NEW YORK COURT OF APPEALS ROUNDUP

SUGARY DRINKS, HYDROFRACKING, 'UNFINISHED BUSINESS'

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In this month's column we discuss a case in which the Court of Appeals struck down New York City's limits on the sale of soda and other sugary drinks in large containers. We also address decisions in which the court upheld the use of local zoning laws to effectively ban "hydrofracking" and in which the court ruled that a dissolved law firm is not entitled to post-dissolution profits earned on work performed on a non-contingency fee basis.

Sugary Drink Ban

In *Matter of New York Statewide Coalition of Hispanic Chambers of Commerce v. The New York City Department of Health and Mental Hygiene*, the court struck down a key element of the plan of former New York City Mayor Michael Bloomberg's administration to address the problem of obesity. In a decision that attracted a significant amount of media attention, the court held that the New York City Board of Health's "Sugary Drinks Portion Cap Rule" exceeded the scope of the board's regulatory authority and infringed upon the legislative jurisdiction of the New York City Council.

As part of its efforts to combat obesity in New York City, and after a public hearing that attracted a large amount of comment, the Board of Health enacted a limitation on the sale of sugary drinks in large containers in September 2012. Specifically, the Portion Cap Rule provides that a "food service establishment may not sell, offer, or provide a sugary drink in a cup or container that is able to contain more than 16 fluid ounces" and "may not sell, offer or provide to any customer a self-service cup or container that is able to contain more than 16 fluid ounces." N.Y. Health Code (24 RCNY) §81.53(b) and (c). The Portion Cap Rule does not apply to establishments such as supermarkets and

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convenience stores that are subject to regulation by the New York State Department of Agriculture and Markets.

Petitioners in this case—six non-profit and labor organizations—commenced an Article 78 proceeding and declaratory judgment action seeking to invalidate the Portion Cap Rule. In March 2013, the Supreme Court, New York County, granted the petition and declared the Portion Cap Rule invalid. The Appellate Division, First Department. unanimously affirmed the Supreme Court's order. The Court of Appeals granted leave to appeal and, in a 4-2 decision written by Judge Eugene F. Pigott, the court affirmed the decision of the Appellate Division. (Judge Jenny Rivera took no part in the decision.)

The court began by noting that the City Council is the sole legislative branch of New York City's government and the Board of Health does not enjoy any inherent legislative authority. It is permitted to regulate matters concerning health and to promulgate rules in that regard, but its role is limited to regulation rather than legislation. Accordingly, the court construed the key question before it as whether the Board of Health properly exercised its regulatory authority in adopting the Portion Cap Rule.

The court answered this question by analyzing the issue in light of its earlier decision in *Boreali v. Axelrod*, 71 NY2d 1 (1987), in which it held that the New York State Public Health Council exceeded its regulatory authority in adopting regulations that banned smoking in certain public areas. *Boreali* sets forth a number of factors to be applied in determining whether an executive agency has crossed the line from administrative rule-making to legislative policy-making. The court described these factors as "coalescing circumstances" rather than discrete conditions to be rigidly applied in every case.

Here, the court considered the fact that the Portion Cap Rule represented a number of policy choices and determined that choosing between public policy ends like this, particularly when personal autonomy is implicated, went beyond simple rule-making and was a legislative prerogative. The court also considered the fact that respondents were unable to identify any legislation from the City Council or state Legislature that the Portion Cap Rule was designed to carry out or supplement, and the court found that inaction of the City Council and Legislature in this regard was further evidence that the Portion Cap Rule constituted an impermissible making of new policy rather than an implementation of existing legislative policy. Accordingly, the court found that the Board of Health exceeded the scope of its regulatory authority in enacting the Portion Cap Rule, and it affirmed the Appellate Division's decision.

Judge Sheila Abdus-Salaam issued a short concurrence in which she reiterated the fact that the majority's decision represents a "flexible case-specific analysis" rather than a "rigid decisional framework to be applied mechanically to other actions" of administrative agencies. Judge Susan P. Read issued a lengthy dissent joined by Chief

Judge Jonathan Lippman in which she provided an historical overview of health regulations in New York City and argued that the Board of Health had broader powers than those described in the lower courts' and majority decisions. She concluded that the Board of Health has broad authority to regulate public health and that the Portion Cap Rule fell squarely within that authority. Accordingly, the dissent concluded that, while the board's action was unpopular, it was not illegal.

