted summary judgment in favor of an employer on a WPCA claim that wages were due during an unpaid leave of absence. The issue leading to judgment for the employer was whether the plaintiff was covered by the WPCA, which applies to persons "suffered or permitted to work by an employer under a contract of employment either *made in Delaware* or to be *performed wholly or partly therein*."[25]

The Court of Chancery found that the plaintiff did not work wholly or partly within Delaware and that nothing suggested that relevant agreements were "made in Delaware." In the Court of Chancery's ruling on this issue, informative analysis was provided regarding why the WPCA is not (and should not be) more broadly applied. Specifically, the Court of Chancery explained that there is no basis to think that Delaware could enforce its vision of appropriate employment law

20 . Rodas v. Serv.ice Gen. Corp*.,* 2010 WL 2355314, at *1 (Del. Super. June 10, 2010).

21. Even if a cause of action is found to exist for the "meal break" statue's penalty, it is unlikely that the penalty would be deemed a "wage" for purposes of the WCPA's liquidated damages provision. *See generally* Hantman v. P/E, LTD*,* 2011 WL 5316763 (Del. Super. Oct. 20,2011), which is discussed *infra*.

22. 2011 WL 5316763.

23. *See also* McNaboe v. NVF Co., 2002 WL 31444484, at *7 (Del. Oct. 31, 2002) (finding liquidated damages provision did not apply to severance pay, which was a wage supplement); Gen. Motors Corp. v. Local 435 of Inter. Union, et al*.,* 546 A.2d 974, 980 (Del. 1988) (finding liquidated damages provision did not apply to holiday pay, which was a wage supplement).

24. 36 A.3d 785 (Del. Ch. 2011).

25. *Id.* (citing Del. Code Ann. tit. 19, § 1101(a)(3)) (emphasis added in *Klig* opinion).

regulation within another state's territory. The court observed that child labor laws, minimum and other wage laws, laws affecting health and safety, and workmen's compensation laws are a few examples of broad authority granted to states (and exercised by states such as Delaware) as police powers to regulate the employment relationship. The Court of Chancery explained that a co-equal state sovereign such as Delaware can readily regulate within its borders, but cannot regulate the wages of an individual working in another state, outside of Delaware's jurisdiction.

A reader should not interpret the *Klig* case as implying that if the WPCA had applied the employee would have had a legitimate claim for wages that were not paid during a leave of absence. The Delaware Superior Court recently held "[n]othing in the Act requires an employer to continue paying wages to a suspended employee."[26]

III. "GOOD CAUSE" TO THROW IN THE TOWEL: RECENT CASE LAW DEVELOPMENTS RELATING TO VOLUNTARY TERMINATION OF EMPLOYMENT UNDER DELAWARE LAW

Delaware law provides that an individual is disqualified from receiving unemployment benefits if he or she "left work voluntarily without good cause attributable to such work."[27] Generally, in order to qualify for unemployment benefits, the claimant bears the burden of demonstrating "good cause" for leaving work.[28] The Superior Court of Delaware has interpreted the phrase "good cause" to mean:

> [S]uch cause as would justify one in voluntarily leaving the ranks of the employed and joining the ranks of the unemployed ….
>
> [A]n employee does not have good cause to quit merely because there is an undesirable or unsafe situation connected with his employment. He must do something akin to exhausting his administrative remedies.[29]

The Delaware Supreme Court most recently concluded that "a more contextually appropriate definition of good cause" would be "where: (i) an employee voluntarily leaves employment for reasons attributable to issues within the employer's control and under circumstances in which no reasonably prudent employee would have remained employed; and (ii) the employee first exhausts all reasonable alternatives to resolve the issues before voluntarily terminating his or her employment."[30] In other words, an aggrieved employee must try to resolve the issues internally with her employer, exploring all reasonable alternatives, before walking out on the process and filing for unemployment. This exhaustion requirement sounds good in theory but as recent case law demonstrates there are some nuances to the rule that make it difficult to put into practice.

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26. Broesler v. Wardens & Vestry of St. Barnabas Episcopal Church, 2011 WL 2174924 (Del. Super. Feb. 28, 2011).

27. Del. Code Ann. tit.19, § 3314(1)(2012).

28. Drummond v. Dentsply LLC, C.A. No. S12A-04-001-ESB, Bradly, J. (Del. Super. Nov. 14, 2012) (concluding that employee could not demonstrate good cause when she voluntarily left work because she felt her body could not withstand the demands of her job and did not supply her employer with any medical documentation that she was medically unable to work). *See* Longobardi v. Unemployment Ins. Appeals Bd., 287 A.2d 690, 692 (Del. Super. 1971).

29. O'Neal's Bus Serv. v. Employment Secur. Comm'n, 269 A.2d 247, 249 (Del. Super 1970).

30. Thompson v. Christiana Care Health Sys., 25 A.3d 778, 783 (Del. 2011).

The Delaware Department of Labor's Division of Unemployment Insurance has made it clear that an employee who voluntarily terminates employment without good cause is not eligible for unemployment benefits.[31] This rule has been upheld even where the employee's decision to leave her job is for good personal reasons and the employer is sensitive and perhaps sympathetic to those reasons, like the employer in *Johnson v. Christiana Care Health System*.[32] However, as *Johnson* makes clear, an employee only has good cause to voluntarily terminate her employment when the issue that gives rise to her resignation is within the employer's control.[33]

In *Johnson*, the claimant, Mary Johnson abruptly left her job with Christiana Care and moved to another state because of a life-threatening incident in her home.[34] Ms. Johnson had worked for Christiana Care for about thirteen years and "liked [her] job" but had to suddenly resign after someone attempted to kill her daughter in their home.[35] The Unemployment Insurance Appeals Board held that Ms. Johnson did not qualify for unemployment benefits because her resignation was not related to the conditions of her employment and moreover, was not within the employer's control.[36] Ms. Johnson appealed and the Delaware Superior Court upheld the Board's decision.[37] The court acknowledged it was sensitive to Ms. Johnson's personal reasons for resigning but her resignation was not attributable to actions taken by her employer, thus she did not qualify for benefits.[38] Put differently, while Ms. Johnson had good grounds for leaving her job, her resignation had to be connected to or the byproduct of an unhealthy *work* environment before she could receive unemployment insurance benefits.[39]

The "good cause" requirement also requires the employee to do something akin to exhausting his or her administrative remedies or exhausting all reasonable alternatives before he or she can be eligible for benefits. Recent case law demonstrates that this exhaustion requirement means the employer must take reasonable measures to remedy the problematic conditions of the work environment, and the claimant must take advantage of the corrective opportunities provided by the employer or at least give the employer the chance to correct the problem before the claimant quits and files for unemployment.[40]

In *Thompson v. Christiana Care Health System*, the claimant, Linda Thompson, worked for Howard Wellness Center, a medical facility operated by Christiana Care Health System, from September 2002 to February 2008.[41] In the

31. Johnson v. Christiana Care Health Sys., 2011 WL 5855039 (Del. Super. Oct. 28, 2011).

32. *Id.*

33. *Id.*

34. *Id.* at *1.

35. *Id.*

36. *Id.*

37. *Id.*

38. *Id.*

39. *Id.*

40. *Thompson*, 25 A.3d at 780.

41. *Id.*

latter part of her employment, "from 2006 to 2008, her working environment was 'very disruptive,' involving power struggles and repeated employee disagreements" with her supervisor and colleagues.[42] Ms. Thompson reported the issues involving her stressful work environment to her supervisor's manager and also complained to a recruiter in Human Resources.[43] The claimant's only misstep was that she did not completely follow her employer's internal procedures for addressing such issues,*i.e.*, she contacted the recruiter and not the employee relations representative.[44] When Ms. Thompson met with her supervisor's manager and requested a transfer to a different wellness center, she was told a transfer was not available.[45] A few days later, Ms. Thompson submitted her letter of resignation just as the internal process for reviewing her complaints had begun.[46]

The Claims Deputy denied Thompson's claim for unemployment benefits and the Appeals Referee affirmed the decision of the Claims Deputy.[47] However, the UIAB reversed the Appeals Referee's decision concluding Ms. Thompson had "voluntarily terminated her employment for 'good cause.'"[48] The UIAB reasoned that the employer had failed to resolve the issues in the workplace and moreover, had transferred other employees to different facilities and wrongfully denied Ms. Thompson's request notwithstanding the turnover in the workplace.[49]

The Superior Court reversed the UIAB's decision concluding "unhappiness arising out of an unpleasant work environment does not constitute 'good cause' for purposes of 19 *Del. C.* § 3314(1)."[50] The Delaware Supreme Court affirmed the Superior Court's decision.[51] The Supreme Court held that the record did not support Ms. Thompson's claim that she resigned because her transfer requests were denied or that she qualified for any of the positions at the other centers.[52] The court also concluded that Ms. Thompson did not give her employer the opportunity to remedy the job conditions, thus her "unpleasant work environment, without more, d[id] not constitute good cause."[53]

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42. *Id.*

43. *Id.*

44. *Id.*

45. *Id.* at 781.

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.* at 783.

50. Christiana Care Health Sys. v. Thompson, 2010 WL 532451, at *3 (Del. Super. Feb. 8, 2010). *See* Swann v. Cabinetry Unlimited, 1993 WL 487892 (Del. Super. Oct. 15, 1993) (affirming the UIAB's decision that an employee did not quit her job for "good cause" where the employee claimed that she could not longer tolerate her employer's temper); Ament v. Rosenbluth Int'l, 2000 WL 1610770 (Del. Super. Aug. 31, 2000) (affirming the UIAB's decision that stress does not constitute "good cause" for leaving employment).

51. *Thompson*, 25 A.3d at 784.

52. *Id.*

53. *Id.* at 784-85.

After *Johnson* and *Thompson* it seems employers now have an affirmative duty to take reasonable measures to remedy the problematic conditions of the work environment that are within their control and make sure those processes are effective. Additionally, claimants must be apprised of the process and give their employers the chance to correct the problems before seeking benefits. *Johnson* and *Thompson* also teach that good cause for leaving employment cannot be based on stress or unhappiness but requires something more that is not always defined by the case law.

IV. DELAWARE PUBLIC SECTOR LABOR LAW: RECENT CASE LAW DEVELOPMENTS

In *AFSCME v. State of Delaware, Public Employment Relations Board*,[54] the Delaware Superior Court considered a motion for summary judgment[55] which alleged that the Public Employment Relations Board ("PERB") exceeded its authority in determining that only unrepresented employees, *i.e.*, employees who were not part of an existing bargaining unit, were eligible to vote in a union representation election.

