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YOUR ROADMAP TO SUCCESSFUL RETIREMENT:

Closing or Selling Your Practice (Professional Conduct)

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SELLING OR CLOSING YOUR LAW PRACTICE
Ethical Considerations and Rule Requirements

I. Rules and Considerations Involved in Selling a Law Practice

A. Background

Prior to 1990, lawyers were not permitted to sell any part of a law practice except for the physical assets of the practice, such as law books, furniture and office equipment. The position of the courts and bar associations was that there was no legally or ethically recognized "good will" in a law practice that a lawyer could sell, pledge, assign or give away. This position was largely based on the view that "clients are not merchandise" and that lawyers are not "tradesmen", having nothing to sell but personal service.

There was also a concern that the sale of a law practice would constitute an improper sharing or division of legal fees. With respect to the sale of a practice by the estate or survivor of a deceased dole practitioner, the pre-1990 versions of Rule 5.4(a) of the ABA Model Rules of Professional Conduct, as well as DR 3-102(A) of the Model Code of Professional Responsibility generally prohibited lawyers or law firms from sharing legal fees with non-lawyers, with certain limited exceptions such as payments made to the survivors or estates of deceased law firm partners and law firm compensation and retirement plans. Thus, compensation for the "good will" of a sole practitioner's law practice, paid by the purchasing lawyer or law firm to the estate or survivor of the sole practitioner and derived from fees paid by the clients of that practice, was considered an improper sharing of a legal fee with a non-lawyer. Additionally, with respect to the sale of a practice by a lawyer or law firm to another lawyer or law firm, both Rule 1.5(e) of the Model Rules and DR 2-107(A) of the Code prohibited the division of legal fees between lawyers who are not in the same firm.

There were additional concerns about the sale of a law practice as well. The Rules have long prohibited payments by a lawyer to anyone for recommending the lawyer's services. *See* Model Rule 7.2(b) and Model Code DR 2-103(B). The concern was that, when a lawyer sells his or her practice, the lawyer is presumably recommending the buyer of the practice to the lawyer's existing clients and in receiving the agreed-upon sale price for the practice is receiving payment for those recommendations.

Finally, there was concern that confidential client information might be disclosed as the result of the sale of a law practice. In particular, since the lawyer's duty to preserve and protect the confidences and secrets of the client continues after the termination of the employment, the lawyer's sale of the law practice, including closed files, would involve the disclosure of client confidences.

However, in 1990, the American Bar Association's House of Delegates approved new Model Rule 1.17, which permits the sale of a law practice, including the "good will" of the practice.

The Ohio Supreme Court did not adopt its own version of the Model Rules of Professional Conduct until 2007. Those rules became effective on February 1, 2007, replacing the former Ohio Code of Professional Responsibility. However, effective February 1, 1993, prior to the adoption of the Rules of Professional Conduct, the Ohio Supreme Court adopted DR 2-111, which was based upon ABA Model Rule 1.17 and both permitted the sale of a law practice and specified to requirements that must be met with respect to such sales.

When the Ohio Supreme Court adopted the Rules of Professional Conduct effective February 1, 2007, those rules included the Court's own version of Rule 1.17 relating to Sale of Law Practice. The text of Ohio's version of Rule 1.17 is significantly different from the ABA Model version of Rule 1.17.

B. The Requirements of Prof. Cond. R. 1.17

Prof. Cond. R. 1.17(a) permits a lawyer or law firm to sell or purchase a law practice, including the good will of the practice. However, the law practice must be sold in its entirety, except where there is a conflict of interest that prevents the transfer of representation of a client or class of clients. When a lawyer or an entire law firm ceases to practice law and another lawyer or law firm takes over the representation, the selling lawyer or firm may obtain compensation for the reasonable value of the practice as may the withdrawing partners of law firms. Prof. Cond. R. 1.17, Comment [1]; see also, Prof. Cond. R. 5.4(a)(2).

However, a lawyer or law firm is not permitted to sell or purchase a law practice if the purchasing lawyer is buying the practice for the sole or primary purpose of reselling the practice to another lawyer or law firm. Prof. Cond. R. 1.17(a).

