

UB LAW SCHOOL GOLD GROUP

FEBRUARY 5, 2020

BUYING OR SELLING A LAW PRACTICE

A. INTRODUCTION

1. History.

a. Until 1996, an attorney was not ethically permitted to sell a law practice in New York State. This created a hardship for attorneys in small firms and solo practices, because attorneys in larger firms were able to realize the value of their practice through retirement agreements with their partners.

b. RPC 1.17, whose predecessor DR 2-111 was promulgated in 1996, permits the sale of a law practice under certain conditions. (See Attachment A).

2. RPC 1.17 Overview.

a. A lawyer retiring from practice, or a law firm which has one or more members retiring from practice, may sell a law practice to one or more lawyers or law firms. The personal representative of a deceased, disabled or missing lawyer may also sell a practice, even if the personal representative is not an attorney.

b. "Retirement" includes the cessation of private practice in the county and city in which the practice was conducted, and any contiguous county or city.

This does not appear to preclude continuing to practice in another state, or even in a different part of New York State.

c. A lawyer may not sell a portion of a practice and continue to practice in other fields in the same geographic area. (NYSBA Committee on Professional Ethics Opinion No. 707).

d. The seller and buyer may agree on “reasonable restrictions” on the seller’s practice of law. (See discussion of non-compete provisions below).

e. The seller may provide certain information concerning clients to a prospective buyer. (See discussion of client information disclosure below).

f. Seller and buyer must give specified notice to seller’s clients. (See discussion of client notification below).

B. WHAT IS YOUR PRACTICE WORTH?

1. You should have your practice valued by a CPA or other professional who has experience in the valuation of professional practices early in the process of selling the practice.

C. WHAT FORM WILL THE SALE OR TRANSFER TAKE?

1. Outright Sale Of Your Practice With No Further Involvement.

a. This may appeal to an attorney who chooses to cease practice completely, for health or other personal reasons.

b. You may not obtain the best value for your practice without having some ongoing involvement, to assist in the transition and retention of your clients.

2. Transfer Or Sale Of Your Practice To Attorney(s) With Whom You Have An Existing Relationship.

a. This would include a transfer or sale to partners or associates.

b. You may realize the best value for your practice through this type of transfer.

c. Client transition and retention should be more successful—clients won't be dealing with a stranger and will have a greater comfort level.

d. An alternative to an outright sale of your practice is an agreement to continue working for a specified period with specified compensation, followed by retirement at an agreed time.

e. It is best to start “succession planning” five to ten years before you plan to retire. This includes selecting a successor and introducing your clients to that person over time to provide for a smooth transition.

f. This arrangement lends itself to a phased in retirement

3. Merging Your Practice With Another Firm.

a. This type of arrangement will involve some ongoing involvement to assist in the transition of clients, with a full retirement at some agreed time.

b. Acquaint yourself with the personalities and culture of your merger partner before agreeing to the merger.

c. If merging with a bigger firm, determine whether any timekeeping and billing requirements will apply to you. Also, what support staff will be provided?

d. Will your status be partner, associate, or of counsel?

e. Of counsel status is common in a practice merger.

- An of counsel relationship may exist where there is a continuing relationship with a lawyer or law firm, other than as a partner or associate. (RPC 7.5).
- American Bar Association Formal Opinion 90-357 includes a detailed discussion about of counsel relationships.
- Conflicts of interest will be imputed where an of counsel relationship exists between an attorney and a firm. (NYSBA Committee on Professional Ethics Opinion No. 793).
- Separate professional liability insurance may be required for an of counsel attorney.
- Other terms are sometimes used in an of counsel relationship, such as counsel, senior counsel or special counsel.

D. PRE-SALE DISCLOSURES

1. Financial Disclosure.

a. The potential buyer will require some type of financial records. For a small practice, income tax returns and bank records may be sufficient.

Accounts receivable information may also be requested. I recommend a non-disclosure agreement before providing any information, especially client information. (See sample agreement attached as Exhibit B).

b. You should also require financial information from the potential buyer, to determine whether the buyer will be able to honor any future obligations to you. This may include a projected income statement for future years.

c. In marketing your practice, it may be helpful to have records of your billings for your larger clients for a period of several years, showing the total billings for each client. You may also consider listing total billings by the type of work for a period of several years.

d. It may also be helpful to provide the potential buyer with information about work in process, if it has not been billed on a regular basis and significant future fees may be realized (e.g. estate or contingent fee matters).

