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Beazley Brief *Update*

Risk management insights for law firms from Beazley

In the February 2012 and July 2012 issues of the *Beazley Brief*, we reported on how the "unfinished business" doctrine - based on the California Court of Appeals decision in *Jewel v. Boxer* (156 Cal. App. 3d 171 (1984) - had spawned a rash of suits by dissolving law firms against departing partners and their new firms for taking the old firm's "unfinished business," or pending client matters, with them to their new firms.

Fortunately, the tide has begun to turn against this troubling trend. Recent decisions by courts in California and New York have determined that dissolved law firms do not have a property interest in pending hourly unfinished business matters. This *Beazley Brief Update* addresses these significant rulings.

We are again pleased that Gibson Dunn & Crutcher partners Kevin S. Rosen and Christopher Chorba and associate Peter Bach-y-Rita have graciously agreed to prepare this update. Kevin is in the firm's Los Angeles office and chair of the firm's Law Firm Defense Practice Group. Chris is a member of the Law Firm Defense Group and Co-Partner in Charge of the Los Angeles office. Peter is in the firm's San Francisco office and a member of the firm's Law Firm Defense Practice Group and the Business Restructuring & Reorganization Practice Group. Kevin, Chris and Peter have extensive experience successfully defending law firms and their partners in high-stakes litigation across the country, including defending law firms facing "unfinished business" claims based on *Jewel v. Boxer*.

We hope you find this *Beazley Brief Update* interesting and informative.

- **Brant Weidner**
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Finishing Some "Unfinished Business"— California And New York Courts Reject "Unfinished Business" Claims Involving Dissolved Law Firms

By Kevin S. Rosen, Christopher Chorba, and Peter Bach-y-Rita - Gibson Dunn & Crutcher LLP

One of the most troubling trends in recent years has been the rise in trustee litigation following the dissolution of several major international law firms. Bankruptcy trustees have brought claims to recover profits on "unfinished business" on behalf of defunct firms, asserting an entitlement to fees earned on matters handled by new firms that hired partners of the dissolved firm. In these cases, trustees and debtors of the dissolved firms have sued both the former partners and their new firms, relying on the California Court of Appeal decision *Jewel v. Boxer*, 156 Cal. App. 3d 171 (1984), which held that absent an agreement to the contrary, profits derived from a law firm's unfinished business are owed to the former partners.

Complicating matters, many distressed firms were aware of *Jewel v. Boxer*, and in fact did agree to waive any duty to account back by modifying their partnership agreements on the eve of dissolution. Until very recently, these "*Jewel* waivers" have been successfully attacked as fraudulent transfers by the trustees for the bankruptcy estates of Brobeck, Phleger & Harrison LLP, Heller Ehrman LLP, Coudert Brothers LLP, Thelen LLP, and Dewey & LeBoeuf LLP. These claims have resulted in adverse rulings and tens of millions of dollars in settlements by former partners of these firms, as well as the new firms that hired them.

Fortunately for the legal profession, however, the tide has begun to turn against "unfinished business" claims.
First, in the Heller Ehrman bankruptcy, Judge Charles R. Breyer of the U.S. District Court for the Northern District of California held that dissolved law firms do not have a property interest in pending hourly unfinished business matters. *Heller Ehrman LLP v. Davis, Wright, Tremaine, LLP*, No. 14-01236, 2014 WL 2609743 (N.D. Cal. June 11, 2014). The case reached Judge Breyer after three and a half years of litigation in the U.S. Bankruptcy Court (before Judge Dennis Montali) involving Davis, Wright, Tremaine, LLP, Jones Day, and Foley & Lardner LLP. Judge Montali applied his earlier ruling in the Brobeck bankruptcy, which upheld the Jewel waiver as a matter of state partnership law but held that it operated as a constructive fraudulent transfer under the Bankruptcy Code. *See generally Greenspan v. Orrick, Herrington & Sutcliffe LLP* (*In re Brobeck, Phleger & Harrison LLP*), 408 B.R. 318 (2009).

Judge Breyer disagreed and held that dissolved firms do not have a property interest in unfinished business for three primary reasons: First, under California law, clients can fire their lawyers at will; accordingly, the partnership does not "own" or have any residual property interest in client matters handled by its partners. 2014 WL 2609743, at *5. Second, equitable considerations weigh against finding a property right that would require partners of dissolved firms to account back, because the dissolved firm is entitled to the fees for the work that it performed, while the partners who "rescue" the clients and perform the work at their new firms deserve to retain the fees from that work. *Id.* at *6. And third, considerations of public policy weigh against finding such a property right, which would discourage law firms from accepting unfinished business matters from dissolved firms. *Id.* at *7. Judge Breyer also distinguished *Jewel* on its facts, because the dissolution in that case involved all four partners splintering across two separate firms, such that the partners could have continued to practice but instead chose to dissolve the firm and carry away the work to the new firms. In the more recent dissolutions of larger, international law firms, the departing partners splintered across dozens of different firms, with client matters likewise dispersed.