The case arose after the PERB scheduled a union representation election for a bargaining unit consisting of 1,636 employees. Of those employees, 1,323 were already represented by AFSCME in other existing bargaining units. AFSCME argued that all 1,636 employees—both represented and unrepresented—should be permitted to vote in the election. The PERB maintained that only the 313 unrepresented employees were entitled to vote. According to the PERB, allowing employees who were already represented by AFSCME to vote would dilute the rights of the 313 unrepresented employees thereby ensuring the outcome of the election,*i.e.*, that AFSCME would become the representative for all employees in the bargaining unit).

At issue was the PERB's interpretation of its rules governing the conduct of elections. Under PERB Rule 4.3(b), "[a]ll public employees who are included within the designated bargaining unit and who were employed as of the end of the pay period which immediately precedes an election or who were on approved leave of absence shall be eligible to vote.[56]

A literal interpretation of Rule 4.3(b) would entitle all 1,636 employees to vote in the representation election, including those already represented by the Union. However, according to Rule 1.9, the PERB is empowered to exercise discretion to suspend or waive the rules to promote the orderly administration of the Public Employment Relations Act:

> These regulations set forth rules for the efficient operation of the Board and the orderly administration of the Act. They are to be liberally construed for the accomplishment of these purposes and may be waived or suspended by the Board at any time and in any proceeding unless such action results in depriving a party of substantial rights.[57]

The court determined that the PERB acted appropriately in utilizing Rule 1.9 to invoke its discretion to "suspend" the terms of Rule 4.3(b) when defining voter eligibility.[58] The court also found that the PERB acted within the scope of

54. 2011 WL 2176113 (Del. Super. May 25, 2011).

55. *Id.* at *2 (though captioned as a motion for summary judgment, the court determined that AFSCME was actually seeking a writ of mandamus pursuant to Del. Code Ann. tit. 29, § 10143).

56. *Id.* at *3.

57. *Id.*

58. *Id.*

its discretionary authority under Rule 1.9 to construe Rule 4.3(b) so as to exclude historically represented employees from eligibility to vote in the election.[59]

While the court explained that this particular issue had not previously been decided under Delaware law, it nonetheless found that the principles underlying Delaware's collective bargaining statute, together with the presumption of validity that accompanies the PERB's construction of its own regulations,[60] confirm that the PERB acted within its authority by deciding which employees were entitled to vote in the representation election. Though the court was mindful that its analysis was complicated by the fact that the right of employees to vote in the representation election would be impacted under either parties' interpretation of the Rules, it concluded that the PERB's determination of the bargaining unit's electorate was discretionary (rather than ministerial) and therefore ruled that AFSCME's request for mandamus relief was inappropriate.[61]

In *AFSCME v. State*,[62] the Delaware Court of Chancery considered an appeal from two orders of the Public Employment Relations Board addressing whether the State committed an unfair labor practice by unilaterally changing the minimum hours for overtime compensation and imposing a temporary freeze on career ladder promotions.

The case arose following a series of efforts by the State to control government expenditures. These included a freeze on "career ladder promotions," and the General Assembly's enactment of legislation restricting overtime payment.[63] In response to these efforts, AFSCME filed unfair labor practice charges with PERB alleging that the State had failed to bargain in good faith by unilaterally stopping payments to employees that earned increases in compensation through the career ladders, circumventing the collective bargaining process, and engaging in impermissible communications with bargaining unit employees.[64]

The PERB hearing officer dismissed the unfair labor practice charges, and AFSCME thereupon sought review by the full Board. The full Board affirmed the underlying decisions unanimously and dismissed the charges.[65]

AFSCME then sought review of the PERB's ruling with the court. It argued that: (1) "employees have a constitutionally protected property right to bargain collectively;" (2) career ladders and overtime compensation are mandatory terms and conditions of employment over which the State must bargain; and (3) the State failed to bargain "in good faith by engaging in unilateral action to alter the terms and conditions of employment."[66]

The State maintained that overtime compensation and "career ladder promotions are not mandatory subjects of bargaining" and can therefore be unilaterally changed.[67] The State also pointed out that the Fiscal Year 2010 Appro-

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59. *Id.*

60. Del. Code Ann. tit. 29, § 10141(e).

61. 2011 WL 2176113, at *3.

62. 61 A.3d 620 (Del. Ch. 2012).

63. *Id.* at 625.

64. *Id.*

65. *Id.* .

66. *Id.* at 626.

67. *Id.*

priations Act superseded the provisions in the collective bargaining agreement, and that it was bound by the Delaware Constitution to implement the provisions of the Appropriations Act imposing the limitations on overtime compensation.[68]

The court agreed with the State's position that it was not required to bargain over non-mandatory or discretionary subjects of bargaining. In this regard, it noted that section 1305 of Title 19 of the Delaware Code provides that:

> A public employer is *not required to engage in collective bargaining on* matters of inherent managerial policy, which include, but are not limited to, such areas of *discretion* or policy as the functions and programs of the public employer, its standards of services, overall budget, utilization of technology, the organizational structure and staffing levels and the selection and direction of personnel.[69]

The court explained that the collective bargaining statute defines "discretionary subject" as "'any subject [1] covered by merit rules which apply pursuant to § 5938(c) of Title 29, and [2] which merit rules have been waived by statute.'"[70] The court reasoned that, "[f]or the purposes of this case, if the first part of this definition is met, the subject matter is a nonmandatory subject of collective bargaining, and, therefore cannot support [an unfair labor practice charge]."[71]

As to whether career ladder promotions and overtime compensation are mandatory or discretionary subjects of bargaining, the court noted that 29 *Del. C.* § 5938(c) "expresses the General Assembly's intent to reserve to the State the exclusive authority to govern the excepted sections (*i.e.*, §§ 5915 through 5921, 5933, 5935 and 5937)." In other words, "the Merit Rules would be controlling over these topics and collective bargaining as to them would not be authorized."[72]

"With these principles … in mind," the court analyzed "whether the career ladder and overtime provisions conflict with a 'general rule-making authority' incident to the excepted sections in Section 5938(c), and, therefore, are not subject to collective bargaining."[73] In conducting this analysis, the court reasoned that the career ladder is a form of promotion under both the collective bargaining agreement and the Merit Rules.[74] It stated that "this conclusion … comports with the plain meaning of 'promotion,'" which is "defined in Merriam-Webster's Dictionary as 'the act or fact of being raised in position or rank.'"[75] The court explained that "the career ladder satisfies this definition in that it raises an employee to a new position based on the acquisition of additional training and certification."[76] The court therefore found that "[b] ecause the career ladder [is a promotion], and promotions are excepted under 29 *Del. C.* § 5938(c), the State could not have violated 19 *Del. C.* § 1307(a) by refusing to negotiate the career ladder or unilaterally making changes to it."[77]

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68. *Id.*

69. *Id.* at 628 (quoting Del. Code Ann. tit. 19, § 1305)).

70. *Id.* at 629 n.56 (quoting Del. Code Ann. tit.19, § 1302(h)).

71. *Id.*

72. *Id.* at 629.

73. *Id.* at 629-30.

74. *Id.* at 632.

75. *Id.* at (citing Merriam–Webster's Collegiate Dictionary (11th ed. 2004)).

76. *Id.*

77. *Id.*

As to whether the State unilaterally made changes to the collective bargaining agreement regarding overtime compensation, the court determined that "[t]he adoption of the overtime provision … was a necessary part of the [State's] pay plan scheme because it provided for "'additional compensation for work performed in excess of the standard work week.'"[78] By including the pay plan scheme in the statute, the court stated that "the General Assembly made clear that compensation for Merit Employees is outside of the mandatory scope of collective bargaining for covered employees. Because premium pay was adopted pursuant to that Section," the court found that there was "no basis for concluding that the State violated section 1307(a) of PERA by making the challenged changes to overtime compensation."[79]

The court also agreed with the State's argument that the collective bargaining agreement "cannot override the Fiscal Year 2010 Appropriations Act."[80] In this regard, the court explained that the plain language of section 1313(e) renders unenforceable any agreements that are "'inconsistent with any statutory limitation on the public employer's funds' or 'contrary to law.'"[81] Here, the court found that the General Assembly, in enacting the Fiscal Year 2010 Appropriations Act, had created irreconcilable conflicts with the collective bargaining agreement by expressly limiting overtime eligibility and implemented a hiring review process in direct opposition to the terms of sections 14 and 15, thereby making these provisions "invalid and unenforceable."[82]

For these reasons, the court "conclud[ed] that PERB correctly found that the career ladder and overtime matters complained of by AFSCME were not mandatory subjects of bargaining, and that, therefore, the State did not violate 19 *Del. C.* § 1307."[83]

In *State of Delaware v. Public Employment Relations Board*,[84] the Delaware Superior Court considered a petition for a writ of certiorari filed by the State asserting that the PERB committed legal error by: (1) basing its decision on information from a web page that was not part of the evidentiary record, and; (2) failing to apply the "community of interest" in concluding that certain employees did not belong in a specified bargaining unit identified in the collective bargaining statute.

The case arose in the context of a union representation proceeding before the PERB. At issue was whether Justice of the Peace Court Constables could belong in a specified bargaining unit. The PERB Hearing Officer concluded that the Constables did not belong in that bargaining unit.[85] In reaching this conclusion, the Hearing Officer relied upon information contained on the website of the State's Office of Human Resource Management.[86] This information had not

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78. *Id.* at 633 (citing Laborers' Int'l Union of N. Am. Local 1029 v. State, 310 A.2d 664, 668 (Del. Ch. 1973)).

79. *Id.* at 633-34.

80. *Id.* at 634.

81. *Id*. at 635.

82. *Id*.

83. *Id.* at 636.

84. 2011 WL 1205248 (Del. Super. Mar. 29, 2011).

85. *Id.* at *2.

86. *Id.*

been introduced into evidence at the hearing.[87] The State appealed the Hearing Officer's decision to the full Board. The full Board affirmed the Hearing Officer's decision.

The State then filed a petition for a writ of certiorari alleging that the PERB erred: (1) when it affirmed the decision based on facts from the State's web page when that information was not part of the record; and (2) in failing to apply the "community of interest" standard in to conclude that the Constables did not belong in the bargaining unit.

