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DIAMOND McCARTHY LLP
Allan B. Diamond
Howard D. Ressler
620 Eighth Avenue, 39th Floor
New York, NY 10018
Tel: (212) 430-5400
Fax: (212) 430-5499

Andrea L. Kim *(pro hac vice)*
Christopher R. Murray *(pro hac vice)*
Daniel W. Meyler
909 Fannin Street, 15th Floor
Houston, TX 77010
Tel: (713) 333-5100
Fax: (713) 333-5199

Counsel to Alan M. Jacobs, Liquidating Trustee
For the Dewey & LeBoeuf Liquidation Trust

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re: **DEWEY & LEBOEUF LLP,** **Debtor.**	**Case No. 12-12321 (MG)** **Chapter 11**
ALAN M. JACOBS, as Liquidating Trustee of the Dewey & LeBoeuf Liquidation Trust, **Plaintiff,** **v.** **WILLIAM C. MARCOUX,**[*] **Defendant.**	**Adv. Pro. No. 13-01765 (MG)**

TRUSTEE'S RESPONSE AND CROSS-MOTION FOR PARTIAL SUMMARY JUDGMENT

[*] Pursuant to the Case Management and Scheduling Order [Adv. Dkt. 11], this Response is filed only in this adversary proceeding but is applicable to the following adversary proceedings whose Defendants collectively joined the Motion for Partial Summary Judgment [Adv. Dkt. 15]: *Jacobs* v. *Altorelli* (Adv. No. 14-01015); *Jacobs* v. *Greene* (Adv. No. 14-01797); *Jacobs* v. *McMillan* (Adv. No. 13-01772); *Jacobs* v. *Otillar* (Adv. No. 14-01818); *Jacobs* v. *Shaw* (Adv. No. 13-01771); *Jacobs* v. *Steele* (Adv. No. 14-01795); *Jacobs* v. *Zdrojeski* (Adv. No. 14-01794); *Jacobs* v. *Mahoney* (14-01817).

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Alan M. Jacobs, as Liquidating Trustee ("Trustee") of the Dewey & LeBoeuf Liquidation Trust, respectfully submits this Response and Cross-Motion For Partial Summary Judgment ("Response") to the Defendants' Motion for Partial Summary Judgment ("PSJ") [Adv. Dkt. 15]. The Trustee adopts and incorporates the Stipulation of Facts [Adv. Dkt. 18] ("Stip.").[1]

Preliminary Statement

Dewey's owners chose to organize their business venture as a New York registered limited liability partnership ("LLP"). If Dewey had been profitable, its partners, as equity holders, would have been entitled to 100% of the upside. But Dewey failed, and now its partners find their status as equity holders to be inconvenient. They ask the Court to ignore their chosen form of business entity. They ask the Court to disregard the plain language of the statutes that define their rights and responsibilities as partners in a New York LLP. They now pretend they were not partners at all and ask the Court to hold as a matter of law that they were mere employees entitled to fixed compensation. Their positions find no support in the law.

Constructive Fraudulent Transfer Claims. The Trustee sues the Defendants under NYDCL §§ 273-75 and Bankruptcy Code §§ 548(a)(1)(B)(i)-(iii).[2] These fraudulent transfer claims apply when a debtor makes a transfer during insolvency for less than "fair consideration" under New York law, or "reasonably equivalent value" under the Code (together referred to as "value"). Both terms are defined the same way: value consists of either property or satisfaction of an antecedent debt.

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[1] Also submitted herewith is the Trustee's Response to Defendants' Supplemental Statement of Facts and to the Declaration of Defendant Anthony Shaw.

[2] For readability, we cite to the Dewey & LeBoeuf Partnership Agreement as the "DLPA," to New York Debtor and Creditor Law as the "NYDCL" and to New York Partnership Law as the "NYPL." Unless noted, other capitalized terms have meanings ascribed in the PSJ.

The Defendants argue that the services they performed as partners of Dewey constitute "value" under a fraudulent transfer analysis. This argument fails because, as partners, the Defendants were only entitled to equity distributions—not compensation—and distributions on equity do not provide value for creditors as a matter of law.

The Defendants cite no cases to justify a departure from this well-settled law. Their only argument is that the Trustee would obtain a "windfall" if he were able to recover equity distributions made during insolvency. This argument ignores the fact that Dewey's creditors suffered harm when Dewey continued to make equity distributions to its owners while the firm was insolvent. To the contrary, it would work a windfall for partners to create a new rule that says: if your business succeeds you keep your equity distributions, and if your business fails you still keep your equity distributions. Dewey's owners took the risks of equity holders. Dewey's creditors did not and should not have their recoveries impaired by a special exception to the rules for the Defendants.

NYDCL § 277. The Trustee also sued the Defendants under NYDCL § 277, which provides that transfers of partnership property to partners are fraudulent regardless of whether fair consideration is given. The Defendants argue that Dewey was not a partnership and that its partners were not partners under the statute. In effect, the Defendants ask the Court to create a judicial exception to an unambiguous statute. They cite no cases in support.

