The Unfinished Business Doctrine: Law Firm Dissolutions Bring Risks (Co-Author)

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Based on the efforts of a highly paid legal industry consultant, your firm has been in confidential negotiations with a practice group looking to leave a prominent, nationally known law firm. One of the attractions of the group is the expectation its lawyers will generate significant fees for your firm on the client matters you anticipate they will bring with them.

On the eve of reaching the final terms of the group's move comes dramatic news: the group's firm, citing a significant downturn in revenue due to recent departures of other partners, announces it is insolvent and will be dissolving, with rumors swirling of an imminent bankruptcy filing. Should your firm now consider terminating the negotiations? If the laterals do join your firm, is there a risk that fees collected for work performed after the clients transfer their files might not actually "belong" to your firm? Might a receiver or bankruptcy trustee for the defunct law firm have authority to a "claw back" those fees from your firm? Is there a way to protect your firm from exposure to such claims?

While this issue appears not to have been addressed by any Connecticut court, other jurisdictions have answered these questions by applying a 1984 California appeals court decision, Jewel v. Boxer. That decision generally stands for the proposition that the "unfinished business" of a dissolved law firm remains an asset of the firm. Thus if a partner of the defunct firm takes "unfinished business" to a new firm and completes the work there, the fees generated from the completion of that "unfinished business" belong to the dissolved firm and not to the new firm even if it is the new firm which performed the work.

Two recent decisions, both from bankruptcy cases in the Southern District of New York, but reaching diametrically opposed conclusions about the applicability of the Jewel doctrine under New York law, have drawn new attention to an increasingly common dilemma: lateral lawyers who move from dissolved law firms exposing their new firms to "unfinished business" claims of a receiver, a bankruptcy trustee or a former partner.

Jewel v. Boxer arose from a dispute between former partners over contingency fees earned in matters that originated with their dissolved firm, but that two of the four partners had handled to conclusion after the dissolution. The California court decided the case under the Uniform Partnership Act (then in effect in California), and held that the contingency fee was not subject to a quantum meruit division between the former partners.

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Because partners of a dissolved partnership owe each other a duty to account for fees generated in carrying out the "unfinished business" of the dissolved firm, all profits earned on ongoing matters pending on the date the former firm shut down belong to the dissolved firm and must be distributed in accordance with the agreement between its partners.

This is required regardless of which of the former partners did the work that earned the post-dissolution fee, and with no special compensation for the post-dissolution efforts, skill and diligence of the partner who actually completed the work. The court expressly held that "[t]he fact that the client substitutes one of the former partners as attorney of record in place of the former partnership does not affect this result."

Courts from around the country subsequently have applied the Jewel doctrine, and its "no compensation" rule, to dissolved law firms whether the firms operate as partnerships, professional corporations or limited liability companies; under the Revised Uniform Partnership Act, as well as under the UPA; and in hourly fee matters as well as in contingency fee matters. Though sometimes arising in disputes between former partners, the doctrine more frequently is invoked when a receiver or bankruptcy trustee — looking to recover funds to pay the creditors of the dissolved firm — seeks to claw back post-dissolution fees collected by those firms which took on partners of the defunct firm.

When Jewel was decided in 1984, dissolutions and bankruptcy filings by major national firms were almost unheard of. In recent years, however, the Jewel doctrine has been invoked with increasing frequency in high profile law firm bankruptcies. And when the former partners of a dissolved firm take the "unfinished business" to new firms, the exposure for the new firms can be significant. For example, in the Dewey LeBoeuf bankruptcy, filed in May, 2012, the Chapter 11 trustee has hinted he intends to pursue firms at which Dewey partners landed for approximately $60 million in unfinished business claims. In 2004, it was reported the firm of Morgan, Lewis & Bockius, which had taken on a practice group exiting the soon–to–be dissolved firm of Brobeck, Phleger & Harrison, agreed to pay $10.2 million to settle the bankruptcy trustee's unfinished business claims.

In the recent decisions from the Southern District of New York, Judge Colleen McMahon and Judge William H. Pauley, III have come to two opposite conclusions about who is entitled to the fees generated from the unfinished business of a dissolved law firm.

