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Attorneys—Fees

Profits From Finishing Bankrupt Firms' Cases Belong to Law Firms That Completed Them

Profits from finishing up a dissolved law firm's pending hourly fee and contingent fee matters belong to the lawyers and firms that have taken over the clients' representations and are not the ''property'' of the defunct firm that can be claimed by its creditors, the New York Court of Appeals held July 1 (*Geron v. Seyfarth Shaw LLP (In re Thelen LLP)*, 2014 BL 182115, N.Y., No. 136, 7/1/14).

In light of a client's unfettered right to hire and fire counsel, ''a client's legal matter belongs to the client, not the lawyer,'' the court said. ''A law firm does not own a client or an engagement, and is only entitled to be paid for services actually rendered,'' Judge Susan Phillips Read wrote for the court.

The opinion severs the state's adherence to the ''unfinished business'' doctrine, which traditionally has dictated that earnings from cases originating in a dissolving law partnership must go back to the firm, to be distributed according to the firm's partnership agreement—or, in the case of a bankrupt firm, to its creditors.

Read emphasized public policy considerations, especially clients' interests, in saying the unfinished business doctrine no longer makes sense in modern legal practice.

Treating a law firm's uncompleted hourly matters as partnership property would have ''numerous perverse effects'' and would harm clients, lawyers and law firms without actually producing financial rewards for a bankrupt firm's estate, the court said.

Lawyers contacted for comment by BNA described the decision as highly significant not only for partners on their way out of troubled firms and the firms they join, but more broadly for the concepts of client choice and attorney mobility. The decision is likely to be influential outside New York, experts predicted.

The decision is a major victory for several law firms that took over legal work brought to them by former partners of two failing law firms, Thelen LLP and Coudert Brothers LLP. Lawsuits over profits from those matters are pending in the firms' bankruptcy proceedings.

Two New York federal district court judges reached opposite conclusions about applying the unfinished business doctrine to a bankrupt law firm's hourly fee matters; the U.S. Court of Appeals for the Second Circuit certified the issue to the highest court in New York for a declaration of state law on the matter.

As a result of the state court's opinion, it appears likely that claims asserted by the bankruptcy trustees of the two law firms are subject to dismissal, in which case the firms that took over the matters at issue would get to keep the fees on the hourly matters that departing partners brought in from the dissolved firms.

'Monster Decision.' ''It's a monster decision in this area of the law'' and is very significant for big law firms, Leslie D. Corwin of Blank Rome's New York office told BNA. Corwin is a co-author with Arthur J. Ciampi of *Law Firm Partnership Agreements* (2014) and wrote dissolution plans for Heller Ehrman LLP and Wolf Block.

The decision is also extremely important for partner mobility, Corwin said.

In comments e-mailed to BNA, Ciampi said the decision ''squarely puts New York at the top of states concerning the protection of a client's right to counsel of their choice and of lawyer mobility.''

A contrary ruling that would permit bankruptcy trustees' claims for unfinished business concerning hourly cases ''would have impeded these important rights and unnecessarily complicated the dissolution of both small and large law firms throughout the state,'' said Ciampi, of Ciampi LLC in New York.

The decision has ''far-reaching implications'' for lawyers and their clients, according to Ronald C. Minkoff of Frankfurt Kurnit Klein & Selz P.C., New York. Minkoff was a co-author of the amicus brief filed jointly in this case by the New York State Bar Association, the New York City Bar Association and the New York County Lawyers' Association.

The decision resolves key uncertainties in partnership dissolutions and bankruptcies for New York lawyers and firms, while reaffirming the principle of lawyer mobility and the fundamental right of clients to retain their lawyer of choice, Minkoff said in comments e-mailed to BNA.

''This is a very important decision,'' Anthony E. Davis of Hinshaw & Culbertson LLP, New York, told BNA. The issue the court addressed has been troubling law firms and interfering with the free movement of lawyers since the unfinished business rule was first asserted in

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many of the major law firm bankruptcies that have erupted in recent years, he stated.

''The decision conclusively resolves the issue in New York,'' Davis said.

Clients' Interests Are Paramount. In an interview with BNA, bankruptcy/restructuring lawyer Leo T. Crowley emphasized the court's focus on clients' interests. The court made clear that the rights of clients are more important than lawyers' rights in deciding the partnership-law issue, he said.

''This is a decision about clients, not about lawyers,'' Crowley said. ''The clients are the intended beneficiaries of the decision.'' He is a partner in the New York office of Pillsbury Winthrop Shaw Pittman LLP.

When the subject of clients' rights comes up in other cases, this will be viewed as a key decision, Crowley said.

Minkoff too lauded the court's attention to clients' interests. ''The real focus of the Court here was protecting clients, and making sure they have the lawyers they want, regardless of what happens to the lawyers' firm,'' he said. In that regard, he said, ''the ruling fosters the most important aspect of lawyer professionalism: service to our clients.''

Good News for Lawyer Mobility. ''On the lawyer mobility front, it's nothing but good news,'' University of California-Davis law professor Robert W. Hillman said in an interview with BNA. He is the author of *Hillman on Lawyer Mobility* and a co-author of the Revised Uniform Partnership Act.

