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A BS Detector's Review of the Latest Howrey News

A good friend of mine served on the executive committees and as an office managing partner of firms ranging from 25 to over 800 lawyers in size. He is an early riser, avid reader and loves to translate what is really going on behind the latest legal news. A couple of us have badgered him about getting his own blog as we sincerely believe that it would be among the best read in the industry. But he's shy. So, with his permission, I'm publishing his latest interpretation of today's news concerning Howrey. I'm sure that you will find his commentary most enlightening:

Howrey's End Wasn't Foregone Conclusion
Posted by Brian Baxter

When Latham & Watkins partner Peter Gilhuly was contacted by Howrey managing partner and chairman Robert Ruyak last December to advise the troubled firm on its options, dissolution wasn't part of the initial discussion. (So, they just hired the leading expert in the country for large law firm dissolution, a bankruptcy practice specialist, for his ability to advise on how to help guide a firm with a business model that works, even though more than 100 partners have left and distributable income is on track to be half of the prior year.)

"Very few firms think they're going to dissolve when you talk to them, so they don't hire you for that purpose initially, although they're aware of it as a possibility down the line," Gilhuly says. "Typically what happens is they have an issue with their bank and they're looking for advice on a broad scale of issues." (So, law firms hire bankruptcy specialists to advise on line of credit financing. Is there any possibility that there is a concern that admitting to insolvency in December might be an admission that would require disgorgement of all of the distributions in January? Or that draws on the bank line of credit might be constructive fraud on the bank for which some partners might have personal liability?)

In time, as a firm's troubles grow deeper, Gilhuly's role often expands. That's what happened with Howrey. The firm had a rough year in 2010 with fading financials and fleeing partners. Given his background advising on the wind-down efforts of Thelen, Darby & Darby, and Brobeck, Phleger & Harrison, Gilhuly had the requisite expertise to counsel Howrey on its increasingly limited options. (Now that it is clear you have leaped from the top floor of the building, let's talk about action options. But first, a few words about terminal velocity and the comparative density of your body and the sidewalk.)

It didn't take long before Gilhuly--and the Howrey lawyers who turned to him for help--realized that Howrey faced problems similar to those that plagued other recently defunct firms. As Gilhuly became more entrenched in the business of the firm, examining its books, and talking to its partners, he noticed that Howrey's focus on litigation had left the firm exposed in the aftermath of the economic downturn in late 2008. (Ooooooooo, here it comes......wait for it.......alternative fees and low cost service providers unexpectedly arose and killed a healthy, well run law firm!)

As previously reported by The American Lawyer, Howrey's troubles started two years ago. After impressive returns in 2008--the firm brought in gross revenues of $573 million, a 20.6 percent increase from 2007, and profits per partner (PPP) averaged $1.3 million--the firm's financial picture changed dramatically by the end of 2009. A drop-off in contingency fees contributed to a 35 percent plunge in PPP to $845,000 that year and a 16 percent decrease in gross revenue to $480 million. The declines set off a wave of partner departures that came to define Howrey in 2010. By last October, those leaving the firm included the bulk of its European IP practice.

Former Howrey vice-chair and Northern California office managing partner Henry Bunsow, who left Howrey in January for Dewey & LeBoeuf, told Washingtonian earlier this year that the firm's PPP had plunged to $550,000 in 2010. Two former Howrey partners who recently left the firm say that number is accurate. According to one of the two, the budgeted compensation for each equity partner was about 50 percent of 2009 compensation, given the firm's expected revenues and expenses for the last fiscal year.

Gilhuly declines to discuss Howrey's financial data, but reiterates what Ruyak has told The Wall Street Journal and The Lawyer--that an over-reliance on contingency fees and the advent of third-party discovery vendors undercut the firm's bottom line. (The American Lawyer reported in May 2010 that Howrey's income from contingency fees dropped from $35 million in 2008 to just $2 million in 2009.) (The partner that drove the firm into the wall is also responsible for hiring Gihuly, and is going to, or at least attempt for as long as possible to, run the wind down. Does anybody expect the "story" to change, or for the hired servant to espouse any other reason than the prior story....no matter how unbelievable it is?)

