Reproduced by permission. ©2012 Colorado Bar Association,
41 *The Colorado Lawyer* 76 (May 2012). All rights reserved.

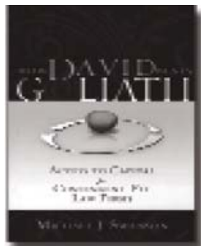
Book Reviews

How David Beats Goliath: Access to Capital for Contingent-Fee Law Firms

by Michael J. Swanson
130 pp.; $14.99
Advantage Media Group, 2011
65 Gadsden St., Charleston, SC 29401
(866) 775-1696; advantagefamily.com

Reviewed by Harmon S. Graves

Harmon Graves, of Harmon S. Graves, P.C., Littleton, is a sole practitioner engaged in civil litigation with emphasis on representing homeowners and contractors in disputes arising out of construction defects and insurance coverage—(303) 798-4262, harmongraveslaw@qwestoffice.net.



As the title suggests, the average contingent-fee law firm attorney is placed at a distinct financial disadvantage next to defense counsel for a self-insured corporate defendant or insurance carrier. A successful mass tort contingent-fee consortium may at some stage be financially competitive, yet in the early stages of the case and expert witness development, it too faces the challenges addressed by author Michael J. Swanson.

Swanson gets right to the nub of it: the law firm staff does not work on a contingency basis, nor do most experts, shorthand reporters, or videographers. These costs are, at least in substantial personal injury cases, typically fronted by the lawyer. Also, costs advanced may lock up huge sums, without interest, and bar anticipated distributions to partners. "It doesn't matter how good a lawyer you are," Swanson reminds us, "if you don't have the cash to pay for that expert witness at trial."

The scene further darkens when the firm is faced with the Internal Revenue Service's (IRS) view of case expenses. The IRS has come to view those advances as loans rather than deductible expenses against current income.[1] Not only is a good portion of the firm's liquid assets tied up, but no current tax relief is available for doing so.

What could possibly be in David's sling that would level the playing field against the corporate/insurance carrier Goliath? Swanson puts on a parade of ten sources of capital for contingent-fee law firms, readily admitting that some of them are out of step with sound business practice and guiding the reader to the most appropriate. Here they are, generally in the order from most expensive to least expensive to the firm: (1) fee sharing; (2) contingent lenders; (3) appeal funding; (4) settlement funding; (5) finance company loans; (6) multiple credit cards; (7) partner's cash; (8) vendor financing; (9) bank line of credit; and (10) loans with interest pass-through.

Looking briefly at contingent-fee funding, for example, a funding company acting much like a commercial factor—while reviewing the firm's valuation of the case[2] and undertaking its in-house evaluation—may offer to "purchase" a portion of the fees that the firm is expected to earn. Usually, that portion is less than 50% of the expected fees, so as to keep the firm motivated to vigorously pursue the case. There normally is no monthly interest payment and the purchase is without recourse against the firm. This form of financing, Swanson concludes, "enables the law firm to 'take some chips off of the table' earlier in a case, although the effective annual rate for doing so is quite high compared to other forms of capital." Based on the duration of the expected payout and the purchase discount required by the funding company, the effective annual interest rate could reach 100%. Funding companies may be reluctant to engage in such services in Colorado, avowedly for the reason that usury is reached at 45% per annum.

Swanson's last-mentioned funding source—loans with interest pass-through—is a practical one that leads to some beneficial tax relief. A loan with interest pass-through permits the borrowing costs from a third-party lender to pass through the law firm to the actual cases. Such a loan is geared to finance the usual litigation expenses, such as expert witnesses, deposition fees, travel expenses, and illustrative exhibits. If the firm is able to borrow on a case-specific basis, having its borrowing costs tracked in this manner, it can obtain reimbursement from the case settlement or judgment for both the litigation expenses and the borrowing costs. Two important requirements must be met: (1) the attorney–client fee agreement must state that the attorney is entitled to seek a loan for case expenses and that the borrowing costs will be passed through to the case; and (2) the lender must have the software and sophistication necessary to track the law firm's loan on a case-by-case basis. This structure avoids the prohibition against the firm charging interest on advancements made on behalf of the client by passing through interest from a third-party lender.

In his final chapter, Swanson stresses the importance of obtaining a loan "term sheet" from the lender. It is critical not to rely on a verbal commitment, in the event the loan agreement is loaded with unanticipated fees.

The book provides some useful strategies for financing the law firm and for funding specific cases. With regard to the latter, it is geared primarily to plaintiffs' firms with a substantial book of contingent-fee cases and will have the most value to those lawyers.

Notes

1. IRS Priv. Ltr. Rul. 8246013 (June 30, 1982) (applying I.R.C. § 162(a)).

2. *See* Little, "Third-Party Litigation Funding: Understanding the Risks," 40 *The Colorado Lawyer* 40 (April 2011) (addressing the potential loss of the attorney–client privilege when making disclosures to finance companies).