FIRM GUIDANCE

The Keys to Handling BigLaw Firm Tenants

By Edwin B. Reeser

A partner considering a departure from his or her law firm previously had to be concerned about the consequences to the firm that the departure would create. Now, in an LLP structure, all a partner needs to do is weigh the cost of the loss of his or her capital invested in the firm against the reward for leaving, and additional direct obligations undertaken, such as limited lease guarantee amounts, if any. If the calculation militates in favor of departure — poof — they can be gone. There may be some entity bankruptcy and other issues that complicate this picture and they cannot be ignored, but the bottom line is that the considerable monetary hardship or unquantifiable amounts of risk caused by a BigLaw firm's demise are no longer present, or at least not to the extent they used to be.

Thus, the change in the profile of liability associated with being a partner, and the increased mobility both in and out of law firms has impacted a critical part of the foundation to the stability of the law firm enterprise, and destabilized it, perhaps greatly. Some confusion over where liabilities rest may also have been created with the "de-equitization" of partners to income or salaried class partner employees. Those people may still be liable on their lease guarantees irrespective of the status of their partnership and absence of a vote, notwithstanding an essentially involuntary conversion of their partner position.

Regardless of whether one subscribes to the premise that greater personal liability motivates greater commitment from partners, or that if it does that it is a "good thing" for the enterprise and/or the partners, it is virtually assured that landlords are going to be of the view that some measure of personal partner recourse is not only a good thing for them, but an essential requirement of granting a lease of expensive space to a law firm tenant.

That simple requirement is going to call the question on whether a lot of the people who have been the "leaders" under one set of liability rules are going to be the people a lawyer is willing to accept as "leaders" under different (and potentially more draconian) liability assumptions. It is one thing to be at risk for a couple of hundred thousand dollars, and another to be at risk for everything you have worked your entire life to own, invest and save. You have a 15-year generation of partners who are accustomed to operating in an environment of limited or no personal liability on leases. And in BigLaw, that means not just for the office you occupy, but potentially the dozen or more scattered around the United States and abroad, many of which you have never even visited. Many such offices have been added to the roster of locations under the umbrella of the LLP. If you are a partner with less than seven or eight years to practice at the firm, what will your perception of signing new lease liabilities likely be? Unless there is very strong trust and confidence in the integrity and business capability of the firm leadership, the answer is usully going to be "no" as the firms return to testing the mutual commitment to each other that they used to perform when, as partners, they discussed leasing decisions.

If you are an investor in the ownership of a property of this type with BigLaw firm tenants, you better step up your supervision of the asset and the risk parameters you will allow your agents to operate within when making their lease deals.

This might leave one scratching his head over how could there be so many smart people from coast to coast working on these leases to BigLaw firms (actually all firms using the LLP entity) and yet this could happen. Was everybody just sleeping?

Perhaps there were a lot of assumptions about the underlying viability of creditworthiness of BigLaw tenants that were not re-tested. But I don't think that is the explanation.

There are two points of intersection/responsibility for dealing with the law firm tenant.

The first point of intersection is the management company/leasing representative for the building. They handle all the firms in the building and the prospective tenants. They have their building form of lease. It is typically prepared for tenants generically, and it then becomes the skeletal structure within which a heavily negotiated and custom business transaction is created. They have the protocol for checking financials and creditworthiness. But they have no idea of how a law firm really works financially. (What other business are you aware of that may generate a half billion dollars in revenue per year, but zeros out its entire net operating income every year end?) In fact, if you look at the fiscal year income statement and the balance sheet for a modified cash basis taxpayer — which is what a law firm often is — you will see for a firm of that size a partnership income figure that is probably on the order of $175 million net operating income annually, and a cash in bank balance on Dec. 31 of $50 million or more, with a working line of capital at a zero balance, though a $100 million credit allowance.

What one doesn't necessary grasp is that on Jan. 15, the date that the fourth quarter estimated tax filings for partners with their payments are due, the firm will have distributed at least $45 million of that cash to the partners, and that is not "profit" in the ordinary sense, but rather income earned by the partners from their labor that as of Dec. 31 had yet to be distributed, and as such is a pass-through to each equity partner proportional with their shares of ownership or as otherwise allocated under the partnership agreement. And that by June 30, the firm may be drawn down on the credit line by $75 million.

The BigLaw firm is a monster of a cash engine, but it is a paper tiger as a capitalized business enterprise.

The manager/leasing representative, whether in house or an outside specialist, is not necessarily attuned to this because, over the history of law firms, they were general partnerships and everybody was on the liability hook. When the conversion to LLP form started, they jumped to the quick and obvious interpretation that it was like a corporation. No more pass through liability. So all they needed to do was to protect against their exposure if the firm went bust early in the lease term (very unlikely) for the front-loaded, out-of-pocket advances that landlords gave as incentives to get the deals, such as high tenant improvements, free rent and other concessions. They were focused on the wrong issues.

The second point of intersection is the outside lawyer representing the landlord in the lease negotiation. Surely, being lawyers, and many of them at BigLaw firms themselves, they would understand this issue. Wrong!

There was nothing in their experience or education to alert them to the risk. They are real estate lawyers with leasing specialization, and while they may have an excellent understanding of the theoretical working of various legal entities, they are not (and nobody is) experts in understanding how there would transpire a gradual evolution in the way in which firms managed themselves, and the relationships among partners would change such as to create this altered risk profile gradually. Indeed, most lawyers in BigLaw firms to this day have no clue about the economics, or the dynamics, of how the business of BigLaw really works, even within their own firms. Because it has not been communicated to them by the leadership of the law firms.

