PerformLaw

A LAW FIRM'S GUIDE TO TRANSITION PLANNING

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AN OVERVIEW:
Law Firm Transition Planning

With an estimated 65% of equity partners approaching retirement age over the next decade, most attorneys working in a firm will be affected by the challenge of transition planning. While this statistic is notable, most law firms pay little attention to partners' plans for retirement. In fact, less than 35% of firms have written agreements covering transition planning and retirement.

A successful transition plan will benefit retiring partners, the firm, and the firm's clients. Wise law firms will take the time to create and implement a solid transition plan and will have a competitive advantage. What steps are needed to develop an effective transition plan?

This eBook can guide your firm in answering such questions:

- 1. What transition compensation should I receive?
- 2. Does my firm have the resources to complete a successful transition?
- 3. How do I fairly value my practice?

PerformLaw for Your Law Firm

PerformLaw is focused on planning, development, analysis & improvement of your firm. We won't waste your time. We operate efficiently to keep costs down and provide professional, dedicated staff to service each client. Committed to earning your trust, we want to serve as your "business coach for life."

In regards to transition planning, PerformLaw can help your firm to navigate the strategic, management, economic and cultural issues involved in transitioning a law firm. We can also share our experience and knowledge of the best practices in the industry and help to benchmark where you stand against your peer firms.

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1. Process Management and Setting Expectations

Law firms taking a progressive approach to considering the elements of a transition plan must have a sustained focus. This is often difficult for administrators and lawyers who must manage daily business demands and press client service issues. To best ensure the planning process remains focused and deliberate, a law firm needs outside support to work in conjunction with in-house resources.

We have found that management personnel shares many of the concerns of younger partners, associates, and staff. Their awareness of the business continuity issues typically comes from their experience and direct input from the individual lawyers and other employees.

We see management and staff as participants in the process who also have a stake in the outcome of the process. Additionally, objective third party advice can enable a less risky communication process from not partner participants.

A typical transition planning process takes six months to a year to complete and involves an in-depth analysis of the following areas:

- Work-life timelines and capacity planning;
- Marketing;
- Attorney development;
- Recruiting;
- Compensation and incentives;
- Transition and buyout compensation;
- Policy formulation;
- Partnership or operating agreement;
- Orderly transfer of ownership interests;
- Technology;
- Platform building;
- Implementation timing and process; and
- Staff Development

Taken together, these areas of concentration inform a firm's highest priorities. The broad purpose of each analysis as follows:

- Work-life timelines provide a planning horizon;
- Marketing effectiveness indicates the firm's ability to meet revenue goals; Attorney development is essential to skill set continuity;
- Recruiting effectiveness enables a firm to address capability and capacity weaknesses;
- Compensation and incentives can attract high-profit laterals, ensure partners practice profitably, and incent senior partner transitions;
- Policy development is essential for promoting consistency and building trust among partners, associates and staff;
- A partnership or operating agreement ensures that necessary actions have the weight of a legal agreement;
- Perpetuating a law firm requires a process for transferring equity without controversy;
- Technology can promote efficiency, provide a competitive advantage and bind clients to the firm;
- Creating a platform that elevates the success of the lawyers and staff builds value;
- A trained and motivated staff can support the knowledge transfer process; and
- Ensuring that process moves from planning to implementation is vital to the long-term interests of the firm.

The goal of the transition planning process is to develop a set of thoroughly analyzed and ready-to implement priorities.

2. Work-life Timelines and Capacity Planning

Work-life timelines for all attorneys within ten years of retirement age are necessary for indicating the future capacity needs of the firm. It is our experience that many attorneys seriously consider retirement between age 68 and 70.

Practice areas are more likely to survive over a longer continuum than many client relationships. For this reason, transition planning ten years before an actual retirement is conceptual and primarily focused on the sustainability of the skill sets in any affected practice areas.

Preparing work-life timelines in advance forces aging partners to consider their successors. In our experience, introducing replacement lawyers into a client account at least three years before a partner retirement can improve client retention probability.

Choosing a successor from an existing account team seems logical, but is not always an optimal choice. In many instances, loyalty and emotional attachment can impair the judgment of the retiring partner. Law firm management can struggle to find a voice in these situations. The retiring partner may feel that a loyal and hardworking member of the account team deserves an opportunity to assume the lead role, which is fine if this person is the best choice.

Most small and mid-sized firms have a non-interventionist policy regarding partner and client relationships, and it’s hard to insert a successor lawyer into a client account without the full support of the retiring partner and key members the account team. As we have had better success with incentives rather than penalties, we recommend approaches that encourage retiring partner cooperation.