2. Conflict of Interest Review.

a. A conflict of interest review should be performed. This is required by RPC 1.17 before any client information is released to a prospective buyer.

3. Client Information Disclosure.

a. RPC 1.6 generally requires attorneys to preserve the confidences and secrets of a client.

b. RPC 1.17 creates an exception to RPC 1.6, and permits an attorney to provide certain information to a potential buyer of a practice under specified conditions. A conflict check must be conducted before releasing any of this information, and the prospective buyer must maintain confidentiality. I recommend that a non-disclosure agreement be signed before any information is provided. The client must consent if any disclosure would violate the attorney-client privilege. The following information may be provided:

- Identity of clients (except that if the client's identity is itself a confidence, the client's consent must be obtained).
- General nature and status of a matter.
- Information available in public court files.
- Financial arrangements with clients and the status of the client's account.

E. OVERVIEW OF TAX CONSIDERATIONS

Note: This is a very general overview of the tax considerations for the seller of a law practice and is not intended to provide tax advice to any party. Each transaction is unique and should be carefully reviewed by a CPA or other tax professional for its specific tax consequences.

1. Sale of Equity.

a. Stock in a professional corporation, or an interest in a partnership, LLP or PLLC, are considered capital assets.

b. The sale of any of these interests creates a capital gain for the seller. The taxable gain is generally the difference between the seller's tax basis and the sale price.

c. Any money paid to a seller for continuing services is ordinary income to the seller and deductible to the buyer.

d. Any money paid to a seller under a non-compete clause is ordinary income in the year it is received. (Such payments are a capital expense for the buyer, amortized over fifteen years).

2. Asset Sale—Price Allocation.

a. In the sale of a practice which is a sole proprietorship, or in the sale of the assets of a professional corporation, partnership, LLP or PLLC, the parties agree to allocate the purchase price to certain categories of assets. These are typically:

- Goodwill (includes client records).
- Equipment and furniture.
- Accounts receivable.
- Non-compete clause.
- Payment for future services provided by Seller.

- b. Payments made for goodwill create a capital gain for the seller.
- c. Payments made for equipment and furniture, accounts receivable, a non-compete clause, or continuing services are ordinary income for the seller. Equipment and furniture may be subject to depreciation recapture, and will also be subject to sales tax.

F. SPECIFIC CONTRACT PROVISIONS

1. Client Notification.

- a. RPC 1.17(c) requires that the seller and buyer provide joint written notice to clients when a practice is sold.
- b. The notice must include the following:
 - Client's right to retain other counsel or to possess the file.
 - Client's consent to the transfer will be presumed if client doesn't object within 90 days, subject to court rule or statute requiring express approval.
 - Any fee agreement with client will be honored by buyer.
 - Proposed fee increases, if the retainer agreement permits this or if the client agrees.
 - Buyer's identity and background information, and whether buyer intends to re-sell the practice.

2. Non-Compete Provision.

a. Unlike every other licensed professional in New York State, attorneys are prohibited from entering into a partnership or employment agreement that restricts an attorney's ability to practice after termination of the agreement, except as a condition of paying retirement benefits, or in connection with the sale of a law practice. RPC 5.6.

b. RPC 1.17(a) provides that the seller and buyer of a practice may agree on "reasonable restrictions on the seller's private practice of law."

c. No definition of "reasonable restrictions" is provided. However, some guidance can be found in the provision in RPC 1.17(a) that "retirement" includes cessation of practice in the county and city in which the practice was conducted and any contiguous county or city.

d. American Bar Association Formal Opinion 06-444 deals with an attorney agreeing to restrictions on practice as a condition of receiving retirement benefits. This Opinion provides:

"Rule 5.6(a) and the associated comments express a strong disapproval of restrictive covenants in lawyer agreements. The exception for restrictions concerning the receipt of retirement benefits must therefore be construed strictly and narrowly."

