Halloween Issue
October 2013

The Lawyers' Lawyer Newsletter

Recent Developments in Risk Management

TRICK OR TREAT!

The editors of the Halloween Edition of *The Lawyers' Lawyer Newsletter* bring you one tasty treat of a case, one nasty trick of a case, and one off-the-wall case involving a judge with an alter-ego, not unlike Dr. Jekyll and Mr. Hyde. We hope these dressed up tales will delight and frighten just in time for All Hallows Eve.

Trick or Treat Editors' note: Advance waivers received a lot of judicial attention over the past year, first with Galderma (see our May 2013 issue) and later with the Macy's case (below). These cases are definitely a "treat" for law firms that want to have their Halloween candy (engagement with a client) and eat it too (be adverse to the same client in the future), without the risk of a guillotine (disqualification).

Conflicts of Interest – Advance Waivers

***Macy's Inc., v. J.C. Penny Corporation, Inc.*, 2013 N.Y. App. Div. LEXIS 4798; 2013 NY Slip Op 4891 (June 27, 2013)**

Risk Management Issue: When are advance waivers of conflicts of interest valid and binding on clients, and what are the requirements that lawyers must meet in order for them to be enforceable?

The Case: By agreement dated March 7, 2008 an international law firm undertook to represent defendant client, a retailer, regarding certain "intellectual property litigation and trade mark registration" in Asia. The agreement expressly informed the client about the possibility that the law firm's present or future clients "may be direct competitors of [the client] or otherwise may have business interests that are contrary to [the client]'s interests," and "may seek to engage [the law firm] in connection with an actual or potential transaction or pending or potential litigation or other dispute resolution proceeding in which such client's interests are or potentially may become adverse to [the client]'s interests." The agreement unambiguously explained that the law firm could not represent the client unless the client confirmed that this arrangement was amenable to it, thereby "waiv[ing] any conflict of interest that exists or might be asserted to exist and any other basis that might be asserted to preclude, challenge or otherwise disqualify [the law firm] in any representation of any other client with respect to any such matter." The agreement also provided, [**2] "However, please note that your instructing us or continuing to instruct us on this matter will constitute your full acceptance of the terms set out above and attached."

Notwithstanding this agreement, the client sought to disqualify the law firm from representing a second retailer in this case. The trial court denied the motion to disqualify, and the New York Supreme Court, Appellate Division, First Department unanimously — and almost summarily — upheld the trial court's decision, holding that it had "providently decided" the motion. The Appellate Division found that "[i]t is undisputed that [the law firm] continued to represent defendant with respect to [the client's] Asian trademark portfolio" after the client accepted the terms set out in the engagement letter, "and, thus, defendant accepted the terms of the agreement, including waiver of the alleged conflict at issue." Further, the court noted that "the interests of defendant that [the law firm] represents, namely intellectual property litigation and trademark registration exclusively in Asia, do not conflict with defendant's interests at issue here . . ." In other words, the court implicitly concluded that the matters were unrelated, and that the law firm held no confidential information from its work on the Asian trademark portfolio that were of any relevance to this matter.

Comment: As we indicated in our discussion of the *Galderma* case in the May 2013 issue of the Lawyers' Lawyer, whether and when law firms should be able to rely on advance waivers of conflicts of interest involves the resolution of competing paradigms of legal ethics. On the one hand, the rules governing conflicts of interest are premised on the fiduciary duties of loyalty and the protection of client confidences. On the other hand, the law governing lawyers recognizes the principles that clients should normally be free to select counsel of their choice, free from outside interference, and that client consent can, in appropriate circumstances, form a proper basis for overcoming prohibitions on conduct that would otherwise be impermissible.

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Unlike the court in *Galderma*, the New York court summarily disposed of the motion to disqualify based upon the straightforward language of the advance waiver in the engagement letter. It appears from the transcript from the lower court decision that the letter containing the waiver was reviewed by a lawyer in the client's in-house law department. Although the waiver wasn't countersigned, the client proceeded to engage the firm, and the firm undertook the engagement on the basis of the letter. In that respect, therefore, this case goes further than *Galderma* in allowing a firm to rely on a waiver that it has supplied to the client and that has been reviewed by independent counsel and not rejected, even if it was not explicitly countersigned and agreed to. The case therefore represents another step along the way of recognition that sophisticated clients should be — and will be — held to understand, and be bound by, explicit advance waivers.

