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Seyfarth Wins Precedent-Setting Dismissal of Thelen Trustee's Unfinished Business Claims

On September 5, 2012, U.S. District Judge William H. Pauley III issued a memorandum opinion rejecting a bid by the trustee for Thelen LLP's bankruptcy estate to recover profits from legal services performed by lawyers at Seyfarth Shaw LLP on hourly fee matters once serviced by now-defunct Thelen.

Thelen formerly was a limited liability partnership registered in California. Thelen had offices worldwide, including in New York City. On October 28, 2009, under the pressures of the global financial crisis and facing mounting partner defections, Thelen's remaining partners voted to dissolve their partnership. At the same time, Thelen's partners adopted an amended partnership agreement that included a "*Jewel* waiver" abandoning, among other things, "any claim or entitlement to clients, cases or matters ongoing at the time of dissolution[.]" The *Jewel* waiver noted expressly the partners' intent to waive any claims to "unfinished business" of the partnership, as that term is defined in *Jewel v. Boxer*, 156 Cal. App. 3d 171 (1st Dist. 1984), or as otherwise provided through interpretation of California's Uniform Partnership Act of 1994, as amended. On September 18, 2009, a little over a year after Thelen's partners voted to dissolve the firm, Thelen filed a voluntary petition for relief under chapter 7 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. Yann Geron was appointed as trustee of Thelen's bankruptcy estate, and thereafter, he instituted adversary proceedings against many of the firms, including Seyfarth, that hired former Thelen partners. The suits, based primarily on fraudulent transfer law, seek to recover profits from hourly fee matters that were pending at Thelen when it dissolved and that the defendant firms thereafter serviced for Thelen's former clients.

In his complaint against Seyfarth, the trustee alleged that prior to the Thelen partners' adoption of the new partnership agreement and the *Jewel* waiver, each of Thelen's partners had a fiduciary duty under California law to account to Thelen "any property, profit or benefit derived by the partner in the conduct and winding up of Thelen's business" or derived from the use of "partnership property or information." According to the trustee, execution of the *Jewel* waiver effectuated Thelen's waiver of "its rights to recover the value of the Unfinished Business and waived the partners' Duty to Account[.]" This waiver, the trustee contended, constituted a transfer by Thelen of an interest in property. The only alleged "property" that the trustee sought to reclaim was Thelen's purported ownership interest in future profits from its former clients' hourly fee matters, or "unfinished business."

Seyfarth moved for judgment on the pleadings, asserting first that New York, not California, law should govern whether Thelen owned its pending hourly fee matters at the time it dissolved. The trustee argued that California law should control because Thelen's partnership agreement contained a choice-of-law provision stating that California law "shall govern the construction, interpretation, and effect of this Agreement." Judge Pauley rejected this argument because Seyfarth was not a party to Thelen's partnership agreement and is thus not bound by its terms. Utilizing New York's choice-of-law rules, the "interest analysis," Judge Pauley then concluded the New York had a greater interest in the litigation than California. He based his decision on the facts that the majority of former Thelen partners whom Seyfarth hired are licensed to practice in New York, Thelen filed for bankruptcy in the Southern District of New York and indicated its domiciliation or residence in New York, and the alleged tort of fraudulent transfer occurred in New York.

Applying New York law, Judge Pauley then considered Seyfarth's argument that New York law does not recognize a dissolved law firm's property interest in pending hourly fee matters. Courts in New York, California, and elsewhere have previously

held that a dissolved firm may recover some portion of future revenue generated from contingency fee matters, but Judge Pauley rejected an expansion of the unfinished business doctrine to hourly fees. In so ruling, Judge Pauley described his role as predicting how the New York Court of Appeals would rule on the property interest question, a state law matter, and ascertaining what the state law is, not what it ought to be. Accordingly, he considered the only New York state court authority on point, a reasoned decision from Justice Eileen Bransten of the New York Supreme Court (the trial level in New York) in *Sheresky v. Shreseky Aronson Mayefsky & Sloan, LLP*. Judge Pauley, like Justice Bransten, noted important distinctions between contingency fee and hourly fee matters, such as the fact that all post-dissolution hourly fees are attributable to the "efforts, skill and diligence" of lawyers at the new firm and that Thelen's estate would receive an unjust windfall if awarded fees that should be paid to the attorneys performing the work.

Judge Pauley also examined New York's strong public policies against restrictions on the practice of law and clients' absolute right to choose counsel and its Rules of Professional Conduct barring a division of legal fees that is not in proportion to the services performed by each lawyer. He took heed of the bizarre consequences that would flow from defining hourly fee matters as property, particularly in the bankruptcy context. Judge Pauley expressed his concern with an outcome that would permit a debtor law firm to sell its pending hourly fee matters to the highest bidder pursuant to Bankruptcy Code section 363 or that would sanction a client who discharges a debtor law firm and transfers his case to a new firm for violating the automatic stay in Bankruptcy Code section 362. His concerns, of course, comport with the unique and special relationship between attorney and client and are consistent with Judge Pauley's refusal to find a property interest in hourly fee matters through analogy to executory contracts in other professions, such as architecture partnerships.

Judge Pauley's decision is important for a number of reasons, two of which are mentioned here. First, the ruling is in direct conflict with a recent ruling by U.S. District Judge Colleen McMahon in the Coudert Brothers LLP bankruptcy case, whereby Judge McMahon concluded that New York courts would recognize unfinished business claims for hourly fee matters. Judge Pauley refused to follow Judge McMahon's reliance on decisions from other jurisdictions applying other states' laws in the face of *Sheresky* and discounted the application of *Stem v. Warren*, a New York case discussed at length by Judge McMahon, in the attorney-client context. He also disagreed with Judge McMahon's comparison of a pending hourly fee matter to a Jackson Pollack painting, reciting the New York Court of Appeals' pronouncement that "Clients are not merchandise." Both Judge Pauley and Judge McMahon have certified their conflicting decisions for interlocutory appeal to the U.S. Court of Appeals for the Second Circuit. Second, Judge Pauley's decision and his realistic approach to how unfinished business claims impact client autonomy and attorney mobility could not come at a better time. Numerous firms across the country that have taken on departing partners from collapsed law firms, such as Thelen, Coudert, Howrey Simon, Heller Ehrman, Brobeck Phleger & Harrison, and, most recently, Dewey & LeBoeuf, are facing or may soon face similar claims.

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