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Partners Till Death Do Us Part?

Law360, New York (October 23, 2013, 11:43 AM ET) -- New York Supreme Court Justice Eileen Bransten's recent summary judgment decision in Le Bel v. Donovan, Index No. 652200/10 (Sup. Ct. N. Y. Co. Aug. 19, 2013), concerns the continued existence of a partnership upon the death of a partner. The decision illustrates that it is very difficult to obtain certainty, even where the partnership agreement explicitly dealt with this very situation.

The case teaches that it is always possible to draft an agreement more clearly to limit the possible lines of attack. It also is a reminder to periodically revisit agreements to assure they reflect current realities.

Background

Mary Yee and Mary Donovan were equal partners in a New York registered limited liability partnership they established in 1997, specializing in intellectual property, originally under the name Donovan Amladi & Yee, but known as Donovan & Yee LLP (the "firm") from shortly after formation. Yee died of injuries suffered in a plane crash in 2008 the day after the crash.

Yee's executor sued Donovan and the firm alleging six causes of action.[1] The gist of all the counts was the same; under the 1997 partnership agreement, the firm dissolved by operation of law upon Yee's death and defendants refused to turn over half of the firm's capital account, refused to account and improperly continued using the firm name.

Section 6.8 of the 1997 partnership agreement was titled Provisions Applicable Upon Death, Disability, Retirement, Withdrawal or Expulsion, and plaintiff relied on Section 6.8(a), which provided:

Priority Among Provisions. A voluntary dissolution (including any dissolution by law resulting from only one partner remaining in the partnership following the death, retirement, expulsion or withdrawal of the other partner(s)) and termination of the partnership shall override any of the provisions of this Article VI then in effect, ...

Plaintiff also relied on the provisions of the 1997 partnership agreement that set forth how a deceased partner's interest in the firm should be calculated, and claimed damages of approximately $208,000.

Defendants asserted that the firm did not dissolve upon Yee's death. They relied on Section 6.8(b) of the 1997 partnership agreement, claiming it took precedence over Section 6.8(a). Section 6.8(b) provided:

Continuation of the Partnership. The death, retirement, disability, withdrawal or expulsion of any partner shall not cause the dissolution of the partnership, unless following such death, retirement, disability, withdrawal or expulsion only one partner shall remain in the partnership and no additional partner shall be admitted within 90 days following such death, retirement, disability, withdrawal or expulsion. The remaining partners, together with any new partners, shall have the right, but not the obligation to continue the use of the partnership name …

The Litigation

In January 2011, defendants moved to dismiss the first three causes of action and to strike allegedly scandalous material from the complaint.[2] The court granted the motion to dismiss the single cause of action for unjust enrichment/money had and received/constructive trust without prejudice and denied the balance of the motion.

Defendants unsuccessfully appealed to the Appellate Division. Thereafter, the parties engaged in acrimonious discovery disputes and extensive motion practice, including an appeal to the Appellate Division, and then both sides moved for summary judgment in 2013.

In an affidavit in support of defendants' motion for summary judgment, Donovan explained that as a result of mutual concern, "there was written into §6.8 a provision designed to insure that a sole surviving partner could prevent the dissolution of the firm by adding a new partner within 90 days of the death of the former partner ... to protect the firm and the surviving partner from the claims of departing (or estates of deceased) partners in certain cases, by changing, to the advantage of the firm, the financial terms otherwise applying."[3]

The factual predicate for application of Section 6.8(b) was as follows: Prior to Yee's death, the firm entered into an agreement with Andrea Calvaruso, an associate at the firm, to become a contract partner, effective Jan. 1, 2008, through Dec. 31, 2009.

Under the Calvaruso agreement, she was not liable for any losses or obligations of the firm, but would "be held out to third parties as a partner on [firm] letterhead, promotional materials, website, firm brochure, business card and the like."

Calvaruso was to be treated as an employee for tax purposes and was to receive a salary, bonus and a portion of her collections. In the litigation, defendants did not claim that Calvaruso's status as a contract partner was relevant to Section 6.8(b).

