Permitting the Sale of a Law Practice: Furthering the Interests of Both Attorneys and Their Clients

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NOTE

PERMITTING THE SALE OF A LAW PRACTICE: FURTHERING THE INTERESTS OF BOTH ATTORNEYS AND THEIR CLIENTS

I. INTRODUCTION

In New York, as well as many other jurisdictions, it is considered unethical to sell a law practice. This means that although practitioners may sell the tangible assets of their practice, such as books or office equipment, practitioners are prohibited from selling their client lists, files, phone numbers, capital assets and goodwill. Currently, there is a very strong movement across the nation to permit

1. See LAWYER'S CODE OF PROFESSIONAL Responsibility EC 4-6 (N.Y. State Bar Ass'n 1990) [hereinafter NEW YORK CODE]; see, e.g., O'Hara v. Ahlgren, Blumenfeld and Kempster, 537 N.E.2d 730 (Ill. 1989); Raphael v. Shapiro, 587 N.Y.S.2d 68 (Sup. Ct. 1992). But see CALIFORNIA PROFESSIONAL RULES Rule 2-300 (West 1993) [hereinafter CALIFORNIA RULES]; FLORIDA BAR AND JUDICIARY RULES Rule 4-1.17 (West 1993) [hereinafter FLORIDA RULES]; MICHIGAN RULES OF PROFESSIONAL CONDUCT Rule 1.17 (West 1991) [hereinafter MICHIGAN RULES]; WISCONSIN COURT RULES AND PROCEDURE Rule 20:1.17 (West 1993) [hereinafter WISCONSIN RULES]; Practice Sales OK'd, NAT'L L.J., Aug. 17, 1992, at 6 (reporting that the state bar board of governors for the state of Oregon approved the recommendation of its ethics committee that no new disciplinary rule was needed to allow attorneys to sell their law practices, including goodwill, because a previous ethics opinion permitted the sale).

2. "Goodwill" is the value of an enterprise above and beyond its tangible assets. John E. Hempstead, Putting a Value on a Law Practice, FAM. ADVOC., Summer 1984, at 14, 15. Specifically, a law firm's goodwill is based on the ability it has demonstrated to attract clients and generate income in the future. Id.

3. The proponents of this movement in the legal profession tend to be solo practitioners and partners in small law firms because they are most adversely affected by the current state of the law in jurisdictions which ban the sale of a law practice. See Don Itkin, Selling Your Law Practice: Why the Rule Change? Who Benefits?, WIS. LAW., Dec. 1991, at 8-9. However, it should be noted that various bar associations are urging changes that would permit lawyers to sell their practices. For example, the Nassau County Bar Association in Long Island, New York, became the first bar group in the state to officially support a change in the Code of Professional Responsibility. Today's News: Update, N.Y. L.J., Oct. 28, 1991, at 1; see also CALIFORNIA RULES Rule 2-300 (West 1993); MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.17 (1991) [hereinafter MODEL RULES] (both provisions allow for the sale of a law practice). Perhaps even more noteworthy is the fact that judges who are adjudicating
the sale of a law practice (from one law firm or lawyer to another law firm or lawyer). Proponents of this movement believe that to allow for the sale of a law practice is in the best interests of both attorneys and their clients. However, despite the current popularity of this movement, there is a lack of authority analyzing and discussing the arguments for and against the sale of a law practice. Rather, the most recent literature concentrates on simply reporting the efforts of the movement and the current state of the law in specific jurisdictions. This is so even though the American Bar Association ("ABA") amended the Model Rules in 1990 to include a provision which would permit the sale of a law practice. Consequently, this Note will analyze the arguments for and against permitting the sale of a law practice, while also providing an update of the status of the law in this area on a nationwide basis.

This Note will show that permitting the sale of a law practice is in the best interests of all members of the legal profession as well as the public as lawyers' clients. Additionally, it will suggest language for a provision which would enumerate certain conditions for the sale of a law practice to be incorporated into the New York Code and the codes of other jurisdictions which presently do not allow for the sale of a law practice. These conditions will ensure that both the lawyers' and the clients' interests will be protected.