Hillman said the decision facilitates lawyer mobility by relieving big law firms of ongoing worries about having to turn over money earned on matters that incoming lawyers bring in from other firms.

He pointed out that *Geron* involved the ''big bang'' situation in which a firm goes under and dissolves, forcing lawyers to find other affiliations. Most lawyers are changing firms short of that dire situation, he noted.

Two Rulings in Three Weeks. Davis pointed out that the decision comes on the heels of a federal district court decision that reached a parallel conclusion with respect to California law (*Heller Ehrman LLP v. Davis, Wright, Tremaine, LLP,* 2014 BL 165392, No. C 14-01236 CRB (N.D. Cal. June 11, 2014)).

In that case, which arose in Heller Ehrman LLP's bankruptcy, Judge Charles R. Breyer of the U.S. District Court for the Northern District of California held that hourly fee matters pending when a law firm dissolves are not the property of that firm under California law. The unfinished business doctrine announced in *Jewel v. Boxer*, 203 Cal. Rptr. 13 (Cal. Ct. App. 1984), does not apply to this situation and, in any event, is trumped by equities and policy considerations, Breyer found.

As for the combined impact of the two decisions, Davis said ''assuming that the California case withstands any appeal, the two cases together represent the death of the unfinished business doctrine'' in regard to lawyers and law firms.

Heller Ehrman's estate intends to appeal Breyer's decision to the U.S. Court of Appeals for the Ninth Circuit, Christopher D. Sullivan of Diamond McCarthy LLP, San Francisco, told BNA.

Ripple Effect. Minkoff said he expects *Geron* to have an impact beyond New York. It is apparently the first modern decision by a state's highest court on the application of the unfinished business doctrine to law firms, he said.

''Also, New York has long been recognized as a leader in understanding the imperatives of the modern legal marketplace, including the erosion of the traditional law firm model,'' Minkoff said.

As an example, he mentioned the nationwide resonance of the New York Court of Appeals' decision 25 years ago in *Cohen v. Lord, Day & Lord*, 550 N.E.2d 410 (N.Y. 1989), which invalidated a provision in a partnership agreement that a departing partner forfeited his right to departure compensation if he practiced law in competition with his former firm, on the ground that it impermissibly interfered with clients' choice of counsel.

Along the same lines, Corwin said he expects the *Geron* opinion to be influential because it is ''a well-reasoned decision by one of the most distinguished courts'' in the nation. ''I'd be very surprised if it isn't followed throughout the United States,'' he said.

Ciampi noted that New York is now ''in the overwhelming minority of states concerning the doctrine of unfinished business.'' But ''one would hope that the *Thelen* decision will be the vanguard of a nationwide trend emphasizing clients' rights and denying claims for unfinished business concerning hourly cases in law firm dissolutions,'' he said.

UPA Jurisdictions May Follow New York's Lead . . . Hillman said he expects the *Geron* decision to be important in the states—about 15 of them—whose partnership statutes, like New York's partnership law, still follow the Uniform Partnership Act.

In these states, Hillman said, courts asked to apply the unfinished business rule to work completed at other firms have no escape hatch from the UPA rule that forbids any additional compensation beyond their partnership share to ex-partners who wind up the firm's business, except in certain narrow circumstances.

These jurisdictions may choose to follow New York's lead and reject the unfinished business doctrine for pending hourly matters because of its harsh consequences under the UPA, according to Hillman.

''New York is a leading jurisdiction on partnership law governing lawyers,'' he stated, noting that it ''kicked off the modern era of lawyer mobility'' with its decision in *Cohen*.

. . . but RUPA States Might Not. The situation is different, Hillman noted, under the Revised Uniform Partnership Act, which is the model for partnership statutes in a majority of jurisdictions, including California.

Under RUPA, he explained, partners are entitled to reasonable compensation for winding up a dissolved

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firm's business; accordingly, former partners of a dissolved firm and their new firms would not be deprived of all recompense for their work if the unfinished business doctrine were applied.

Because RUPA furnishes a way out from the dilemma that lawyers and firms face in UPA states by allowing firms to finish business but be compensated, courts applying RUPA may be more likely to accept the unfinished business doctrine for hourly fee matters that former partners of dissolved firms take to other firms, Hillman said.

Hillman noted that while *Geron* addressed policy concerns and the problems facing lawyers and firms, ''it gave the statute fairly short shrift.'' The court did not mention a couple of the most pertinent statutory provisions in the partnership law, nor did it discuss the effect on creditors, he said.

The UPA may be outmoded in disallowing compensation for winding up partnership matters, but the unfinished business doctrine is a well-established feature of partnership law, he said.

The decision should not have any effect on applying the unfinished business rule to partnerships other than law firms, Hillman said. As a result of *Geron*, ''lawyers have special rules now,'' he commented.

Jewel Waivers. New York law firms no longer have to worry about obtaining *Jewel* waivers in their partnership agreements, Minkoff said, referring to partnership agreement provisions intended to get around the rule in *Jewel v. Boxer*.

