SHORT FORM ORDER

SCAN

SUPREME COURT : STATE OF NEW YORK
COUNTY OF NASSAU

PRESENT:
HON. IRA B. WARSHAWSKY,
Justice.

TRIAL/IAS PART 10

BRESLIN REALTY DEVELOPMENT CORP., WILBUR F. BRESLIN, EASA EASA, JACK EASA, BAY HARBOUR ASSOCIATES, L.P., HUNTINGTON SQUARE ASSOCIATES, L.P., ROCHESTER ASSOCIATES, L.P., BUSY BEE ASSOCIATES, L.P., VERLEYE & JERICHO ASSOCIATES, L.P. and RIVERWOOD LA PLACE ASSOCIATES, LLC,

Plaintiffs,

INDEX NO.: 004182/2005
MOTION DATE: 03/10/2008
MOTION SEQUENCE: 004 and 005

-against-

J. STANLEY SHAW, JOHN H. HALL, a/k/a JOHN H. HALL, JR. and SHAW, LICITRA, GULOTTA, ESERNIO & SCHWARTZ, P.C.,

Defendants.

The following papers read on this motion:

Notice of Motion, Affirmation, Affidavits & Exhibits Annexed	1
Notice of Cross-Motion, Affirmation & Exhibits Annexed	2
Reply Affirmation in Further Support of Plaintiffs' Motion for Renewal and Reargument (and in Opposition to Defendants' Cross-Motion) of Robert M. Calica & Exhibits Annexed	3
Reply Affirmation of Barry Jacobs & Exhibits Annexed	4

Plaintiffs' motion for leave to reargue and leave to renew a prior motion by defendant which resulted in an order dated September 28, 2007 granting summary judgment dismissing the complaint and upon reargument for an order denying such relief is granted. Defendants' cross-

motion for leave to reargue is also granted, but upon defendants' motion for reargument, the court adheres to so much of its prior decision as denied defendants' motion for summary judgment on the grounds of lack of standing and res judicata/collateral estoppel.

This is an action for legal malpractice. Defendants were counsel to the plaintiff debtors in a series of jointly administered Chapter 11 bankruptcy proceedings.

Plaintiffs Bay Harbour Associates, L.P., Huntington Square Associates, L.P., Busy Bee Associates, L.P., Rochester Associates, L.P., and Verleye & Jericho Associates, L.P are limited partnerships which owned fee or leasehold interests in five commercial properties.[1] Plaintiff Wilbur F. Breslin held a 50% interest in each of the limited partnerships. Plaintiff Easa Easa owned a 50% interest in Busy Bee and a 40% interest in Bay Harbour. Plaintiff Jack Easa held the remaining 10% interest in Bay Harbour. Plaintiff Breslin Realty Development Corporation appears to have been the general partner for each limited partnership. In any event, the limited partnerships were controlled by Breslin.

In December 1993, Cargill Financial Services Corporation made a series of mortgage loans to the limited partnerships in the approximate amount of $61 million.[2] The loans were actually "bridge loans," or short term financing, which Breslin intended to repay by offering shares in a real estate investment trust to the public.[3] The promissory notes secured by the mortgages were issued without recourse. Because each loan was made without recourse, the limited partnership was not liable for the mortgage debt, and the lender was required to look only to the collateral. To the extent that the balance of any loan exceeded the value of the property, the lender would be unable to obtain payment of the indebtedness.

However, pursuant to a series of modification agreements and nonrecourse guaranties, the

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[1]Bay Harbour Associates was the owner of Bay Harbour Mall in Lawrence. Huntington Square Associates owned Huntington Square Mall in East Northport. Busy Bee Associates owned commercial property located in Massapequa. Rochester Associates owned J. Scutti Plaza located near Rochester. Verleye & Jericho Associates owned a retail shopping center located in Elwood, New York. See Ex. U to defendants' original motion for summary judgment.

[2]See decision of U.S. Bankruptcy Judge Melanie Cyganowski dated December 31, 2003, Ex. GG to defendants' cross-motion for leave to reargue, at 2.

[3]See Ex. A to Barry Jacobs' reply affidavit in support of defendants' original motion for summary judgment at 6.

loans were cross-collateralized.[4] Thus, the property held by each limited partnership secured the loans to all the other partnerships. However, because the loans remained nonrecourse, the lender could still look only to the properties to obtain payment. Moreover, the lender was undersecured and unable to obtain payment, to the extent that the total amount of the loans exceeded the total value of the properties.

On or about March 15, 1994, plaintiff Riverwood LaPlace Associates, LLC, a Breslin affiliate which held property in Louisiana, guaranteed the total debt and granted Cargil a first mortgage lien in the amount of $61,650,000. Because the financing provided to Riverwood was cross-collateralized, certain of the properties held by the limited partnerships also secured Cargil's loan to Riverwood.[5]

On February 29, 1996, Cargill assigned its rights under the various loans and mortgages to CFSC Capital Corp. In March 1996, CFSC commenced actions in Louisiana and New York to foreclose the mortgages on plaintiffs' properties. On September 3, 1996, Riverwood filed a Chapter 11 reorganization petition in the Bankruptcy Court for the Eastern District of New York.[6] The petition listed defendant Shaw, Licitra, Gulotta, Esernio, & Schwartz as the attorney for the debtor. The immediate effect of the filing of the petition was to stay the foreclosure action pending against the Louisiana property(11 USC § 362[a]). Whether the automatic stay also impeded the New York foreclosures is unclear. In any event, in February 1998, the Appellate Division granted summary judgment in favor of CFSC.[7]

Some background as to the operation of Chapter 11 proceedings is necessary in order to understand the nature of the legal representation provided by defendants. The recognized policies underlying reorganization proceedings are the preservation of going concerns and the

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[4]See affidavit of Michael Brofman in support of plaintiffs' motion for reargument at ¶ 14.

