

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re:

CASE NO. 01-20111

RICHARD T. MUNDRICK,

Debtor.

DECISION & ORDER

BACKGROUND

On January 16, 2001, Richard T. Mundrick (the "Debtor") filed a petition initiating a Chapter 7 case. On the Schedules and Statements required to be filed by Section 521 and Rule 7001, the Debtor: (1) indicated that his assets included \$7,500.00 on deposit in the trust account of his former matrimonial attorneys, Lacy, Katzen, Ryen & Mittleman, LLP ("Lacy Katzen"); and (2) claimed an available \$2,500.00 cash exemption, which included \$1,676.00 of the amounts on deposit with Lacy Katzen.

On April 12, 2001, Lacy Katzen filed a Motion (the "Proceeds Motion") which requested that the Court determine the rights of various parties in the approximately \$7,500.00 on deposit in its trust account.

The Proceeds Motion alleged that: (1) the amounts on deposit in the Lacy Katzen trust account (the "Sale Proceeds") were the

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remaining proceeds of an October 1999 sale of 267 Judy Ann Drive, Rochester, New York, the former residence of the Debtor and his spouse, Deborah P. Mundrick ("Mundrick"); (2) Lacy Katzen had agreed to hold the Sale Proceeds "pending resolution of the matrimonial action," then pending between the Debtor and Mundrick; (3) in Mundrick's Chapter 7 case, filed on December 3, 1999, her trustee (the "Trustee")¹ had demanded and received one-half (1/2) of the Sale Proceeds pursuant to an April 11, 2000 Order of the Bankruptcy Court (the "Turnover Order"); (4) by Findings of Fact and Conclusions of Law entered on December 6, 2000 and a judgment entered on December 19, 2000 (the "Matrimonial Judgment"), the matrimonial action between the Debtor and Mundrick was concluded when the New York State Supreme Court Justice presiding in the action: (a) denied each of the parties claims and counterclaims for divorce; and (b) awarded Mundrick maintenance and child support, including retroactive maintenance and child support; (5) by a February 2, 2001 Order to Show Cause, the New York State Supreme Court, in an action (the "Enforcement Action") to collect various amounts due Mundrick, including arrearages set forth in the Matrimonial

¹ The same Chapter 7 Trustee was appointed by the Office of the U.S. Trustee in the cases of Mundrick and the Debtor.

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Judgment, enjoined Lacy Katzen from further disbursing the Sale Proceeds; (6) on April 9, 2001, the Trustee demanded the balance of the Sale Proceeds; (7) Lacy Katzen was owed \$11,881.85 from the Debtor in connection with the services it had rendered to him in the matrimonial action, and it claimed an attorney's retaining lien (the "Retaining Lien") on the Sale Proceeds; and (8) the Court should enter an Order determining the rights and interests of the various parties in the Sale Proceeds.

The Trustee, Maureen A. Pineau, Esq. ("Pineau"), the matrimonial attorney for Mundrick, and John A. Belluscio, Esq., the bankruptcy attorney for the Debtor (the "Opposing Parties") interposed opposition to the claim of Lacy Katzen to a Retaining Lien on the Sale Proceeds that had priority in the Proceeds over the interests of the Trustee and the Debtor, to the extent that the Debtor claimed a cash exemption in the Proceeds.

The Opposing Parties asserted that: (1) the Sale Proceeds were not subject to a Retaining Lien because they were held by Lacy Katzen in escrow, *See Schelter v. Schelter*, 614 N.Y.S.2d 853 (App. Div. 4th Dept. 1994); *Marsano v. State Bank of Albany*, 279 N.Y.S.2d (App. Div. 3rd Dept. 1967); *Entertainment & Amusements of Ohio v. Barnes*, 267 N.Y.S.2d 359 (Sup. Ct. Onondaga County 1966) (collectively, the "Escrow Cases"); and

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(2) Lacy Katzen had waived any Retaining Lien in the Sale Proceeds by the actions of its associate, Denine K. Carr, Esq. ("Carr"), who filed a February 12, 2001 affirmation (the "Carr Affirmation") in the Enforcement Action, which stated that she was prepared to pay over approximately \$6,700.00 of the amounts being held in the escrow in satisfaction of the Debtor's child support arrearages.

