The Lawyers' Lawyer Newsletter

Recent Developments in Risk Management

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Lateral Movement – Another Take on the Unfinished Business Rule

***Geron v. Robinson & Cole LLP, et al.*, 2012 WL 3800766 (S.D.N.Y., Sept. 4, 2012)**

Risk Management Issue: 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? 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 opposite decisions from the same court on the future of the unfinished business rule – and how should firms deal with the risks while the uncertainty continues?

Editors' Note: If the risk management issue and the questions at stake in the case seem familiar to our readers, there is a simple explanation. In the September 5, 2012, issue of the *Lawyers' Lawyer* we discussed the decision in *Development Specialists, Inc. v. Akin Gump Strauss Hauer & Feld, LLP, et al.*, No. 11-cv-5994 (S.D.N.Y.) (Mem. Order Granting Defendants' Join Motion to Withdraw the Bankruptcy Reference and Denying Defendants' Joint Motion for Abstention, filed Nov. 2, 2011) (the "Coudert case"). In this new case, involving the bankruptcy of another once prominent firm, Thelen LLP, a different judge from the same federal district reached opposite conclusions. The implications of this development are discussed below.

The Case: The case arises from the bankruptcy of Thelen LLP. Just as in the Coudert case, the trustee of the Chapter 7 estate of Thelen brought adversary proceeding against the law firms to which Thelen's attorneys departed, seeking to recover, on a preference theory, the value of pending hourly fee matters that attorneys brought with them to these new firms, based on the unfinished business doctrine. Defendants moved to dismiss trustee's complaint or for judgment on pleadings.

The unfinished business doctrine developed based on the decision in *Jewel v. Boxer*, 156 Cal. App. 3d 171 (1984), and springs from the longstanding rule in partnership law that when a partnership dissolves the former partners are responsible for winding up the business of the partnership for the benefit of that partnership. The *Jewel* court significantly extended the rule by holding that, following dissolution, no partner of a defunct law firm is entitled to extra compensation for completing unfinished business and that "income generated through the winding up of unfinished business is allocated to the former partners according to their respective interests in the partnership." 156 Cal. App. 3d at 176. The case expressly determined that this rule extends to all of the legal fees collected on matters begun at the old firm.

Here, in a very carefully reasoned opinion, Judge Willliam H. Pauley, III framed the question thus:

> "The pursuit of pending hourly fee matters as assets of the estate has become a recurring feature of [major law firm] bankruptcies. But this concept of law firm "property" collides with the essence of the attorney-client relationship. That relationship springs from agency law, not property law. The client is the principal, the attorney is the agent, and the relationship is terminable at will. The question presented is whether a dissolved law firm's pending hourly fee matters are nevertheless its property."

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Thus, from the outset, Judge Pauley signaled that he viewed the issues very differently from Judge McMahon's analysis in the Coudert case. First, however, he dealt with a choice of law issue – whether New York's or California's law should apply – and decided to apply New York law except as to a defendant firm (Robinson Cole) that had conceded that California law should apply. Then, as to the other defendants, and following a close reading of New York case law, he concluded that:

> "Although New York cases deem pending contingency fee matters to be 'assets' of a dissolved firm,' . . . In an hourly fee case, unlike a contingency fee case, all post-dissolution fees that a lawyer earns are due to that lawyer's 'post-dissolution efforts, skill and diligence[.]' [citations omitted]. Accordingly, New York law does not recognize a debtor law firm's property interest in pending hourly fee matters."

Most significantly, Judge Pauley explored in depth the applicable ethics rules and case law that address the client's right to select counsel. He expressly rejected Judge McMahon's analogy in the Coudert case that a pending matter is no different than a painting on a law firm's walls:

> "A pending client matter is not an ordinary article of commerce. Contrary to [the Coudert case], an hourly fee matter is not akin to 'a Jackson Pollack [sic] painting' that a departing attorney 'rip[s] off the wall of the reception area [.]' The client, not the attorney, moves a matter to a new firm. Thus, the attorney-client relationship is unique, and . . . New York law does not countenance such a result."

