

LAW PRACTICE SUCCESSION AND EXIT PLANNING

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Scope of Presentation

Succession & Exit Planning for:

- ▶ Solo Practices
- ▶ Small Firms
- ▶ *Large Firms
 - Adds unique issues and challenges (*e.g.*, Taking Care of “Founders,” Retirement Mandates or Options, Evaluating Qualified Retirement Plans, etc.)

The Primary Goal – To Plan for “Triggering Events”

- ▶ Death
- ▶ Disability
 - 19% of US population has a disability (US Census 2012)
- ▶ Involuntary Leave of Absence (*e.g.*, Addiction or Mental Issues)
- ▶ Voluntary Leave of Absence (*e.g.*, Mid-life Crisis)
- ▶ Technological Disruptions (*e.g.*, AI)
 - Legal analytics, document automation, electronic discovery, dispute resolution, litigation trends, risk management, etc.
- ▶ Retirement
- ▶ Bar Delinquency or Discipline

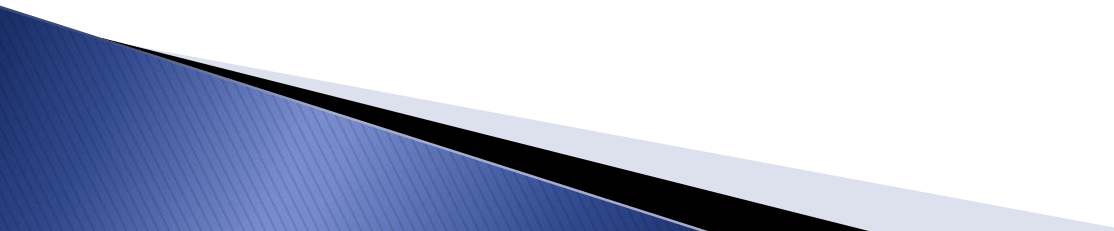
Only Two Choices

- ❖ YOU deal with succession/exit issues now while in “Business Mode,” or
- ❖ YOU or **SOMEONE ELSE** deals with succession/exit issues when in “Crisis Mode,” and risk harm to Your Clients, Yourself, Your Heirs and others.

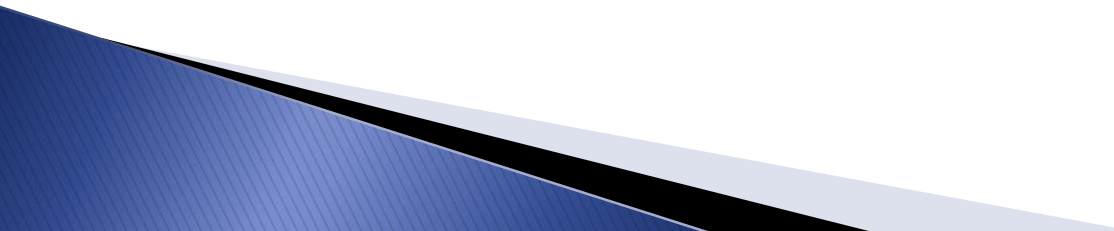
Reasons Given For Not Doing a Business Succession Plan

1. It's not urgent.
2. The focus on tax avoidance and “Drop Dead Plans” creates a false sense of security.
3. Family member and/or employee push back.
4. It's always safer not to change – easier, less costly and emotionally safer to NOT change.
5. Not knowing how to start – no history of succession planning.
6. Unwillingness of next generation family business leaders to raise issues with current leaders – love, reverence, respect.
7. Not knowing how, but wanting “fairness” between employee and non-employee children.
8. It costs too much.

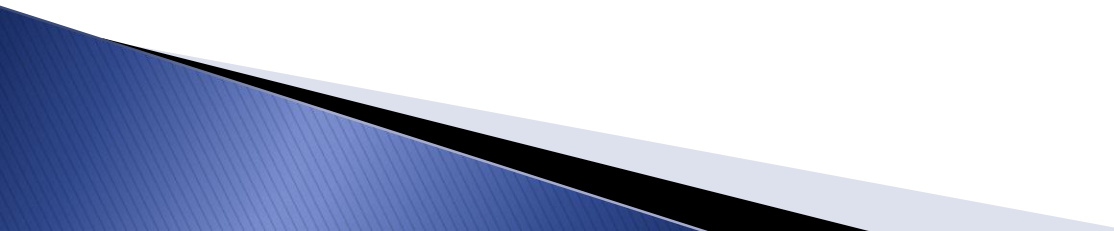
Family Business Consulting, Family Business Institute, *Succession Planning*,
www.familybusinessinstitute.com.



