Why a Bankruptcy Attorney Serving Prison Time Matters to Us All

A book review of

EAT WHAT YOU KILL by Milton C. Regan, Jr.
University of Michigan Press (2004)

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John Gellene, the subject of EAT WHAT YOU KILL, is the only Wall Street bankruptcy lawyer to serve a federal prison term for violating his disclosure obligations under Bankruptcy Rule 2016. The book does not treat the crime as an aberration of Gellene's character; rather, it is presented as the unfortunate but understandable confluence of a number of different developments in the practice of law over the past quarter century, allowing the reader to sympathize with Gellene, and, more importantly, demonstrating that the motivations and incentives that led to Gellene's actions are engrained in current law firm life.

In the late 1980s, a management led leveraged buyout left Erie-Bucyrus, a rust-belt heavy equipment manufacturer, in precarious financial circumstances. It tried to patch over its problems with a private placement of junk bonds, and thereafter with a secured debt financing, before concluding that a pervasive recapitalization in a Chapter 11 case would be required. The company looked to Milbank, Tweed for representation and John Gellene, a junior bankruptcy partner, was assigned to the case. He attempted to negotiate a pre-packaged Chapter 11 Plan of Reorganization and succeeded in reaching agreement with all of the creditor classes… except the holder of the junk bonds. By the time the bankruptcy case was filed, it was positioned as a cram-down, and thereafter the case rapidly degenerated into intense and bitter litigation between the company and the holder of the junk bonds. Ultimately, the holder of the junk bonds prevailed and gained control of the company.

Years later it came to light that Milbank and Gellene had done some work for the company's secured creditor at the time it applied to the bankruptcy court to represent the debtor. It did not disclose its "connection" with the secured creditor at the time, or in subsequent additional disclosure filings, or in connection with its fee application at the end of the case. Had it disclosed that it also represented Erie-Bucyrus' sole and pivotal secured creditor at the time it sought employment as debtor's counsel, the employment application would almost certainly have been denied. When the company – then controlled by the adversarial former holder of the junk bonds – became aware of the

[1] Mr. St. James limits his practice to business bankruptcy and insolvency cases. After 20 years in the tournament of partners, he left law firm life to practice as the sole employee of St. James Law, P.C., and has never regretted the decision. His article on forum shopping will appear in the current issue of the University of Tennessee's Business Law Review.

connection, it sought disgorgement of Milbank's fees, prosecuted a malpractice claim against Milbank and indirectly fomented Gellene's criminal prosecution. The U.S. Attorney concluded that Gellene's non-disclosure constituted perjury and a bankruptcy crime and successfully prosecuted him, ultimately obtaining a felony conviction and a 15 month prison sentence.

Regan presents Gellene's failure to disclose as the confluence of a number of factors affecting the legal community over the past quarter century. The first factor was a general shift in the legal environment. For decades Milbank had enjoyed a sinecure as the sole law firm of the Rockefeller family and Chase Manhattan, who could both be expected to provide volumes of work without competitive efforts for the indefinite future. (Indeed, I remember the waning days of an era in which a client bill would consist of a general description of many good services performed on the left side and a single dollar amount "due" on the right side of a single piece of paper).

In the 1970s and 1980s those days ended, with what had been the "bread and butter work" of law firms migrating to in-house departments, and law firms frantically courting new client revenues. Law had become a business, and competition proved a more significant force than client loyalty. This change tended severely to destabilize the law firm environment, and led to the second and most critical influence.

Historically, since the inception of the "Cravath system" in the early 1900s, large Wall Street law firms had conducted a "tournament of associates" in which only the fittest would become partner. (The book has a fascinating discussion of the law firm dynamic prior to and after the creation of the "Cravath system"). Once one was admitted to the club, however, the tournament ended and collegiality and loyalty to the firm were thereafter fostered by lock step compensation and the sense that both the firm and one's association with it were permanent. These all fell victim to the destabilization and competition of the '70s and '80s and the lock step largely vanished, to be replaced by the tournament of partners.

The tournament of partners further destabilized law firm life. Compensation and stature in the firm were no longer static, they changed year by year in response to market pressures and competition and, most fundamentally, a lawyer's ability to be a rainmaker or, next best, to be the favorite of a rainmaker and so to generate substantial billings.

Prior to the *Erie-Bucyrus* case, Milbank was adrift. It had lost its hold on the Rockefeller family and the Chase bank business to competitive pressures, and was not itself viewed as a serious competitor. The firm faced the prospect of drying up and becoming a backwater. In response, the firm took two major steps in a commitment to correct its problems. First, it made the shift from lock step to "merit based" compensation, which proved to be a jarring and destabilizing step. It was also, however, a step universally viewed as necessary in order to becoming competitive. Second, it brought in from outside the firm a rainmaker, Larry Lederman, who was assured compensation greater than that received by any existing Milbank partner. Lederman became Milbank's bet on the future.

Gellene is presented as the prototypical worried "service partner." He was not a rainmaker and could not generate material business, so his position in the tournament of partners would always be tenuous. He expressed constant concern about whether Milbank would have sufficient business in the future, and he understood that there was nothing more important to his long-term survival than to cultivate his relationship with Lederman, who brought with him both the *Erie-Bucyrus* case *and* the representation of its secured creditor.

