BROOK HOLLOW

7 Secrets To Maximizing Your Contingent Legal Fees

After years of blood, sweat, and tears (and a lot of money), you are finally able to enjoy the fruits of your labor. Before you make any rash decisions about how best to manage the influx of cash, you should consider your options and take time to make informed decisions. We're going to let you in on the seven secrets to maximizing your impending legal fees.

Secret #1
Flexibility Might Be More Important Than Being Right

Some decisions are just more important than others. Marry the wrong person, and you can be a multi-millionaire on Maui and be miserable. Marry the right person, and you can find happiness cleaning septic tanks in Cleveland. Similarly, you need to make the right decisions with your contingent legal fees to set yourself up for success.

For many, the sheer size of the fees can put a lot of pressure on you to get it right. With the right moves, you have a real opportunity to make exceptional strides toward financial freedom, no matter what your financial position is today. Being right means maximizing the utility of your fees. Brook-Hollow Financial can help you accomplish this with a tax-deferral, which allows all of your contingency fees to grow tax-deferred, instead of half your fee growing subject to tax[1].

Being flexible means being able to exploit opportunities or resolve problems when they arise. If part of your strategy involves a tax deferral, you'll likely have twice as much money available to deal with your future circumstances.[2] And more money means more flexibility.

The smart attorneys will consult with the best financial minds available and develop a strategic plan to use their contingent legal fees to advance that plan. They'll assess their current situation, they'll explore all the possible options related to their fees, and they'll develop a winning plan that provides the flexibility to pivot based on future opportunities. What these attorneys do with their fees needs to be both powerful and flexible in the short term, so they can also be powerful in the long term. There's little excuse not to get it right, all it takes is thoughtful planning.

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[1] Assumes a 50% income tax rate.
[2] Assumes a 50% income tax rate.

Secret #2
Accept That Capital is Your Limiting Factor

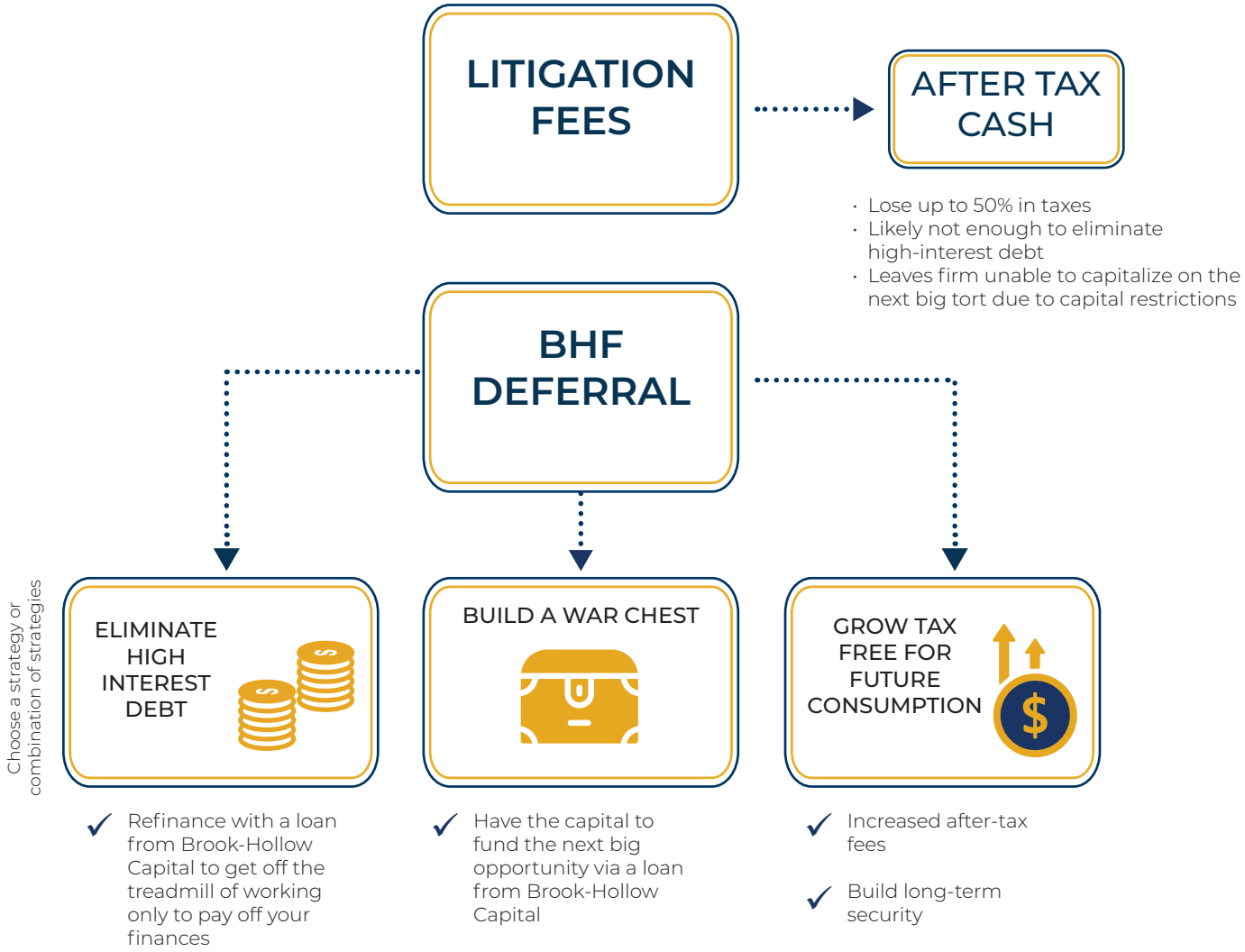
The financial return of any major litigation is driven by four factors: opportunity, talent, time, and access to capital. You've identified a specific tort as a big opportunity, applied your time and your talents to acquiring and navigating the cases and the return proved to be substantial.

