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Feature

Law Firms Brace For More COVID-19 Financial Woes

By **Natalie Rodriguez**

Law360 (April 9, 2020, 7:05 PM EDT) -- Much of the news coming out of the legal industry in response to the coronavirus is pretty alarming these days: staff furloughs, partner pay cuts, hiring freezes. But if the economic impact of the pandemic lasts into the third quarter of the year, law firm leaders know they have to prepare for further actions.

From drawing down credit lines to hitting pause on long-planned capital projects, firms are trying to brace for the impact of lost billable hours right now, and they may have to pull the trigger on additional moves, such as partner capital calls and further layoffs, according to experts.

"Firms are doing everything they can to build as much reserve as they can while they wait to see what the market tells them is going to happen," said Michael Blanchard, managing director of the law firm advisory team at risk mitigation firm Aon PLC.

The good news is most law firms came into this economic turmoil in good shape, with strong billings and clean balance sheets after spending the decade since the last recession reducing debt, according to James Cotterman, a principal at professional services consulting firm Altman Weil Inc.

"But that can change rather quickly," Cotterman said.

With the exception perhaps of the top 50 firms, most firms have two to three months tops of cash reserves, according to Blanchard. So cash preservation has been the name of the game these past few weeks.

"They are doing line-by-line review of capital projects and decisions about what can be delayed or suspended," said Gretta Rusanow, who leads Citi Private Bank's law firm group advisory team. "I'm not seeing so much attorney headcount reductions at this stage, but certainly decisions about hiring freezes or reducing or eliminating staff."

Staff and associate furloughs have already hit a handful of firms, including Pryor Cashman LLP and reportedly Nixon Peabody LLP. Further furloughs and potentially attorney headcount reductions may come later this year, according to some experts.

Firms are also considering a range of other measures, such as cutting payments to retired partners, salary reductions for nonequity partners or deferrals of salary payments, according to experts.

The hardest part, experts say, is that the economic fallout tripped by the spreading novel coronavirus is unlike previous recessions, and many law firm leaders just don't have a playbook to guide them on how it may play out. Nobody knows if the economy will bounce back once the virus is contained, or if there will be an L-shaped recession where the economy dips and essentially plateaus.

"What is making this particular situation unique versus any other is we don't have any data. We don't know how long its going to last, we don't really know which practice areas it may affect," Blanchard said.

Firm leaders are carefully monitoring their firm's daily vitals — billable hours going in, daily cash flow, Blanchard said. At New York boutique Barton LLP, managing partner Roger Barton says the firm is also carefully monitoring where work is going to make sure those seeing a dip are getting some potential new work reassigned to them to help spread around billable hours.

"We are looking almost daily at workflow. Partners are being mindful of pushing work to associates they may not have worked with before but who may have a lighter workflow," Barton said.

With many deals on ice, Levenfeld Pearlstein LLC managing partner and chair Robert Romanoff knows that his midsize firm will take a hit. "We do think that will have an impact on revenues in the short term, so we are actively monitoring production and collection in order to plan and preserve resources for that. Basically, we're cutting back on nonessential expenses in order to preserve our cash," said Romanoff.

Like many firms, Levenfeld Pearlstein has also planned to adjust equity partner draws, which he says has met unanimous support from the partners. Theirs will start in mid-April.

A number of other firms, including BigLaw, have responded to the crisis in a similar manner. In recent days, firms including Winston & Strawn LLP, Linklaters LLP and Cadwalader Wickersham & Taft LLP have announced changes — if not outright cancellations — to partner pay distributions.

Suspending partner draws can free up 35% to 50% of a firm's profit margins to create some working capital coverage for about a month to a month and a half, Blanchard said.

And there is a thread of thought throughout the legal community that partners with skin in the game should feel the hit first, Rusanow said.

The cuts have also already begun trickling down, however. Blank Rome trimmed compensation by 15% across all ranks, from partners down to associates, counsel and staff, while Bryan Cave Leighton Paisner announced a similar cut for any employee making more than $40,000 for a 13-week period starting in May.

In response to the market uncertainty and in an effort to try to stave off further pay cuts or furloughs, a number of firms have been borrowing heavily on lines of credit while interest rates are down to create a rainy day fund if clients tighten the purse strings on outside legal work, said John Remsen of law firm management consultancy The Remsen Group.

Most firms with lines of credit have drawn down on them, some fully, according to Rusanow. And many firms that saw trouble ahead in the early days of the pandemic also sought to increase their credit lines.

Some firms are also delaying the distribution of 2019 income, particularly in light of the three-month pushback on certain tax deadlines, according to Rusanow.

With regards to debt, some firms that had floating rate loans for real estate or technology investments are moving to take advantage of the low interest environment by locking down fixed-rate loans, Rusanow said.

"A firm that has been running without debt might be more amendable to considering a longer-term debt facility. I think firms carrying debt certainly aren't looking to increase their debt," said Blanchard.

Rusanow and her colleagues at Citi have been getting on the phone every other week to survey top clients about their cash flow management and other issues in the midst of the pandemic. The bottom line? If the economic situation continues into the third quarter, law firms know they will have to get more aggressive.

So far, Rusanow hasn't seen any widespread trends in partner capital calls, but it is something many experts are eyeing. Blanchard, who has seen at least three firms do partner capital calls in recent weeks, expects more in the future.

Normally, a capital call could be viewed as a red flag that there are deeper financial issues at the foundation of the firm. But in this uncertain environment, it could be a "prudent step" even for a stable firm wanting to have as much capital as possible on hand, Blanchard said.

Layoffs are seen as a last resort, but it's a resort many firm leaders are quietly preparing for, according to experts.

"That second wave, everyone is discussing it. Everyone is planning for it," Blanchard said.

Anecdotally, smaller firms seem particularly committed to keeping their firms as intact as possible. "It's taken us years to build our team. I'm incredibly proud of our team and the last thing we would want to do is to take steps that would undermine our business strategy," Romanoff said.

In late March, Levenfeld Pearlstein hired a young bankruptcy associate it had been actively pursuing, and the firm has brought on other new hires as originally planned. "We didn't feel the need to put that on ice," Romanoff said, though he acknowledged the pace of recruiting in some areas may slow.

In a phone call with about a dozen other managing partners for firms of a similar size, there was no talk of layoffs, Romanoff said, though some firms are using furloughs or reducing people's schedules.

"Our most important, valuable asset are our people. This is a time to support them. They work very hard each and every day to do the best job for our clients. This is a time for us as a firm to be there to support them," Barton said.

Blanchard and Rusanow, however, say there isn't much distinction between what larger and midsize firms are doing. Ultimately, if the economic downturn is longer and deeper than expected, some may have the decision taken out of their hands.

"Clearly, the smaller the firm, the less access to riding this out longer term and they may have to make deeper cuts," Blanchard said.

He added that some firms may see their existence threatened outright and that the industry could see more firm consolidation.

But Romanoff said, "I'm still an optimist, I don't believe things will fall off the cliff."

--Additional reporting by Aebra Coe and Kevin Penton. Editing by Brian Baresch.