New York Partnership Law explicitly and clearly defines partnership to include, "for all purposes under the law of this state, a registered limited liability partnership." NYPL § 10. That definition was amended to include LLPs at the time LLPs were created in 1994. There can be no question that an LLP is a partnership under New York law.

Nor can the Defendants disclaim their status as partners by arguing that they were "partners in name only." As partners under the DLPA, the Defendants stood to benefit from the upside if Dewey succeeded. They also had rights under the partnership agreement to vote on important partnership decisions and to inspect the books and records. Creditors and employees did not have such rights. It would undermine debtor and creditor law to allow owners to recast themselves as ordinary employees simply because the bargain they struck did not pan out.

Return of Capital Payments. In addition to suing to recover equity distributions made to former partners while they were still partners, the Trustee also sued to recover repayments of capital accounts to partners after their departure. The Defendants argue that capital contributions convert from equity interests into debts upon departure because the partnership agreement has a provision providing for the repayment of capital contributions.

This argument ignores New York law, federal bankruptcy law and the DLPA, which all provide that a partner may not receive a return of capital until all other debts of the partnership are paid. Dewey will never repay all of its debts, so none of the Defendants have a right to repayment of their capital. Further, the only court in the country to address precisely this argument in the law firm bankruptcy context rejected it. Judge Montali (in the Howrey LLP cases) held that an equity interest does not convert to debt simply because a partnership agreement provides for a return of capital.

The Defendants cite cases where courts declined to recharacterize debt instruments as equity simply because the notes were purchased with shares. Those cases are inapposite because, here, Dewey did not issue debt instruments to departing partners. There is only the DLPA, which is not a note and itself subordinates payments to all other debts of the partnership.

Bankruptcy Code § 548(b). Finally, the Trustee sued under section 548(b), which provides that transfers to a "general partner" in a "partnership debtor" during insolvency are fraudulent without regard to reasonably equivalent value. The Defendants argue that Dewey was a "corporation"—and therefore not a partnership—under the Bankruptcy Code and that Dewey's partners were not "general partners" within the meaning of the statute. The Trustee cross-moves for summary judgment on the first argument, but not the second.

The Code defines "corporation" to include a "partnership association" for which partner liability is limited to the capital subscribed. In New York, unlike many other states, an LLP partner is liable for more than just the capital subscribed—he is also personally liable for the partnership's tort liability when he was personally involved or supervising the person involved in the tort. This additional liability takes New York LLPs outside the definition of "corporation."

On the second argument, the Trustee does not argue that all of Dewey's partners were "general partners" within the meaning of section 548(b) as a matter of law. "General partner" is not defined by the Code, and the limit on personal liability for a partner in an LLP means that such partners are not "general partners" as that term was understood before the advent of LLPs. Whether any individual partner should be treated as a general partner under section 548(b) will depend on individual facts and circumstances such as the level of control and access to information each partner had. This issue is not ripe for summary judgment, so the Trustee does not cross-move on the question.

Argument

Summary judgment for the Trustee is appropriate on these points of law because the relevant facts are not in dispute. *See* Fed. R. Civ. P. 56(c); Fed. R. Bankr. P. 7056.

I. Dewey's Owners Have No "Value" Defense.

Whatever worth Defendants' work may have had, it does not constitute "fair consideration" under NYDCL §§ 273-75 or "reasonably equivalent value" under Bankruptcy Code § 548(a)(1)(B)(i)-(iii). The Trustee is entitled to summary judgment because, as a matter of law, Dewey's partners were not entitled to compensation beyond their share of the profits, and such equity distributions during insolvency provide no value for creditors.

A. Partners Are Only Entitled To Equity Distributions, Not Compensation, For Their Services.

Dewey's partners were not entitled to compensation. New York follows the "no-compensation" rule, under which "[n]o partner is entitled to remuneration for acting in the partnership business, except that a surviving partner is entitled to reasonable compensation for his services in winding up the partnership affairs." NYPL § 40(6); *see also* NYPL § 52 ("A partner's interest in the partnership is his share of the profits and surplus . . . .").

Case law affirms the no-compensation rule: "[I]t is a well-recognized rule of partnership law that, except by agreement, a partner has no right to any compensation for services rendered for the firm apart from his share of the profits arising therefrom." *Friedman* v. *Golden Arrow Films, Inc.*, 442 F.2d 1099, 1106 (2d Cir. 1971); *see also Development Specialists, Inc.* v. *Akin Gump Strauss Hauer & Feld LLP*, 480 B.R. 145, 155 (S.D.N.Y. 2012) ("Partners are presumed to devote all of their efforts to the partnership business, and are entitled to no compensation for doing so beyond their proportional interest in the profits the business generates.").[3]

The no-compensation rule squarely applies to Defendants because they were partners of Dewey. Dewey was a New York registered limited liability partnership organized under the

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[3] *Consolidated for appeal and rev'd on other grounds by In re Thelen LLP*, --- N.E.3d ---, 2014 WL 2931526 (N.Y. July 1, 2014).