"A lot of Howrey's litigation clients were extending their dates for payment later and later and increasingly asking for litigation matters to become more partial or full contingencies, which were not planned," Gilhuly says. "The timing of the contingency payments worked out great in 2008, but 2009 and 2010 were pretty much dry in terms of big contingency recoveries." Even so, Howrey's problems were not rooted in financial issues, Gilhuly says, but stemmed from a loss of confidence in the firm's performance. (So, to be perfectly clear, the reason you failed was not because of financial issues, it is because the partners were not willing to accept severely reduced compensation now and into the foreseeable future. Ah, a distinction that many of us would not understand. To put it simply: "We didn't lose the battle for lack of ammunition; we just ran out of bullets.")

"Almost every partner at Howrey has been underpaid over the past couple of years, and some had to write checks back to the firm," (Play that sympathy chip. It always hurts to give back money you didn't earn.) Gilhuly says. "That's the problem you run into with law firm wind-downs. You don't have the currency to retain your best talent (When you can no longer siphon money to pay the big dogs even when you have starved the service partners, associates and staff, as the firm performance continues to go down the drain) and you need to be able to pay productive partners a market salary. You can hold it together for a year, sometimes two, but people need to believe that you're strategically going in the right direction." (Translated: "If you cannot guarantee that you will pay me what I can get across the street, irrespective of the consequences to others here, I am outta here.")

Gilhuly believes Howrey could have survived the financial stress. The firm eventually would have benefited from recently enacted cost-cutting measures--the firm held two rounds of layoffs in 2010--and lower-priced services available to clients (Howrey opened a back office in India in 2008 to handle document management). (If only we had a little more time everything would have worked out. As in, by the time I got the learn to fly by flapping my arms booklet, I had already reached the fourth floor above the sidewalk.) Howrey also incurred a $25 million restructuring charge last year. (This one should not be slipped by so fast. Smells like some recapture of creative accounting from prior periods that came due....like capitalization of headhunter fees from the growth periods of prior years....maybe? That is not actually "restructuring", but we will find out in due course if this goes BK.) The firm just needed more time to work through a transition period and implement changes while keeping partners on the same page about its future, Gilhuly says.

But partners weren't on the same page. (Show me the money, and show me now.) By the end of 2010, the number of partner departures had accelerated, with litigation cochair Gary Bendinger and antitrust partner Michael Cowie decamping for new firms. (According to our scorecard on Howrey departures, more than 140 partners left the firm between April 2010 and the time of the firm's dissolution.) (These are the insider elite, who know that there just isn't the ability to give them the sweet juice that they want now, or any time soon, from this dessicated orange).

Most large firms are bound by default covenants that are triggered if a certain percentage of partners--10 to 15 percent is the norm--leave within a single quarter, as we've previously reported. And lenders are reactive to the market, looking for cohesion among partners even in tough times. Cohesion wasn't what lenders--including Citibank, which is owed $75 million by Howrey--saw in the firm. (To draw $65 million into the LOC this early in the new fiscal year is exceptionally high for a firm of this size. How could the bank be asleep at the switch on this? I suspect that they had to clamp down and that the draws were

The $75 million owed to Citi includes $10 million in letters of credit that back up the firms' leases, Gilhuly says. The figure is high because almost all major law firms take out large loans early in the year to pay rent and salaried employees, then pay down the debt as the year progresses and client fees are collected. (absolute silliness. The line of credit would be paid to zero with collections in Nov/Dec at the latest. Even if the firm had zero collections they would typically only draw $15 to 18 million per month on the revolver in the first two months of the year. They either did not pay down the revolver....which is why they hired Gihuly in December....and/or they used the revolver to pay of departing partner capital, pay draws to partners that stayed on as "loyalists", etc.)