The purpose of requiring that the seller's entire practice be sold in to protect 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. The purchasers are required to undertake all client matters in the practice, subject to conflict clearance, client consent and the purchasing lawyer's competence to assume representation in those matters. This requirement is satisfied even if a purchaser is unable to undertake a particular client matter because of a conflict of interest or if the seller, in good faith, make the entire practice available for sale to the purchasers. The fact that a number of the seller's clients decide not to be represented by the purchasers but take their matters elsewhere does not result in a violation of the rule. However, in accordance with Prof. Cond. R. 1.1, the purchasing lawyer may be required to associate with other counsel in order to provide competent representation. See Prof. Cond. R. 1.17, Comment [6].

As used in Rule 1.17, the term "purchasing lawyer" means either an individual lawyer or a law firm. Prof. Cond. R. 1.17(b)(1). A "selling lawyer" includes an individual lawyer, a law firm, the estate of a deceased lawyer or the representatives of a disabled or disappeared lawyer. Prof. Cond. R. 1.17(b)(2)

The selling lawyer and the prospective purchasing lawyer may engage in general discussions regarding the possible sale of a law practice but, before the selling lawyer may provide the prospective purchasing lawyer with information relative to client representation or confidential material contained in client files, the selling lawyer must require the purchasing lawyer to sign a confidentiality agreement. The confidentiality agreement must bind the prospective purchasing lawyer to preserve information relating to the representation of the clients of the selling lawyer, consistent with Prof. Cond. R. 1.6 as if those clients were clients of the prospective purchasing lawyer. Prof. Cond. R. 1.17(c); see also, Prof. Cond. R. 1.17, Comment [7].

The selling lawyer and the purchasing lawyer may negotiate the terms of the sale of the law practice, subject to the following requirements or restrictions:

(1) The sale agreement must include a statement by the selling lawyer and purchasing lawyer that the purchasing lawyer is purchasing the law practice in good faith and with the intention of delivering legal services to clients of the selling lawyer and others in need of legal services;

(2) The sale agreement must provide that the purchasing lawyer will honor any fee agreements between the selling lawyer and the clients of the selling lawyer relative to legal representation that is ongoing at the time of the sale. The purchasing lawyer may negotiate fees with clients of the selling lawyer for legal representation that is commenced after the date of the sale;

(3) The sale agreement may include terms that reasonably limit the ability of the selling lawyer to re-enter the practice of law, including, but not limited to, the ability of the selling lawyer to re-enter the practice of law for a specific period of time or to practice in a specific geographic area. The sale agreement may not include terms limiting the ability of the selling lawyer to practice law or re-enter the practice of law if the selling lawyer is selling his or her law practice in order enter academic, government or public service or to serve as in-house counsel to a business.

Prof. Cond. R. 1.17(d).

Prior to completing the sale of the law practice, the selling lawyer and purchasing lawyer must provide written notice of the sale to the clients of the selling lawyer. The clients of the selling lawyer include all current clients of the selling lawyer and any closed files that the selling lawyer and purchasing lawyer may agree to make subject of the sale. Prof. Cond. R. 1.17(e).

The written notice provided by the selling and purchasing lawyer must include (1) the anticipated effective date of the sale; (2) a statement that the purchasing lawyer will honor all existing agreements for legal representation that is ongoing at the time of the sale and that fees for legal representation commenced after the date of the sale will be negotiated by the purchasing lawyer and client; (3) the client's right to retain other counsel or take possession of his or her case files; (4) the fact that the client's consent to the sale will be presumed if the client does not

take action or otherwise object within ninety (90) days of receipt of the notice; and (5) biographical information about the professional qualifications of the purchasing lawyer, including but not limited to information consistent with Prof. Cond. R. 7.2, information regarding any disciplinary action taken against the purchasing lawyer and information regarding any pending disciplinary proceedings against the purchasing lawyer. Prof. Cond. R. 1.17(e).

The sale of the law practice cannot be financed by increases in fees charged to the clients of the practice. Existing arrangements between the seller and the client as to fees and the scope of the work must be honored by the purchaser. Prof. Cond. R. 1.17, Comment [10].