Furthermore, this Note will examine the alleged problems which arise from the sale of a law practice, focusing on relevant ethical and

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4. Although it is not criminal to contract for the sale of a law practice, including its goodwill, an agreement for the sale of an attorney's interest in a law firm which includes goodwill is improper and prohibited by either the Model Code or the Model Rules of Professional Responsibility in many jurisdictions. Such a contract is "illegal" in the sense that it will be void and unenforceable by the parties as violative of the Model Code or the Model Rules governing the conduct of attorneys. See Raphael, 587 N.Y.S.2d at 69.

policy considerations. It will be shown that the seller’s obligations before and after the sales agreement will be consistent if the sale occurs under certain conditions. This will involve an examination of selected portions of the many ethical codes for lawyers, specifically the American Bar Association’s Model Rules of Professional Conduct (“Model Rules”) and the Professional Rules for the State Bar of California (“California Rules”), which both contain provisions that allow for the sale of a law practice under specified conditions.6 The Lawyer’s Code of Professional Responsibility (“New York Code”), which is based on the ABA Model Code of Professional Responsibility (“Model Code”) and does not provide for sale of a law practice, will also be examined.

In addition to analyzing the alleged ethical problems associated with selling a law practice, this Note will address some of the practical problems incidental to a sale and suggest solutions. For example, language for the selling attorney to use in disclosing the conditions of the sale to clients will be suggested. This Note will also survey the authority dealing with the treatment of the value of goodwill in a law practice (if any value is given) with an emphasis on New York authority and other authority which depicts the current trend towards selling goodwill. Furthermore, this Note will give exposure to a method of calculating goodwill in a law firm as suggested by some commentators.

II. EXPOSURE TO THE INHERENT AND CONSEQUENTIAL PROBLEMS ASSOCIATED WITH THE SALE OF GOODWILL AND POSSIBLE SOLUTIONS

The opponents’ argument to the sale of a law practice turns on issues that involve the lawyer’s ethical obligations to her specific clients as well as the general public and the possibility that behavior and agreements which necessarily arise out of a sale will be inconsistent with these ethical obligations.7 Those who are in favor of permitting the sale of a law practice argue that the sale can be conduct-

6. CALIFORNIA RULES Rule 2-300; MODEL RULES Rule 1.17; see also FLORIDA RULES Rule 4-1.17; MICHIGAN RULES Rule 1.17; WISCONSIN RULES Rule 20:1.17.

7. Most opponents are presumably viewing the sale of a law practice as unrestricted. In this light, opponents consist of those who object based on the belief that the occurrence of an unrestricted sale would cause ethical obligations to be breached and those who object simply because it has traditionally been considered, by some, unethical to sell a law practice. See, e.g., Sterrett, supra note 5. There is not substantial commentary from opponents who have considered the sale as occurring in the restricted manner set out in the ABA Model Rules or the California Code.
ed in such a manner as not to compromise these obligations. Furthermore, they argue that permitting the sale is actually more consistent with these obligations.8

The arguments on both sides for allowing and enforcing agreements for the sale of a law practice also involve policy considerations, carefully balancing the interests of all parties that are affected by the sale. These parties include the seller, the buyer, the seller’s clients, and the public at large. Opponents suggest that the seller’s clients and the public will suffer if the sale of a law practice is permitted. Proponents insist that all affected groups’ interests will be protected. To support their conclusion, they point to the disparity of treatment between the sole practitioner or the practitioner of a small firm, and other legal practitioners,9 notwithstanding the difference of treatment between the legal profession and members of other professional practices.10

A. Conflict of Interest

The thrust of Canon 5 in both the New York Code and the Model Code does not prohibit conflicts of interest, but rather requires that any conflict must be fully disclosed to the client.11 Although there are no specific provisions which apply to the lawyer who sells her practice,12 there are two separate conflicts which can arise as the result of a sale: one on the part of the seller and the other on the part of the buyer.

