Kowalski&Associates

Read more on our blog by clicking [here](#).

For Law Firm Liquidators, There's a Lot of Gold in Them Thar Hills Aside from Jewels

Jerome Kowalski

Kowalski & Associates

June, 2012

There may be trouble ahead

Marshalling the assets of a law firm that has imploded and paying its creditors requires an admonition similar to that often given to vacationers: Pack half as much clothing and bring along twice as much money as originally planned. In the case of too many failed law firms, the value of the remaining assets is often half or less than originally estimated, the amount of liabilities is often a multiple of those originally anticipated and the length of the process takes many years longer than projected. A principal focus of those charged with marshalling assets of defunct law firms (as well as former partners of the law firm who are personally incentivized to maximize assets recovered not coming out of their own wallets) is therefore maximizing the value of estate assets marshaled.

Rarely has the gap between assets and liabilities of a failed law firm been as wide as they appear to be in Dewey & LeBoeuf's case: As of the filing date, Dewey reported liabilities of $315,000,000 and assets of $215,000,000, with fees due from clients accounting for most, if not virtually all of the latter. A more detailed filing of assets and liabilities is expected in about 45 days. Previously, in the Howrey case, the subsequent more detailed statement of assets and liabilities posted after filing and after more detailed study contained stunning decreased assets and whopping increases in liabilities. As one expert noted, the Dewey accounts receivable are unlikely to yield as much as forty cents on the dollar. Nor does this calculus include the likely enormous costs of bankruptcy administration, which will come off the top and certainly aggregate eight figures, once the shooting is done. The listed debt also does not include amounts purportedly due to former employees under the WARN Act (which may amount to many millions more), amounts due to landlords for rejected leases (again, likely am eight figure amount) or amounts due to former partner under deferred compensation agreements, which may add as much as an additional $100,000,00, if these claims are allowed. Finally, no listing of potential malpractice claimants have yet been publicly identified. Law firm failures beget malpractice claims and with Dewey being self insured for $2,000,000 per claim, the exposure to Dewey will be considerable in the aggregate. We assume that prior to filing for bankruptcy relief, Dewey identified every potential claim then known or suspected to exist against Dewey to its carrier, since its coverage is extended on a "claims made" basis and it was in Dewey's best interests to identify each potential claim to its carrier while coverage was still in existence. The public record does not disclose whether "tail" insurance was obtained (in the absence of tail coverage, former partners are in for some more serious real pain). With secured debt amounting to some $225,000,000, there doesn't seem anything left for unsecured general creditors. Ed Reeser, a brilliant analyst, succinctly observed that Dewey is likely a zero asset estate. No previously reported case of an imploded law firm has the incentive to find assets to pay down debt been greater. Here, former partners looking at a world of pain, are even now scrambling to limit or divert that pain.

Much public discourse on the subject has focused on the "unfinished business doctrine," often referred to as *Jewel v Boxer* claims. These discussions have recently been raised by several decibels since Judge Colleen McMahon of the United States District Court for the Southern District of New York recently rendered a comprehensive, well reasoned and thoughtful opinion in *In re Coudert* which she held that *Jewel v Boxer* principles applied in New York, an unsurprising result, given a fair amount of prior authority to the same effect in New York and no contrary authority.

The likely coming battlefields

As the lawyers who were formerly partners at Dewey & LeBoeuf lawyer up (if the firm's general counsel gets her own lawyer, will that mean that the lawyers' lawyer has a lawyer?), we address briefly the additional claims and defenses that these professionals are likely focusing on during these warm spring days.

First, we start with one of New York's seminal cases, *Graubard Mollen v Moskovitz*. In that case, the law firm of Graubard Mollen sought to ensure that it would continue to have the benefit of the substantial client base of name partner Moskowitz, who was approaching retirement age. Thus, the firm entered into an agreement with Moskowiz under which Moskowitz received substantial compensation in his final three years with the law firm and agreed that Moskowitz would insure that his largest clients would remain with the law firm upon his retirement. At the conclusion of the three year wind down and payout, Moskowitz joined another law firm (ironically, LeBoeuf, Lamb, Leiby & MacRae) and took all of his major clients with him. Graubard Mollen sued for breach of contract and breach of fiduciary duty. The contractual claim was given short shrift by the court given the ethical proscriptions extant regarding contractual proscriptions on limitations of a lawyer to practice law. But the court held that it was a breach of a partner's obligations to law firm to have met with and solicited clients he originated to join a new firm he plans on joining. Moscovitz was alleged to have met with his major clients to solicit them to join him at his new firm and to have even brought along LeBoeuf partners to at least one of those meetings, all while he was still a partner at Graubard and before he announced his plans. Such conduct, if proved to be true, was actionable and subjects the straying partner to damages.

In *Gibbs v Breed Abbott*, the chairman of a law firm's trusts and estates department decided to leave his firm and solicited another partner to join him at a new firm. These two partners, during their interviewing process, provided their new firm with detailed billing and personnel information concerning associates they proposed to bring along with them. The court assessed these former partners with damages of some $1,861,045. The award was made because of the improper solicitation by one partner of another to leave the firm and the providing of law firm personnel and billing information to a prospective new law firm.

