UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re

JOHN H. CLAREY and
JENNIFER L. CLAREY   Case No. 05-18045 K
Debtor

OPINION AND ORDER

One of the joint Debtors in this case is an attorney. Beginning six years before the filing of the Petition in this case, he had a "special counsel" or "of counsel" relationship with a law firm with which he was not otherwise affiliated. The relationship addressed five specific class actions involving alleged underpayments of royalties to landowners for natural gas extracted from their lands by energy companies. A 1999 written agreement was followed, in 2001, with an agreement, the stated purpose of which was "to amend, supplement and clarify the . . . 1999 letter agreement."

The revision was clearly necessary because as of 1999, the law firm had not decided whether it would pursue the litigation. That agreement, in essence, promised the Debtor $50,000 for the "leg work" by which the firm would make a determination regarding a decision to sue or not to sue. The 2001 letter agreement explicitly stated that the firm had decided to go ahead and would be filing five specific class actions.

One form of additional compensation to the Debtor was set forth in both the 1999 and the 2001 letter agreements, but in drastically different language. The 1999 letter agreement stated that in addition to $50,000, the Debtor "will . . . also receive twelve and one-half (12 ½%)

percent of all legal fees received by [the firm] relating to the proposed litigation, calculated after deducting all out of pocket expenses, payments to [the debtor] and reimbursing [the firm] for its work at its normal hourly rates."

The 2001 letter agreement, however, stated that the Debtor shall be paid twelve and one-half (12 ½%) percent "of all legal fees received by [the firm] for each action; calculated after deducting all un-reimbursed out of pocket expenses for that action, the aggregate amount of all monthly payments to [the Debtor] . . . (less any part of such monthly payments previously reimbursed from the proceeds of another action) . . . and reimbursing [the firm] for its billable hours worked on such action at its normal hourly rates without charge for the hours by [the debtor]."

The "monthly payments" referred to in the 2001 letter were provided for in that agreement. They were monthly "advances" (though that term was not used in the agreement) of what the Debtor would earn in the event that the firm, as class action plaintiff's counsel, were eventually to receive awards.

By the time of the filing of the bankruptcy petition, none of the actions had yet been resolved, and the aggregate of monthly advances to the Debtor exceeded $450,000. Since the filing of the petition, four of the five proceedings have been resolved, with fee awards to the firm.

The Debtor believes the fees sufficed to repay the advances in full, and that his bankruptcy Trustee is entitled to approximately $77,000 from those awards. The Debtor would like to see the Trustee recover that amount because the priority non-dischargeable taxes filed in this case could thereby be paid down.

The firm interprets the letter agreement a different way - - one which satisfies none of the advances, leaves only a small entitlement for the Debtor in just one of the cases, and seeks lift of stay to set that small amount off against the $456,000 the Debtor received in advances.

How can the two sides differ so drastically in their interpretation of one sentence of the 2001 letter agreement? The differences lies in the question of who gets first “dibs” against those fee awards: the twelve and one-half (12 ½%) percent that the Debtor is to receive, or the firm, for its billable hours in the litigation. If the Debtor gets first “dibs” on over $2.5 million of fee awards, then his obligations for advances has been satisfied, and there also is a $77,000 net due his bankruptcy estate. If the firm gets first “dibs,” then all of the cases turned out to be “losers” for the firm except for one case, and so none of the obligations for advances were satisfied at all, and the small entitlement of the Debtor as to the one case that was not a “loser” should be the subject of set-off.

Examining the paragraph in question, the grammatical question presented is this, “What is modified by everything in the sentence that follows the first semi-colon? Does it all modify the phrase ‘shall be paid twelve and one-half (12 ½%) percent,’ or does it modify the phrase ‘all legal fees received by [the firm]?’”

APPLICABLE LAW

The principles governing interpretation of such a contract are these:

> While the grammatical construction of a contract is often a reliable signpost in the search for the intention of the parties, at times the language of a contract, read as a whole and in light of the circumstances surrounding its execution, may disclose an intention which would be thwarted by a strict grammatical construction; in such case the court is not bound to follow the signpost of grammatical construction, particularly when it appears to point in the wrong direction, as intention may be formulated in terms that are not grammatical. Accordingly, while a court, in construing its contract, will give due force to the grammatical arrangement of the clauses, it will disregard the grammatical construction if it is at variance with the intent of the parties as indicated by the contract as a whole. The court will not permit mistakes in grammar to vitiate the manifest intent of the parties as gathered from the language of the contract. [17a Am. Jur.2d, Contracts § 365. Authorities Omitted.]

Additionally,

> When the language employed in a contract is unambiguous, a court shall give effect to its ordinary, natural, or plain meaning, where nothing appears to show that it was used in a different sentence or has a technical meaning, and where no unreasonable or absurd consequences will result from doing so. Indeed, in determining whether a contract is ambiguous in the fist instance, the words of the contract must be given their natural and ordinary meaning. Because the determination of what the contracting parties intended is an objective inquiry, the first step is to decide what a reasonable person in the position of the parties would have thought the terms of the contract meant. The words used in the contract are afforded the plain meaning a reasonable person would give to them. A court will interpret a contract according to the common meaning of its words and phrases and judge the intent of the parties' objective criteria rather than the unmanifested states of mind of the parties. [17a Am. Jur.2d, Contracts § 356. Authorities Omitted.]

With these principles in mind, the Court rejects both of the interpretations offered by the parties.