The court explained that the purpose of a common law writ of certiorari is not to review the merits of the underlying action (as would be the case with an appeal), but to determine whether an error of law occurred below.[88] According to the court, "review on certiorari is on the record and the reviewing court may not weigh evidence or review the lower tribunal's factual findings."[89] Having determined that this case met the threshold requirements for a writ of certiorari, the court explained that the issue was whether PERB committed two errors of law in affirming the decision of the Hearing Officer.[90]

The PERB claimed that the Delaware Rules of Evidence ("D.R.E.") provide guidance in administrative hearings and that the administrative notice taken in this case was in accord with D.R.E. 201.[91] The court found that the PERB failed to comply with D.R.E. 201(e) which requires the parties be given notice of the facts to be judicially noticed and an opportunity to be heard.[92] The fact that the State was on notice of the nature of the hearing and that the information was publicly available was not sufficient, according to the court. Instead, it explained that D.R.E. 201(e) explicitly states each party "is entitled upon timely request to an opportunity to be heard as to the propriety of taking judicial notice and the tenor of the matter noticed."[93] By taking administrative notice of facts outside the record without first giving the parties notice and an opportunity to be heard, the court concluded that the PERB committed legal error.

However, the court found that the PERB did not err in relying on the statutory language to determine whether the Constables belonged in the bargaining unit. The court explained that the PERB is empowered to administer the Public Employment Relations Act and to determine the proper assignment of job classifications to bargaining units and the bargaining unit status of individual employee.

Accordingly, the court found that while the PERB applied the correct test in deciding the composition of the bargaining unit, it impermissibly relied upon information outside the record—job classification taxonomy from the State's website—that was not introduced into evidence. As a result of the reliance on evidence outside the record, the court reversed and remanded the case to the PERB.

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87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.*

91. *Id.* at *3.

92. *Id.*

93. *Id.*

FORTY YEARS OF TITLE IX: HISTORY AND NEW APPLICATIONS

Margaret E. Juliano*

Signed into law by President Nixon on June 23, 1972, Title IX of the Education Amendments of 1972 has done more than create a frenzy of ponytailed girls playing soccer. Its original intention was to "remedy to some extent sex discrimination in education."[1] It was passed with two objectives in mind: "to avoid the use of federal resources to support discriminatory practices," and "to provide individual citizens effective protection against those practices."[2] Its effect has been immense.

	1971-72	**2010-11**
Boys in high school varsity sports	3,666,917	4,494,406
Girls in high school varsity sports	294,015	3,173,549
Bachelor degrees awarded to men	500,590	685,382* (2008-09)
Bachelor degrees awarded to women	386,683	915,986* (2008-09)
Men entering medical school	10,435	10,193
Women entering medical school	1,653	9,037

These dramatic numbers show that Title IX has had its intended effect: to increase equality and to promote parity in entrance to graduate school, math and science programs and after school activities, though the majority of the attention given to Title IX has focused on sports. That focus has a good reason.[3] There is evidence that shows that participation in sports provides life skills beyond the playground. For example, Secretary of State Hillary Clinton stated: "I was never a great athlete, but I loved sports. Sports helped me learn how to be part of a team. It also helped me learn how to lose. You

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1. Trs. of Univ. of Del. v. Gebelein, 420 A.2d 1191, 1196 (Del. Ch. 1980).

2. Cohen v. Brown Univ., 101 F.3d 165 (1st Cir. 1996).

3. Karen Blumenthal, *The Truth About Title IX*, THE DAILY BEAST (June 22, 2012), *available at* http://www.thedailybeast.com/articles/2012/06/22/the-truth-about-title-ix.html.

can't win every time you go out, and you have to figure out what you're made of after you do lose and whether you're ready to get up and keep going."[4] Similarly, others report that sports participation is linked to "higher wages, greater educational attainment and overall professional success in adult life."[5] If the goal of Title IX was to increase parity between women and men, then allowing access by women to sports seems to be a vital part of the program.

But has Title IX achieved its goal of parity? Is the act still relevant and important? In answering this question, this article will explore the history of Title IX, its implementation, and the significant case law that shapes the operation of Title IX today, as well as briefly discuss the ways in which Title IX is being used to combat bullying in schools.

I. HISTORY

No one can dispute that the passage of Title IX of the Education Act of 1972 (the "Act") has had a dramatic impact on girls' participation in sports; one that began almost immediately. "The proportion of high school girls in sports went from 1 in 27 in 1972 to 1 in 4 in 1978, while the proportion of boys in sports held steady at 1 in 2."[6] But the focus of the Act was not sports when it was originally conceived.

Title IX was added to the Educational Amendments of 1972 as a last minute amendment at a committee hearing by Representative Edith Green.[7] As written, Title IX of the Act reads: "No person in the United States shall, on the basis of sex, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any education program or activity receiving Federal financial assistance."[8]

This Act effects more than who plays sports or the conditions under which they play. In essence, Title IX is an anti-discrimination law, with provisions to address sexual harassment and sexual assault on school campuses.[9] "Title IX is not an affirmative action statute; it is an anti-discrimination statute….[10] That means it seeks to prevent discrimination in many different areas.[11] In fact, it was originally intended to address inequality in science, technology, engineering and math (so called "STEM" areas) among other topics.[12]

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4. *The Cheat Sheet*, The Daily Beast, June 21, 2012 *at*: http://www.thedailybeast.com/cheats/2012/06/21/hillary-clinton-gets-sporty

5. Maha Atal, *Happy 40th Anniversary Title IX: From Girls' Sports to Women's Wages*, Forbes (June 22, 2012), *at* http://www.forbes.com/sites/mahaatal/2012/06/22/happy-40th-anniversary-title-ix-from -girls-sports-to-womens-wages/.

6. *Id.*

7. Blumenthal, *supra* note 3.

8. 20 U.S.C.S. § 1681; Mann v. Oppenheimer & Co., 517 A.2d 1056, 1065 n.10 (Del. 1986).

9. Alexander v. Yale Univ., 631 F.2d 178 (2d Cir. 1980) (applying Title IX to sexual harassment as a form of sex discrimination); North Haven Bd. of Ed. v. Bell, 456 U.S. 512 (1982) (applying Title IX to prohibit discrimination in employment). *See* David H. Williams, *Sexual Harassment in Schools*, 16 Delaware Lawyer 19, 20-21 (Winter 1999); *see generally* Simms v. Christina Sch. Dist., 2004 Del. Super. LEXIS 43 (Del. Super. Ct. Jan. 30, 2004); *see also* Valerie Jarrett*, 40th Anniversary of Title IX,* White House Blog, *at* http://www.whitehouseblog/2012/06/21/40th-annivesary-title-ix. For an excellent comparison of Title IX to other anti-discrimination laws, such as Title VII, *see* David S. Cohen, *Title IX: Beyond Equal Protection*, 28 Harv. J.L. & Gender 217 (Summer 2005).

10. Cohen v. Brown Univ., 101 F.3d 155, 170 (1st Cir. 1996).

11. *See* Alicia Jessop, *The 40th Anniversary of Title IX: The 21St Century Issue of College Coaches' Salaries*, Forbes (June 23,

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At the time Representative Green introduced her amendment, her focus was on ending educational quotas for admission found at law and medical schools.[13] That the law would have the revolutionary impact on sports that it has arose later when the Act was being considered in the Senate. When Senator Birch Bayh introduced the same amendment to the Act as Representative Green, he admitted in response to questioning from a colleague that Title IX would call for girls to have equal access to after-school activities.[14] The key and controversial areas of Title IX came more sharply into focus in its implementation.

II. IMPLEMENTATION

It was left to the Department of Health, Education and Welfare to determine how the Act would be implemented. That effort was led by Secretary Weinberger, who specifically decided that Title IX would apply to sports programs.[15] His vision, as stated at a press conference after releasing the implementing regulations in 1975, was that male and female teachers would be paid equally and all students would be equally able to participate in sports with similar equipment, facilities, and coaches.[16] The regulations issued in 1975 have remained virtually unchanged since that time.[17] In 1995, the Office for Civil Rights ("OCR"), the entity charged with enforcing Title IX, issued a new guidebook on how Title IX would be enforced.[18]

As to the most highlighted aspect of Title IX, involving varsity sports, the OCR regulations required equal opportunity for members of both sexes.[19] Specifically, those regulations state that "[a] recipient which operates or sponsors interscholastic, intercollegiate, club or intramural athletics shall provide equal athletic opportunity for members of both sexes."[20] The regulations as to varsity sports address "whether the selection of sports and levels of competition effectively

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2012), *at* http://www.forbes.com/sites/aliciajessop/2012/06/23/ the-40th-anniversary-of-title-ix-the-21st-century-issue-of-college-coaches-salaries. It's worth noting that the pay discrimination claims under Title IX focus on the sex of the team coached, not the sex of the coach. *Id.*

12. *See generally* Zachary Nathan Klein, *NOTE: STEMing Out Disparities: The Challenges of Applying Title IX to the Study of Sciences, Technology, Engineering, and Mathematics*, 64 Rutgers L. Rev. 895 (Spring 2012). For more information on STEM programs, see http://www.stemedcoalition.org/.

13. Blumenthal, *supra* note 3.

14. Blumenthal, *supra* note 3.

15. *Id*.

16. *Id*.

17. Diane Heckman, *On the Eve of Title IX's 25th Anniversary: Sex Discrimination in the Gym and Classroom*, 21 Nova L. Rev. 545, 546 (Winter 1997).

18. *Id*. at 546.

19. *Id*. at 549.

20. *Id*. at 561.

accommodate the interests and abilities of members of both sexes."[21] The method by which this equal opportunity is assessed, under the 1979 OCR Policy Interpretation, is:

> (1) Whether intercollegiate level participation opportunities for male and female students are provided in numbers substantially proportionate to their respective enrollments; or (2) Where the members of one sex have been and are underrepresented among intercollegiate athletes, whether the institution can show a history and continuing practice of program expansion which is demonstrably responsive to the developing interest and abilities of the members of that sex; or (3) Where the members of one sex are under-represented among intercollegiate athletes, and the institution cannot show a continuing practice or program expansion such as that cited above, whether it can be demonstrated that the interests and abilities of the members of that sex have been fully and effectively accommodated by their present program.[22]

In sum, schools have three options for showing that they have met the OCR regulations concerning Title IX. The analysis for meeting these three options has been fleshed out in the case law, as discussed below. Most important to determining the scope and interpretation of Title IX has been the Supreme Court's decision that individuals have a private right of action under Title IX.[23] Once that decision was entered in 1979, the scope of Title IX began to form.