Capacity planning that includes a consideration of skill and experience levels is an essential element of any transition plan. The items considered in a capacity plan include the following:

- **Age;**
- **Experience;**
- **Unique skill sets;**
- **Billable hours targets;**
- **Skill development needs;**
- **Marketing goals;**
- **Bar and professional goals;**
- **Pro Bono commitments;**
- **Recruiting responsibilities; and**
- **Administrative contributions.**

These analyses are prepared, as relevant, at the firm, section, practice or by strategic grouping. For example, by client team or even by skill set such as trial experience.

Capacity planning is inexpensive but curing the indicated weaknesses typically comes at a cost. For example, hiring in advance of the need to allow for training can run into six figures during the ramp up period.

Several benefits and risks come with this approach to capability and capacity management including:

Benefits:

- ➢ Enables transition planning;
- ➢ Guards against turnover;
- ➢ Can contribute to the competitiveness of the firm;
- ➢ Can create competitive peer pressure;
- ➢ Helps ensure high client service levels; and
- ➢ Can maximize profitability when work surges.

Risks:

- Financial risk;
- People don't always work out;
- Excess capacity can impact productivity of others;
- Training objectives not achieved;
- Clients may not cooperate;
- Potential compensation implications; and;
- Partners who do not directly benefit may lose patience with the process.

Assuming a firm can get comfortable with the risks, staffing in advance of demand is a useful tool in transition readiness.

Another element of capability and capacity management is the concept of strategic staffing. This staffing approach seeks to align case assignments with skill development or client transition objectives. For example, assigning a senior associate who needs trial experience to cases that are going to trial, or working a successor lawyer into a client's most important matters.

The largest impediment to this staffing approach is a workload imbalance (big case, new work, turnover, etc.) that causes immediate capacity needs to meet client demands. When this happens, the firm's short-term needs come into conflict with long-term strategic goals.

Typically, short-term priorities win. The pressure of the work and the immediate financial gains can create an overwhelming force. Unfortunately, these situations can result in unprepared associate lawyers, a weak transition posture, a bloated cost structure and challenging HR situation.

Ensuring the long-term viability of the firm requires a more thoughtful approach to staffing and a genuine interest in the careers of colleagues and co-workers. The risks to a disciplined approach to staffing are real, but the benefits can define a firm for decades.

3. Marketing Plan

Successfully transitioning a law firm to the next generation is imperative to the continuation of a law firm. Law firms must be able to retain longstanding clients and also consistently attract new business. To do this, a law firm must often develop a strategic staffing process and expand its marketing approach.

Strategic Staffing:

Smart competitors will seize any possible opening in a client relationship. Ensuring that the firm is ready for these challenges is an advantage. We recommend strategic client staffing to ensure that younger lawyers build the essential relationships among the firm's current clients, which will make competitive challenges more difficult.

Senior partners should evaluate their client staffing assignments at least three years before any planned transition. If no existing resources are available, we recommend a targeted recruiting process.

Expanded Marketing Approach:

Modernizing the firm's marketing efforts can also improve the chances of a successful transition. With the help of workflows driven by software applications, law firms can also use support staff in the marketing process.

New marketing techniques focus on reaching clients digitally with written content, webinars, video education, and blogging. The intent is to attract visitors to the firm's website, where the firm has the most marketing latitude.

Many successful lawyers also create content rich blogs to support their value to existing clients and to build new relationships. Often these blogs are hosted apart from the firm's main website. We like an approach that has some content hosted on a blogging platform and some on the law firm's website.

Regardless of the content hosting method, we recommend that law firms commit resources to the following items, which are affordable for any size firm:

- Web Development;
- Search Engine Optimization;
- Social Media Support;
- Video Production Support;
- Graphics Support;
- Editorial Support;
- Marketing Automation Software;
- Research; and
- Content development.

Building a marketing platform to assist lawyers and future recruits with their marketing efforts will better enable and incent them to commit to any transition plan the partners adopt.

Relying only on current clients remaining with the firm is typically insufficient. A marketing system that draws new clients to the firm, while hard to perfect, helps ensure that talented lawyers stay with the firm rather than leaving for better-equipped competitors.

Overcoming Resistance:

It is typical, however, to meet resistance to new styles of marketing. More experienced lawyers often prefer traditional marketing activities such as travel, entertainment, speaking, professional and trade associations, and some structured publishing.