Gellene worked for about a year on the effort to pre-package *Erie-Bucyrus*' Chapter 11 case. In the process, he became Bucyrus' principal and most valued insolvency advisor, and became intimately acquainted with all of the players and the negotiations respecting each of their positions. By the time of the bankruptcy filing, he had billed and collected many hundreds of thousands of dollars on the case and was the principal player in it. Had Milbank resigned on the eve of the bankruptcy filing – or admitted a "connection" with a significant creditor that would have resulted in its disqualification – Milbank's and Lederman's position in the case and the community at large would have been irrecoverably compromised, as would have been Gellene's hope of a bright future at Milbank as the lieutenant of its principal rainmaker, Lederman. In the tournament of partners, the consequences of disclosure and the resulting disqualification of the firm were utterly unacceptable. Hence the motivation for Gellene's failure to disclose.

Practice group culture also represented a critical factor in the process. Regan points to the fact that in specialized practices, such as business bankruptcy, the views of one's peers strongly influence one's own views. In this case, the culture was at best indifferent and at worst hostile to disclosure. Large firms developed the attitude that their clients were best served by large firms, and that the bankruptcy disclosure rules did not protect the integrity of the system, but rather created an opportunity for adversaries to impede the reorganization by attempting to displace the debtor's preferred choice of counsel. No substantive conflict of interest or harm to the system was perceived; rather, it was viewed as a mere litigation tactic that adversaries, like the holder of the junk bonds, could use to harass and distract the debtor.

The large firm bankruptcy community's lack of respect for disclosure obligations was exacerbated by the response from the bankruptcy courts. On the one hand, the bankruptcy courts in Manhattan and Delaware proved the most flexible on conflict issues, routinely accepting the imposition of "ethical walls" and the retention of "conflicts counsel" as complete solutions, while other courts proved less accommodating. Since both groups of courts could not be "right," it was human nature for bankruptcy attorneys in large firm practice to characterize the Manhattan and Delaware courts as "(correctly) more sophisticated" and the other courts, with less accommodating views of conflicts, as "(incorrectly) more parochial." This led firms with potentially significant conflicts to select Manhattan or Delaware as the venue for the case, or to view the other courts' more restrictive views as unreasonable, unjustified and not worthy of accommodation.

Second, the existing jurisprudence imposed comparatively minor penalties for disclosure violations. As recounted by Regan, none of the cases before *Erie-Bucyrus* resulted in disgorgement of all fees, and certainly none went further. Rather, prior to the *Erie-Bucyrus* case the most monumental penalty for an egregious failure to disclose connections was the loss of approximately 20% of the aggregate fees – but not the debtor's representation – in the *Leslie Fay* case. Thus, the community could reasonably view disclosure as much less than a moral imperative; rather, it was a business risk. Viewed as such, the calculus was easy: if made at the outset, disclosure would likely result in a loss of the representation and permanent injury to the reputation and career of the firm and counsel involved, while non-disclosure might never be noticed and, if it were, would likely not result in a loss of the representation; at most, it might lead to adverse economic consequences that, while material, were not unacceptable.

The final contributing factor, in Regan's view, was the influence of the small project team. As part of the sea-change in the practice of law generally, large law firms were not hired to perform mundane, repetitious tasks – those went in-house. Large law firms were hired to solve intense, critical, "bet your business" problems such as mergers and acquisitions and, in this case, a Chapter 11 reorganization. The work was performed by practice groups combining outside counsel, in-house counsel and client representatives that naturally developed a passionate advocacy for the underlying client and, as naturally, a "group think" approach to the problems of the case. Had Gellene confided in project team partners about the disclosure issues, he might well have received the response that disclosure constituted an unacceptable risk to the client: the holder of the junk bonds would inevitably exploit the potential conflict and would likely disqualify Milbank, leaving the client adrift in a bankruptcy case without counsel, months from having new counsel "up to speed", and consequently facing severe business crises, all to no purpose, because Milbank was not, in fact, truly conflicted or acting inappropriately. Were the *Erie-Bucyrus* case pending in New York or Delaware, the problem might be solvable with full disclosure, but pending as it was in Milwaukee, the risks associated with disclosure were too disastrous to the client for anyone to accept.

The conclusions to be drawn from EAT WHAT YOU KILL are sobering: The factors that motivated Gellene's misconduct, and then permitted him to rationalize that misconduct, are stable aspects of the current law firm environment, unlikely to change.

First and foremost, the instability and fear caused by competition among law firms and, more importantly, the tournament of partners motivates both desirable goals, such as increased productivity, and undesirable conduct, such as Gellene's misconduct. Indeed, it is designed to motivate and reinforce only the specific conduct valued by the tournament – increased revenue generation through rainmaking or long hours – and to counter balance conflicting sources of motivation, such as legal ethics.

Second, the ability to forum shop will likely continue to undermine any effort by the bankruptcy community to establish coherent normative standards and a single culture around issues like conflicts and disclosure. Whether it is due to competition among judges, as Professor LoPucki posits, or the cultural differences between sophisticated, money-center courts that work primarily with large firms, on the one hand, and parochial courts that work primarily with small firms, on the other hand, the judiciary is unlikely to speak with one voice on the subject, encouraging attorneys to select the view they find most appealing, whether in choosing the venue of the case or merely in forming their own rationalizations.

The tournament of partners and the fragmented bankruptcy culture resulting from the ability to forum shop are likely to prove stable and persistent aspects of the environment. While they may not lead to results as dramatic as federal prison terms, it seems likely that their pernicious effects will be felt in many future cases.