When a law practice is sold, the seller usually refers her client

8. See, e.g., Minkus, supra note 5.
9. Itkin, supra note 3, at 8, 10. In addition, this unfair treatment of the sole practitioner or partner in a small firm is compounded by the fact that goodwill is included in the value of their practice for purposes other than a sale in most jurisdictions. For example, in a divorce situation the value of a sole practitioner’s law practice includes goodwill. See Hempstead, supra note 2, at 14; see also Carmen Valle Patel, Note, Treating Professional Goodwill as Marital Property in Equitable Distribution States, 58 N.Y.U. L. Rev. 554 (1983) (arguing that it is proper for equitable distribution states to treat professional goodwill as an asset subject to equitable distribution upon divorce).
10. See COUNCIL ON ETHICAL AND JUDICIAL AFFAIRS, AM. MEDICAL ASS’N, CURRENT OPINIONS 29 (1989), stating that:
   A physician or the estate of a deceased physician may sell to another physician the elements which comprise his practice, such as . . . goodwill. In the sale of a medical practice, the purchaser is buying not only furniture and fixtures, but also goodwill, i.e., the opportunity to take over the patients of the seller.
11. Minkus, supra note 5, at 369.
12. Id. at 368.
to the buyer. This scenario could lead to a potential conflict of interest in that rather then being based on disinterested and informed considerations, the recommendation from the seller to the client will be based on financial self interest. A conflict may arise between the concern for the client’s interests (in which case the seller would want the most competent buyer) versus the seller’s financial interest in selling the practice (in which case the seller would want the highest bidder, regardless of competence). The seller may thus refer her clients to an unreliable or unqualified successor if that successor happens to be the highest bidder. Furthermore, the conflict may escalate when the sale is for a fixed amount rather than for payments over a period of time (based on fees received from the seller’s clients) because in the latter case, the seller would have to recommend a buyer who would maintain the attorney-client relationships over time in order to make money for the payments.

In order to comply with this obligation, the selling lawyer should fully disclose to her clients all aspects of the proposed arrangement with the buyer when advising clients that they should retain the buyer as counsel. This situation is not significantly different from others in which there is a conflict of interest that is curable by full disclosure and informed consent.

Another safeguard to insure the competent selection of a buyer might be the imposition of direct liability on the seller for making a negligent referral or for negligently selecting a buyer. Under this approach, the seller owes a duty to her clients to at least make a minimal investigation into the integrity and competence of the buyer. As discussed above, the seller must disclose to her clients that the buyer is, in a sense, “paying” her to make the referral, but further, she should inform her clients that she will remain vicariously liable for all current cases involving the seller’s clients on matters that the seller is obligated to complete.

13. Sterrett, supra note 5, at 310.
14. Minkus, supra note 5, at 368. However, the situation where the sale is for a fixed amount will be rare because the buyer will not want to pay for a referral before finding it successful. Kalish, supra note 5, at 489.
15. Minkus, supra note 5, at 369; see, e.g., CALIFORNIA RULES Rule 2-300(B)(1)(a); MODEL RULES Rule 1.17(c).
17. See Kalish, supra note 5, at 490.
18. Id. at 491; Minkus, supra note 5, at 364.
19. This is analogous to the situation where the seller is the partner of the buyer. Kalish, supra note 5, at 491.
The same conflict may be magnified in the situation where the selling attorney is deceased and the sale is handled by the estate. This situation holds more potential for conflict for several reasons: the estate is likely to be less concerned with reputation than would be a retiring attorney; the deceased obviously cannot maintain an ongoing relationship with her old clients; the fiduciary duty of the estate planner to the estate may be to obtain the best price; and the chances of outright sale (rather than extended fee arrangements) are increased. Therefore, unless treated differently, the arguments are strong for prohibition of the sale. To avoid situations where potential hardship for the client may arise, it is suggested that the sale should be approved by court order.

The second potential conflict results on the buyer's end, specifically, when a conflict of interest exists between the buyer and a seller's client. However, this is not a problem under either Model Rule 1.17 or California Rule 2-300. Although both provisions require that the sale include all or substantially all of the practice, this requirement is satisfied even if the buyer cannot undertake all client matters due to a conflict of interest in a specific matter. Perhaps the transaction itself should include a full list of clients and some acknowledgement by both the seller and the buyer that there are no conflicts of interest, or to the extent that a conflict exists, the buyer waives control of those matters.

B. Fee-Splitting

Ethical codes prohibit lawyers from sharing a single legal fee except when: (1) the client consents; (2) the fee is divided in proportion to the services rendered by each attorney; and (3) the total fee does not exceed reasonable compensation for the services rendered.

