

More Than One Way Out: Options for Lawyers Looking to Transition Out of Practice

By: Hong Dao

Introduction

Even the best lawyers must quit one day. No attorney can practice forever. Those who plan ahead to transition out of practice have the chance of passing along the legacy they've built over many years. Those who don't plan ahead may have their hands tied. An office closure, either by the lawyers themselves or by someone else because the lawyers passed away while in practice, is a likely consequence of the latter. Consider the following scenarios.

Ingrid has a successful solo practice that she has built over the last 30 years ago. Her husband recently passed away and she is expecting her first grandchild. She wants to slow down a bit to spend more time with her family. She can certainly work for another 10 years, but wants to retire in 5-7 years. After many years of practicing alone, she is ready to share her practice with someone whom she hopes will eventually take over and continue to serve her clients. Ingrid tries to make plans to transition, but postpones taking action because she doesn't know what her options are.

Irene and Clarence started practicing law together over almost 40 years ago. They practice in a limited liability partnership with a few legal support staff. Their successful firm is known and respected in the region. Both partners want to retire in a year. They have never hired associates to work with them for different reasons. At this stage, they think it is too late to do so. They decide their only option is to close the practice completely. So they start to wind down the practice.

Attorneys may find themselves in Ingrid's or Irene and Clarence's situation. They may wonder whether they have to close their office or whether they can sell their law practice to another lawyer. Are there other options that do not involve a buy-sale, but still allow them to transition out of practice without closing their doors?

Alternative to an office closure

The common thing that lawyers do when they want to retire or leave private practice is to close their law practice. While office closure is a perfectly sound option, there is one particular disadvantage worth mentioning. An office closure means all the hard work and resources that attorneys invested in building their law practice will evaporate. An office closure shuts off the possibility for the attorneys to reap the benefits of the value and legacy they created.

If lawyers give themselves enough time to come up with a transition plan and actually take steps to implement it, they can avoid an office closure. Here are some alternatives to an office closure: (1) sell the law practice; (2) take in a partner or associate to make a gradual transition; (3) merge with an existing law practice.

Selling the Practice

It is permissible for lawyers to sell their law practice. Under Oregon Rule of Professional Conduct 1.17, lawyers may sell all or part of their law practice, including their goodwill. The sale must comply with the requirements of ORPC 1.17. The selling attorneys are required to provide written notice of the proposed sale to each current client. ORPC 1.17(b) and (c) specify the information that must be included in the notice.

Unlike the sale of a home in which a buyer may freely walk around in the house to look at everything inside, the buying lawyer is not allowed to access client files or any information subject to ORPC 1.6. It is, however, permissible under ORPC 1.6(b)(6) for the selling lawyer to disclose certain information, provided it does not compromise attorney-client privilege or otherwise prejudice any of the clients. The information that could be revealed includes: the identities of the client and any adverse parties; the nature and extent of the legal services involved; and fee and payment information.

Lawyers buying and selling law practices should understand their professional ethical obligations to avoid any missteps that can get them into hot water.

Valuing the Law Practice

Not all law practices can be sold. The simple reason is that not every law office has a marketable value. According to Roger Delles, a transition specialist, the value of a law practice is based on (1) tangible assets like office furnishings, equipment, building, and books, and (2) intangible assets like business earnings and goodwill. Valuing the former is fairly easy through appraisals and fair market value estimates. Unless the lawyer owns the land and the actual office building, the tangible assets of a law office is relatively miniscule. The desk, computer, chairs, filing cabinets, bookcases, and law books do not add up to great value. General business earnings can be gleaned from various financial documents. A business valuation expert may be able to assist with accessing the financial condition of the practice.

The reality is that earnings of a law practice fluctuate. Lawyers rarely have clients who return regularly for legal services. Most lawyers see a client only once or maybe twice in their life. Few have a consistent book of business. Thus, when lawyers sell their law practice, they are essentially selling their goodwill generated from the reputation of the firm, client base and loyalty, the sources of referrals, and personality of the lawyer. But placing a monetary value on goodwill can be tricky. For this reason, it may be difficult to put a price tag on the law practice for the sale.