Dewey & LeBoeuf LLP Partnership Agreement. (Stip. ¶¶ 2-3.) In New York, a registered limited liability partnership is a "partnership . . . for all purposes of the laws of this state." NYPL § 10(1). That includes for purposes of the NYDCL and the "no compensation" rule.

The DLPA, in fact, adopts the no-compensation rule. The DLPA provides that "[e]ach partner shall devote full time to the conduct of Firm affairs" (DLPA § 3.1), and that "[i]t is the intent of this Agreement that all net profits and net losses of the Firm for any calendar year be shared among the Partners in accordance with their respective interests in the Firm" (DLPA § 6.1; *see also* DLPA § 6.3 (providing for excess profits to be distributed to partners); DLPA § 6.4(b) (requiring return of draws if profits come up short); DLPA § 6.4(c) (if net income is negative, losses are to be shared by partners in proportion to their equity interest)).

The only exceptions to the rule provided for in the DLPA are not applicable here because they apply to three types of side agreements. The Executive Committee may (a) award "Special Payments" to individual partners (DLPA § 6.2); (b) provide for payments to individual partners "as a full or partial fixed annual amount with no or partial or full participation in losses" (DLPA § 6.5(a)); or (c) designate individual attorneys as "Salaried Partners" who are authorized to use the title of "partner" in marketing, but who receive fixed salaries and are not "Partners" under the DLPA (DLPA §§ 4.10; 1.5(a).) Without such side agreements—which are beyond the scope of this motion—Defendants were entitled to nothing more from Dewey than equity distributions.

B. Equity Distributions Provide No "Value" To Creditors.

As a matter of law, equity distributions do not provide "value" to creditors under a fraudulent transfer analysis. "It is widely held that true creditors hold claims regardless of the performance of the partnership business, whereas payments of partnership distributions are subject to profits and losses." *United States* v. *Rocky Mountain Holdings, Inc.*, 782 F. Supp. 2d

106, 122 (E.D. Pa. 2011) ("[D]istributions made on account of partnership interests do not give rise to a "right to payment" and are thus not "for value.").

For this reason, courts uniformly hold that "the payment of [an equity] dividend is a conveyance lacking fair consideration under the [NYDCL]." *State* v. *First Investors Corp.*, 592 N.Y.S.2d 561, 567 (N.Y. Sup. Ct. 1992); *see Hayes* v. *Palm Seedling Partners-A (In re Agric. Research and Tech. Group)*, 916 F.2d 528, 540 (9th Cir. 1990) ("The partnership distributions here were not for value because [defendant] made the distribution on account of the partnership interests and not on account of debt or property transferred to the partnership in exchange for the distribution."); *Buncher Co.* v. *Official Comm. of Unsecured Creditors*, 229 F.3d 245, 252 (3d Cir. 2000) ("[A] partnership receives less than reasonably equivalent value when it redeems the equity interest of its principals."); *In re SemCrude, L.P.*, 2013 WL 2490179, at *5 (Bankr. D. Del. June 10, 2013) ("[E]quity distributions on account of partnership interests do not confer 'value' upon the transferor."); *Fidelity Bond and Mortgage Co.* v. *Brand (In re Fidelity Bond and Mortgage Co.)*, 340 B.R. 266, 286-87 (Bankr. E.D. Pa. 2006) ("[A] dividend or reduction in capital through the purchase of stock adds no value for creditors."); *Levit* v. *R.T. Milord Co. (In re: Thunderdome Houston L.P.)*, 2000 WL 889846, at *9 (Bankr. N.D. Ill. June 23, 2000) ("[L]imited partners did not give reasonably equivalent value for the distributions they received."); *Daley* v. *Chang (In re Joy Recovery Tech. Corp.)*, 286 B.R. 54, 75 (Bankr. N.D. Ill. 2002) ("[S]tock redemptions are treated as dividends to shareholders which return no value to the company.").

This rule ensures that creditors are treated fairly. "To hold that a limited partner interest constitutes debt of the partnership would allow limited partners to receive distributions ahead of even secured creditors." *Rocky Mountain Holdings*, 782 F. Supp. 2d at 122-23. As the Ninth

Circuit has explained, value is to be determined in light of the purpose of fraudulent transfer law: "to protect creditors." *Hayes*, 916 F.2d at 540. "Any consideration not involving utility for the creditors does not comport with the statutory definition." *Id.* Thus, distributions to partners are "not for value because any other definition would not further protection of creditors." *Id.*; *accord Tomsic* v. *Pitocchelli (In re Tri-Star Tech. Co., Inc.)*, 260 B.R. 319, 327 (Bankr. D. Mass. 2001) ("[T]he equity interests of an insolvent company have generally no value whatsoever.").[4]

Even if the Court were to consider the distributions to be compensation for services rendered as opposed to equity distributions, Defendants would still have to show that distributions satisfied an antecedent debt. They cannot do this as a matter of law.