3. Providing Continuing Services.

a. In most situations, it will be beneficial to provide continuing services to the buyer for a specified time to assist in the transition and retention of clients.

b. For example, the agreement may state that you will provide a certain level of services for a specified time period leading up to your retirement and/or the sale of your practice. (Remember, under RPC 1.17 you must “retire” before you can sell your practice).

c. If you enter into this type of agreement, specify the level of services that will be required (how many hours per week, year or month, and for what period of time), and what compensation and other benefits you will receive.

d. Even though a lawyer must retire to be permitted to sell a practice, the seller may assist the buyer “in the orderly transition of active client matters for a reasonable period of time after the closing of the sale.” However, the client cannot be charged by either attorney for these transition services. American Bar Association Formal Opinion 468 (2014).

4. Purchase Price Arrangements.

a. In the sale of a law practice the buyer typically pays a down payment, and the balance is paid under a promissory note held by the seller.

b. Part of the payment can be based on a percentage of future fee income from the seller’s clients.

c. A 2019 NYSBA Ethics Opinion provides that a retiring lawyer who transfers his wills to another lawyer can receive a referral fee for new

representations of the testators or estates, if he assumes joint responsibility for the representation. NYSBA Committee on Professional Ethics Opinion 1172.

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ATTACHMENT A

RULE OF PROFESSIONAL CONDUCT 1.17

Sale of Law Practice

ATTACHMENT B

Non-Disclosure Agreement

NON-DISCLOSURE AGREEMENT

This Non-Disclosure Agreement (the "Agreement") is entered into as of _____, 2020, by and between _____(the "Disclosing Party") and _____(the "Interested Party").

1. In connection with the Interested Party's desire to explore the possibility of purchasing the assets of the Disclosing Party's law practice conducted in Buffalo, New York (the "Transaction"), the Disclosing Party agrees to furnish certain Information to the Interested Party. The term "Information" shall mean all information that the Disclosing Party has furnished and is furnishing to the Interested Party, whether furnished before or after the date of this Agreement, whether tangible or intangible, and in whatever form or medium provided, as well as all information generated by the Interested Party or by its Representatives, as defined below, that contains, reflects, or is derived from the furnished information. This includes, without limitation, any Information concerning former or current clients of the Disclosing Party (including the identity of such clients), and any matter involving the clients of the Disclosing Party in which the Disclosing Party is providing or has provided legal representation ("Client Information").

2. In consideration of the Disclosing Party's disclosure to it of the Information, the Interested Party agrees that it will keep the Information confidential and that the Information will not, without the prior written consent of the Disclosing Party, be disclosed by the Interested Party or by its officers, directors, partners, employees, affiliates, agents, or representatives (collectively, "Representatives") in any manner whatsoever, in whole or in part, and shall not be used by the Interested Party or by its Representatives other than in connection with the Transaction. The Interested Party shall be fully liable for any breach of this Agreement by its Representatives and agrees, at its sole expense, to take all reasonable measures (including, but not limited to, court proceedings) to restrain its Representatives from prohibited or unauthorized disclosure or use of the Information. Notwithstanding this Agreement or anything to the contrary set forth herein, however, the Interested Party understands and agrees that the Disclosing Party shall have no obligation to disclose any Information to it.

3. The Interested Party specifically acknowledges its obligation, including its professional obligation under the New York Code of Professional Responsibility, to maintain the confidentiality of any Client Information provided by the Disclosing Party. This includes, without limitation, the obligation under The New York Rules of Professional Conduct to maintain the confidentiality of any provided Client Information in the same manner and to the same extent as if the Interested Party represented the client.

4. Without the prior written consent of the Disclosing Party, neither the Interested Party nor its Representatives shall disclose to any person the fact that the Interested Party

has received any of the Information or that discussions or negotiations are taking place concerning the Transaction, including the status thereof.

5. The Interested Party agrees that at the conclusion of its review of the Information or within three business days of the Disclosing Party's request, whichever occurs sooner, all copies of the Information in any form whatsoever will be delivered by the Interested Party and its Representatives to the Disclosing Party. The Interested Party's obligations under this Agreement shall continue in full force and effect notwithstanding the return of any Information.

