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Unfinished-Business Suits Live On Despite NY Drubbing

By **Andrew Scurria**

Law360, New York (September 22, 2014, 3:13 PM ET) -- New York's highest court dealt unfinished-business litigation a body blow this summer, but subsequent decisions demonstrate that trustees of bankrupt law firms still have viable avenues for capturing profits made by onetime partners at their new homes, with targets' liability differing widely from state to state.

While the New York Court of Appeals' July ruling in the Thelen LLP and Coudert Brothers LLP bankruptcies was expected to have rung the death knell for unfinished-business claims nationwide, the Second Circuit and a California bankruptcy court have both walked back that narrative. Both issued rulings this month that allowed liquidating trustees to pursue hourly fees that defunct law firms might have made in the future.

The rulings may not have endorsed the trustees' positions, but they indicate that the Thelen case didn't spell the end for unfinished-business litigation and that its reach is likely to be limited outside New York, leaving claims intact elsewhere until the law in other states catches up. In many jurisdictions, it's still unclear when fees from pending client matters at a dissolved firm are the property of a bankruptcy estate and when they belong to the firms that picked up the work.

"It's probably too soon for people to relax and take great comfort in any of these decisions quite yet," said Mark C. Zebrowski of Morrison & Foerster LLP.

Suits over unfinished-business profits have been popular in recent years among trustees tasked with digging up funds to distribute to creditors. But they have faced resistance within the bankruptcy community and from the targeted law firms over fears that they interfere with attorney mobility and a client's right to choose its counsel.

The New York judges relied heavily on those policy considerations in concluding that firms do not "own" clients and cannot claim profits they might have made as their property. Although attorneys hailed the ruling, it eliminated only a property-based theory of recovery and only in New York.

There is no overarching bankruptcy law on unfinished-business claims, which are instead governed by the state laws of a firm's partnership agreement.

That means that changes to the pro-trustee law on the books in most states — informally known as Jewel, after a California appeals court's 1984 ruling in Jewel v. Boxer — will have to come from state appellate courts, said Alec P. Ostrow of Becker Glynn Muffly Chassin & Hosinski LLP. The Thelen and

Coudert Brothers cases, for example, wound up before the New York judges after working their way up the federal system from bankruptcy court.

“I don’t think you can come up with a broad-based rule of law that would in essence replace the unfinished-business rule that you can apply across the board,” Ostrow said. “You can’t have one court reconcile them.”

Judges handling these claims could look to the applicable state law and conclude that the reasoning announced in the Thelen decision does not apply in a given situation because the legal standards differ, according to Angelo G. Savino of Cozen O'Connor.

That’s exactly what U.S. Bankruptcy Judge Dennis Montali in California did on Sept. 9 in **preserving the Howrey LLP trustee’s unfinished-business claims** over partners who left both before and after the firm’s dissolution. Howrey’s partnership agreement was covered by District of Columbia law, where those claims are alive and well.

Whether such suits are viable in a particular state also depends on which version of the Uniform Partnership Act is in force, according to Matthew O’Hara of Hinshaw & Culbertson LLP. The UPA was amended in 1997 to include some features that cut against liquidating trustees, but a minority of states still have the original plaintiff-friendly version in place.

One provision in the amended UPA says that partners of dissolving firms are entitled to payment for services rendered in closing out partnership business, while another clarifies that a partner’s obligations not to compete with a previous employer terminates when a firm goes under, O'Hara said.

Although neither provisions speak directly to unfinished-business litigation, they have been cited in rulings on the issue, including a decision from a California federal court in January that shut down unfinished business in the Heller Ehrman LLP liquidation. The Heller trustee is appealing in the Ninth Circuit, which attorneys says is likely to affirm.

Until more decisions come down, the possibility for divergent case law to emerge among different states could prompt some firms facing large contingent liabilities to rethink their place of incorporation.

“National partnerships are going to have to think about what law they want to organize under,” Ostrow said. “It may be that a lot of LLPs that are organized under other jurisdictional laws might say that we like the New York rules, and maybe we should reorganize under New York law.”

Even New York, though, might not be safe. After the state high court ruled on the unfinished-business question in Coudert, it kicked the case back to the Second Circuit, which had sought its input. But the Second Circuit surprised observers by ruling on Sept. 2 that the Coudert administrator deserved a fresh chance to craft an alternate theory of recovery, possibly based on a partners' fiduciary duty to the defunct firm.

“Never underestimate the acumen of trustee counsel to come up with new arguments,” Savino said.

Attorneys will be watching closely to see if a new theory can survive, but no matter what happens in New York, the patchwork of precedents across different states is likely to persist.

“People do undertake commitments that they don’t have to undertake ... and if there’s an enforceable

commitment, you could probably create something out of that, but it would have to be really fact-specific," Ostrow said. "It couldn't be a blanket rule."

--Editing by Kat Laskowski and Christine Chun.