Both New York Debtor and Creditor Law and the Bankruptcy Code define value for fraudulent transfer purposes the same way. In New York, "fair consideration" is defined by statute as existing where "property is conveyed or an antecedent debt is satisfied." NYDCL § 272. The Bankruptcy Code defines "value" as "property, or satisfaction or securing of a present or antecedent debt of the debtor." 11 U.S.C. § 548(d)(2)(A).

The Defendants have not, and cannot, argue that they provided "property" in return for their equity distributions. *See, e.g.*, *In re Fischer*, 411 B.R. 247, 265 (Bankr. D. Md. 2009) (holding personal services do not constitute "property" in a fair consideration analysis under Maryland's version of the UFCA). Instead, the Defendants must argue that their services gave rise to an "antecedent debt." Because New York Partnership Law section 40(6) and the DLPA

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[4] The Defendants' reliance on Judge Allan Gropper's recent opinion in the *Thelen* bankruptcy is misplaced. (*See* PSJ at 12 (*citing Geron* v. *Fontana (In re Thelen LLP)*, 2014 WL 2178156, at *6 (Bankr. S.D.N.Y. May 23, 2014).) There, the trustee argued that the value of partners' services was set by contract. Judge Gropper, *sua sponte*, recognized that the partnership agreement in that case created an exception to the general rule. *See id.* (The Trustee "accepts the proposition that the Defendants were entitled to their net payments under the Partnership Agreements even though the payments were equity interests in the partnership.").

make clear that partners are entitled to no compensation for their services, such services could not, as a matter of law, have given rise to a right to payment or an antecedent debt.

C. In New York, Transfers To Partners Lack The Good Faith Required For Fair Consideration.

The Defendants have no fair consideration defense under New York law for the additional reason that partners—because they are partners—cannot take in good faith under New York law.

"Fair consideration" requires both value and good faith. NYDCL § 272; *Gowan* v. *The Patriot Group, LLP (In re Dreier LLP)*, 452 B.R. 391, 443 (Bankr. S.D.N.Y. 2011) ("[T]he Trustee need only allege a lack of 'fair consideration' by pleading a lack of 'fair equivalent' value **or** a lack of good faith on the part of the transferee.") (emphasis in original).

As a matter of New York law, transfers from an insolvent debtor to insiders are "*per se* violative of the good faith requirement of Section 272 [for fair consideration]." *Allen Morris Commercial Real Estate Serv. Co.* v. *Numismatic Collectors Guild, Inc.*, 1993 WL 183771, at *9 (S.D.N.Y. May 27, 1993) ("Such a transfer is irrebuttably presumed to be fraudulent for purposes of [the NYDCL]."). This rule applies to "transfers to directors, officers and shareholders of insolvent corporations." *Farm Stores Inc.* v. *School Feeding Corp.*, 477 N.Y.S.2d 374, 378 (N.Y. App. Div. 1984). This is because it would be inequitable to allow insiders to use inside information to benefit themselves over the claims of others. *Id.* (quoting *Southern Indus., Inc.* v. *Jeremias*, 411 N.Y.S.2d 945 (N.Y. App. Div. 1978)).

Here, there is no question that Dewey's partners had the right to unfettered access to inside information regarding the financial condition of the firm. (DLPA § 5.5 ("Any Partner, on reasonable notice, shall have the right to inspect books and records of the Partnership at all reasonable times during regular business hours.").) Their status as owners with privileged access

to information unavailable to creditors creates the irrebutable presumption that any transfer to Defendants was not for fair consideration.

II. NYDCL § 277 Applies to New York LLPs.

The Defendants are also liable under NYDCL § 277 for all transfers received while Dewey was insolvent. NYDCL § 277 provides:

> Every conveyance of partnership property and every partnership obligation incurred when the partnership is or will be thereby rendered insolvent, is fraudulent as to partnership creditors, if the conveyance is made or obligation is incurred,
>
> a. To a partner, whether with or without a promise by him to pay partnership debts, or
>
> b. To a person not a partner without fair consideration to the partnership as distinguished from consideration to the individual partners.

The statute is unambiguous. *See In re Osei*, 389 B.R. 339, 346 (Bankr. S.D.N.Y. 2008) ("If the language of a statute is not ambiguous, all other inquiry ends and the statute is construed in accordance with its plain meaning."). Transfers to Defendants were fraudulent as a matter of law and they have no "fair consideration" defense.

