Exit Planning Considerations for Attorneys

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The current law firm landscape is littered with a number of well respected firms that are essentially being forced to consider liquidation due to the lack of a thoughtful, well articulated and understood succession plan. As a certified public account and business consultant with an emphasis in practice management consulting, I find myself being called on more than ever to address firms in various stages of transition. My prior experience as a legal administrator for a large law firm prior to building my CPA practice has helped me successfully guide clients through this often difficult transition and make them more productive and profitable in the process.

Quite often there is a need to reconcile expectations between relatively older and younger professionals where, in one context or another, a suitable exit plan is desperately needed to insure the continuity of the enterprise or, at a minimum, maximize the value proposition for the departing attorneys. In order for a succession plan to be successfully implemented and executed as time rolls forward, it is essential that it is embraced by all affected parties, both those departing and those who will remain behind.

Before expanding discussion on the subject of succession plans, here are some exit planning basics. There are generally four basic ways to transfer an ownership interest in a professional practice:

1. Sale to other owners or employees

2. Merger with or acquisition by another firm
3. A qualifying sale of the practice to another firm
4. A liquidation of the practice

These alternatives may seem straightforward and logical, but many law firm partners have never given much serious consideration to their alternatives for exiting their practice. Often it is simply assumed that an internal succession plan will emerge when the time is right, based on past precedent or just hopeful thinking. Many practitioners and their respective firms are relying on what has worked in the past as being an acceptable formula for the future. This can be a critical error, as is being proven over and over in today's turbulent and challenging economic environment. Those looking to exit are learning the hard way that members of the up and coming generation are often not willing to pay the price, in terms of both dollars and commitment, which prior partners had received upon their exit from productive practice.

In today's "new normal," practitioners need to focus on a longer horizon to enable them to optimize their objectives when exiting their practice. Each of the above alternatives can be a viable option in most instances. Larger firms obviously are able to structure mergers and internal transfers more efficiently than small firms or solo practitioners, but one does not need to look too far to find examples of very large, established firms that have chosen to liquidate, or have been forced to, due to a lack of planning and foresight as much as anything.

The sale of a practice to another qualified firm is a relatively new alternative, given the advent of ABA Model Rules of Professional Conduct - Rule 1.17 and the adoption of equivalent rules at the state level. To summarize, in most jurisdictions, a lawyer can now sell a law practice to another duly licensed attorney as long as:

- The practitioner ceases to actively practice in the jurisdiction;
- The entire practice is sold;
- Clients are given notice of the transfer of their files to the new firm and their right to choose alternate counsel if they wish; and
- The acquiring attorney agrees not to increase fees to recover the cost of the acquired practice.

Let's assume that liquidation is not a favored option for the purpose of this discussion. We will focus the balance of our attention on how practitioners can best evaluate and position themselves to make the best choices between the remaining alternatives, an internal transfer to current and possibly future ownership versus a merger or acquisition by another established firm.

The key is picking the pathway that is best suited for your firm's specific situation. Understanding the intricacies of each option and assembling a team of competent and trusted advisors to help evaluate alternatives, define expectations and then assist in executing the appropriate plan is a prudent way to move forward. Two excellent resources for transition planning are books written by John Brown, Denver attorney and Principal, (Minor & Brown**,** P.C.) and president of the Business Enterprise Institute, Inc. His books include: "*The Completely Revised How to Run Your Business So You Can Leave It in Style*" (Brown, J. H. (1997). Golden, CO: Business Enterprise Press.) and "*Cash Out, Move On,*" (Brown, J. H. and Short, K. M. (2008). Golden, CO: Business Enterprise Press.). Mr. Brown's first book documents a very effective framework process for exit planning. Let's consider some of Mr. Brown's recommended steps as a framework for getting your exit plan underway:

Determine Your True Exit Objectives

- Do you know exactly what your retirement goals are - and how much cash it will take to achieve the financial goals you require?
- Consider the team of advisors required to assess, monitor and implement the "plan" - typically this team would include an investment/insurance advisor, a CPA, estate/business/tax attorneys, investment banker (middle market business) or business broker (smaller business), and a transaction attorney.

  Some of these professionals might already be serving your business if you utilize an outside advisory board to assist you with seeing things objectively and with a full view of the landscape.

Assessing Value and Price

- Do you have a sense of how much your practice is worth today – in cash – to a motivated buyer?
- Your practice may easily be your most valuable asset. But realizing that value will involve significant planning, and sometimes some luck, with respect to timing and other outside influences to maximize value.
- Transfer or sale to insiders will often focus on securing an income stream as the value driver, while a transaction with an outside firm will often result in a higher realized economic value.
- Business valuation is a fundamental aspect of this step in order to understand the give and take, regardless of whether you are willing to consider both options versus setting the stage for either an internal transfer or outside deal.

