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The Times, They Are A-Changin' *Leasing Strategies in a World of Flux*

By Scott McFetters

As more and more commercial clients move their legal teams in-house, competition among law firms continues to grow. A considerable number of law firms have been pooling expertise and gaining market share through mergers and acquisitions.

The biggest and most recent: Boston's Bingham McCutchen and Philadelphia's Morgan Lewis & Bockius merged to create a legal behemoth. The combination saw Morgan Lewis increase its headcount to over 2,000 lawyers in 28 offices. Other 2014 mergers of note include LeClairRyan's merger with Houston's Hays, McConn, and Fox Rothschild's combination with David & Goodman in Dallas.

Shifting Law Firm Landscape

Merging is not the only path law firms have been opting for in order to gain ad-vantage. Office and back-office relocations are becoming commonplace for many firms around the country. Last year, the New York-based firm, Pillsbury Winthrop Shaw Pittman, joined a slew of Washington, DC, law firms who relocated its offic-es. The firm relocated its 225 employee DC office to a significantly smaller office located less than a mile away. *The Washington Post* reported that the firm's new office was considerably scaled down, with a 37 % decrease from 160,000 square feet to 101,000 square feet with partner offices shrinking 40% to 200 square feet.

Pillsbury also opened its business operations center in Nashville to house much of its back office operations, including human resources, IT and a small number of staff attorneys. Kaye Scholer joined this trend of moving back-office operations to locations with lower operating costs by centralizing its administrative staff in Tallahassee in 2013. And in late 2014, Kaye Scholer left its Park Avenue location in New York, its home since 1957, to a new office on West 55th Street, downsizing from 330,000 square-feet to a 250,000 square-foot office. In preparation for the move, the firm discarded almost 95% of its law library, opting to use electronic resources.

Next, according to Robert Half Legal, is Greenberg Traurig, which is in the process of reconfiguring its more than 30 offices to use less square footage.

Is Increasing Technology Spending a Financial Disconnect?

So what's the driver for so many of these mergers, office and back-office relocations? The answer is to reduce cost. Common sense dictates looking at the second-highest cost for law firms after people — real estate — or investigating a merger to pool resources and expertise while diversifying their practice.

Another driving force behind this trend is the ever-evolving nature of technology. A recent report by Robert Half Legal found that access to technology, including smartphones, tablets and cloud computing, has legal work being done outside the traditional physical confines of a law firm, resulting in a rise in telecommuting and reduction in physi-cal law firm space — facilitating the shifting of many law firms' locations. *See*, "Technology's Transfor-mation of the Legal Field," http://bit.ly/1BNudEW.

The Robert Half report found that 59% of lawyers expect their law firms to increase spending on technology in the next two years, with the overwhelming majority of the firms surveyed focusing on increasing technology investments that included additional software, hardware, PCs, laptops, tablets and smartphones. On the other hand, although lawyers are expecting their firms to increase tech spending, the 2014 ILTA Technology Survey found that nearly half of firms plan to keep their technology operating expenses flat. *See*, http://bit.ly/1FwY5Ir.

The ILTA survey also reported that among firms' top three technology issues and annoyances, keeping up with new software versions, along with high costs of technology and software maintenance costs, were in the top 10.

This might be an indicator of a disconnect between the needs of the attorney end-users and the firms' procurement and finance departments.

Do I Want To Own This Equipment?

Moore's Law provides the framework for the pace of change in technology (and thus its increasingly rapid obsolescence) which, according to Intel executive David House, is that chip performance would double every 18 months — which can be extrapolated to mean that the technology that you purchase today will become obsolete in 18 months. This is shorter than the depreciable life of any of these assets.

These principals have proven to be true — and also reveal the fundamental question we all face when faced with a new technology: Should I *purchase* that device? Since the period of exponential improvement in technology has actually increased as breakthroughs in speed, functionality and processing power are released in ever-shorter cycles, we are constantly seeing the delivery of better, cheaper and faster products. And who even knows what changes the Internet of Things (IoT) will bring?

The pace of technology change, coupled with law firms' shifting resources, merger activity, downsizing and moving their physical resources, creates a unique and potent combination. From a financial perspective, when it comes to the firms' technology and equipment needs, options such as leasing and financing offer flexibility to stay on the leading edge, which may make strategic sense rather than an outright purchase. Firm ownership of technology and equipment in a fluctuating market can put up roadblocks against strategic and cost-effective decisions.

Mergers and moving offices to locations with lower cost requires flexibility regarding law firms' technology, software and equipment needs as these are reconfigured and optimized. If your firm owns technology, the result of reconfiguring operations could leave you with equipment that is no longer needed, but will require dedicated staff hours to handle.

