REUTERS

Avoiding the fate of Dewey partners

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By Jennifer Hoyt Cummings

NEW YORK (Reuters) - The failing law firm Dewey & LeBoeuf is a good reminder to financial advisers about the complications of managing money for people in business partnerships.

The partners at Dewey - once among the 20 largest firms in the United States - not only have to deal with losing their jobs. They also will likely see the bulk of their pensions vanish. Some may even face clawbacks and have to return money they have already been paid.

More than two-thirds of Dewey's 300 partners already have jumped ship, with the rest mulling their options in the wake of public statements by executives that the firm is nearly broke.

On Tuesday the firm was sued on behalf of employees of the firm by the Pension Benefit Guaranty Corp, and last week the agency said it would seize control of three Dewey pension plans covering 1,800 retirees.

Unlike most traditional clients, who can depend on a regular paycheck and a pension or 401(k) retirement plan, lawyers, doctors, accountants and other professionals tied to business partnerships can have huge vulnerabilities to their net worth and tenuous retirement plans.

Despite these risks, many people in partnerships are too busy focusing on their jobs to keep tabs on the health of their business. And more inquisitive partners can be stymied by secretive managing partners.

For many at Dewey, this meant that they didn't know the firm had massive debt and multimillion-dollar financial guarantees to certain partners.

"If somebody isn't thinking about how this could impact a firm like theirs, they're not watching the news," said Marc Minker, a managing director at CBIZ MHM LLC, a New York-based business management consulting firm that handles finances for several lawyers.

Advisers aren't expected to stop a partnership from imploding, but they can motivate their clients to create a financial safety net, and to ask hard questions about the health of their firm.

BUILD EMERGENCY FUNDS

The biggest risk for many partners is that they typically have a huge amount of their own capital tied up in the business - money that can disappear if the firm gets into trouble.

That's why financial advisers who manage money for business partners often recommend a much higher emergency fund for these clients than other people.

Ryan Wibberley, founder of the Gaithersburg, Maryland-based CIC Wealth Management Group, said that he has his clients with conventional jobs set aside enough money to cover six months of expenses, but he recommends double - sometimes quadruple - that for his lawyer clients, depending on their spending habits.

This safeguarding also applies to retirement planning. Dewey's undoing had to do in part with the portion of its pension plan that was unfunded, meaning the firm carved its retirees' pension payments out of current revenues. This means that if the revenues stop flowing, so can the pension payments.

It is fairly common in business partnership to have a retirement plan that has an unfunded portion. Advisers should see if this is the case for their clients by carefully reading the partnerships agreements and firm financials. If the adviser doesn't spot anything about an unfunded pension, they should get the client's permission to ask the firm about this directly, suggests Minker, of CBIZ MHM.

If there is an unfunded portion, the adviser should set up a separate retirement account with relatively conservative asset allocations to serve as a backup, Minker said.

For instance, if he had a client who expected to get $300,000 a year in retirement income, but half of that was in unfunded plans, he'd have them put aside about $65,000 a year in a backup retirement plan. This could vary based on how long the partner plans to stay at the firm, among other factors.

DISCOVERY WORK

Advisers also should do discovery work on the business' contracts and financials so they can help partners spot potential land mines before they blow up.

Most people in business partnerships get a regular payment, or a draw from the firm's profits, on a bi-weekly or monthly basis. From there, they usually get bonuses, but those can vary widely based on the performance of the individual or the firm as a whole. In rare cases, the partners may actually have to pay in money if business is bad.

The bottom line is that these clients' incomes can vary from year to year, so their budgets should be set up with the worst-case scenario as the benchmark.

These agreements should also spell out what will happen to a partner's stake if they die or become disabled. Scott Cramer, president of the Maitland, Florida-based wealth management firm Cramer & Rauchegger, likes it when a partnership has life insurance in place to cover the cost of buying back a disabled or deceased partner's stake.

Advisers should look at three years of the firm's financial statements to see if the revenue and net income have declined, said Joel Rose, president of Joel A. Rose, a Cherry Hill, New Jersey-based management consulting firm to law offices. Advisers should encourage their clients to talk to their partners about these red flags. They should also look closely at the outstanding debts on the balance sheets.

If the firm is borrowing to reinvest in its phone system, that is fine, but if it is borrowing to pay people's salaries, that is a concern, Rose said.

If the partners managing the books refuse to give out the financials, the other partners should take a stand, even if it means resigning, said Bruce MacEwen, president of Adam Smith Esq., a management consulting firm to the legal industry. Another alternative is to band together with other partners to demand more transparency.

While it can be awkward to tell professionals like lawyers and accountants that you want to check up on their businesses and contracts, clients are likely to be receptive to these conversations following the falling out at Dewey.

"In today's environment no firm is too big to fail," Rose said.

(Reporting by Jennifer Hoyt Cummings; Editing by Walden Siew and Tim Dobbyn)