Additional Reasons:

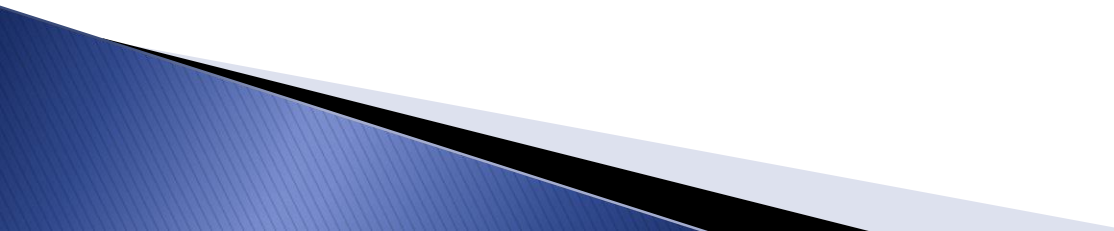
- ▶ Aging & Mortality
 - ▶ Loss of Professional Identity
 - ▶ Future Uncertainty
- 

Presentation – Three Sections

- ▶ First – Importance of Succession Plan and the Consequences of Not Having a Plan
 - ▶ Second – Immediate Short-Term Actions to Protect Your Clients, You, Your Heirs & Others
 - ▶ Third – Long-Term Succession/Exit Planning to Capitalize on Value and Preserve Wealth
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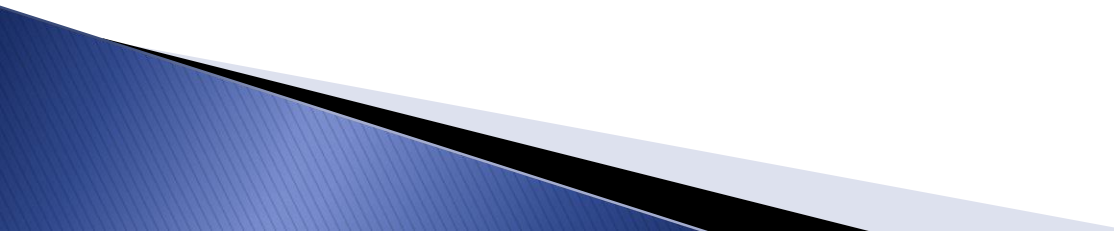
Takeaways from Presentation:

Immediate Short-Term Protection Planning

- What are the goals and objectives?
 - How long does it take?
 - How to fund short-term protections?
 - Who benefits from the plan?
 - Who is harmed if there is no plan?
- 

Takeaways from Presentation:

Long-Term Succession/Exit Planning

- How to value your law practice?
 - How to capture “wealth” from your practice?
 - How to transition:
 - Management?
 - Ownership?
 - Clients?
 - Referral relationships?
 - How to fund retirement?
- 

Succession Plans are Critical!

- ▶ Business is Business!
- ▶ Last several years -- a lot of focus on succession/exit planning.

Why so much focus?



Demographics In General

- ✓ 52% of all US businesses are owned by individuals aged 50 to 88. (U.S. Small Business Administration, 2015).
- ✓ Retiring business owners will sell or bequeath \$10 trillion worth of assets over the next 20 years. (California Association of Business Brokers, 2016).
- ✓ 78% of small business owners plan to sell their businesses to fund their retirement (FPA/CNBC Business Owner Succession Planning Survey, 2015).
- ✓ 60 – 100% of the retirement funding is coming from the sale of the business.
- ✓ Despite these statistics, less than 30% of those surveyed had a succession plan.

The Coming Wave of Business Succession: The Role of Private Equity and Stakeholder Theory, Lindsey, K., Mauck, N. and Olsen, B.,

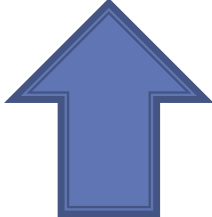
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2925608 (February 28, 2017)

Law Practice Demographics – American Bar Association

- ▶ 89% of Law Firms have 10 Attorney's or Less
- ▶ Median Age of Lawyers:
 - 49 Years Old (2005)

National Lawyer Population Survey, American Bar Association (2014)

Law Practice Demographics – American Bar Association Aging Lawyers

	<u>1980</u>	<u>2005</u>	<u>2019</u>
Age: 45 to 54	16%	28%	
55 to 64	12%	21%	

National Lawyer Population Survey, American Bar Association (2014)

Law Practice Demographics – Business Reference Guide 2018 28th Edition

▶ Statistics (Law Firms)

◦ Number of Establishments	468,957
◦ Avg Profit Margin	21.2%
◦ Revenue per Lawyers	\$222,000
◦ Avg Number of Lawyers	3
◦ Avg Wages per Lawyers	\$80,142

▶ Products & Services Segmentation

◦ Commercial law	44.2%
◦ Other Services	25.5%
◦ Civil Negligence, Personal Injury & Criminal Law	16.8%
◦ Real Estate Law	8.1%
◦ Labor & Employment	5.4%

Law Practice Demographics – Business Reference Guide 2018 28th Edition

- ▶ Expenses as % of Annual Revenue
 - Profit 21.2%
 - Wages 36.2%
 - Purchases 1.5%
 - Depreciation 0.8%
 - Marketing 2.3%
 - Rent & Utilities 6.3%
 - Other 31.7%

Jurisdictional Trends -- Mandatory Succession Planning

WHY?

WV Rules of Professional Conduct

1.3 Diligence

A lawyer shall act with reasonable diligence and promptness in representing a client.

COMMENT

* * *

[5] To prevent neglect of client matters in the event of a **sole practitioner's death or disability**, the duty of diligence may require that each **sole practitioner** prepare a plan, in conformity with applicable rules, that designates another competent lawyer to review client files, notify each client of the lawyer's death or disability, and determine whether there is a need for immediate protective action.