21. Id. at 371-72.
22. One exception is the case where the estate is simply finishing the seller's transaction, in other words, the seller started the process before the seller died. Id. at 373.
23. The court order should be required in both the case where the estate planned the entire sale and where the now deceased seller began the transaction. Id. at 373. In the case where the estate plans the entire sale, the estate planner should be prohibited from taking any of the clients as her own. Id. at 372.
24. MODEL RULES Rule 1.17 cmt. 5.
25. E.g., MODEL RULES Rule 1.5(e); NEW YORK CODE DR 2-107; MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 2-107 (1983) [hereinafter MODEL CODE]. Often, the real concern with fee-splitting is joint responsibility. Minkus, supra note 5, at 365 (discussing ABA Comm. on Professional Ethics and Grievances, Formal Op. 316 (1967)). Not surprising
In regard to a sale, the concern is that fee-splitting interferes with the buyer's ability to exercise independent judgment. Therefore, the buyer may charge excessive fees. Since the buyer must split a portion of her fees received with the selling attorney, there may be pressure to charge more than the services rendered would otherwise merit.\(^\text{26}\)

Both Model Rule 1.17 and California Rule 2-300 address the possibility that the buyer's future fees will be split with the seller as a consequence of the sale. Both Codes require full disclosure to the clients and require that the fees charged shall not be increased solely by reason of the sale.\(^\text{27}\) Therefore, existing fee agreements between the clients and the seller must be honored by the buyer, unless the clients consent to a change after consultation.\(^\text{28}\)

However, even if the fee charged to the client is not increased, the danger that the seller will sell to the buyer most willing to pay the split fee still exists. In that scenario, even a competent buyer might take shortcuts to minimize the money that she must pay the seller.\(^\text{29}\) A possible solution would be to hold the seller liable for damage caused by negligence on the buyer's part due to a breach of the duty to exercise reasonable care in recommending a new lawyer, and additionally, the seller should remain responsible for active cases.\(^\text{30}\)

then, the fee-splitting issue often arises in the context of the referral fee. Referral fees do comply with these rules when the referring attorney works on the file in some way. Some commentators contend recommendations alone cannot be considered legal services and as a result would bar referral fees. See, e.g., Sterrett, supra note 5, at 313-14. Consider, however, the proposition that California, by permitting referral fees, provides more protection to the client because (1) the fee cannot be raised for the sole reason it is being split; (2) the fee cannot exceed reasonable compensation; and (3) full disclosure to the client is required. Minkus, supra note 5, at 363. Therefore, responsibility for malpractice by the seller would solve this. The seller can maintain insurance to cover liability for a reasonable period of time. \(\text{Id. at 365.}\)

\(^{26}\) Sterrett, supra note 5, at 313-14.

\(^{27}\) \text{CALIFORNIA RULES} Rule 2-300(A); \text{MODEL RULES} Rule 1.17(d).

\(^{28}\) \text{MODEL RULES} Rule 1.17 cmt. 9.

\(^{29}\) \text{See Kalish, supra note 5, at 502; Minkus, supra note 5, at 364.}\n
\(^{30}\) \text{See supra notes 17-19 and accompanying text. Many ethical codes also contain provisions which prohibit lawyers from dividing fees with non-lawyers. E.g., NEW YORK CODE DR 3-102; MODEL CODE DR 3-102. However, this need not be a concern in this case. An exception is allowed for the pecuniary value of the interest of a deceased lawyer in her firm or practice to be paid to her estate, heirs, etc. Why? Because the purpose of the rule is to prevent the aiding or encouraging of laymen to practice law. This is indistinguishable from the case where a buyer pays to the estate, etc. Therefore, because the policy of the rule is not violated, a similar exception should be allowed in the case of a sale. Although, as discussed previously, the sale may have to be handled differently.}
C. Confidentiality

One of the more traditional concerns associated with the selling of a law practice (or any other type of professional practice for that matter) is that a breach of confidentiality will occur. The New York Code requires confidentiality to continue after termination and consequently prohibits a lawyer from selling her practice. However, a study of other statements contained in the New York Code regarding confidentiality reveal that a sale should be qualified with rules addressed at avoiding breaches of confidentiality, rather than proscribed completely.

For example, the New York Code states that it is common knowledge that non-lawyer employees and other partners or associates are exposed to confidential information in the normal operation of a law office. The New York Code further states that limited information can be given to an outside agency for bookkeeping and other similar purposes. The New York Code states that confidences cannot be used for the advantage of a lawyer or a third party except where the client has consented after full disclosure. In other words, a lawyer is permitted to reveal confidences of a client after full disclosure to and consent by the client.

