



Family Wealth Institute

Succession Planning for Lawyers...Shoes for the Shoemaker

By

Douglas K. Freeman, J.D., LL.M.

Lee Hausner, Ph.D.

First Foundation Advisors

Attorneys are familiar with the popular statistics on the succession of family businesses. The data reveals that only 30% successfully transfer to the next generation and only 1 out of 8 will survive the passage to the third generation of ownership. These statistics rarely apply to the professional businesses, including law firms.

Though the data is harder to find, we have found some important generalities

- Attorneys rarely create written succession plans for themselves. The same can often be said of accountants and even physicians.
- Most of the plans that are developed consist of buy-sell agreements which apply upon the death of a law partner, and are most often partially funded with life insurance, but rarely priced on true economic values of the deceased partner's interest.
- Few of the succession plans anticipate or fund a buy-out based on the full or partial disability of the attorney.
- Even fewer plans anticipate a buy-out upon the retirement of a partner.
- Sole practitioner's are virtually unprepared for any succession, and are unaware of the State Bar requirements for the transition of client files.
- Clients of a deceased or incapacitated lawyer will eventually move their matters to replacement counsel that they choose, and often pay only a fraction, if anything, of the outstanding bills owed to the former lawyer. All the unbilled time related to work in progress is usually lost. Consequently, the value of the receivables and client work is considerably less than the attorney may have anticipated. In the meantime, there are continuing office expenses. This affects the cash flow to the family. Our experience suggests that the value of receivables and client relationships will deteriorate almost 50% in the first three months following the death of the attorney.



- Many clients may not realize their counsel has died, and assume that someone is handling their affairs. There is substantial risk of missed deadlines and timely follow-ups, so potential damages to clients become real and significant and the liability of the estate grows proportionately.

Here's what we know:

- The Florida Bar rules (Rule 1-3.8 of the Rules Regulating the Florida Bar) provide that, if an attorney dies (or abandons his practice, disappears, or is disbarred), and no partner or other party is qualified to continue the practice, the circuit court will appoint an attorney to inventory all the client files of the deceased attorney and take whatever action the "Inventory Attorney" deems necessary to protect the interests of the client, including returning all client property and trust funds. But this action requires that someone, a spouse, child, secretary, or someone else, takes responsibility for notifying the court of the loss of the attorney.
- The Inventory Attorney does not replace the deceased attorney, but is charged only with gathering and disposing of the files and informing clients of timely filings, actions, or other emergencies.
- While planning for death is critical, the probability of disability is often two or three times greater. So disability planning is even more important.

Here's what we suggest:

- All sole practitioners should consider establishing a succession plan with colleagues whom they trust and to whom they would like to transfer their clients should they die or become permanently disabled. The nominated transferee agrees to accept the responsibility to gather the files, review them, and coordinate with the clients based on the various levels of action required. In effect, the transferee becomes both the Inventory Attorney and the "Replacement Attorney". The price paid to the family of the deceased attorney and the terms and timing of the payment are the key challenges.
- Attorneys who are in partnership with others may feel less compelled to create a succession plan, believing that their partners will handle the process. However, this ignores many realities. In many professional corporations, partnerships and limited liability companies, the other partners come from different fields of practice and can't service the clients of the deceased or disabled attorney. Even where there are attorneys of similar discipline and experience, they often can't handle someone else's full book of business. The fall off in clients who remain with the firm is significant. Buy out agreements, where they exist, are rarely priced based on the real value of the practice, but rather on a financial statement book value or the amount of insurance the parties were



willing to purchase. Few law firms purchase disability buy-out insurance, which functions like a death buy-out and cashes out the interest of the disabled attorney. Consequently, thoughtful succession planning in these firms is equally important.

- Valuing a law practice is very difficult for all the above reasons. A successful strategy is based on an “earn-out” approach. Under this methodology, the Replacement Attorney agrees to pay the family of the deceased attorney based on a declining percentage of the actual fees paid to the Replacement Attorney. The percentage declines because, in the first year of the transfer, virtually all the economic benefit of the fees paid to the Replacement Attorney were generated because of the transfer but, as the years go on, these clients remain with the Replacement Attorney because of his or her skills and talents. We usually see a three to five-year payout period, and a percentage paid that typically begins around 40% of the revenue in year one to 10% of the revenue by year 5. Thereafter, there is no further payment to the family. This arrangement is fair, because it’s based on the real value of the book of business, rather than an estimated value which is rarely accurate, and is paid from the cash generated by the work.

+++++

At the First Foundation Inc., we are concerned not just with the tax and economic consequences of wealth planning, but with the impact of that planning on the lives of those for whom the wealth was intended to benefit. Our planners, investment advisors, bankers, and trust officers see the results of both effective and ineffective planning. We are pleased to offer you our insight, experience, and perspective.

To contact the authors, please call the toll free number at 866-833-1112.

The Family Wealth Institute is a project of the First Foundation Inc., a comprehensive wealth management firm. We provide banking, trust services, financial planning, family strategic planning and skill training, foundation planning and full back-office services. First Foundation Advisors, is a wholly owned subsidiary of First Foundation Inc.