[5]See affirmation of Barry Jacobs, Esq. at 4, Ex. D to defendants' cross-motion for leave to reargue.

[6]The petition appears as Ex. A to defendants' original motion. The date of filing is shown in Ex. C to defendants' original motion.

[7]*CFSC Capital Corp. v. W.J. Bachman Mechanical Sheet Metal Co.*, 247 AD2d 502 [2d Dep't 1998]).

maximizing of property available to satisfy creditors(*Bank of America Nat'l Trust v. 203 North LaSalle Street Partnership*, 526 U.S. 434, 453 [1999]). However, preserving an entity as a going concern does not require that those who held equity in the company must continue to do so after its reorganization. Thus, generally speaking, if creditors are not paid in full, a former equity holder may receive an equity interest in the reorganized entity, only if the equity holder makes a contribution "in money or money's worth, reasonably equivalent" to the equity interest(11 USC § 1129(b)(2)(B); *Bank of America Nat'l Trust v. 203 North LaSalle Street Partnership*, 526 U.S. at 445). The reason for the so-called "new value corollary" is that if a debtor's reorganization plan is "too good a deal for the debtor's owners," the interests of creditors will not be adequately protected(Id at 444).

The filing of a voluntary petition pursuant to Chapter 11 constitutes the commencement of a case and an order for relief under Chapter 11(11 USC § 301). For the first 120 days after the date of the order for relief, the debtor has the exclusive right to file a plan for reorganization(11 USC § l121[b]). If the debtor files a plan within the initial 120-day period, creditors are not permitted to file their own plans until 180 days after the date the petition was filed(11 USC § 1121[c]).

Pursuant to 11 USC § 1129(a), the bankruptcy court shall confirm a plan of reorganization only if all of the requirements of the statute are met. One of the most critical requirements is that each class of claims must either accept the plan or not be "impaired" under it(11 USC § 1129(a)[8]). A class of claims accepts the plan if a majority of the creditors and those holding two-thirds of the total dollar amount of claims within that class vote to approve the plan(11 USC § 1126[c]). Generally speaking, a class of claims is impaired under a plan if, with respect to each claim in the class, the legal, equitable, or contractual rights of the holder of the claim are altered(11 USC § 1124).

If a class of creditors whose rights are impaired refuses to accept a reorganization plan, the debtor may nonetheless "cram down" the plan on the dissenting creditors if certain conditions are met(11 USC § 1129[b]). One of the most important conditions is that the plan be accepted by at least one class of impaired creditors(11 USC § 1129(a)[10]). Another critical condition is that the plan "does not discriminate unfairly, and is fair and equitable, with respect to each class of claims...that is impaired under, and has not accepted the plan"(11 USC § 1129(b)[1]). Section

1129 is neutral in the sense that a plan of reorganization may also be "crammed down" over the objection of the debtor, provided a class of impaired creditors accepts the plan, and it does not "discriminate unfairly" as to other impaired creditors.

The class in which a particular claim is placed may determine whether confirmation of the plan may be obtained. For example, if a large claim held by a creditor who objects to the plan is separated from an impaired class which accepts the plan, the plan may be confirmed despite the objection by the creditor holding the large claim(See *Bank of America Nat'l Trust v. 203 North LaSalle Street Partnership*, supra, 526 U.S. at 439). On the other hand, if the large claim is placed in the impaired class, acceptance by the creditor with the large claim will determine whether confirmation may be obtained. A plan may place a claim in a particular class only if the claim is "substantially similar" to the other claims of the class(11 USC § 1122[a]). Thus, a party objecting to confirmation of a plan may argue that substantially similar claims have not been treated similarly, that is the classes have been "gerrymandered" to obtain confirmation (526 U.S. at 439 n.7).

Where a secured obligation was issued without recourse, an argument could be made that the creditor's rights have not been impaired as long as its lien is recognized. However, the general rule under 11 USC § 1111(b) is that a nonrecourse secured creditor who is undersecured, because the debt exceeds the value of the collateral, will be treated as if the creditor had recourse in Chapter 11. Thus, to the extent that the debt exceeds the value of the collateral, the creditor would have an unsecured deficiency claim.(11 USC § 506[a]). However, the class of which the secured claim is a part may elect for the entire claim to be treated as a secured claim by a vote of a majority of the creditors in the class and 2/3 of the total dollar amount of claims(11 USC § 1111[b]).

As an exception to the general rule, 11 USC § 1111(b)(1)(A)(ii) provides that a nonrecourse creditor is not treated as having recourse if the property securing the claim "is to be sold under the plan." The property is considered to be "sold under the plan," if the creditor is afforded the right to foreclose or obtain the return of its collateral, whether pursuant to the plan or in a separate foreclosure action(*In re Constitution Plaza Associates*, 161 B.R. 563, 565 [D. Conn. 1993]). If the creditor forecloses or obtains title to the property securing the claim, the creditor is not entitled to recourse treatment and does not have an unsecured deficiency claim. In

effect, recourse treatment for the undersecured claim is limited to the situation where the debtor does not repay the debt in full and intends to retain the collateral after bankruptcy(*In re DRW Property Co.* 57 B.R. 987, 992 [N.D. Tex. 1986]). The class may not elect for the entire claim to be treated as a secured claim if the holder of the claim has recourse and the property is to be sold under the plan(11 USC § 1111(b)(1)[B]).

If the undersecured creditor is treated as though it had recourse, the creditor's unsecured deficiency claim should be classified separately from its secured claim. Whether the secured creditor's deficiency claim must be classified separately from other unsecured claims is less clear(*Bank of America Nat'l Trust v. 203 North LaSalle Street Partnership*, supra, 526 U.S. at 439 n.7). Thus, the segregation of a secured creditor's deficiency claim from other unsecured claims may present another opportunity to "gerrymander" the classes of claims in order to gain approval of a reorganization plan(Id). Additionally, if the debtor is to retain the property pursuant to a plan proposed during the exclusivity period, the plan must provide some type of "market test" in order to determine the value of the property(*Bank of America Nat'l Trust v. 203 North LaSalle Street Partnership*, supra, 526 U.S. 434). Without a market test, there is no assurance that the "new value" provided by the equity holders is reasonably equivalent to the value of the property.