The financial burden of office relocations, like Tallahassee by Kaye Scholer and Nashville by Pillsbury, can be alleviated by converting all new technology and equipment needs into a monthly expense as opposed to a single, large cash outlay. At the same time, in addition to the hardware and equipment needs, firms can also finance the software, software upgrades and associated "soft costs" (including training, implementation, installation and services), which can help alleviate the cost of onboarding new staff in new locations.

Leasing a firm's hardware, software and other technology costs is a strategic solution that can allow a firm to convert what would be a large purchase into an affordable monthly expense. Leasing conserves cash, keeps bank lines of credit open for their intended short-term use, and cuts out of pocket costs for security upgrades while enabling the necessary new projects to be fit into the budget.

Combined, these financial strategies allow flexibility and rapid decision making; distinct advantages in a merger and re-sizing market.

Have a Strong Leasing Partner

If your firm wants to lease technology, the choice of a leasing partner is crucial. A leasing company owned by an equipment manufacturer may not be flexible when you want to replace that manufacturer's equipment with a competitor's. A leasing company that is vendor and manufacturer agnostic will give you more flexibility to change out equipment manufacturers and select the cutting-edge technology that is best suited to meet your needs, not just the needs of a single equipment manufacturer.

Also, when selecting a leasing partner, it's best to review its expertise in the legal field and make sure the lessor has a vetted and demonstrable understanding of the unique challenges faced by law firms — and most importantly, that the lessor has a reputation for creating custom and flexible financial solutions.

While leasing can be an excellent strategic advantage to your firm, be aware that not all Master Lease Agreements (MLAs) are created equal. Although you may get an MLA that is clear and straightforward, many of the ones being presented to unsuspecting firm administrators, IT and purchasing departments can contain terms and conditions that are onerous to a law firm. For example, some MLAs require that you either return software licenses at the end of the lease or purchase them for an amount dictated by the leasing company, sometimes called "fair market value." But is it fair to purchase something that has already been paid for once over the lease term with interest? Another example are MLAs that state you must return the equipment in its original packaging, or pay a penalty to the leasing company for not doing so. Is this a fair practice when we all know those boxes will long gone way before a three or four year lease is up? And does anyone have the space to store a mass of cardboard?

It is important to ask your peers about the transparency and fairness of a Lessor's lease documents. It is good to make reading and reviewing MLAs part of your firm's best practices when contemplating a lease to ensure that due diligence has been done for the firm, and that you have selected the Lessor that best suits the firm's needs. It is never about just finding the lowest lease rate factor or monthly payment; it is essential to consider both the end of lease provisions and the overall Master Lease terms and conditions.

We asked Ted Gerber, Director of Data Systems of Hawkins Parnell Thackston and Young, regarding best practices for deciding whether to own or lease equipment and these are Ted's recommended tips for reviewing MLAs:

- Careful review of the Master Lease Agreement (MLA) and any addenda.
- Do not fixate on lowest lease rate factor.
- Do fixate on Total Cost of Ownership of the MLA and any addenda.
- Start with the lease end of terms in mind and ask these questions:
  - What are my costs during the installation process?
  - What are the financial ramifications of pro-rata and quarterly interim rent? Is there anything I can do about these prior to signing?
  - What is my notification process at end of term?
  - What are the consequences if I miss deadlines detailed in the notification? Is there an auto-extension? If so, how long is that extension, 30 days? 180 days?
  - What does my firm have to do to satisfy the terms at the end of the lease?
- Consider the qualifications of your lessor:
  - Are they a knowledgeable resource for your firm?
  - Will they communicate consistently and transparently?
  - Are they responsive and able to accommodate changing needs over time?

Leasing is a long term relationship: Make sure your Lessor has a reputation for transparency, flexibility and customized solutions. Terms and conditions buried in lease contracts can end up costing you much more in the long run than you originally anticipated. It is vitally important at the outset to look at any leasing contract with the flexibility offered at end of the lease in mind.

Conclusion

Although the outlook for the legal industry in terms of revenue is positive, firms are always looking for ways to cut costs and improve efficiencies through consolidating resources, relocating offices and back offices to smaller, more cost-efficient spaces. These trends are partially driven by new technology, which allows firms to operate in less square footage than they previously required.

Successful mergers, acquisitions and relocations require flexibility and avoidance of any unnecessary large cash outflows. Leasing gives firms the flexibility and quick decision making needed to meet these challenges.

Scott McFetters, a member of this newsletter's Board of Editors, is President of CoreTech Leasing, Inc. CoreTech is an independent leas-ing company working in strategic partnership with over 100 law firms. For more information, please visit www.coretechleasing.com, follow on Twitter@CoreTechLeasing, and like on Facebook at www.facebook. com/technologyleasing.