New York Law Journal

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At What Price a Big Law Partnership?

During the late 20th century, being a Big Law partner had the sweet smell of success.[1]

The beginning of the 21st century, however, has seen a wave of Big Law bankruptcy filings, mainly involving Big Law firms organized as limited liability partnerships (failed Big Law Partnerships).[2]

Circa 2014, the phenomenon of failed Big Law partnerships has caused the odor associated with achieving the status of a Big Law partner to become distinctly gamey. Why? Because bankruptcy filings by failed Big Law partnerships have routinely prompted attacks on the former partners in failed Big Law partnerships (former Big Law partners) on various theories of personal liability.[3]

In sum, former Big Law partners are often looked upon as the ultimate deep-pocket defendants in Failed Big Law Partnership bankruptcy cases, both (i) by the bankruptcy trustees of failed Big Law partnerships[4] as well as (ii) by the individual creditors of failed Big Law partnerships.[5]

This article explores why—of all the various forms of business organizations presently being utilized by Big Law firms[6]—forms of business organizations which require their equity security holders to identify themselves to the public as "partners" are by far the most problematic of all the various and sundry forms of business organization presently in use by Big Law.[7]

Question Presented

What is it about LLLPs that likely makes them uniquely dangerous for former Big Law partners when they (such LLLPs) become failed Big Law partnerships?

Summary Answer

The reason LLLPs are especially problematic is that the law governing LLLPs is an integral part of the common law (presently codified as the Uniform Partnership Act (1997) (RUPA) which governs all aspects of partnership.[8]

Analysis

Under the Bankruptcy Code, LLLPs are not *true* partnerships at all.[9]

Rather, and as is made clear in Bromberg & Ribstein, §7.05(a), LLLPs are primarily tax avoidance devices intended to also insulate their so-called "partners" from personal liability to the same extent as the shareholders in an LC or the members in an LLLC are also protected from such personal liability.

This article posits that RUPA's above-noted incorporation of the law of limited liability partnerships into the law of general partnerships both must and should be recognized for what it is: An imperfect attempt by RUPA's drafters to allow former Big Law partners to both have their cake and eat it too, i.e., to allow such individuals to *call* themselves partners and yet never *be* partners.[10]

As will be demonstrated, infra—and once having elected the LLLP form of business organization prepetition—those Big Law firms who do not heed the red flags contained in this article by promptly ceasing to be LLLPs may well wind up (at least post-insolvency) prevented from paying their partners reasonable compensation for services rendered if such partners choose to stay on despite a financial crisis[11]—with the resulting chaos caused solely by an irrational desire to call individuals practicing law in a group setting by the sobriquet "partner," an exercise in nostalgia which (at least in today's brutal Big Law marketplace) has about as much practical significance as does describing a junior banker as a "vice president" at some anonymous money center bank (meaning none at all).

Thus, RUPA §103(a) makes clear that, insofar as "relations [i] among the partners and [ii] between the partners and the partnership" are concerned, i.e., with respect to Article IV of RUPA, it is the partnership agreement that controls, not RUPA itself.

On its face, however, RUPA §103(a) does *not* absolutely turn Article IV of RUPA into a mere default statute. Rather, RUPA §103(a) cross-references RUPA §103(b)(1)-(10). That latter statute lays out a series of limitations on just how far a partnership agreement can go in deviating from Article IV as a default statute.

For present purposes, the key aspect of RUPA §103(b) is subdivision (b)(10). RUPA §103(b)(10) reads, in full:

The partnership agreement may not … restrict rights of third parties under [RUPA].

Comment 12 to RUPA §103(b)(10) reads, in pertinent part:

Although stating the obvious, [RUPA §103(b)(10)] provides expressly that the rights of a third party under [RUPA] may not be restricted by an agreement among the partners to which the third party has not agreed.

Thus, RUPA §103(b)(10) expressly assumes that it is possible to draft a partnership agreement that would sufficiently change "relations [i] among the partners and [ii] between the partners and the partnership" so as to "… restrict rights of third parties under [RUPA]" and then goes on to forbid such behavior without the consent of any third parties (obviously including creditors) affected thereby.

