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RUDEN: THE STORY OF THE FIRST SUCCESSFUL REORGANIZATION OF A LAW FIRM AND LESSONS LEARNED

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Ruden McClosky, P.A. ("Ruden"), a formerly large and prestigious law firm that was founded in 1959 and at its peak had more than 200 attorneys commenced a bankruptcy case by filing a petition for Chapter 11 relief ("Petition") in the United States Bankruptcy Court for the Southern District of Florida on November 1, 2011. The firm was a victim of the changing economy and the Great Recession. Ruden's practiced largely in areas serving financial institutions and real estate developers—areas particularly hard hit by the recession. After faltering revenues and some partner departures, the law firm could no longer generate enough income to sustain itself. Many equity partners had departed, and their equity positions (i.e., money that they paid to the firm upon becoming equity partners) were now debt obligations of Ruden. The income of the firm materially decreased due to the depressed economy and because there were far fewer attorneys still working at Ruden to obtain new clients in order bring in much needed revenue. Moreover, real estate clients began defaulting on their bills as those clients no longer had sufficient cash to pay their legal bills due to the economic downturn. Ruden began looking for a way to successfully navigate these problems, including a possible merger with, or sale to, another law firm. One day prior to commencing its bankruptcy case and after a substantial marketing effort, Ruden entered into an agreement to sell its assets, including its receivables, to another law firm, Greenspoon Marder, P.A. ("Greenspoon"). On the date that it filed for bankruptcy protection, Ruden filed a motion to approve the sale of substantially all of its assets to Greenspoon.

Under the United States Bankruptcy Code, the approval of a sale of a debtor's assets in the chapter 11 process generally requires at least 21 days of notice to interested parties. Despite the complicated nature of selling the assets of an operating law firm, the sale of Ruden's assets to Greenspoon was approved by the bankruptcy court on November 30, 2011 (a mere 30 days after Ruden commenced its bankruptcy case), with a closing that occurred the next day. Ruden was able to accomplish this remarkable feat by retaining knowledgeable and experienced professionals which allowed Ruden to enter immediately into productive negotiations with all relevant parties and to mutually resolve all of the outstanding and pressing issues within a short period of time. At the time Ruden filed its Chapter 11 case and through to today, we are unaware of any other operating law firm to sell itself as a going concern in a bankruptcy case. A few examples from the Ruden case highlight the proactive and novel approaches taken by Ruden and its professionals.

In a Chapter 11 case, a committee of unsecured creditors (the "Committee") is appointed soon after the case is filed by the Office of the United States Trustee ("UST") and it usually includes the five or seven largest unsecured creditors willing to serve. In Ruden, the Committee included both trade vendors and former equity partners. As the UST is also a party with a voice in Chapter 11 cases, Ruden's counsel met with the UST before the bankruptcy case was commenced, so that the UST would have knowledge of what to expect in the case, and to obtain support for Ruden's immediate intention to move quickly toward a sale to maximize value for all constituents, as well as to try and save as many jobs as possible. Equally important, The Florida Bar was consulted on issues related to the filing of the bankruptcy case, the continued provision of client service while in Chapter 11 and the transfer of client files.

During negotiations with the Committee, as well as the UST, concessions were reached that sweetened the deal for Ruden's general unsecured creditors, giving them a bigger upside under the sale agreement. Issues also arose regarding the value of the assets to be sold by Ruden to Greenspoon, in particular, the value of accounts receivable and so-called "work in progress" (i.e., time that has been entered by lawyers working for the law firm but not yet billed to the clients). The solution? Give the bankruptcy estate fifty (50%) percent of all receivables collected in excess of $10 million, within a collection period of three years. This solution resolved the valuation issue on accounts receivable, because one half of any receivables collected in excess of $10 million, considered the low end of valuation, would go to the bankruptcy estate. The original sale agreement provided for the estate to retain only one-third of these receivables, but the agreement to provide 50% of the excess to the bankruptcy estate resolved the objections of the UST and Committee. Ultimately, the total upside from these collections provided an additional income of almost $1.2 million to the estate.