An examination of the overall policy regarding client confidences makes it clear that if the sale is handled according to set procedures, the sale can comply with these provisions. Therefore, the concern for confidentiality should not demand an outright ban on the sale of a law practice. The sale can comply with the confidentiality provisions on the condition that the seller writes to her clients informing them

31. Although this is a concern for the sale of any professional practice (e.g., medical, dental, veterinarian, and psychiatric), these practices are not prohibited from being sold in many jurisdictions. See, e.g., COUNCIL ON ETHICAL AND JUDICIAL AFFAIRS, AM. MEDICAL ASS’N, CURRENT OPINIONS 29 (1989).

32. See, e.g., Sterrett, supra note 5, at 312-13 (arguing that the substitution of attorneys can only be made with the consent of the client and that a lawyer cannot dispose of the client’s property without specific authorization).

33. NEW YORK CODE EC 4-6. The Model Rules do not have a similar provision, since the rules authorize a sale.

34. NEW YORK CODE EC 4-2. However, in reality, is the client really aware this will occur? For example, consider the case where the client hires a sole practitioner who later hires an associate. It is ethical under the Code for the attorney to share client confidences with the new associate without the client’s authorization.

35. NEW YORK CODE EC 4-3.

36. NEW YORK CODE DR 4-101(B)(3).

37. NEW YORK CODE DR 4-101(C)(1).
that: (1) the seller is retiring or moving, etc.; (2) the buyer is a competent lawyer who can satisfactorily handle their affairs; and (3) there will be an eventual need to disclose privileged information to the buyer. The letter should make clear that the client has the right to refuse to allow disclosure and that the client has the option to select another lawyer and discharge the buyer if dissatisfied.

The initial phase of the sale will consist of negotiations which will disclose only financial and generalized statements about the composition of the practice. Clients could reasonably expect lawyers to disclose this kind of information in the normal operation of their practices. The buyer would not be allowed to scrutinize a particular client’s confidences at this stage. During the second phase, the actual transfer of business, the risks of unwarranted disclosure of information are still slight. The seller should not transfer the files until she has the fully informed consent of the client.

D. Solicitation

The rationale for most anti-solicitation provisions in the ethical codes is that the earned reputation of the lawyer should be the basis for the selection of an attorney. In the context of the sale of a law practice, an argument can be made that when the seller recommends the buyer to her clients, the seller has violated the anti-solicitation provisions. This argument is based on the notion that the buyer is in a sense “paying” for the recommendation. There is also an assumption made that the recommendation is not based on the competency of the buyer after checking into the buyer’s background, but rather upon the seller’s own financial interest. Furthermore, there is a concern that the client will be pressured by fraud or undue influence into

38. Minkus, supra note 5, at 358.
39. Id.
40. Kalish, supra note 5, at 484-86; Minkus, supra note 5, at 361.
41. Kalish, supra note 5, at 486-87; Minkus, supra note 5, at 361.
42. CALIFORNIA RULES Rule 2-300(E); MODEL RULES Rule 1.17(c). This mechanism will also alleviate the dangers of unanticipated disclosure which accompany the formation of “quickie” partnerships. Kalish, supra note 5, at 486-87.
43. Sterrett, supra note 5, at 316.
44. See MODEL RULES Rule 7.2(c); NEW YORK CODE DR 2-103(B); MODEL CODE DR 2-103(B) (prohibiting a lawyer from giving anything of value to a person for having recommended his employment). Note that the Model Rules have been amended to include an exception for the sale of a law practice in accordance with Rule 1.17. MODEL RULES Rule 7.2(c)(3).
having the buyer represent him or her.45

A truthful letter by the seller, however, does not invade the client’s interest in confidentiality. The client expects communications from her attorney. A retiring lawyer does not breach her duty of confidentiality by informing the client that she wishes to retire and by recommending that the buyer continue with the client’s work. Furthermore, the likelihood of undue pressure upon the client are minimal. The recipient will have the chance to consider the letter and even to seek outside assistance in evaluating it. The recipient will be able to do this at her leisure, without the pressure of the soliciting lawyer’s presence.46