III. SIGNIFICANT CASES

Before its enactment, Title IX faced a variety of challenges in the Senate and House, each seeking to curtail the possible effects of Title IX on sports. Once enacted, no challenge was bigger than the *Grove City v. Bell* decision.[24] In that case, the court ruled that Title IX was only applicable to athletic programs which received "direct" federal financial aid. Congress responded to this significant limitation on Title IX when it created the Civil Rights Restoration Act of 1988, overriding a Presidential Veto by President Reagan. The Civil Rights Restoration Act was specifically targeted to overcome the *Grove City* decision and mandated that all educational institutions which receive any type of federal financial assistance, whether direct or indirect, were bound by Title IX.

Cohen v. Brown University,[25] was the first case to tackle how a federal court would review the three part test set forth by the OCR. The case, and its appeal, involved the demotion of two women's athletic teams from university-sponsored to donor-sponsored level.[26] The Court of Appeals affirmed the District Court's finding that a school may satisfy one of the three prongs of that policy; it need not show specific proportionality between the two sexes.[27]

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21. *Id.* at 562-63

22. HEW Policy Interpretation, 44 Fed. Reg. 71,413, 71,418 (1979).

23 *Heckman*, *supra* note 17; *see also Cohen*, *supra* note 10. The case determining that there is a private right of action is Cannon v. University of Chicago, 441 U.S. 677 (U.S. 1979). The issue of whether monetary damages were available for infringement on that private right was answered in the affirmative in Franklin v. Gwinnett County Public Schools, 503 U.S. 60 (1992).

24. 465 U.S. 555 (1984).

25. 809 F. Supp. 978 (D.R.I. 1992).

26. The specifics of the case involved the levels of participation of men and women at Brown. The Court of Appeals found: "In the course of the preliminary injunction hearing, the district court found that, in the academic year 1990-91, Brown funded 31

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The Court of Appeals was clear that Title IX did not mandate exact parity. "No aspect of the Title IX regime at issue in this case – inclusive of the statute, the relevant regulation, and the pertinent agency documents – mandates gender-based preferences or quotas, or specific timetables for implementing numerical goals."[28] This goes to the heart of a major source of contention in the implementation of Title IX today – the idea that to meet the requirements of Title IX, men's sports teams must be cut. The Court of Appeals addressed this when it stated:

> absent a demonstration of continuing program expansion for the underrepresented gender under prong two of the three-part test, an institution must *either provide opportunities in proportion to the gender composition* of the student body so as to satisfy prong one, or *fully accommodate the interests and abilities of athletes of the underrepresented gender* under prong three.[29]

Much of the criticism against Title IX has come in response to cutting men's teams. Some opponents of Title IX have tried to argue that cutting men's teams violates Title IX as discriminatory towards men; they have failed.[30] In *Neal v. Board of Trustees of California State University*, decided in the Ninth Circuit, the court held that reducing the number of positions available on men's athletic teams in order to save money and to promote participation by women is not a violation of Title IX, putting such arguments to bed for the future.[31]

IV. CURRENT USE OF TITLE IX

While Title IX has had an impressive, possibly monumental impact on women's and girls' access to sports,[32] it has some serious ground to cover as to other areas of education. In 2000 the National Science Foundation and the Department of Energy performed an on-site compliance inspection of universities.[33] The results of that inspection, released in 2006, found that women were 25% less likely to attain full professorship and made up only 19% of full professors in the

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intercollegiate varsity teams, 16 men's teams and 15 women's teams, *Cohen I*, 809 F. Supp. at 980, and that, of the 894 undergraduate students competing on these teams, 63.3% (566) were men and 36.7% (328) were women…" Cohen v. Brown Univ., 101 F.3d 155, 163 (1st Cir. 1996).

27. *Cohen*, 101 F.3d at 166.

28. *Id.* at 170.

29. *Id.* at 176.

30. National Wrestling Coaches Assoc. v. U.S. Dept. of Ed., 366 F.3d 930 (D.C. Cir. 2004).

31. 198 F.3d 763 (9th Cir. 1999).

32. Many commentators note that there is still a serious disparity in minority children's access to sports programs. *See* Tom Farrey, *Too High a Price to Play*, ESPNW (June 7, 2012), *available at* http://espn.go.com/espnw/title-ix/7986414/too-high-price-play; *see also* Debra DeMeis, *Sex, Sports and Title IX on Campus: The Triumphs and Travails*, The Daily Beast (June 22, 2012), *at* http://www.thedailybeast.com/articles/2012/06/22/sex-sports-and-title-ix. Farrey presents a serious issue and states "Title IX also unwittingly introduced new barriers for disadvantaged girls because one way courts evaluate gender inequities is by looking at college scholarship aid for athletics, and recipients of that aid are often children of families with the means to chase it…."

33. DeMeis, *supra* note 32.

STEM areas.[34] This isn't to say that the sports situation is all wrapped up; serious discrepancies remain including massive disparities in coaches' salaries.[35]

Courts are still working out how Title IX should be applied. For example, in 2011, a federal judge ruled that the University of California, Davis, failed to offer enough athletic opportunities to women even though the judge went on to find that the University did not deliberately discriminate against the women (in that case female wrestlers).[36] This case highlights the *Cohen* decision discussed above in that the judge found that the University failed to follow Title IX because it could not prove that it had a continuing history of expanding opportunities for women, one of the three prongs of the enforcement set forth by the OCR.[37]

A significant issue has also been whether cheerleading can be considered a sport sufficient to meet requirements of a "sport" under Title IX.[38] The issue arose in a suit brought against Quinnipiac University in Connecticut.[39] In that case, Quinnipiac argued that the 30 women on the competitive cheerleading squad replaced the varsity volleyball team it cut.[40] The district judge found that cheerleading was not a sport because it was not conducted according to the U.S. Department of Education's standards for varsity sports. The NCAA has made clear that it does not recognize competitive cheerleading as a sport.[41]

Also at issue in the Quinnipiac case was whether the school was using roster-inflating tactics to make it seem as if they were meeting gender-equity minimums. The issue there, which is common in recent Title IX cases, involved the school's requirement that female cross country runners participate in track teams. Counting students who play more than one sport (cross country and track are distinct sports) is not in itself a violation of Title IX, but at Quinnipiac the school counted injured athletes as participants, raising a question of whether those athletes were actually participating in the sport, since participation is a key aspect of determining whether the OCR regulations have been met. As to whether injured athletes can be counted for determining rates of participation, the NCAA has stated "you can still count an athlete every time he or she is on a sport's roster, but you have to make sure they are having a legitimate participation experience."[42]

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34. *Id.*

35. *See* Jessop, *supra* note 11, for a chart of the top universities and the pay differential between the men's teams, coaches and the women's as of 2010-11.

36. Mansourian v. Bd. of Regents of Univ. of Cal., 816 F. Supp. 2d 869 (E.D. Cal. 2011).

37. *See* Katie Thomas, *Mixed Ruling in Title IX Case*, The New York Times B16 , 2011 WLNR 15500113 (Aug. 5, 2011).

38. For an in depth discussion of this issue, please see Erin Buzuvis, *The NCCAA At 100: Perspectives on its Past, Present, And Future: The Feminist Case for the NCAA's Recognition of Competitive Cheer as an Emerging Sport for Women*, 52 B.C. L. Rev 439 (March 2011), *available at* http://lawdigitalcommons.bc.edu/bclr/vol52/iss2/3/.

39. Michelle Brutlag Hosick, *Competitive Cheerleading Case Could Affect Title IX Landscape*, NCAA.Org (July 23, 2010) *available at* http://www.ncaa.org /wps/wcm/connect/public/NCAA/Resources/Latest+News/2010+news+stories/July+latest+news/Competitive+cheerleading+case+could+affect+Title+IX+landscape; Biedeger v. Quinnipiac Univ., 691 F. 3d 85 (2d Cir. 2012).

40. *Biedeger*, 691 F.3d 85. *See also* Linda Greenhouse, *The Court at the Olympics,* The New York Times (Aug. 8, 2012), *available at* http://opinionator.blogs.nytimes.com/2012/08/08/the-court-at-the-olympics.

41. *Hosick*, *supra* note 39.

42. *Id*.

Another recent development includes appropriate plaintiffs under Title IX. Retaliation claims, made by individuals who claim that they were fired for raising concerns about parity, are a large part of modern Title IX claims.[43] In 2005, the Supreme Court ruled in favor of a girl's high school basketball coach who alleged that he was fired for repeated requests for more money and access to similar equipment as the boys' teams. The Court ruled that the coach had a right to challenge his retaliatory dismissal.[44]

Finally, there is the issue of how Title IX can be used in bullying cases. In making the link between bullying and Title IX, it's important to recall that Title IX addresses not only discrimination but also harassment. For example in 1992, a case was brought against a school concerning harassment occurring between students (as opposed to earlier cases involving harassment by staff against students). Student-on-student harassment may fit into the definition of bullying.[45] According to the National Women's Law Center, bullying crosses the Title IX line when it "is so serious that it creates a hostile environment for the victim and such harassment is encouraged, tolerated, not adequately addressed, or ignored by school employees."[46] The issue of what constitutes bullying versus what falls into harassment may not be clear to school administrators. The Department of Education recently addressed this issue[47] and stated that student-on-student harassment or bullying will trigger Title IX liability when it "creates a hostile environment when the conduct is sufficiently severe, pervasive, or persistent so as to interfere with or limit a student's ability to participate in or benefit from the services, activities, or opportunities offered by a school."[48] In this way, the Department of Education has expanded how Title IX can be applied, and now can be used in student-on-student harassment, also referred to as bullying.

This application of Title IX to bullying is true both for bullying based on gender and on sexual orientation. "On March 13, 1997, the United States Department of Education released guidelines that state: if 'harassing conduct of a sexual nature is directed at gay or lesbian students it may create a sexually hostile environment and may constitute a violation of Title IX in the same way that it may for heterosexual students.'"[49] Scholars have made the link between anti-gay bullying and Title IX in the following way: "though Title IX does not prohibit discrimination on the basis of perceived orientation, in some cases, harassment based on gender identity or orientation (even perceived orientation) may occur "because of" sex and, therefore, be sexual harassment of the type proscribed by Title IX."[50]

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43. *Heckman*, *supra* note 17, at 552.