6. In the event that the Interested Party or anyone to whom it supplies the Information receives a request to disclose all or any part of the Information under the terms of a subpoena or order issued by a court or by a governmental body, the Interested Party agrees:

- To notify the Disclosing Party immediately of the existence, terms, and circumstances surrounding such request;
- To consult with the Disclosing Party on the advisability of taking legally available steps to resist or narrow such request; and
- If disclosure of such Information is required to prevent the Interested Party from being held in contempt or subject to other penalty, to furnish only such portion of the Information as, in the written opinion of counsel satisfactory to the Disclosing Party, it is legally compelled to disclose and to exercise its best efforts to obtain an order or other reliable assurance that confidential treatment will be accorded to the disclosed Information.

7. Neither the Disclosing Party nor any of its Representatives has made or makes any representation or warranty as to the accuracy or completeness of the Information. The Interested Party agrees that neither the Disclosing Party nor its Representatives shall have any liability to it or any of its Representatives resulting from the provision or use of the Information.

8. The Interested Party acknowledges and agrees that, in the event of any breach of this agreement, the Disclosing Party would be irreparably and immediately harmed and could not be made whole by monetary damages. Accordingly, it is agreed that, in addition to any other remedy to which it may be entitled in law or equity, the Disclosing Party shall be entitled to an injunction or injunctions (without the posting of any bond and without proof of actual damages) to prevent breaches or threatened breaches of this Agreement and/or to compel specific performance of this Agreement. The Interested Party also agrees to reimburse the Disclosing Party for all costs and expenses, including attorneys' fees, incurred by the Disclosing Party in attempting to enforce the obligations of the Interested Party or of its Representatives hereunder.

9. No failure or delay by the Disclosing Party in exercising any right, power, or privilege hereunder shall operate as a waiver thereof, nor shall any single or partial exercise of any such right, power, or privilege preclude any other or further exercise thereof.

10. The Interested Party agrees that, unless and until a definitive agreement between the Disclosing Party and the Interested Party with respect to the Transaction has been executed

and delivered, neither the Disclosing Party nor the Interested Party will be under any legal obligation of any kind whatsoever with respect to the Transaction by virtue of this or any other written or oral expression by it or by any of its Representatives except, in the case of this Agreement, for the matters specifically agreed to herein. This Agreement may be modified or waived only by a separate writing by the Disclosing Party and by the Interested Party expressly so modifying or waiving such agreement.

11. If a court of competent jurisdiction determines that one or more provisions of this Agreement is in any respect unenforceable, invalid or illegal in any jurisdiction, such unenforceability, invalidity or illegality (1) shall not affect any other provision of this Agreement, which shall be construed as if such unenforceable, invalid or illegal provision had never been a part hereof, and (2) shall not render such provision or provisions unenforceable, invalid, or illegal in any other jurisdiction. In any event, the parties intend each and every provision of this Agreement to be enforceable, valid and legal and each of them waives to the fullest extent permitted by law the right to object to any such provision.

11. THIS AGREEMENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF NEW YORK. ANY ACTION OR PROCEEDING ARISING OUT OF OR RELATED IN ANY WAY TO THIS AGREEMENT SHALL BE BROUGHT SOLELY IN A COURT OF COMPETENT JURISDICTION IN ERIE COUNTY, NEW YORK.

ATTACHMENT A

Rule 1.17

Sale of Law Practice

lawyer shall take steps, to the extent reasonably practicable, to avoid foreseeable prejudice to the rights of the client, including giving reasonable notice to the client, allowing time for employment of other counsel, delivering to the client all papers and property to which the client is entitled, promptly refunding any part of a fee paid in advance that has not been earned and complying with applicable laws and rules.

RULE 1.17:

SALE OF LAW PRACTICE

- (a) A lawyer retiring from a private practice of law; a law firm, one or more members of which are retiring from the private practice of law with the firm; or the personal representative of a deceased, disabled or missing lawyer, may sell a law practice, including goodwill, to one or more lawyers or law firms, who may purchase the practice. The seller and the buyer may agree on reasonable restrictions on the seller's private practice of law, notwithstanding any other provision of these Rules. Retirement shall include the cessation of the private practice of law in the geographic area, that is, the county and city and any county or city contiguous thereto, in which the practice to be sold has been conducted.
- (b) Confidential information.
- (1) With respect to each matter subject to the contemplated sale, the seller may provide prospective buyers with any information not protected as confidential information under Rule 1.6.
 - (2) Notwithstanding Rule 1.6, the seller may provide the prospective buyer with information as to individual clients:
 - (i) concerning the identity of the client, except as provided in paragraph (b)(6);
 - (ii) concerning the status and general nature of the matter;
 - (iii) available in public court files; and
 - (iv) concerning the financial terms of the

client-lawyer relationship and the payment status of the client's account.