E. Restrictive Covenants

A restrictive covenant is an agreement in which the seller is restricted from entering into private practice in the immediate geographic area surrounding the buyer.47 Such covenants commonly arise from agreements involving the sale of a law practice because the buyer demands assurance of the future patronage by the seller’s clients. Some commentators argue that restrictive covenants are against public policy as they make the lawyer/client relationship a marketable piece of merchandise and limit the client’s right to decide who shall represent him or her.48

It is important to note that there is no requirement that a lawyer take all the cases that are referred to her.49 A covenant not to compete which is reasonable in terms of time, geography, and clients should be enforceable. These types of covenants will not handicap the client by precluding the client from choosing an attorney who has

45. Minkus, supra note 5, at 374; see Kalish, supra note 5, at 500.
46. Kalish, supra note 5, at 499-502. Consider the requirement that the clients be given written notification of the proposed transaction. See, e.g., CALIFORNIA RULES Rule 2-300(B); MODEL RULES Rule 1.17(c).
47. Note that the anti-solicitation rule in the New York Code is primarily concerned with preventing the employment of “campers and runners” compensated on a per capita basis and/or preventing violations of the fee-splitting provisions, such as DR 2-107 or 3-102. However, this rule should be amended to make the advice given by an attorney in a sale legitimate. Minkus, supra note 5, at 375; see NEW YORK CODE DR 2-103(B), (C).
48. Sterrett, supra note 5, at 316-18.
49. Kalish, supra note 5, at 496. In addition, the Model Rules clearly support the notion that a lawyer should be able to resign from a matter already undertaken by the lawyer if there will be no material harm to the client. Id. at 497; see MODEL RULES Rule 1.16(b).
willingly agreed to a reasonable restrictive covenant incident to the sale of a practice. The seller is only advising her clients that she is going to retire and transfer her business to the buyer. The clients still have the opportunity to choose whomever they desire as their next attorney.\(^5\)

\section*{F. Misleading Name and Conduct}

The notion exists that a lawyer should only use the names of present partners or employers because benefitting from the goodwill and recognition of that name would only be legitimate in those situations.\(^5\) However, the Model Rules permit the use of a retiring partner's name and permit trade names provided that they are not misleading.\(^5\) Thus the relevant inquiry would be whether the use of the name would be misleading rather than automatically banning its use in all other situations.\(^5\)

\section*{III. AN EXAMPLE OF THE TRANSACTION}

It is important to note that advocates for permitting the sale of a law practice do not propose an unrestricted sale. Indeed, as is suggested by the opponents, an unrestricted sale could lead to the breach of various ethical obligations that a lawyer owes to her clients. Rather, if the sale occurs under certain prescribed conditions, proponents argue that these obligations will not be compromised.

Four codes presently contain provisions which allow for the sale of a law practice, including goodwill, and specify the conditions to which that sale is subject.\(^5\) These provisions\(^5\) will serve as the basis for a discussion concerning what kinds of restrictions on a sale of

\addvrefnote{Kalish, supra note 5, at 495-97.}
\addvrefnote{Sterrett, supra note 5, at 318-19.}
\addvrefnote{Kalish, supra note 5, at 505-07.}
\addvrefnote{Kalish, supra note 5, at 506-07. A rule which would discourage the seller from engaging in or assisting the buyer in any misleading practices would have the retiring partner remain liable for the buyer's acts or omissions to those who might rely on the apparent fact of partnership unless explicit notice was given.}
\addvrefnote{CALIFORNIA RULES Rule 2-300; FLORIDA RULES Rule 4-1.17; MICHIGAN RULES Rule 1.17; WISCONSIN RULES Rule 20:1.17; MODEL RULES Rule 1.17.}
\addvrefnote{In particular, the provisions of the Model Rules and California Rules will be analyzed because of their substantial similarity to other states' provisions. Differences between the state provisions and the Model Rules will be discussed as well.}
a law practice are necessary so that agreements that arise out of a sale do not compromise any ethical obligations.

Model Rule 1.17 in the ABA's Model Rules provides for the sale of a law practice. The Model Rules contain four restrictions, three of which are reflected in some fashion in the comparable rule under the California Code. First, Model Rule 1.17 specifies that the seller must agree to some kind of restrictive covenant in her private practice of law. This restriction does not prohibit the seller from gaining employment on the staff of a public agency or a legal services entity, or as in-house counsel to a business. Additionally, it permits the seller to return to private practice if there is an unanticipated change in circumstances. This condition accommodates the seller who sells the practice because she is moving to another jurisdiction or state. The underlying rationale of such a provision is to ensure that the seller must sell the entire practice and not retain control over selected files. California Rule 2-300, regarding the sale of a law practice in California, does not have a similar provision.