Risk Management Solution: Although this court did not go through the extended analysis that the Texas court did in *Galderma*, the steps recommended in our report about that case bear repeating as a useful checklist for law firms seeking to obtain enforceable advance waivers from sophisticated clients:

- First, as to existing or presently identifiable potential conflicts, in order for a waiver to have the greatest likelihood of being upheld, disclosure of both the specific facts and the potential adverse consequences should be made.
- Second, as to advance or blanket waivers of potential future conflicts, the disclosure should be as comprehensive and detailed as is possible, laying out the foreseeable types of adversity and the nature of the potential negative consequences for the client.
- Third, as to waivers of both existing and future conflicts, these should be obtained in circumstances that — as far as possible — preclude the client from later averring that the client did not understand the meaning or implications of the waiver. Waivers standing the greatest likelihood of being upheld are those where the client actually received independent legal advice with respect to the waiver – but a very significant element of the decision in this case is that in-house counsel for a corporation can serve that independent function.

Accordingly, the ideal signatory of a conflict waiver letter is a client's independent counsel — whether in-house, or outside. At a minimum, lawyers should advise clients to obtain the advice of independent counsel before signing waivers of conflicts, and, preferably, clients should be required to do so before lawyers proceed based on the waiver. Generally, this is easier where an in-house counsel is available, but, when there is not, if the law firm believes that there is any likelihood that it will later need to rely on the waiver, the case is even stronger for requiring the affected client to have another lawyer review the waiver letter before signing it.

Trick or Treat Editors' note: The "unfinished business" rule can certainly be a "trick" for law firms looking to acquire laterals from firms that are failing, or may fail in the near future. We hope that the risk management lessons learned from the "Hell"er case will help you and your firm avoid a long elevator trip in the wrong direction.

The 'Unfinished Business' Rule – Fraudulent Transfers – Risks in Hiring Attorneys From Failing Law Firms

***In re Heller Ehrman LLP*, Bankruptcy Case No. 08-32514DM; *Heller Ehrman LLP, Liquidating Debtor, v. Jones Day, et al.*, Chapter 11 Adversary Proceeding No. 10-3221DM, Memorandum Decision on Motions and Cross-Motions for Summary Judgment (Bankr. N.D. Cal. Mar. 11, 2013)**

Risk Management Issues: What are the special financial risks potentially faced by firms seeking to hire lawyers laterally from firms that dissolve? What is the meaning and scope of the "unfinished business" rule - at least under California law as viewed by the Bankruptcy Court for the Northern District of California? What can hiring firms do to mange the risks of the application of the rule in connection with lawyers whom they hire – and what can firms generally do to prevent the issue from arising? What are the implications of this case in the light of the two opposite decisions from the US District Court for the Southern District of New York (discussed in the November 2012 issue of the Lawyers' Lawyer) on the future of the unfinished business rule – and how should firms deal with the risks while the uncertainty continues?

The Case: In 2008, after a global law firm defaulted on its loans, its partners voted to dissolve the partnership pursuant to a written dissolution plan. The dissolution plan included a provision commonly referred to as a "*Jewel* waiver." The term refers to a California appellate decision, *Jewel v. Boxer*, 156 Cal. App. 3d 171 (1994), in which the court held that when a lawyer moves from a failing firm to a new firm, the new firm and the lawyer must pay the failed firm any profits on unfinished business taken to the new firm. The law firm's "*Jewel* waiver" provision waived the firm's rights and claims to seek payment of legal fees generated after the departure date of any

lawyer or group of lawyers with respect to unfinished firm business. After the dissolved law firm filed for Chapter 11 bankruptcy, its plan administrator sued various law firms, to which former partners of the dissolved law firm transferred, to recover profits those firms earned while completing former the dissolved-law-firm client matters that were pending, but unfinished on the date of the dissolved law firm's dissolution.

The dissolved law firm's plan administrator moved for summary judgment against all defendants, arguing that the *Jewel* waiver constituted a fraudulent transfer to the defendant law firms under both federal and California law. U.S. Bankruptcy Judge Dennis Montali first concluded that "unfinished business" meant "any business covered by retainer agreements between the firm and its clients for the performance of partnership services that existed at the time of dissolution," and that such unfinished business was the dissolved law firm's property absent the disputed *Jewel* waiver.