(Emphasis added).



West Virginia State Bar Proposed Rule

Rule 14 Succession planning

14.01 Successor designations

The duty of diligence may require that an active member of the West Virginia State Bar who is operating as a **sole practitioner** prepare a written succession plan specifying what steps must be taken in the event that the member is unable to continue his or her law practice due to death or disability. See West Virginia Rules of Professional Conduct, Rule 1.3, Comment 5. As part of any succession plan, a lawyer should arrange for one or more successor lawyers to protect the interests of the lawyer's clients in the event of **death or any disability** that precludes practicing law. Such designation may set out a fee-sharing arrangement with the successor lawyer or lawyers. Nothing in this rule or the lawyer's designation shall prevent a client from seeking and retaining a different lawyer or law firm. Any lawyer to be designated as a successor must consent to the designation.

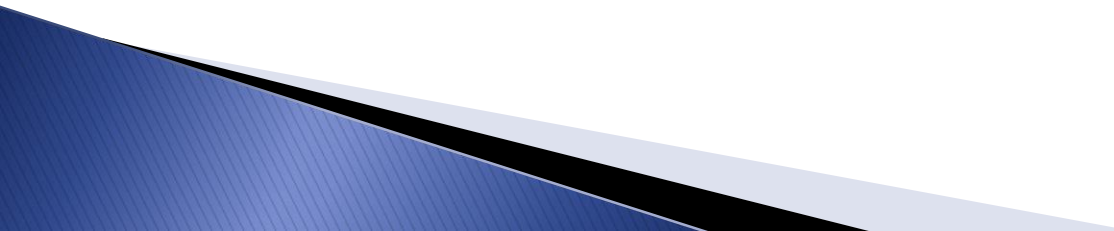
14.02 Registry of successor designations

The West Virginia State Bar shall maintain a registry of successor designations and identify the existence of a member's succession plan as part of the Bar membership information. Active members who are operating as **sole practitioners** shall disclose to the State Bar whether they have a designated successor and a succession plan. Such disclosure shall be made annually on or before July 1 and submitted in the form required by the State Bar.

14.03 Responsibility for costs if court-appointed trustee is required

If a trustee is appointed for a deceased or disabled lawyer under Rule 3.29 of the Rules of Lawyer Disciplinary Procedure, and no successor designation is on record for that lawyer as part of the State Bar membership registry, then the lawyer, or the lawyer's estate, shall be adjudged responsible for payment of the reasonable and necessary fees and costs of the trustee that are assessed by the appointing court pursuant to Rule 3.29. To the extent that the trustee's fees, costs, and expenses are paid by the Office of Disciplinary Counsel or other third party, the lawyer or the estate shall be liable to make reimbursement for such payment or payments.

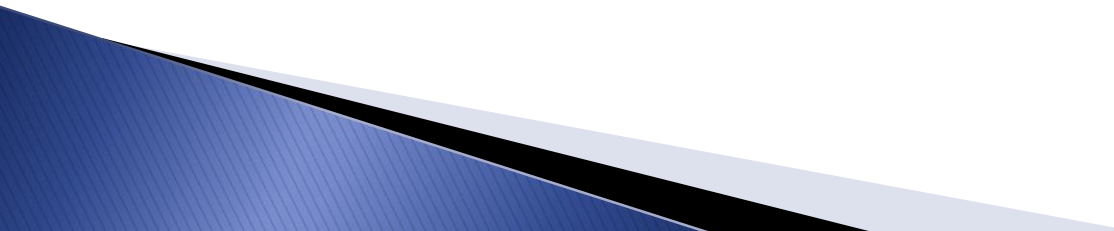
Don't Have A Successor?

- ▶ Rule 3.29 – Rules of Lawyer Disciplinary Procedure
 - WV Supreme Court appoints successor.
 - You or Your Estate pays costs
 - Not Obligated to Collect Fees
 - Not Obligated to Recover Client–Related Expenses
 - ▶ Wouldn't you rather decide?
- 

The Consequences of No Plan



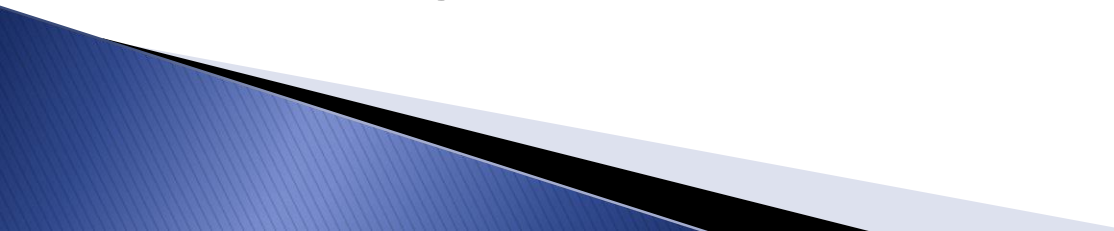
WHO MAY BE HARMED FROM NO PLAN?

