LAW OFFICE MANAGER™
Learn More, Earn More, Be a Better Administrator

Presenter

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CPA/ABV, ASA, CVA, CGMA

Moderator

Catherine Jones
Editor, Law Office Manager

A Basic Guide to Succession Planning for Law Firms

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Exit & Succession Planning: Transitioning a Law Practice (and it's owners) for the Next Stage of Life

May 7, 2015
Law Office Manager

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Beyond the Number$

Ronald L. Seigneur,

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Ron is a partner in Seigneur Gustafson LLP, a CPA and consulting firm located in Lakewood, Colorado. He holds the AICPA specialty designations of Accredited in Business Valuation (ABV), Certified in Financial Forensics (CFF), and is a Certified Valuation Analyst (CVA) with the National Association of Certified Valuation Analysts. Ron is also a Senior Appraiser in Business Valuation from the American Society of Appraisers (ASA). Ron has opined on the value of over 80 law firm equity interests.

He has published over 100 articles on business valuation, economic damages, leadership, compensation systems and related practice management subjects. Ron has taught a number of intermediate and advanced seminars and courses for state Bar Associations and law firms; and has successfully facilitated over 100 law firm retreats and planning meetings. Ron is a past Chair of the Colorado Society of CPAs and currently chairs their 2020 strategic planning committee.

Ron has been an Adjunct Professor at the University of Denver Sturm College of Law for over 20 year where he teaches a course on Applied Leadership Theory for Law firms. He is a Fellow of the College of Law Practice Management and on the editorial board of Law Office Manager.

Ron has been qualified and provided testimony as an expert witness in several jurisdictions on a wide range of issues ranging from complex business valuations, forensic investigations, and various forms of economic damages. Ron has served appointments as trustee, mediator, arbitrator, special master of the court, as well as serving as an expert for the Colorado State Board of Accountancy and Colorado Attorney General. Ron was inducted into the AICPA Business Valuation Hall of Fame in 2006 and is a Fellow in the College of Law Practice Management. Ron is one of only 28 charter members of the AAML Forensic and Valuation Services Division. He has helped more than 400 law firms to be more profitable, collegial and productive.

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Objectives

- Introduction and housekeeping points
  - Limited time requires we move quickly through slides/content
  - Time for Q&A and follow up
- Briefly review demographic trends and fundamental concepts
  - Recognition of the diversity of attendees: Big/small firms, solo focus/multiple specialties, age, have a plan/have no plan/think you have a plan
- ABA Rule 1.17 and law practice valuation
- Letting go of the reins, assessing culture and operating philosophies
- Understanding motivations of buyers and sellers
- Ancillary information
- Polling questions

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Polling question #1

- What size is your firm?
  - Solo practitioner
  - 2 to 10 attorneys
  - 11 to 25 attorneys
  - 35 to 70 attorneys
  - 70+ attorneys

LEADERSHIP & OWNERSHIP SUCCESSION CYCLE

Changing industry dynamics within the professional sectors

Personal services are defined by the Internal Revenue Code as services performed in the fields of:

- Health
- **Law**
- Engineering
- Architecture
- Accounting
- Actuarial Science
- Performing Arts
- Consulting

Demographic and Competitive Trends

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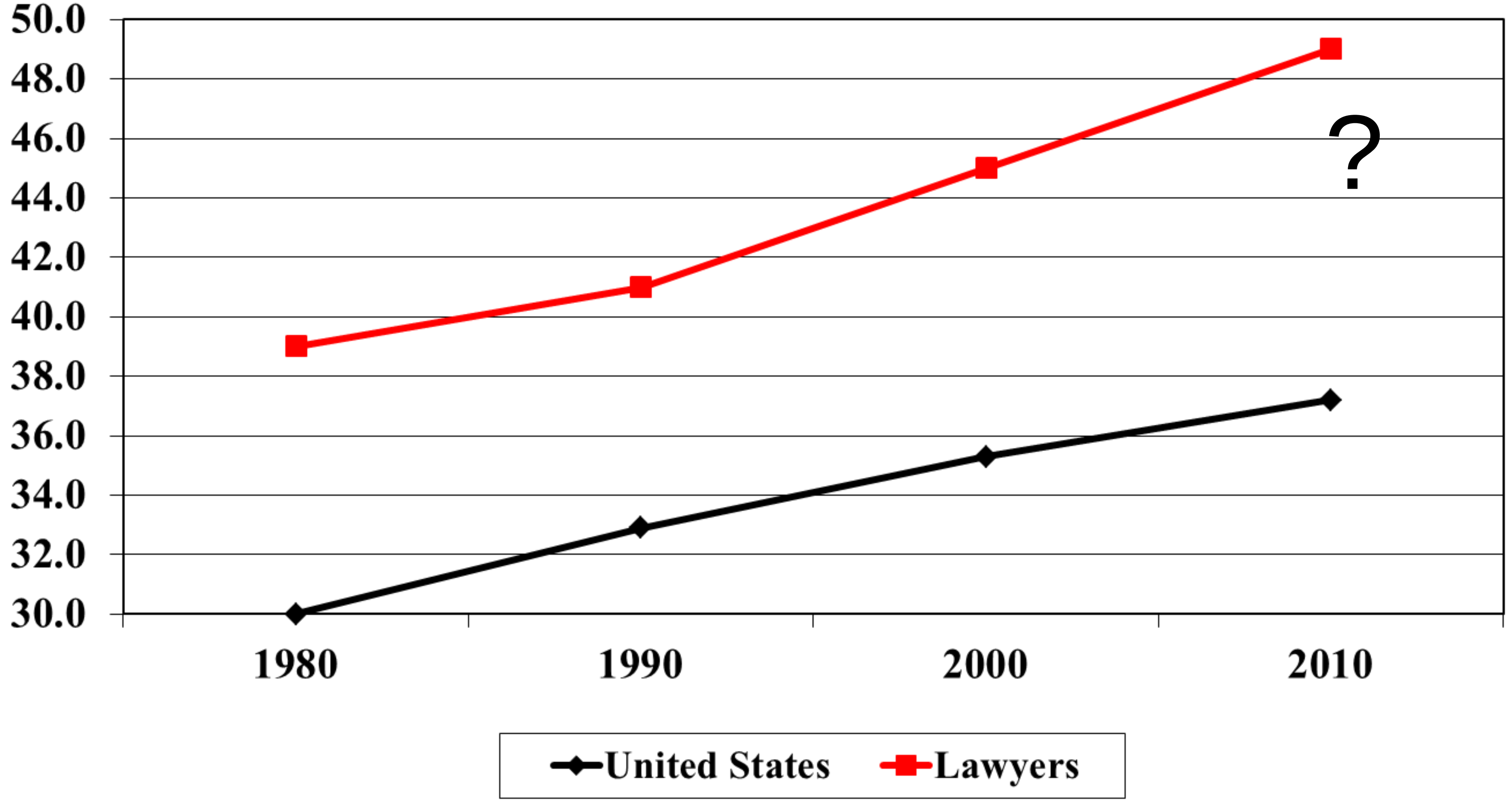
Median ages

