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AFTER A LAW FIRM files for bankruptcy, a former partner walks into the reception area, removes a painting from the wall, and takes it to his new law firm. Does the partner owe the dissolved firm for the painting? Clearly, the partner would have to compensate the dissolved firm for the painting. What if the partner takes existing client matters to the new law firm instead? Is he obligated to share profits from continuing matters with the defunct firm? Does it matter whether the work involved a contingency matter as opposed to an hourly fee matter?

These questions were answered by the New York Court of Appeals in July 2014 when the Court held that existing legal matters are not property of a bankrupt law firm, rejecting the "unfinished business rule." But the rule is far from universally finished. Decisions applying California law and Washington D.C. law have recently ruled on the issue, and it is probable that other courts will do so. Given the unsettled nature of the unfinished business rule across the country, multi-office law firms and their lawyers should be aware of the wide-ranging implications of the rule as it relates to their practices, partnership agreements, rights to fees and profits, and ethical obligations.

UNFINISHED BUSINESS: FINISHED IN NEW YORK • Former partners of two dissolved international law firms, Thelen LLP and Coudert Brothers LLP, joined new firms and brought their existing client matters with them. The bankruptcy representatives of the defunct firms sued to recover profits from those matters at the new

firms. They argued that those matters and the resulting profits were "partnership property" under New York Partnership Law. [1]

In the *Coudert* case,[2] decided in May 2012, the United States District Court for the Southern District of New York sided with the bankruptcy representatives, holding that a firm's "unfinished business" is akin to a Jackson Pollock painting hanging on the wall of a dissolved firm's reception area. The Court declared unfinished business to be property of the partnership that cannot be removed by a partner without compensating the firm. The Court observed that a client matter, like a piece of artwork, constitutes an asset of the dissolved firm and any profits derived from it by the new firm must be turned over to the firm's bankruptcy estate. In contrast, in the *Thelen* case,[3] decided in September 2012, a different judge of the same Court sided with the former partners and their new firms, ruling that unfinished business does not constitute an asset of the dissolved partnership, as would a Jackson Pollock, because the clients, not the partners, decide who will handle their work. Confronting inconsistent decisions in the District Courts, the Court of Appeals for the Second Circuit hearing the appeals in the *Thelen* and *Coudert* cases certified the questions to the New York Court of Appeals.

In July 2014, the New York Court of Appeals[4] rejected the bankruptcy representatives' argument and unanimously held that clients' hourly fee matters are not partnership property or "unfinished business" within the meaning of New York's Partnership Law. Instead, the Court agreed with the *Thelen* ruling, reasoning that the matters belong to the client, not the partner, and that future hourly legal fees "are too contingent in nature and speculative" to be considered property of the dissolved partnership.

The Court of Appeals acknowledged that some New York Appellate Division decisions had referred to contingent fee matters as "property" of a law partnership, but held in substance that the "property" ended when the matter left the law firm: "In this context, statements that contingency fee cases are 'assets' of the partnership subject to distribution simply means that, as between the departing partner and the partnership, the partnership is entitled to an accounting for the value of the cases as of the date of the dissolution."[5]

Ethical Implications

"Clients are not merchandise. Lawyers are not tradesmen." This fundamental conception of the profession of law, expressed by the New York County Lawyers' Association in a 1943 ethics opinion to emphasize New York's commitment to client autonomy, still has life. It was quoted by the New York Court of Appeals in *Thelen* to emphasize that any rule that deters competition in the legal marketplace and treats clients like goods that can be "bartered" is incompatible with the core values of the legal profession.

Public Policy Considerations

Observing that the unfinished business rule has "numerous perverse effects" on the attorney-client relationship, the New York Court of Appeals in *Thelen* overturned the rule after considering the following significant negative public policy implications for attorneys, law firms and clients alike:

- For attorneys departing a troubled firm with pending client matters, it may be easier to join a new firm without a cloud of future litigation hanging over their heads. Abandoning the unfinished business rule will essentially remove the threat that a lateral attorney will be compelled to share any future profits with the former firm, and in turn, such security will enhance attorney mobility;
- For faltering firms, the unfinished business rule encourages partners to jump ship, with clients in hand, at the first sign of trouble, rather than staying and attempting to save the ship from

sinking. This run-on-the-bank mentality would make it more difficult for a struggling firm to turn its fortunes around;

- For firms hiring lateral partners with existing matters, the financial risk of taking on their incoming clients is considerable. Firms may be reluctant to invest significant resources to serve clients if they are not entitled to the corresponding profits earned;
- For clients who move to new firms with lateral attorneys, the removal of the rule will ensure that clients receive the necessary representation they seek because the new firm will bear no risk of losing their profits to the former firm. Additionally, abolition of the rule will maximize client autonomy and promote the client's unfettered right to choice of counsel.

