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Selling or Transferring a Law Practice

By Michael Downey

Many lawyers who have built successful practices and vibrant client-bases are approaching retirement age. According to a 2014 Missouri Bar survey, 63 percent of responding firms reported that at least 25 percent of their business is controlled by lawyers age 60 or older – and almost 19 percent of responding firms report that more than 50 percent of business is controlled by such lawyers.

Many of these relatively senior lawyers wonder how they can monetize the investment they have made building their law practices, and who will take care of their clients and practices when the lawyers stop practicing law.

Newer members of the legal profession, meanwhile, are often eager to develop clients and practices, but find it difficult to navigate increasing regulation for opening a new law practice and to land positions with established firms.

The ABA Model Rules of Professional Conduct – and the ethics adopted by virtually every state – provide four possible methods for transferring a law practice from one lawyer to another. This article looks at the ethical regulations and some risk management concerns for each of these law practice transfer methods.

Intra-firm transfer. The most common means for transferring a practice is to have a lawyer at the same firm acquire or inherit the practice. Often this involves identifying lawyers who will take over a departing lawyer's practice, and then introducing those successor lawyers to the clients matters or increasing their role when already engaged on client matters. The lawyer transferring the practice often also receives compensation for transferring the practice.

Intra-firm transfers are virtually unregulated by ethics rules. Lawyers within a firm are largely free to structure the transaction, including how the transferring lawyer will be paid and how clients will learn about the potential transfer.

The virtual absence of ethics rules regulating these transfers should not be understood to mean that lawyer ethics rules do not impact intra-firm transfers, for the ethics rules have at least six impacts on intra-firm transfers. The first three are rather mundane. Rule 1.4 generally requires client notice if a lawyer's retirement or departure would be material to that client. The common law and Rule 1.16(a)(3) generally allow a client to terminate a representation and move work to a new lawyer and firm if they dislike a proposed successor lawyer or how a transfer is handled. And Rule 5.1 requires a firm and its management to ensure the successor lawyers provide competent, ethical representation.

In addition to these rather obvious impacts, the Rule 5.6(a) general prohibition against non-compete agreements may impact intra-

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firm transfers in three ways. First, although generally prohibiting non-competes, Rule 5.6(a) does permit restrictions on a lawyer's right to practice as long as the restrictions are imposed as conditions for receiving "benefits upon retirement." This means that a firm can "pay" a transferor lawyer for his or her practice and ensure the firm and successor lawyers are purchasing buying something of value by preventing the selling lawyer from opening a competing practice by coupling a non-compete requirement with a retirement benefit. The firm must take care, however, to ensure the benefit is truly a "retirement" benefit, not simply a benefit that rewards a lawyer not for retiring but instead for not competing, for example by providing the benefit even if the lawyer moves to a non-competing practice setting (for example, as a judge, corporate counsel, or law professor).

Second, the firm must ensure the benefit is sufficient to induce the transferor lawyer to retire. Otherwise, a lawyer may forego a benefit and simply move the practice to a new firm, knowing Rule 5.6(a) will generally protect that lawyer's practice against invocation of a non-compete by the former firm.

Finally, the retirement benefit to the transferor lawyer cannot be too large, or the lawyers who inherit or acquire a practice may be encouraged to take the practice and – again, protected by Rule 5.6(a) – move to a new firm, hoping to get the benefit of the transferred practice without paying the stipulated price.

Despite these limitations, many solo and small-firm lawyers seek to add a lawyer to or develop a lawyer already at their practice so this lawyer will succeed to lead the practice, and compensate their mentor-boss for the practice. Such partnering-to-succession arrangements, however, can be difficult to execute. Often personality and practice differences between the two lawyers, as well as inevitable vacillations between the parties' interest in consummating the transfer, cause succession plans to unravel. Yet partnering-to-succession remains a popular method for attempting a law-practice transfer.