Source: U.S. Census, ABA



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Invasive Species:
Part of the New Normal

clearspire

LawVest

axiom
law redefined

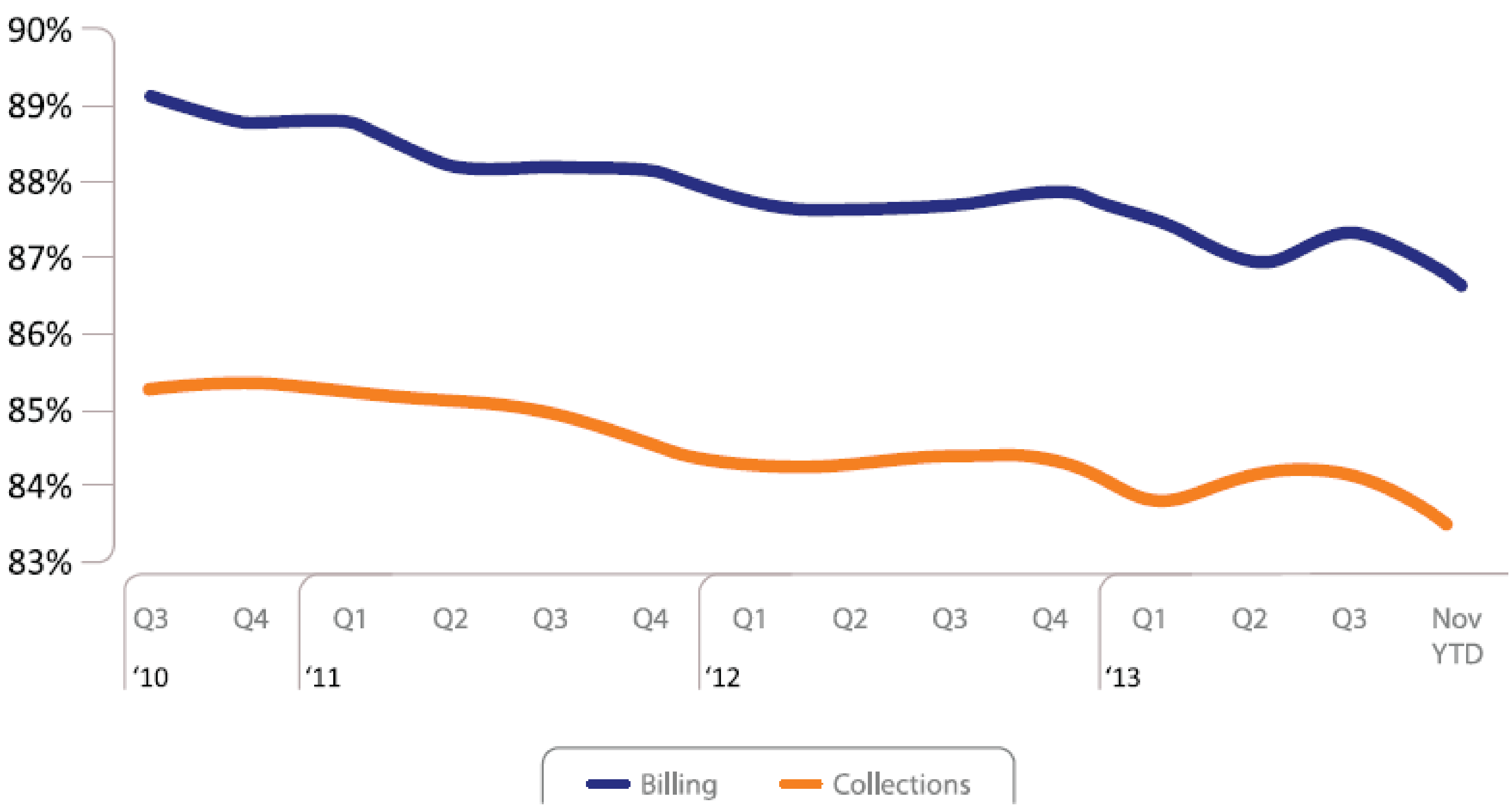
Riverview
LAW

legalzoom®

ROCKETLAWYER

Working just as hard, collecting less

Chart 5 - Billed and Collected Rates against Standard



Source: Thomson Reuters Peer Monitor

Can we learn from CPA Firms?