If the new administration of Mayor Bill de Blasio wants to continue the prior administration's efforts to combat the epidemic of obesity in New York City, they will have to come up with other methods of doing so.

'Unfinished Business'

The court's decision in *In re Thelen LLP* and *In re Coudert Brothers LLP* has attracted less attention in the public media, but it has nevertheless attracted a great deal of attention among the legal community in New York and nationwide. These cases, jointly decided by the court in a unanimous opinion in response to questions certified by the U.S. Court of Appeals for the Second Circuit, arose out of the insolvency and subsequent dissolution of two New York law firms.

Both the Chapter 7 trustee for Thelen LLP and the administrator for Coudert Brothers LLP brought actions in the U.S. District Court for the Southern District of New York against firms that former Thelen and Coudert partners had joined. The Thelen trustee and Coudert administrator sought to recover profits earned by the partners at their new firms in connection with matters that they had previously worked on at their old firms on an hourly basis pursuant to the "unfinished business" doctrine. That doctrine generally provides that profits derived from work begun by former partners of a dissolved law firm are a partnership asset that must be completed for the benefit of the dissolved partnership and distributed to former partners in proportion to their partnership interests.

The Thelen and Coudert courts reached opposite conclusions with the Thelen court ruling that the unfinished business doctrine does not apply to a dissolving law firm's pending hourly fee matters and the Coudert court finding that the doctrine did apply to matters subject to an hourly fee arrangement. The Second Circuit certified two questions asking: 1) whether, under New York law, a client mater billed on an hourly basis is the property of a law firm such that upon that firm's dissolution the law firm is entitled to the profit earned on such matters as "unfinished business" and 2) if so, how does New York define a client matter for purposes of the doctrine and what proportion of the profit derived from an ongoing hourly matter may the new firm retain?

The court, in a decision written by Judge Read, answered the first question by determining that the unfinished business doctrine does not apply to hourly fee matters, thereby rendering the second question moot. The court explained that the doctrine arises out of the legal principle that departing partners owe a fiduciary duty to the dissolved firm and their former partners to account for profits obtained from the use of partnership property in winding up the partnership's business. Clients in New York, however, enjoy an unqualified right to terminate the attorney-client relationship at any time. Accordingly, the expectation of continued or future business is too contingent and speculative to constitute a property interest and there is no duty to account for profits obtained in connection with such business.

Moreover, while New York courts have applied the unfinished business doctrine in the context of contingency fee cases, the court distinguished those cases on the grounds that the courts found that the former firm was only entitled to the "value" of its services. In other words, the dissolved firm was entitled to the value of the case at dissolution but the client matter itself is not property of the firm and the firm is not entitled to any fee not earned by the firm's own pre-dissolution work.

Finally, the court considered the public policy implications of a contrary ruling including the fact that it would encourage partners of a troubled firm to leave prematurely rather than remain and try to support the firm and that it would make it even more difficult for departing partners to obtain positions with new firms.

The court's clear articulation of the rule in New York should effectively resolve a number of other New York matters pending against firms that hired the former partners of dissolved firms and may provide persuasive authority in other jurisdictions dealing with similar cases.

Local Hydrofracking Bans

In companion cases *Matter of Wallach v. Town of Dryden* and *Cooperstown Holstein Corporation v. Town of Middlefield*, the court found that local government zoning ordinances prohibiting "hydrofracking" are not preempted by state law.

The cases concern the mining practice of accessing natural gas from shale deposits using hydraulic fracturing (commonly called "hydrofracking"). To access the natural gas, a well is drilled vertically to a horizontal tunnel above the target depth. Pressurized fluids are then injected to fracture the shale formations and cause the release of natural gas. This method has been used to access natural gas in the Marcellus Shale formation, which covers areas across parts of New York, Pennsylvania, Ohio and West Virginia.