- ▶ Clients
 - ▶ You
 - ▶ Heirs
 - ▶ Partner(s) and Associates
 - ▶ Employees
 - ▶ Case-Sharing Co-counsel
 - ▶ Case-Referring Co-counsel
 - ▶ The WV State Bar/ODC
 - ▶ Possibly others
- 

With No Plan . . .

- Options may be limited and Opportunities missed.
- Addressing critical financial, ethical and other issues in “Crisis Mode.”

Even Having a Plan May Not be Enough!

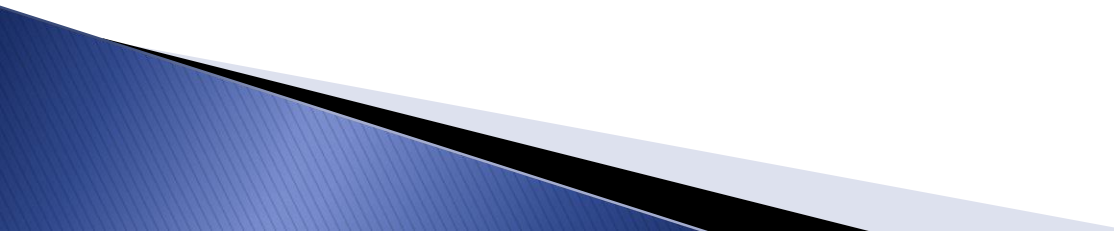
- Updating a Plan is Equally Crucial!
 - Must consider **ALL** potential “trigger events”
 - Don’t stop thinking about:
 - Contingencies
 - Business Changes
 - Partners’ Age/Health/Financial Status, etc.
 - Have your Plan reviewed by team of succession planning specialists.
- 

IMMEDIATE SHORT-TERM PROTECTION PLANNING


to

Avoiding “Crisis Mode” from a Triggering Event


Some Questions to Ask

- ▶ Who will deal with and protect my clients?
 - ▶ How will the law practice continue operating?
 - ▶ What will be the costs of transition?
 - ▶ Will operating costs delay administration of my estate or affect my heirs financially?
 - ▶ Is there potential liability that could affect me or my heirs?
 - ▶ Who will collect fees owned and/or outstanding client expenses?
 - ▶ What will happen to my staff?
 - ▶ Who will have access to my electronic and non-electronic client and financial files?
- 

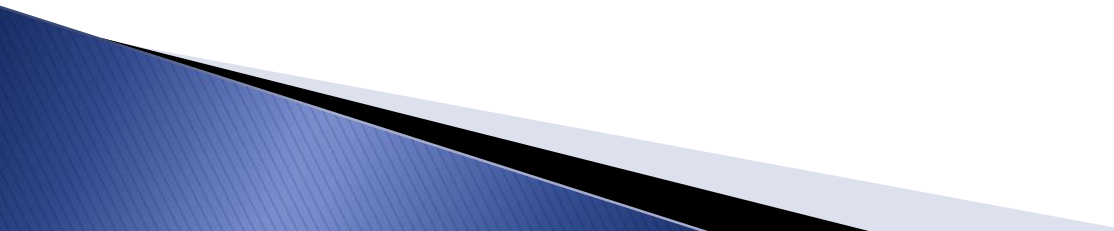
Avoiding Crisis Mode!

- ▶ **Appoint A Successor Attorney** (a/k/a Triage Attorney, Inventory Attorney, Trustee Lawyer, Assisting Attorney, etc.)
 - ▶ **Define Duties of a Triage Attorney**
 - ▶ **Considerations after Appointment**
 - ▶ **Information to Provide to a Triage Attorney**
- 

Appointing A Triage Attorney

- ▶ Someone inside or outside the firm?
 - ▶ Competence in area of your practice?
 - ▶ Conflicts of interest with your clients?
 - ▶ How will they be compensated?
 - ▶ Ability to take on a long-term commitment?
 - ▶ Ability to deal with stress?
 - ▶ Work ethic and values of successor?
- 

Do you need an Alternate?

- ▶ Consider size and type of practice.
 - ▶ Consider age of successor attorney.
 - ▶ Consider experience of successor attorney.
- 

Duties of a Triage Attorney

- ▶ Review files ASAP.
- ▶ Triage files for needed actions.
- ▶ Advise clients, if necessary, to retain new counsel.
- ▶ Provide clients with files where needed.
- ▶ Return client property.
- ▶ Audit the Client Trust Account.
- ▶ Collect outstanding fees and client-related expenses.
- ▶ File final accounting, tax or other reports.
- ▶ Close Bank Accounts.
- ▶ Determine which files must be maintained, for how long and where will they be kept.
- ▶ Other actions specific to your practice.

Factors to Consider When Asked to be a “Successor”

- ▶ Affect on your workload and family?
- ▶ Types of cases and your experience?
- ▶ The number of cases?
- ▶ Any conflicts of interest?
- ▶ Allocation of resources
 - Will you need to use your staff?
 - Will you be reimbursed for expenses?
- ▶ Location of Law Practice?