- **Succession**
  - 81% of the firms did not have a written succession plan
    - Of those, 22% stated that they did not need to have one.
  - 8% of Sole Proprietors had Practice Continuation Agreements
  - 30% of the firms did not answer the question as to when the senior partner(s) were going to retire
  - 56% of the firms said at least 1 partner would retire in the next 5 years with 18% stating that more than one would retire

Can we learn from CPA firms? (con't)

- Regarding the likely transition plan:
  - 14 percent – will look for a merger candidate in order to fund the retirement of the senior owners.
  - 11 percent – will look for a merger candidate in order to gain access to the leadership skills necessary for the firm to prosper.
  - 16 percent – the firm would most likely be sold so that the senior owners can maximize the value of their investment.
  - 12 percent – the firm would most likely be sold because the remaining leadership would not be strong enough for the retiring owners to feel confident that they would be paid.
  - 12 percent – the will run their firm until they can not work productively and then simply "turn out the lights".

Profession Specific Attributes

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Law Firm Nuances

- Full Service vs. Boutique Practices
- Three Distinct Approaches to Service Delivery:
  - Procedural – Foreclosure, Collection, Probate
  - Expertise – Patent Law, Oil & Gas
  - Experience Driven – Complex Litigation
- Large vs. Small Firm Considerations
- Origination Credit Concepts
- Hourly, Contingency or Value Billing
- Regulatory Influences – e.g. Tort Reform, ACA, Tax, 280E
- ABA Model Rule 1.17

Managing the Professional Services Firm, David H. Maister

Part One: Basic Matters

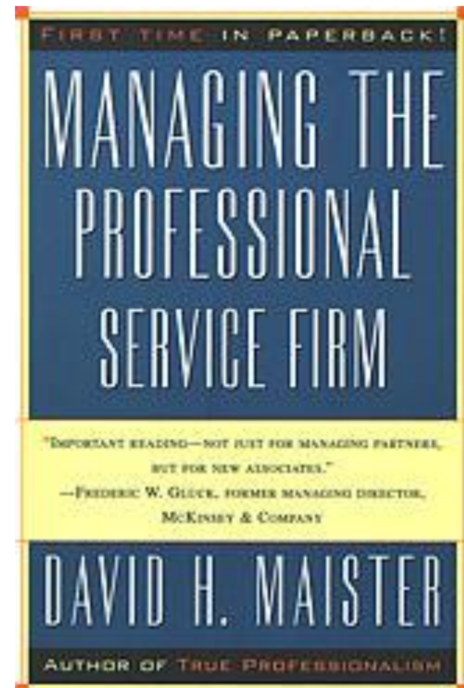
Part Two: Client Matters

5. **The Practice Development Package**
6. **Listening to Clients**
7. **Quality Work Doesn't Mean Quality Service**
8. **A Service Quality Program**
9. **Marketing to Existing Clients**
10. **How Clients Choose**

Part Three: People Matters

Part Four: Management Matters

Part Five: Partnership Matters



ABA Rule 1.17

A lawyer may sell or purchase a law practice, including the associated goodwill, if the following conditions are satisfied:

a. Seller ceases to engage in the private practice of law in the jurisdiction in which the practice has been conducted.

b. The practice is sold as an entirety to another lawyer or law firm in good standing.

ABA Rule 1.17

c. Written notice is given to each of the seller's client's regarding:

   i) the proposed sale;
   ii) the terms of any proposed change in the fee arrangement;
   iii) the client's right to retain other counsel or to take possession of the file; and
   iv) the fact that the client's consent will be presumed if no action or objection within 90 days (requires court order in some circumstances).

ABA Rule 1.17

d. The fees charged to the client may not be increased by reason of the sale. The purchaser may, however, refuse to undertake representation unless the client consents to pay the purchaser fees at a rate not exceeding the fees charged by the practitioner for rendering substantially similar services.

Other Issues

- Preserving Client Confidentiality
- The Question of a Referral Fee
- Clearing Conflicts of Interest
- Coordinating Transfer of Client Files and Records
- Continuing E&O Insurance
- Breaking the News to Employees
- Don’t forget the Intellectual Property, including phone numbers, websites and standardized forms

Polling question #2

- Does your firm have a written succession plan?
  - Yes, and its fully ratified
  - Yes, but it still needs work
  - No

A Simple Example of the Excess Earnings Method to Derive the Value of Goodwill

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Let’s value a law practice

An simple excess earnings example:

• Attorney A compensation		$400,000
• Comparable compensation	*	(280,000)
• Attorney A excess earnings		120,000
• Cap rate .25		
• Value of excess earnings		$**480,000**

* taken from ALM (formerly Altman Weil) economic survey based on practice area, size of firm, geographic area, size of city practice is located within and years out of law school