44. Jackson v. Birmingham Bd of Ed., 544 U.S. 167 (2005). *See also* Title IX Case Law, AAUW, *available at* http://www.aauw.org.

45. *See* Davis v. Monroe County Board of Ed., 526 U.S. 629 (1999).

46. *Title IX Protections From Bullying & Harassment in School: FAQs for Students*, National Women's Law Center (Dec. 12, 2011), *available at:* http://www.nwlc.org/resource/title-ix-protections-bullying-harassment-school-faqs-students.

47. Victoria Stewart-Cassell, Ariana Bell, J. Fred Sprinter, U.S. Department of Education, *Analysis of State Bullying Laws and Policies,* at 17 (2011) *available at*: http://www2.ed.gov/rschstat/eval/bullying/state-bullying-laws/state-bullying-laws.pdf .

48. *Id.*

49. Jane T. Monahan, David J. J. Facciolo, Shakuntla Bhaya, Deborah I. Gottschalk, *Gay & Lesbian Civil Rights: Marriage Is Not Enough*, 15 Delaware Lawyer 10, 35 (Summer 1997) (discussing the US DOE guidelines).

50. J. Dalton Courson and Abigayle C. Farris, *Title IX Liability for Anti-Gay Bullying*, ABA Section of Litigation, LGBT Litigator (Jan. 23, 2012), *available at* http://apps.americanbar.org/litigation/committees/lgbt/articles/winter2012-title-ix-liability-anti-gay-bullying.html.

This link between anti-gay bullying and Title IX was reinforced by the federal court in *Galloway v. Cheasapeake Union Exempted Village Schools Board of Education*.[51] In that case, the court found that a student who had been bullied throughout middle and high school, including having his pants pulled down and having other boys grind into his back, had made a showing sufficient to satisfy Title IX's requirement that discrimination be "because of sex."[52] In contrast, an Oregon school district won a motion to dismiss in a similar peer harassment case based on physical taunting because there was a lack of evidence to support the plaintiff's claims that the harassment was motivated by his perceived homosexuality and thus covered by Title IX.[53]

It's clear that these harassment claims, which were first made subject to Title IX in *Davis v. Monroe County Board of Education*,[54] are on the rise. In 2009, the number of Title IX complaints based on athletics was 1,264. By way of contrast, in the same year, the number of racial harassment/sexual violence complaints was nearly identical at 1,137.[55] The future of Title IX seems to now encompass both claims based on discrimination in athletics, with all of its potential life enriching aspects, as well as student-on-student harassment or bullying.

In looking to whether the intention of Title IX to achieve parity in participation in school activities between the sexes has come close to fruition, it is important to look beyond the idea that there are three times, or ten times, as many women participating in high school and college sports as before Title IX was passed. According to the Women's Sports Foundation, "female high school athletes receive 1.3 million fewer athletic participation opportunities than their male counterparts (3.2 million female vs. 4.5 million male). Female athletes receive 63,000 fewer opportunities at NCAA Institutions (193,000 female vs. 256,000 male). Female college athletes receive $183 million less in NCAA athletic scholarships ($965 million female v. $1.15 billion male). In addition, female high school and college athletes continue to lag behind males in the provision of equitable resources such as equipment, uniforms and facilities."[56] So while women have been participating more than ever in sports, they still haven't reached parity with their male counterparts in major elements, such as scholarships, equipment and facilities. Given that there are still strides to be made as to parity, it seems clear that Title IX is still very much relevant, especially as it is now an effective tool to be used to quash bullying and student-on-student harassment.

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51. 2012 WL 6268946 (S.D. Ohio Oct. 23, 2012).

52. *Id.*

53. A.E. ex rel. Evans v. Harrisburg Sch. Dist. No. 7, 2012 WL 4794314 (D. Or. Oct. 9, 2012).

54. Davis v. Monroe County Board of Ed., 526 U.S. 629 (1999).

55. Presentation by Professor Ann C. Juliano to DSBA Women and Law Section, December 4, 2012, on file with author.

56. *Title IX Myths and Facts*, Women's Sports Foundation (last viewed March 15, 2013), *available at* http://www.womenssportsfoundation.org/home/advocate/title-ix-and-issues/what-is-title-ix/title-ix-myths-and-facts.

THE "2010" AMENDMENTS TO DELAWARE UCC ARTICLE 9

Norman M. Powell*

The current version of Article 9 ("Current Article 9") of the Uniform Commercial Code ("UCC"), as promulgated in 1998 by the Uniform Law Commission ("ULC") and The American Law Institute ("ALI"), has been enacted in all fifty states, the District of Columbia, and the U.S. Virgin Islands, and generally took effect on July 1, 2001. From 2008 to 2010, a committee (the "Review Committee") convened by the ULC and the ALI considered certain issues, ultimately recommending amendments to the official text of, and official comments to, Current Article 9 (the "2010 Amendments"), intended to take effect on July 1, 2013. While most are unremarkable and simply clarify existing text, some are noteworthy. Some address issues seemingly anticipated by nonuniform text in Current Article 9 as enacted in Delaware ("Delaware Current Article 9"). This article provides a summary and brief discussion of the 2010 Amendments as well as nonuniformities in their text as recently enacted in Delaware (the "Delaware 2010 Amendments"). To the extent feasible, related provisions are discussed together regardless of their juxtaposition (or lack thereof) in the UCC. Unless otherwise noted, all citations in this article are to Current Article 9. Where the Delaware 2010 Amendments differ from the 2010 Amendments, such differences are discussed below.

I. SUMMARY

The 2010 Amendments were approved by the ULC at its 2010 annual meeting, and are being adopted by the various states in anticipation of a proposed uniform effective date of July 1, 2013. They include provisions that clarify, rather than change, what was intended by Current Article 9, as well as substantive changes reflecting emerged and emerging thought. Perhaps the most significant change is the offering of two alternative approaches to the vagaries of determining individual debtors' names. Alternative A, the so-called "only if" approach, would require that such names be rendered as they appear on a driver's license or other specified document. Alternative B, the so-called "safe harbor" approach, would merely create a safe harbor for financing statements naming debtors thus. Delaware took a nonuniform approach to individual debtors' names in 2001, and continues essentially that same approach under the Delaware 2010 Amendments, but with the addition of Alternative B's safe harbor. Other debtor name changes are relevant where collateral is held by the personal representative of a decedent, and where collateral is held in a trust. The classification of certain entities as "registered organizations" is clarified, as is the record to be consulted to determine a registered organization's name. The current "four month rule" that continues perfection following a change in a debtor's location is changed to provide not merely that a secured party's perfected security interest continues for four months following a change in its debtor's location (or, similarly, for four months following a new debtor becoming bound under an existing security agreement), but that such secured party is generally perfected in collateral acquired by its debtor within four months thereafter. The much-misunderstood "correction statement," which has no legal effect and can be filed only by a debtor, is renamed an "information statement," continues to have no legal effect, but can be filed by either a debtor or a secured party. The

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proposed changes eliminate the requirement that financing statements indicate a debtor's type of organization, jurisdiction of organization, and organizational identification number, based on the judgment that the burden of providing such information outweighs the resulting benefits. For precisely that reason, Delaware did not require inclusion of organizational identification numbers under Delaware Current Article 9. These and the other revisions are discussed in more detail below.

II. PROPOSED CHANGES TO PART 1: GENERAL PROVISIONS

The 2010 Amendments begin with revisions to certain definitions, most reflecting further refined thinking or facilitating greater clarity and certainty.

A. Section 9-102(a)(7) – "Authenticate"

Section 9-102(a)(7) is revised such that the definition of "authenticate" more closely resembles the definitions of "sign" in revised UCC Article 1 (general provisions) and Article 7 (documents of title). Recall that Current Article 9, intended to be medium-neutral, largely did away with anachronistic terms that suggested any requirement for paper documents and manual signatures affixed by humans wielding pens. This amendment brings to Article 9 the further-refined thinking of the years since the text of Current Article 9 was finalized in 1998.

B. Section 9-102(a)((10) – "Certificate Of Title"

Section 9-102(a)(10)'s definition of "certificate of title" is revised to comport with the emerging practice in many jurisdictions of maintaining nonpaper electronic records evidencing both ownership and security interests. Conforming changes appear in section 9-311 (Perfection of Security Interests in Property Subject to Certain Statutes, Regulations, and Treaties). The 2010 Amendments include a new sentence in Official Comment 5b to section 9-102, noting that when electronic chattel paper is converted to tangible form ("papered-out," in industry parlance), tangible chattel paper results. In a similar vein, Official Comment 3 to section 9-330 is modified to more clearly state that a secured party may achieve priority with respect to "hybrid" chattel paper (that is, chattel paper that is partly tangible and partly electronic) under Section 9-330(a) or (b), and to clarify how a secured party can retain its priority when tangible chattel paper is converted to electronic chattel paper and vice versa.

C. Official Comment 5D To Section 9-102 – Assignment Of Lessor Rights As Chattel Paper

Rejecting the holding in *In re Commercial Money Center, Inc.*, 350 B.R. 465 (B.A.P. 9th Cir. 2006), the 2010 Amendments provide in their changes to Official Comment 5d to section 9-102 that if a lessor's rights under a lease constitute chattel paper, an assignment of the lessor's right to payment under the lease, even if the assignment excludes any other rights, would be an assignment of chattel paper.

D. Section 9-102(A)(68) – "Public Organic Record"

Section 9-102(a)(68) is new, and brings specificity to the question of just what public record should be consulted to determine a registered organization's name. The new term "public organic record" generally means the document filed with or issued by the relevant state or the United States to form or organize a registered organization. Revisions to the accompanying Official Comment 11 explicitly indicate that a certificate of good standing is not a public organic record and, thus, is not an appropriate referent for determining a registered organization's name. In a modest nonuniformity, the Delaware 2010 Amendments recognize that relevant filings relating to Delaware registered organizations can include not only initially filed records, amendments thereto, and restatements thereof, but also related corrective filings. Similarly, the definition of "registered organization" in (what is renumbered as) section 9-102(a)(71) is amended to clarify that the term includes organizations (i) formed or organized, (ii) by (a) the filing or issuance of a public organic record, or (b) by legislative enactment, even if such organizations are created without the need for a public organic record. These latter two provisions work in concert with revisions to section 9-503 (discussed below).