Financing the Sale

Although a law practice may be difficult to value, it is not impossible. For example, an attorney who represents only dental clinics on a whole range of issues from discipline and licensing to commercial lease and employment has a valuable and consistent book of business. The lawyer may be able to value her law practice based on prior business tax returns, personal income tax returns, and balance sheets and other financial data. A professional business appraiser can help determine whether an asset, market, or income approach should be used to determine the value of a law practice.

Once a law practice has been valued and placed on the market for sale, then it's a matter of finding an able and willing buyer. The ideal buyer is a lawyer who can secure financing through a bank or credit union to close the purchase. Realistically, most lawyers are burdened with student loans, a mortgage, a car loan, and other personal/consumer debt that they just can't afford to buy a law practice. So while it is permissible and appealing to sell and buy law practices, it may not be financially practical.

That being said, one Oregon lawyer was able to buy the law practice of a deceased attorney. The lawyer read in the community newspaper about the attorney's passing and approached the estate with an offer to buy the office building. They also negotiated for the contents inside the building, which including furnishings and all client files. Offer accepted. Financing secured. The sale closed.

If the buy-sale option is out of reach, there are alternatives that benefit both the transitioning out lawyer as well as the incoming lawyer.

Gradual Transition

For lawyers who are not looking to retire or leave the private practice of law in the immediate future, a gradual transition may work as succession plan for those looking to retire some day. Gradual transition is a way of bringing in another lawyer, usually someone younger, and having that person slowly take over the practice so the older lawyer may slowly transition out of practice. This transition model benefits the transitioning-out lawyer in the following ways:

- Ability to work fewer hours and have someone available to cover in their absences;
- Clients continued to be served by someone trained by the lawyer;
- Staff, if any, remain employed;
- Sharing of overhead costs; and
- Opportunity to mentor and teach.

The incoming lawyer also benefits from this model:

- Consistent workflow;

- An established office system (and legal staff, if any);
- Opportunity to be mentored and learn from the experienced lawyer; and
- Eventually or immediately owning a law practice without opening one's own practice.

There is no “right” transition model. What works for one lawyer may not work for another. A lawyer may make a gradual transition by:

- Forming a partnership with a lawyer of some legal experience;
- Hiring an associate with the intention that the associate will take over the practice as a partner in the future; or
- Hiring a contract attorney on a few projects, see how the attorney performs, then hire that attorney as an associate or enter into partnership.

Forming a Partnership

In Ingrid's situation, she may decide to enter in a partnership with another lawyer right away. The decision to partner with a new lawyer or one with limited legal experience is completely up to the transitioning-out lawyer. It is prudent for the lawyer to thoroughly research and vet the potential candidates for partnership. See “Finding the Right Fit” section below. The lawyer and the new partner will need to work out the details of the partnership before signing an agreement. Some items to consider: partnership buy-out; allocation of losses, profits, expenses, and income; limits on partnership authority; and management duties. A detailed checklist for creating a partnership agreement can be found on the Professional Liability Fund's website at www.osbplf.org. Click on Forms under Practice Management.

Once the partnership is in place, the lawyer may then do what is necessary to gradually transition out of practice. For Ingrid, she may continue working full time for one or two years, then slowly reduce her caseload. She will have the flexibility to spend more time with her family because her partner will cover for her in her absences.

Hiring an Associate

If Ingrid is uncomfortable with forming a partnership with a stranger, she may hire that person as an associate with the intent to have the person take over the practice as partner in the future. This may require paying the associate a salary that Ingrid can afford. Lawyers in Ingrid's position should be open to candidates of varying legal experience. It may be unrealistic to expect the candidate to be a partner or a senior associate of a law firm. Those lawyers may not want to leave their salaried position with benefits to start over as an associate in another practice.

It can take up to several months for the lawyer to evaluate whether the associate is a good fit. If the associate is not someone with whom the attorney wants to continue practicing, the attorney should terminate the employment and be prepared to hire another associate. It is not unusual for a lawyer to go through a couple of associates before finding the right one to offer partnership. The attorney may avoid this problem by taking time to research the candidate.