Let’s value a law practice

Attorney A has averaged 2,000 charge hours per year compared to 1,600 hours for the peer group based on previously mentioned criteria

- 2,000/1,600 = 1.25
- 1.25 * 280,000 = 350,000 effort adjusted comparable compensation

Let's value a law practice

An simple excess earnings example:

• Attorney A compensation	$400,000
• Comparable compensation (i)	(350,000)
• Attorney A excess earnings	50,000
• Cap rate	.25
• Value of excess earnings	$**200,000**

(i) as adjusted for productivity

Letting Go and Grabbing the Reins

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5 Key Questions for Owners

- Am I ready to share authority and power?
- Do I have a vision for my future, once retired?
- Will I share increased profits (my key people will produce) to facilitate the buy out?
- How will fulfill my economic objectives and needs as they relate to the transfer/exit from my practice?
- Am I willing to lose a key employee if attitude and fit are an issue?

5 Key Questions for
Up and Coming Leaders

- Am I willing to do whatever it takes?
- Do I take initiative? Do I have the confidence to contribute by challenging the thinking of the owners when appropriate?
- Do I have good judgment and strong people skills? Will people follow me?
- Can I articulate the companies vision, values and mission on a practical basis each day?
- Do I have business acumen? Do I care about making money?

Finders and Keepers: How to Attract and Retain Top Level Associates

Top motivational factors for associates:

- Time for personal life
- Opportunities for advancement
- Professional growth
- Sense of and evidence of achievement
- Interesting, challenging work
- Being a member of a team
- Training and mentoring
- Employment security
- Leadership opportunities

Finders and Keepers: How to Attract and Retain Top Level Associates

Why associates leave:

- Not a good fit with particular firm
- Compensation – present or future
- Desire to do a different kind of legal work
- Relocation to a different state
- Desire for more family time
- Desire to move in-house
- Desire to work fewer hours
- Leaving the profession
- Desire for more trial experience
- “Small firm blues”
- Lack of advancement, career prospects
- Personality clashes with partners

Tough Questions to Ask Yourself

- Do you have the right person/people to succeed you?
  - Are you sure? If your heir has been living in your shadow for the last decade, are they really the right person to step into the spotlight and lead?
  - How many calls is your heir getting for new projects?
- Are you psychologically prepared to let go?
  - Can you be honest with yourself about how much of your identity is tied to your role in the firm?
  - Do you continue to find excuses why you each project is “special” and requires your deep involvement?
- Does your firm have a brand that can transcend you, or are you the firm?
- Schedule a “Fire Drill” to assess your preparedness and alternatives

Polling question #3

- If a partner announced his/her intention to retire by year end, which is your firm best prepared for?
  - The financial upheaval
  - The leadership upheaval
  - Both
  - Neither

Assessing Culture and Operating Philosophies

"Superstar" Model

- Extraordinary People
- Natural Leader
- Strong Personalities
- Only the Strong Survive
- Entrepreneurial mindset - creating, changing, inventing, experimenting, risk taking

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“Operator” Model

- Extraordinary Processes
- Strong Infrastructure
- More processes, support & methodology
- Career management, mentoring & “pathing”
- Consistency, controls, setting standards, compliance orientation, slow but sure improvement, low risk tolerance

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Basic Principles of the Operator Model

- Recognizing and developing leadership
- Creating viable & enduring chain of command
- Operating like an enterprise rather than like a group of individual owners
- Transitioning of clients occurs anytime firm decides client could be better served by other resources,
  - In other words, fostering an institutional attitude
- Developing compensation models and systems to reward desired behavior
- Developing staffing model that leverages realization & utilization