Wallach arose following the acquisition by predecessors of petitioner Norse Energy Corp. USA of oil and gas leases from landowners in Dryden. In response, in August 2011, the Town Board amended its zoning ordinance to provide that all oil and gas exploration, extraction and storage activities were prohibited in Dryden. The amendment also purported to invalidate oil and gas permits issued by state and federal agencies.

Norse commenced an Article 78 proceeding and declaratory judgment action challenging the validity of the zoning amendment on the basis of preemption by Section 23-0303(2) of the Environmental Conservation Law (ECL). The Supreme Court granted Dryden's motion for summary judgment with the exception that it struck down the provision of the amendment invalidating state and federal permits. The Appellate Division, Third Department, affirmed, and the court granted Norse leave to appeal.

Similarly, in *Cooperstown Holstein*, plaintiff Cooperstown Holstein Corporation (CHC) executed two leases with a landowner for exploration of natural gas resources. In response, the Board of the Town of Middlefield amended its master plan with a zoning provision classifying oil, gas and solution mining and drilling as prohibited uses. CHC brought an action to set aside the zoning law contending it was preempted by ECL §23-0303(2). The Supreme Court denied CHC's motion and granted Middlefield's cross-motion to dismiss the complaint. The Third Department affirmed, and the court granted CHC leave to appeal.

The majority opinion by Judge Victoria A. Graffeo, joined in by Chief Judge Lippman, and Judges Read, Rivera, and Abdus-Salaam, began with a review of the constitutional and legislative authority establishing the "fundamental precept that regulation of land use is '[a]mong the most significant powers and duties granted…to a town government.'" (quoting Town Law §272-a(1)(b)). Precedent dictates that the court will only invalidate a zoning law as preempted where there is a "clear expression of legislative intent to preempt local control over land use." *Matter of Gernatt Asphalt Prods. v. Town of Sardinia*, 87 NY2d 668, 683 (1996).

Norse and CHS argued that there was a clear expression of legislative intent here, in the form of the "suppression clause" of the Oil Gas and Solution Mining Law (OGSML), which says in relevant part that "[t]he provisions of this article [i.e., OGSML] shall supersede all local laws or ordinances relating to the regulation of the oil, gas and solution mining industries." ECL 23-0303(2). The court analyzed this contention under the three-factor framework established in *Frew Run Gravel Prods. v. Town of Carroll*, 71 NY2d 126 (1987).

The first and most important consideration is the plain language of the suppression clause at issue. The court noted that in *Frew Run* it found that a similar provision

distinguished between laws regulating the actual operation and process of mining, which were preempted, as opposed to laws regulating land use generally, which was not. Relying on *Frew Run*, the court found that ECL 23-0303(2) "is most naturally read as preempting only local laws that purport to regulate the actual operation of oil and gas activities, not zoning ordinances that restrict or prohibit certain land uses within town boundaries," like those at issue in the case at hand.

The court found this distinction was supported by the second relevant factor, the statutory scheme as a whole. Reviewing the OGSML, the court found it was concerned with regulating the safety, technical, and operational aspects of oil and gas activities. Accordingly, the suppression clause was aimed at preempting local laws that would interfere with this regulatory oversight. The court then turned to the third factor, the legislative history, and found that it indicated a legislative intent to prevent wasteful oil practices and regulate the technical operations of the industry rather that an intent to take away local zoning powers.

Lastly, the court considered Norse and CHS's fallback position that even if the suppression clause does not preempt all local zoning laws, it does preempt those laws that completely prohibit hydrofracking. The court found this position foreclosed by *Gernatt*, where the court held that nothing in *Frew Run* obligated a town that "contains extractable minerals…to permit them to be mined somewhere within the municipality."

Judge Pigott dissented, in an opinion joined by Judge Robert Smith. The dissent concluded that blanket bans on an entire industry, such as the ordinances at issue, do more than regulate land use and, instead, actually regulate the industries. According to the dissent, such prohibitions are therefore preempted.

Notably, the court made clear that the case was confined to the issue of preemption and not about economic, environmental or other policy questions concerning hydrofracking. Those issues must be resolved by the other branches of government.