Plaintiffs do not discuss the plans of reorganization which they filed.[8] Thus, an inference arises that the plaintiffs' proposed plans were "too good a deal" for the equity holders because they did not involve a sufficient contribution of new capital. In any event, in December 1998, after the exclusivity period expired, a plan of reorganization was filed by CFSC. A key feature of the proposed plan was that the Louisiana property would be transferred to CFSC.[9]

On February 3, 1999, Breslin and the other plaintiffs filed objections to CFSC's plan.[10] Interestingly, plaintiffs' objections to the plan were filed not by defendants but by another

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[8]See Ex. A to reply affirmation of Barry Jacobs submitted in support of defendants' original motion at 5.

[9]Ex. A to reply affirmation of Barry Jacobs submitted in support of defendants' original motion at 18.

[10]Ex. A to reply affirmation of Barry Jacobs submitted in support of defendants' original motion at 3.

bankruptcy firm, Rosen & Slome. It appears that plaintiffs were at that time represented separately from Riverwood, the debtor in the Chapter 11, because Riverwood claimed that the mortgage in favor of CFSC constituted a fraudulent conveyance.[11] The debtor's theory was that it had assumed $58 million of preexisting debt in exchange for an advance of only $3.3 million, and the mortgage was not for fair consideration.[12] Plaintiffs objected to the CFSC plan on the ground that it was not proposed in good faith in that CFSC had purchased claims on terms different from those proposed in its own reorganization plan(See 11 USC § 1129(a)[3]). Plaintiffs further argued that the plan violated 11 USC § 1111(b) with respect to CFSC's "Class 3 deficiency claim."[13] CFSC's plan provided that its "deficiency claim" would be treated as recourse pursuant to § 1111(b). Plaintiffs argued that pursuant to 11 USC § 1111(b)(1)(A)(ii), CFSC's undersecured claim was not entitled to recourse treatment because the property securing the claim was to be transferred to CFSC under the plan. Finally, plaintiffs objected on the ground that the plan was not "feasible" because it failed to provide for payment of the Breslin Group's unsecured claims(See 11 USC § 1129(a)[11]).

On February 12, 1999, Bankruptcy Judge Francis Judge Conrad stated on the record that the debtor had established a "prima facie" fraudulent conveyance. However, Judge Conrad refused to set the Riverwood mortgage aside because defendants had failed to bring a timely adversary proceeding.[14] Almost immediately after Judge Conrad's ruling, a "settlement agreement" was reached in the Bankruptcy Court. The settlement agreement involved not only Riverwood, but also the five limited partnerships. According to the terms of the settlement, plaintiffs had the right to "buy out" CFSC's interest in the loans for $49 million if payment was

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[11]See transcript of proceedings before Bankruptcy Judge Francis Conrad, Ex. B to Barry Jacobs reply affirmation in support of defendants' original summary judgment motion, at 13.

[12]Transcript of proceedings before Judge Conrad at 34. See also Debtor and Creditor Law § 273.

[13]Ex. A to reply affirmation of Barry Jacobs submitted in support of defendants' original motion at 17.

[14]Transcript of proceedings before Judge Conrad, Ex. B to reply affidavit of Barry Jacobs in support of defendants' original motion, at 35-36.

made on or before July 16, 1999.[15] In the event that payment was not made by that date, the properties of the limited partnerships would be transferred to CFSC in accordance with "pre-packaged" plans of reorganization to be confirmed by the Bankruptcy Court. Pursuant to the settlement, plaintiffs withdrew their objections to the amended plan of reorganization which had been submitted by CFSC.[16]

While the terms of the settlement were spread on the record before Judge Conrad, not all of the implications concerning confirmation of the plan appear to have been discussed. Specifically, if financing to buy out the loans was not obtained by Breslin, the properties were to be transferred to CFSC. In that situation, because the loans were nonrecourse, CFSC would not have a deficiency claim.

However, if financing was obtained, the debtor would retain the properties, and CFSC would have an unsecured deficiency claim. At the time of the settlement, the balance of CFSC's loan was approximately $72 million.[17] Although the total value of the properties at that time is in dispute, plaintiffs subsequently claimed in their Chapter 11 petitions that the aggregate value was $62.8 million.[18] Thus, treating CFSC as if it had recourse could have resulted in its having a $9.2 million unsecured deficiency claim.

It appears that CFSC's unsecured deficiency claim was not classified with any other class of creditors.[19] In any event, the issue of gerrymandering was academic because plaintiffs had withdrawn their objections to CFSC's plan. Moreover, since CFSC had agreed to the buy out price, there was apparently no concern that the absence of a "market test" allowed plaintiffs to

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[15]A $1.5 million down payment was made on the date of the hearing(Ex. B to reply affirmation of Barry Jacobs submitted in support of defendants' original motion at 43).

[16]Transcript of proceedings before Judge Conrad at 40.

[17]See Ex. A to reply affirmation of Barry Jacobs in support of defendants' original motion at 4.

[18]Ex. D to defendants' cross-motion to reargue, affirmation of Barry Jacobs, Esq. at 33.

[19]CFSC's unsecured claim was Class 3 (See Ex. A to Jacobs' reply affirmation in support of defendants' original motion at 17). Except for Class 4 (allowed unsecured claims), each class either accepted the plan or was not impaired under it (Ex. TT to defendants' original motion at 4).

contribute insufficient new value for the properties. Nevertheless, the parties would have to wait to seek Bankruptcy Court confirmation of the plan because it might not be known until the "last minute" whether Breslin would obtain the financing.