Secondly, along the same line of concern, Model Rule 1.17 requires that the entire practice be sold to a single buyer. Similarly, California Rule 2-300 requires that "all or substantially all" of the practice be sold. This condition allows the seller to retain one or two clients who have a longstanding personal and professional rela-

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56. The Model Rules contain a condition that requires the seller to terminate private practice in the geographic area or jurisdiction. Model Rules Rule 1.17(a). Although the California Code does not have a similar requirement, it seems to address the same concerns by requiring that the practice be sold as a single entity to the extent allowed under other provisions in the Code. See California Rules Rule 2-300.

57. The Rule provides, in pertinent part:

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

(a) The seller ceases to engage in the private practice of law [in the geographic area in the jurisdiction] (a jurisdiction may elect either version) in which the practice has been conducted.[]

Model Rules Rule 1.17(a).

58. Id. cmt. 3.
59. Id. cmt. 2.
60. Id. cmt. 4.
62. Rule 1.17 provides in pertinent part:

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

(b) The practice is sold as an entirety to another lawyer or law firm[.]

Model Rules Rule 1.17(b).

63. California Rules Rule 2-300.
PERMITTING THE SALE OF A LAW PRACTICE

Permitting the sale of a law practice requires a careful examination of the relationship with the seller such that transfer of those clients may not be desired or feasible. It is not intended to authorize a sale in a piecemeal fashion. This condition addresses the concern of the protection of those clients 'whose matters are less lucrative and who might find it difficult to secure other counsel if a sale could be limited to substantial fee-generating matters.'

Thirdly, Model Rule 1.17 provides that actual written notice must be given to each of the seller’s clients advising them of the sale, any proposed change in the fee arrangement (authorized under paragraph (d) of the Rule), and of the clients’ right to retain other counsel or take possession of their files. California Rule 2-300 contains a similar requirement but distinguishes situations where the seller is deceased, in which case the purchaser is to provide the written notice to the clients. This requirement addresses the traditional concern that...
when a sale occurs there will be a breach of client confidences.

Finally, both Model Rule 1.17 and California Rule 2-300 provide that the fees charged to clients shall not be increased solely by reason of the sale. This restriction addresses the concern that the buyer will increase the fees charged to the clients as a method of financing the sale.

As discussed supra, these restrictions and conditions directly
speak to the concerns of both the opponents and proponents of permitting the sale of a law practice. Thus, this author suggests that any jurisdiction which permits the sale of a law practice should impose the same or similar conditions in its sale provision. In addition, because there is frequently valuable goodwill inherent in a solo or small law practice, if the sale of a law practice is not permitted even under specified conditions, lawyers may attempt to circumvent the law that prohibits its sale. A "sham sale" could exist whereby the buyer pretends to purchase only the seller's physical assets and pays an excessive amount for those assets because the transaction actually includes goodwill. Alternatively, the two parties might attempt to form a "quickie partnership," where the buyer and seller enter into a partnership and several months later, the seller will retire leaving the buyer with the business as an ongoing concern.

IV. PRACTICAL PROBLEMS ASSOCIATED WITH A SALE

A. Providing Full Disclosure to the Client

Some commentators view the typical sale as follows: The seller turns over both the tangible and intangible assets of the practice, then contacts her clients and informs them that the buyer is now handling their affairs. The seller suggests that the clients continue with the buyer, praising the buyer's professional talents, although no disclosure is made that the practice is being sold or that the buyer is in effect paying for the recommendation. Compare that perspective of the typical sale with one that would occur according to the provisions in the codes discussed above.

