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In the Zone

Davis Polk has been a go-to firm during Wall Street's meltdown. How much will all that "strategic" work pay off?

By Julie Triedman

O **N JULY 23** the Federal Home Loan Mortgage Corporation's general counsel, Robert Bostrom, called Randall Guynn, head of the financial institutions group at Davis Polk & Wardwell. Davis Polk wasn't one of Freddie Mac's outside law firms—Covington & Burling did its regulatory and disclosure work, and Cadwalader, Wickersham & Taft did its routine corporate work. But Bostrom needed an equity products specialist. Regulators, concerned about the lender's massive exposure to the U.S. mortgage market, had demanded that it shore up its core capital. But with Freddie Mac shares trading at gutter levels, issuing billions of dollars in new equity could backfire.

Bostrom called Davis Polk because it had helped a half-dozen investment banks arrange a series of unprecedented multibillion-dollar bank capital raisings—high-speed transactions whose announcements were timed to coincide with news of massive writedowns—the previous winter. Several firms with similar experience were also invited to pitch Freddie Mac.

Within minutes, Bostrom had the same Davis Polk team that had helped the banks—Guynn, equity derivatives partner John Brandow, and capital markets partner Jeffrey Small—on the phone. They outlined alternative equity products that had the advantages of both equities and debt. Significantly, they promised that the firm's senior cash-raising group would handle the matter. Swayed by the promise of such an experienced team, Bostrom called Guynn back to tell him that the firm was hired.

The relationship didn't stop at products counsel. A week after the Davis Polk trio was tapped, underwriters, nervous about business and political risk, demanded that Freddie get a disclosure opinion on the proposed offering. Bostrom again chose Davis Polk. Then, on a Friday in early September, when the government announced that it was taking over the lender, Bostrom called Guynn again. Could he get himself down to D.C. for an emergency board meeting the next morning?

Guynn grabbed fellow financial institutions group partner Luigi De Ghenghi, M&A partner Phillip Mills, and corporate partner Nicholas Kronfeld, and the group caught the 10 P.M. Acela. They left in such a hurry that Guynn's clothes had to be sent down separately by car service. "We didn't know how long we'd be down there," recalls Guynn (who ended up spending four days in D.C.). The Davis Polk lawyers were joined by Covington and Freddie's Virginia counsel, McGuireWoods. But after the federal government took over the lender, Davis Polk played the broader role in helping Freddie Mac deal with a variety of new problems, Bostrom says. Soon, Carey Dunne, the firm's litigation department head, was tapped to help Bostrom respond to investigations launched by prosecutors, the Securities and Exchange Commission, and Congress.

PHOTOGRAPHS BY MICHAEL J.N. BOWLES



RANDALL GUYNN, (CENTER), WITH SOME OF HIS DAVIS POLK PARTNERS, HAS A HAND IN 11 RESCUE-RELATED MATTERS.

WHAT'S BEEN BAD for the country has been good for Davis Polk. Clients, citing the firm's skill at building instant multidisciplinary teams, have awarded it a major share of significant rescue-related work [see "Into the Breach"]. Only Sullivan & Cromwell and Wachtell, Lipton, Rosen & Katz have been as ubiquitous. In a few cases, Davis Polk was asked to advise on more than one side of a matter, with client consent. Other businesses affected by the meltdown, including large investment funds and banks, are also coming in the door.

Partners say that the rush of new work validates a collegial culture that stems, to a large degree, from its lockstep compensation system. And partly due to planning and partly to serendipity, the 750-lawyer firm has the go-to bench for the times: bank regulatory and insolvency prowess underpinned by broad M&A and capital markets experience. "If you look at the confluence of all those areas of expertise, it isn't surprising that Davis Polk was tapped for these matters," says a partner at a rival firm.

Though it has been criticized by competitors and a handful of ex-partners for being slower than its peers to adapt to changing times, some of that griping now sounds like sour grapes. In fact, some of the firm's decisions—not to move into structured finance when others embraced that area, for example—now look prescient. "You've got to hand it to them for sticking to their knitting," says Citigroup Inc. vice-chair Lewis Kaden.

Staying the course has paid off—for now. Rescue-related assignments will ease the shortfall from the deal drought that has paralyzed the M&A and capital markets worlds for the last several months. However, "what Davis Polk, Sullivan, and others still don't know," notes law firm consultant Peter Zeughauser, "is how much legs this work is going to have."

Davis Polk is particularly vulnerable to the pain in the financial sector. In 2007 work for that industry lifted firm revenues to a record \$789 million, according to *The American Lawyer*. A third of its lawyers specialize in M&A and capital markets work; an additional two dozen lawyers do project or acquisition financing, which are in a slump as access to credit markets has dried up. A partner from a rival firm says, "The high-profile assignments are nice, but even the best are probably worth \$10–20 million. They need [several hundred] million dollars to keep the firm going, and they need the M&A and capital markets work to get those kind of numbers."