On June 24, 1999, pursuant to the settlement agreement, voluntary Chapter 11 petitions were filed by all of the limited partnerships. Shaw, Licitra was listed as the attorney for the debtor on all of the petitions. On July 2, 1999, with the deadline fast approaching, plaintiffs entered into the agreement with Leucadia, Inc. which forms the basis of the present malpractice action.[20] According to the agreement, Leucadia agreed to purchase the outstanding mortgages for $49 million, the price set by the CFSC agreement, to "allow for a restructuring and refinancing of the properties." Following acquisition of the loans, plaintiffs and Leucadia were to enter into a series of new limited partnerships, and plaintiffs were to contribute 100% of their interests in the properties in exchange for a 50% interest in "the Venture(s)."

The agreement provided that Leucadia and plaintiffs would obtain a new cross-collateralized first mortgage loan in the approximate aggregate amount of $34 million. Only the properties owned by Bay Harbour, Huntington, Rochester, and possibly Riverwood were to be encumbered by the mortgage.[21] Additionally, Leucadia was to retain a second mortgage in the amount of $11 million, if the partnerships were unable to sell assets to reduce the secured debt. The remaining $4 million of the purchase price for the mortgages was to be "Leucadia's equity contribution for 50% of the Venture(s)." In order to acquire the loans, Leucadia agreed to take an assignment of plaintiffs' rights to purchase the mortgages pursuant to the settlement with CFSC.

Under Section 1.4 of the agreement, Leucadia promised not to foreclose the mortgages, provided that "restructuring" occurred by December 15, 1999. Leucadia was free to exercise any of its rights with respect to the loans if restructuring had not occurred by that date. After the "Closing Date," i.e. the date when Leucadia purchased the loans, plaintiffs had no right to acquire the loans for any amount less than the total amount outstanding. However, the agreement further provided that "notwithstanding the foregoing," prior to December 15, 1999, plaintiffs

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[20]Ex. M to defendants' original motion.

[21]Ex. U to defendants' original motion at 8.

could request Leucadia to foreclose the mortgages in a "consensual foreclosure" and then convey the properties to the "appropriate Venture."

Plaintiffs allege in this action that they accepted the Leucadia agreement based upon defendants' advice that plaintiffs were entitled to demand "consensual foreclosure," regardless of whether financing to restructure the mortgages was obtained. Nonetheless, the Leucadia agreement further provided that it was not a joint venture agreement and no "similar relationship" would exist between the parties "until the Ventures are formed." Furthermore, the agreement provided that it represented the "entire agreement" between the parties and superceded all prior oral or written agreements.

Bankruptcy Court Judge Melanie Cyganowski approved the Leucadia agreement on July 7, 1999. Once the Leucadia agreement was in place, it appeared, at least from plaintiffs' perspective, that the debtors would retain the properties. Thus, despite the nonrecourse nature of the original financing, CFSC had an unsecured deficiency claim. Judge Cyganowski confirmed CFSC's amended plan of reorganization nunc pro tunc on July 15, 1999.[22]

Pursuant to the Leucadia agreement, plaintiffs assigned their interests in the loans to Leucadia, and Leucadia purchased the loans from CFSC. However, plaintiffs and Leucadia were not able to obtain the required financing.[23] On December 14, 1999 Wilbur Breslin sent Leucadia a letter purporting to exercise plaintiffs' rights to request consensual foreclosure. In response, Leucadia asserted that because the financing had not been obtained, it had the right to foreclose for its sole benefit and acquire a 100% equity interest in the properties.

On March 20, 2000, Luk-Shop LLC, Leucadia's nominee, filed a liquidating Chapter 11 plan for each of the four debtors with the Bankruptcy Court. Luk-Shop filed an amended liquidating plan on May 17, 2000.[24] The amended plan called for transfer of all of plaintiffs' properties to Luk-Shop in order to satisfy the loans. Thus, under Luk-Shop's proposed plan, Luk-Shop was not entitled to an unsecured deficiency claim.

On April 14, 2000, plaintiffs submitted their own plans of reorganization, in an effort to

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[22]Defendants' Ex. TT in support of their original motion for summary judgment.

[23]Because of the intervening sale of Busy Bee's property, the required funding was reduced to $34 million. See Ex. U to defendants' original motion at 9.

[24]Ex. DDD in support of defendants' original motion for summary judgment.

retain equity interests in the properties. In essence, plaintiffs proposed two alternatives: 1) proceeding with "the Venture" by obtaining new financing or consensual foreclosure, or 2) selling the properties.[25] Under the latter scenario, selling the properties pursuant to the plan, because the CFSC financing had been nonrecourse, Luk-Shop would clearly not have been entitled to an unsecured deficiency claim. Under the first scenario, proceeding with the Venture, plaintiffs would retain a 50% equity interest in the properties. However, since Luk-Shop would also be a joint venturer, there was perhaps no need to consider whether Luk-Shop was entitled to an unsecured deficiency claim.

In May 2000, defendants filed on behalf of plaintiffs an adversary complaint in the Bankruptcy Court, seeking, among other relief, a judgment declaring the rights of the parties to the Leucadia agreement. In the Bankruptcy Court, defendants asserted that the agreement gave rise to a joint venture, despite its language to the contrary. Defendants argued that because a joint venture had been formed, Leucadia was under a fiduciary obligation to pursue consensual foreclosure and convey the properties to the new partnerships. Defendants further argued that Leucadia had not made a good faith effort to obtain the financing necessary to effectuate the joint venture agreement.

On August 4, 2000, Bankruptcy Judge Melanie Cyganowski ruled that the Leucadia agreement did not give rise to a joint venture. The court held that December 15, 1999 was a firm "deadline," and after that date Leucadia was free to foreclose the mortgages on its own behalf. Moreover, plaintiffs could not request "consensual foreclosure" unless the financing were first obtained. Judge Cyganowski further held that Leucadia did not breach its obligation to make a good faith effort to obtain the financing needed to effectuate a joint venture agreement.

