

Resolving 'Unfinished Business' From a Defunct Law Firm

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If rainmakers have an incentive to stay at a firm through rough seas, the firm's chance of survival may increase.

There have been several high-profile dissolutions of law firms over the last decade. With those dissolutions has also come litigation over whether those law firms can claim any ownership to their "unfinished business"—work that the firms were once hired to do that is being brought to new firms by the dissolved firms' former partners.

In a long-awaited decision, the California Supreme Court has unanimously decided that a dissolved law firm has no property interest in fees earned by their former partners working for new firms on hourly fee matters.

In *Heller Ehrman LLP v. Davis Wright Tremaine LLP*, the California Supreme Court reviewed a law firm that, at the time of its dissolution, had several active matters for which the firm was billing on an hourly basis. Once the firm dissolved, those matters went to new firms (typically with the former partners of the dissolved firm who joined new partnerships). Now that the firm was dissolved and bankrupt, its plan administrator began pursuing claims to recover assets for the firm's debts. The plan administrator sought to recover profits from the new firms generated by the hourly fee matters that were pending at the time of dissolution. The court ultimately decided that the dissolved partnership is not entitled to profits earned from its former partners' work on unfinished hourly fee matters.

Although the national impact of *Heller* remains to be seen, it provides a helpful touchstone for law firms considering their futures and for those firms that have hired partners from dissolved firms.

Jewel's potential application to contingent fee matters

Prior to the *Heller* decision, the standard on "unfinished business" in California was *Jewel v. Boxer*, which found that when an attorney leaves a dissolving firm and takes ongoing contingency work to a new firm, the departing partner and new firm may be required to disgorge profits earned in the completion of that work. The reasoning is that, for contingency fee matters, the dissolved firm completed at least a portion of the representation, which the eventual resulting contingent fee would have compensated.

Over the years, *Jewel* has become a benchmark for courts all over the country in reviewing these issues. However, there was doubt nationwide as to whether *Jewel* had any application out of California and, even within California, if it applied to non-contingency fee cases. This ambiguity still remains outside of California, to some degree, because other jurisdictions are still reviewing these issues under their own laws. For example, in February, the US Court of Appeals for the Ninth Circuit certified to the DC Court of Appeals legal issues relating to whether dissolved firms can recover profits from its former partners' new firms.

Although *Heller* on its face could appear to be at odds with *Jewel*, the *Heller* court recognized that *Heller* and *Jewel*

arose in different contexts: “*Jewel* dealt with contingency fee matters, and whether our conclusion in this case extends to such matters is a question we need not address here.” Thus, *Jewel* likely remains good law in the context of contingency fee cases, at least in California (and perhaps in those states that have adopted *Jewel*’s reasoning).

Client choice

The California Supreme Court’s decision was motivated in part by the conclusion that the client’s right to choose its own counsel is superior to any dissolved law firm’s future interest in clawing back profits for hourly fee matters.

This does not mean, however, that lawyers are expected to work for free. Indeed, dissolving law firms can seek payment for or recovery of fees for work already performed for clients. Further, the court was clear that the decision is fairly limited in scope to review simply a dissolved firm’s property interests, and not intended to resolve issues of fiduciary obligations owed by a partner to a partnership.

Considering a *Jewel* waiver

Law firms who may be subject to *Jewel* for contingency fee matters can consider whether, as a partnership, they wish to adopt what is known as a “*Jewel* waiver.” In most situations, including such a term in a partnership agreement permits a partner to complete unfinished business originated at the dissolved firm without the financial or legal obligation to disgorge fees earned from that business after moving to a new firm. The *Jewel* court recognized such a provision as a means “to endure a degree of exactness and certainty unattainable by rules of general application.”

A waiver may be attractive to rainmakers who are focused on the portability of their practice and want to be able to move to a new firm upon dissolution without owing any fees to the dissolved practice. But firms that want to deter a mass exodus of defecting partners at the first sign of trouble may not want to pursue a waiver option. Indeed, if rainmakers have an incentive to stay at a firm through rough seas, the firm’s chance of survival may increase.

Interestingly, *Heller* involved a *Jewel* waiver that “governed only those matters billed on a non-contingency—that is continual, or hourly—basis.” However, *Jewel* waivers may no longer be helpful for firms that do not conduct contingency business, as hourly fee disputes may be governed entirely by *Heller* in applicable jurisdictions going forward.

One thing to note for firms and partners considering waivers: A last-minute *Jewel* waiver that permits partners to take all the proceeds of contingency fees with them may be subject to increased scrutiny. There is a risk that if such a waiver is effectuated once the law firm is already on the verge of or in the process of dissolving, the waiver could be deemed a fraudulent transfer under the Bankruptcy Code and unenforceable.

Although jurisdictions still may vary regarding the impact of *Jewel* and *Heller*, additional decisions on these issues are clarifying things not only those firms that may face economic collapse, but also for those firms that may hire partners leaving a dissolved firm.

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