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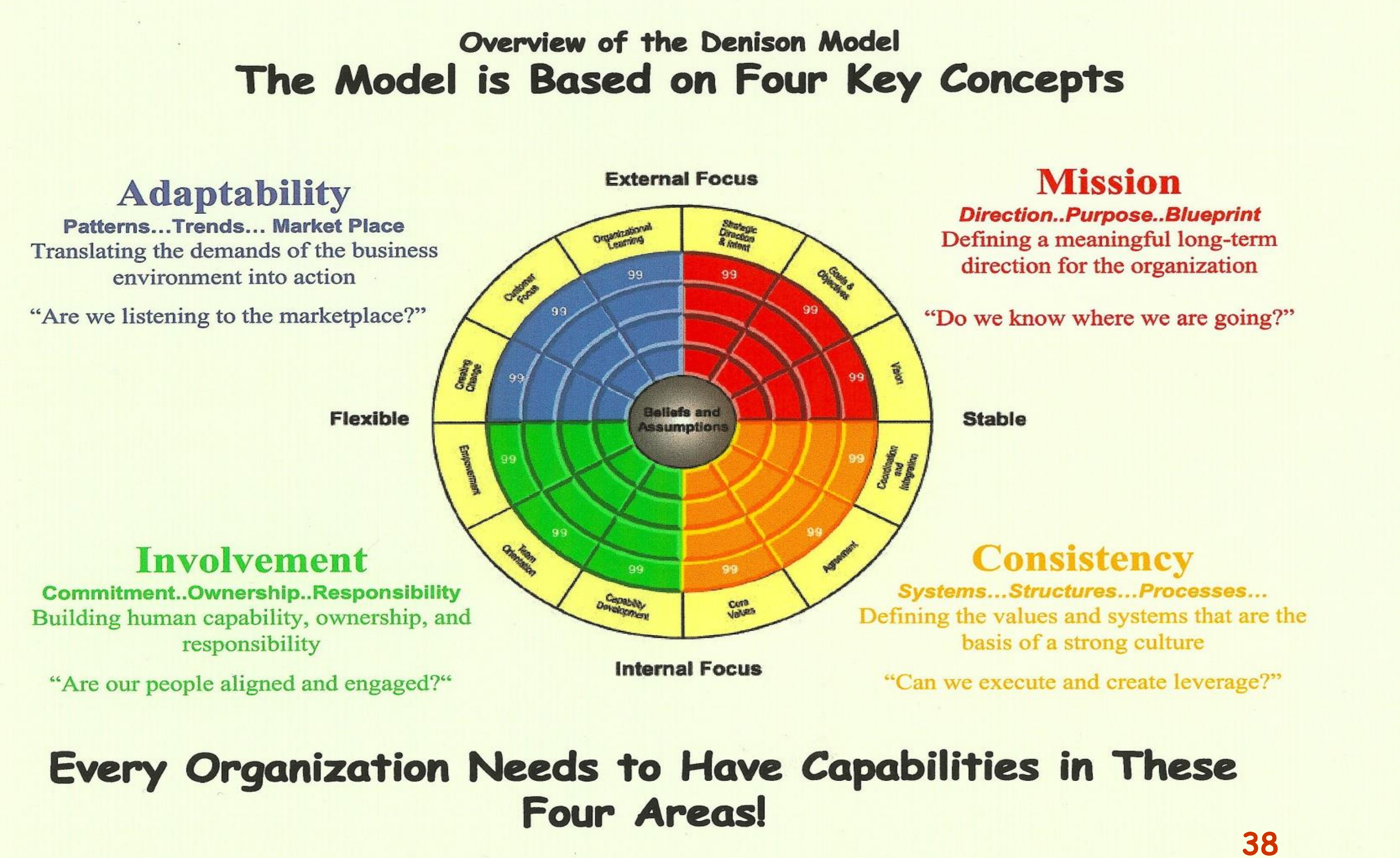
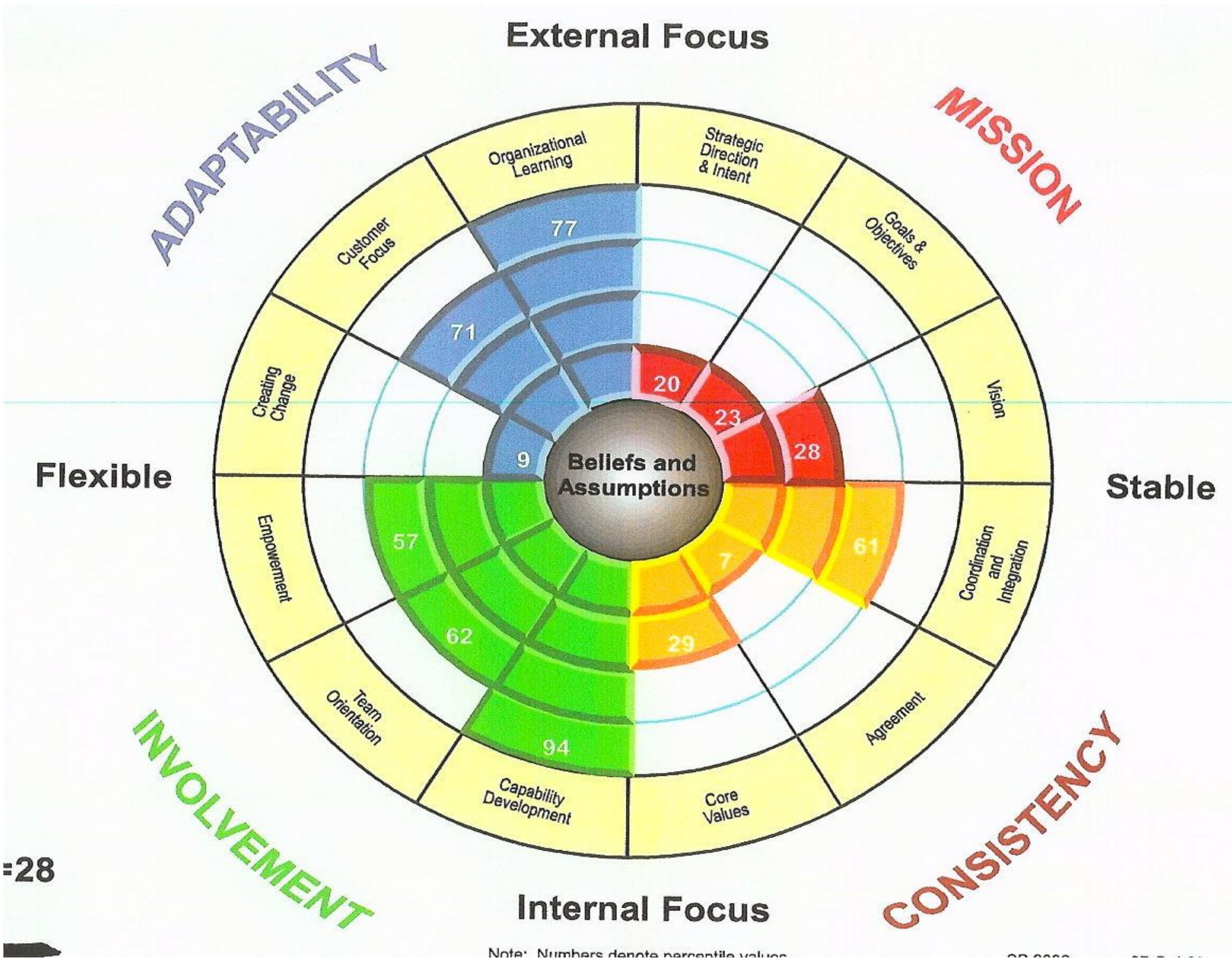
Assessing Culture



