Dewey Partners Likely To Face Wrath Of Creditors

Law360, New York (May 10, 2012, 7:20 PM ET) -- Dewey & LeBoeuf LLP partners owed potentially millions of dollars in unpaid compensation are not only unlikely to recover any of that money, but could also end up on the hook for payments to creditors should the tottering firm file for bankruptcy protection, experts said.

While the struggling firm has denied plans to file for bankruptcy, experts said this week that equity partners seeking millions in unpaid compensation would be doing so as unsecured creditors if the firm does enter bankruptcy, most likely at the back of a very long line.

Further, Dewey partners who were paid their guaranteed compensation could be exposed to "clawback" claims lodged by a bankruptcy trustee or the firm's estate arguing that payments partners received while the firm was insolvent were fraudulent conveyances, according to experts.

"Certain amounts of monies paid out to partners when a firm is in financial distress … can be collected," said Yann Geron of Fox Rothschild LLP, drawing on his experience as Chapter 7 Trustee in the Thelen LLP bankruptcy.

Under a fraudulent conveyance argument, a bankruptcy trustee may contend that payments to partners were made with the intent to hinder, delay or defraud creditors, like an owner who continues to pay himself while he knows the business is insolvent, experts said.

But the success of such an argument will come down to whether the firm was insolvent or not at the time of the payments and if the partners knew the extent of the financial situation, experts said.

Kevin Lippman, section head of Munsch Hardt Kopf & Harr PC's insolvency group, cautioned against immediately labeling compensation packages or draw payments as fraudulent conveyances, saying it would be hard to meet the burden that the partners or firm management had actual intent to defraud.

But even if they don't face fraudulent conveyance claims, partners who defected to competing law firms will likely face lawsuits seeking to reclaim lost profits, experts said. The so-called 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.

"Any partner involved in an insolvent partnership would potentially be facing … claims," said Sean C. Southard of Klestadt & Winters LLP, who has been involved in several major law firm bankruptcies.

Heller Ehrman LLP — which filed for Chapter 11 protection in December 2008 — targeted about 50 firms in adversary proceedings alleging its former attorneys had fraudulently transferred business when they joined other firms. Heller Ehrman settled with about 40 of them, recovering more than $7.5 million from the adversary suits.

The firm's estate or trustee can be expected to pursue any and all avenues in which to recover funds, and any partner within the partnership could be liable for a portion of the debt, Southard said.

"Partners of an insolvent firm are a huge target," he said.

Dewey is facing a mountain of debt, including a roughly $75 million draw on a $100 million revolving credit line held by JPMorgan Chase & Co., HSBC Holdings PLC and other lenders, sources familiar with the matter reported last week.

Additionally, Dewey took on a massive obligation when it sold $125 million in corporate bonds to insurance companies and others, including the firm's clients, in 2010.

Dewey's lenders reportedly agreed to temporarily extend the deadline on the firm's credit for a couple more weeks, in order to give the firm more time to continue to operate and collect on client bills. But that was a temporary fix rather than a permanent solution, experts said.

If Dewey's debts do force the firm to enter bankruptcy proceedings, experts say that equity partners could be facing an uphill battle to gain any money from guaranteed compensation contracts or even millions in unpaid wages.

Former vice chairman Morton Pierce — who left Dewey for White & Case LLP last week — said in his resignation letter that the firm owed him at least $61 million, a source told the New York Times on Monday.

But experts doubted that partners like Pierce would completely recover the payments Dewey allegedly owed. Because law firms do not have much in terms of assets, there may not be a lot to divide between Dewey's creditors, said David Skeel, professor of corporate law at the University of Pennsylvania Law School.

"It will be very difficult … for them to recover a large percentage of what they're owed," Skeel said.

Although equity partners have ownership shares in the firm, they do not typically have collateral, making them unsecured creditors — and fairly low on the repayment totem pole — in the event of a bankruptcy filing, experts said.

"They will have to stand in line with everyone else," Skeel said.

Bank lenders typically would come first, if they are secured creditors, followed by a range of potentially higher-priority unsecured claims from parties such as landlords or vendors. Employee wage claims of up to $11,700 and any unpaid tax claims are also typically repaid before any money is allocated to general unsecured creditors.

Of all the potential partner claims, former Dewey partners with outstanding capital will most likely fall to the bottom of the distribution list, Lippman predicted, as those payments were likely to be characterized as equity contributions by owners.

“They’re not likely to get anything,” Skeel added.

Last month, Dewey reportedly considered filing a prepackaged Chapter 11 in order to then pursue a merger with another law firm such as Greenberg Traurig LLP. But talks reportedly fell through with that firm and others, and Dewey management said as late as last week that the firm had no plans to file for bankruptcy.

But Lippman said that he would not be surprised to see creditors “band together” and force Dewey into an involuntary bankruptcy.

“In recent years, firms that talk about dissolution end up in bankruptcy,” said Howard L. Simon, partner in Windels Marx Lane & Mittendorf LLP’s bankruptcy and creditors' rights practice group.

In addition to Dewey’s debt, the firm has struggled with massive partner defections, losing almost two-thirds of its global partnership within the space of just a few months. The ailing firm issued notices last week under New York’s Worker Adjustment and Retraining Notification Act, saying Dewey could shutter its business, resulting in massive layoffs.

According to a lawsuit filed Thursday in New York federal court, Dewey informed employees Monday that it planned to lay off over 450 employees from its New York office effective May 11.

On Thursday, the Pension Benefit Guaranty Corp. — which operates as an independent governmental insurance program for pension benefit plans — said it planned to take responsibility for Dewey’s three pension plans covering almost 1,800 people. Dewey’s pension plans were collectively underfunded by more than $80 million, PBGC said.

A spokesperson for Dewey did not immediately respond to requests for comment.

--Editing by John Quinn.