UNFINISHED BUSINESS: STILL UNFINISHED ELSEWHERE • Although the law in New York is now settled, as the recent flurry of case law seems to illustrate, the unfinished business rule is still being applied to client matters in various jurisdictions around the country.[6] Therefore, law firms with offices outside New York (including New York based law firms) should take a close look at these legal developments, which may have far reaching ramifications on their clients, lawyers and practices.

California Law

Heller Ehrman, a global law firm with over 700 attorneys, filed for bankruptcy in 2008 and sought to recover its unfinished business from law firms that absorbed its former partners. In June 2014, a California District Court applied California law and ruled that the Heller bankruptcy estate had "no property interest in hourly fee matters pending at the time of its dissolution."[7] Like the *Thelen* Court, the *Heller* Court determined that "a law firm—and its attorneys—do not own the matters on which they perform their legal services. Their clients do. A client, for whatever reason, may summarily discharge counsel and hire someone else." The Heller bankruptcy representatives appealed the decision. On November 14, 2014, the case was certified for direct appeal to the Ninth Circuit.[8]

Washington D.C. Law

Howrey LLP was an international law firm headquartered in Washington D.C., which filed for bankruptcy in 2011. In September 2014, the Northern District of California ruled[9] that District of Columbia law governed, found that courts in D.C. consistently applied the unfinished business rule to hourly fee cases and ruled for the bankrupt law firm. The *Howrey* Court acknowledged the recent *Thelen* and *Heller* decisions applying New York law and California law, respectively, but chose to follow existing D.C. precedent, instead. Interestingly, although the *Howrey* Court dismissed the Howrey trustee's unfinished business claims against partners who left pre-dissolution,[10] it permitted the trustee to prosecute claims against such partners on an unjust enrichment theory.

In *Howrey*, the former partners of dissolved firms and their new firms argued that the unfinished business rule interfered with the ethical principles prohibiting fee sharing, upholding client autonomy and the right to choice of counsel, and minimizing restrictions on attorney mobility. The *Howrey* Court[11] rejected these arguments, holding that "remitting profits from unfinished business does not constitute impermissible fee splitting." The Court concluded that no D.C. authority suggested that the rule violates any ethical rules on fee sharing. In addition, the *Howrey* Court determined that courts have repeatedly dismissed arguments equating unfinished business to an unlawful restrictive covenant against the practice of law. The *Howrey* Court observed that the rule does not prevent former partners in a firm from accepting employment with competitors, and that given the firm's dissolved status, it is no longer a rival restricting employment with a competing firm.

WHAT LEGAL FRAMEWORKS APPLY WHERE UNFINISHED BUSINESS HAS BEEN UPHELD? • In light of the conflict over the unfinished business rule today, how should law firms outside New York (including New York-based law firms) react to the *Thelen*, *Heller,* and *Howrey* decisions? There are many unanswered questions. What law applies to a firm with offices in different jurisdictions? Would different laws apply to the offices in different states? What about international firms that may have separate partnership agreements governing partners practicing in different jurisdictions?

Interestingly, the case law outside New York dealing with unfinished business exhibits the effect of multiple legal doctrines and analogies. Is this a doctrine of contract law, partnership/fiduciary duty law, property law or fraudulent transfer law? Are pending client matters best thought of as property of the law firm that cannot be taken without compensation or should the situation be analogized to breaches of contract or fiduciary duties among the partners, or is the movement of matters to new firms a breach of duty to the old firm's creditors? The *Heller* Court concluded that pending matters are too speculative to be treated as partnership property,[12] suggesting that "unfinished business" is not sufficiently akin to a Jackson Pollock painting, but perhaps more akin to a paintbrush that has yet to hit the empty canvas.

Property Law or Contract Law?