E. Section 9-105 – Control Of Electronic Chattel Paper

Section 9-105 is revised to provide a general test, and a safe harbor, for achieving perfection by control of electronic chattel paper. The language derives from the Uniform Electronic Transactions Act, and defers to emerging systems that reliably establish the secured party as the assignee of the chattel paper, contemplating continued innovation in this field.

III. PROPOSED CHANGES TO PART 3: PERFECTION AND PRIORITY

The revisions to Part 3 clarify certain matters related to transmitting utilities, location of debtors, and priority issues. They also affect changes resulting from a change in governing law, as for example when a debtor's location changes from one jurisdiction to another.

A. Section 9-301 – Law Governing Perfection And Priority

The 2010 Amendments include revision and augmentation of Official Comment 5b to section 9-301 to clarify certain matters relevant to fixture filings and nonfixture filings against collateral of transmitting utilities. A security interest in most types of collateral, including fixtures, of a transmitting utility can be perfected by a central filing in the jurisdiction where the transmitting utility is located. But a fixture filing is effective to perfect a security interest only in fixtures located in the jurisdiction in which such fixture filing is made, with the consequence that multiple such filings may be required.

B. Section 9-307 – Location Of Debtor

Section 9-307 of Current Article 9 provides the rules for determining a debtor's location, and thus the place in which one must generally file a financing statement naming that debtor for such financing statement to be effective.[1] Its subsection (f) addresses the location of registered organizations organized under federal law. Subparagraph (f)(2) currently provides that when an organization's location is designated in accordance with federal law, such location constitutes the organization's location for filing purposes. Alas, this succinct and seemingly clear provision has given rise to considerable consternation. In the parlance of many federal laws (e.g., the National Bank Act), what's designated is actually denominated

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1. The general rule is subject to exceptions, e.g., for fixture filings and for security interests in timber to be cut and as-extracted collateral. *See* U.C.C. § 9-301, cmt. 5.

a "main office" or "home office," not a location. In its initial enactment of Current Article 9, Delaware added to section 9-307(f) nonuniform language to the effect that designating a main office or home office constitutes designation of a location. Revised versions of the Official Comments to Current Article 9 offered the same assurance,[2] but of course lack the force of law. The 2010 Amendments remove any doubt that such designations are, in fact, designations of a location for filing purposes. Inasmuch as the language to such effect in the 2010 Amendments differs from the nonuniform language in Delaware Current Article 9, for avoidance of any uncertainty Delaware both carries forward its original nonuniformity and adopts the new uniform text.

C. Section 9-316 – Effect Of Change In Governing Law

The 2010 Amendments significantly alter the effect of a change in governing law. Under Current Article 9 section 316, perfection of security interests that have attached prior to a change in the debtor's location continues for four months after such change. The 2010 Amendments add a new subsection 316(h) pursuant to which a secured party would also enjoy perfection of security interests that attach within four months after a change in the debtor's location, provided the secured party has already taken steps pursuant to which it would have been perfected absent the change in location. To illustrate, assume D is located in Florida and SP has properly perfected its security interest in D's inventory and accounts receivable by filing a financing statement in Florida. Thereafter, D's location changes to Delaware. Under Current Article 9, SP remains perfected, for four months following the change in location, in any inventory and accounts receivable in which it was perfected *before* the change. Under the 2010 Amendment, this remains so, but SP is *also* perfected in any (newly acquired) inventory and (newly arising) accounts receivable to which its security interest first attaches during the four months *after* the change in location. Such perfection continues until the end of this four-month period.

Similarly, a new subsection 316(i) provides for perfection of security interests that attach within four months after a new debtor becomes bound by an existing security agreement. Returning to our example, let's suppose that upon its "relocation" to Delaware "old D" is succeeded by "new D" as the debtor bound by the existing security agreement in favor of SP. Let us further suppose that, within the four months following such "relocation," "new D" enters into a financing transaction in which it grants SP2 a security interest in all of its inventory and accounts receivable, and that SP2 promptly perfects its security interest by filing in Delaware a financing statement naming "new D" as debtor. As between SP and SP2, both of which have perfected security interests in inventory acquired and accounts receivable arising within the four months immediately following "new D's" becoming bound, who has greater priority? Current Article 9 section 326 generally provides that, with respect to collateral in which the original debtor never held an interest, the security interest perfected by filing against the original debtor is subordinate to the security interest perfected by filing against the new debtor. The 2010 Amendments include revisions to Section 326 that preserve and extend this result to the circumstances contemplated by new subsection 316(i). Thus, in our example, SP is subordinate to SP2 with respect to collateral in which "old D" never held an interest. A modest revision to Official Comment 2 to Section 9-326 clarifies the interplay between that section and section 9-508 regarding subordination of certain security interests created by a new debtor.

D. Section 9-317 – Interests That Take Priority Over Or Take Free Of Security Interest Or Agricultural Lien

In what is viewed as a clarification, the language of section 9-317 is expanded to explicitly cover buyers of all types of collateral not susceptible to possession. Thus, a licensee of a general intangible, and a buyer (other than a secured party)

2. *See Id.* § 9.307 cmt. 5.

of any collateral other than tangible chattel paper, tangible documents, goods, instruments, or certificated securities takes free of a security interest if such licensee or buyer gives value without knowledge of, and before perfection of, such interest.

E. Section 9-322 – Priorities Among Conflicting Security Interests In And Agricultural Liens On Same Collateral

In another clarification, Official Comment 4 to section 9-322 has been augmented to include an explicit statement to the effect that a financing statement filed without authorization, but later authorized or ratified, thereupon becomes effective, but nevertheless enjoys priority from its time of filing. Official Comment 8 to the same section has been augmented to complete the explanation of certain priority rules applicable to proceeds: specifically, where two security interests in the same original collateral are entitled to priority in proceeds under section 9-322(c)(2), the security interest having priority in the original collateral has priority in the proceeds.

IV. PROPOSED CHANGES TO PART 4: RIGHTS OF THIRD PARTIES

Current Article 9 section 406 includes a broad override of certain contractual restrictions on assignability of property including accounts, chattel paper, payment intangibles, and promissory notes, but does not apply to a sale of a payment intangible or promissory note. Current Article 9 section 408 includes a more narrow such override of certain contractual restrictions on assignability of property including promissory notes, health-care insurance receivables, and general intangibles, but applies only to security interests in payment intangibles or promissory notes arising out of a sale. Thus, if a right to payment is evidenced by a promissory note, or is a payment intangible, Current Article 9 sections 406 and 408 facilitate assignments for security but not assignments by sale. Uncertainty has arisen as to whether foreclosure should be regarded as a "sale" or an assignment "for security." The 2010 Amendments clarify that the anti-assignment provisions of both sections apply to sales pursuant to Article 9 Section 9-610 and acceptances of collateral under Article 9 section 9-620.

V. PROPOSED CHANGES TO PART 5: FILING.

Amendments to Part 5 relate to determination of debtor names, persons entitled to file amendments, what to do when a debtor entity is "converted" into another debtor entity (and thus may be the same debtor, albeit perhaps with a different name or location, or may be a new debtor), certain filings against utility companies, bases on which filing offices can rightfully reject filings, filings asserting that specified existing filings are inaccurate or unauthorized, and revisions to the safe harbor written forms accepted by all filing offices that accept written filings.

A. Section 9-503 (Name Of Debtor And Secured Party)

Perhaps the most significant of the 2010 Amendments, these changes are relevant to filings against registered organizations, filings where collateral is being administered by the personal representative of a decedent, filings where collateral is held in a trust that is not a registered organization, and, most significant of all, filings against individual debtors. With different variations in each context, it has proven challenging to determine exactly what a given debtor's name is, and likewise challenging to make other determinations antecedent to filling out financing statements and tendering them for filing. In addition to the changes discussed below, consistent changes appear in Official Comment 2 to section 9-506 (Effect of Errors or Omissions).

B. Registered Organizations

It has proven unclear just which public record is relevant to determining the name of a registered organization. Many quickly came to the view that good standing certificates were not the appropriate source of such information, but uncertainty remained as to which filed, or issued, formation document should be consulted.[3] As revised by the 2010 Amendments, Section 9-503 refers to the "public organic record," the newly defined term appearing at new subsection 9-102(a)(68),[4] which includes a record filed with the relevant state or the United States, and a charter issued by such state or the United States. Helpfully, it explicitly notes that a certificate of good standing or an index of domestic entities is irrelevant.[5] In a modest nonuniformity, the Delaware 2010 Amendments refer to the "public organic record inclusive of the record most recently filed," rather than the uniform 2010 Amendments' formulation "public organic record most recently filed." The term "public organic record" is collective, and thus includes initially filed records and amendments thereto and restatements thereof, as well as (in Delaware—*see* discussion of 9-102(a)(68) *supra*) related corrective filings. Moving beyond the challenge of determining a registered organization's name, the 2010 Amendments revisit the threshold question of what organizations are registered organizations. "Registered organization" includes an organization created without a public record but that is "formed" only when a public filing has been made. For example, a Delaware statutory trust is "created" by its governing instrument,[6] but is "formed at the time of the filing of the initial certificate of trust in the office of the Secretary of State…."[7] Many have had little doubt that Delaware statutory trusts are "registered organizations," but may nonetheless take further comfort from the explicit assurance afforded by the 2010 Amendments. Similarly, the 2010 Amendments clarify that a Massachusetts business trust is a registered organization.[8]

C. Decedents And Their Estates; Trusts And Trustees.

The 2010 Amendments respond to some extent to difficulties experienced by those endeavoring to determine, in contexts involving decedents and their estates, and trusts and trustees acting with respect to property held in trust, the exact identity of the "debtor," which is to say the person possessed of the requisite rights in the collateral to meet the statutory

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3. In a better world, of course, a registered entity's name would be rendered identically always and everywhere. The concern arises because many states maintain separate databases from which different documents and informational reports are generated. For a variety of reasons, including human error in data entry, programming or execution error in the transfer of data from one database to another, differing field length limitations, and differing protocols for the rendering of nonstandard characters, it should be contemplated that the rendering of a registered organization's name may not be identical always and everywhere.

4. *See* discussion *supra*.

5. *Id.*

6. *See* Del. Code Ann. tit. 12, § 3801(a)(1).