At the end of November, Davis Polk managing partner John Ettinger predicted "decent" results for 2008, though down from 2007, a record-setting year. While work flow through June was weak, September and October were even busier than a year earlier, he says, declining to give specific numbers. Assignments for

some new clients like Freddie Mac and Citigroup "will have enormous consequences" down the road, he says. But the strategic importance of government assignments remains "speculative."

For more than a century, Davis Polk's fortunes have been tied to its major investment banking clients. Its relationship with both J.P. Morgan Chase & Co. and Morgan Stanley, for

example, harks back to the late 1800s, when J. Pierpont Morgan became a Davis Polk client. The firm's work for the government in the current financial crisis echoes its help in 1895, when Francis Stetson, a name partner at Davis Polk's predecessor firm, accompanied Morgan to the White House to meet President Grover Cleveland to buy \$65 million worth of government bonds. Morgan resold them to the public,

INTO THE BREACH

Davis Polk has played a prominent role in rescue-related work.

Highlights include:

FREDDIE MAC

Lead counsel to the Federal Home Loan Mortgage Corporation on the U.S. government's conservatorship and on parallel investigations of the lender.

CONSERVATORSHIP ISSUES PARTNERS:

Randall Guynn
Jeffrey Small
Luigi De Ghenghi
Phillip Mills

PARALLEL INVESTIGATIONS PARTNERS:

Carey Dunne
Robert Fiske, Jr.

AIG GOVERNMENT TAKEOVER

Lead counsel to the Federal Reserve Bank of New York and the U.S. Department of the Treasury on more than \$150 billion in financing transactions to date.

LEAD PARTNERS:

Marshall Huebner
Donald Bernstein
Bradley Smith
Ethan James

MORGAN STANLEY

Counsel for bank regulatory, compliance, and corporate issues related to its conversion to a bank holding company; counsel on the structure of an equity stake to Mitsubishi; and counsel on Morgan Stanley's participation in the U.S. Treasury's \$250 billion bank capitalization program.

PARTNERS INVOLVED:

Randall Guynn
Luigi De Ghenghi
Arthur Long
Annette Nazareth

CITIGROUP

Lead counsel to Citi on its aborted \$56 billion rescue of Wachovia Corporation and on Citi's second government cash injection.

LEAD PARTNERS ON RESCUE FINANCING:

Randall Guynn
George Bason, Jr.
Avishai Shachar
Louis Goldberg

LEAD PARTNERS ON WACHOVIA:

John Ettinger
Phillip Mills
Randall Guynn
Avishai Shachar

and according to firm lore, helped the government stave off a financial crisis brought on by a gold shortage.

Davis Polk's fortunes have also been historically tied to its capital markets practice, the firm's largest, with approximately 100 lawyers. Roughly 30 of those attorneys are devoted to the equity derivatives practice, a lucrative over-the-counter market the firm has dominated for 15 years.



Though capital markets work is way down, its main U.S. clients of the practice—Morgan Stanley, J.P. Morgan Chase, and Bank of America Corporation—are the survivors of the recent Wall Street bloodbath; when the crisis eases, the work should flow again. Meanwhile, just one of several concurrent matters for Morgan—advising its transformation into a bank holding company—was expected to provide work for a large group of lawyers over several months.

Davis Polk has also been the most prominent U.S. firm involved in the U.K. government rescue deals this fall. It owes those assignments not to luck, but to nurturing longtime ties with the U.K. Treasury and Slaughter and May. Davis Polk has a “best friends” relationship with the British firm, and the connection with the U.K. Treasury dates back many years. In the 1980s, for example, Guynn's mentor, the late

Joseph Chubb, was the lead U.S. adviser to the U.K. Treasury when Great Britain privatized many of its nationally owned companies.

This fall, as the structure for a potential U.K. bank capital injection plan was hashed out, the U.K. Treasury and Slaughter brought Davis Polk in to provide counsel on U.S. regulatory concerns. Concurrently, the Royal Bank of Scotland Group plc and Lloyds TSB Group plc both came knocking for advice on how the U.K. bank

capitalizations would affect their U.S. interests.

Maintaining personal ties has also paid off with Citigroup, not historically a mainstay client. The bank's new management team includes several executives with connections to the firm, including CEO Vikram Pandit, a former Morgan Stanley president, and vice-chair Kaden, a former Davis Polk partner. (The long-term future of that current team, however, was uncertain at press time.)