In the present context, what this all means is simple: RUPA §401(h) forbids payment to partners of "remuneration for services performed for the partnership." An LLLP's contracting in derogation of this provision—as occurred, for example, when the Dewey & Leboeuf LLP management committee agreed to make guaranteed payments to its many so-called "deal partners" (all as was recently and very eloquently described in "The Collapse"[12])—is necessarily ineffectual as respects creditors' remedies because creditors' RUPA-created "rights" *not* to have their creditors' remedies diluted by large creditor claims coming from such "deal partners" cannot be stripped from them (or, in bankruptcy, from the bankruptcy trustee acting in his creditors' representative capacity) without their consent.[13]

In contrast, the truly corporate (as opposed to partnership) form of business organizations presently in use by Big Law firms, i.e., the LC form of business organization, does not in any manner contemplate the wholesale deprivation of creditors' remedies that adversely affect former Big Law partners in failed Big Law partnerships.[14] Meaning that—at least when a Big Law entity wisely operates as such an LC—then its individual shareholders retain (i) the freedom to legitimately contract with their LCs on an employer to employee basis and (ii) to legitimately claim that the professional services which they rendered their insolvent LCs were, in and of themselves, a legally cognizable type of reasonably equivalent value.

Conclusion

'Tis but thy name that is my enemy; thou art thyself though, not a [partner].

What's [a partner]? It is nor hand, nor foot, nor arm, nor face, nor any other part belonging to a man.

O! Be some other name: What's in a name? That which we call a rose by any other name would smell as sweet; so [a partner] would, were he not [a partner] call'd, retain that dear perfection which he owes without that title.

[Partner], doff thy name; and for that name, which is no part of thee, take all myself.

Romeo & Juliet, LC (with apologies to the Bard).

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Endnotes:

1. This article employs "Big Law" as a synonym for the Am Law Gross Revenue 100. The law firms comprising the 2013 Am Law Gross Revenue 100 may be found at http://www.americanlawyer.com/PubArticleTAL.jsp?id=1202596371400.

2. As is demonstrated on Appendix 1 (which itself may be found at https://mcgrane.egnyte.com/h-s/20140125/d090238851ee420b), some 89% of the 2013 Am Law 100 utilize the limited liability partnership form of business organization. Big Law limited liability partnerships which eventually became failed Big Law partnerships on and after Jan. 1, 2000, include: *In re Brobeck, Phleger & Harrison, LLP*, U.S. Bankruptcy Court for the Northern District of California, Case No. 03-32715 (Brobeck bankruptcy); *In re Coudert Brothers LLP*, U.S. Bankruptcy Court for the Southern District of New York, Case No. 06-12226 (Coudert bankruptcy); *In re Dewey & LeBoeuf, LLP*, U.S. Bankruptcy Court for the Southern District of New York, Case No. 12-12321 (Dewey bankruptcy); *In re Heller Ehrman, LLP*, U.S. Bankruptcy Court for the Northern District of California, Case No. 08-32514 (Heller bankruptcy); *In re Howrey LLP*, U.S. Bankruptcy Court for the Northern District of California, Case No. 11-31376 (Howrey bankruptcy); *In re Thelen, LLP,* U.S. Bankruptcy Court for the Southern District of New York, Case No. 09-15631 (Thelen bankruptcy). See also http://en.wikipedia.org/wiki/Category:Defunct_law_firms_of_the_United_States.

3. See William McGrane, "Bankruptcy Pitfalls of Big Law LLPs for Big Law Firms and Suggested Alternative(s)," Vol. XXX, No. 2 The LLC & Partnership Reporter 45 (September 2013) (McGrane ABA Article); David M. Stern, "Law Firm Bankruptcies," 8-9 (Program 11, 85th Annual Meeting of the State Bar of California, October 2012) (Stern CA State Bar Article). The McGrane ABA Article may be found at https://mcgrane.egnyte.com/h-s/20131224/6136626f31ae4531; the Stern CA State Bar Article may be found at https://mcgrane.egnyte.com/h-s/20131224/3210eb9babe34ab1.

4. See e.g., Dewey bankruptcy, Docket Nos. 1886–88, 1890-95, 1922, Adv. Cases Nos. 13-01769–01777, 13-01796 (filed December 2-5, 2013) (a series of adversary complaints brought by the Dewey & LeBoeuf Liquidation Trust against former Dewey equity partners); Heller bankruptcy, Docket No. 1398, at pp. 40-41 (Aug. 2, 2010) (Joint Plan of Liquidation of Heller Ehrman LLP); Brobeck bankruptcy, Docket No. 1032 (Motion Approving Settlement Agreements with 189 Former Partners of the Debtor, etc.)