The Bankruptcy Court decision was affirmed by the U.S. District Court on March 20, 2002,[26] and the District Court judgment was affirmed by the U.S. Court of Appeals for the Second Circuit on January 23, 2003. In the opinion of the Court of Appeals, the case involved a "contract interpretation dispute" which was resolved correctly by the District Court.[27] This court

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[25]See Ex. V to defendants' original motion.

[26]Ex. Y to defendants' original motion.

[27]See Summary Order of the U. S. Court of Appeals, Ex. 1 to plaintiffs' original opposition at 4.

notes that the interpretation of the Leucadia agreement which the parties advocated in the Bankruptcy Court would have resulted in plaintiffs' obtaining a 50% equity interest in the reorganized "venture" with no new value contribution, other than the $1.5 million which plaintiffs paid at the time of the Cargil settlement. Thus, the underlying rationale for the bankruptcy court decision may have been that defendants' interpretation of the contract would have resulted in "too good a deal" for the plaintiffs.

Meanwhile, on August 9, 2000, Judge Cyganowski held a hearing on confirmation of Luk-Shop's liquidating Chapter 11 plan.[28] Although the plan set forth separate classifications of claims for each debtor, the four classes of claims and equity interests for each debtor were essentially the same.[29] Class 1 was Luk-Shop's allowed secured claim which Luk-Shop considered to be impaired. The plan called for each property to be transferred to Luk-Shop in satisfaction of the corresponding Class 1 secured claim. Class 2 was non-insider unsecured claims. Class 2 was not impaired because the claims were to be paid in full with interest. Class 3 was unsecured insider claims. Certain of the estates held claims against Wilbur Breslin. The plan called for the estates' claims against Breslin to be assigned to the insider creditors in full satisfaction of their claims against the estate. Class 3 was impaired because the plan did not call for any other distribution with respect to allowed unsecured insider claims. Class 4 was equity interests which were to be extinguished by the plan. At the conclusion of the hearing, Judge Cyganowski delivered her decision granting confirmation of the plan.

This action for legal malpractice was commenced on March 18, 2005. Plaintiffs allege that defendants gave them faulty advice with respect to the Leucadia agreement which led them to lose their equity in the various properties. As a second cause of action for malpractice, plaintiffs allege that defendants failed to assert a "non-recourse defense" at the confirmation hearing. Plaintiffs assert that since the debtors were not retaining any interest in the properties, Luk-Shop was not entitled to an unsecured deficiency claim. Plaintiffs further assert that the plan was confirmed because defendants' failed to raise a "nonrecourse defense" to Luk-Shop's liquidating plan. Plaintiffs allege that as a result of defendants' negligence, they have been

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[28]See Ex. F to reply affirmation of Barry Jacobs in support of defendants' original motion for summary judgment.

[29]See Ex. DDD to defendants' original motion for summary judgment.

damaged in the amount of $10 million, the claimed value of their equity in the properties.

By order dated September 28, 2007, the court denied defendants' motion for summary judgment dismissing the complaint upon the grounds of lack of standing and res judicata/collateral estoppel. The court held that defendants did not carry their burden of establishing prima facie that they did not represent Breslin Realty and the individual plaintiffs as well as the debtor limited partnerships. The court further held that plaintiffs' claims of malpractice, faulty advice with respect to the Leucadia agreement and failure to assert a "non-recourse" defense, arose after the date that the bankruptcy petitions were filed. Since the malpractice causes of action accrued after the filing of the petitions, they were not part of the bankruptcy estate. Thus, plaintiffs had standing to pursue their malpractice claims.

The court further held that the confirming of the plans of reorganization did not bind the debtors, or the other plaintiffs, as to the quality of legal services provided by defendants in the bankruptcy proceeding. Finally, the court held that Judge Cyganowski, in approving defendants' fee application, had decided that defendants' legal services were reasonably likely to benefit the debtors' estate. However, defendants had not carried their burden of establishing that the Bankruptcy Court had necessarily decided that a reasonable attorney for the debtor would have counseled his client to enter into the Leucadia agreement. Nor had the bankruptcy court necessarily decided that a reasonable attorney would not have asserted a nonrecourse defense. Thus, the court refused to give preclusive effect to the bankruptcy court order granting defendants' fee application.

However, the court granted defendants' motion for summary judgment dismissing the complaint on the ground that there was no malpractice. The court reasoned that the bankruptcy court decision awarding substantial fees to defendants established prima facie that defendants exercised the degree of skill and knowledge commonly possessed by members of the legal profession. Furthermore, the confirmed plans of liquidation established prima facie that plaintiffs had no equity interest in the properties and sustained no damages which were proximately caused by defendants' negligence. Thus, the burden shifted to plaintiffs to offer proof that the result of the reorganization proceedings would have been more favorable but for defendants' negligence.

Finding that plaintiffs had offered no alternatives to entering into the agreement with

Leucadia, the court concluded that plaintiffs had not carried their burden of showing that defendants' advice with respect to the agreement proximately caused the loss of their equity interests. Additionally, the court held that defendants committed no negligence in failing to raise a nonrecourse defense because plaintiffs' purported defense was clearly without merit. Accordingly, defendants' motion for summary judgment dismissing the complaint was granted.

Defendants served a copy of the order with notice of entry by first class mail on October 15, 2007. Plaintiffs filed a notice of appeal from this court's order granting summary judgment dismissing the complaint on or about October 30, 2007. On November 7, 2007, defendants filed a cross-appeal from those parts of the order denying their motion for summary judgment on the grounds of standing and res judicata/collateral estoppel and the part of the order determining that certain plaintiffs were clients of defendants.