The firm's interpretation places the firm at the head of the line, ahead even of the

Debtor’s claim for his own hours billed on the cases. In other words, it is a subordination agreement by which the Debtor agreed that he wouldn’t see a penny from any award - - not even for his own work on the cases - - unless and until all of the firm’s billable hours, from all the cases, were paid in full.

The firm’s argument produces an absurd result, supported by no evidence whatsoever. The argument is that the Debtor agreed to “volunteer” his own services to all five cases, and also to “borrow” $8600/mo. from the firm during the pendency of the cases, gambling that the firm would make money over the aggregate of the five cases, and thereby paying off his “debt” to the firm, and maybe actually getting some more money at the end. That is not an “ordinary, natural or plain meaning” of the words.

Rather, the agreement was a “contract counsel” agreement, by its own terms, not some sort of highly speculative, highly-leveraged “investment” contract by which the Debtor would incur much debt and devote much time, on a hope that he would at least break even at the end: Nothing in the 1999 or 2001 agreements bespeaks such a gamble on the Debtor’s part.

Rather, the 1999 agreement reflects that the firm was willing to pay $50,000 absolutely, for having brought the clients to the firm and for agreeing to do substantial work toward building the cases. The 2001 agreement bespeaks the firm’s decision that that work had value - - the cases were worthy of suit - - and that the Debtor and the firm would share the potential risks and benefits of “each action.”

Both sides, of course, shared the risk of losing one or more of the cases. Both sides agreed that unreimbursed actual expenses of the firm would come first - - those are real dollars - - in each case. In exchange for the advances, the Debtor agreed to waive compensation for the actual time he worked on the cases (time for which the firm billed). <u>But</u> they agreed that as to each case in which there was a fee award, there would be a sequence of "priorities," so to speak. First, the firm's unreimbursed expenses ("real dollars"), then repayment of advances (those were paid out as "real dollars" too), <u>then</u> the non-cash expenditures of the firm - - its own attorney's billable time (not real dollars). And at the end, twelve and one-half (12 ½%) percent of what is left, to the Debtor.

The Debtor's argument too is rejected. It negates the unequivocal opening clause of the provision. By his analysis, he would have received over $450,000 in satisfaction of his debt for advances, plus the $77,000 he further claims. Rounding off to $525,000, he would have received nearly 20% of "all the fees," not 12.5%. (Even leaving off the $77,000 satisfaction of the debt, he would have received 16%.) Moreover, his percentage would rise monthly as he continued to receive advances that would be repaid "off the top." That is not a common sense interpretation.

The Court adopts the most natural interpretation under the actual facts. Divide the fee award in each case by 8 (12.5%). That is the amount of the debt (for advances) to credit in favor of the Debtor. (Only when the advances are paid in full would the Debtor be entitled to "further" compensation.) Applying this to the facts, the advances were never fully repaid. This is obvious from the fact that $450,000 exceeds 12.5% of all of the gross fees. (The "reimbursement" deduction would kick-in after the advances were paid, and before further payments to the Debtor, but again be divided by 8, because it is clear that the firm was to be reimbursed for its hours spent on the Debtor's 12.5% share only.)

The natural construction is illustrated as follows:

Presume only three cases, settled within a month of each other, after $400,000 in advances. Presume that the firm's billable hours in case #1 totaled $1.5 million, and a fee award of $1 million (with all expenses already reimbursed).

Case #1	$1,000,000	award
	12.5% is	$125,000

$125,000 is credited to advances, leaving debt of $275,000

The billable hours are irrelevant as to case #1.

Now case #2. Presume $9 million award and the firm's billable hours were $6 million.

Case # 2	$9,000,000	award
	12.5% is	$1,125,000

The balance of debt ($275,000) is satisfied, leaving $850,000

Then reimbursement of 12.5% of the firm's hours, representing the <u>firm's</u> work on the <u>Debtor's</u> 12.5% share. 12.5% of $6 million is $750,000.

$750,000 from

$850,000 = $100,000

At this point the debt is fully paid, and there is additional compensation of $100,000 for the Debtor.

Finally case # 3. Almost all the work was done by the Debtor. The firm's billable hours were only $200,000

$2,000,000 award

12.5% is $250,000

12.5% of the $200,000 of the firm's billable hours is $25,000

$250,000

- 25,000

$225,000

Debtor would receive $225,000 from the $2,000,000 award. A net of 11.5% from the $2,000,000 received by the firm on that case.

With the hypothetical cases completed, the Debtor has received $400,000 in paid-up advances, plus $325,000 on cases # 2 and #3. $725,000 from total awards of $12,000,000 to the firm.

It turns out to be only about 6%, but that is because (1) the advances got so high that it took two of the cases to wipe them out, (2) the firm's work on the Debtor's share of cases 1 and 2 was very substantial, and (3) case # 1 was a loss.

CONCLUSION

This proceeding is a "lift-stay" motion by the firm, not a "claim objection" by the

Debtor. Therefore, the Court ought not to reduce the firm's claim at this time. Further, a claim objection will never be necessary if the estate's assets do not reach beyond § 507 priority claims. If objection does become necessary, however, the Court will rule as stated above; and it will be at that time that the firm will have an adverse order to appeal.

For now, the firm's Motion to Lift Stay is granted, to exercise the contractual right of setoff that is clearly manifested in the contract provision at issue.

SO ORDERED.

Dated: Buffalo, New York
December 7, 2007

s/Michael J. Kaplan

U.S.B.J.