In The News

Ex-Howrey Partners' Clawback Deal Will Pressure Holdouts

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Law360, New York (May 07, 2014, 7:18 PM ET) -- The $4 million clawback deal that Howrey LLP's bankruptcy trustee struck with 60 former equity partners represents a milestone in the defunct law firm's Chapter 11 case that could pave the way for more settlements with ex-partners, experts say.

Unveiled in court filings late Monday, the settlement provides that the partners will pay a combined $4.2 million to the estate, which represents about 16 percent of the amounts U.S. Trustee Allan B. Diamond of Diamond McCarthy LLP says they received in compensation while the firm was insolvent.

Former partners who have not yet made peace with the trustee will probably feel pressure to follow suit, attorneys said.

"What it does is it creates a momentum," Richard Levy of Pryor Cashman LLP said.

In court papers, lawyers for Diamond say the settlement was structured in a similar fashion as Dewey & LeBoeuf LLP's, which brought in $70 million to the estate in August 2012 and protected hundreds of the firm's former partners from clawback litigation. The Dewey deal was viewed at the time as a blueprint for other administrators for bankrupt law firms.

Howrey, the Washington, D.C.-based antitrust and intellectual property firm that at one time employed 750 attorneys across three continents, was placed by creditors into an involuntary Chapter 7 bankruptcy in April 2011. It had begun to wind down operations the previous month after its much of its top talent jumped ship when its profits started to decline. By June of that year, it had converted the case into a voluntary Chapter 11. Diamond was appointed to the trustee role in October 2011.

Back in August 2012, Diamond, whose firm recently took on the Heller Ehrman LLP bankruptcy as well, told a California bankruptcy judge that the firm's ability to pay back creditors would rest on recovering major contingency fees and going after ex-partners who received distributions while the firm was insolvent.

Since then, he has settled claims with individual partners here and there, many of them over unfinished business profits. But Monday's deal, which took more than a year to establish, is notable for how many partners it brought on board. The settling partners reportedly represent about half of those who had clawback claims pending against them, and experts say there is a good chance that the remaining partners will now feel the pressure to settle and to do so quickly.

"I think it will encourage them to give strong consideration to [a settlement]. As the number of potential targets gets smaller and the trustee builds up a war chest, so to speak, of funds that were recovered, they have to be mindful of that," Kevin Lippman of Munsch Hardt Kopf & Harr PC said.

Of course, partners are typically reluctant to hand over any of their compensation to an old firm when it goes under, and many feel that they have valid defenses against a trustee's clawback claims. But clawback litigation, which usually comes in the form of either preference or fraudulent conveyance claims and involves extensive document review and witness questioning, can be costly and time-consuming, especially when it comes to proving when the firm became insolvent.

The potential time and expense will likely drive partners toward a deal, even if they're not wild about the terms, attorneys said.

Moreover, there is no guarantee that other partners who haven't settled clawback claims will get as good a deal as the 16 percent offer the trustee is making now, Michelle Novick of Arnstein & Lehr LLP said. The deals that bankruptcy trustees for law firms cut with former partners on clawback claims vary from case to case, but the 16 percent Diamond has secured presumably sets the bar for Howrey.

"It will be harder for individual holdouts to negotiate something more favorable," she said.

The Howrey case has not yet produced a liquidation plan, but attorneys say that with the partner settlement in place, a proposal is likely not far off. Though it has taken significantly longer for the trustee to come to terms with former Howrey partners than attorneys for Dewey took with their ex-partners, experts say Dewey was unusual and that no other law firm bankruptcies move as quickly as it did.

For now, the trustee can take solace in the $4.2 million he rounded up for the estate, which will likely be used to eventually make payments to creditors or to fund additional litigation with former partners.

"There's now a settlement, which I suppose some people might view as a template," Levy said. "But you can't force people to settle."

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