Unfinished Business, Migrating Lawyers

In previous columns,[1] we looked at some of the ethical considerations that apply when lawyers leave one firm and go to work for another. There are some considerations not specifically covered by our ethics rules that are involved in the process, one of which has become a hot topic in an era when many major law firms have dissolved and gone out of business.[2] When some of the firms sought or were forced into bankruptcy, the question arose about ongoing work, both hourly and contingent, that the departed lawyers took with them: Does the profit from their efforts belong to them and their new firms or, as several trustees in bankruptcy have argued, to the bankrupt firm's estate? The reported decisions are not uniform, and several of these are presently on appeal, so the final word is yet to come.

The concept at issue here is what is known as the unfinished business doctrine. Its genesis is the California case *Jewel v. Boxer*,[3] which held that the unfinished work of a dissolved or dissolving partnership remains an asset of the firm. This is based on a partner's continuing duty to wind up the firm's affairs without being entitled to extra compensation for doing so. In short, the legal fees generated from those cases belong to the firm, and the partner who does the work simply gets what he would have received if the firm had kept operating.

The effect of the ruling can be "contracted around" with what some lawyers refer to as a "*Jewel* waiver," providing that if the firm dissolves, the partners/members/shareholders can keep the fees from unfinished cases taken to another firm. This all well and good until a bankruptcy court gets involved,[4] because the trustee in bankruptcy, upon timely motion, can set aside anything that can arguably be called a fraudulent transfer, which is what some such agreements have been considered.[5] The theory is that the firm gets nothing back (i.e., there's no consideration) for having made the agreement, potentially hurting firm creditors.

In spite of the number of reported cases concerning the issue, several questions still seem to bother the courts.

First, in considering the unfinished business that a lawyer may take with her, it is easy to see where a successfully completed contingent fee case could yield a profit that might rightfully be claimed by a bankruptcy trustee. But what about transactional matters and other cases billed at hourly rates? In the Heller Ehrman bankruptcy, pending in the Southern District of California, a ruling by a District Court after an appeal from a bankruptcy judge's findings sets forth some considerations distinguishing *Heller* from the standard *Jewel* analysis.[6]

The court pointed out that in *Jewel* a four-lawyer firm had voluntarily divided itself into two new firms of two lawyers each, and got the respective clients to agree to substitutions of counsel, leaving the dissolved firm's creditors high and dry. In the *Heller* case, the dissolution was brought about involuntarily after the firm's revolving line of credit lender declared a default and seized its bank accounts. This in effect left the firm's clients without their chosen lawyers unless they went with present counsel to a new firm. The Heller lawyers did just that, joining a number of firms and having their clients sign new engagement letters with the new firms. Noting that clients have an absolute right to hire and fire their lawyers and that the Heller firm accordingly never "owned" its clients' matters (having only an "expectation" of future business at best), the court found that the trustee in bankruptcy could not prove the value of those expectations sufficiently to allow claims against the third-party law firms to which the Heller lawyers had migrated. The court said that the market for legal services should not be "encumbered by quarrelsome claims of disgruntled attorneys and their creditors" and dismissed the trustee's third-party claims for fees the former Heller lawyers had generated after joining the new firms.

Can a bankruptcy trustee "claw back" profits from partners who jumped ship?

Another troublesome question involves the timing of the partner's leaving: Can a partner/member/shareholder leave what he considers to be a "sinking ship" with his clients prior to dissolution or bankruptcy without being later subjected to claims under the unfinished business doctrine?

The standard response until recently was that the doctrine didn't apply until dissolution or bankruptcy proceedings were commenced. However, a recent ruling in the Howrey bankruptcy would allow trustees to make such claims when lawyers leave as their firms begin circling the drain.[7] In that case, the Bankruptcy Court stated that it saw "no reason to limit the definition of Howrey unfinished business matters pending as of dissolution" and allowed the trustee to attempt to "claw back" any profits for that work from partners who jumped ship prior to the firm's ceasing operations.

Advocates for this position claim that the ruling is consistent with the notion that partners or members should show loyalty and

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trust to the organization, putting the firm's interests ahead of their own. The trustee is quoted as saying that otherwise, "At the first sign of a partnership in trouble, every partner, clients permitting, would leave with his or her unfinished business, to the likely detriment of one's partnership."[8] Opponents claim that clients ought to be able to take their business wherever they want whenever they want, and to limit their choices through the unfinished business doctrine is to limit unfairly the mobility of their lawyers and in effect to treat the clients as "chattels."

Any resolution of these issues will have to await further proceedings. In the meantime, to be forewarned is to be forearmed: Lawyers moving between firms and the firms they move to need to be aware that the demise of the former firm may trigger claims for which allowances should be made in the terms of any new relationship.

endnotes

1. *When Lawyers Change Firms,* ARIZ. ATT'Y (October 2011); *Post Departure Fee Splitting Agreements*, ARIZ. ATT'Y (April 2007).
2. Some of the names will be familiar: Dewey & LeBoeuf; Coudert Brothers; Brobeck, Pheger & Harrison; Heller Ehrman, Thelen LLP; and of special note, the Washington DC firm Howrey LLP.
3. 203 Cal. Rptr. 13 (Ct. App. 1984). The opinion has been criticized on several occasions, and it may ultimately be limited to its facts. For instance, in the Thelen bankruptcy, the New York Court of Appeals has just ruled on certification from the Second Circuit, that the unfinished business of a law firm is not partnership property under New York partnership law, rejecting the California holding.
4. This includes, of course, the result of an involuntary petition, brought by the firm's creditors aware of the issue.
5. *See Heller Ehrman LLP v. Jones Day (In re Heller Ehrman LLP)* (Bankr. N.D. Cal., No. 08-3251DM, Jan. 28, 2014), 30 LAW. MAN. PROF. CONDUCT 108.
6. *See* Order re Summary Judgment dated June 11, 2014, in *Heller Ehrman LLP v. Jones Day*, No. C 14-01237 CRB (U.S.D.C., N.D. Cal).
7. *Ruling May Curb Mobility of Lawyers at Struggling Firms*, WALL STREET J., Feb. 17, 2014.
8. *Id*. This is what happened in the Brobeck, Pheger & Harrison collapse: As the firm languished, a group of partners left to join Clifford Chance, which ended up paying more than $5 million to the bankruptcy trustee to settle unfinished business claims.