Plaintiffs moved for reargument and renewal of defendants' motion for summary judgment on November 19, 2007. Plaintiffs seek reargument on the ground that the court misapprehended the element of causation with respect to the malpractice of the attorney for a debtor in a Chapter 11 case. Plaintiffs note that they did in fact offer an alternative to the Leucadia agreement, a proposed joint venture agreement with Starwood Ceruzzi LLC, on the prior motion. Plaintiffs further move for reargument on the ground that the court misapprehended the nature of the nonrecourse defense and how it might have defeated the plan of reorganization. In support of their motion to renew, plaintiffs submit an affidavit from their bankruptcy expert, Michael Brofman, Esq., which largely repeats the affidavit submitted by Mr. Brofman in opposition to defendants' original motion. On January 11, 2008, defendants cross-moved for reargument of their motion for summary judgment on the grounds of standing and res judicata/collateral estoppel.

CPLR 2221(d)(3) provides that a motion for leave to reargue shall be made within 30 days after service of a copy of the order with notice of entry. CPLR 2103(b)(2) provides that where a period of time is measured from the service of a paper and service is by mail, five days shall be added. Since defendants served notice of entry on October 15 and plaintiffs moved for reargument 35 days later on November 19, 2007, the court concludes that plaintiffs' motion for reargument is timely. This court has jurisdiction to reconsider its prior order regardless of the statutory time limits concerning motions to reargue(*Itzkowitz v. King Kullen Grocery Co.*, 22

AD3d 636 [2d Dep't 2005]). Similarly, the court will overlook the untimeliness of defendants' reargument motion.

Where a party seeking reargument has also taken an appeal, the court may, as a matter of discretion, grant reargument if the appeal has not yet been perfected(*Leist v. Goldstein*, 305 AD2d 468 [2d Dep't 2003]). The court notes that neither plaintiffs nor defendants have perfected their appeal from the order granting summary judgment dismissing the complaint. Because of the importance of the issues raised, the court will proceed to the merits of both reargument motions.

Defendants move for reargument of their motion for summary judgment on the grounds that plaintiffs are without standing to bring a malpractice action and plaintiffs are collaterally estopped by the bankuptcy judge's order approving defendants' fee application. If these complete defenses, which are both in the nature of confession and avoidance, were established, defendants would be entitled to summary judgment without regard to the quality of the legal services which they performed(*Maddox v. New York*, 66 NY2d 270, 277 [1985]). Accordingly, the practical place to begin is by considering defendants' motion.

A debtor may convert Chapter 11 proceedings to liquidation proceedings pursuant to Chapter 7(11 USC § 1111[a]). Upon request of a party in interest, the bankruptcy court may convert a Chapter 11 case to Chapter 7 on various grounds including inability to effectuate a plan(11 USC § 1112[b]). However, a confirmed plan of reorganization under Chapter 11 may provide for the distribution of all of the debtor's assets to creditors without conversion to Chapter 7(See *In re The Airporter, Inc.*, 49 Bankr. Ct. Dec. 147 [D. Mass. 2008]).

Where counsel for the debtor commits malpractice in the course of Chapter 11 proceedings, the debtor's claim for malpractice vests in the bankruptcy trustee when the case is converted to a liquidation proceeding pursuant to Chapter 7(*In re R & R Associates of Hampton*, 402 F.2d 257 [1st Cir. 2005]). Defendants argue that a debtor should similarly be deprived of standing where the proceeding has not been converted to Chapter 7, but the debtor is divested of all of its assets pursuant to a Chapter 11 liquidating reorganization plan.

However, the vesting of the malpractice claim in the trustee upon conversion to Chapter 7 is required by the provisions of the Bankruptcy Code. The conversion of a plan from Chapter 11 to Chapter 7 constitutes an order for relief pursuant to Chapter 7(11 USC § 348). The order for

relief constitutes the commencement of a voluntary or involuntary case and creates an estate to be administered by the Chapter 7 trustee, consisting of all property previously constituting the estate created pursuant to Chapter11(11 USC § 541[a]).

On the other hand, in Chapter 11, the debtor's estate is created at the time the petition is filed(11 USC § 541[a]). Where a Chapter 11 case has not been converted to Chapter 7, no "new estate" is created upon the confirmation of the plan. Thus, the rule is simply that "pre-petition causes of action are part of the bankruptcy estate and post-petition causes of action are not"(*Witko v. Menotte*, 374 F.3d 1040, 1043 [11th Cir. 2004]). The court rejects defendants' argument that the debtors were divested of standing to bring a malpractice action by virtue of the confirmation of the reorganization plan.

Additionally, the court notes that the actions of a limited partnership as a debtor in bankruptcy should be understood as taken on behalf of its equity holders(11 USC § 101(16)(B); *Bank of America Nat'l Trust v. 203 North LaSalle Street Partnership*, supra, 526 U.S. at 438 n. 2). There may indeed have been a divergence of interests between Riverwood and the other plaintiffs during Riverwood's Chapter 11. However, defendants were clearly representing not only the debtors, but also Breslin Realty and all of the individual plaintiffs, during the other bankruptcy proceedings.

It is the decision of the court that upon reargument, defendants' motion for summary judgment dismissing the complaint on the ground of lack of standing is denied.

Next for consideration is defendants' argument that the bankruptcy court's order awarding fees is collateral estoppel on the issue of malpractice. Collateral estoppel requires that there be an identity of issue which has necessarily been decided in the prior action and is decisive of the present action, and a full and fair opportunity to contest the decision now said to be controlling(*Buechel v. Bain*, 97 NY2d 295, 303-04 [2001]). Collateral estoppel is a "flexible" doctrine which must be applied on a "case-by-case" basis(Id at 304).

An attorney who has been discharged for cause has no right to compensation (*Campagnola v. Mulholland*, 76 NY2d 38, 44 [1990]). In a plenary suit to recover fees, the factfinder must necessarily determine whether the attorney was discharged for cause and whether there was any malpractice. If an attorney recovers a judgment in an action for legal fees, the doctrine of collateral estoppel may bar the client from claiming, in a subsequent

malpractice action, that the same services were negligently performed(*Afsharimehr v. Barer*, 303 AD2d 432 [2d Dep't 2003]). However, because an application for fees in a bankruptcy case raises different issues than a plenary suit by an attorney for his fees, the court determines that an award of fees should not be preclusive in this malpractice action.