The *Howrey* Court, which upheld the unfinished business doctrine, applied property law in determining whether hourly fees matters were property of the partnership. However, at the core of the underlying dispute was a contract—the Howrey partnership agreement—which presumably was signed by the firm's partners, and gave rise to contractual and fiduciary relationships among the partners.

Applying property law to the unfinished business rule raises some interesting issues to which multi-office firms and non-New York single-office firms should be aware, as discussed below.

Pre- vs. Post-Dissolution

By its terms, the unfinished business rule only applies after dissolution of the partnership. If a partner leaves a faltering law firm and takes unfinished business the day *before* dissolution, the unfinished business rule would not apply, and the partner need not compensate the old firm for the unfinished business. However, if the partner takes unfinished business the day *after* dissolution, the rule would apply, and the partner must account for and compensate the dissolved firm accordingly. Why does this pre- vs. post-dissolution distinction exist if client matters are considered firm property? The *Heller* Court wondered why "the duties, rights, and property interests at stake here should be different simply because Heller dissolved." That Court believed it to be unfair and inequitable that "only as a result of Heller's dissolution were departing shareholders burdened with a duty to account for unfinished business taken from the firm."[13]

Partner/Non-Partner Distinction

Interestingly, if the day after dissolution a *partner* takes unfinished business, the unfinished business rule would apply, and he would have to account for and compensate the firm's estate. However, if a non-equity partner, of counsel lawyer, or associate takes unfinished business, the rule would not apply, and they would not owe such duties because they are not signatories to the firm's partnership agreement. To our knowledge, no plaintiff has attempted to argue that the unfinished business doctrine, based on an application of the Uniform Partnership Law, should be applied to non-partners, and no court has conclusively addressed this partner/non-partner distinction. If unfinished business were property, like a Jackson Pollock painting, it wouldn't

matter whether the person who took it was a partner who had signed the partnership agreement.

However, if the analogy to property law is abandoned, then the question focuses on the rights and obligations among the partners or others who signed an agreement with the firm as a matter of contract law and partnership fiduciary duty law, and the standing of third parties (such as the law firm or its creditors) to enforce those rights and obligations.

PRACTICAL STEPS TO MINIMIZE UNFINISHED BUSINESS RISK • There are some measures that multi-office and non-New York single-office firms can consider taking in order to mitigate potential unfinished business risks.

Choice of law Provision

For law firms with clients, attorneys and offices in multiple states, a choice of law (and a choice of forum) provision in the firm's partnership agreement may be helpful to assure that the desired rule will apply. Otherwise, courts may look to where a partnership is headquartered or registered to determine the governing law, or to other locations of the offices handling the client's matter—particularly if only one office was doing so.

Choice of law provisions, however, may not always withstand judicial scrutiny. For example, in *Thelen*, the firm was registered in California and the partnership agreement contained a choice of law provision for the State of California. However, the Southern District of New York[14] ruled that a contractual choice of law provision governs only a cause of action sounding in contract, not a tort claim like fraudulent transfer. In the end, the Court conducted an interest analysis and determined that a majority of the firm's contacts occurred in New York, based on its examination of a number of factors, including the firm's principal place of business, its LLP registration, where a majority of the firm's attorneys were licensed to practice, and where the alleged tortious conduct occurred. Thus, even a well-crafted choice of law provision may not necessarily be effective.

Jewel Waiver

A "Jewel waiver," as formulated in the 1984 California case, *Jewel v. Boxer,*[15] is an agreement entered into by the partners of a law firm that permits departing partners to take unfinished client matters upon dissolution of the firm, resulting in a waiver of rights the partnership might otherwise have to any claims or entitlements against the partners based upon the unfinished business rule. However, courts do not always honor a law firm's Jewel waiver. In *Howrey*, the Court ruled that a waiver adopted on the eve of dissolution was an invalid fraudulent transfer made without fair consideration.

By invalidating the Jewel waiver for lack of fair consideration, the *Howrey* Court raises interesting issues. If a partner agrees to remain past dissolution in exchange for a waiver, is that sufficient consideration to avoid application of the fraudulent transfer laws? Also, if unfinished business does not constitute an asset of the partnership until the date of dissolution, why is a waiver preventing the transfer of the potential asset to the partnership fraudulent?[16] It seems more akin to a partner deciding not to make an equity contribution to the firm than a fraudulent transfer. Additionally, if a law firm is not a party to the partnership agreement, why should it have standing to challenge the waiver? And, if the law firm debtor does not have standing, should a third-party creditor have standing? *Howrey* does not seem to answer these questions.

