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Law Firm Clients Defeat Bankruptcy Trustees in New York Court of Appeals

By Michael L. Cook

The New York Court of Appeals, on July 1, 2014, in response to questions certified by the U.S. Court of Appeals for the Second Circuit, held that "pending hourly fee matters are not [a dissolved law firm's] 'property' or 'unfinished business'" under New York's Partnership Law. *In re Thelen LLP*, _____ N.Y.3d _____, 2014 N.Y. LEXIS 1577, *1 (July 1, 2014). *See In re Thelen LLP*, 213 F.3d 213, 216 (2d Cir. 2013). A federal district court had applied California law to reach the same conclusion in a similar case three weeks earlier. *In re Heller Ehrman*, 2014 U.S. Dist. LEXIS 81087, *2 (N.D. Cal. June 11, 2014) ("A law firm — and its attorneys — do not own the matters on which they perform their legal services. Their clients do.")

The bankruptcy trustees of two dissolved law firms (Thelen LLP and Coudert Brothers) raised the issue when they sought to recover profits that other law firms had earned on hourly fee matters brought to those firms by departing Thelen and Coudert partners. According to the trustees: 1) pending hourly fee matters that were taken to the new firms were Thelen and Coudert property; and 2) the new firms had to account for their earnings on those matters. As *The Wall Street Journal* noted on July 7, 2014, the trustees were trying to "claw back money earned on pending matters for the benefit of [the dissolved firms'] creditors."

Relevance to Clients

The court stressed that the trustees' position "would have numerous perverse effects," and would conflict "with basic principles that govern the attorney-client relationship under New York law and the Rules of Professional Conduct." 2014 N.Y. LEXIS 1577 at *1. Among other things, the departing lawyers "might advise their clients that they can no longer afford to represent them, a major inconvenience for the clients and a practical restriction on a client's right to choose counsel." *Id*. at *20. In addition, "clients might worry that their hourly fee matters are not getting as much attention as they deserve if the [new] law firm is prevented from profiting from its work on them." *Id*. More important, New York has a "strong public policy encouraging client choice and, concomitantly, attorney mobility." *Id*. at *21. Quoting from a 1943 New York County Lawyers' Association opinion, the court stressed that "[c]lients are not merchandise. Lawyers are not tradesmen. They have nothing to sell but personal service." *Id*. at 17.

The Unfinished Business Doctrine

The Thelen and Coudert trustees relied on the so-called "unfinished business doctrine" that had originated with an intermediate California appellate court. *Jewel v. Boxer*, 156 Cal. App. 3d 171 (Cal. Ct. App. 1984) (held, absent an agreement to the contrary, profits derived from a law firm's unfinished business are owed to former partners in proportion to their partnership interests). As the N.Y. Court of Appeals noted, according to *Jewel* and other courts that have followed it, "departing partners owe a fiduciary duty to the dissolved firm and their former partners to account for benefits obtained from use of partnership property in winding up the partnership's business. …" *Id*. at *1. But nothing in New York's Partnership Law, continued the New York court, says anything "about whether a law firm's 'client matters' are partnership property." *Id*. In rejecting the unfinished business doctrine, the court reasoned that "no law firm has a property interest in future hourly legal fees because they are 'too contingent in nature and speculative to create a present or future property interest'… , given the client's unfettered right to hire and fire counsel. Because client matters are not partnership property, the trustees' reliance on [New York] Partnership Law … is misplaced." *Id*. at *13. As the *Heller* court in California stressed, "[t]he client always owns the matter, and the most the law firm can be said to have is an expectation of future business." 2014 U.S. Dist. LEXIS 81087, at *18.

A law firm only owns unpaid compensation for legal services already provided with respect to a client matter. In the words of the New York court, "a client's legal matter belongs to the client, not the lawyer." *Id*. at *15.

The Thelen and Coudert trustees' litigation will now return to the Second Circuit for disposition. Because of this final ruling on applicable New York Law, the court should direct the dismissal of the trustees' complaints. In New York, at least, the unfinished business doctrine is finished — and may be on its way out in California, too, given the strong *Heller* decision handed down two weeks before *Thelen*, but not cited by the New York court. The trustee in *Heller* will reportedly appeal to the Ninth Circuit. Other trustees around the country will also try to salvage their unfinished business claims in courts not bound by *Thelen* and *Heller*.

Conclusion

Thelen is not based on any unique feature of New York Law. Other appellate courts may find the New York court's pragmatic, sensible reasoning persuasive. It is based on sound policy considerations, particularly clients' right to counsel and lawyer mobility. Any other business-minded states should follow New York's lead in grasping the legal "profession's traditions and commercial realities of the practice of law today." *Id*. at *23.

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