- (3) Prior to making any disclosure of confidential information that may be permitted under paragraph (b)(2), the seller shall provide the prospective buyer with information regarding the matters involved in the proposed sale sufficient to enable the prospective buyer to determine whether any conflicts of interest exist. Where sufficient information cannot be disclosed without revealing client confidential information, the seller may make the disclosures necessary for the prospective buyer to determine whether any conflict of interest exists, subject to paragraph (b)(6). If the prospective buyer determines that conflicts of interest exist prior to reviewing the information, or determines during the course of review that a conflict of interest exists, the prospective buyer shall not review or continue to review the information unless the seller shall have obtained the consent of the client in accordance with Rule 1.6(a)(1).
 - (4) Prospective buyers shall maintain the confidentiality of and shall not use any client information received in connection with the proposed sale in the same manner and to the same extent as if the prospective buyers represented the client.
 - (5) Absent the consent of the client after full disclosure, a seller shall not provide a prospective buyer with information if doing so would cause a violation of the attorney-client privilege.
 - (6) If the seller has reason to believe that the identity of the client or the fact of the representation itself constitutes confidential information in the circumstances, the seller may not provide such information to a prospective buyer without first advising the client of the identity of the prospective buyer and obtaining the client's consent to the proposed disclosure.
- (c) Written notice of the sale shall be given jointly by

the seller and the buyer to each of the seller's clients and shall include information regarding:

- (1) the client's right to retain other counsel or to take possession of the file;
 - (2) the fact that the client's consent to the transfer of the client's file or matter to the buyer will be presumed if the client does not take any action or otherwise object within 90 days of the sending of the notice, subject to any court rule or statute requiring express approval by the client or a court;
 - (3) the fact that agreements between the seller and the seller's clients as to fees will be honored by the buyer;
 - (4) proposed fee increases, if any, permitted under paragraph (e); and
 - (5) the identity and background of the buyer or buyers, including principal office address, bar admissions, number of years in practice in New York State, whether the buyer has ever been disciplined for professional misconduct or convicted of a crime, and whether the buyer currently intends to resell the practice.
- (d) When the buyer's representation of a client of the seller would give rise to a waivable conflict of interest, the buyer shall not undertake such representation unless the necessary waiver or waivers have been obtained in writing.
- (e) The fee charged a client by the buyer shall not be increased by reason of the sale, unless permitted by a retainer agreement with the client or otherwise specifically agreed to by the client.

RULE 1.18:

DUTIES TO PROSPECTIVE CLIENTS

- (a) A person who discusses with a lawyer the possibility of forming a client-lawyer relationship with respect to a matter is a "prospective client."
- (b) Even when no client-lawyer relationship ensues, a lawyer who has had discussions with a prospective

client shall not use or reveal information learned in the consultation, except as Rule 1.9 would permit with respect to information of a former client.

- (c) A lawyer subject to paragraph (b) shall not represent a client with interests materially adverse to those of a prospective client in the same or a substantially related matter if the lawyer received information from the prospective client that could be significantly harmful to that person in the matter, except as provided in paragraph (d). If a lawyer is disqualified from representation under this paragraph, no lawyer in a firm with which that lawyer is associated may knowingly undertake or continue representation in such a matter, except as provided in paragraph (d).
- (d) When the lawyer has received disqualifying information as defined in paragraph (c), representation is permissible if:
 - (1) both the affected client and the prospective client have given informed consent, confirmed in writing; or
 - (2) the lawyer who received the information took reasonable measures to avoid exposure to more disqualifying information than was reasonably necessary to determine whether to represent the prospective client; and
 - (i) the firm acts promptly and reasonably to notify, as appropriate, lawyers and non-lawyer personnel within the firm that the personally disqualified lawyer is prohibited from participating in the representation of the current client;
 - (ii) the firm implements effective screening procedures to prevent the flow of information about the matter between the disqualified lawyer and the others in the firm;
 - (iii) the disqualified lawyer is apportioned no part of the fee therefrom; and
 - (iv) written notice is promptly given to the prospective client; and
 - (3) a reasonable lawyer would conclude that the