In [*Cohen v. Lord, Day & Lord*, 75 N.Y.2d 95, 96, 551 N.Y.S.2d 157, 550 N.E.2d 410 (1989),] the New York Court of Appeals drew on an ethics opinion from the New York County Lawyers' Association to emphasize New York's commitment to client autonomy: "Clients are not merchandise. Lawyers are not tradesmen. . . . An attempt, therefore, to barter in clients, would appear to be inconsistent with the best concepts of our professional status. . . . This policy applies just as forcefully to client matters." (emphasis added, citations omitted). Accordingly, save as to contingency fee matters, as to which Judge Pauley granted leave to replead, he dismissed the trustee's claims for the value of unfinished hourly business matters.

With respect to the defendant firm that had conceded that California law should apply, Judge Pauley declined to dismiss the trustee's claims. He concluded that California law may still recognize a dissolving firm's pending hourly fee matters as "assets." Specifically, to the extent that Robinson & Cole earned profits from former Thelen matters exceeding "reasonable compensation," California law dictates that those profits belong to Thelen.

Comment: Because the court in the Thelen case relied upon the opposite reasoning and reached a contrary outcome to the Coudert case, it now seems almost certain that one or both will be appealed. As indicated in connection with the Coudert case, the issues of New York law may well be referred by the U.S. Court of Appeals for the Second Circuit to the New York Court of Appeal for determination. For those readers who recall our comments on the Coudert decision, it will be apparent that we view Judge Pauley's analysis of the issues, the applicable principles, and the outcome as correct, in stark contrast to Judge McMahon's decision in the Coudert case. The critical issue for the appellate courts to address is whether New York's public policies in favor of unfettered movement of lawyers, and favoring the freedom of clients to select counsel of their choice trump the unfinished business rule in noncontingency fee cases. There are several reasons why New York appellate courts should reach these conclusions. First, if the Coudert decision is upheld over the result in this case, it would amount to an invitation for departing laterals to race for the exit as soon as there is the slightest concern that their current firm may dissolve, in order to avoid application of the *Jewel* rule (bypassing the bankruptcy rules governing preferences). Inevitably, the *Jewel* rule can serve to destabilize perfectly viable law firms. Second, such an outcome is likely to be unfair in its application as between transactional lawyers and litigators. Frequently, litigators' unfinished business lasts longer and may have greater value than transactions in terms of total billings. Third, the principal of unfettered movement has been critical in shaping the legal profession, so that leaving the unfinished business rule in place would materially limit its future efficacy. Finally, the fact that in the Coudert case Judge McMahon accepted that partners can agree in advance not to treat unfinished business as an asset of the partnership adds further to the inequity of application of the rule. By making it harder for lawyers to leave firms that have not amended their agreements, and riskier for hiring firms to take on lawyers from such firms, upholding the *Jewel* rule makes for an uneven playing field among lawyers seeking to make a move, and undermines the rule favoring unfettered movement of lawyers and established case precedent.

Risk Management Solutions: Unless and until this decision is very clearly upheld on appeal, and the Coudert decision rejected, and the unfinished business rule is abrogated as to hourly fee cases, hiring firms' due diligence efforts will continue to be significantly complicated. Confidentiality obligations generally prevent a potential lateral from revealing the contents of 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, such as a rash of resumes on the marketplace, of incipient problems. 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 wish to give serious consideration to adopting so called anti-*Jewel* (perhaps in future to be called "anti-Coudert") provisions 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, as described above in the Comments. 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.

Responsibilities of Co- and Local Counsel – Liability for Acts of Primary Counsel, Including for Malicious Prosecution – ("*Hear No Evil, See No Evil, Speak No Evil*" Doesn't Work)

***Cole v. Patricia A. Meyer & Associates, APC* (2012) 206 Cal. App. 4th 1095 (June 8, 2012)**

Risk Management Issue: What is the scope of the duties and responsibilities of co-, associated or local counsel towards clients and third parties for the acts of primary counsel? May associated counsel of record insulate themselves from exposure to malicious prosecution liability by doing nothing or knowing nothing about a case?