The bankruptcy court may award an attorney reasonable compensation for services provided in a proceeding pursuant to Chapter 11(11 USC § 330[a]). In determining the amount of reasonable compensation, the court shall consider the nature, extent, and value of such services, the time spent, and whether the services were necessary to the administration of the case(11 USC § 330(a)(3). In *In re Equipment Services, Inc.*, 290 F.3d 739 [4th Cir. 2002]), the court held that the attorney for the debtor may not be awarded fees for legal services performed after the case has been converted to Chapter 7. The court noted that in Chapter 11, debtors and creditors often "act like a team" to enlarge the estate available to pay creditors and to preserve the debtor as a going concern(290 F.3d at 744-45). Thus, in determining the value and necessity of the debtor's attorney's services, the bankruptcy court will consider the benefit to creditors as well as the debtor during the course of the Chapter 11.

In the case upon which defendants primarily rely, *Grause v. Englander*, 321 F.3d 467 [4th Cir. 2002], the attorney for the debtor prepared the debtor's schedule of assets, a legal service which was undertaken for the benefit of both the debtor and creditors of the estate. Because the attorney inadvertently omitted substantial community property interests from the schedule of assets, the debtor was denied a discharge. However, the federal court dismissed the debtor's subsequent malpractice action against his attorney on the grounds of collateral estoppel. The court determined that the bankruptcy court had necessarily inquired as to the quality of the attorney's professional services within the context of the attorney's fee application(Id at 473). Nonetheless, *Grause* is distinguishable because, like *Equipment Services*, it did not involve legal services performed solely for the benefit of the debtor, but rather legal services which were undertaken for the benefit of both the debtor and creditors of the estate.

In approving defendants' fee application, Judge Cyganowski similarly decided that defendants' legal services were reasonably likely to benefit both the debtor and creditors of the

estate.[30] However, the present case illustrates that in Chapter 11 proceedings there are times when the attorney for the debtor must zealously represent his client to the exclusion of other parties. In particular, when negotiating the terms of a buy out deal with a supposed "white knight," counsel for the debtor must single mindedly protect the interests of his real clients, the equity holders.

It is the conclusion of the court that defendants have not carried their burden of establishing that the Bankruptcy Court necessarily decided that defendants adequately represented plaintiffs' interests when dealing with Leucadia.

Furthermore, defendants have not established that the bankruptcy court necessarily determined that after the deal "went sour," defendants adequately represented plaintiffs' interests in opposing Luk-Shop's liquidating plan. Thus, the court cannot give preclusive effect to the bankruptcy court order granting defendants' fee application.

Upon reargument, defendants' motion for summary judgment dismissing plaintiffs' malpractice complaint on the ground of collateral estoppel/res judicata is denied.

The court now turns to plaintiffs' motion for renewal and reargument of defendants' summary judgment motion. In order to sustain a claim for legal malpractice, a plaintiff must establish that the defendant attorney failed to exercise the ordinary reasonable skill and knowledge commonly possessed by a member of the legal profession, resulting in actual damages, and that the plaintiff would have succeeded on the merits of the underlying action "but for" the attorney's negligence(*Ambase Corp. v. Davis, Polk & Wardwell*, 8 NY3d 428, 434 [2007]). To make the requisite showing of "success on the merits," plaintiff must establish that there would have been a more favorable outcome but for the attorney's negligence(*Ellsworth v. Foley*, 24 AD3d 1239 [4th Dep't 2005]). Particularly in litigation, an attorney does not ordinarily promise to obtain a specific result(*Ferdinand v. Crecca & Blair*, 5 AD3d 538 [2d Dep't 2004]). However, an attorney who represents a debtor in a Chapter 11 proceeding undertakes to provide the debtor with a reasonable opportunity for reorganization.

Plaintiffs' malpractice complaint may be read as alleging that by misinterpreting the Leucadia agreement, defendants' misled plaintiffs as to the need for new financing and deprived

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[30]See decision of U.S. Bankruptcy Judge Melanie Cyganowski dated December 31, 2003, Ex. GG to defendants' cross-motion for leave to reargue, at 20.

plaintiffs of a reasonable opportunity to retain an equity interest in the various properties. On a motion for summary judgment, it is the proponent's burden to make a prima facie showing of entitlement to judgment as a matter of law, tendering sufficient evidence to demonstrate the absence of any material issues of fact(*JMD Holding Corp. v. Congress Financial Corp.*, 4 NY3d 373, 384 [2005]). Failure to make such a prima facie showing requires denial of the motion, regardless of the sufficiency of the opposing papers(Id).

The Leucadia agreement has been definitively interpreted by the federal courts as requiring plaintiffs to obtain financing by a date certain in order to proceed with the joint ventures. Thus, to make a showing of entitlement to judgment on the faulty advice claim, defendants must establish prima facie that plaintiffs were unable to obtain sufficient financing to retain an equity interest in any of the properties. On the issue of available financing, defendants offer Wilbur Breslin's examination before trial which was taken in the course of the Chapter 11 proceeding. At the deposition, Breslin testified that his credit application with GMAC had been abandoned.[31] Breslin further testified that GECC, another potential lender, refused to extend credit because Breslin had a reputation for being "litigious," as opposed to not being a good credit risk.[32]

The court holds that defendants have failed to make a prima facie showing that plaintiffs unequivocally did not have access to sufficient financing. Accordingly, upon reargument, defendants' motion for summary judgment dismissing the complaint is denied with respect to plaintiffs' claim based on faulty advice concerning the Leucadia agreement.

