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Malpractice suits grow as Ponzi schemes unravel

BY JULIE KAY for THE MIAMI HERALD, September 29, 2009

A \$50 million malpractice lawsuit filed against Holland & Knight earlier this month and one filed against mega New York law firm Proskauer Rose just days earlier are raising questions about just how much due diligence law firms must perform on clients.

The legal industry expects more malpractice, conspiracy and aiding and abetting lawsuits to be leveled against law firms as the economy falters and more financial frauds and Ponzi schemes unravel.

“The perpetrator of the fraud has no money, so of course plaintiffs look for any deep pockets around,” said Bruce Katzen, a partner at Kluger Kaplan Silverman Katzen and Levine in Miami and a former CPA. “The accountants and the lawyers or brokerage firms, those deep-pocket defendants become the targets because they have so much malpractice insurance.”

Both the suit against Holland and the one against Proskauer Rose were filed by investors and receivers victimized by Ponzi schemes.

In the case of Holland & Knight, a 1,000-lawyer Florida-based firm, the plaintiff was the receiver in a \$347 million Ponzi scheme in Sarasota Circuit Court. The suit followed a similar one against the firm filed in March by wronged investors.

INCOMPLETE RESEARCH

The suit in Sarasota alleges Holland & Knight and partner Scott MacLeod prepared disclosure documents for investors that failed to mention Arthur Nadel, who headed the Scoop Management hedge fund, was a disbarred New York attorney who had drained a client's escrow account. The firm and MacLeod are also accused of conflicts of interest by simultaneously representing Nadel and his investment funds.

The receiver's suit seeks \$50 million in punitive damages.

Karen McBride, a spokeswoman for Holland & Knight, denied any wrongdoing by the firm. “We've done nothing wrong, and we intend to vigorously defend the case,” she said.

Securities work, or representing financial firms or hedge funds in public offerings, is considered the riskiest area of law. For that reason, typically only large law firms with dedicated conflicts departments and plenty of malpractice insurance take such cases. Legal malpractice insurers specifically ask law firms in applications whether they handle

securities cases, and then charge a considerable extra sum if they do. The deductibles are as high as \$1 million.

But the work can be highly lucrative. For example, the lawsuit against Holland & Knight alleges the firm took hundreds of thousands of dollars in legal fees from Nadel.

“You definitely want to check out who your client is before you take a case, but with securities cases, the bar is higher, obligations are higher,” said Glen Waldman, a partner with HellerWaldman in Coconut Grove. “I wouldn’t do any securities cases because it’s a highly specialized area, and that’s how you can get yourself in trouble.”

Several lawyers said they believed Holland & Knight should have done the research necessary to unearth the fact that Nadel had been disbarred in New York.

SIMPLE GOOGLE SEARCH

Large law firms routinely do extensive background checks on clients, particularly in the financial arena. In this case, some lawyers wondered whether a simple Google search would have picked up the Nadel disbarment, and they questioned whether someone below MacLeod dropped the ball. In smaller firms, paralegals and librarians do the checks. In large firms, sophisticated conflicts departments undertake them.

“If they did their due diligence on him, they would have caught this,” said Waldman. “With the Web these days and the sites available, you don’t even have to be in a big firm to do a comprehensive check. But you are only as good as the people doing the checks for you. Either they have a faulty system or the person doing the check erred.”

A managing partner of another large Miami firm who did not want to be identified agreed, saying, “it looks like they have a problem.”

But Carl Schuster, managing partner of Ruden McClosky in Fort Lauderdale, said it’s easy to make a mistake about a client. Ruden itself was sued 15 years ago after it later came out that a client for whom they had written a prospectus had a criminal record.

“You get them to sign a statement that they have never been criminally charged, but I don’t know what more you can do,” said Schuster. “If Madoff had come to us five years ago -- and we had a number of clients who used him -- I don’t know if we would have done much due diligence on him.”

Steve Hagen, a former 10-year partner at Holland & Knight who now practices at Harper Meyer in Miami, said firms are under increasing pressure from clients to cut costs. Full background investigations can cost clients extra -- perhaps \$10,000 to \$15,000 more, he said.

“There is a tension between wanting to do the complete amount of diligence you want to do and what the client is willing to pay,” Hagen said, adding that his firm has turned down cases when the client refuses to pay for background checks. “That’s why if you don’t feel comfortable with the background investigation they want, you walk away.”

Hagen defended MacLeod, whom he knows well and to whom he refers clients. “The

clients love him," he said.

FAITH IN SYSTEM

Bowman Brown, managing partner of Shutts & Bowen's Miami office, which does considerable representation of financial firms and banks and oversees public offerings, said he is confident his background checks are sufficient.

"You need to be careful, especially on disclosure statements and initial public offerings, where there is not a lot of information out there," Brown said. "We bend over backwards to be careful with our background checks. That's not an area where you want to save money. The cost of a mistake can be so great."

Still, Brown added, "you never know. You can miss something."

Will there be any residual damage to Holland & Knight's reputation as a result of the lawsuit? Probably not, said the lawyers interviewed.

"The fact that this has been filed against a prestigious firm suggests that no one is immune, and my belief is most professionals are very well-intentioned," said Katzen. "It's a sign of the times. People are looking to go after professionals."