However, within 90 days of Yee's death, in order to come within the ambit of Section 6.8(b) of the partnership agreement, the Calvaruso agreement was amended and restated. Under the new agreement, Calvaruso received five of the 100 units of participation in the firm, and net profits and losses were to be shared among the partners on the basis of units of participation.

However, Calvaruso was not required to make a capital contribution. The name of the firm was changed to Donovan, Calvaruso & Yee LLP. Calvaruso was issued a K-1 for 2009, showing she received $223,910 in "guaranteed payments" as defined in the amended and restated Calvaruso agreement.[4]

As Donovan explained in her affidavit, "I do not deny, in fact I affirm, that the reason for this new agreement at that time was specifically to prevent the firm from dissolving. As Calvaruso and I intended to continue in the practice of law with the same clients and with the same employees of the firm, it was the only decision that made business sense."

Interestingly, although the 1997 partnership agreement was an agreement drafted by lawyers for use by a law firm, it did not contain the standard, almost boilerplate, provision that any amendment had to be in writing.

In her affidavit, Donovan made a separate factual argument that a change in the designation of beneficiaries on the $1 million “key-man” life insurance policies Yee and Donovan each owned on the other was an oral modification of the agreement. She claimed it was intended to effect a change in the intention of the parties under the agreement and was a substitute for the accounting provided for in Section 6.2.[5]

Originally, upon the death of one of them, half the proceeds of the policy was payable to the firm, to buy out the interest of the decedent, and half to the surviving partner. Based on their mutual concerns that the 1997 partnership agreement was not very generous to the estate of a deceased partner, and Yee’s particular concerns for her two sons’ financial security following her divorce in 2006, they each changed their respective policies so that one-half of the proceeds was payable to the surviving partner and the other half to the decedent’s survivors, rather than the firm.

Donovan claimed that the changes they each made to the back-to-back policies “were to be in lieu of payment under any accounting by the firm, although (and because), as indicated, the expectation remained that under the accounting provisions of the agreement, there would not in any event be much benefit to the estate of a deceased partner ...”

Under the policy on Yee that Donovan owned and paid for, $500,000 was paid out to Yee’s two sons after her death. As Donovan noted in her affidavit, that was more than twice the $208,000 that plaintiff alleged in the complaint as damages.

The Summary Judgment Decision

Bransten denied plaintiff’s motion for summary judgment, granted defendants’ motion to dismiss the claims for an accounting and for injunctive relief, severed and continued the claims for breach of contract and fiduciary duty, and adjudged and declared that the firm did not dissolve by operation of law upon the death of Yee on Dec., 1, 2008. Therefore, the firm had the right to continue using Yee in its name.

First, the court began its legal discussion with Partnership Law § 62[4], noting that a New York partnership dissolves by operation of law upon the death of any partner where there is no agreement to the contrary. It then agreed with defendants’ interpretation of Section 6.8(a) and (b) of the 1997 partnership agreement:

“subsection (a) merely provides that if the firm dissolves because of, among other reasons, the death of one of two partners, then all the provisions of Article 6 are overridden. It does not, however, mean that the death of a partner necessarily causes a dissolution by operation of law.”

Plaintiff’s proposed construction of the agreement would mean that the provision for continuing the firm by the timely addition of a new partner could never be invoked, in violation of the basic principle that courts should avoid an interpretation that would leave contractual clauses meaningless. “Thus, if a dissolution by law is avoided by the surviving partner by the addition of a new partner of the firm within 90 days of death, as Yee and Donovan provided for in [§6.8(b)], there is no dissolution by law.”

Second, the court examined whether, as plaintiff alleged, Calvaruso’s partnership was a sham as a factual matter merely to avoid dissolution of the firm, and concluded that it was not. Based on Calvaruso’s deposition testimony and Donovan’s affidavit, the court concluded that plaintiff failed to raise a triable issue of fact whether Calvaruso was timely added as a new partner.