Traditional marketing activities are all still necessary, but possibly to a lesser degree. A good marketing plan can combine traditional and digital marketing approaches to increase the overall effectiveness of the firm's marketing efforts.

4. Attorney Development

Attorney development can happen at any age, but starting the process early in a lawyer's career provides greater opportunity to identify future leaders. The goals of an attorney development system include:

- Nurturing those best suited to serve client needs;
- Enabling lawyers to reach their full potential; and
- Early identification of those who would perform better in another role.

To achieve these goals, we recommend a systematic approach to attorney development built on setting expectations, capacity planning, compensation, and progress measurement. More specifically, developing the best lawyers requires several policies, systems, and guidelines that include:

- Hiring criteria;
- Model associate guidelines and expectations;
- Evaluation and or feedback process;
- Practice planning process;
- Client and senior lawyer staffing alignment;
- Compensation and Incentives for billable contributions;
- Compensation and incentives for supervision and training;
- Compensation and incentives for targeted recruiting;
- Origination and origination sharing policies; and
- A transition compensation structure.

At the attorney level, effective capacity planning requires a balanced approach to time investments. In addition to billable expectations, developing a quality lawyer requires time commitments in the following areas:

- Client service fundamentals;
- Personal development;
- Marketing competence;
- Training and mentoring contributions;
- Professional profile and peer recognition;
- Skill development;
- Leverage and supervision;
- Recruiting; and
- Basic law firm economics.

A strategic approach to staffing (aligning client work with training needs) although challenging, can materially speed up attorney development. Client collaboration is necessary, and creating incentives for using junior staffing to can make strategic staffing possible.

A quality attorney development system that includes the essential elements, systems and processes enhances a firm's ability to operate more profitably and can ready lawyers for future leadership and management positions.

5. Recruiting Process

Most law firms need more talent to implement a transition plan successfully. Prospective recruiting and lateral hiring strategies are often needed. A well communicated plan with incentives for those who actively recruit has the potential to transform a firm immediately.

The goals of the recruiting process are as follows:

- Attract good fit laterals;
- Attract good fit new graduates;
- Manage expectations.

To accomplish these goals, an expedited recruiting process and system of rewards are necessary.

Recruiting Process:

Lateral hires with business

Ensuring that the recruiting process is thorough and moves quickly are two key factors. Most good laterals have several opportunities and the firm that can evaluate a transaction quickly and offer a transparent economic deal has an edge.

Firms must efficiently address the following questions when considering a potential lateral hire:

- Opportunity costs and benefits;
- Impact on revenue and cost and profit per hour;
- Compensation, and equity slotting if appropriate; and
- Impact on cash flow and current year earnings.

Creating a streamlined process that can simulate compensation post admission (equity is essential). Smart laterals will want to see current compensation levels of current partners with similar levels of profitability.

New Lawyers and Laterals Without Business

In some instances, attracting the right lawyers to service the firm's current clients can match the impact of a lateral hire with business. Often these contributions are overlooked because they happen over time and with less fanfare. Many firms also only hire when someone leaves, and there is an immediate need. When this occurs, and no suitable replacement is available, law firms are often forced to rely on lesser-talented or lesser trained lawyers to service client work. Eventually, a permanent decline in the capability of the firm can result. To guard against these risks we recommend the following:

- Hiring in advance of need;
- Accept that not everyone is in the right role and upgrade; and
- Appropriately delegate at the partner level to create opportunities.

Recruiting in advance of need requires an honest evaluation of the firm's current staffing capacity and capability. It also requires a budgeting process that allows for a level of prospective hiring.

Compensation and Incentives:

At the equity partner level, most firms consider recruiting a responsibility of partnership and do not compensate for recruiting successes. The benefits of the right lateral hires and new lawyers are often significant. Additionally, those who recruit another attorney to join the firm are more inclined to also stay with the firm.

For these reasons, we recommend that firms consider compensating for all recruiting contributions at every level. The value of attracting quality lawyers to the firm include:

- Profitability contributions;
- Creating competition to drive lawyer
- performance; Longevity;
- Capability increases; and
- Reputational benefits.

Recognizing that recruiting successes can provide substantial economic and cultural benefits will improve the chances of creating a high-performance firm. Favorable market perceptions regarding the trajectory of the firm are invaluable.

6. Compensation and Incentives

In addition to promoting profitable behaviors, a market sensitive compensation plan can produce a very competitive firm, ready to support a transition process for their most successful attorneys.

