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Coudert Ruling Spells Trouble For Firms With Dewey Gains

By **Megan Leonhardt**

Law360, New York (May 25, 2012, 8:44 PM EDT) -- Firms picking up Dewey & LeBoeuf LLP partners should watch their step in light of a New York federal court ruling finding that profits former Coudert Brothers LLP partners made on continuing business belonged to the defunct law firm, experts warned Friday.

Experts said law firms everywhere should be taking a second look at how their partnership agreements deal with unfinished business — especially those with recent Dewey defections — after a judge on Thursday gave Coudert an opening to recoup money from former partners and their new firms.

“Any partner in a law firm needs to be mindful of this opinion,” said Kevin Lippman, section head of Munsch Hardt Kopf & Harr PC’s insolvency group.

On Thursday, U.S. District Judge Colleen McMahon refused to toss clawback suits against DLA Piper, Dechert LLP, Jones Day, Duane Morris LLP and six other major firms, ruling that former Coudert partners and their new firms were liable for profits made on so-called “unfinished business.”

The unfinished business doctrine generally allows bankruptcy trustees to sue former partners and their new firms for money generated by work the lawyers started at their old firms and took with them.

“The unfinished business doctrine does not exist to assure that a law firm is paid for the value of the work it has performed prior to dissolution,” McMahon said. “It exists to settle accounts among partners upon dissolution of their business.”

Judge McMahon ruled that former partners are obligated to account for any profits they earned while finishing Coudert work at a new firm, defeating the defendant firms' argument that the doctrine didn’t apply because the work was billed hourly and not taken on contingency.

"I conclude that ... all client matters pending on the date of dissolution are assets of the firm — regardless of how the firm was to be compensated for the work," McMahon said.

“A departing partner is not free to walk out of his firm’s office carrying a Jackson Pollack painting he ripped off the wall of the reception area, simply because the firm is dissolved,” Judge McMahon said in explaining client profits.

Judge McMahon’s ruling took a “hand grenade” to the perception that a partner’s practice and clients are proprietary, said Steven J. Harper, a retired Kirkland & Ellis LLP partner and adjunct professor at Northwestern University's School of Law.

And while the beleaguered Dewey has not yet filed for bankruptcy, experts said Friday that rival firms were taking a calculated risk by picking up partners from the drained firm. About 70 firms have added former Dewey partners since January, with only about 20 partners still remaining at the firm.

“There’s a new level of risk for firms that take on partners from dissolving firms,” Harper said.

Experts said that litigators, rather than partners involved in transactional matters, pose the greatest liability for their new firms. Transactional attorneys generally “burned off” specific deals in a matter of months, while litigation could carry on for years, business lawyer Edwin B. Reeser said.

Rainmakers who have practices worth millions of dollars are likely to make attractive targets for unfinished business claims. For Dewey, that includes former Office of the Chairman members Martin Bienenstock and Jeffrey Kessler, as well as former vice chairman Morton Pierce.

Coudert’s bankruptcy estate administrator Development Specialists Inc. has declined to go after unfinished business claims from partners who left prior to the firm's dissolution, instead limiting clawback attempts to recover profits generated after dissolution.

But experts predicted Friday that it is more likely in the event of a Dewey bankruptcy that attempts would be made to recover profits generated before dissolution, given the number of partners that have already left before a vote to formally dissolve the firm was called. A trustee would not have much to go after if claims are limited to post-dissolution, experts noted.

Like Coudert, a Dewey bankruptcy could also quickly become mired in what Judge McMahon called the “thorny task” of attempting to reach decisions on how much of a former partner’s profits should be reimbursed to the bankrupt firm.

Because Thursday’s ruling handed the trustees and estates of bankrupt firms a powerful argument, experts predicted that if Dewey entered bankruptcy, many firms may choose to settle their claims quickly rather than attempt protracted litigation.

Once a firm picks up a Dewey partner, there isn’t much to be done to avoid clawback claims in a bankruptcy, experts said. They added that many knew exactly what they were getting into, but felt the rewards outweighed the risks.

The best option for many firms may be to conduct a cost-benefit analysis that evaluates a number of variables — including the possibility of clawback claims — before extending an offer, said Jerry Kowalski, founder and a principal of Kowalski & Associates.

Many firms may try a theory put forth by Akin Gump Strauss Hauer & Feld LLP, which argued in the Coudert bankruptcy that it only took on new client matters, rather than unfinished business, according to Sean C. Southard of Klestadt & Winters LLP, who has been involved in several major law firm bankruptcies. The judge has yet to rule on the viability of that argument.

“[The argument regarding new business] is an area where many firms will focus their attention when considering taking on departing Dewey partners in terms of how they paper the transition and how clients of Dewey become clients of the successor firm,” Southard said.

Judge McMahon said in Thursday’s order that these unfinished business issues could have been easier to resolve had Coudert added appropriate provisions in its partnership agreement, but experts said that’s easier said than done.

Because the issue of liabilities on unfinished business profits is a relatively new issue, many partnership agreements have traditionally failed to provide guidance for how much liability partners may face, said Mark Zauderer of Flemming Zulack Williamson Zauderer LLP.

"Historically, partnership agreements have not dealt with this issue," Zauderer said, adding that if they do in the future, it would most likely involve a compromise on the matter.

Kowalski said no firm would add such stipulations if it were “healthy” and not in danger of struggling. Adding provisions that guaranteed continued payment to the firm even after a partner left would discourage partners from joining in the first place, he said.

Dewey’s health began to decline after the firm racked up major debts, forcing pay cuts for some partners who later left the firm.

The firm owes JPMorgan Chase & Co. and others nearly $75 million on the credit line, sources familiar with the matter have said. Additionally, Dewey is on the line for $125 million worth of senior secured bonds that are scheduled to come due in 2017 and 2020.

--Editing by Jocelyn Allison and Kat Laskowski.