The undisputed evidence was that Calvaruso was a 5-percent equity partner pursuant to written agreement, obligating her to share in profits and losses up to her 5-percent interest, and was treated as a partner by the firm’s outside accountant. Calvaruso participated in firm management, although without “equal” management rights with Donovan. Accordingly, the firm did not dissolve by operation of law by virtue of the timely addition of Calvaruso as a partner.

Third, the court found defendants' oral modification argument that the insurance proceeds payout was in lieu of the accounting provided in the agreement raised a triable issue of fact. The court also found a factual issue with respect to the financial statements provided to Yee's estate. Accordingly, the court severed and continued the breach of contract and breach of fiduciary duty claims. There appears to be no substantive activity in the case since the decision.

The Takeaway

In this situation, the parties believed that they did everything in a timely fashion by contract to recognize and resolve in advance the very situation being litigated — the death of a partner and the addition of a new partner thereafter to prevent dissolution of the firm as a matter of law.

At the time of contracting, neither partner could know who would die first and who would benefit (or be hurt) by the provision; it was even-handed and protected both partners equally. Nevertheless, the executor of one of the contracting parties brought suit on the very issue the parties thought they had permanently resolved by contract.

With the benefit of hindsight, assuming that both Donovan and Yee expected their respective executors to abide by their agreement, they could have drafted it with greater clarity.

They could have specifically and affirmatively stated that in the event the surviving partner invoked Section 6.8(b) and admitted another partner within 90 days of the death of the other, the firm was not dissolved under the Partnership Law or under any other provision of the agreement.

They could have required that any amendment be in writing, and amended the agreement to provide that the revised division of proceeds of the "key-man" insurance replaced the existing provisions.

Still, to these writers' eyes, the agreement established the parties' expectations under these exact circumstances, at least with respect to the continuation of the firm. The only conclusion we can draw is that even a written agreement will not insulate a party when the other party — here the executor — is not happy with the financial result.

--By Joan M. Secofsky and Richard I. Janvey, Diamond McCarthy LLP

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[1] The claims were breach of contract; breach of fiduciary duty; unjust enrichment and money had and received and constructive trust; accounting; declaratory relief and injunctive relief.

[2] The plane crash that killed Yee occurred on Nov. 30, 2008, but she did not die until the following day, December 1. The firm canceled her medical insurance effective December 1, unaware that was the date of death. The insurer then refused to cover hospital expenses incurred that day. The firm reinstated the insurance and the insurer then reimbursed the estate for medical expenses incurred on December 1. Nevertheless, paragraph 20 of the complaint contained allegations with respect to the premature, but then reinstated, premium cancelation; "Donovan improperly and prematurely canceled the medical insurance covering Yee, ... resulting in the estate unnecessarily being charged for such medical expenses." Defendants unsuccessfully moved pursuant to CPLR 3024(b) ("a party may move to strike any

scandalous or prejudicial matter unnecessarily inserted in a pleading") to have that paragraph struck as scandalous. The denial of that portion of defendants' motion to dismiss was not appealable as of right, and the Appellate Division denied defendants' motion for leave to appeal.

[3] Donovan wrote that when the 1997 partnership agreement was being drafted, she and Yee were concerned that partner Amladi would leave the firm shortly. "Accordingly, Yee and I personally met with the attorney who was handling the drafting of our contract ... and discussed with him our concern that if only the two of us remained partners, and one of us thereafter died, relationships of the surviving partner with clients, and the status of employees of the firm, would suffer if the firm were to be dissolved by that death .... As a result ... there was written into § 6.8 a provision designed to insure that a sole surviving partner could prevent the dissolution of the firm by adding a new partner within 90 days of the death of the former partner."

[4] Calvaruso left the firm at the end of 2009, and is not a party to the suit, although she was deposed.

[5] Section 6.2 of the 1997 partnership agreement, titled Death, provides that the interest of a partner terminates upon death, and the firm "shall pay to the estate of the deceased partner the following amounts in full satisfaction of the interest of the deceased partner in the partnership ..."