Gilhuly says that Howrey wasn't burdened with expensive and onerous leases. "They actually had very good lease deals relative to the market," he adds. Thelen, on the other hand, suffered greatly from just one of its leases. "[It] had a midtown Manhattan lease that was a $50 million claim just from that one lease and no market for it [in late 2008]," Gilhuly says. Howrey's main creditors after Citi are its landlords, and, as previously reported, it's the landlords who could determine whether or not the firm files for bankruptcy. Gilhuly says Howrey is working hard to transition its current employees and office space to mitigate the firm's liabilities and possible claims for damages against the firm. "What's really in the interest of creditors is good management of the liabilities, efficient collections, and low expenses," Gilhuly says. "And bankruptcy doesn't accomplish any of those." (They lose control of the process is what he really means, and they don't want that until damage control on some really serious stuff occurs. How many shredders are working at capacity?)

Gilhuly says that it will likely take six to eight months for Howrey to pay down the Citi debt. The firm has "more assets in relation to their bank debt and less liabilities that are unmanageable" compared to other recently disbanded firms, he says. (So a smoking crater that is only forty feet wide and ten feet deep is a pretty good outcome when compared to the seventy foot wide and fifteen feet deep crater of other recent failures.)

As for collections, Gilhuly says the notion that former clients don't want to pay up is false. Citi's experience over the years is that they typically collect 70 percent of accounts receivable and work in progress, Gilhuly adds, noting that some matters are uncollectible even if a firm were not winding down.

"The truth is [clients] do pay, because if they don't they'll get sued just the same," Gilhuly says. "There are some people that try and play games, but creating excuses just won't work, especially when you have folks that are very motivated to collect." Partners that stayed were at Howrey until the end worked together to issue bills to their clients through the dissolution on March 15. Beyond that date, partners will bill clients from their new employers, to the extent that they have new jobs. (If you took clients and are working on their matters, you will be coughing up Jewel money). Collection of any outstanding contingency fees remains tricky, Gilhuly says, and will have to be worked out in a matter fair to both Howrey and its former partners.

Howrey commercial litigation cochair Martin Cunniff says he is serving as a member of the firm's five-member dissolution committee, which has been tasked with bringing in all of Howrey's assets to manage its liabilities. On the matter of outstanding contingency fees, a number which is difficult to determine since many cases have yet to be resolved, Cunniff says that "the amount of work each firm contributes has a value, and our job is to reach agreements with the firms as to what the ratio" of fees for each firm will be.

Also serving with Cunniff on Howrey's dissolution committee are managing partner and CEO Robert Ruyak (For as long as he can get paid, as his market value is not at its peak currently), commercial trial practice cochair Gregory Commins, Jr., and litigation partners Robert Green and Gary Fischman. Cunniff says that Howrey's executive committee selected all five members and that the firm's partnership approved the appointments as part of their dissolution vote last week. (Was there an alternate slate proposed?)

Cundiff, who confirmed on Tuesday that he will join Arent Fox, says he will represent the interests of partners joining other firms on Howrey's dissolution committee. Fischman, who is based in Houston and thus headed for Winston, represents that constituency of ex-Howrey partners. Commins is representing 4,000 dairy farm plaintiffs on contingency in a massive antitrust suit against several milk industry defendants. And Ruyak and Green, who have held several administrative functions at Howrey, will both stay on and manage the wind-down of the firm. (With the same vision and expertise that brought the firm to this point, undoubtedly).

In the end, Latham's Gilhuly says that Howrey should be remembered for the quality of the individuals it once employed, many of whom have been hired by competitors. "You can try to find bad guys here, but nobody did anything wrong," Gilhuly says. "This is the story of a law firm that didn't perform like it needed to and people decided that it had run its course in its current platform." (This could be challenged if independent eyes get into the working of the firm and conclude differently.)

IN CONCLUSION: "Gihuly is playing with fire. Who is he talking to? What is his message? Why is he talking at all? It cannot be for the bank or landlords. He already ran the dissolution meeting for the partners. Surely not to tell clients if they do not pay they will be sued! It is more like a prayer "please dear God, please let no one file a bankruptcy". Will smart creditors and their smart lawyers read it differently? Should one measure the prospect of an involuntary bankruptcy filing in weeks now, rather than months?"