A. NYDCL § 277 Makes No Exception For LLPs.

The Defendants do not argue ambiguity. Instead, they ask this Court to create an exception to NYDCL § 277 for LLPs. They argue that the statute: (a) should not apply because it was enacted long before LLPs existed; (b) should only apply to "general partners;" (c) should not apply to anyone whose personal assets are not counted in the insolvency analysis; (d) should not apply because Dewey's partners were more like employees; and (e) should not apply because there is a dearth of relevant case law. (*See* PSJ at 12-16.) The Defendant's arguments are unpersuasive and do not justify a judge-made exception to an unambiguous law.

First, there is no question that Dewey was a "partnership" within the meaning of section 277. When New York created LLPs in 1994, it simultaneously amended the existing definition of "partnership" under New York law as follows (the amended language is in **bold**):

> A partnership is an association of two or more persons to carry on as co-owners a business for profit **and includes for all purposes of the laws of this state, a registered limited liability partnership.**

NYPL § 10(1).[5] This confirms that LLPs must be treated like partnerships "for all purposes of the laws of [New York]." It is therefore irrelevant that LLPs did not exist when section 277 was enacted. LLPs did not exist when nearly every other provision of state law were enacted. Those provisions of law still apply to LLPs, as expressly instructed by NYPL § 10(1).

Second, NYDCL § 277 is not limited to "general partners." Section 277 does not distinguish among types of partners, but rather between "a partner," on the one hand, and "a person not a partner," on the other. The drafters of section 277 knew how to distinguish types of partners, as they did in NYDCL § 271, which refers separately to "general partners" and "limited partners" for the definition of insolvency.[6] No such distinction is made in section 277.[7]

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[5] Amendment detailed at New York Limited Liability Company Law, 1994 Sess. Law News of N.Y. ch. 576.

[6] NYDCL 277 and NYDCL 271 were both enacted in 1925.

[7] The Defendants' only cited authority on this point is a 1940 law review article. (PSJ at 14 (*citing Remedies in Bankruptcy of Partnership Creditors on Transfer of Firm Assets to One Partner*, 49 Yale L.J. 686 (1939-40).) The article suggests that section 8 of the Uniform Fraudulent Conveyance Act ("UFCA"), upon which NYDCL 277 is based, was designed to prevent one partner from trading his equity for a promise to pay partnership debts, thereby limiting creditor recovery by reducing the number of partners liable for partnership debts. The argument proves too much. Even assuming the premise, the statute is not so limited. It applies expressly to "a partner, whether with **or without** a promise by him to pay partnership debts." NYDCL 277(a) (emphasis added). The statute is clear that a promise to pay partnership debts is **not** required for the statute to apply to a transfer of partnership property to a partner.

Third, the Defendants argue that because they are not "general partners" for the purposes of the definition of insolvency in NYDCL § 271, they cannot be "partners" under the fraudulent conveyance rule in NYDCL § 277. (*See* PSJ 13-16.) The Defendants conflate insolvency and fraudulent transfer liability. They cite no authority for this novel proposition, which is unsustainable as a matter of New York law.

In New York, an LLP is a general partnership in every way except one: limited liability. The purpose of LLPs is to allow partners the flexibility of having a say in management without the risk of personal liability. As one contemporary commentator explained:

> The LLP structure appeals to members of professional partnerships because they can continue to function as general partnerships while limiting partners' vicarious liability for other partnership' malpractice. Unlike the LLC, the LLP does not require the creation and administration of an entirely new type of business entity.

Saab Fortney, *Seeking Shelter in the Minefield of Unintended Consequences – the Traps of Limited Law Firms*, 54 Wash. & Lee L. Rev. 717, 725-26 (1997); *see also*, Karon S. Walker, 1 West New York Practice Series, *New York Limited Liability Companies and Partnerships* § 14:10 (West Group 2002) (listing benefits of registering as a New York's LLP).

There is no dispute that Dewey's status as a registered New York LLP protected its individual partners from personal liability for partnership debts. Therefore, the decision to register as an LLP is obviously relevant to the test for insolvency under NYDCL § 271, which compares a partnership's debts with the assets available to pay those debts.

But it does not follow, logically or otherwise, that registration as an LLP would affect an individual partners' potential liability for fraudulent transfers any more than it would affect their rights to vote on partnership matters or to receive distributions of profits under New York Partnership Law. The only difference between partners in an LLP and partners in a general

partnership under New York law is the limitation on liability. Indeed, we are aware of no precedent that only individuals who are jointly liable for a debtor's debts are subject to liability for fraudulent transfers. The two concepts simply have nothing to do with each other.

Fourth, the Defendants argue that they should not be treated like "partners" under New York Debtor and Creditor Law because they were more like "employees." (*See* PSJ at 19-20.) This distinction does not exist under New York Debtor and Creditor Law. There is no exception in NYDCL § 277 for partners who function 'more like employees'—whatever that may mean.