In response to the opposition, Lacy Katzen asserted that:

(1) Carr's words and actions did not constitute a knowing waiver of the firm's Retaining Lien on the Sale Proceeds, because Carr never realized that there was such a thing as a common law attorney's Retaining Lien until she discussed this matter further with a creditor's rights expert in the firm in connection with the Enforcement Action and a possible bankruptcy to be filed by the Debtor; and (2) at the time of the filing of the Debtor's petition, the Sale Proceeds were no longer being held in escrow by Lacy Katzen, because: (a) when the Trustee demanded and received one-half (1/2) of the Sale Proceeds, the escrow was broken; and (b) as previously asserted in the Carr Affirmation, "because the matrimonial action ha[d] been 'resolved' by a dismissal of each party's complaint for divorce,

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the law office of Lacy, Katzen, Ryen & Mittleman, LLP ha[d] the right to release the remaining funds."

DISCUSSION

I. An Attorney's Retaining Lien

A common-law retaining lien, also known as a general possessory lien, entitles the attorney 'to retain all papers, securities or money belonging to the client' that come into the attorney's possession in the course of the representation, as security for payment of attorneys' fees.²

See *Hoke v. Ortiz*, 83 N.Y.2d 323, 331 (citing *People v. Keeffe*, 50 N.Y.2d 149, 155); see also 1 Warren's *Weed*, New York Real Property, Attorneys at Law, § 6.02 [4th ed].

A. Exception for Amounts Held in Escrow

Although attorneys may have a retaining lien on monies, the funds over which such a lien is asserted must come into the attorney's possession in his professional capacity as attorney at law and not while acting as an escrow agent or trustee. See *Marsano v. State Bank of Albany*, 279 N.Y.S.2d (App. Div. 3rd Dept. 1967); *Entertainment & Amusements of Ohio v. Barnes*, 267 N.Y.S.2d 359 (Sup. Ct. Onondaga County 1966). The Opposing

² An attorney's retaining lien is different than a charging lien under the New York Judiciary Law Section 475, which creates an equitable assignment to the attorney of the fund procured by his efforts to the extent of the amount of his lien, See *Marsano* at 413 [citing *Matter of City of New York* (U.S.A. -- Coblentz), 5 N.Y.2d 300, 307.]

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Parties have asserted that the Sale Proceeds were initially delivered and held by Lacy Katzen in escrow, and that Lacy Katzen continued to hold the Proceeds in escrow at the time of the filing of the Debtor's petition.

I find that at the time of the filing of the Debtor's petition, as between the Debtor and Lacy Katzen, the Sale Proceeds continued to be held in escrow by Lacy Katzen, so that the exception to a retaining lien set forth in the Escrow Cases applies, for the following reasons:

1. The Sale Proceeds were delivered to Lacy Katzen and accepted by it in escrow, as confirmed by a November 10, 1999 letter from Lawrence J. Schwind, Esq. ("Schwind") on behalf of Lacy Katzen to Pineau (See Exhibit A to Exhibit D of the Proceeds Motion).³ Thus, Lacy Katzen did not receive possession of the Proceeds in its professional capacity as attorneys at law with no strings attached. Lacy Katzen was an escrowee and did not fall under the contemplated definition of "possessor" as used in retaining lien cases.

³ A November 3, 1999 letter from Schwind to the attorney who represented the Mundricks on the sale of Judy Ann Drive proposed that he hold the Sale Proceeds in escrow, stating that it had been mutually agreed that the Proceeds would be held in escrow pending resolution of the matrimonial action pending between the parties. However, Schwind's November 10, 1999 letter to Pineau only referred to the "escrow of the net proceeds."

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2. The Turnover Order directed Lacy Katzen to pay one-half (1/2) of the "escrowed funds" to the Trustee, and Lacy Katzen did not object to the characterization of the Sale Proceeds as escrowed funds.

3. Pineau advised the Court in a letter dated May 31, 2001, that she believed that the terms of the escrow were that Lacy Katzen "would hold the money in escrow pending an agreement by the parties as to its ultimate distribution by agreement or by way of equitable distribution by the presiding justice of the matrimonial action." This raises a question of fact as to even the basic terms of the escrow arrangement, and this ambiguity cannot be resolved against the Debtor and in favor of Lacy Katzen. It is Lacy Katzen's burden to clearly demonstrate that the terms of the escrow arrangement had been fully complied with at some point, and it has failed to meet that burden.

