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Trials & TRIBULATIONS

$40 million contingent fee found conscionable

Review of client's personal gifts of more than $5M to firm's partners barred by statute of limitations

Last week the Court of Appeals issued a decision that ended more than 30 years of contentious and prolific litigation surrounding the estate of Sylvan Lawrence, *In re Lawrence*, 2014 NY Slip. Op. 07291 (Oct. 28). The last decade of this odyssey involved a dispute between the client (and eventually her estate) and the law firm that represented both her and her children.

By SARAH MERKEL

Daily Record Columnist

Ultimately, the Court of Appeals determined that a revised retainer agreement, entered into after over 20 years of representation and the past payment of $18 million in fees, was neither procedurally nor substantively unconscionable. The court also found that review of personal gifts to three partners that amounted to over $5 million was time-barred, and the continuing representation doctrine did not toll the statute of limitations.

The Lawrence Estate litigation

Over 30 years before the Court of Appeals issued its decision, the New York City law firm of Graubard Miller (the "firm") began its representation of Alice Lawrence and her children in connection with the estate of her husband, commercial real estate developer Sylvan Lawrence. For over 20 years, the dispute focused on the conduct of Sylvan's brother and business partner, Seymour Cohn, who was named executor of Sylvan's estate.

In addition to the litigation spawned in the New York County Surrogate's Court, the firm instituted a separate unsuccessful federal court action, claiming that Cohen committed securities fraud, *Lawrence v. Cohn,* 325 F. 3d 141 (2d Cir. 2003).

After Cohn's death in 2004, his son took over as executor, and the Lawrence estate litigation continued against Cohn's estate. Roughly one year after Cohn's death, Alice's attorneys discovered a "smoking gun" that led to a $100 million settlement, Slip. Op. at *3. A revised retainer agreement that included a 40 percent contingent fee, entered into only five months before the settlement, sparked another decade of litigation between Alice, eventually Alice's estate, and the firm.

Payments to the law firm and its partners

In 1998, $84 million was distributed from the estate to Alice, and $40 million was distributed to her children. Alice, who had a pre-distribution net worth of $220 million, was apparently thrilled with this partial victory. Indeed, she was so moved that she elected to make monetary gifts to three of the partners involved in the litigation.

In envelopes dated Nov. 30, 1998, Alice enclosed effusive notes to each partner. For the lead attorney handling the estate litigation, she also enclosed a $2 million check. Checks for $1.55 million and $1.5 million were enclosed with the envelopes addressed to two other partners. Alice requested that these gifts be kept confidential.

All three attorneys heeded this request, and did not disclose the receipt of these gifts to their partners, and in one case, to the partner's spouse. In addition, Alice made a gift of $400,000 to the firm itself, although the note contained with the $400,000 check suggested that this "gift" was given begrudgingly.

Alice soon learned from her accountant that if she did not treat these payments as "bonuses," she would be required to pay gift taxes. Ultimately, Alice elected to treat the payments as gifts, and paid taxes totaling approximately $2.7 million.

Despite the distribution to Alice and her children in 1998, the estate litigation continued. By 2004, Alice had paid approximately $18 million in legal fees to the Graubard Firm, not including the "gifts" to her attorneys and the firm.

According to the Court of Appeals, the remaining contested issues involved objections to the executor's accounting, which alleged that Cohen had breached his fiduciary duty by engaging in self-dealing. In 2003 and 2004, Alice incurred a total of $4.88 million in legal fees pursuing these objections.

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These fees, and an adverse ruling, prompted Alice to seek a new fee arrangement. Alice and the firm engaged in some negotiation, ultimately agreeing on a fee arrangement that included payments by Alice coupled with a contingent fee. The firm would bill Alice on a quarterly basis in 2005. Alice agreed to pay a flat sum of not more than $300,000 each quarter in 2005.

If the fees ultimately exceeded that amount, Alice would not be responsible for any additional fees for the remainder of the litigation. If the firm was successful in achieving any distribution to the estate beneficiaries, the firm was to be paid 40 percent of the total distribution, minus any fees that had already been paid by Alice in 2005. The fee was to be paid only from Alice's share of the estate distribution, not from the share of her children.

The agreement was entered into on Jan. 19, 2005. The case settled five months later for $100 million dollars.

Alice seeks to vitiate both the contingent fee and the gifts

After reaching the settlement, the firm commenced a proceeding in Surrogate's Court seeking payment of its legal fees. One month later, Alice instituted an action in Supreme Court seeking to rescind the retainer agreement, and also seeking a return of all legal fees that had been paid to the firm. Alice's action was removed to Surrogate's Court, and both the firm and Alice filed dispositive motions.

Since "numerous questions of fact" precluded dismissal, both motions were denied, *Lawrence v. Miller*, 11 NY3d 588, 593 (2008). The First Department affirmed, and granted leave to appeal to the Court of Appeals.

Thus, in 2008, the Lawrence fee dispute made its first trip to the Court of Appeals. The court noted that the fee arrangement could be unconscionable either at the time the agreement was made, or in retrospect, but that the facts were not sufficiently developed to make that determination. With respect to whether the agreement was unconscionable in retrospect, the court found that although the fees appeared excessive based on the short five months of legal work conducted by the firm, especially considering the $18 million of fees already paid, the lack of a full factual record precluded a determination.