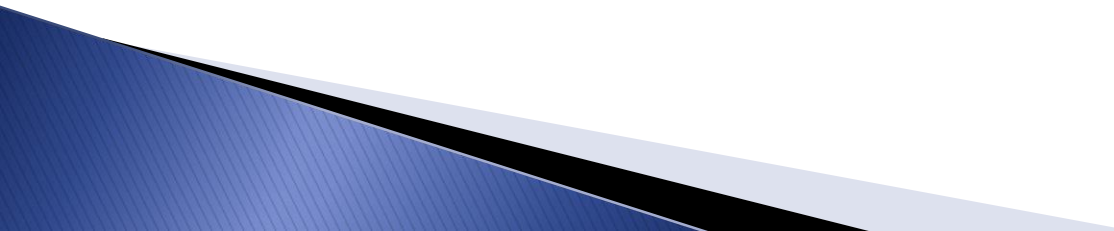
After Appointment, consider

- ▶ Inserting in Fee Agreements to Advise Clients.
- ▶ Notifying Office Staff.
- ▶ Notifying Malpractice Carrier.
- ▶ Advising Heirs.
- ▶ Including Successor Attorney in Your:
 - Will/Trust
 - POA
 - Forms available from WV State Bar, Virginia State Bar, Oregon State Bar and others. *See Sources and References.*

Information to Provide To (or Make Available) to Triage Attorney

- ▶ Client List and Contact Information.
 - ▶ List of Client money or property being held.
 - ▶ Types of Cases and Fee Agreements.
 - ▶ List of outstanding fees and client-related expenses.
 - ▶ Location and access to calendar and case-related software.
 - ▶ Passwords for Online Accounts, Electronic Devices, Email Accounts, Websites, etc.
 - ▶ Location of Bank Accounts and Numbers.
 - ▶ Malpractice Insurance Company and Name of Agent
 - Copy of Declaration Sheet.
 - ▶ Office Lease Information.
 - ▶ Name of Information Technology Person or Firm.
 - ▶ Location of and Access to All Non-Electronic Files.
 - ▶ Other Important Information.
-
- ▶ Update periodically

Anticipate the Time & Expenses That Will Be Incurred From a “Triggering Event”

- ▶ Client Property and the IOLTA Account
 - ▶ Files and Documents
 - ▶ General Expenses
 - ▶ Extended Reporting Endorsement
 - ▶ Do you need a “Triggering Event” Fund?
- 

Time & Expenses:

Client Property & IOLTA Account

(See Sources and References)

- Notifying clients of file destruction (if not in Representation or Retainer Agreement)
- Destroying other client property (confidential or proprietary information, radiographic studies, pathology material, etc.)
- Returning client property or original documents (Wills, Trusts, Deeds, Certificates, Contracts, Photographs, etc.)
- Are you holding funds for clients/uncashed checks in IOLTA Account?
 - *See WV State Bar Rule 10.09, Disposition of IOLTA Funds Whose Owners Cannot Be Located or Identified.*

Time & Expenses: Files and Documents

(See Sources and References)

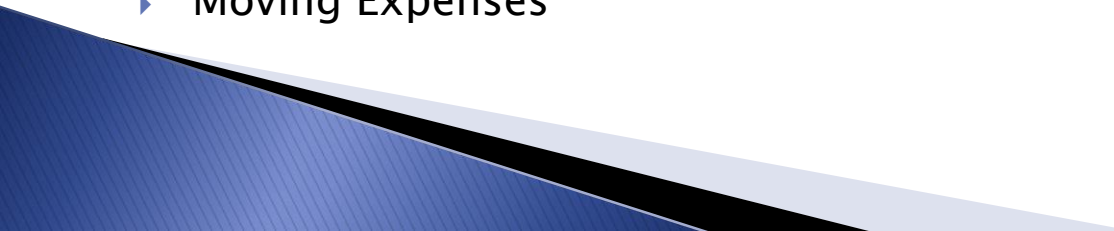
- File Retention
 - Files Involving Minors
 - Estate Planning Files
 - Files Involving Tax Matters
 - Propriety Business Information
 - Mass Torts

 - Storage of Accounting Records
 - Client Trust Account

 - Digitization of Documents and Data

 - Destruction Costs
 - Shredding, burning, etc.
- 

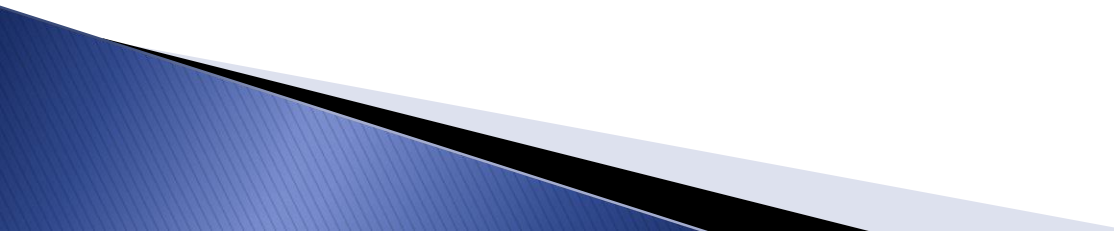
General Expenses--Operating Costs Until Transition Complete

- ▶ Costs for Key Employees
 - ▶ Software Platform Costs
 - ▶ Equipment Leases
 - ▶ Maintaining Email Accounts and Telephone Number
 - ▶ Costs to Maintain File Back-up Programs
 - ▶ Rent/Mortgage
 - ▶ Expense for deleting digital confidential information
 - ▶ Moving Expenses
- 

Expense of Extended Reporting Endorsements (ERE)-- “Tail Coverage”

- ▶ How does it work?
- ▶ Malpractice Policies are “Claims Made”
- ▶ ERE’s extend the claims reporting period
- ▶ Time period for purchasing ERE is limited!!!!
- ▶ Duration of Coverage?
- ▶ Can be Costly!