Maintaining Competitiveness

Preserving the competitiveness of a law practice over an extended period requires a consistent focus on several fundamentals including:

- Marketing effectiveness;
- Origination sharing;
- Rates and realization;
- Billing and collection habits;
- Legal staffing and capacity;
- Training and leveraging contributions;
- Recruiting contributions;
- Attorney development;
- Client service metrics; and
- Client relationship fundamentals.

It is tough for busy lawyers to pay attention to these factors and also to manage client legal challenges. A good support system that can help order priorities can make the job much easier.

Self-Interest versus Firm Interest

Many experienced partners indicate that it becomes more difficult to keep their practices fundamentally sound with time and success. At some point in a partner's career, he or she faces a choice between continuing to invest in their practice for the likely benefit of others or focusing on short-term profit maximization to correspond with their retirement horizon. Choice one helps the firm, but choice two does not.

Ceding client control is an individual decision

It is equally important to recognize that ceding client control happens on an individual lawyer basis and can often lead to adverse income implications. Further, many lawyers believe that they have not received ample compensation for their years of hard work and personal sacrifice. Together, these factors make the transition process exceedingly difficult.

Beyond transition issues

A well-managed firm is better able to manage the transition process. Often factors not directly related to transitioning partners or their staffs can affect a firm's ability to focus on the necessary longer-term strategic factors.

For example, savvy younger partners may come to the realize that their firm has no transition plan and decide to find a better opportunity. Often, the primary motivation for leaving is the reality that their earnings will erode as a result of an inevitable loss of business from aging senior partners.

Consider another example. Other partners may believe that their current good fortune may not last forever and want to maximize their income during success periods. A compensation plan that is not responsive to the market makes the firm vulnerable to either losing these partners or worse create an atmosphere of declension.

Data-Driven Compensation

A data-driven compensation plan that pays at competitive market levels can reconcile the perceived and actual value of a lawyer's economic contributions – there is no better gauge of value than what a competent competitor will pay. Accomplishing this level of acceptance will remove a large obstacle inherent in the practice transition process.

The primary tool for compensating at the market is a contributed profit analysis by originator with client and file level detail. The main elements of this system include:

- Origination sharing policies;
- Profitability by originator with client, file, and timekeeper detail;
- Maximum empowerment over directly allocated costs;
- Maximum empowerment over case staffing;
- Maximum empowerment over directly assigned marketing costs; and
- Minimum of 80% of total income based on contributed profit; and
- Two year rolling average contributed profit for income allocation.

Admittedly, these systems take time and effort to build, but experienced professional help is available. The resulting impact on profitability, firm competitiveness and attractiveness in the market can transform a struggling firm and elevate the success of high performing firms. With a market-based compensation system, a transition compensation feature, and a process for the orderly transition of ownership interests, firms can will significantly increase their ability to pass from one generation to the next.

7. Transition (Buyout) Compensation

Many personal reasons motivate people to continue working rather than retiring. One significant factor is the lack of of remuneration for their income generating asset. Of course, the income generating asset is their client base, which may not be transferable.

Compare this situation to the owner of a successful operating company. In most instances, the owner of the company can sell the business or pass it along to family and reap a reward for his or her lifetime of work.

Since this is not the case with small and mid-sized law firms, especially defense firms, these firms struggle with senior partner buyouts.

Some of the more common reasons for these struggles include:

- Most small to mid-sized firms compensate for originations and profits, which will be affected in the transition years for those partners involved in a buyout;
- Buyouts are more feasible when they are a transaction between the retiring senior partner (seller) and the individual partner or partners assuming control of the work (buyers);
- Other partners are often reluctant to fund a buyout from which they do not directly benefit;
- The firm or partners cannot afford a buyout
- There is a risk associated with not being able to keep the business;
- Other partners may feel that all clients are "firm" clients. If a senior partner was paid fairly along the way, he or she is not entitled to any more money;
- Junior partners who have worked on the senior partner's clients may feel they have earned the right to the origination credit;
- The timelines of the remaining partners may be shorter than the potential rewards reaped from buying a senior partner out;

  and
- The reality that relatively few transitions work as planned.

Any of these reasons can have a degree of validity, and firms must overcome them for any transition to occur. Removing the economic disincentives for senior partner retirements increases the chances of a successful transition.

It is equally important not to overlook the interests of the younger partners. Creating sensible buyouts helps ensure that the firm's best attorneys are not incented to start a new firm to avoid paying senior partners a disproportionate share of current profits

I recommend that clients evaluate each retirement as if it were an individual transaction.