The surrogate referred the matter to a referee. Not surprisingly, litigating the underlying fee dispute was not a quick matter. After what the court described as "extensive motion and appellate practice," the parties completed discovery and the referee heard 15 days of testimony over three months, Slip Op. at *4.

The referee concluded that the agreement became substantively unconscionable only in retrospect, due to the amount of the award, the disproportionate amount of effort on the part of the firm, and the low risk that the firm would work without compensation. The surrogate affirmed, but the First Department reversed, determining that the revised retainer agreement was both procedurally and substantively unconscionable.

COA determines that the revised retainer agreement was neither procedurally nor substantively unconscionable

The court first addressed whether the agreement was procedurally unconscionable at the time it was entered into. Thus, the court examined "the contract formation process for a lack of meaningful choice," Slip Op. at *7.

This inquiry goes beyond the question of fraud or undue influence. "[T]he attorney must show that the client executed the contract with full knowledge of all the material circumstances known to the attorney and that the contract was one free from fraud on the attorney's part or misconception on the part of the client," *Id.* at *8 (quotations and citations omitted).

The court described Alice as a shrewd and formidable client, and found that she did not lack meaningful choice in entering into the agreement. Alice understood and was an active participant in the estate litigation. Indeed, it was Alice who sought the agreement.

Moreover, as a sophisticated business woman, Alice should have understood the agreement, and in fact her accountant explained to her both the agreement and the 40 percent contingency fee. Although the firm had underestimated the potential recovery as "at least a few million dollars," neither the firm nor Alice anticipated the "smoking gun" revelation that would alter the landscape of the litigation, *Id.* at *8-9.

The court then addressed whether the agreement, in hindsight, was substantively unconscionable. The court described this retrospective review as relatively narrow. While an exorbitant fee, without explanation, may suggest that an agreement is procedurally unconscionable, the amount of the fee in and of itself will not render an agreement substantively unconscionable. "Absent incompetence, deception or overreaching, contingent fee agreements that are not void at the time of inception should be enforced as written," *Id.* at *9.

The primary factors in determining whether a fee is unreasonably excessive include "the risk to the attorneys and the value of their services in proportion to the overall fee." In sharp contrast to the referee's determination, the court found that given the storied history of the estate litigation, the firm did in fact incur the risk that the litigation would continue to drag on, resulting in work without the benefit of an hourly fee. With respect to the value of the firm's services, the court stressed that value is measured not just by the time spent on the matter, but also by the degree of recovery obtained for the client.

In short, the court found that Alice was an astute and savvy

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client. The fact that an agreement that was reasonable when it was entered into became less advantageous in hindsight does not render that agreement substantively unconscionable.

The continuous representation doctrine did not toll claims seeking the return of the gifts

The gifts to the firm's partners were made in late November 1998. Alice brought suit against the firm and the individual partners on Sept. 13, 2005. As a result, the longest relevant potential statute of limitations, six years, had lapsed, Slip Op. at *10.

The court then examined whether the continuous representation doctrine tolled the statute of limitations. Continuous representation will toll the statute where there is 1) "a claim of misconduct concerning the manner in which professional services were performed" and 2) "the ongoing provision of professional services with respect to the contested matter or transaction," Slip Op. at *10.

Both the referee and the First Department noted that the attorneys potentially violated their ethical obligations in accepting the gifts, *Id*. at *13. The attorneys accepted the unquestionably large gifts without disclosing them to the firm and advising Alice to seek independent counsel. However, the court concluded that although this alleged violation of the attorneys' ethical obligations may be "unflattering," the conduct itself did not constitute self-dealing.

The court described self-dealing as occurring "when an attorney (or other fiduciary) takes advantage of his position in a transaction and acts in his own interests rather than in the best interests of the client." *Id*, at *12. Self-dealing can toll the statute of limitations, but only where the disputed transaction is in fact the subject of the ongoing professional representation, Id. Ultimately, the court declined "to expand the continuous representation rule to encompass" what the court viewed as "a financial dispute between a professional and his client," *Id*. at *13.

Judge Jenny Rivera concurred with the majority regarding the retainer agreement, but dissented with respect to the tolling of the statute of limitations. In addition to raising concerns about the failure to advise Alice to seek independent counsel, Judge Rivera noted that the attorneys may have had an ethical obligation to disclose these gifts because their clients included not only Alice, but her children. As such, the children had a right to assess whether these "life-altering gifts" would interfere with the attorneys' abilities to continue to provide them with zealous representation, *Id*.

Conclusion

The endorsement of a $40 million contingent fee for five months of paid work by a law firm seems extreme. However, there is no question that the Lawrence estate litigation represented a saga for the parties, the beneficiaries and their attorneys.

In my opinion, it was this underlying saga, and the client's active and knowing role in it, that informed the court's decision. It is also apparent that the court's determination regarding the "gifts" to the three partners was likewise influenced by the unique facts of this case.

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