Law practice sales. The second method for transferring a law practice, and the first of three methods for transferring a practice to a lawyer outside the transferor's firm, is the sale of a law practice.

Model Rule 1.17 permits a lawyer to sell a practice or portion of the lawyer's practice to one or more other lawyers. Rule 1.17 contains a rather complex set of requirements, and should often be used as a checklist for a law practice sale. The Rule 1.17 requirements include that the selling lawyer must sell the entire practice or a portion of a practice, for example all legal work done in a specific jurisdiction or on a specific type of matter. "Cherry-picking" or transferring only the most valuable cases or clients is not permitted.

Following these rather complex requirements of Rule 1.17 provides four clear benefits. First, Rule 1.17 requires and thus ensures that selling lawyer accepts a non-compete requirement for the practice or portion of the practice sold. This requirement helps protect the value of the transaction for the purchasing lawyer.

Second, although the transferring lawyer likely needs to secure a buyer competent to handle transferred client matters, the transferring lawyer is then relieved of further responsibility for the matters after transfer, as well as for the continuing operations of the firm itself.

Third, as long as the Rule 1.17 notice requirements are satisfied, Rule 1.17 excuses the lawyers involved in the sale from

securing consent from each transferred client. After the proscribed notice period (90 days), a client's consent to transfer the matter is presumed unless the client previously objected.

Fourth, although Rule 1.17 requires the transferring lawyer to cease practice in the transferred practice, ABA Formal Ethics Opinion 468 (2014) explains the transition need not be immediate or abrupt. Thus, the lawyer selling the practice can work with the purchasing lawyer for a reasonable time, helping insure the clients are happy with and well represented by the new lawyer.

Case-by-case transfer. The third method for transferring a law practice involves case-by-case transfers of clients or client matters. This method is often used to transfer contingency-fee litigation practices, and is governed by Model Rule 1.5(e). Rule 1.5(e) allows lawyers to share reasonable fees generated by a matter as long as the client consents and the consent is confirmed in writing.

The share of fees each lawyer receives under Rule 1.5(e), however, must be proportionate to the services each lawyer has performed, or – the more common approach – each lawyer must assume joint responsibility for the matter.

Ordinarily lawyers using fee-sharing arrangements will have a joint meeting with the client, discuss the proposed arrangement, and have the client authorize sharing of the case and fee. Because the share of fee is predetermined, both lawyers then retain joint responsibility throughout the duration of the matter. This may require the transferor lawyer to maintain some oversight, and even to retain malpractice insurance and the like. A transfer through Rule 1.5(e) fee-sharing is therefore rather easy to accomplish, but it does not relieve the transferor lawyer of all future responsibilities.

Surrogate attorneys. The final method for transferring a practice is the use of a surrogate attorney. States including Delaware, Florida, Illinois, Indiana, Maine, Michigan, Oregon, and Wyoming have surrogate-attorney rules. Perhaps the best known is Indiana Rule 23, § 27, adopted in 2008.

Surrogate attorney rules generally allow a solo or small firm lawyer to designate a successor lawyer, often on an annual bar registration form. The surrogate attorney will then assume control and responsibility for the lawyer's practice if the lawyer unexpectedly becomes unable to practice.

Surrogate attorney rules generally provide for transfer of a lawyer's practice (including trust account) and client matters, and grant certain protections – including automatic extensions of deadlines and protections from certain conflict problems and malpractice claims – for the surrogate attorney.

Lawyers taking advantage of surrogate attorney rules, or attempting to establish such a transition without the benefit of the Rule, often provide that some portion of fees obtained are paid to the lawyer or lawyer's estate. Rule 5.4(a) generally allows fee-sharing with lawyer's estate even if the estate does not include lawyers.

Conclusion. The Rules of Professional Conduct in most jurisdictions afford a lawyer seeking to transfer or acquire a practice a selection of methods. Each has its advantages and disadvantages, however, so both a buyer and a seller need to be aware of practice transfer requirements.

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