What kept you from securing an even bigger share of a prior litigation? Let's face it; it's probably not your time or your talent. That's not to say you never lose, but those for whom time & talent are limiting factors, are probably not reading this article. They're no longer in business!

The limiting factor was the amount of capital available to invest, which limited the number of cases that you could acquire. Until recently, the mass tort attorney (or any contingency fee attorney for that matter) was damned to the slow "Invest, Win, Pay Tax, Repeat" process of building capital. Unless you tap into high interest capital, which will quickly eat away at your bottom line, the capacity to capitalize on opportunities like Roundup, TVM or 3M is limited to the cash on hand.

The solutions offered by our financial consultants help attorneys accumulate the capital they need more rapidly giving them the ability to pay off high interest loans and still build a sizable war chest. Accepting that capital is your limiting factor is the first step. Contingent legal fees can be strategically planned to turbo charge the "Invest, Win, Repeat" cycle while also removing the need for any high interest loans in the future. By deferring the payment of your taxes, it immediately gives you access to additional capital to invest and grow tax free. [See Diagram 1 on the next page]

DIAGRAM 1


LITIGATION FEES
AFTER TAX CASH
· Lose up to 50% in taxes
· Likely not enough to eliminate high-interest debt
· Leaves firm unable to capitalize on the next big tort due to capital restrictions
BHF DEFERRAL
Choose a strategy or combination of strategies
ELIMINATE HIGH INTEREST DEBT
BUILD A WAR CHEST
GROW TAX FREE FOR FUTURE CONSUMPTION
✓ Refinance with a loan from Brook-Hollow Capital to get off the treadmill of working only to pay off your finances
✓ Have the capital to fund the next big opportunity via a loan from Brook-Hollow Capital
✓ Increased after-tax fees
✓ Build long-term security

Secret #3
Get Off the Hamster Wheel of High Cost Debt

When new litigation opportunities are ripe for the picking, accessing capital that isn't yours comes at a cost. It's not likely to come from a bank at a reasonable 6% interest rate. To increase their share of the next big litigation, loans from an alternative financier who charges an average of 16-22% (per year, not total) is often a firm's only choice.

To help illustrate, let's go ahead and look at a few examples that I believe follows the process attorneys go through when getting into an alternative loan. The first [see Figure 1] illustrates the economics of a typical $10 million loan arrangement without interest; the second [see Figure 2] adds the element of simple interest; finally, a third [see Figure 3] that twists some of the assumptions to reflect the shifts that often occur between the time the money is borrowed and when fees are realized.

Returns on cash invested can reach up to 400% in the mass tort world; it might seem like a good investment. Let's think about it first without interest [see Figure 1]. You invest $10 million. You get $40 million. That's a profit of $30 million pre-tax and $15 million after-tax (assuming a 50% total tax rate). When you combine your $15 million after-tax profit with your $10 million investment, you have $25 million where you started with $10 million. You've more than doubled your money.

Figure 1: Projected economies on a typical loan without interest

Invest	($ 10mm)
Fees Earned	$ 40mm
Profit	$ 30mm
Taxes (50%)	($ 15mm)
After-Tax Income	$ 15mm
	$25mm/$10mm = 250%

Now, we take interest expense into account [see Figure 2]. With 20% annual interest, simple math tells us that $2,000,000 in interest expense per year (20% of $10 million investment) means you'd have to pay interest for 15 years before you eat up all of your $30 million pre-tax profit. You project this hypothetical litigation will be done in five years. So, after paying $10 million in interest over five years and repaying $10 million in principal, you still profit $20 million pre-tax and $10mm after-tax. You have $20 million where you started with $10 million. This results in a pure double.