In this regard, prior to the filing of his petition, the Debtor had not: (1) advised Lacy Katzen that he no longer considered the firm to be holding the Sale Proceeds in escrow subject to his directions; (2) directed Lacy Katzen to apply the Sale Proceeds to his outstanding legal bill; or (3) otherwise taken a position in writing or otherwise, as between him and Lacy Katzen, that was inconsistent with the firm being required

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to continue to hold the Sale Proceeds in escrow subject to his further instructions. In addition, the escrow arrangement was entirely independent of any retainer agreement for services performed that was entered into between the parties, and there was no reference made in Schwind's letter to such a retainer agreement or to any compensation or reimbursement for expenses associated with the escrow.

4. Even if the terms of the escrow arrangement were that the Sale Proceeds were being held in escrow pending the resolution of the matrimonial action, it is not clear that the action was "resolved" by the time of the filing of the Debtor's petition.

Lacy Katzen has argued that the matrimonial action between the Debtor and Mundrick was "resolved" when the Matrimonial Judgment was entered, because it denied both party's request for a divorce, so that the Sale Proceeds which were being held "in escrow pending resolution of the matrimonial action," were no longer being held in escrow, the terms of the escrow arrangement having been satisfied.

I find that Lacy Katzen's interpretation of "resolved" is too narrow. In my view, the matrimonial action may not have been "resolved" at the time of the filing of the Debtor's

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petition because there were still unpaid maintenance and child support arrearages that had been included in the Matrimonial Judgment.

I further find that the resolution of this ambiguity as to when the matrimonial action was "resolved" for the purpose of satisfying the escrow arrangement between the Debtor and Lacy Katzen, could not, on all of the facts and circumstances presented, be determined unilaterally by Lacy Katzen. It could only be determined by the client, the Debtor, who had placed the Sale Proceeds in escrow in good faith with the firm.

The same conclusion is drawn when evaluating Pineau's alleged terms of the escrow arrangement. If her terms are accepted as correct, there was no equitable distribution in the matrimonial action. Therefore, the only way the funds could be released from the escrow arrangement and distributed would be in accordance with an agreement of the parties. However, by the time the Debtor filed for bankruptcy, Mundrick's one-half interest had been turned over to the Trustee. What remained was the Debtor's one-half interest and its distribution could only be directed by him.

Once again, there is no evidence that the Debtor ever advised Lacy Katzen that he believed the matrimonial action had

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been "resolved" and the terms of the escrow arrangement had been satisfied so that the Sale Proceeds were no longer to be held by Lacy Katzen in escrow.⁴

II. Mundrick's Interest in the Sale Proceeds

Any interest, including an ownership interest, that Mundrick had in the Sale Proceeds, an interest which was Section 541 property of her bankruptcy estate, was fully realized when the Trustee demanded that one-half (1/2) of the Sale Proceeds be paid over to him, and such Proceeds were delivered to him pursuant to the Turnover Order.⁵

III. The Debtor's Claim of an Exemption in the Sale Proceeds

The Debtor claimed a \$1,676.00 cash exemption in the Sale Proceeds, which was not objected to by the Trustee. Therefore, in accordance with the holding of the United States Supreme Court in *Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992), the Debtor's claim of an exemption in the Sale Proceeds is allowed. However, since: (1) the Debtor's obligations for child support and perhaps maintenance are nondischargeable under Section

⁴ Since the Court finds that Lacy Katzen did not have a valid Retaining Lien prior in right to the interests of the Trustee at the time of the filing of the petition, it is not necessary for the Court to discuss the argument of the Opposing Parties that Lacy Katzen had waived its Retaining Lien.

⁵ For administrative convenience, and to resolve matters without litigation, Trustees frequently take the position that joint property is owned one-half by each joint tenant.

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523(a)(5); (2) child support under New York State Law can be collected from exempt property; and (3) the Sale Proceeds were restrained by the New York Supreme Court's Order to Show Cause in the Enforcement Action, Lacy Katzen shall continue to hold the \$1,676.00 claimed by the Debtor as exempt, subject to further order of the New York Supreme Court.

CONCLUSION

Within ten (10) days of the filing of this Decision & Order, Lacy Katzen shall pay over the Sale Proceeds to Douglas J. Lustig, Esq., the Chapter 7 Trustee, together with any accumulated interest, less \$1,676.00 which it shall continue to hold subject to further order of the New York Supreme Court.

IT IS SO ORDERED.

HON. JOHN C. NINFO, II
CHIEF U.S. BANKRUPTCY JUDGE

Dated: August 23, 2001