If the seller of the law practice is the estate of a deceased lawyer or the representative of a disabled or disappeared lawyer, the purchasing lawyer must provide the written notice required by division (e) and the purchasing lawyer must obtain written consent from each client to act on the client's behalf. However, the client's consent is presumed if no response is received from the client within 90 days of the date the notice was sent to the client at the client's last known address as shown on the records of the seller or the client's rights would be prejudiced by a failure to act during the 90 day period. Prof. Cond. R. 1.17(f).

At a minimum, the notice must include sufficient information about the proposed sale and the purchasing lawyer that will enable each client to make an informed decision regarding consent to the sale. A client may elect to opt out of the sale and seek other representation. However, consent is presumed if the client does not object or take action within 90 days of receiving the notice of the proposed sale. Prof. Cond. R. 1.17, Comment [7A].

The written notice to clients must be provided by regular mail with a certificate of mailing or other comparable proof of mailing. In lieu of providing notice by mail, either the selling lawyer or the purchasing lawyer, or both, may personally deliver the notice to a client. In the case of personal delivery, the lawyer providing the notice must obtain written acknowledgement of the delivery from the client. Prof. Cond. R. 1.17(h).

A lawyer or law firm ceasing to practice law cannot be required to remain in practice because some clients cannot be given actual notice of the proposed purchase. Prof. Cond. R. 1.17, Comment [8].

If the client cannot be given the notice required by division (e), the representation of that client may be transferred to the purchaser only after the selling lawyer and purchasing lawyer have caused notice of the sale to be made by at least one publication in a newspaper of general circulation in the county in which the sale will occur or in an adjoining county if no newspaper is published in the county in which the sale will occur. Upon completion of the publication, the client's consent to the sale is presumed. Prof. Cond. R. 1.17(g).

All elements of client autonomy survive the sale of the law practice, including the client's absolute right to discharge a lawyer and to transfer the representation to another lawyer. Prof. Cond. R. 1.17, Comment [9].

Finally, neither the selling lawyer nor the purchasing lawyer may attempt to exonerate the lawyer or law firm from or limit liability to the former or prospective client for any malpractice or other professional negligence. The provisions of Prof. Cond. R. 1.8(h) is incorporated in all agreements for the sale or purchase of a law practice.[1] However, the selling lawyer or the purchasing lawyer, or both, may agree to provide for the indemnification or other contribution arising from any claim or action in malpractice or other professional negligence.

C. Considerations and Steps for the Selling or Buying of a Law Practice[2]

The buyer's primary goal in the prospective purchase of a law practice is typically to secure a sustainable revenue stream from the seller's current clients and business relationships. On the other hand, the seller of the practice wants to be certain that the buyer will be able to meet his or her financial commitment for the purchase of the practice. Both parties, however, must also be concerned with safeguard clients and complying with their respective ethical obligations.

The interested parties to the law practice sale and purchase are not limited to the buyer and the seller. Other individuals or entities that are likely to be involved in the transaction include (a) the firm's clients; (b) accountants for both the buyer and seller; (c) independent valuation experts; (d) office staff and key employees to maintain operations; (e) bankers and financing entities. Depending upon the nature of the practice, the transaction may also include (f) a landlord; (g) equipment leaseholders; (h) insurance providers; (i) outside entities (e.g., courts, Bureau of Workers Compensation, etc.).

1. Components of the Confidentiality Agreement

The first substantive step toward the sale and purchase of a law practice is the preparation and execution of the Confidentiality Agreement ("Agreement") required by Prof. Cond. R. 1.17(c). The Agreement must make it clear that the buyer wants to obtain and review confidential and proprietary information from the seller that may include confidences and secrets of the seller's clients. The Agreement must also represent that the buyer is qualified to be a "purchasing lawyer" under Prof. Cond. R. 1.17(b)(1) and that the seller agrees to provide information pursuant to the terms of the Agreement and Prof. Cond. R. 1.17(c) and 1.6.

Necessary components of the Confidentiality Agreement include the following:

(a) Confidentiality: the buyer agrees to treat and handle in a confidential manner all information that the buyer obtains concerning the seller and his/her clients;

[1] Prof. Cond. R. 1.8(h) prohibits a lawyer from, among other things, making an agreement that limits the lawyer's liability to a client for malpractice or requiring arbitration of a claim against the lawyer unless the client is independently represented in making the agreement.