Figure 2: Same facts with simple interest on an "alternative" loan

Borrow/Invest	($ 10mm)
Fees Earned	$ 40mm
Profit	$ 30mm
5 Years Interest (20%)	($ 10mm)
Pre-Tax Income	$ 20mm
Taxes (50%)	($ 10mm)
After Tax Income	$ 10mm
Capital After/Before	$20mm/$10mm = 200%

If you've never experienced less than expected fees, cash-flow issues, or delays in settlement, you can disregard the rest of this section. Otherwise, you should know, when borrowing at high interest rates, the reality of mass tort fees never coming in according to plan can quickly wipe out all your gains.

Let's assume three simple twists in our fact pattern [see Figure 3]:

1. Fees turn out to be $30 million instead of $40 million,
2. You're unable to make your interest payments out of pocket and need to finance them, and
3. The litigation takes six years to settle instead of five.

With compounded interest, the bill for your interest expense is $20 million, wiping out all your profit[3].

[3] ($10 million x $(1.2)^7$ - $10 million)

Figure 3: More likely facts - longer wait, lower fee, compounded interest

Borrow/Invest	($ 10mm)
Fees Earned	$ 30mm
Profit	$ 20mm
6 Years Compounded Interest (20%)	($ 20mm)
Pre-Tax Income	$ 00mm
Taxes (50%)	($ 00mm)
After Tax Income	$ 00mm
Capital After/Before	$0mm/$1mm = 0%

The financier got your double and despite doing all the work, you struck out.

But there's some good news. It doesn't have to be this way. Working with Brook-Hollow, you can use up to 97%[4] of your pre-tax fees to refinance your high cost debt from 20% to 3%. This allows you to:

1. Pay down your debt twice as fast, which significantly reduces the interest costs that are wiping out your profits, and
2. Get back to building capital that benefits you twice as fast.

Secret #4
Leverage the Government's Money - Start Turning Your Doubles into Triples

If you're like most attorneys, you invest your own money in your cases [see Figure 4]. For example, if you invested $10 million of your existing capital, and earned $30 million in fees, you would net $10 million after-taxes, doubling your investment. This is where you will be if you take $20 million of your fees, pay your income taxes, invest the remaining $10 million, and achieve these results.

[4] Loan amounts and interest rates vary by transaction and are subject to review and approval based on individual applications.

Figure 4: Invest your $10mm, earn $30mm, pay taxes

Invest	($ 10mm)
Fees Earned	$ 30mm
Pre-Tax Income	$ 20mm
Tax (50%)	($ 10mm)
After-Tax Income	$ 10mm
Capital After/Before	$20mm/$10mm = 200%

Doubles are good. Triples are great! But how? The secret lies in the source of funds. If you have $10 million now, at some point in the past it was likely $20 million in fee income. It's $10 million now because you paid $10 million in taxes[5]. And I'm guessing you would have rather invested $20 million for every $10 million you invested in a mass tort or class action lawsuit. We can't go back in time, but you can defer your $20 million fee, borrow up to 80% or more of it and put it to work.

To help illustrate let's run through an example of the economics of a typical Brook-Hollow Capital $20 million loan arrangement with interest compounded over six years [see Figure 5].

You invest $20 million[6] in the next big litigation opportunity, allowing you to have access to twice as many cases, and you earn $60 million in fees. Taking into account a loan with a net annual interest rate of 3%, the result is $18.6 million in after-tax profit. You have $28.6 million where you started with $10 million[7]. The result is that you have 286% of that $10 million, a near triple.

[5] Assumes a 50% income tax rate.
[6] We'll use 100% of the fee instead of 97% to simplify the math.
[7] $10 million = $20 million fee deferral - $10 million future income tax.

Figure 5: Invest $20mm borrowed from Brook-Hollow Capital, earn $30mm fee, pay taxes

Borrow/Invest	($ 20mm)
Fees Earned	$ 60mm
Profit	$ 40mm
6 Years Compounded Interest (20%)	($ 2.8mm)
Pre-Tax Income	$ 37.2mm
Taxes (50%)	($ 18.6mm)
After Tax Income	$ 18.6mm
Capital After/Before	$28.6mm/$10mm = 286%

But that's not the end of the story. Keep in mind:

1. You still have your original $20 million of capital to deploy on future deals instead of $10 million, and;
2. It's possible you could defer your $40 million pre-tax profit and have that much money working for you on a tax-deferred basis in an investment portfolio, just waiting for the next opportunity to be paired with your time & talent.

This is how you can make leverage work for you!