Since Luk-Shop's plan of reorganization called for the properties to be transferred to Luk-Shop and the loans were nonrecourse, Luk-Shop was not entitled to an unsecured deficiency claim. To carry their burden of proof as to entitlement to judgment as to plaintiffs' claim based on failure to raise the "nonrecourse defense," defendants must make a prima facie showing that 1) Luk-Shop's plan did not contain an allowed unsecured deficiency claim, or 2) defendants adequately advised the bankruptcy court that the debtors were objecting to Luk-Shop's unsecured deficiency claim, or 3) the classes of creditors were "gerrymandered" in some other fashion, that

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[31]Ex. U to defendants' cross-motion for reargument at 126.

[32]Ex. U to defendants' cross-motion for reargument at 121.

is without aggregating an impaired class of creditors with Luk-Shop's unsecured deficiency claim.

Luk-Shop's amended disclosure statement filed in the bankruptcy court states, "Luk-Shop's claim is secured to the extent of the value of the collateral supporting it."[33] While the disclosure statement could have been more explicit, it appears to mean that Luk-Shop had an unsecured deficiency claim to the extent that the debt exceeded the value of the properties(11 USC § 506[a]).

The court concludes that defendants have not carried their burden of showing prima facie that Luk-Shop did not have an allowed unsecured deficiency claim.

Defendant John Hall, a member of the Shaw Licitra firm, represented the debtors at the confirmation hearing before Judge Cyganowski. Luk-Shop and the debtors had agreed that the value of the properties was $63.5 million.[34] At the hearing, Hall stated: "[T]he court has found they have a claim for $92 million minus whatever they were paid...."[35] "There is a difference, though, Your Honor, between a claim and how that claim is to be treated in bankruptcy and what the claimant is entitled to get paid....their contention, your Honor, solely is that they are an undersecured creditor in a typical bankruptcy case." "[T]he Bankrupcty Code adequately allows claimants to request, agree to, and accept different treatment of their claim. And this is exactly what happened in this case, Your Honor, by virtue of the July 2nd agreement and the July 7th order of this court."[36] "[T]he July 2nd agreement...stated it [i.e. Leucadia] would pay unsecured creditors in full based on representations the debtor made of its best estimate at that time of non-insider unsecured creditors."[37]

From a review of the entire transcript, Hall appears to have been arguing that, by virtue of the Leucadia agreement, Luk-Shop had elected not to have their claim treated as an unsecured

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[33]Ex. DDD to defendants' original motion for summary judgment at 17.

[34]Ex. F to reply affirmation of Barry Jacobs in support of defendants' original motion at 23.

[35]Ex. F to Barry Jacobs reply affirmation in support of defendants' original motion at 25.

[36]Ex. F. to Jacobs' reply affirmation in support of defendants' original motion at 26.

[37]Ex. F. to Jacobs' reply affirmation in support of defendants' original motion at 28.

deficiency claim to the extent that the debt exceeded the value of the collateral. Because Hall stated that Lecadia had promised to "pay unsecured creditors in full," his statements may perhaps be interpreted as arguing that Luk-Shop was bound by the agreement not to gain the acceptance of an impaired class of unsecured creditors by aggregating the class with Luk-Shop's unsecured deficiency claim. His statements may also be interpreted as an attempt to reargue Judge Cyganowski's ruling that the Leucadia agreement required financing to be obtained before the joint ventures were formed.[38] In any event, the transcript does not indicate that Hall argued that Luk-Shop was not entitled to an unsecured deficiency claim because the properties were being transferred to Luk-Shop pursuant to the terms of the plan.

The court concludes that defendants have not carried their burden of showing prima facie that they adequately advised the Bankruptcy Court of the nonrecourse defense.

Judge Cyganowski determined that the plan could not be confirmed under § 1129(a) because every class of creditors had not either accepted the plan or not been impaired under it.[39] The bankruptcy court then proceeded to determine whether there was compliance with § 1129(b) in order to have a cram down. The court stated that "[T]he impaired, non-accepting creditors are the insider holders of the unsecured claims."[40] Since Judge Cyganowski concluded that the requirements for a cram down were met, an inference arises that Luk-Shop's plan was confirmed by aggregating the insider holders with Luk-Shop's unsecured deficiency claim. In affirming the order confirming the plan, Judge Hurley in the Eastern District stated that Judge Cyganowski concluded that plaintiffs "still owe" Luk-Shop $76 million although "the value of the properties to be sold was $63,500."[41] Thus, Judge Hurley's decision is consistent with the cram down having been effected in this manner.

The court concludes that defendants have not carried their burden of establishing prima facie that the plan was confirmed in a manner other than classifying the claims held by insiders

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[38]Ex. F. to Jacobs' reply affirmation in support of defendants' original motion at 31.

[39]Ex. F. to reply affirmation of Barry Jacobs in support of defendants' original motion for summary judgment at 102.

[40]Ex. F. to reply affirmation of Barry Jacobs in support of defendants' original motion at 103.

[41]See plaintiffs' Ex. 38 in opposition to defendants' original motion at 9.

with Luk-Shop's unsecured deficiency claim.

The court notes that summary judgment was awarded to CFSC in the New York foreclosure action. As the successor to CFSC, Luk-Shop had the option of resuming the foreclosure action. Thus, plaintiffs may have a difficult burden at trial to prove that they would not have lost their equity in the properties in any event. Nonetheless, it is not the court's role to resolve the issue of proximate cause on this summary judgment motion(*Sommer v. Federal Signal Corp.*, 79 NY2d 540, 544 [1992]).

Accordingly, upon reargument, defendants' motion for summary judgment dismissing the complaint is denied as plaintiffs' claim based on failure to raise a nonrecourse defense to the confirmation of Luk-Shop's reorganization plan.

The clerk of the court shall forward a copy of this decision to the clerk of the Appellate Division, Second Department.

This shall constitute the decision and order of the court.

Dated: April 21, 2008

J.S.C.

ENTERED

APR 24 2008
NASSAU COUNTY
COUNTY CLERKS OFFICE