WHETHER DAVIS POLK'S landing will be a soft one depends, in part, on Randall Guynn. Just days after putting out the fires at Freddie Mac, he found himself in another once-in-a-lifetime situation. Clients started calling him on Saturday, September 13, at 7:30 A.M. as he shuttled one child, then another—he has seven—to

games in suburban Connecticut. Five clients rang in short succession, all wanting instant answers. Some calls were related to the impending collapse of Lehman Brothers Holdings Inc. or American International Group, Inc.; others to Freddie Mac's conservatorship; still others to nonpublic matters. Many clients wanted to know how existing banking laws applied to the unprecedented rescue efforts—and which regulators they needed to get to know quickly. “They didn't want an encyclopedic answer. They wanted a one-line black-or-white answer,” recalls Guynn, a tall and deceptively boyish-looking 50-year-old. After five hours on the phone, “I literally had to lie down for ten minutes to get back to my senses.”

Guynn's entire Davis Polk career could be viewed as a rehearsal for these moments. In the late 1980s, he cut his risk management chops on matters related to Brussels-based Euroclear, the world's largest securities transaction settlement system, which Davis Polk had helped J.P. Morgan create. Guynn's rise at the firm has been rapid. In 1994, when a fellow banking expert, Edward “Ned” Kelly, left for J.P. Morgan, Guynn, only a year into his partnership, was appointed head of the financial institutions group. These days, clients are looking to Guynn not just for his banking regulatory creds but his power Rolodex. This fall, Guynn had a guiding hand in 11 significant rescue matters. Only Sullivan & Cromwell's H. Rodgin Cohen and Wachtell, Lipton's Ed Herlihy have played as prominent a role in providing legal advice on the financial crisis.

Even before the historic events of mid-September, Donald Bernstein, head of Davis Polk's 30-lawyer insolvency group, was chalking up 18-hour days advising clients on their exposure to companies in near-default. Despite being fully occupied a year earlier, his group's hours were

**FIRST RESPONDERS:
(FROM LEFT)
NORA JORDAN,
RANDALL GUYNN,
DONALD BERNSTEIN,
THOMAS REID, AND
JOHN ETTINGER**

up a third in September. Some 50 lawyers from other practice areas punched time on insolvency-related matters. While many firms are still waiting for the boom in bankruptcy-related work, “those of

us at Davis Polk, we feel really busy,” Bernstein says. “And the truth is, the big wave of bankruptcies hasn't even hit yet.”

While Guynn was fielding calls by the soccer field, Bernstein was getting frantic calls of his own. One was from Citi, whom he had been advising since the previous winter on its collateralized debt obligation investments and, more recently, its exposures to The Bear Stearns Companies Inc. and Lehman. Another call to Bernstein was from longtime client J.P. Morgan. The U.S. Treasury had asked it and other banks to help find a private solution to AIG's

spiraling debt. Without a second thought, Bernstein—who in mid-September was working at the Fed alongside Citi executives to help head off Lehman’s impending collapse—handed the J.P. Morgan/AIG matter to a colleague, Marshall Huebner. Ultimately, when J.P. Morgan dropped out of the running, Huebner was tapped by two new clients—the Federal Reserve Bank of New York and the Treasury [“The Center of the Storm,” November 2008].

Under the lockstep system, Bernstein, 55, didn’t think twice about passing on a significant matter like J.P. Morgan/AIG. “It would be a lot harder to say that if it came out of my own pocket,” he says. “I can just hand off a potentially huge matter, and not worry about compensation issues.”

Meanwhile, Bernstein’s work for Citi has also paid off. The bank’s credit recovery and distressed lending units have now become regular clients of his insolvency group. According to Citi’s Kaden, Bernstein’s work also contributed to the bank’s growing confidence in the firm. At the end of September, Davis Polk’s M&A team, led by managing partner Ettinger and partner Phillip Mills, was tapped by Citi in its \$56 billion rescue of Wachovia Corporation—work that, a year ago, would likely have gone to Skadden, Arps, Slate, Meagher & Flom, Citi’s dominant outside M&A counsel the previous 15 years.

When Wachovia was swiped from Citi four days later by Wells Fargo & Company, Davis Polk was widely criticized for its failure to lock up the deal. But Citi’s Kaden said the firm’s lawyers did everything they was asked to do. “There’s a high confidence level in the firm at a senior level,” Kaden said in October. “My guess is, [the relationship] will expand.”

That proved the case in late November, as Citi’s future suddenly appeared uncertain and new worries about potential trading losses drove the bank’s share price below \$4. On November 21 a team led by M&A head George “Gar” Bason, Jr., and Guynn assisted Citi in negotiating its own rescue financing package. The agreement with Treasury, the Federal Reserve Board, and the Federal Deposit Insurance Corporation involves \$20 billion in additional direct aid to Citi and a federal backstop on hundreds of billions of dollars of debt it holds.