Hiring a Contract Attorney

The fact that Ingrid has never employed another attorney in the past may lead her to hire a contract attorney first to test things out. Ingrid can hand a few cases to the contract attorney to work on. The contract lawyer relationship may continue until the Ingrid feels she has a good understanding of the lawyer's work ethics, work quality, and personality. Just like the situation with the associate above, if the contract lawyer is not a good fit, Ingrid will need to terminate the independent contractor relationship and find another person. If the contract lawyer is a good fit, Ingrid may decide to make that person an associate or a partner.

Merging Law Practices

Some lawyers do not want to take on associates or deal with contract attorneys. There is no guarantee that after training and mentoring them, the associates won't leave the firm to work for a competitor or start their own practice. In that case, the gradual transition model may not work for these lawyers. The lawyers may consider merging their law practice with an existing practice—another partnership or a solo practice. These two existing practices will have their own office systems, files, legal staff, technologies, management styles, among other issues, that will need to be addressed. Once those issues are resolved, the merger will allow both practices to capitalize on each other's goodwill and offer more services to clients.

In Irene and Clarence's situation, a merging with another practice is a viable option. They can avoid having to hire an associate or bringing in a younger partner, but at the same time benefit from passing their legacy to the merged firm. Once they retire, the remaining lawyers can decide whether they want to hire associates to fill the gaps left by Irene and Clarence.

Finding the Right Match

Finding and recruiting the right candidate to bring in for the transition is not easy if lawyers do not leave plenty of time to look. Ideally, lawyers should leave 3-5 years for the transition process to unfold. Realistically, 1-to-2-year period is the time frame that lawyers are operating in.

The most common recruitment method is to take out an ad in the Bar Bulletin, MBA newsletter, craigslist, or newspaper, or on a listserve of a professional organization or a Bar section. An effective ad should be clear as to what the lawyer wants. If the lawyer wants to bring in an associate who can someday take over the practice, that intention should be clearly stated. Experienced attorneys or partners of a firm may be willing to leave their firm if they know that the associate position is a small step away from owning their own practice.

Lawyers should also inform their contacts at the different law schools and career services about this opportunity. Law professors may know of potential new graduates interested in taking over an existing law office rather than opening their own.

Even the courthouse can be a good place to recruit potential candidates.

One younger solo practitioner, who frequently appeared in court, used that opportunity to observe an experienced attorney at trial. Both practiced in the same legal area, so they saw each other in court regularly and got to observe each other. They soon became acquainted. The experienced attorney started giving the younger lawyer cases to work on as a contract attorney. That attorney later hired the young lawyer as an associate, who later became a partner.

Another attorney in rural Oregon, who is also a pro tem judge, found his transition partner by observing a younger lawyer in his court for over a year. The senior attorney was impressed at how smart, professional, and exceptional the younger lawyer was. One day, the senior attorney invited him to lunch and offered him an opportunity to become an owner in the firm. The younger lawyer accepted. This lawyer started out as an associate and became a partner within a few short years.

Attorneys may not want to make their transition public for various reasons. These attorneys can start by talking to trusted colleagues and friends in the legal community who may know of potential candidates. If the lawyers have worked with a contract attorney in the past or are acquainted with someone with whom they are impressed, it does not hurt to just approach that person.

One solo, who is now retired, found his transition partners in two younger attorneys who were renting office space from him. The attorney hired these lawyers on a contract basis to work on certain cases for about two years. He then approached them about entering into a partnership and they accepted. The attorney retired three years after the partnership was formed.

When it comes to recruitment, lawyers need to keep their eyes and ears open, and be willing to take a leap of faith to approach another lawyer.

Researching the Lawyer

The candidates must be researched and vetted for skills, experience, and competence. The lawyer should meet multiple times with the candidates to get to know them. Ask for their resume and professional references. Some sample due diligence tasks include:

- Verify the candidate's credentials to ensure that you will leave your practice in competent hands;
- Research their reputation and talk to people in the legal community with whom the candidates have had contact;
- Ask the candidates to provide a list of malpractice claims and check the Oregon State Bar for disciplinary actions against them; and
- Ask the candidates about their open files and closed cases and whether there are legal staff and office systems that they will bring with them in the transition.

A thorough checklist for lawyers transitioning in and out of practice can be found at the Professional Liability Fund's website at www.osbplf.org. Click on Forms under Practice Management.