Preserving, Protecting, Promoting Value

- Have you considered what is required to maximize the potential for future work opportunities, and in turn the income stream generated by your ownership interest? Consider the three Ps of value: preserving, protecting and promoting value.
  - Preserving involves exit planning activities such as an annual review of income tax status and corporate entity status [e.g. electing S Corporation status in a down economy, for example, when stuck in a C Corporation, versus a more flexible LLP/LLC status]; review, evolve and document a legitimate business plan; undertake individual wealth planning steps; consider the use of an Employee Share Ownership Plan (ESOP) or stock appreciation rights.
  - Protecting value from creditors includes having an annual fiscal and legal audit; reviewing risk management; removing personal guarantees and similar actions, all in anticipation of an exit transaction.
  - Promoting value is critical in exit planning and involves focusing on the value drivers of the particular practice.

The key point here is for the practitioner to spend some time working ***on*** rather just than ***in*** the business. This point is not unique to exit planning, but is almost a universally accepted good business practice.

- Value Drivers are factors that affect the actual and perceived value of a practice. As such, potential investors, be they internal or external, look for the enterprise's performance in the following areas:
  - Universal value drivers, including: increasing cash flow; enhancing operating systems that improve sustainability of cash flows; implementing improved technology platforms and facilities; reducing or restructuring

debt; documenting the sustainability of earnings; implementation of strategies to grow and sustain the inflow of clients and client service opportunities; insuring for a competent administrative/management team.
  - Industry-specific value drivers, including: stability and outlook for growth of the areas emphasized within the practice; technical expertise; diversity of clients and services provided; employee performance and morale.

Converting the Value Proposition to an Agreed Arrangement

- Once you have made a decision to move forward with an exit strategy, do you know how to “sell” your practice to either your partners or another firm, while minimizing the taxes you will be paying?
- Planning and preparation are critical here. Get connected with a competent accountant and other advisors as appropriate, including a transactional attorney, your banker and your investment advisor.
- Give adequate consideration to the planning horizon needed to fully implement a successful exit plan, as it can take up to 5 years of thoughtful planning, positioning, and negotiation to get the right deal done.

Contingency Planning

- A multi-owner practice should insure that it has a well thought out and adequately funded buy-sell agreement to enable remaining owners to acquire a deceased's practitioners ownership interest. The agreement should address: death; disability; right of first refusal on transfer to a qualifying third party; termination of employment with or without competitive practice; retirement; and events such as bankruptcy and divorce. Keep in mind also that we are finding more and more practitioners who want to cut back on their work over time but not fully retire, and many firms have not sufficiently addressed how to facilitate this aspect.

- What happens when traditional sources of capital for the practice are no longer as readily available, as is often the case in today's tough economy? The demands on financial resources can be relieved somewhat by funding death and disability events with appropriate insurance; and providing for more conservative ongoing capitalization philosophies in anticipation of exits of older practitioners.
- Loss of key talent can be mitigated by insuring the employees in place can actually assume responsibility when called upon to do so. Have you assessed the team in place and are they the right players for the exit plan being considered? Often, it is these "people" issues, friendships and loyalties, which outweigh what needs to be done to properly position the practice for transition. Getting "the elephant up on the table" on how a transition will affect both departing and continuing players is often the constraint that avoids adequate progress from being made on a plan that is acceptable to all involved.

Wealth Preservation and Life after the Exit Event

- Have you properly considered the resources you will need post-exit and how best to preserve the value derived in the transaction?
- Have you considered what your daily life will be like after you exit your practice? I encourage practitioners to take that long-sought sabbatical as a means to both test the waters as to what you will do for a relatively prolonged period without the demands and stimulation of your practice, and also as a way to see how the practice will fare while you are away from it for a month or more.

The discussion above is intended to stimulate your thinking on where you are on the timeline of the need for an exit plan. It might even be to assist someone within your firm to open up opportunities for yourself or others by getting things in focus or at least moving in the right direction. There are a growing number of resources available, including the Brown books noted above, this newsletter's editorial board member Ed Poll's book on selling a law practice (Poll. E. (2005). *Selling Your Law Practice, The Profitable Exit Strategy*, Venice, CA: Lawbiz Management Co.) and many others. The important thing is to start thinking about the future and laying the groundwork for your plan.

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