LIKE MANY FIRMS, 2007 was a year for the record books at Davis Polk. Nowhere was that more true than in M&A. It advised ABN AMRO Holding N.V. in its \$101 billion acquisition by a consortium of banks, the largest global deal announced that year, according to Bloomberg. It

was also tapped for help on three other top-ten deals globally. That work helped contribute to a 26 percent hike in firm profits in 2007.

In 2008 the deals mostly stopped coming. The largest was announced just before the financial storm, when Roche Holding Ltd. tapped the firm in its proposed \$44 billion bid for Genentech, Inc.; that deal had not closed at press time. Of the handful of others the firm was involved in this past year, none came close to that size.

A truer picture of the practice, says Bason, would include several deals that were not listed on league tables, such as the Freddie Mac and AIG government takeovers, both of which have employed many M&A lawyers. “Are the economics of [being involved in bailout matters] the same as the LBO that consumes 30 associates for six months? No,” says Bason. “But which is the strategic assignment?”

Looking ahead, Bason says the firm’s ties to banks and insurers, tempered in the recent crises, have positioned it to capture a greater share of the distressed-bank sales and mergers many lawyers see coming in the near term.

Other parts of the firm are extremely busy right now. Take Nora Jordan. If it’s a burden helping carry Davis Polk through a downturn, Jordan, head of the firm’s 36-lawyer investment funds group, isn’t showing it. Her practice has been the firm’s fastest-growing in hours booked over the past five years. “You’ve got to follow the money,” says Jordan, 50. “It’s clear [hedge funds] are the next investment bank-type entity.”

On a morning in late October, Jordan, best known for her regulatory expertise and work on SEC matters, likened her recent role to an intake valve. During the month of September, she says the firm was tapped by three new hedge fund clients that the firm had not even pitched to, “and the smallest was \$5 billion under management.” A day earlier, Jordan noted, one hedge fund called looking for advice on equity derivatives; she routed the client to a partner in that group. A second fund called about a distressed debt issue; she sent that person to a credit group lawyer.

Another walk-in client was Allianz SE’s PIMCO, among the largest asset managers in the United States. The fund called the firm out of the blue on October 15 to invite it to provide counsel on two matters: its proposed contracts with the New York Fed to manage the trillion-dollar commercial paper purchase program and to manage TARP assets (the TARP program was jettisoned by Treasury secretary Henry Paulson in November, but Jordan says the firm is helping PIMCO with other unspecified potential

contracts). “We didn’t pitch [PIMCO]—they just called and asked. And we said, ‘Hmm, let’s think about that,’” says Jordan, laughing. “Ten seconds later, we said, ‘Sure!’ ” (PIMCO, which has a confidentiality agreement with the government, declined to comment.)

TRADITIONALLY, Davis Polk has made strategic decisions by consensus. “Have we changed as fast as some of our competitors? No,” says Thomas Reid, 44, a corporate partner who became the firm’s newest management committee member this past June. “If you require broad consensus, it does take time.”

In recent years, however, a core of senior partners have become more assertive about the need for change. Formally led by managing partner Ettinger, 57, Reid, and Dunne, Davis Polk has broadened its practice areas and geographical footprint. Over the past five years, the once hermetic firm has brought in 18 lateral partners and many more midlevels to grow its Paris, Beijing, and Menlo Park, California, presences. The Menlo Park office now stands at 60 lawyers, second only to New York’s 600. Hong Kong has 30. Washington, D.C., is next. On September 22 the firm announced its first D.C. lateral hire. Annette Nazareth, a former SEC commissioner, joined the eight-lawyer office.

Davis Polk has also invested in Jordan’s and Guynn’s practice groups through promotions. And there has been an all-hands effort to broaden beyond its traditional underwriting clientele. The firm now tops the capital markets rankings for issuers almost as often as for underwriters.

In June partners overwhelmingly returned Ettinger to a fourth consecutive term. As he looks toward the new year, Ettinger says the firm was planning to prepay as many 2009 expenses as it can out of this year’s profits. But “at some point,” he admits, “the crisis-related stuff will slow enough so it won’t continue to make up for the absence of more traditional transactional work. It’s unknowable [how things will pan out].” Ettinger adds, “I’m a little more optimistic than most people, just because there’s a fair reservoir of work.”

In the end, says M&A head Bason, “If you are looking for signs of a preeminent practice, it’s ‘who do clients go to in a crisis.’ As long as we’re one of the two or three firms people go to in a crisis, than everything else will take care of itself.”

E-mail: julie.triedman@incisivemedia.com.