Hillman suggested that including a *Jewel* waiver in a partnership agreement is still a good idea because it can be difficult to know in advance which state's law will govern. There can be thorny conflict-of-law issues in cases involving large, multistate firms, he noted.

A *Jewel* waiver is a ''freebie'' that doesn't cost anything, and ''there's no downside'' to including one, Hillman said.

Other Implications. Minkoff said that, contrary to the positions taken by creditors of the bankrupt law firms, ''this decision will actually encourage lawyers to work to solve problems at their law firms, rather than bolt at the first sign of trouble.''

The economic incentive for partners to leave early created by the *Jewel v. Boxer* rule is now gone, he said.

Minkoff said that ''if anyone is hurt by this decision, it is not the law firm's creditors; ''they are big boys and girls who should know how to take care of themselves.''

But it's a different story for the junior partners of the dissolved firm, Minkoff said, because they may have taken on personal liability for firm debts, yet don't have the client base or economic leverage to make a favorable move, and are not in an economic position to pay off their share of the firm's debts.

''The partners with business who leave will do fine (and have done fine in past break-ups); those without business, not so much,'' he said.

Applies to Contingent Fee Matters Too. Davis pointed out that *Geron* also rejects the idea of contingent fee matters as ''property'' of dissolving law firms.

Part of the trustees' claim with respect to hourly fees rests on the argument that the unfinished business rules applies to contingent fee cases, he noted.

''The court of appeals explicitly rejects this argument, notably by showing that the rule as to contingent fees in fact is also limited to the distribution of fees based on where the work was performed,'' Davis said.

The court extensively reviewed lower New York courts' decisions on this issue and held that they correctly allocate contingent fees on that basis, he said.

Not Partnership 'Property.' The court in *Geron* stated that ''pending hourly fee matters are not partnership 'property' or 'unfinished business' within the meaning of New York's Partnership Law.''

It pointed out that the partnership statute does not define property; rather, it supplies default rules for how a partnership upon dissolution divides property as elsewhere defined in state law. ''As a result, the Partnership Law itself has nothing to say about whether a law firm's 'client matters' are partnership property,'' Read said.

The court emphasized that, in New York, clients have always enjoyed the unqualified right to terminate the attorney-client relationship at any time without any obligation other than to compensate the attorney for the fair and reasonable value of the completed services.

In short, the court said, no law firm has a property interest in future hourly legal fees because the client's unqualified right to hire and fire counsel makes receipt of anticipated fees too speculative to create a present or future property interest.

Public Policy Considerations. ''Treating a dissolved firm's pending hourly fee matters as partnership property, as the trustees urge, would have numerous perverse effects, and conflicts with basic principles that govern the attorney-client relationship under New York law and the Rules of Professional Conduct,'' according to the court. It said that:

■ By allowing former partners of a dissolved firm to profit from work they do not perform, all at the expense of a former partner and his new firm, the trustees' approach creates an ''unjust windfall.''

■ Because the trustees disclaim any basis for recovering profits from the pending client matters of a former partner who leaves a troubled law firm before dissolution, ''their approach would encourage partners to get out the door, with clients in tow, before it is too late, rather than remain and work to bolster the firm's prospects.'' This ''run-on-the-bank mentality'' would make the turnaround of a struggling firm less likely, the court said.

■ Attorneys who wait too long before leaving are placed in the difficult position either of advising clients that they can no longer afford to represent them or, more likely, of not being able to secure a position in another law firm because profits from their work for existing clients would be due their old law firms, not their new employers.

■ Clients might worry that their hourly fee matters are not getting as much attention as they deserve if the lawyer's new firm is prevented from profiting from its work on them.

''The notion that law firms will hire departing partners or accept client engagements without the promise of compensation ignores commonsense and marketplace realities,'' the court said, adding: '' Followed to its logical conclusion, the trustees' approach would cause clients, lawyers and law firms to suffer, all without producing the sought-after financial rewards for the estates of bankrupt firms.''

‘‘Ultimately, what the trustees ask us to endorse conflicts with New York’s strong public policy encouraging client choice and, concomitantly, attorney mobility,’’ the court said.

Howard P. Magaliff of Rich Michaelson Magaliff Moser LLP, New York, argued for Yann Geron, the trustee in Thelen’s bankruptcy. David J. Adler of McCarter & English LLP, New York, argued for Development Specialists Inc., the administrator of Coudert’s bankruptcy estate.

Michael R. Levinson, Seyfarth Shaw LLP, Chicago, argued for his firm. Joel L. Miller, Miller & Wrubel P.C., New York, argued for K&L Gates LLP. Shay Dvoretzky of Jones Day, Washington, D.C., argued for his firm.

BY JOAN C. ROGERS

Full text at http://www.bloomberglaw.com/public/document/In_re_Thelen_LLP_2014_NY_Slip_Op_04879_2014_BL_182115_NY_July_01_.

The June 4 oral argument can be viewed at http://www.nycourts.gov/ctapps/arguments/2014/Jun14/060414-136-137-Oral-Argument-Webcast.asx.

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