Example 1



External Focus
ADAPTABILITY
MISSION
Organizational Learning
Strategic Direction & Intent
Customer Focus
Goals & Objectives
Creating Change
Vision
Flexible
Stable
Beliefs and Assumptions
Empowerment
Coordination and Integration
Team Orientation
Agreement
Capability Development
Core Values
INVOLVEMENT
CONSISTENCY
Internal Focus
77
71
9
20
23
28
57
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94
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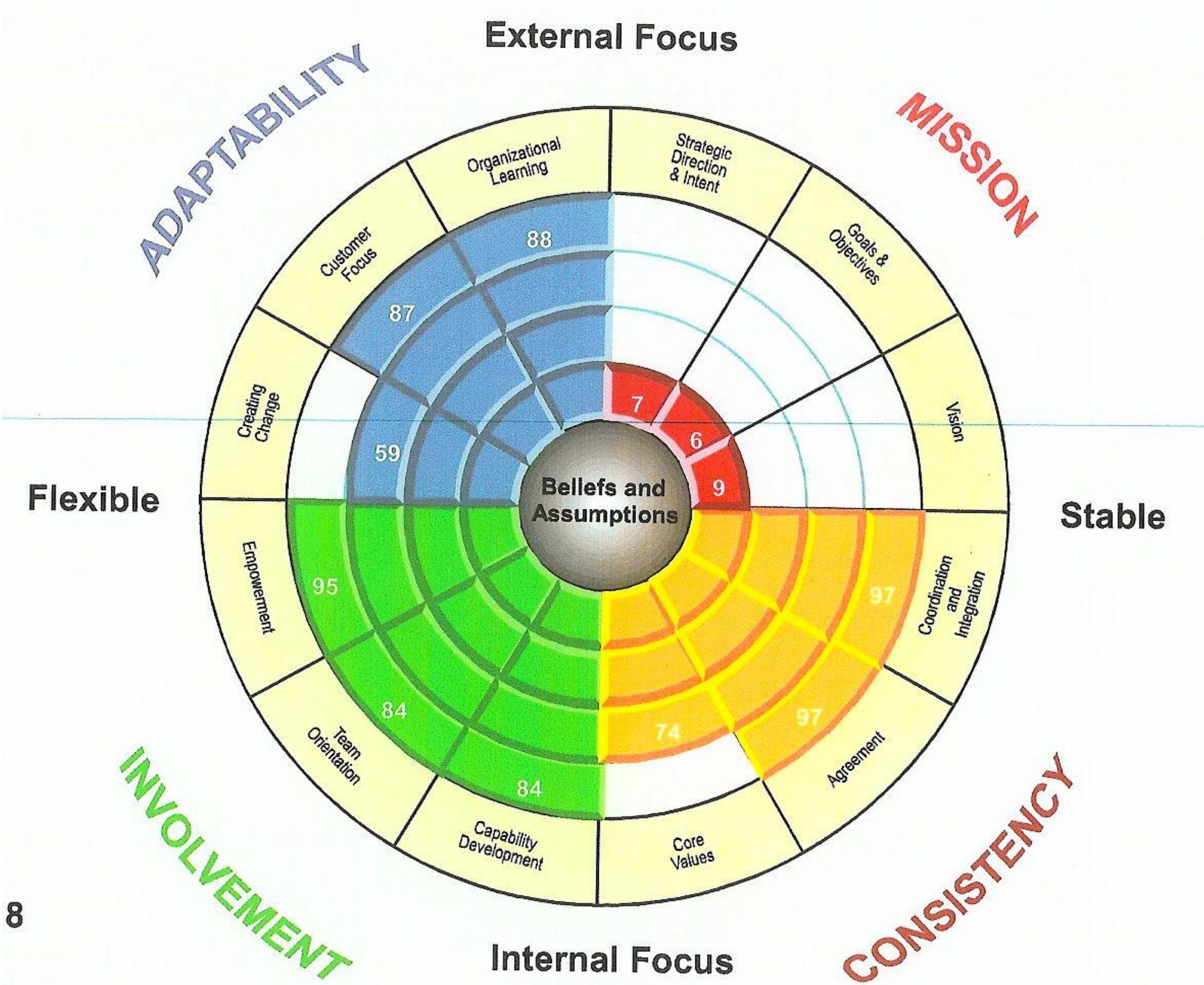
29
61

Example 2



External Focus
ADAPTABILITY
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88
87
59
7
6
9
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Flexible
Stable
Empowerment
Coordination and Integration
95
97
84
74
97
84
Team Orientation
Agreement
Capability Development
Core Values
INVOLVEMENT
CONSISTENCY
8
Internal Focus

Assessing Culture

Overview of the Denison Model

The Model is Based on Four Key Concepts

Adaptability

Patterns…Trends… Market Place

Translating the demands of the business environment into action

"Are we listening to the marketplace?"