In a decision issued on May 24, 2012, in Development Specialists, Inc. v. Akin Gump Strauss, Hauer & Feld LLP, involving the bankruptcy of the venerable Coudert Brothers firm, Judge McMahon concluded that such fees belong to the estate of the bankrupt firm, and therefore are subject to claw back by the Chapter 11 trustee. But less than four months later, in Geron v. Robinson & Cole LLP, arising out of the bankruptcy of the Thelen Reid firm, Judge Pauley concluded that the dissolved firm has no interest in any hourly fees earned after dissolution, even for matters that could be characterized as "unfinished business."

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Both decisions turned on interpretations of New York law, but each judge considered different aspects of New York law. Judge McMahon saw the question as one of property and partnership law. She concluded that the general rule of partnership law applied, holding that "the business of a partnership that is unfinished on the date the partnership dissolves is an asset of the partnership , and must be concluded for the benefit of the dissolved partnership." A pending hourly fee matter should be treated as an asset of the dissolved firm, as if it were a "Jackson Pollack [sic] painting [a departing partner] ripped off the wall of the reception area" as he abandoned the failing firm.

Judge Pauley, on the other hand, framed the issue as one implicating the particular nature of the attorney–client relationship and the public policy considerations — reflected in the Rules of Professional Conduct — promoting unfettered client choice in both the selection, and termination, of counsel. These actions arise from an alarming phenomenon — the bankruptcy of a major law firm. The pursuit of pending hourly fee matters as assets of the estate has become a recurring feature of such bankruptcies. But this concept of law firm 'property' collides with the essence of the attorney-client relationship. That relationship springs from agency law, not property law. The client is the principal, the attorney is the agent, and the relationship is terminable at will."

His answer to the question was that, at least under New York law, hourly fee matters are not the "property" of the dissolved firm. Judge Pauley expressly rejected Judge McMahon's comparison of a law firm's client matters to its reception area art work: "The client, not the attorney, moves a matter to a new firm." Quoting the 1989 decision in Cohen v. Lord, Day & Lord, he explained the difference between client matters and law firm property: "'Clients are not merchandise. Lawyers are not tradesmen.'"

On July 18 Judge McMahon certified her ruling for interlocutory appeal to the U.S. Court of Appeals for the Second Circuit. Judge Pauley did the same when he issued his decision in September. It is likely the Second Circuit will, in turn, certify the state law questions to the New York State Court of Appeals for an advisory opinion. Judge Pauley's decision also included an analysis under California law, which may be certified to the California Supreme Court, to resolve whether Jewel remains good law in light of California's 1994 adoption of the Revised Uniform Partnership Act to replace the UPA.

A New York Court of Appeals decision may resolve the split between the two competing Southern District decisions — whether adopting the Jewel doctrine or recognizing, in effect, an exception for law firms based on the special nature of the attorney–client relationship. Such a ruling would likely become the new standard for determining whether unfinished client matters are in fact "assets" of a shuttered law firm and therefore whether the firms which took on exiting partners must remit to a receiver or a bankruptcy trustee the post-dissolution profits earned from such matters. And if the answer is yes, the New York court may also provide guidance on a related question: how to calculate the profit portion of the "unfinished business" fees.

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It is obvious that, until the split is resolved, law firms must pay careful attention in taking on laterals seeking to affiliate with them. Among other things, they should try to get assurance from lateral candidates that their current firm is not on the brink of insolvency or dissolution, and investigate that firm's economic health to the extent possible from publicly available information. The hiring firm should not, of course, ask the potential hire for internal law firm information that is confidential.

Any law firm has the ability to include in its partnership or operating agreement a provision in which it, and its partners, prospectively waive Jewel claims in the event of a dissolution. Thus a hiring firm should ask a lateral candidate if his or her current firm has such a provision in its agreement. But this suggestion comes with a significant caveat: as the Thelan Reid partners learned in the Geron case, any such "unfinished business" waiver may be set aside as an insider preference or fraudulent conveyance if the failed firm adopted it either after the firm began its downhill slide or within the bankruptcy preference period. Accordingly, any inquiry about a Jewel waiver should include a question about when it was adopted.

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