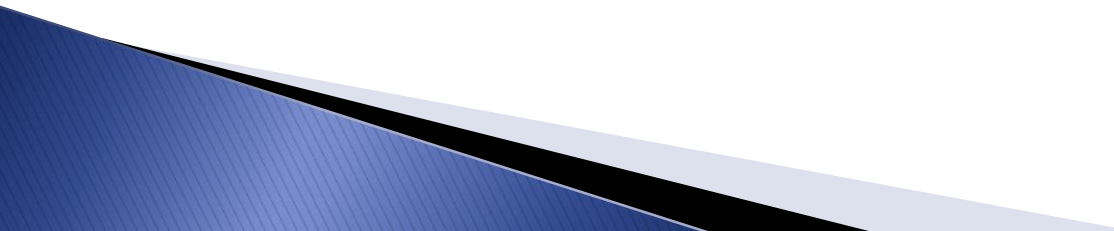
Plan for ERE!

- ▶ Who will determine whether or not you need an ERE?
 - ▶ Who will know the time limitation under your policy?
 - ▶ Where will the money come from to pay the premium?
- 

You Need a Succession/Exit Fund!

- ▶ Just discussed expenses associated with:
 - Retention and Destruction of Files and Documents
 - Clients Funds and Property
 - Operating the Office
 - Auditing the Client Trust Account
 - Extended Reporting Endorsement
- ▶ “Triage Attorney” Fees
- ▶ Insurable Contingencies (*e.g.*, Death or Disability)
- ▶ Uninsurable Contingencies (*e.g.*, Voluntary or Involuntary Absences)
- ▶ One Potential Solution!
 - Create a Fund from *e.g.* a Percentage of Gross Revenues

Short-Term Protection Planning:
In Sum, if you do these steps, you will protect your clients, yourself, your heirs, and others

- ▶ Appoint A Triage Attorney and Alternate
 - ▶ Define Duties, Compensation, Etc.
 - ▶ Provide Important Information
 - ▶ Designate Triage Attorney in Client Agreements, Will, Trust, POA, etc.
 - ▶ Establish a “Triggering Event” Fund
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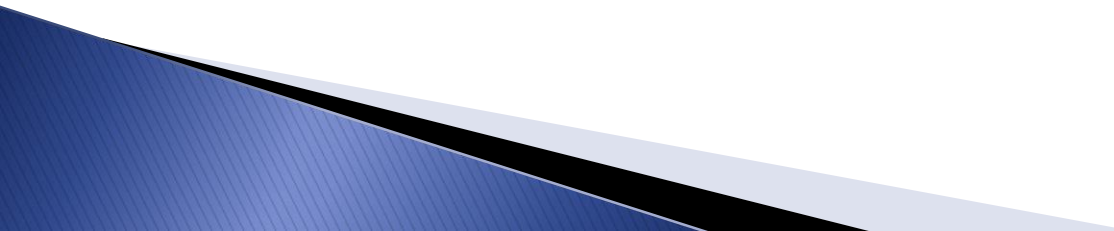
LONG-TERM SUCCESSION/EXIT PLANNING

to

Capitalize on Value and Preserve Wealth



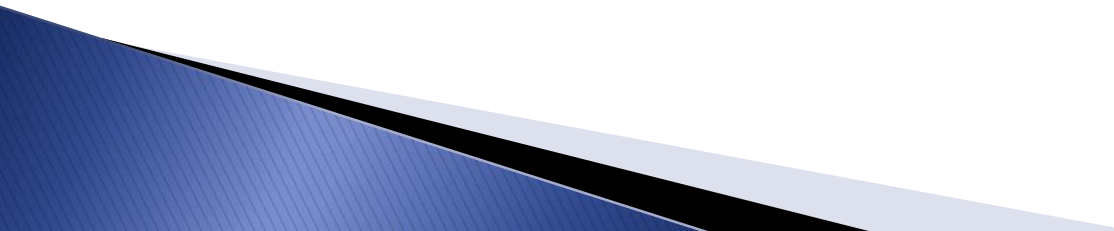
The Goals of a Long-Term Succession/Exit Plan

- ✓ The orderly transition of business that considers all potential contingencies;
 - ✓ That protects clients, family/heirs, employees, partners, co-counsel and others
AND
 - ✓ Preserves the value you created!
- 

Some Questions to Ask

- How do you value your Firm?
- What are the long-term goals and objectives?
 - How will these affect You, Your Heirs, Your Partners/Associates, the Successor, Key employees, etc.
- Who will ultimately manage the Firm?
- Who will ultimately own the Firm?
 - How will that occur?
- How to preserve the wealth of the Firm?
 - Is there a plan for management succession?
 - Is there a plan for client succession?
 - Is there a plan for referral network succession?
 - Is there a plan for selling or merger?
- What are the financing options?
- What role will taxes play?
- How do you protect all stakeholder interests?
- What issues will be involved?