[2] Acknowledgement and appreciation is given to *OfficeKeeper*, Chapter 9, "Closing, Selling or Acquiring a Law Practice" by Theodore Mann, Jr.

(b) No Detrimental Use: the buyer agrees that the information received will not be used by the buyer in any way that is detrimental to the seller or the seller's clients and that such information will be kept confidential by the buyer.

(c) Disclosure and Discussions: neither the buyer nor representatives of the buyer will, without the prior written consent of the seller, disclose to any person or entity that discussions or negotiations are taking place or may be taking place regarding a proposed transaction between the buyer and seller or any of the terms or conditions of any possible transaction.

(d) Representative: this provision specifies who may have access to the information regarding the law practice or the proposed transaction. Typically, representatives may include an officer or employee of the buyer, an accounting firm or other entity or person who, in the good faith judgment of the buyer needs to have access to some or all of the information for the purpose of evaluating the transaction.

(e) Disclosure Required by Law: this provision specifies that, if the buyer is requested or required by law to disclose any of the information regarding the law practice or the transaction, the buyer will provide the seller with prompt prior notice of the request so that the seller may seek an appropriate order or, alternatively, waive compliance with the confidentiality provisions of the Agreement.

(f) No Representation or Warranty: this clause provides that, although the seller will try to be sure that the information provided to the buyer is accurate and reliable, the buyer understands that the seller makes no warranty as to the accuracy and completeness of the information and that the seller has no liability to the buyer for the use of the information.

(g) Return of Materials: the Agreement should include a provision that the buyer will return all written information to the seller at the conclusion of the transaction and that the buyer will destroy all notes and other documents.

(h) Injunctive Relief: it may be appropriate to include a provision entitling the seller to immediate injunctive relief and a temporary order restraining any breach of the Agreement.

(i) Non-Waiver: the parties agree that a failure or delay by the seller in exercising any right will not operate as a waiver of subsequent rights or breaches of the Agreement.

(j) Applicable Law: this provision will specify that the applicable law in the interpretation and application of the Agreement will be Ohio law.

Once the Confidentiality Agreement has been executed, the evaluation of the law practice and negotiations regarding the terms and conditions for the sale and purchase of the practice can proceed. Those terms and conditions should thereafter be incorporated into a Contract for Sale.

2. Contract for Sale

The terms and conditions for the sale and purchase of the law practice should be memorialized in a Contract for Sale that includes the following provisions:

(a) The introductory paragraph of the Contract for Sale ("Contract") will identify the parties to the Contract and will specify the law practice that is the subject of the sale.

(b) A provision addressing the requirements of Prof. Cond. R. 1.17(d)(1) through 1.17(d)(3) specifying that (i) the buyer is purchasing the law practice of the seller in good faith and with the intention of delivering legal services to clients of the seller and others in need of legal services; (ii) the buyer will honor any fee agreements currently in existence between the seller and existing clients but reserves the right to negotiate fees with clients of the seller for legal representation that commences after the date of the sale; and (iii) the buyer reserves the right to negotiate for reasonable limitations on the ability of the seller to re-enter the practice of law as further defined in the Contract.

(c) An itemization of what the buyer is purchasing and the seller is selling, which may include (i) the furniture, fixtures, equipment and library of the seller's practice; (ii) the files and records pertaining to clients of the seller that are being transferred to the buyer with the consent of the clients; (iii) files, books, records, work papers and other tangible assets pertaining to the sellers practice (including accounts receivable); (iv) any leasehold interest owned by the seller for the premises; and (v) the trade, goodwill and other intangible assets of the seller's practice.

(d) The total purchase price to be paid by the buyer and specification of how the purchase price will be paid.

(e) A date for the consummation of the sale and what the seller will deliver to the buyer on that date, which may include (i) a bill of sale; (ii) an assignment of any existing lease; (iii) a consent to assignment of the lease; (iv) all other documents or instruments reasonably necessary or convenient for buyer's operation of the practice.

(f) A provision about the buyer assuming any expenses related to the law library for the practice.