Mission

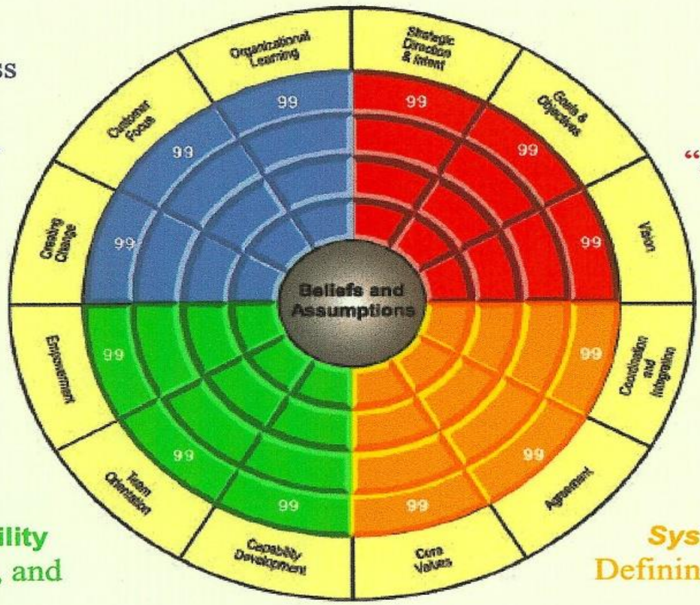
Direction..Purpose..Blueprint

Defining a meaningful long-term direction for the organization

"Do we know where we are going?"

External Focus

Flexible



Stable

Internal Focus

Involvement

Commitment..Ownership..Responsibility

Building human capability, ownership, and responsibility

"Are our people aligned and engaged?"

Consistency

Systems…Structures…Processes…

Defining the values and systems that are the basis of a strong culture

"Can we execute and create leverage?"

Every Organization Needs to Have Capabilities in These Four Areas!

Denison Model of Culture and Leadership

Involvement

- Empowerment
- Team Orientation
- Capability Development
  - Commitment, ownership, responsibility
  - Building human capability
  - Are our people aligned and engaged?

Consistency

- Core Values
- Agreement
- Coordination and Integration
  - Systems, structures, processes
  - Defining the values and systems that are the basis of a strong culture
  - System create leverage?

Denison Model of Culture and Leadership

Adaptability

- Creating Change
- Customer Focus
- Organizational Learning
  - Patterns, trends, the marketplace
  - Translating demands of the business environment into action
  - Are we listening to the marketplace?

Mission

- Strategic Direction & Intent
- Goals and Objectives
  - Defining a *meaningful* long-term direction for the organization

Vision

- Do we know where we are going?

Transitions and Exits Potporri

Key Non-Financial Considerations

- **People issues**
  - Leadership
  - Entrepreneurial “zest”
  - Customer/supplier relationships
  - Intellectual capital
  - Human resources generally
- Emotional issues
- Personal needs and objectives

Internal Versus External Sales

- Transitioning clients
  - Who
  - When
  - How
  - What to watch out for

- Transitioning relationships/referral sources
  - Who
  - When
  - How
  - What to watch out for

How To Chose An External Successor and What To Expect From Them

- Specialties you have they need to understand
- Size of successor, their retention rates and excess capacity
- Billing rates and philosophies
- Use and reliance on technology and social media platforms
- Location(s)
- Professional reputation
- Financial strength
- Professional/staffing strength
- Ethnic/language considerations
- Age and longevity partners of successor together
- Track Record of employee retention and advancement

Recognize the Three Types of Potential Buyers

- **Entrepreneurial Buyers**
  - Often looking for a lifestyle, image or outlet for talent
- **Financial Buyers**
  - Seeking an acceptable economic return
- **Strategic Buyers**
  - Typically brings specific motivations, such as a competitor or even a customer

Know the Motivations of the Sellers

Sellers of a Closely Held Business can be:

- **Financially motivated**
- **Focused on family values/key personnel**
- **Entrepreneurially grounded**
- **Emotional/Irrational**
- **All of the Above!**

Ancillary Information –
Provided for Participant Reference

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Sample Law Practice Business Appraisal Information Request

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Sample Request for Production of Documents

- **Access to all available management reports detailing practitioner, practice unit and firm-wide <u>utilization and realization statistics</u> for the periods to be covered in the analysis**
- **Details of all <u>compensation plans and formulas</u> used for professional staff and members of ownership, including any <u>special deals or arrangements</u> with specific individuals**
- **Details of the firm's <u>client fee arrangements</u>, including details on <u>contingency fee work, and the use of success fees & hybrid fees</u>**

Sample Request for Production of Documents

- **Minutes and supporting documentation for any <u>business planning retreats</u> and related meetings, including any <u>strategic planning initiatives and the status thereof</u>**
- **Detail of employee <u>fringe benefit programs</u> and allowances, including automobile, computer, cell phone and travel costs, continuing education allowances, and business development allowances.**
- **Details on any <u>soft costs incurred by the firm related to owner activities</u> outside the business, such as sports tickets, vacation homes and the like should be disclosed**

