

How Law Firms Finance Their Practices To Encourage Business Development

Most lawyers today seem to focus on attracting new clients and increasing their revenues. But there's another side to the balance sheet that also needs a firm's attention: the liabilities. Here are the ways that firms can make sure they are able to pay their bills.

By Steven A. Meyerowitz

There's probably nothing as exciting to a litigator as obtaining a big jury verdict, unless it's having a case thrown out before trial or winning on appeal. Transactional lawyers just love their closing binders — not to mention the plastic deal toys. And, let's face it, every lawyer is thrilled when a new client signs a retainer agreement, or even when someone who has not previously retained the firm simply calls for information or requests a copy of the firm brochure.

It's all good, right? Any positive development that leads to new business, higher revenues, or more fees is wonderful news, and becomes the topic to talk about at lunch, after work, or at home.

But then, there's the other stuff to consider; the more mundane side of law firm practice. Secretaries and receptionists, and paralegals and associates, are entitled to receive their

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salaries twice a month. They work on computers that the firm has to provide, and they use paper and ink. And stamps. The rent has to be paid. And the utility bills! Not to mention the other invoices that a law firm, as a business, has to meet on a regular basis.

In a perfect world, a firm's income would be sufficient to pay its expenses (with a satisfactory profit left over). The timing would be right, too, so that salaries and invoices could be paid on time.

Unfortunately, as is apparent, we do not live in a perfect world.

There are, however, a number of ways that law firms can handle their costs.

A CAPITAL IDEA

The call to a law firm partnership, which so many young lawyers avidly seek, typically comes with a bill: the requirement to make a capital contribution to the firm. Some law firms are able to finance their practices on their own by relying primarily on their partners' capital contributions.

For example, Barley Snyder LLC is a business law firm with about 70 lawyers in seven offices in Pennsylvania. According to Paul G. Mattaini, a partner in the firm's Lancaster office, the firm is "pretty conservative" in how it finances its practice, generally relying on capital contributions from equity partners, as well as cash flow.

Mattaini suggests that smaller firms of between, say, one and 10 attorneys might find it more difficult to self-finance because their capital contributions are smaller in the aggregate (and perhaps smaller individually) and because their cash flow may be more unpredictable. There are several other financing options available for these firms.

A LINE

One option is obtaining a short-term line of credit from a bank. Richard A. Zendel, a principal with New York City-based Citrin Cooperman & Company, LLP, a tax, accounting, and business consulting firm that handles the accounting and business consult-

ing work for many law firms and routinely helps firms with financing options for their practices, states that a bank will provide a line of credit to a law firm when the firm has a relationship with the bank and the bank is knowledgeable about the firm. He adds that one law firm that he works with has three partners, all of whom had to give personal guarantees to the bank for the line of credit. Toward that end, they also had to provide personal financial statements to the bank that his firm reviewed; audited statements were not required.

The amount of a line of credit needed by a firm will differ depending on its obligations and other requirements, but Zendel says that a small firm might need a line of credit of between \$50,000 and \$100,000, which it will draw upon from time to time to meet its expenses. (Paul Mattaini of Barley Snyder says that his firm also has a line of credit with a bank, but that it has been "rarely used, if at all.")

Personal guarantees, even when they are for a limited amount, can be a sticking point for some partners. Where that is the case, they may want to shop around until they find a bank willing to extend a line of credit without their having to provide those guarantees. Indeed, Mattaini says that partners in his firm have not provided guarantees for their line of credit. In other cases, Zendel adds, some but not all partners might be asked to provide personal guarantees. For instance, if a firm has 20 to 25 partners, with four partners owning 60% of the equity, those four partners might have to sign, while the others can avoid incurring that obligation.

ASSET BASED FINANCING

Law firms with a track record have accounts receivable that they may be able to rely on to obtain financing from lenders. Zendel says that some firms with "substantial" receivables can obtain an asset-based loan from a bank, where the firm receives a

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loan and grants a lien on its receivables to the bank as security. A firm making a purchase of a large capital item such as a computer system also may be able to use that asset to secure a loan — from the seller or a bank — over the life of the asset.

Moreover, where a firm owns its building, it should be able to obtain a mortgage from a lender. Barley Snyder's Paul Mattaini points out that his firm owns some of its locations and that those buildings are secured by mortgages. Banks look to the value of the underlying real estate and the lease, often requiring an assignment of the lease — and sometimes insisting on, yes, personal guarantees from the firm's partners — when making such a loan.

PRIVATE LENDING

A firm that is too small, too undercapitalized, or that has a receivables trail that is too inconsistent, perhaps because it is a plaintiffs' or class action firm, may have to go another financing route and seek out a company specializing in law firm financing. Doing so will be costly, with high, and perhaps extremely high, interest rates.

It pays for firms in this position to shop around, too. Some law firm finance companies offer non-re-

course loans, with payback completely contingent on victory in an underlying case or appeal. Others offer loans on terms similar to loans offered by banks — except for the higher interest rate — based on a firm's practice. Keep in mind that interest costs might be a tax-deductible business expense, or perhaps an expense that is even recoverable from clients.

There are different types of finance companies that specialize in offering different financing to law firms. Some solely finance post-jury verdicts, some offer financing before verdicts based on an evaluation of a case, and some finance complete litigation practices. Mass torts cases have their own group of lenders, including venture capital funds.

RD Legal Funding LLC, based in Englewood, NJ, has a special niche: it buys attorneys' fees earned in settlements. As explained on its Web site, RD Legal Funding purchases fees from matters relating to personal injury, workers' compensation, malpractice, discrimination, debt collection, corporate defense and transactional matters, among other things. RD Legal Funding provides up to \$3,000,000 of legal fees from a proposed settlement.

Why would a firm that has obtained a settlement and is waiting for payment need to discount its

fees? As RD explains: "You don't have to wait months for final settlement and distribution of your fees. You can use these funds from your older cases to take on new cases or allocate more resources to cases likely to have the highest multiplier."

The cost — or discount — for turning to finance companies can be significant. At RD Legal Funding, the discount is usually in the range of three to 10%; discounts are lower where it believes that the payor is creditworthy and will pay quickly and where the firm's fee is higher. As an example, suppose that a firm settles a case for \$60,000 and would be receiving a \$20,000 legal fee in a month. RD Legal Funding states that its discount "would only be \$600."

Is paying such a fee worth it to a firm that has gone to the very point where a lawsuit is concluded and it needs only to await payment, especially when many settlements are paid out by good credit risks such as insurance companies? That's a decision an individual firm has to make, based on its own economics and an analysis of its financial posture.

At the least, it's nice to know that there are options available to help finance all kinds and sizes of law firm practices.