(g) A provision regarding any reasonable limitation on the seller's future practice that complies with Prof. Cond. R. 1.17(d)(3). The Contract cannot include any practice limitation provision if the seller is selling his or her practice in order to enter academic, government or public service or to serve as in-house counsel to a business.

(h) If one or more of the employees of the seller's firm are staying, their identities should be included in the Contract, along with their positions, salaries, etc. The buyer may wish to consider retaining subordinate lawyers from the seller firm or may wish to seek other attorneys for the practice.

(i) A provision addressing any service contracts that the seller may have. These service contracts should be listed as an exhibit to the Contract so the buyer knows that the service contracts exist.

(j) A provision addressing "work in progress", i.e., who will be responsible for legal work on client matters that commenced prior to the effective date of the sale but that will not be completed until after that date.

(k) A provision that identifies and prorates responsibility for various obligations, such as (i) personal property taxes; (ii) rent for the offices of seller's practice; (iii) salaries of employees; (iv) social security taxes; (v) charges accruing on service contracts.

(l) There may be a provision for indemnification by the seller of the buyer arising from seller's operation of the practice prior to the effective date of the sale as well as indemnification of the seller by the buyer from claims arising after the effective date of the sale. However, neither the seller nor the buyer may attempt to exonerate himself or herself or limit his or her liability to a client for malpractice or professional negligence. See Prof. Cond. R. 1.8(h).

(m) A provision indicating that the property described in the Contract and the books of account have been inspected and are being purchased as a result of that inspection and not as a result of any representation by the seller.

(n) A provision may be included for the buyer to indemnify and hold the seller harmless from any and all claims, losses, damages, etc. arising from or in connection with operation of the seller's practice or ownership, control or management of any assets or property after the effective date of the sale.

(o) A provision indicating that the Contract constitutes the sole and only agreement and that it correctly provides for the obligations of each party.

(p) A provision may be included that specifies that any controversy or claim arising out of the Contract or related to the Contract be resolved through arbitration.

(q) A provision making the Contract binding and inure to the benefit of the heirs, executors, administrators, successors and assigns of the parties.

(r) A provision specifying that the Contract will be interpreted and applied in accordance with Ohio law and the Ohio Rules of Professional Conduct.

3. Other Key Documents and Notices

Additional documents that are important to finalization of the sale and purchase of a law practice are the Notice of Sale to Clients ("Notice of Sale") and the Client Consent Form required by Prof. Cond. R. 1.17(e) and 1.17(f), respectively.

The Notice of Sale, which must be provided before the sale of the law practice is completed, must be sent to all current clients of the seller and to those clients whose matters have been completed but are nevertheless made a subject of the sale (e.g., files with accounts receivable).

The Notice of Sale must include the following specific information to the client:

(i) Effective Date: The anticipated effective date of the sale.

(ii) Legal Fees: A statement that the buyer will honor existing fee agreements and will negotiate terms for any new matters.

(iii) Client Rights: A statement that the clients have the right to retain other legal counsel or take possession of their files.

(iv) Consent: A statement that, if the sending lawyers do not hear from the client within 90 days of receipt of notice, consent will be presumed.

(v) Purchasing Attorney Information: Complete information about the purchasing attorney, including his or her date of admission, any prior disciplinary history or any pending disciplinary complaints. This is also an opportunity for the purchasing lawyer to introduce himself or herself of the selling attorney's clients.

The Notice of Sale must be provided by certified mail, return receipt requested since the time limit for responding is calculated from the date of receipt of the notice.

Although not mandatory, the inclusion of a Client Consent Form and a stamped return envelope can make it easier for clients to respond and agree to the inclusion of their matter(s) in the proposed sale.

II. Closing a Law Practice

There are several Rules of Professional Conduct that must be considered in connection with a lawyer's decision to close his or her law practice, whether it is the lawyer's intent to retire from the practice of law or to take an academic, governmental, public service or in-house counsel position.

Foremost among the Rules that must be considered and complied with are: Prof. Cond. R. 1.15(a), 1.15(f), 1.16(c), 1.16(d), 1.16(e) and, potentially, Prof. Cond. R. 1.9 and 1.11.

The lawyer who decided to close his or her law practice should also take steps to either return or, with client consent, destroy closed files as permitted.