Determining a fair compensation formula

Deciding on how to compensate the incoming lawyer and buying out the retiring lawyer does not happen in one meeting. Both attorneys need to take a lot of time to talk about different compensation formulas that will work for both of them.

Compensating the Incoming Lawyer

It is important for the incoming lawyers to have realistic expectations of how they will be compensated. Attorneys who transition into a small firm or solo practice should not expect to be compensated with a fixed salary or annual income guarantee from the transitioning-

out lawyer. A few solos can provide that fixed income, but the vast majority cannot. A fair compensation for the incoming lawyer will depend on many factors, including whether the lawyer comes in as an associate (employee) or a partner (self-employed). Having lengthy discussions about compensation up front will help both attorneys understand what is feasible and what is not. As there is no magic compensation formula that works for every situation, it may be helpful to see how other lawyers in Oregon have done this in the past.

The compensation arrangement that a sole practitioner and his transition partner entered into has been successful for them. The agreement is this: incoming lawyer keeps 100% of his earned fees and pays 100% of the overheads. Transitioning-out lawyer contributes 20% of his earned fees to the new lawyer to help cover overheads. Each lawyer pays for their own bar dues and PLF assessments. They have a system to divide the earnings from staff billing.

For example: New attorney brings in \$8,000 a month of earned fees. She keeps the entire amount. Transitioning-out lawyer brings in \$15,000 of monthly earned fees, and gives 20% to the new attorney. New attorney now has \$11,000. Overhead is \$6,000, which the new attorney has to cover. Staff bring in about \$2,000 of monthly billable hours, and let's say new attorney gets 50% of those fees. So the new attorney nets \$6,000 a month. $((\$8,000 + \$3,000 + 1,000) - \$6,000.)$

The main concern about this compensation model is that that new attorney may not have enough earned fees in a month to cover the overhead. This is something that both attorneys should discuss in details to work out a plan B. The transitioning-out lawyer could agree to "subsidize" the new lawyer for a few months until she catches up on her billing. Or they can agree the new lawyer should take a draw to cover the first few months of practice. There is no fixed and fast rule on this.

Some other common compensation models used by Oregon lawyers include:

- Evenly splitting overhead and expenses, but dividing revenues on a percentage based on ownership share in the firm or amount of fees each lawyer generates or both.
- All lawyers keeping their own fees but sharing overhead based on a percentage that depends on fees earned by each lawyer.
- Paying the incoming lawyer a salary with options to buy shares in the firm on an annual basis. Cost of overhead is split based on percentage of shares owned.

Compensating the Transitioning-out Lawyer

Not every law practice can afford to buy out a retiring partner. This is especially true for law practices that do not have consistent book of business and stable client base. Retiring

attorneys with a small or solo practice normally do not expect a buy-out from their transitioning-in partner. But no lawyers will be opposed a buy-out if one is possible. An example of how this could be done may be instructive.

The previous section mentions a now-retired lawyer who found his transitioning partners in two younger lawyers to whom he rented his office space. Their partnership agreement laid out a plan to compensate the original lawyer upon retirement. The lawyer retired three years after the transition. The compensation formula was based on going back three to four years prior to retirement to compute an average of the annual income of the firm and using that figure to buy the lawyer out. That figure was paid to the lawyer on a monthly basis for a period of four years. The retired lawyer also owned the building, so the new attorneys paid rent to him until they eventually bought the building from the lawyer.

Other buy-out models are based on paying the retired or transitioning-out lawyer a certain percentage based on the annual income revenues of the firm. The payments are made on a monthly basis for a period of three to seven years. This model differs from the example above because the monthly payments vary depending on the firm's current earnings. In the above example, the retired attorney received a fixed amount of monthly payment determined by how much he generated when he was in practice.

There are other models out there, both complicated and simple, and lawyers are encouraged to find the one that fits their needs.

Conclusion

Now is the time to think about transition. There are many options available to lawyers who leave plenty of time to transition out of private practice. Whether it is to sell the practice, or make a gradual transition, or to merge with another office, time is required to make it all happen in a way that leads to a happy ending for everyone involved.

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