Succession Planning is a Process not an Event

- ▶ The secret is to allow enough **TIME**.
 - ▶ Multiphase, Multiyear Process
 - ▶ Approximate Timeframes:
 - For Management Succession – ~3 to 10 years
 - For Financial Succession – ~2 to 4 years
 - For Closing Your Office – ~months to years
- 

**THE INTEREST IN YOUR FIRM MAY BE ONE
OF YOUR MOST VALUABLE ASSETS!!!**

Law Firm Business Model

- ▶ Good for Producing Income
 - Average Profit Margin – 21.2% (Business Reference Guide (28th ed. 2018))
- ▶ Not So Good for Passing on Wealth without Planning
 - You spent years building:
 - A Client Base
 - Referrals through Co-Counsel & Other Relationships
 - A Reputation of Honesty and Hard Work

Don't throw it away by failing to plan!

A Multitude of Issues Must Be Considered

- ▶ No Two Businesses (Firms) are the Same
- ▶ Must Address Direct and Indirect Issues

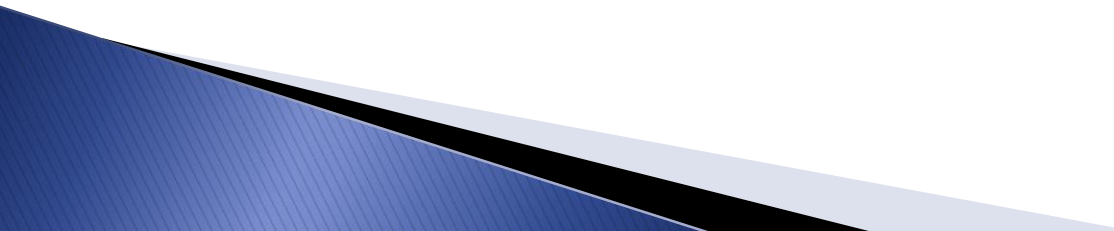
Areas of Likely Issues

- Ethical
 - Privacy and Confidentiality
 - Diligence
 - Competency
- Financial
 - Valuation of Firm
 - Costs of Succession/Exit
- Accounting and Tax
- Management and Operations
 - File Retention
 - File Destruction
- Employment
- Insurance
 - Ongoing – property & casualty, health, liability, etc.
- Business Structure – Partnership, Limited Liability Co., Corporation, etc.
- Estate Planning
- Others

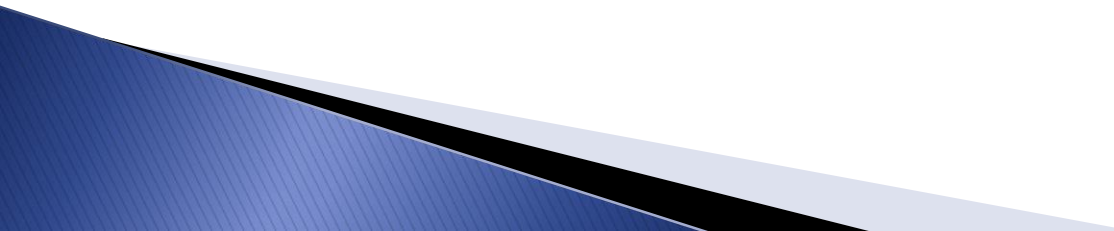
Requires a “Team Approach”

- ▶ Valuation Service Provider
 - ▶ Financial Planner
 - ▶ Estate Planning Attorney
 - ▶ Certified Public Accountant
 - ▶ Insurance Consultant
 - ▶ Perhaps Others
- 

DEVELOPING A LONG-TERM PLAN

- ▶ Firm Valuation
 - ▶ Capitalizing on Value/Wealth
 - ▶ Determine Your Financial Needs
 - ▶ Management Succession
 - ▶ Recruit a Successor
 - ▶ Financing
 - ▶ Tax Planning
 - ▶ Protecting Interests
- 

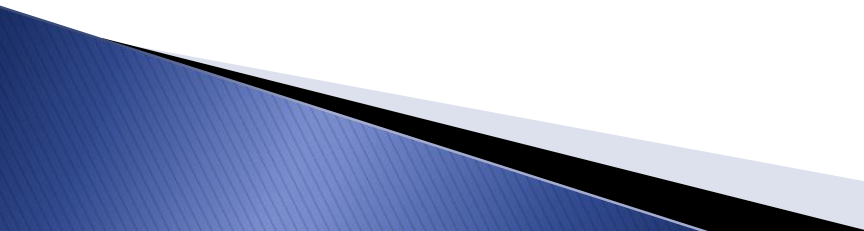
The Importance of Valuation

- ▶ Why is Valuation Important?
 - Maximize Value/Preserve Wealth
 - ▶ Who will Value your Practice?
 - Law Firm Management Consultants
 - Exit Planning Professionals
 - CPA's, Commercial Appraisal Firms, Attorneys
- 