Just three weeks after Judge Breyer's decision, the New York Court of Appeal issued its long-awaited opinion in the *In re Thelen LLP and In re Coudert Brothers LLP* bankruptcies. These cases reached the state high court after federal district courts in New York had issued conflicting rulings on whether revenue from "unfinished business" matters was recoverable under New York partnership law. Compare *Geron v. Robinson & Cole LLP*, 476 B.R. 732 (S.D.N.Y. 2012), *with Development Specialists, Inc. v. Akin Gump Strauss Hauer & Feld LLP*, 480 B.R. 145 (S.D.N.Y. 2012). Both cases reached the United States Court of Appeals for the Second Circuit, which certified two questions to the New York Court of Appeal: (1) Whether client matters are property of the dissolved firm such that the law firm is entitled to the profits on any unfinished business; and (2) if so, how New York law defines a "client matter."

The New York Court of Appeal concluded that a law firm does not have a property interest in client matters under New York law, because of the client's "unqualified right to terminate the attorney-client relationship at any time." *Geron v. Seyfarth Shaw LLP*, No. 136, 2014 N.Y. LEXIS 1577, at *12 (App. Div. July 1, 2014) (*quoting In re Cooperman*, 83 N.Y.2d 465, 473 (1994)). The court also cited public policy justifications for this conclusion. Among other reasons, a contrary rule may encourage rainmakers to depart struggling firms just before dissolution, "with clients in tow," instead of risking a move after dissolution and facing clawback claims from the dissolved firm. *Id.* at *19.

These decisions in the nation's two most populous states bring some welcome relief to firms that are considering hiring lawyers from dissolved firms. However, it would be premature to eulogize *Jewel* claw-back litigation just yet. Among other things, Judge Breyer's decision hinges on an interpretation of what qualifies as "property" under California law, *see, e.g., Heller Ehrman*, 2014 WL 2609743, at *1 ("While this Court distinguishes *Jewel v. Boxer* on its facts, it is also of the opinion that the California Supreme Court would likely hold that hourly fee matters are not partnership property . . ."), and the debtor's counsel in that case has publicly vowed to appeal Judge Breyer's ruling to the U.S. Court of Appeals for the Ninth Circuit. The federal appellate court may follow the lead of the Second Circuit and certify the state law property question to the Supreme Court of California.

Further, both courts have suggested that partners will continue to have a duty to account when the dissolution is motivated by the desire of certain partners to break off work, rather than the insolvency and inability of the firm to continue operating.

Therefore, because future *Jewel* litigation may arise, it would be advisable for firms to consider enacting *Jewel* waivers in advance of dissolution, though there are countervailing arguments against such waivers.[1] Even under the most aggressive interpretation of Judge Montali's decisions, had waivers been enacted at least two years before dissolution, no fraudulent transfer claim would have been available to the Brobeck or Heller estate under federal bankruptcy law. *See* 11 U.S.C. § 548(a)(1)(A)-(B). State law generally provides for a longer fraudulent transfer look-back period of at least four years. *See*, e.g., Cal. Civ. Code § 3439.09.

1 For example, healthy firms may be concerned that waiving the duty to account back would remove existing incentives for rainmakers or certain lucrative practice groups to remain with the firm in tough times. It is for these and other reasons that many firms declined to adopt *Jewel* waivers until dissolution was imminent.

Inside the Box

Since Fall 2008, the *Beazley Brief* has closely followed the evolving law on a critical question: are internal communications between attorneys and their firm's general counsel regarding the representation of a current client protected by the attorney-client privilege? The decided recent trend in the law says that the answer is yes - so long as certain requisites are maintained.

The latest court to join the chorus in favor of the privilege is Oregon. On May 30, 2014, the Oregon Supreme Court issued a decision in *Crimson Trace Corporation v. Davis Wright Tremaine LLP* (355 Or. 476 (2014)).* Oregon joins state high courts in Massachusetts (*RFF Family Partnership v. Burns & Levinson, LLP*, *465 Mass. 702 (2013))* and Georgia (*St. Simons Waterfront, LLC v. Hunter, Maclean, Exley & Dunn, P.C.*, 293 Ga. 419 (2013) in upholding the "intra-firm" privilege. The ABA has also lent its support. At its 2013 Annual Meeting, its House of Delegates joined the grounds well against the line of cases that challenged the intra-firm privilege when it adopted Resolution 103 which urged courts and other rule makers to support the view that the attorney-client privilege does protect confidential communications between law firm personnel and the firms' designated in-house counsel.

These decisions make clear, however, that the likelihood that the privilege will be recognized is enhanced if a firm follows certain requisites. Key to the analysis are the following: that the in-house counsel role within the firm has been formally established (with a lawyer acting as general counsel or ethics counsel) and is clearly defined; that a separate billing file has been established for in-house matters and those files are kept segregated from others relating to client work; that the in-house counsel has not worked on the matter involved in the communication; and that the consultation time with the in-house counsel is not billed to the client but rather to billing codes expressly set up for the in-house counsel's use.

***It is worth noting here that Gibson Dunn's Kevin Rosen was the attorney arguing in the Oregon Supreme Court on behalf of Davis Wright Tremaine LLP in the *Crimson Trace* case.**