As a result of these factors and the current economic cycle downturn, landlords nationwide suddenly find themselves in a position where the dynamic elements that used to combine to hold a firm's partners together and previously made a law firm an incredibly stable and desirable tenant, now have eroded those elements andt combined to tear law firms apart, without meaningful recourse to the landlord to protect itself.

This is going to become relevant on a broad scale, as the underwriting of the value of buildings by lenders, and especially prospective lenders or those asked to renew or extend loans to these big office towers must change. If you are a lender with a loan on a million square foot office tower, and you have 400,000 square feet leased in the aggregate to large law firms (or other professional LLPs), you have to examine the financial statements and dissect and understand the working dynamic of the partnership agreements of those firms with a new forensic focus to understand what those leases are really worth as income streams.

This is going to require some new skill sets and risk evaluation models. If you are a leasing manager for a building, you must change the approach to leasing to these types of entities to properly reflect the real risks involved. If you are an investor in the ownership of a property of this type with BigLaw firm tenants, you better step up your supervision of the asset and the risk parameters you will allow your agents to operate within when making their lease deals. The question has been called.

Edwin B. Reeser is a business lawyer in Pasadena specializing in structuring, negotiating and documenting complex real estate and business transactions for international and domestic corporations and individuals. He has served on the executive committees and as a office managing partner of firms ranging from 25 to over 800 lawyers in size.

Understanding Firm Culture Is Essential to an Integrated Marketing Plan

By Jennifer Manton

A new day has dawned for those of us who work in the legal industry. After more than a decade of double-digit growth, the steady, predictable wind that we have come to depend on has turned. Through the years, those of us in law firm marketing were more fortunate than our counterparts in other industries. These days, we are all in the same boat.

According to the Hildebrandt and Citi Private Bank January 2009 Client Advisory, this recession is different than others. The severity is unusual, and its breadth across all industries is unique. The impact on the legal profession resulted in layoffs both at attorney and staff levels: some dissolutions, budget cuts, lateral movement and continued merger and acquisition activity.

Marketers and attorneys in large and small firms everywhere must be proactive in addressing these challenges. This means discovering new tools that give you an edge and knowing how to use them. It also means reaching out to others and sharing best practices. The days of solo stars have come to an abrupt end; shining in these tough times takes a collaborative effort.

If most of this sounds familiar, it should. The basics of marketing do not differ from good times to bad. When the economy is challenging, however, it's more important than ever to get back to the roots of solid marketing strategies.

A solid marketing strategy isn't dependent on a single tactic. These magic bullets don't exist today any more than they did five years ago. An integrated marketing plan is required to produce measurable results. Such a plan should be based on your target audience and, given today's global and multi-modal environment, should encompass the new mediums by which clients receive content and information.

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Yesterday's firm brochure has migrated online, replaced by a dynamic and informative Web site that provides clients and prospects a deeper look inside your firm and the chance to learn more about your attorneys. The advent of online collaborative tools, systematic content delivery, social networking sites and other interactive applications that collectively are referred to as Web 2.0 are also proving to be extremely cost-effective in terms of marketing.

While today's economy may be soft, the demands of clients haven't diminished. Marketers must be prepared to address the very real fact that clients' needs have likely increased in complexity while their resources have moved in the opposite direction. Some aspects of the buying process, however, are unlikely to change. Clients continue to choose forward-thinking firms. They choose firms with impeccable reputations. They choose firms that demonstrate value. They choose firms they know will deliver what they promise, when they say they'll deliver it — all at a price point that reaffirms the buying decision. Pencil-sharpening is the norm, not the exception. Firms must be committed to delivering the very best while doing everything to help shave unnecessary time and expenses.

The substantial investment by law firms in sophisticated technology is one of the key factors in their ability to reduce client costs while increasing internal efficiency and accuracy. Secure client portals, interactive communication and collaboration tools, access to online libraries and legal resources, eDiscovery advances and the ability to instantly alert attorneys and clients of important developments on cases are just a few examples of how we've come of age in the last decade. It's our job to make sure clients know about the many options available, understand how to use them and appreciate the savings these tools can deliver. Information technology is, without question, one of the biggest win-wins of the past decade and will continue to fuel successful client relationships.

Before you attempt to implement or deploy any marketing plan or tactic, you must understand the law firm itself: who the attorneys are, what their core practice areas are, what their emphasis is on, where the firm is heading and where they want to grow. Next, you need to understand the unique areas of the practices and what makes them different. Then, you will want to understand the individual attorneys and their clients — including what type of work they do for them and what type of work may be left on the table. In other words, you must know your firm, know its product and know the attorneys who are your biggest sales force and torchbearers of your brand. Consistency, creativity and commitment are musts when defining and deploying your plan, regardless of whether you're trying to win new clients or earning repeat business from existing clients.

It is essential to know the culture of your firm. You have to invest in building relationships, within your firm; you have to the firm's practices and the nuances of those practices, be familiar with your firm's clients and their industries. While you may be very knowledgeable about marketing tactics and best practices, these practices should not be put to work until you understand what impact they will have on your culture, your clients and your target audience.

Whether it's looking for new business, identifying up-and-coming industry sectors or maximizing internal and external efficiencies, one thing is certain: Tomorrow's business opportunities will not come as easily or as painlessly as they have in the past. You must know your marketplace and be prepared to clearly define who you are. Then you — the firm's management and its attorneys — will be ideally positioned to communicate that message each and every day and to demonstrate how the promise of your brand is matched with the product you deliver.

Jennifer Manton is president of Legal Marketing Association International.