Such a sale would require that the transaction occur as follows: with the two-fold purpose of providing for her own financial security and providing competent representation for her present clients, the seller agrees to inform her clients, in writing, that: (1) she intends to retire; (2) they are entirely free to select any attorney they wish to represent them; (3) she recommends the buyer and lists the reasons for her recommendation; and (4) she will receive compensation from the buyer which is based in part on the gross income earned by the

70. Kalish, supra note 5, at 475-76.
71. Id. at 476.
72. Id.
73. See, e.g., Sterrett, supra note 5, at 307-08.
The buyer can then agree to pay the seller, over time, amounts contingent in part upon the gross income of the buyer.\textsuperscript{24}

\section*{B. Determining the Value of Goodwill}

One of the major practical problems involved in selling a law practice is determining the value of the firm's goodwill.\textsuperscript{25} Methods that have been developed for some other professional practices are useful in determining the value of a law firm.\textsuperscript{26} Furthermore, it is also helpful to use the method that is associated with determining the value of the practice for the purpose of a sale as opposed to some other purpose.\textsuperscript{27} Of the various methods that exist, it has been suggested that the capitalized excess earnings method is most appropriate for valuing law firms.\textsuperscript{28}

The steps involved in applying this method are:

- Determine the firm's average net income, before partner compensation is deducted, for the past four or five years. This should be determined on accrual-basis accounting, and any unusual or non-recurring expenditures should be eliminated. Revenues should also be reviewed for any non-recurring items, such as proceeds from the sale of assets.
- Subtract from the average net income a reasonable rate of return (e.g., 8 percent to 10 percent) based on the firm's net tangible assets. This, in effect, represents what the law firm could earn on the value of its tangible assets if the value of the assets had been invested for other purposes.
- Deduct a reasonable amount representing compensation for the firm's partners. This should reflect what the partners could earn as employees of a comparable firm or what the firm would have to

\textsuperscript{74} See, e.g., Minkus, supra note 5, at 353.

\textsuperscript{75} Id.

\textsuperscript{76} The value that a business possesses above and beyond the worth of its underlying assets is referred to as goodwill. Michael E. Kline, \textit{Firm Valuation: Picking the Appropriate Formula}, \textit{Nat'l L.J.}, Jan. 15, 1990, at 15.

\textsuperscript{77} It is important to note that unusual characteristics exist in the case of a law firm. Traditionally, goodwill is associated with a business entity and not with the individuals who are affiliated with it. However, in the case of a law firm, perhaps due to the attorney/client relationship, goodwill can be associated with the law firm and another distinct type of goodwill can be associated with the individual lawyers. Id.

\textsuperscript{78} Id.

\textsuperscript{79} Id. at 16. The other less appropriate methods include the capitalized earnings approach, the discounted cash flow or discounted future earnings approach, the fair market value of assets method, the price/earnings method and the capitalized dividends approach. See id. (discussing the various methods for calculating goodwill).
pay to hire additional attorneys to replace the partners as employees. Geographic factors and the nature of the law practice should be considered in estimating this compensation. Published surveys and reports on lawyer compensation are available to aid in this step.

The remaining amount is capitalized to determine the value of the law firm’s goodwill. The rate used may vary depending on the individual circumstances, but a rate of approximately 20 percent is reasonable. This method is considered fair and reasonable because it is based on the excess earnings potential of the law firm. This is a factor that indicates the existence of goodwill. If the calculation does not produce any excess earnings, then the law practice does not have any goodwill.

Valuing a professional practice is not an exact science, therefore, the method described only provides guidelines which can serve as a valuable tool for the sale of a law practice.

V. CONCLUSION

It is important to once again point out that the proponents for permitting the sale of a law practice do not advocate an unrestricted sale. If the sale is regulated, by imposing conditions similar to those in Model Rule 1.17 or California Rule 2-300, the lawyer wishing to sell her practice will be able to do so in a manner that is completely consistent with her other ethical obligations. Furthermore, the lawyer will actually be doing her clients a great deal of service by providing for representation of their matters after her departure rather than leaving the clients unassisted in this event. This author suggests that New York and other jurisdictions consider incorporating a provision which is based on Model Rule 1.17 or California Rule 2-300 into the code that governs the conduct of attorneys for their jurisdiction.

Allowing for the sale of a law practice will alleviate one aspect of the unfair treatment regarding some members of the legal profession, namely, sole practitioners and members of small firms. Furthermore, permitting the sale of a law firm will bring to the legal profession as a whole the benefits and security that members of other professions enjoy and rely upon over the course of their professional

80. Id.
81. The approach used for marital dissolution purposes may be different. In these matters, a distinction is made between past and future (post-divorce) earnings. Id.
82. Id.
practice. In addition, having a specific course of conduct to follow during the course of a legitimate sale will eliminate the attempts to circumvent the law, thereby eliminating the dangers that occur by having the practice remain prohibited.

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