Information Needed for Valuation


- Financials
 - Tax Returns
 - Compensation Agreements
 - Employee census (number, position & responsibility)
 - Short Term Payables & Liabilities
 - Long Term Liabilities – Loans, Leases, Pensions, etc
 - Partnership & Associate Compensation system
 - Partnership Agreements *i.e.*, Buy-Sell Agreements

 - Operations/Systems

 - Business Plan
 - Marketing Plan
 - Succession Plan
- 

Valuation Drivers & Wealth Preservation

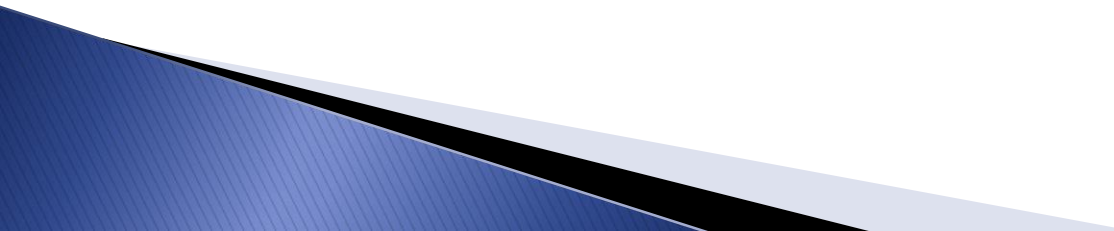
- ▶ Type of Law/Services
 - ▶ Recurring vs Transactional Revenue
 - ▶ Profitability
 - ▶ Geography & History of Practice

 - ▶ Transferability
 - Clients
 - Referral Network
 - ▶ Goodwill
 - Personal or Professional
 - Practice
- 

Calculating Valuation

- ▶ Business Valuation Approaches/Methods
 - Asset Based
 - “Rule of Thumb” a Multiple of Annual Gross Revenue
 - Multiplier (ranges between 0.5 to 3.0)
 - Prior Year(s) Revenue
 - Multiple of EBIT (Earnings before Interest & Taxes)
 - Multiple of EBITDA (Earnings before Interest, Taxes, Depreciation & Amortization)
 - Comparable Transactions
 - Discounted Cash Flow
- ▶ How often will you Value your Practice?
- ▶ The costs of Valuation (informal vs formal)
- ▶ The Bottom Line

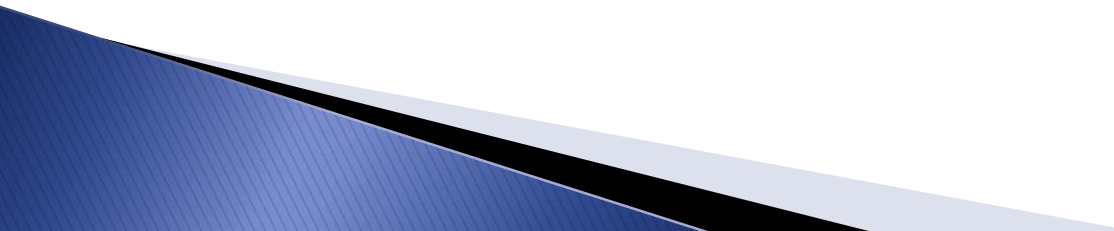
Trends

- ▶ Consolidation
 - ▶ Geographical Expansion
 - ▶ Systems and Software
 - ▶ Advice vs Transactions
 - ▶ Attorneys are Working Longer
- 

Determining Your Needs

- ▶ Seven Areas of a Client's Financial Well Being
 - Life Style (in today's dollars)
 - Insurance – Life & Health
 - Retirement Funds
 - Estate Planning
 - Liabilities
 - Assets
 - Tax Planning
- ▶ Education
- ▶ Long-Term Care

Finding a Buyer, Merging or Exiting

- ▶ Attorney's Inside the Firm
 - ▶ Attorney's Outside the Firm – Laterals, etc.
 - ▶ Merger Contenders
 - ▶ Other Sale Candidates
- 



When Handing Over Your Firm To A Successor


Financing Options



Common Financing Options

- ▶ Earn out/Seller Financing*
 - Rewards
 - ▶ Buy In & Buy Out
 - ▶ Traditional Lenders
 - Bank Financing
 - ▶ Life insurance
 - Key Person – Buy Sell Agreement
 - Disability
- 

In Sum: If you do these steps, you will preserve the value/wealth you created!

- ▶ Start Early – It's a Process not an Event!
 - ▶ Assemble a Team
 - ▶ Consider All Possible Contingencies
 - ▶ Value Your Firm
 - ▶ Determine Your Financial Needs
 - ▶ Finding a Buyer, Merging or Exiting
 - ▶ Reviewing the Plan Periodically
 - ▶ Completing the Process
- 

Conclusion

A magnifying glass with a black handle and a silver rim is positioned over the word "Conclusion". The lens of the magnifying glass is centered over the letters "clu", making them appear larger and more prominent than the rest of the word. The background is a plain, light gray surface. In the bottom left corner, there is a decorative blue and black geometric shape.

Thank You!

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