7. Del. Code Ann. tit. 12, § 3810(a)(2).

8. §§ *See, generally,* 2010 Amendments §§102(a)(68) and (71), and Official Comment 11 thereto.

definition of "debtor" in section 9-102(a)(28). In the former context, the 2010 Amendments eliminate the requirement that a filing indicate whether, in fact, the debtor is "a decedent's estate,"[9] and instead simply require indication that the collateral is "being administered by the personal representative of the decedent." In the latter context, the 2010 Amendments eliminate the requirement that a filing indicate whether, in fact, the debtor is "a trust" or, alternatively, is "a trustee acting with respect to property held in trust," and instead simply require indication that "the collateral is held in a trust." In both contexts, special transition rules provide, in effect, that financing statements filed prior to the effective date of the 2010 Amendments and meeting the current requirements (that is, the requirements of Current Article 9) in this regard will not cease to be effective by reason of their failure to provide the simpler (yet arguably different) indication required by the 2010 Amendments. The reader is cautioned, however, that although the challenge of determining the precise identity of the "debtor" need no longer be met as a precondition to properly filling out a financing statement, it remains vitally important inasmuch as the financing statement, to be effective, must generally be filed in the jurisdiction in which the debtor is located within the meaning of section 9-307.[10] The 2010 Amendments clarify that these special rules applicable to property held in a trust don't apply where collateral is held by a trust that is itself a registered organization – in such cases, the ordinary rules for filing against registered organization debtors should be followed.

D. Individual Debtor Names

The issue that presented the greatest challenge to the Review Committee was that of individual debtor names. Under Current Article 9, when the debtor is an individual, a financing statement is sufficient only if it provides the "name of the debtor." While Current Article 9 provides guidance for determining and rendering a debtor's name "sufficiently," such guidance is less than helpful in the case of individual debtors, for whom use of their "individual" names is required.[11] The simplicity of the requirement belies the challenge of its application. American law provides individuals nearly unlimited freedom to change their names, often with little or no formality or documentation. Consider, for example, the name changes that commonly accompany marriage and divorce, and the insidious spread of informality by which many a Thomas is known far and wide as Tom and many an Elizabeth as Liz (or, if personal preference so dictates, Beth), to say nothing of Stefani Joanne Angelina Germanotta (or is her name now "Lady Gaga"? And if so, is that a first name and surname, or something else?). The simplicity of requiring the "name of the debtor," while appealing, presupposes that one can determine a debtor's name with greater certainty and ease than experience suggests one actually can. The Review Committee found no panacea, and instead offered in the 2010 Amendments two alternative approaches.

Alternative A – the "only if" approach – requires use of the name that appears on the debtor's driver's license or other specified document (e.g., an identification card issued by his or her state of residence) or, if the debtor has no such document, the debtor's surname and first personal name. Alternative B – the "safe harbor" approach – retains the current "name of the debtor" approach, but also provides a "safe harbor" for using either of the names designated by statute (viz., the surname and first personal name, or the name appearing on the debtor's driver's license or state-issued identification card). These alternatives strike different balances in the allocation of risks and protections among filers and searchers. The "only if" approach appears very simple – if only the name on the relevant identification document will suffice, searchers

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9. Often, the "debtor" will be the personal representative of the decedent, not the estate itself. See 2010 Amendments, section 9-503, Official Comment 2c.

10. *See supra* note 1 and accompanying text.

11. U.C.C. § 9-503(a)(4)(A).

need only conduct searches in such name. But this approach is not without its limitations and shortcomings. The Delaware Division of Motor Vehicles utilizes only uppercase letters, truncates surnames at forty characters, lists first and middle names (without distinction between them) in a second field truncated at forty characters, omits all commas, renders "junior" and "senior" as "JR" and "SR," renders roman numerals as arabic (Thurston Howell, III, had he lived in Delaware, would have been issued a driver's license identifying him as THURSTON HOWELL 3RD), and uses only the twenty-six letters of the English alphabet and arabic numerals modified as shown in the preceding parenthetical. Hyphens are used only in the surname field; no "foreign" letters or characters whatsoever are used. Of course, these conventions could change at any time. If the relevant identification document expires, it is no longer a proper source for determining the debtor's name. One moves progressively down the waterfall of possible source documents or other indicia of individual names, any of which could provide something different as the debtor's name. That is to say, a financing statement once perfectly featuring the debtor's name could cease to be effective upon expiration of a driver's license, or issuance of a replacement license rendering the debtor's name differently.

Delaware was the first state to act on the challenge presented by individual debtors' names. Prior to the enactment of Delaware Current Article 9, it was recognized that determining an individual debtor's name could prove problematic. This issue arises as follows. Current Article 9 provides, in its subsection 9-503(a)(4)(A), that (as noted above) a financing statement "sufficiently" provides an individual debtor's name if it provides such debtor's individual name. Section 9-506 provides that a financing statement containing minor errors and omissions is effective unless the errors or omissions make it "seriously misleading." Any financing statement that fails sufficiently to provide the debtor's name is, of necessity, "seriously misleading."[12] Note that financing statements are generally indexed and searched by debtor's name. Subsection 9-506(c) provides a safe harbor, providing in effect that if a search under the debtor's correct name would disclose a filing that fails to provide the debtor's name in accordance with subsection 9-503(a), such filing would not be "seriously misleading" for that reason, and thus could be effective despite the rendering of the name. A corollary of this rule, of course, is that such a financing statement, if not so found, is "seriously misleading" and ineffective. In its enactment of Current Article 9, Delaware exempted filings naming individual debtors from Section 9-506's search logic test by inclusion of nonuniform text (i.e., "[e]xcept in the case of individual debtors…").[13] This approach has worked well for Delaware, and is continued through the Delaware 2010 Amendments, though with the addition of Alternative B. Thus, the Delaware 2010 Amendments offer safe harbors for filings providing either the surname and first personal name of an individual debtor, or such individual debtor's name as it appears on an unexpired driver's license or state-issued identification card.

E. Individual Debtor Names – Special Rule For Mortgages

The Review Committee recognized the very real possibility that people may continue to hold real estate in names that differ (at least to some extent) from their names as they appear on their driver's licenses. New subsection 502(c)(3)(B) recognizes that strict requirement of a debtor's "driver's license" name may not make sense in the context of real estate documents, and provides that use of the debtor's "individual name" or "surname and first personal name" suffices in the case of a mortgage effective as a financing statement. As explained in a legislative note to the 2010 Amendments, section 9-502 should only be amended in states that adopt Alternative A – the "only if" approach – for naming individual

12. U.C.C. § 9-506(b).

13. Del. Code Ann. tit. 6, § 9-506(b).

debtors under section 9-503, and is unnecessary in states that adopt Alternative B – the "safe harbor" approach. No such amendment has been made in Delaware.

F. Section 9-507 – Effect Of Certain Events On Effectiveness Of Financing Statement

Current Article 9 recognizes that debtors sometimes change their names, and that such changes can render existing financing statements seriously misleading and, thus, ineffective, unless appropriate amendments are filed. The Review Committee recognized that Current Article 9 subsection 507(c) focuses on behavior –"If a debtor so changes its name" – and in efforts to coordinate with the proposed revisions to section 9-503 regarding individuals' names, shifts the focus to consequences – "the name that a filed financing statement provides for a debtor becomes insufficient … under Section 9-503(a)." That is, it recognizes that under the 2010 Amendments a debtor's name may change not only by reason of action on the part of the debtor, but also by reason of, for example, expiration (or reissuance) of a driver's license.

G. Section 9-509 – Persons Entitled To File A Record

An amendment to Official Comment 6 to section 9-509 is intended to clarify that authorization to file a record under section 9-509(d) (that is, an amendment other than an amendment that adds collateral covered by a financing statement or an amendment that adds a debtor to a financing statement) need not appear in an authenticated record. This stands in contrast with the requirement that any authorization required under section 9-509(a) (that is, in connection with an initial financing statement, an amendment that adds collateral covered by a financing statement, or an amendment that adds a debtor to a financing statement) must appear in an authenticated record.

H. Section 9-512 – Amendment Of Financing Statement (New Debtor Or New Name)

Many have puzzled over section 9-512 (Amendment of Financing Statement), and its requirements where a debtor undergoes a "conversion" to a different form of business entity under applicable state law. Many states permit "conversion" of one organization into another, but state laws differ (and some are simply unclear) as to whether the organization resulting from the conversion is the same legal person as the organization prior to conversion, or is a new legal person. That is, it is sometimes unclear whether the debtor is the same organization, albeit with a different name (and perhaps a different type of organization and jurisdiction of organization), or is a different organization entirely. Current Article 9 defers to the law governing conversion for a determination as to whether the resulting organization is the same legal person as the original debtor, and the 2010 Amendments make no change in that approach. New Official Comment 5 is intended to clarify and emphasize this deference. It explicitly provides that when such organizations are one and the same, an amendment reflecting the name (and any other) change should be filed, whereas when such organizations are separate and distinct, an amendment adding the resulting entity as a new debtor should be filed. Helpfully, the Official Comment offers that in the face of uncertainty, one would do well to follow both courses of action. Owing to the ubiquity of Delaware entities, in the interest of greater salience and clarity the Delaware 2010 Amendments include nonuniform text to such effect at section 9-512(f).

I. Section 9-515 - Evergreen Filings Against Transmitting Utilities

Recognizing a systems limitation present in many filing offices, section 515(f) is revised to require that in order to take advantage of the special rule that a financing statement naming a transmitting utility as debtor is effective until terminated, the initial financing statement (as contrasted with an amendment thereto) must indicate such status. The similar rule, found in section 515(b), providing for thirty year effectiveness of financing statements relating to public-finance or manufactured-home transactions, has always required the designation in the initial financing statement. Many filing offices simply can't revisit their initial coding of a financing statement to change its lapse date.

J. Section 9-516 – What Constitutes Filing; Effectiveness Of Filing

This section deals with the question of what constitutes filing, whether of an initial financing statement or any amendment (including assignments, terminations, and continuations). It also provides an exclusive list of grounds upon which a filing office may rightfully reject a record, and the correlative concept that a wrongfully rejected filing is generally effective except as to a purchaser that gives value in reasonable reliance upon the absence of the wrongfully rejected record. This section is amended to reflect certain nomenclatural changes (see *infra* for discussion of section 9-518 and the change from "correction statements" to "information statements"; see above for discussion of section 9-503 and certain changes regarding the rendering of debtors' names).