Other issues were raised and resolved in the 30 days between the commencement of the bankruptcy case and the date the sale was approved. For example, Ruden was able to "reject" (that is, terminate) uneconomical and burdensome contracts and leases that had been entered into by Ruden prior to the bankruptcy, and others were "assumed and assigned" by Ruden to Greenspoon (a process by which the prepetition contract or lease has continuing existence and Greenspoon agrees to step "into the shoes" of Ruden, thereby becoming the legal counterparty). These actions significantly reduced the unsecured claims held against Ruden because the non-debtor party to a "rejected" contract or lease would have been allowed to assert a claim against the bankruptcy estate for damages arising from the rejection. As a result, the remaining unsecured creditors holding claims against the Ruden bankruptcy estate received higher distributions in the case. The end result could not have been accomplished without lengthy negotiations and concessions by all.

Our firm has substantial experience in advising financially distressed law firms, and we have assisted in out of court restructurings for many of them. In the Ruden case, another key to the success of the bankruptcy case resulted from Ruden's decision to hire Joseph Luzinski, a professional experienced with law firm dissolutions, as its Chief Restructuring Officer (a professional who, along with his team, replaces top management during a chapter 11 case). Mr. Luzinski also acted as the Plan Administrator after confirmation of the plan of liquidation by the bankruptcy court, thereby providing continuity and expertise during the final phase of the chapter 11 case. As a result of the collaborative approach by the professionals retained in the case, Ruden was able to file a joint plan of liquidation with the Committee, which was amended after negotiations, and confirmed at a bankruptcy court hearing on October 10, 2012, less than a year after the commencement of the bankruptcy case. Due to the structure of the sale and plan, litigation against the firm's former attorneys relating to the value of client relationships and files that were taken by such former attorneys to their new firms, known as the "unfinished business doctrine" developed under partnership law and common in other law firm bankruptcy cases[1], was avoided. This resulted in a more efficient and productive case, as it was not bogged down by years of litigation with current and former attorneys which could have delayed and lessened distributions in the case to the general unsecured creditors. Moreover, many of the Ruden attorneys and staff employees obtained employment with Greenspoon after the sale, thereby preserving numerous jobs. General unsecured creditors, including the claims of the trade vendors and prior attorneys, received an interim dividend of about 10.5% in May 2015 and a final dividend in December 2016 of about 3%, for a total dividend of 13.5%. All priority wages and tax claims were paid in full, as well as a secured bank loan in excess of $4.8 million. All in all, a great result. Litigation was limited to a few so-called "preference" cases (which are generally cases initiated by a debtor against creditors who received transfers from the debtor during the 90-day period prior to the commencement of the bankruptcy, as such transfers are presumptively invalid under the Bankruptcy Code).

Lessons learned? Chapter 11 can be a good fix for a law firm contrasted with liquidation under Chapter 7 of the Bankruptcy Code. The key is to immediately engage all constituents in negotiation to produce the best result for all parties concerned. Keep the appropriate Bar Association involved to avoid mishaps regarding ethics, and importantly client and file issues. Move quickly and efficiently to maximize the value of the firm's assets. Be creative and use mediation if needed. Using Chapter 11 as a vehicle for selling a law firm as a going concern gives all interested parties sufficient notice, due process and a place to be heard. Disputes can be quickly resolved before the bankruptcy court, and the entry of orders adjudicating any disputes provides protection and finality. In the Ruden case, incentives were put in place to maximize accounts receivables, jobs were preserved and creditors, including both trade vendors and former attorneys, received a 13.5% dividend. Secured loans, priority wages and priority taxes were paid in full. The success of the Ruden case highlights some of the many positive reasons to consider Chapter 11 as an option for a law firm in financial distress.

[1] The “unfinished business doctrine is the subject of ongoing litigation in several U.S. Circuit Court cases, in litigation relating to other law firm bankruptcies. See (put in article link)

For more information on this topic, please contact Leslie Gern Cloyd, on the firm’s Business Reorganization Team.

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