Secret #5
Use Contingent Legal Fees to Build Your War Chest

Managing a mass tort practice is becoming more and more like managing a hedge fund. Having adequate capital to invest at the right times in a diversified "portfolio" of mass tort litigations can be as important as the time and talent required to successfully navigate the various litigations. Litigations worthy of investment emerge at different times, warranting various levels of investment.

You can't possibly know what number of litigation investments, or the amount of each, you're going to want to make three, five and 10 years from now.

But you can use your contingent fees to maximize your capital available for investment when the next big opportunity presents itself. You can enter a series of fee deferral transactions that can result in more capital than any alternative available to you. Often you have fees coming in over multiple years, allowing you to design the characteristic elements of each deferral (length of deferral, investment policy, distribution strategy, etc.) to create an overall solution that provides the flexibility and reflects adaptation to your future reality.

When you're not using up to 97% of your deferred fees in your practice, they're growing tax-deferred in accordance with your custom instruction. At all times your war chest is arguably employed in the highest and best use, waiting for deployment in your practice.

It's quite possible what you do with your next big fee might have a greater impact on your income in 10 years than anything else you do.

Secret #6
Consumption is Fine, but Avoid the Urge to Splurge - It's More Expensive Than You Think

As the old saying goes, "I have yet to see a U-Haul behind a hearse." No, you can't take it with you.

What's the point of generating wealth if you can't enjoy it? None! However, you owe it to yourself to make good choices on consumption. Not for your health, but for your future bottom line, your future life of financial independence (aka retirement), and your funding "the lifestyle to which you wish to become accustomed."

Our fourth secret showed you that after-tax fees limited your future investment to a double instead of a stand-up triple in six years. Recalling the economics of Figures 4 & 5, consuming that $10 million after-tax fee (Figure 4 investment) today is roughly the same as consuming $30 million in six years (Figure 5 "Capital After"), or $90 million in 12 years.[8] So, you have a choice of $10 million now or $30 or $90 million later.

[8] Assumes repeat of Figure 5 economics with full reinvestment.

There's a famous marshmallow study that was conducted at Stanford University in the '60s and '70s involving marshmallows and 4-year olds. An adult placed a marshmallow on the table in front of the child, who was told he could eat that marshmallow now, or any time before the adult returned from a 15-minute errand. But if the child waited until the adult returned, he could have two marshmallows. The researchers found that children who were able to wait longer for the preferred rewards tended to have better life outcomes.

Your contingent fees are not marshmallows and 6 – 12 years is not 15 minutes. But $90 million could also buy 70% of the entire US marshmallow industry[9] (100% if it was purchased inside your deferral). Keep in mind that the decision isn't all or nothing. And we're very aware it's important to take care of the golden goose who's laying the golden eggs - you. But it's very important to strike a mindful balance between investment and consumption. Keep in mind, you can defer your $20 million fee, borrow up to 97% and use a portion for consumption and the balance for investment. This strategy is almost always superior to consuming strictly after-tax dollars when all the economic implications are considered.

Your fees are a great resource, for present consumption or investment (and future consumption). The smart attorneys will prioritize their war chest and consume mindfully now so their future is even better than today.

Secret #7
Call Brook-Hollow and Become the Firm You Envy

We don't talk about this with our clients, but I suspect everybody has one. There has to be a firm out there that you'd like to be, or at least be more like. What is it about them? Is it their ability to have a lot of cases in the biggest litigations? Is it their reputation as successful attorneys who can get things done? Their gravitas? Is it their lifestyle? Is it that they look so relaxed doing it?

Whatever it is, I'm sure they all have one thing in common? Undisputed financial success...with emphasis on undisputed. And if it were easy or simple, everyone would be doing it. It's not. It takes discipline and intelligence and a ton of hard work and a good portion of luck. Like most things.

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[9] Per Candy USA, Americans spend $125 million annually on marshmallows.

The idea for retirement among the average baby- boomer professional is shifting from being able to do nothing to not having to do anything. But for the exceptional, the brass ring is having the resources to do the coolest things they can think of, knowing they are financially secure for generations to come. At that point, their imagination is the limiting factor, not their capital.

But it also takes capital. And every firm you envy has it. So as you brainstorm all the potentially wonderful things your fees can do for you, now and in the future; as you contemplate the exceptional opportunity your fees will provide over the next several years, and you develop your strategic plan; do yourself a favor and give Brook-Hollow a call to see how they can help you become the firm you envy (because the firm you envy is already talking with us).

With your next big fee on the horizon, it's no longer about someday...it's about now.

For more information or to set up a personalized consultation please contact our team at info@brook-hollow.com.

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Joe received his BBA and MBA/Tax degrees from the University of Notre Dame in 1987 and 1990, respectively. Joe began his career with PriceWaterhouse Coopers, and has since worked with numerous successful emerging companies and high net-worth entrepreneurs as a contract CFO and CPA.