Sample Request for Production of Documents

- Details of <u>prior ownership redemptions and related commitments for future stock redemptions for retirement, disability, death, and withdrawal for competitive and non competitive reasons</u>
- Copies of all buy-sell agreements, including:
  - Current agreements
  - Agreements in force during the last five years
- Copies of any employment contracts, including:
  - <u>Of Counsel and Special Counsel relationships</u>
  - Details on any terminated or withdrawing practitioners within the last five years

Sample Request for Production of Documents

- Information on any pending or threatened lawsuits or malpractice claims
- List of any affiliated entities and related party business relationships, including investments in outside activities
- Detail on any honorariums, teaching stipends, directorship compensation, or related subsidies received by the practice or individual lawyers

Sample Request for Production of Documents for a Law Firm

- Details on all <u>bartering transactions</u>, including stock in lieu of fee arrangements and direct or indirect investments third party entities
- Access to all available departmental, branch office and client grouping performance data

Sample Request for Production of Documents for a Law Firm

- **Accounts receivable and work in process schedules, with <u>aging to 180 days</u> or more, as of valuation date.**
- **Details on all contingent fee work in process as of the valuation date and the <u>methods used to evaluate the potential success of cases</u>**
- **Copies of firm brochures and other promotional sales literature**
- **Copies of deferred compensation plans and commitments**
- **List of <u>major clients and client groups</u>, including the top 5 and top 20 clients in terms of annual revenues for each of the past 2 years**
- **Martindale Hubbell information on the firm and all members of ownership**

Practice and Professional Goodwill aka Blue Sky

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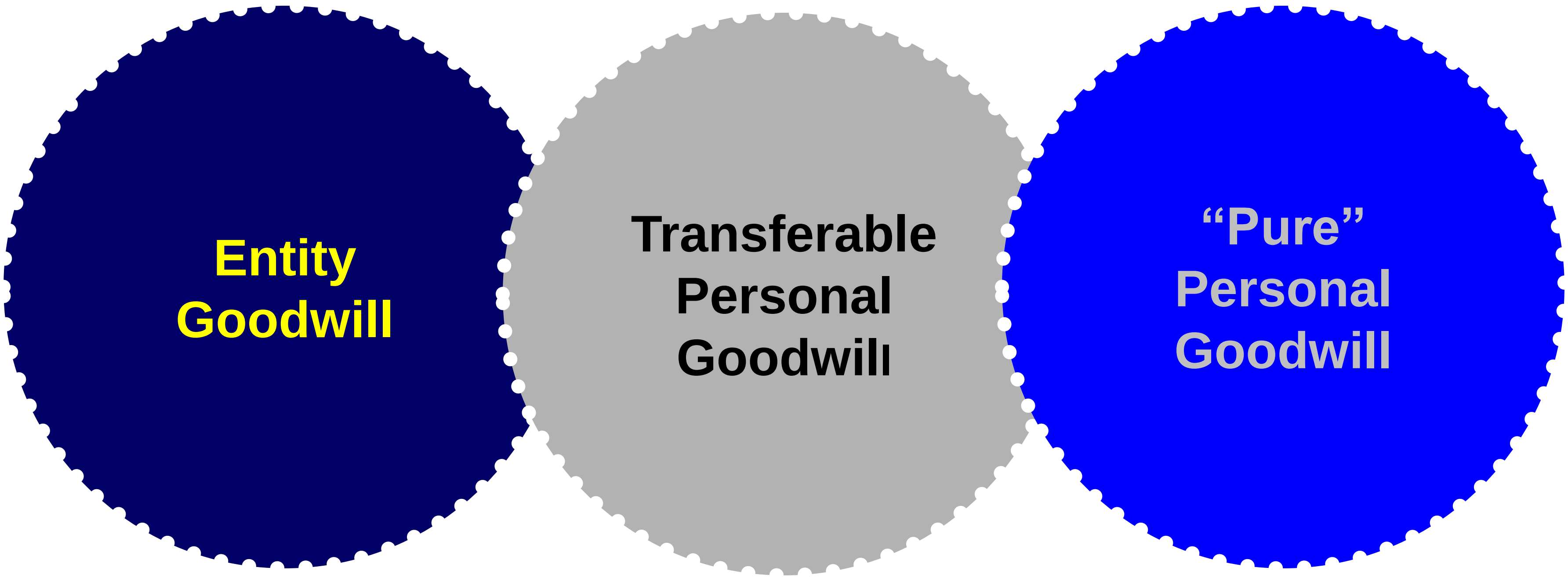
Defining Goodwill

- That intangible asset arising as a result of name, reputation, customer loyalty, location, products, and similar factors not separately identified.

  - International Glossary of Business Valuation Terms, June 2001

Three Parts Of Goodwill



Recommended Resources

- **Valuing Professional Practices and Licenses, Ron Brown, Editor Aspen Publishing**
- **Selling Your Law Practice, Edward Poll, LawBiz Publishing, 2005.**
- **ALM 2014 Survey of Law Firm Economics**
- **Exit Planning Considerations for Attorneys**
- **Law Firm Valuation Checklist, BV Update, July 2011**
- **Succession Planning for Attorneys and Law Firms**
- **Partner's Capital: How much is enough?**
- **What is my Practice Worth to my Spouse, My Partners or to Another Attorney?**

Jim Collins Got it Right

- **Get the right people on the bus over time**
- **Get the wrong people off the bus over time**
- **Get those that remain into the right seats**

Greatness is not a function of circumstance. Greatness is largely a matter of conscious choice and discipline – Jim Collins

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