

## Book review

# Funding alternatives for contingency fee firms

*How David Beats Goliath: Access to Capital for Contingent-Fee Law Firms* by Michael J. Swanson, 2011. (Advantage, 2011, 139 pp., paperback) \$14.99.

by Morris H. Rosenberg

Scenario #1, you are a newly licensed attorney establishing a personal injury practice as a sole practitioner. After covering your rent and buying office furniture, computer, supplies, etc., you have little or no funds left to advance costs on behalf of the clients that you are expecting. Scenario #2, you have been practicing for several years as a P.I. attorney and have managed to advance costs which have usually been under \$1,000. Now you have been hired on what you believe can be a \$500,000 claim that you know you can win if you get good experts lined up at an estimated cost of \$10,000 to \$20,000. Scenario #3, you are a partner in a three person firm handling the firm's P.I. work. The firm has a cost account that ranges between \$10,000 and \$20,000 at any given moment. You have been hired to handle a wrongful death claim that in your view should be the firm's first million dollar plus claim. Experts, deposition fees, and other necessary costs will run \$40,000 to \$60,000. One or more of these scenarios likely sounds familiar. How will the capital to fund these cases be secured?

In *How David Beats Goliath: Access to Capital for Contingent-Fee Law Firms*, Michael Swanson will provide you with basic knowledge as to all the different available methods of covering those costs. For the past twelve years the author has been a financial executive in the law firm finance industry and it is fair to assume that during that time he has become quite knowledgeable about financing for law firms. His book is a short, easy read and contains information that was not part of the curriculum when I went to law school in the late 60's and likely is not taught today either. He states some facts that are quite evident to those of us handling plaintiff's personal injury claims: the most telling and obvious is that the insurance

company has an unlimited "war chest." Thus he calls plaintiff's P.I. attorneys the "Davids" seeking justice for injured clients and up against the "Goliath," the insurance company for the negligent party.

Swanson begins with some basics about a law practice and the difficulties of raising capital i.e., money. Non-lawyers cannot own an interest in a law firm so stock cannot be sold. If the owner attorney(s) have funds, tying them up in advanced costs will tie up significant sums of money potentially for the life of the law firm and while that may be viewed as a "cheap" source of funds, there are opportunity costs associated with having after tax cash tied up for years and not invested for the owner attorney. Many law firms have little or no tangible assets to use as collateral for a traditional bank loan. There is likely no real estate, little value in equipment (which may be rented anyhow) and no true accounts receivable because all those contingent fee cases that you know will ripen into significant fees over time, are not what bankers consider as accounts receivable even though they may ultimately provide a better cash flow than a lot of unpaid hourly work!

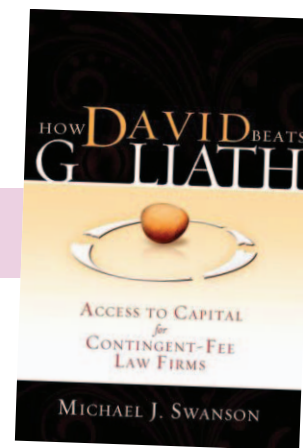
After a short chapter of basic accounting concepts and a "pitch" urging all attorneys to have financial statements regularly prepared and reviewed, Swanson has ten chapters, each dealing with a different source of capital for contingent fee law firms. The ten are:

1. Fee Sharing
  2. Contingent Lenders
  3. Appeal Funding
  4. Settlement Funding
  5. Finance Company Loans
  6. Credit Cards
  7. Partner's Cash
  8. Vendor Financing
  9. Bank Line of Credit
  10. Loans with Interest Pass-through
- Typically fee sharing is the most expen-

sive manner of securing capital to fund a case. Often it is done because the "war chest" of the bigger firm or its expertise or both necessitate that a sole practitioner or small firm enter such an arrangement. Those are good reasons but be aware, Swanson notes, of the very high interest rate that is effectively being charged. If the "financing" firm is not providing any of the legal service but is solely paying all the costs in return for a 50/50 split, the effective interest rate can be exceptionally high. He lays out the example of the "capital" law firm fronting \$10,000 in costs on a case that settles for \$100,000 after a year. If the fee is \$30,000 (\$15,000 going to each firm), the small firm is effectively paying \$15,000 to have the use of \$10,000 for a year, an annual interest rate of 150%. Again, there may well be good reasons for doing so but being aware of the true cost may cause the small firm to reassess where it gets its capital.<sup>1</sup>

Contingent fee practices financed by use of credit cards (personal or business) would appear to be quite common especially for the new practitioner. We have all had credit cards sent us with "teaser" initial interest rates especially a few years ago when credit was so "easy." The "teaser" rate of course does not last and once over the rate can go up to 20 or 30% per annum. Also, being late in one payment may trigger a much increased interest rate on the entire debt. Use credit cards to finance a practice only if there are no other viable sources.

Outside of the sole proprietor or partners financing the firm with their own funds, a bank line of credit is likely the most common form of case expense funding. If you/your firm can meet the underwriting requirements, and banks are sticklers for compliance, a bank line of credit is likely the least expensive method of raising capital. The other seven sources of capital all involve some type of finance institution or capital sourcing business to



provide the funds with differing requirements and rates of interest pegged to the risk versus security of the funds provided. Swanson's best advice as to each of those is to very carefully review every document that is required for the transaction.

Michael Swanson states that his motives for authoring this book are twofold: "a belief in the important work that trial lawyers do and a recognition of the almost complete lack of financial or business education that most lawyers receive." If I were a cynic I would suggest that a third motive is that he is the CEO of a company that provides financing for law firms including case expense financing and there is nothing wrong with that. An attorney considering the need for financing costs advanced for a potentially large case, or just to finance the ongoing case expenses of more ordinary cases, might want to consider Mr. Swanson's firm along with the competition. Certainly an attorney needing to raise capital can get a quick overview of the sources available by reading this book.

Perhaps the best reason to buy the book is that all profits from the sale of *How David Beats Goliath* will be donated to the American Association for Justice (AAJ) 7th Amendment Fund which provides AAJ with resources to continue its fight to protect the civil justice system and Americans' right to a trial by jury.

#### Endnotes:

1. RPC 1.5(e) sets out the arrangements that are permissible as to fee sharing in Washington.

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