The Defendants' only support is a line of inapposite cases treating some partners in a partnership as "employees" under Title VII and the Americans with Disabilities Act. Those cases hold, not unremarkably, that a partner for state law purposes might function as an employee under those federal statutes. (PSJ at 19 n.80 (*citing Clackamas Gastroenterology Assoc. P.C.* v. *Wells*, 538 U.S. 440, 446 (2003); *Smith* v. *Castaways Family Diner*, 453 F.3d 971, 978 (7th Cir. 2006); *E.E.O.C.* v. *Sidley Austin Brown & Wood*, 315 F.3d 696, 701 (7th Cir. 2002)).) Those cases interpret federal laws and provide no support or justification for an extra-statutory exemption from NYDCL § 277 for partners who claim to function as employees.

Fifth, the weight of authority favors application of NYDCL § 277 to general partnerships that register as LLPs. As noted, NYDCL 277 is based on section 8 of the UFCA. By the time states began creating LLPs in the 1990s, most states had already adopted the Uniform Fraudulent Transfer Act ("UFTA"). The UFTA eliminated the UFCA provision on which NYDCL 277 is based. UFTA § 5, cmt. 3. It is therefore unsurprising that few courts have had occasion to consider applicability of UFCA § 8 to LLPs.

Comparison to Maryland law is instructive. Like New York, Maryland was one of the few jurisdictions to still operate under the UFCA when it created LLPs. Unlike New York,

which made no change to NYDCL § 277 when it created LLPs, Maryland modified its version of section 8 to ensure that partners in an LLP had a value defense. The amendment is in **bold**:

> (a) Every conveyance of partnership property and every partnership obligation incurred when the partnership is or will be thereby rendered insolvent by it, is fraudulent as to partnership creditors, if the conveyance is made or obligation is incurred,
>
> 1. To a partner, whether with or without a promise by him to pay partnership debts **unless the conveyance or obligation represents fair and reasonable compensation for services provided or to be provided by the partners to the partnership and the services are provided or will be provided within 120 days before or after the date the conveyance is made or the obligation is incurred**, or
>
> 2. To a person not a partner without fair consideration to the partnership as distinguished from consideration to the individual partners.

Md. Code, Com. Law § 15-208.[8] This amendment, by another UFCA jurisdiction, demonstrates that the applicability of section 8 to limited liability partnerships was known and acknowledged, rendering New York's decision not to similarly amend its laws all the more consequential.

B. NYDCL § 278 Does Not Apply To Equity Distributions To Partners.

The Defendants argue, in the alternative, that even if NYDCL § 277 were to apply, they would still be entitled to a fair consideration defense under NYDCL § 278, which authorizes a creditor to recover "against any person except a purchaser for fair consideration without knowledge of the fraud at the time of the purchase." NYDCL § 278; (*see also* PSJ at 16).

This attempted end-run fails. If section 278 were to treat a partner who receives an equity distribution as a "purchaser for fair consideration," it would moot the distinction drawn between partners and non-partners in section 277. "The law is settled that in interpreting

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8 Amendment detailed in Limited Liability Reform Act of 1997, 1997 Md. Laws ch. 659.

statutory authority, specific provisions of the statute must prevail over the general provisions." *Prospect* v. *Cohalan*, 490 N.Y.S.2d 795, 799 (N.Y. App. Div. 1985); *see also New York Cnty. Lawyer's Assn.* v. *Bloomberg*, 914 N.Y.S.2d 875, 881 (N.Y. Sup. Ct. 2011) ("This court's role in interpreting the statute is . . . to reconcile and give effect to all of the provisions of the subject legislation."). NYDCL § 277 refers specifically to transfers of partnership property to partners, and therefore takes precedence over the more general rule of section 278. The Defendants cite no authority for departing from these well-established rules of statutory construction.

III. Defendants Do Not Have a Right To Repayment Of Their Capital Contributions.

The Trustee seeks to recover payments in return of capital to former Dewey partners while Dewey was insolvent. The Defendants argue that the DLPA created a "right to payment" of the amount of the capital account upon a partners' departure from the firm, thereby transforming an equity interest into debt, and the former partner into a creditor. (PSJ at 22-25.)

The Defendants are wrong. In New York, no partner has a right to repayment of his capital contribution until "after all partnership liabilities are satisfied." *Liebman* v. *Gersten, Savage, Kaplowitz, Zukerman & Liebman*, 602 N.Y.S.2d 16, 16 (N.Y. App. Div. 1993) (citing NYPL § 40). NYPL § 40 provides that partners shall be repaid their capital contributions only after "all liabilities" are satisfied. NYPL § 40(2). The DLPA does not alter this basic rule, providing that return of capital payments "shall be subordinated in priority to all other Partnership indebtedness incurred." (DLPA § 7.7(c)); *see also Herrick* v. *Guild*, 13 N.Y.S.2d 115, 117 (N.Y. App. Div. 1939) (holding partner was not entitled to return of capital because the partnership agreement provided that "payments to the partners upon termination should be made after payment of all debts and liabilities of the partnership." (internal quotation marks omitted)).