Of course, we also must pay particular homage to Judge Cardozo's admonition in *Meinhard v Salmon*, in which the noted jurist set forth the enduring standard that partners, and most especially managing partners, are "held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior… the level of conduct for fiduciaries [has] been kept at a level higher than that trodden by the crowd."

While Professor Steven Harper regularly takes BigLaw to task because of the "corporatization" of the practice, focus on short term profits, distracted attention to metrics, top down management and more, *Meinhard* remains the law.

Longstanding substantial authority also provides that a law firm partner holding a management level position is barred from seeking alternative employment without first resigning from his or her management role. Managing partners who failed to heed this basic maxim have confronted serious claims, as have the firms they ultimately join.

There seems little reasonable doubt here that Dewey partners, fleeing for safety, solicited other partners and associates to join with them in new safer climes, proprietary law firm information was shared with prospective new employers and management partners actively sought new positions without first stepping down from their management roles. The rather unique eleventh hour pronouncement by Dewey senior management "encouraging" partners to leave may well be actionable in and of itself, since no authority exists which we have found that permits a managing partner to promote massive breaches of fiduciary duties, particularly in the absence of any dissolution vote. Said management at the time when most of the horses had already left the barn, "Dissolution vote? Why would we do that?" Perhaps because the New York Partnership Law seems to mandate doing so under these circumstances and the rights and duties of the parties are thereafter described. We have little doubt that the standards of conduct actually practiced by management level partners will be scrutinized through the prism described by Judge Cardozo, particularly where issues of lack of candor and inadequate management oversight seem evident from the limited record made public thus far.

Lawyers, long trained to follow the money, have always asserted *Jewel v Boxer* claims against both former partners *and their new law firms.* Thus to the extent that that these breach of fiduciary claims are pursued, they will doubtless often name as additional parties defendant the new firms which former Dewey partners call home. Procedural conundrums will likely ensue as Dewey partners are presumably subject to mandatory arbitration, while successor law firms are not.

To be sure, breach of fiduciary claims against former partners of an imploded law firm have rarely been instituted and as far as we can determine none have ever been tried to conclusion. All seem to have settled either under the threat of litigation or after suit was actually instituted. In all events, the real battleground has now been clearly identified here; namely the clawbacks, clawforwards and potential claims against the dozens of law firms that provided lifeboats for Dewey partners. And the need to maximize assets available for distribution to creditors has never been greater.

In the past, in most law firm implosions, after much finger pointing, threats, recriminations, anger and infighting, claims against former partners and their new law firms have been resolved using a relatively straightforward calculus: Clawbacks from former partners were calculated on the basis of an algorithm in which certain factors were included. These included fixing the date when the firm was first actually insolvent from applying bankruptcy law definitions, which, in Dewey's case may be at or about the very beginning of the merger between Dewey and LeBoeuf, the amounts actually paid to each partner during that period, the role played by each partner in management and finally, the net worth of each partner. Al Togut, Dewey's bankruptcy lawyer, a capable seasoned veteran of similar wars, who first emerged on these battlefields as counsel for the creditors' committee in Finley Kumble in 1988, is intimately familiar with this calculus, which was utilized first in Finley Kumble. Clawforwards – the *Jewel v Boxer* claims -- are also relatively easily calculable and have until now always been settled since successor firms have been disinclined to take the litigation risk. That may change as the Coudert antagonists (and Seyfarth Shaw in the Thelen bankruptcy) are battling it out, seemingly looking to go the full fifteen rounds.

But Dewey may well change all of the rules; it was not simply be too big to to fail, it may be too big to fail in the relatively orderly way others before it failed.

Jerry Kowalski is the founder of Kowalski & Associates, a consulting firm serving the legal profession exclusively. Jerry is a regular contributor to a variety of publications and is a frequent (always engaging and often humorous) speaker to a variety of forums. Jerry can be reached at jkowalski@kowalskiassociates.com or at 212 832 9070, Extension 310

Related articles

- Avoiding Law Firm Implosions by Mandating Firms to Undergo Annual Stress Tests (kowalskiandassociatesblog.com)
- Saving Dewey & LeBoeuf (kowalskiandassociatesblog.com)

- Storied law firm folds after partners flee (msnbc.msn.com)
- After the Sun Went Down, Dewey Filed for Bankruptcy (jdjournal.com)
- After Dewey & LeBoeuf, It's Lawyers v. Lawyers (businessweek.com)
- Dewey & LeBoeuf files for bankruptcy (money.cnn.com)
- The end of an era: Why Dewey & LeBoeuf went under (features.blogs.fortune.cnn.com)
- Dewey, Sex, Lies and Videotape (kowalskiandassociatesblog.com)
- Dewey & LeBoeuf files for Chapter 11 (bizjournals.com)
- Too Big to Work: Dewey and LeBoeuf Bankruptcy Sets Records (theatlanticwire.com)