Prof. Cond. R. 1.15(a)

Prof. Cond. R. 1.15(a) requires a lawyer to maintain records of each client's funds that have been deposited into the lawyer's client trust account for a period of seven years after termination of the representation or the appropriate distribution of the client's funds or property, whichever comes first. For property, the records maintained by the lawyer must include (a) a record that identifies the property; (b) the date the property was received; (c) the person on whose behalf the property was held; and (d) the date of distribution.

With respect to funds, Prof. Cond. R. 1.15(a) requires the lawyer to maintain, for the required seven-year period the following:

(a) a copy of any fee agreement with each client;

(b) a client ledger for each client whose funds were deposited into the client trust account, including (i) the name of the client; (ii) the date, amount and source of all funds received from or on behalf of such client, (iii) the date, amount, payee and purpose of each disbursement made on behalf of the client; and (iv) the current balance for the client;

(c) a general ledger for each client trust account that sets forth (i) the name of the account; (ii) the date, amount, and client affected by each credit or debit; and (iii) the balance in the account;

(d) all bank statements, deposit slips and cancelled checks for each bank account (if provided by the bank);

(e) perform and retain a monthly reconciliation of the items contained in subdivisions (b) through (d) above.

Prof. Cond. R. 1.15(f)

Rule 1.15(f) provides that, upon dissolution of any law firm, the former partners, managing partners or supervisory lawyers shall promptly account for all client funds and shall make appropriate arrangements for the maintenance of all records generated upon subdivision (a) of Rule 1.15.

Prof. Cond. R. 1.16(c)

Rule 1.16(c) provides that, if permission for withdrawal from employment is required by the rules of a tribunal, a lawyer shall not withdraw from employment in a proceeding before that tribunal without its permission.

The term "tribunal" includes a court, an arbitrator in a binding arbitration proceeding, or a legislative body, administrative agency or other body acting in an adjudicative capacity. See Prof. Cond. R. 1.0(o).

Thus, if the lawyer is retiring or leaving his or her law practice while there are still matters pending before a tribunal, he or she must obtain permission for withdrawal from that pending matter if required by the rules of the tribunal.

<u>Prof. Cond. R. 1.16(d)</u>

If the lawyer who is retiring or leaving the private practice of law still has pending client matters, whether or not there is a pending proceeding before a tribunal, the lawyer must comply with the requirements of Rule 1.16(d), which provides as follows:

> "As part of the termination of representation, a lawyer shall take steps, to the extent reasonably practicable, to protect a client's interest. The steps include giving due notice to the client, allowing reasonable time for employment of other counsel, delivering to the client all papers and property to which the client is entitled, and complying with applicable laws and rules."

As defined by Rule 1.16(d), the phrase "client papers and property" includes pleadings, correspondence, deposition transcripts, exhibits, physical evidence, expert reports, and other items reasonably necessary to the client's representation.

<u>Prof. Cond. R. 1.16(e)</u>

This rule provides that a lawyer who withdraws from employment shall refund promptly any part of a fee paid in advance that has not been earned, except when withdrawal is pursuant to Rule 1.17 [sale of a law practice].

With respect to the refund of unearned fees, it should be noted that Prof. Cond. R. 1.15(d) requires a lawyer, upon request of a client or third person on whose behalf the lawyer is holding funds, to promptly render a full accounting regarding the client's or third person's funds or other property.

<u>Prof. Cond. R. 1.9</u>

Rule 1.9(c) provides that a lawyer who has formerly represented a client in a matter shall not (1) use information relating to the representation to the disadvantage of the former client except as the Rules of Professional Conduct permit or require; or (2) reveal information relating to the representation.

Prof. Cond. R. 1.11

Rule 1.11 relates to special conflicts of interest for former or current government officers and employees. This rule may be applicable if the lawyer is closing his or her law practice in order to enter government service.

In that regard, Rule 1.11(d) provides that, except as law may otherwise expressly permit, a lawyer currently serving as a public officer or employee must comply with Rules 1.7 and 1.9 [relating to the conflicts of interest of relating to current and former clients of the lawyer] and may not participate in a matter in which the lawyer participated personally and substantially while in private practice, unless the appropriate government agency gives its informed consent, confirmed in writing.