To the extent Dewey was insolvent at the time capital was returned to the Defendants, as the Trustee alleges, those transfers were redemptions of equity interests and therefore not for value.

Judge Dennis Montali recently addressed this very issue in the Howrey LLP bankruptcy. *See* Order of Dec. 23, 2013, *Diamond* v. *Gabler (In re Howrey LLP)*, Adv. No. 13-03211 (Bankr. N.D. Cal. Dec. 23, 2013) (ruling for reasons stated on the record at Dec. 17, 2013 hearing) (Exhibit A); *see also* Hrg. Tr. of Dec. 17, 2014 (Exhibit B). A former Howrey partner withdrew from the firm and received a return of capital payment after his departure, but during a time when the trustee alleged insolvency. The partner argued that the return of capital payment was not an equity distribution because Howrey's partnership agreement provided that he was entitled to "the balance of his/her capital account . . . payable one hundred eighty (180) days after" his departure. Howrey Mot. to Dismiss (Exhibit C). Judge Montali rejected the former partner's argument, explaining that "[t]here's a principle in the world of insolvency called once a shareholder always a shareholder. And if we translate that to the law firm, I don't see how you take something called a capital contribution, recognizing as I do from the record, that at the time you were repaid you were no longer a partner, it was still a return of a capital contribution." Tr. (Ex. B) at 4:3-8; *see also* Tr. (Ex. B) at 6:24-10:8 ("How does [the capital account] turn into a debt by the mere signature of a resignation from the partnership[?].").

The Defendants cite no authority in support of their argument that a capital account can convert to a debt instrument by operation of a partnership agreement. Instead, they cite two cases that deal with trustee attempts to re-characterize debt as equity. Neither is on point.

The Defendants cite *In re Mobile Tool International Inc.* for the proposition that when "stock is exchanged and a separate debt instrument is issued by the debtor . . . the claimant is converted from an owner of stock to a creditor." 306 B.R. 778, 781 (Bankr. D. Del. 2004). This

authority is inapposite because the DLPA in no way constitutes "a separate debt instrument." First, the DLPA itself does not treat the repayment of capital as a debt, but instead expressly subordinates it in priority to all other indebtedness of the firm. (*See* DLPA § 7.7(c).) Second, the repayment of the capital is not tied to a fixed schedule, like the repayment of debt generally is. (DLPA § 7.6(a)(i) ("[T]he Chairman, at his discretion, shall have the right to alter the foregoing payment schedule.").) Third, there is no interest due on unpaid amounts or penalties upon default, as one would expect in a debt instrument. Fourth, the partnership agreement already existed when the partners joined Dewey, and therefore it is not a separate debt instrument. At most the DLPA sets a mechanism for redemption of equity.

The Defendants also cite *In re Montgomery Ward Holding Corp.* for the proposition that a contractual obligation to pay a sum certain is a debt. 272 B.R. 836, 842 (Bankr. D. Del. 2001). In that case, the debtor issued a promissory note as partial payment for redeemed stock. The Court held that the a claim for non-payment on the note was a debt that could not be subordinated to equity. Here, there is no promissory note. There is only an owner who asks this Court to treat the return of his capital account as a payment on a debt, rather than equity.

Neither *Montgomery Ward* nor *Mobile Tool* applies. The Defendants have no right to repayment of their capital account until all of Dewey's debts are satisfied. That will never happen, so the repayments of capital accounts were never fixed rights to payment.

IV. Whether Bankruptcy Code § 548(b) Applies Is A Question Of Fact.

The Trustee has also sued under section 548(b) of the Bankruptcy Code, which defines as fraudulent all transfers from a "partnership debtor" to a "general partner" while the partnership is insolvent. 11 U.S.C. § 548(b). The Defendants argue that this section is inapplicable to them because Dewey was not a "partnership debtor" (PSJ at 9-11), and its partners were not "general partners" (PSJ at 11-12).

The Trustee cross-moves on the first argument because, as a matter of law, a New York LLP is a "partnership debtor" within the meaning of section 548(b). However, whether any individual partner should be treated as a "general partner" within the meaning of section 548(b), will depend on individual facts and circumstances.

A. Dewey Is a Partnership Debtor, Not a Corporation, Under The Bankruptcy Code.

Dewey was organized as a limited liability partnership under New York law. The term "partnership" is not defined in the Bankruptcy Code. As discussed above, New York defines "partnership" to include, for all purposes, LLPs. Dewey was therefore a "partnership debtor."

The Defendants only argument to the contrary is that Dewey falls under the definition of "corporation" under section 101(9) of the Bankruptcy Code. This argument fails because New York LLPs do not fit the statutory definition of section 101(9).

