

Ruling May Curb Mobility of Lawyers at Struggling Firms

Judge's Ruling Raises Risk of Suits Against New Employers

By

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Partners at struggling law firms may find it harder to jump ship in the future after a new ruling raised the risk of lawsuits against the firms that hire them.

Firms that hire lawyers from bankrupt law firms have long been subject to "unfinished business" claims, which seek to recover profits from ongoing legal work that partners take with them to their new homes. Such claims have typically been confined to firms that take on lawyers once a firm has shut down, under the theory that pending matters are assets that rightfully belong to the failed firm.

But a ruling this month in the case of defunct Washington, D.C., law firm Howrey LLP has rattled some in the industry because it said that partners who leave a firm before it dissolves also have a duty to return any profits from unfinished legal work.

The result could constrict a key escape hatch for law-firm partners at a time when many firms, caught between frugal clients and a dearth of business, are struggling to boost revenue. At least 10 major law firms have gone under in the past 15 years, scattering hundreds of partners who typically take ongoing legal work with them to their next job. The next wave may have a harder time making such moves as their firms circle the drain.

On Feb. 7, California Bankruptcy Judge Dennis Montali ruled that "there is no reason to limit the definition of Howrey unfinished business to matters pending as of dissolution."

He gave bankruptcy trustee Allan B. Diamond the green light to try to recoup any profits from such work from firms that hired Howrey partners prior to the firm's demise.

That approach could "throw a wrench into how law firms do their hiring," said Barbra Parlin, a partner at Holland & Knight LLP who is defending the law firm Orrick, Herrington & Sutcliffe LLP against unfinished business and other claims in a separate case relating to the defunct law firm Coudert Brothers LLP.

But Mr. Diamond said the ruling is consistent with the notion that partners should demonstrate loyalty and trust and put the partnership's interests ahead of their own. "Otherwise," he said, "at the first sign of a partnership in trouble, every partner, clients permitting, would leave with his or her unfinished business, to the likely detriment of one's partnership."

The California decision comes as judges are increasingly coming down on the side of bankruptcy trustees who say that profits from unfinished legal matters belong to the estate. In 2012 a federal judge in New York ruled that such clawbacks were permitted under the state's partnership law. The decision has since been appealed.

And last month Judge Montali, in a separate case involving the failed law firm Heller Ehrman LLP, rejected attempts to dismiss unfinished business claims against Orrick, as well as Davis Wright Tremaine LLP, Foley & Lardner LLP, and Jones Day.

The estate has recovered \$8.6 million through such claims so far, according to Christopher Sullivan of Greenfield Sullivan Draa & Harrington LLP, which is representing Heller and estimates it could collect "a substantial amount" from the above firms.

Both of Judge Montali's recent decisions are likely to irk the handful of big law firms that have chosen to push back against unfinished-business claims instead of settling, as most firms have done so far.

They argue that clients should be able to take their business where they please, and that such lawsuits unfairly restrict lawyers' mobility. In their view, targeting large law firms with claims seeking to claw back profits from hourly legal work that would otherwise have been left undone is a misapplication of a narrow ruling from a 1984 California case. The case involved divvying up contingency fees that had not yet been paid after the breakup of a small, four-partner firm called Jewel, Boxer & Elkind.

To compound that approach by going after partners who leave before their firms officially shut down is a bridge too far, according to Robert Mittelstaedt, a partner at Jones Day. Mr. Mittelstaedt is defending the firm against unfinished business claims in both the Howrey and Heller Ehrman cases.

"He [the judge] has this idea that if you leave a law firm...and take the client with you, then the old firm has the right to all the profits on that business," Mr. Mittelstaedt said of the Howrey ruling. "He is almost treating the clients as chattel."

Questions over unfinished business claims are hardly settled.

While bankrupt law firms have been found to have a stake in profits from contingency-fee matters—where a firm can devote a huge amount of resources to a case but not see payment until a settlement or judgment—it isn't clear whether such a stake applies to work that attorneys bill by the hour.

A New York appeals court is set to hear arguments later this year on whether, under the state's partnership law, defunct law firms are entitled to profits from legal work billed on an hourly basis. That question arose in two separate cases involving failed New York law firms—the Coudert Brothers matter and one involving Thelen LLP.

The ultimate ruling could have an impact on firms that took on partners from New York law firm Dewey & LeBoeuf LLP. Its 2012 demise was the largest failure of a U.S. law firm to date, with early estimates pegging its unfinished business claims at about \$60 million.

The legal developments come at a time when ambitious partners often hop from one firm to the next, lucrative clients in tow, as firms hoping to boost revenue dangle big pay packages.

Partner exits can destabilize law firms. If a firm is troubled, the departure of star lawyers representing lucrative clients can set off the equivalent of a bank run as partners flee for other firms. Such mass defections are common when law firms collapse, and they played a role in Dewey's demise.

Still, the law firms that hired those lawyers didn't have much to fear as long as they brought them in early because the legal doctrine underpinning most unfinished-business suits didn't apply until the time when or even after a firm shut its doors.

"Even if the firm was teetering," said Ms. Parlin, "you could hire that person and not worry about it."

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