Judge Montali next concluded that the partners who left the dissolved law firm and joined defendant law firms did not provide "reasonably equivalent value" to the dissolved law firm in exchange for the *Jewel* waiver. Judge Montali reasoned that there was no evidence that any partner would have refused to execute the dissolution agreement absent the *Jewel* waiver. Thus, the *Jewel* waiver was not given to the departing partners in exchange for anything. Based on these conclusions and his finding that the dissolved law firm, at the time of the *Jewel* waiver, was incurring debts that were beyond its ability to pay, Judge Montali ruled that, notwithstanding the *Jewel* waiver, the transfer of the dissolved-law-firm matters to defendant law firms constituted a fraudulent transfer.

Judge Montali then looked to whether defendant law firms had any affirmative defenses to the fraudulent transfer claim. He determined that those law firms were "subsequent transferees" of the fraudulent transfers, in that the departing partners transferred to them unfinished business "free of any burden to account for profits." Under federal and California law, a subsequent transferee may be protected from recovery by the plaintiff, but only where the transferee "gave value" for the transferred property "in good faith." Judge Montali found that while defendant law firms bestowed many benefits on the former partners of the dissolved law firm, such as office space, staff and compensation, none were in exchange for the *Jewel* waiver, as defendant law firms all provided evidence that they did not hire the partners based on their unencumbered unfinished business. Because the benefits provided to the incoming partners would have been provided even without the *Jewel* waiver, defendant law firms could not take advantage of this affirmative defense.

Based upon the existence of a fraudulent transfer and the lack of any affirmative defense by defendant law firms, Judge Montali granted the dissolved law firm's motions for summary judgment and ordered a trial to determine amount of money earned by defendant law firms as profit on the unfinished business from the dissolved law firm.

Comment: This case is the latest in the series of recent decisions involving the "unfinished business" rule. See prior issues of the *Lawyers' Lawyer* newsletter: Volume 17, Issue 3, September 2012, discussing *Development Specialists, Inc. v. Akin Gump Strauss Hauer & Feld, LLP, et al.*; and Volume 17, Issue 5, November 2012, discussing *Geron v. Robinson & Cole LLP, et al.*, 2012.

Risk Management Solutions: Even if the *Geron* case is very clearly upheld on appeal, and the *Development Specialists* case is rejected as to New York law, and the unfinished business rule is abrogated as to hourly fee cases in New York, the rule will remain a problem as to cases where California law governs, as demonstrated by this decision. Accordingly, hiring firms' due diligence efforts continue to be significantly complicated. Confidentiality obligations generally prevent a potential lateral from revealing the contents of his or her current firm's partnership agreement, but educating a lateral on the issues that the rule presents — both for the lawyer and the hiring firm — and seeking assurances regarding those risks (*e.g.*, that the lateral's current firm is not about to dissolve, and whether or not the current firm's partnership agreement contains an anti-*Jewel* provision) is reasonable and prudent for hiring firms. Once a lateral lawyer has given notice to his or her solvent former firm and clients have responded to joint notification letters, it may be worth considering whether there is an opportunity to negotiate a fee division with the former firm to avoid the potentially devastating effects of a *Jewel* claim years later. The opposite, of course, is true when a prior firm is insolvent because agreements that divert assets from an organization on the verge of bankruptcy are risks arguably not worth taking.

Other due diligence procedures may also be worthwhile, if more uncertain, to avoid or at least limit the possibility of these claims. For instance, careful research of publicly available information about the firm which the lateral prospect wishes to leave may produce useful intelligence about the firm's long-term prospects. Similarly, even firms that resist using "headhunters" to identify potential recruits may wish to consider engaging one or more of these professionals to act as consultants — extra eyes and ears to the market place — to identify firms where there are signs of incipient problems, such as a rash of resumes on the marketplace. Finally, whenever there is the slightest perceived risk that the rule will be applied to work being brought by the lateral to the hiring firm, the financial terms offered to laterally moving lawyers are likely to be significantly circumscribed.

Additionally, law firms generally may seriously consider adopting so-called anti-*Jewel* provisions, while they are still going concerns, in order to avoid the problems posed to both partners who leave the firm and the firms to which they seek to move, if the prior firm subsequently dissolves. An example of such a provision might be:

> The [partners/shareholders/principals] each acknowledge the duty to complete work undertaken for clients while with the firm. However, all [partners/shareholders/principals] and [name of entity/firm] waive any and all rights to receive payment of legal fees generated from unfinished business after dissolution or fees generated by any departing lawyer or group of lawyers following their departure in connection with matters that were in-progress at the time of departure. Following dissolution, each lawyer or group of lawyers shall be solely entitled to the post-dissolution fees they generate from the winding up of [entity/firm name's] unfinished business.