Section 101(9) of the Bankruptcy Code provides that the term "corporation" includes a "partnership association organized under law that makes only the capital subscribed responsible for the debts of such association." 11 U.S.C. § 101(9)(A)(ii). An LLP under New York law does not qualify because the liability of individual partners is not so limited. New York law provides that, notwithstanding the limited liability protection of an LLP,

> each partner, employee or agent of a partnership which is a registered limited liability partnership **shall be personally and fully liable** and accountable for any negligent or wrongful act or misconduct committed by him or her or by any person under his or her direct supervision and control while rendering professional services on behalf of such registered limited liability partnership.

NYPL § 26(c) (emphasis added). Because partners are liable for the partnership's obligations arising out of torts they commit as partners, it cannot be said that the partners' liability for those torts is limited "to the capital subscribed."

The Defendants cite two cases in support of their argument that a New York LLP is a "corporation" under the Bankruptcy Code. Neither is apposite. Both cases dealt with LLPs organized in other states and, further, addressed only the question of whether a partner in an LLP has the authority to file an involuntary petition. *In re Beltway Law Group, LLP*, concerned an LLP under District of Columbia law. 2014 WL 3882424, at *2 (Bankr. D.D.C. Aug. 7, 2014). That jurisdiction's code limits an LLP partner's liability for all debts "whether arising in contract, tort, or otherwise," without a separate provision for torts for which the individual partner was responsible. *See* D.C. Code § 29-603.06. The Defendants' second case, *In re Rambo Imaging*, only addresses a partner's authority to file an involuntary petition, and relies on Texas law to answer the question. 2008 WL 2778846, at *6 (Bankr. W.D. Tex. July 15, 2008).

B. Whether An LLP Partner Is a "General Partner" Under § 548(b) Depends On Individual Facts.

Given the purpose of section 548(b)—to prevent partners from abusing their insider position—whether a partner in a New York LLP is a "general partner" for purposes of section 548(b) is a question of fact. The term "general partner" is not defined in the Bankruptcy Code. And New York law supplies no clear answer. The one court to address the issue explained that "it is incorrect to think of the universe of partners as being only general partners and limited partners . . . the universe of types of partner in New York, consists of general partners, limited partners, and partners in a registered limited liability partnership," *Wallach* v. *Douglas (In re Promedicus Health Group, LLP)*, 416 B.R. 389, 391-92 (Bankr. W.D.N.Y. 2009).

Despite the lack of case law directly addressing the issue, cases addressing the purpose of section 548 make clear that partners in a New York LLP could, depending upon their individual facts, be included in the term "general partner." Case law holds that section 548(b) is intended to prevent general partners from abusing a position akin to an insider to the detriment of non-

insider creditors. Judge Lifland explained that "[s]ection 548(b) is designed to prevent the general partner from taking advantage of its insider status by appropriating funds belonging to the estate prior to bankruptcy filing." *Berisford, Inc.* v. *Stroock & Stroock & Lavan (In re 1634 Assocs.)*, 157 B.R. 231, 234 (Bankr. S.D.N.Y. 1993).

The question is therefore whether a Defendant's relationship with Dewey created a sufficient risk of insider dealing that it would be appropriate to treat that defendant as a general partner for the purposes of section 548(b). At this stage of the case, the facts are not sufficiently developed to permit litigation of that issue, and the question is not ripe for summary judgment.

Conclusion

For the foregoing reasons, the Trustee asks the Court to deny the Defendants' PSJ and grant the Trustee partial summary judgment on the following points:

1. Absent a separate agreement to the contrary, Defendants' services cannot establish fair consideration as a matter of law under NYDCL §§ 273-75.

2. Absent a separate agreement to the contrary, Defendants' services cannot establish reasonably equivalent value as a matter of law under NYDCL §§ 273-75.

3. All transfers to Dewey's former partners while Dewey was insolvent were constructive fraudulent transfers under NYDCL § 277.

4. NYDCL § 278 does not apply to equity distributions to partners.

5. Payments in return of capital under the DLPA are equity distributions.

[Signature block appears on following page.]

Respectfully submitted on September 2, 2014.

DIAMOND McCARTHY LLP

/s/ Christopher R. Murray .
Allan B. Diamond
Howard D. Ressler
620 Eighth Avenue, 39th Floor
New York, NY 10018
Tel: (212) 430-5400
Fax: (212) 430-5499

Andrea L. Kim *(pro hac vice)*
Christopher R. Murray *(pro hac vice)*
Daniel W. Meyler
909 Fannin Street, 15th Floor
Houston, TX 77010
Tel: (713) 333-5100
Fax: (713) 333-5199

Counsel to Alan M. Jacobs, Liquidating Trustee
For the Dewey & LeBoeuf Liquidation Trust

CERTIFICATE OF SERVICE

I certify that a true and correct copy of the above and foregoing was filed via the ECF system in the above-captioned case on September 2, 2014.

/s/ Christopher R. Murray .
Christopher R. Murray