
Hughes Hubbard & Reed

New York Court of Appeals Shuts the Door on Unfinished Business Litigation

Client Advisories

Hughes Hubbard & Reed LLP • A New York Limited Liability Partnership
One Battery Park Plaza • New York, New York 10004-1482 • +1 (212) 837-6000

Attorney advertising. Readers are advised that prior results do not guarantee a similar outcome. No aspect of this advertisement has been approved by the Supreme Court of New Jersey. For information regarding the selection process of awards, please visit <https://www.hugheshubbard.com/legal-notice-methodologies>.

July 24, 2014 - The New York Court of Appeals may have just halted failed law firms' efforts to recover fees from their former partners and those partners' new firms from ongoing client representations under the so-called "unfinished business doctrine." Unfinished business litigation has proliferated in recent years after the dissolutions and bankruptcies of several major law firms. In *In re Thelen LLP*, 2014 N.Y. LEXIS 1577, 2014 NY Slip Op 4879, 2014 WL 2931526 (N.Y. July 1, 2014), the Court of Appeals held that these profits cannot be avoided and recovered by the old firm once the matters have been transferred to a new firm. Specifically, the court held that "pending hourly fee matters are not partnership 'property' or 'unfinished business' within the meaning of New York's Partnership Law. A law firm does not own a client or an engagement, and is only entitled to be paid for services actually rendered." These questions arose out of the bankruptcies of two law firms—Thelen LLP and Coudert Brothers LLP—and subsequent litigation between the bankruptcy estates and the law firms to which former partners of both firms moved.

The "unfinished business doctrine" arose from a California Court of Appeals decision—*Jewel v. Boxer*, 156 Cal. App. 3d 171 (1984). *Jewel* held that, absent a waiver in the partnership agreement, former partners of a dissolved law firm have an ongoing duty to account to the firm and to each other for profits earned from client matters that continue after the partner leaves the firm or the firm dissolves. The *Jewel* court also held that partnership agreements may include provisions that structure exactly how a partnership will deal with unfinished business in the event of dissolution; a *Jewel* waiver of this kind has since been employed by many law firms to attempt to eliminate the partners' ongoing duty to each other and to the dissolved firm for profits from unfinished business in the event of a dissolution.

On the day that Coudert Brothers dissolved in August 2005, the partnership added a "Special Authorization" to its partnership agreement that gave the partnership the power to sell the firm's assets to other firms to maximize value, to wind down business in an orderly fashion, and to maintain continuity for clients. After Coudert filed for bankruptcy protection one year later, the administrator of its estate, Developmental Specialists, Inc. ("DSI")

commenced adversary proceedings against certain of the former partners' new firms to recover profits from the unfinished matters. In each case, DSI relied on *Jewel* and the unfinished business doctrine to support its claims.

On summary judgment, the former partners' new firms argued that the unfinished business doctrine did not apply to hourly matters, while DSI argued that the unfinished client matters were Coudert's property. *Development Specialists, Inc. v. K & L Gates LLP (In re Coudert Brothers LLP)*, 447 BR 318, 326 (S.D.N.Y. 2012). The District Court agreed with DSI, holding that the "Special Authorization" provision did not negate the presumption that client matters are the property of the firm on the day of dissolution. *Id.* Thus, the District Court struck down Coudert's attempt to waive any *Jewel* claims. *Id.*

Similarly, Thelen's partners added a *Jewel* waiver to Thelen's partnership agreement on the day it dissolved in October 2008. Thereafter, eleven of the firm's former partners moved and transferred their unfinished matters to Seyfarth Shaw LLP. After Thelen subsequently filed for bankruptcy protection, its trustee commenced an adversary proceeding against Seyfarth Shaw seeking to avoid the *Jewel* waiver in the hopes of recovering profits from Thelen's unfinished business. *Geron v. Seyfarth Shaw LLP (In re Thelen LLP)*, 476 BR 732, 742-43 (S.D.N.Y. 2012). The trustee argued that Thelen's incurrence of the *Jewel* waiver constituted a fraudulent transfer because the waiver was adopted without consideration immediately before the firm's dissolution. *Id.*

Contrary to *Coudert*, the District Court in *Thelen* held (1) that the unfinished business doctrine does not apply to a dissolving law firm's unfinished hourly fee matters and (2) that a partnership retains no property interest in those matters after dissolution. *Id.* The judge found that this rule was consistent with New York's strong public policy favoring client autonomy and attorney mobility; additionally, ruling otherwise would contribute a windfall to the Thelen estate—compensating former partners no longer working on matters while diminishing the fees paid to the attorneys performing the work. *Id.* The court *sua sponte* certified an appeal to the Second Circuit, which in turn certified the questions stemming from both cases to the New York Court of Appeals. *Id.* at 745-46.

The New York Court of Appeals sided with the new law firms and rejected the authority relied on by the *Thelen* and *Coudert* trustees: the so-called contingency fee cases and *Stem v. Warren*, 222 N.Y. 538 (1920). In the contingency fee context, the court explained, a law firm owns only yet-unpaid compensation for legal services already provided; a dissolved firm is entitled only to the value of its services, not to work performed by former partners at new firms. In other words, the client—not the lawyer—owns the matter.

The trustees also relied on *Stem v. Warren*, which arose out of a dispute between two architectural partnerships, for the propositions that (1) absent intent to the contrary, contracts to perform professional services are partnership assets and (2) unfinished client engagements are partnership property. The Court of Appeals held, however, that *Stem* was merely a breach of fiduciary duty case involving a joint venture that partners explicitly intended to survive after dissolution of the partnership; it did not, the court found, define partnership property or assets.

The Court of Appeals in *Thelen* rejected the trustees' arguments that clients will pay any law firm as long as their matters are handled effectively and that forcing lawyers to forfeit their fees to another, dissolved, firm will not affect attorneys or their clients. This, the court held, ignores "common sense and marketplace realities."

The court considered the "perverse effects" of holding that a dissolved firm's unfinished hourly business is the property of the former partners. Creating a windfall for the dissolved firm's partners would conflict with the principles underpinning attorney-client relationships in New York and the State's Rules of Professional Conduct. The court predicted a future in which partners would be incentivized to run for the door with their clients as their firm contemplates dissolution, decreasing the possibility saving a failing firm. Conversely, attorneys who don't flee could no longer afford to represent their clients. The court found that contrary to New York public policy, each of

these possible scenarios would inconvenience clients, restrict clients' right to choose counsel, and constrain attorney mobility.

Finally, the court considered and rejected the trustees' suggestion that a *Jewel* waiver in the partnership agreement can evade the unfinished business doctrine. Rather, the court found, this would lead to "untoward, unintended consequences": if a client's unfinished matter is considered property of the dissolved partnership, then any lawyer who leaves a firm with her clients has breached her fiduciary duty to her former firm and its partners. The court found that this is contrary not only to the practical reality of practicing law today, but also to the history and traditions of the legal profession.

The author thanks Hughes Hubbard Summer Associate Kate Aufses for her assistance with the preparation of this post.

Related People



Chris Gartman

Related Areas of Focus

[Corporate Reorganization & Bankruptcy](#)