In an effort to assist searchers in eliminating from concern filings that appear to relate to the debtors with which they are concerned but which, in fact, relate to other, identically or similarly named debtors, Current Article 9 provides that a financing statement can be rejected if it fails to state the debtor's type of organization, jurisdiction of organization, and organizational identification number (or an indication that it has none).[14] Of course, such information has little relevance except as applied to registered organizations, as to which filings are generally to be made in their jurisdiction of formation. And jurisdictions generally preclude the duplicative use of registered organization names and confusingly or deceptively similar names. The consequence is that the burden of providing such information was adjudged greater than any resulting benefit. The 2010 Amendments eliminate any requirement for these three data. Interestingly, Delaware Current Article 9 never required inclusion of organizational identification numbers – Delaware declined to adopt subsection 9-516(b)(5)(C)(iii). Thus, Delaware is no longer nonuniform in this regard.

Delaware Current Article 9 contains certain nonuniform provisions intended to coordinate with other provisions of Delaware law. These include text in section 9-516(c) relating to records filed in the office of the recorder of deeds in the several counties. Title 9, Chapter 96 of the Delaware Code requires that certain information appear on documents filed in such offices (e.g., real estate tax parcel number and identity of document preparer). While the 2010 Amendments do not bear directly on these nonuniform provisions, their text has been revisited in the Delaware 2010 Amendments to make certain nonsubstantive, conforming changes.

Finally, Delaware Current Article 9 contains certain nonuniform provisions intended to bring greater clarity and certainty to filings involving trusts and trustees as debtors. These provisions, which speak in terms of the debtor being a trust or trustee, have been amended to conform to the general nomenclature of the 2010 Amendments, and now speak in terms of the collateral being held in a trust. See *supra* for discussion of Decedents and Their Estates; Trusts and Trustees.

K Section 9-518 – Claim Concerning Inaccurate Or Wrongfully Filed Record

In a pernicious example of regrettable word choice, Current Article 9 gave rise to the so-called "correction statement." Conceptually, it was intended to be something akin to the statement an aggrieved debtor could send to the omnipotent consumer credit rating agencies, under the Fair Credit Reporting Act, to place "on record" a statement of

14. U.C.C. § 9-516(b)(5)(C).

disagreement with respect to an entry believed to be erroneous or unauthorized. The Article 9 correction statement is a mechanism by which a debtor can add to the public record an objection to a statement that he or she believes to be inaccurate or unauthorized. As a matter of law, it can be filed only by a debtor, and has no legal effect whatsoever.[15] Despite the clarity with which these limitations are stated, not a few secured parties have purported to file correction statements, sometimes seeking to "undo" terminations filed in error[16] or to add a collateral description where one is otherwise missing. In any event, the 2010 Amendments would rename these filings "information statements," and would permit both secured parties and debtors to file them. They would continue to have no legal effect, but nonetheless may prove helpful in certain contexts. For example, consider the secured party whose financing statement has not been terminated, but appears to have been terminated owing to the presence in the record of an erroneous termination statement filed by a rogue actor without authority.

L. Section 9-521 – Uniform Form Of Written Financing Statement And Amendment

While an increasing proportion of financing statements are filed online, some filers continue to tender written financing statements. Filing offices that accept written records may accept them on any number of different forms (including both current and out-of-date forms promulgated by IACA (the International Association of Commercial Administrators, a professional association for government administrators of business entity and secured transaction record systems)). Section 9-521 mandates, however, that a filing office that accepts written records must accept them on specified "safe harbor" forms. The 2010 Amendments include revisions to such forms, reflecting the substantive changes effected by the 2010 Amendments. The Delaware 2010 Amendments include such revised forms, as well as conforming revisions to certain alternative forms suitable for filing with the Delaware Secretary of State.

V. PROPOSED CHANGES TO PART 6: DEFAULT

The rules applicable following the occurrence of a default are being revised in three respects: nonjudicial enforcement of mortgages, public notice of electronic disposition of collateral, and prohibition of a secured party's buying collateral in its private disposition.

A. Section 9-607 – Collection And Enforcement By Secured Party

As it appears in Current Article 9, subsection 9-607(b)(2)(A) relates to nonjudicial enforcement of mortgages. It permits the secured party to record a copy of the relevant security agreement and a sworn affidavit with the mortgage

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15. *See* U.C.C. § 9-518.

16. A prominent example can be seen in Bank of America's filing of a correction statement in an attempt to fix its potentially $58 million filing mistake. Bank of America, acting for itself and as an agent of Citibank, terminated perfection of both institutions' security interests in certain assets of the now defunct law firm Heller Ehrman by accidently checking the "termination" box instead of the "continuation" box on the amendment it filed. The issue was litigated in connection with the bankruptcy of Heller Ehrman LLP (*See, In re:* Heller Ehrman LLP, Case No.: 08-32514 (Bankr. N.D. Cal. Mar. 27, 2009), *Order Granting Official Committee of Unsecured Creditors' Motion for Order Authorizing the Creditors' Committee to Pursue Certain Estate Causes of Action.* The author is unaware of the final resolution of this issue, which was before the U.S. Bankruptcy Court for the Northern District of California, San Francisco Division).

records. This sworn statement must state that a default has occurred, but the subsection is less than explicit in requiring indication that such default must have occurred with respect to the obligation secured by the mortgage, as contrasted with some other obligation. For example, suppose Homeowner obtains a mortgage loan from Bailey Savings and Loan, which in turn sells the mortgage loan to Bear Stearns, which bundles it with others and sells interests in the pool through a securitization. If the securitization vehicle defaults, for example by failing to make a scheduled payment under the securities it issued, the holder of such securities would not be able to foreclose on Homeowner's mortgage. This result, intended by Current Article 9, is more clearly mandated by the 2010 Amendments.

B. Section 9-613 – Contents And Form Of Notification Before Disposition Of Collateral: General

There has been much consternation in recent years regarding notification of a public disposition of collateral that will be conducted electronically. New text in Official Comment 2 to section 9-613 (Contents and Form of Notification Before Disposition of Collateral: General) would confirm the applicability of such section to those dispositions, and clarify what information is required for compliance. Among other things, the 2010 Amendments clarify that a Uniform Resource Locator (URL) or other Internet address currently suffices as an electronic "location."

C. Section 9-624 – Waiver

Official Comment 2 to section 9-624 (Waiver) notes that such section is a limited exception to the general rule of section 9-602 prohibiting waiver by debtors and obligors. It explicitly notes that the rule prohibiting a secured party from buying at its own private disposition, the equivalent of a "strict foreclosure," cannot be waived. The 2010 Amendments add language to similar effect to both Official Comment 3 to section 9-602 and Official Comment 7 to section 9-610. A new Official Comment 10 is added to section 9-611 (Notification Before Disposition of Collateral), reminding readers that enforcement of an Article 9 security interest may implicate other law.

VI. PROPOSED CHANGE TO PART 7: TRANSITION (TO CURRENT ARTICLE 9).

The 2010 Amendments include the addition of text to Official Comment 2 to section 9-706 (When Initial Financing Statement Suffices to Continue Effectiveness of Financing Statement), emphasizing that the "minor error" rule in section 9-506(a) applies to any initial financing statement filed as an "in lieu" continuation statement pursuant to section 9-706.

VII. PROPOSED (NEW) PART 8: TRANSITION (TO THE 2010 AMENDMENTS)

When current Article 9 was released for consideration and enactment, there was great interest in having a uniform effective date in all enacting jurisdictions. In furtherance of that goal, its text provided for a uniform effective date of July 1, 2001, roughly three years after its release. Similarly, the 2010 amendments contemplate a July 1, 2013 effective date.[17] Generally, there's a five-year transition period before "old" filings made in conformity with Current Article 9 must be amended or otherwise revised to conform to the 2010 Amendments. The most significant transition issue, and the one

17. 2010 Amendments § 9-801.

likely to require the greatest number of amendment to previously filed financing statements, involves sufficiency of debtors’ names under section 9-503, particularly those relating to individual debtors. Less common, but no less important, is the fact that certain debtors perhaps not currently but soon-to-be considered “registered organizations” may experience a change in location (i.e., from their place of business or chief executive office to their jurisdiction of formation). Recognizing the risk, burden, and potential for errors posed by the transition from former Article 9 (i.e., Article 9 as in effect prior to July 1, 2001) to Current Article 9, Delaware Current Article 9 includes a nonuniform (and no longer relevant) subsection § 9-703(c) providing special transition rules for financing statements filed under former Article 9 with respect to trusts and trustees as debtors. This nonuniform provision, and the accompanying nonuniform text in subsection 9-705(f), effectively provides that certain Delaware filings made under former Article 9 and identifying the debtor in the manner customary under former Article 9 (e.g., ABC Trust Company, not in its individual capacity, but solely as Owner Trustee) could be continued under Delaware Current Article 9 without the necessity of complying with the debtor naming convention mandated by Delaware Current Article 9. This special rule is carried forward by the Delaware 2010 Amendments. As before, it applies only to continuations, and not to amendments. When such a Delaware filing made under Current Article 9 is first amended in any respect, it also must concurrently be amended to comply with then-current requirements for identifying the debtor.

VIII. ACCOMPANYING REVISION TO UCC ARTICLE 8 (INVESTMENT SECURITIES)

The 2010 Amendments add a new paragraph to Official Comment 13 to UCC Article 8 (Investment Securities) Section 8-102 (Definitions). The paragraph addresses the registerability requirement in the definition of “registered form” and its parallel in the definition of “security,” clarifying that such requirement is satisfied only if books are maintained for the purpose of register of transfer, including termination of rights under section 8-207(a) (or if, in the case of a certificated security, the security so states). Explicitly rejecting the holding of *Highland Capital Management LP v. Schneider*, 8 N.Y.3d 406 (N.Y. 2007), the comment notes it is not sufficient that the issuer record ownership or transfers for other purposes, nor is it sufficient that the issuer, though not in fact maintaining books for such purpose, theoretically could do so (for such is always the case).

IX. INVITATION TO REPEAL UCC ARTICLE 11

Finally, noting that UCC Article 11 affects transactions that were entered into before the effective date of the 1972 amendments to Article 9, the 2010 Amendments invite states to consider whether they may wish to repeal Article 11. The Delaware 2010 Amendments do not affect UCC Article 11.