5. See *Pinewood Enters., L.C. v. Williams (In re Living Hope Southwest Med. Serve., LLC)*, 481 B.R. 485 (W.D. Ark. 2012) (allowing claims seeking alter ego remedies to be brought post-petition against equity security holders of a debtor by individual creditors as distinct from bankruptcy trustees); see also *In re Howrey LLP*, U.S. District Court for the Northern District of California, Case No. 13-CV-00449 (appeal by creditors from a Bankr. N.D. Cal. decision regarding the issue of whom—bankruptcy trustees, individual creditors, or both or neither—should be held to have alter ego remedies against certain former Howrey LLP partners).

6. Again as set forth in Appendix 1, these various and sundry forms of business organizations include law vereins (LVs); law general partnerships (LGPs); law corporations (LCs); law limited liability companies (LLLCs) and, finally, the law limited liability partnerships (LLLPs) that are the predecessor entities to the failed Big Law partnerships which are the subject of this article.

7. LGPs are subject to 11 U.S.C. §723(a) (making their partners personally liable to the bankruptcy trustee for any deficiencies in amounts otherwise due creditors). LGPs are, however, very rare (see Appendix 1) and thus LLLPs (and not LGPs) are the primary subject of this article.

8. See http://www.uniformlaws.org/shared/docs/partnership/upa_final_97.pdf.

9. 11 U.S.C. §101(9)(A)(ii); *In re Rambo Imaging, L.L.P.*, 2008 Bankr. LEXIS 231, *16 (Bankr. W.D. Tex. 2008) ("By defining 'corporation' to include such partnerships, Congress apparently intended that such limited liability partnerships would be treated as corporations and not as partnerships under the Code."); Alan R. Bromberg and Larry E. Ribstein, Bromberg and Ribstein on Limited Liability Partnerships, The Revised Uniform Partnership Act and The Uniform Limited Partnership Act (2001) §7.02, pp. 240-45 (Wolters Kluwer 2012 ed.) (Bromberg & Ribstein).

10. Bromberg & Ribstein at §1.03, pp. 19-22, §§3.01-3.03, pp. 111-23.

11. As the McGrane ABA Article highlights in much greater detail than this short piece—and as compared to the remaining alternatives to LLLPs, i.e., LVs, LGPs, LLLCs and LCs—only LCs appear to represent a practical alternative form of business organization for Big Law firms. This is because LVs are not operating forms of business organization in the United States; former Big Law partners in LGPs are subject to personal liability to bankruptcy trustees under 11 U.S.C. §723(a); and LLLCs may not operate in all of the major U.S. markets for legal services, California in particular. Even Big Law firms attempting to employ LCs as a form of business organization can have double taxation problems, but such double taxation problems are not insurmountable. See McGrane ABA Article at n.23 (suggesting any Big Law firm LC having more than 100 shareholders may be capitalized other than by means of retained earnings, thereby allowing such Big Law firm LC to avoid double taxation by means of its distributing all earnings as salaries annually while also avoiding undercapitalization by requiring such Big Law firm LC's shareholders to use their own personal funds to buy sufficient capital shares in the Big Law firm LC so as to adequately capitalize the Big Law firm LC in question as one very likely solution to avoid double taxation).

12. James B. Stewart, "The Collapse: How a Top Legal Firm Destroyed Itself," The New Yorker (Oct. 14, 2013) at p. 80.

13. The RUPA-created right not to be diluted can be alternatively phrased, depending on the state of play, as a RUPA-created "right" not to have "deal partners" be permitted to defend a bankruptcy trustee's clawback claims by claiming reasonably equivalent value was rendered by "deal partners" for whatever dollars they actually got post-insolvency but pre-petition when such a bankruptcy trustee sues them under 11 U.S.C. §§544, 548. The main point is that there is no sensible way to interpret RUPA §103(b)(10) as not having been intended to recognize just such creditors' remedies as rights arising out of Article IV that were created for the benefit of creditors of a debtor entity.

14. See McGrane ABA Article at p. 48; compare Stern CA State Bar Article at pp. 6-10.