The Case: Three attorneys, Meyer, Boucher and Ottilie, acted as plaintiffs' co-counsel in a shareholder action brought against Mr. Cole and Peregrine Systems, Inc. Cole successfully obtained summary judgment in the underlying shareholder suit and sued Meyer, Boucher, and Ottilie for malicious prosecution and defamation.

The trial court granted Boucher and Ottilie's anti-SLAPP special motion to strike, based upon their representation that they had not participated in the underlying suit, and had only associated in the case for purposes of trial and any later awarded attorneys' fees. On Cole's appeal, the California Court of Appeal reversed, finding that Cole had demonstrated a likelihood of prevailing on the malicious prosecution claims.

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Boucher and Ottilie had been consistently identified as co-counsel of record in the underlying case, along with lead counsel Meyer, and never objected to anyone that they did not actually represent the underlying plaintiffs. Boucher argued that he had a working relationship with Meyer, wherein Meyer would perform the pretrial workup of the case, and Boucher would try it. Ottilie argued that his role was only to assist with the trial, and he billed no time on the case. Both disclaimed any duty to make a probable cause determination in the malicious prosecution case, due to their limited scope of engagement.

The court of appeals rejected this unilateral limitation, holding that as formal counsel of record, both Boucher and Ottilie owed a duty to their client that encompassed a knowledge of the law, and an obligation of diligent research and informed judgment. The court further rejected Boucher and Ottilie's argument that Cal. R. Prof'l Conduct 3-110(C) allowed them to associate with other counsel they reasonably believed to be competent, where they themselves were not. The court held that even where work on a case is performed by an experienced attorney, "competent representation still requires knowing enough about the subject matter to be able to judge the quality of the attorney's work."

The court held that while the law permits an attorney to formally associate in another attorney and divide the duties of conducting the case, that associated attorney is not absolved of the obligation to know about the case in which he or she is associated. An associated attorney whose name appears on a case may not shield him or herself from malicious prosecution liability by intentionally failing to learn anything about the case.

Further, by lending their names to all filings in the case, Boucher and Ottilie supported the inference they also "presented" the filings to the court, and thus "initiated and prosecuted" the case along with lead counsel, Meyer. The court stated that attorneys may easily avoid liability for malicious prosecution without having to engage in premature work on a case if they refrain from associating in it until their role is triggered, or if they refrain from lending their names to pleadings or motions about which they know next to nothing. Because Boucher and Ottilie had not shown that they had any knowledge of the claims against the underlying plaintiffs, or that they made any effort to independently investigate or research those claims, the inference was that they lent their names to the case with indifference to its actual merit, opening up the possibility that these attorneys could be exposed to liability for malicious prosecution.

Comment: This case provides a cautionary tale for those attorneys who appear in a lawsuit as an associated attorney of record. Such lawyers may not simply rely on the competence of co-counsel to avoid liability if mistakes are made. All attorneys of record in a matter owe an independent duty to make certain that the case has a legitimate legal and factual basis. By lending one's name formally in litigation, an attorney exposes him or herself to the same liabilities as lead counsel for malicious prosecution, notwithstanding any agreement with lead counsel to limit his or her role in the case.

Risk Management Solutions: The case has implications for client intake systems, to make sure that appropriate investigation has been or is being undertaken to determine the appropriateness of the client's objectives. Equally, on an ongoing basis while a matter is open and an engagement is continuing, and consistent with every state's equivalent of Model Rules 5.1 and 5.2 of the Rules of Professional Conduct dealing with supervisory responsibilities, the responsibilities of subordinate lawyers, and the other rules governing competent and diligent representation, "*see no evil, hear no evil, speak no evil*" in relation to the conduct of other lawyers involved in the matter is not an appropriate method of case or matter management.

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