In New York, following *Thelen*, Jewel waivers may no longer be necessary. Nevertheless, Jewel waivers retain some significance in other jurisdictions if adopted prior to insolvency, and law firms with offices outside New York should consider their use as a precautionary measure to waive any unfinished business rights of the dissolved firm.

"No Third-Party Beneficiary" Provision

Typically, a partnership is not a party to a partnership agreement. To that extent, a partnership could only enforce its rights as a third-party beneficiary when seeking to enforce unfinished business claims against departing partners. To eliminate third-party beneficiary claims, contracting parties often include "no third-party beneficiary" provisions into their agreements, to clarify that the parties intend only the signatories to the agreement to have standing to sue on the contract.

In the law firm context, "no third-party beneficiary" provisions may be tailored to prohibit standing for the partnership or its creditors, should an unfinished business dispute arise. However, firms should carefully consider including these provisions in partnership agreements, because despite their benefits, they can have unintended adverse consequences.

FINISHING TOUCHES • Current New York law, abolishing the unfinished business rule and upholding client autonomy and attorney mobility, reflects the fundamental ethical principles and public policy considerations at stake for clients, lawyers and law firms. However, recent decisions in California and Washington D.C. and potentially other states, serve as important reminders that law firms of all sizes should consider taking practical steps to prevent unnecessary, protracted post-dissolution disruption or litigation resulting from the application of the unfinished business rule. Until a uniform rule is established with respect to the unfinished business doctrine, law firms should take great care to avoid being impacted by the not-quite-finished, unfinished business rule.

Endnotes

[1] In New York, the unfinished business rule originated from § 43 of the New York Partnership Law, which provides, in relevant part, that "[e]very partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property."

[2] *Dev. Specialists, Inc. v. Akin Gump Strauss Hauer & Feld LLP*, 477 B.R. 318 (S.D.N.Y 2012).

[3] *Geron v. Robinson & Cole LLP*, 476 B.R. 732 (S.D.N.Y. 2012), *aff'd per curiam,* 762 F.3d 157 (N.Y. 2014).

[4] *In re Thelen LLP*, 20 N.E.3d 264 (N.Y. 2014).

[5] *Id.* at 271.

[6] The unfinished business rule appears to be a judicially crafted rule interpreting each state's version of section 404 of the Uniform Partnership Act, which provides, in relevant part, that "[a] partner's duty of loyalty to the partnership and the other partners is limited to ... account to the partnership and hold as trustee for it any property, profit or benefit derived by the partner in the conduct and winding up of the partnership business or derived from a use by the partner of partnership property, including the appropriation of a partnership opportunity."

[7] *Heller Ehrman LLP v. Davis, Wright, Tremaine, LLP*, 2014 WL 2609743 (N.D. Cal. June 11, 2014).

[8] See http://ia802607.us.archive.org/32/items/gov.uscourts.cand.282061/ gov.uscourts.cand.282061.7.2.pdf.

[9] *In re Howrey LLP*, 515 B.R. 624 (Bankr. N.D. Cal. 2014).

[10] To our knowledge, no court has allowed a law firm debtor to pursue an unfinished business claim against a partner who left pre-dissolution.

[11] *In re Howrey LLP*, 2014 WL 507511 (Bankr. N.D. Cal. Feb. 7, 2014).

[12] For example, the client may decide to stop further work, go out of business, or decide independently to change representation. The firm itself may suffer a disqualifying conflict of interest.

[13] *Heller Ehrman LLP*, supra, at *3, 6.

[14] *Geron*, supra.

[15] *Jewel v. Boxer*, 203 Cal. Rptr. 13 (Cal. Ct. App. 1984).

[16] The Bankruptcy Court for the Northern District of California, in *In re Brobeck, Phleger & Harrison LLP*, 408 B.R. 318, 338 (Bankr. N.D. Cal. 2009), rejected the argument made by the departing partners that unfinished business was not property of the partnership on the date of the Jewel waiver because the unfinished business did not become property of the partnership until the date of dissolution. The Bankruptcy Court provided little discussion of its reasoning, stating "the right was there all along." Moreover, the Court did not discuss why a partner's agreement to stay with the partnership after dissolution would not constitute adequate consideration for the Jewel waiver.

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