Limits on Extra-Judicial Activities - Conduct of Judges

In re Advisory Letter No. 3-11, 2013 WL 5269755 (N.J.)

Risk Management Issue: What are the risks if a part-time sitting judge engages in a side-career as an actor and comedian, and what generally are the limits for extra-judicial activities of judges?

The Case: The New Jersey Supreme Court Committee on Extra-Judicial Activities recently considered the question of whether a part time municipal judge could maintain a career as a part time comedian and actor. Judge Vincenzo August Sicari a/k/a Vince August (his stage name) originally began practicing law in New Jersey as a personal injury attorney in the late 1990s under his given name, while pursuing an entertainment career in television, films and commercials under his stage name. He also appeared regularly as a stand-up comedian in a night club in New York. He managed to keep both his legal and acting careers separate during this time period.

In 2007, the mayor of Hackensack, New Jersey appointed Sicari as a part-time municipal court judge. Sicari disclosed his entertainment career to the mayor and he assured the mayor that he had always kept his legal and entertainment professions separate. He never mentioned his practice of law in any comedy or acting routines.

The conflict came to a head when Judge Sicari was asked for an interview with a local New Jersey paper regarding his dual roles as judge and comedian. Sicari had been interviewed for a previous article that discussed his dual professional life when he had been an attorney. Unsure whether he should agree to an interview while a judge, Sicari asked for an ethics opinion from the Advisory Committee. The Advisory Committee told him, in a written opinion, that not only should Sicari not give the interview, but that his entertainment career was incompatible with his service as a sitting municipal court judge.

Sicari appealed, wherein he received an advisory letter from the Advisory Committee. The letter stated that Sicari's entertainment profession could create an appearance of impropriety. It noted several factors that influenced the Advisory Committee's decision including a LinkedIn account and a website in the name of Vince August which identified himself as an attorney. The Advisory Committee was concerned that viewers of the website might believe that Judge Sicari "shares the same views as the characters he portrays" thereby creating a perception of bias or lack of impartiality, or that it may "impair the dignity and esteem in which the court should be held."

Sicari appealed to the New Jersey Supreme Court Committee on Extra-Judicial Activities. In its opinion, the Committee emphasized that not only was it concerned with judicial integrity, but also with the appearance of judicial integrity. It noted that judges must conduct their extra-judicial activities so that they do not cast reasonable doubt on the judge's capacity to act impartially, demean the judicial office, or interfere with proper performance of judicial activities.

The Committee examined various entertainment projects engaged in by Sicari as his alter-ego, Vince August. It looked at a TV show entitled "What Would You Do?", a show that was described as a social experiment in which members of the public would be presented with situations where they might be expected to intervene or aid a stranger. Shows dealt with such issues as the harassment of gay men in a bar or "shopping while black." In the "Shopping While Black" episode, Sicari/August played a security guard engaging in racial profiling of black customers.

The Committee reviewed a DVD provided by Sicari that contained some of his comedy club performances. His routines follow current events and were described as "constantly changing." Sicari admitted that his performances are largely self-deprecating and flow from his personal experiences as an Italian Catholic living in America.

Sicari also wrote, directed and produced an award-winning comedy film called "Vinsanity." Although he referred to it as the centerpiece of his comedy career, Sicari claimed he could not locate a copy of this performance to present to the Committee. His failure to produce a copy of the film to the Committee led it to the belief that "Vinsanity" was likely replete with humor which would be inappropriate for a municipal court judge.

The Committee found that although there was no evidence that Sicari ever conducted himself in the courtroom in any fashion that was unprofessional, his entertainment career created any impression to the public that Sicari could have biases that would be unbecoming for a municipal court judge, largely based upon the characters he played and the jokes he told as his alter-ego Vince August. The Committee found that while Sicari could continue his entertainment career as an attorney practicing in the courts of New Jersey, he could not do so as a sitting municipal court judge.

Risk Management Solution: Choose your career path carefully! This decision focuses on the limitations on the activities of judges and contrasts the competing precepts that judges should not be isolated and should be encouraged to remain active members of the community, while also holding them to a very high standard of conduct within the community. This decision holds that a judge may not portray a character with questionable or controversial activities or views due to the possibility that the performance might be perceived as exhibiting personal biases held by the judge. Taken to its logical conclusion, however, the New Jersey Supreme Court Committee on Extra-Judicial Activities effectively decreed that once any person dons a judicial robe, he or she gives up the right to engage in political or controversial speech that might create the perception of bias, so long as he or she remains a judge.

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