The tools needed to perform this evaluation include:

- Client matter profitability of the transitioning partner's book of business;
- Capacity Analysis post transition;
- Worklife timeline for the retiring partner;
- Worklife timeline for the assuming partner(s);
- Origination ceding schedule;
- Pro-forma profitability of the transitioning book for three years; and
- Compensation pro forma for the retiring partner and the assuming partner(s).

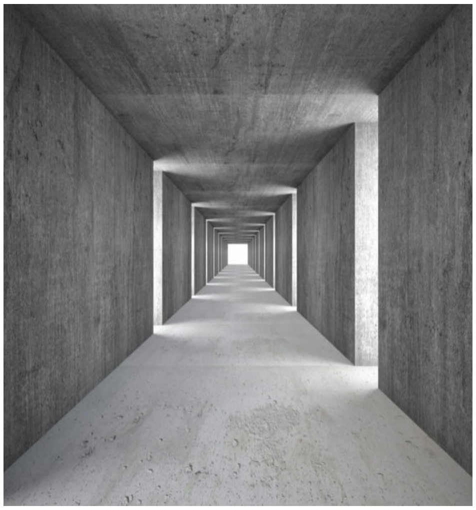
Using an objective process-oriented approach to arriving at a buyout price and structure removes much of the emotion from the negotiation. Firm's that have the data to complete the recommended analyses can set expectations early in the process and create a model for future buyouts. To help manage expectations, we recommend transition modeling two years before the start of any transition.

Buyout period

We prefer a three-year buyout period with a declining payment schedule based on a measure of profitability before buyout costs. For example, the senior partner would continue to receive full origination credit in year 1, a lesser amount in year 2 and a lower amount in year 3. The assuming partner's originations would increase correspondingly. The slope of the origination changes would depend upon the senior partner's level of involvement.

The keys to setting transition compensation include an objective process oriented approach; setting expectations early in the process, and a model to ensure consistency.

8. Policy Development



Developing policies that support the strategic goals of the firm are an essential component of a transition plan. Typically, the results achieved by the implementation of strategic policies take years to actualize, which creates resistance in many law firms.

Strategic policies are often changed or ignored in response to current events. When this occurs, management actions become inconsistent and short-term focused.

If law firms wish to ensure client business continuity, a disciplined approach to policy development and implementation is necessary.

The policies described below can significantly improve the chances of a smooth law practice transition.

Associate and Income Partner Progression

Consider what is at stake when developing progression criteria for the associate lawyer group. Partnership admission criteria are important long-term considerations for talented young professionals deciding to invest in the firm's success or look elsewhere.

A clear advancement structure can make the difference between a good lawyer making her current law firm better or improving the offering of a well-managed competitor.

These policies are equally important to top professionals evaluating a possible association with the firm. Producing written advancement criteria can make a positive difference in the recruiting process.

Policies Needed

- Associate progression criteria
- Partnership admission criteria

* Following policies that support longer-term strategic interests helps ensure that the right people advance, makes it easier to recruit suitable laterals, and helps prepare the firm for future partner retirements.

Retirement Timing

Mandatory retirements do allow for a leadership change and force senior partners to make room for junior partners, but an unprepared firm my face painful consequences by forcing a premature retirement. On the other hand, not making room for younger partner advancement can have equally devastating effects on a law practice.

Mandatory retirement ages are controversial. Many clients value the experience of a senior lawyer who may have an invaluable amount of institutional knowledge or trial experience. Arbitrarily setting a retirement age without a transition plan is often unproductive and not feasible. No setting a retirement age, however, comes with its set of potentially serious issues.

Consider the example of the senior partner who is unwilling execute a transition plan and choosing instead to exert maximum client control. Typically, these partners have not properly introduced any of their partners or senior associates into their client accounts. They also have probably not discussed any continuity plan with their clients. When this occurs, a practice can erode when clients realize that their lawyer has no succession plan, which leaves them exposed.

These instances can result in a conflicted position for the law firm. The question becomes whether a partner is free to destroy their legal practice. As a practical matter, a partner can allow a practice to erode, and once the decline starts, there is little a firm can do to stop it without the retiring partner's cooperation.

Eventually, the retirement question requires an answer. Firms that adopt a transition period approach can ease partners into retirement, which can benefit clients and ensure the future success of the law firm.

Transition Period

We deal with this situation frequently and have better success with creating incentives for transitioning a practice rather than consequences for failing to act. Specifically, we recommend a process that includes creating a policy that encourages partners to declare that they wish to enter a transition period formally.

As mentioned earlier, partners should create a succession plan at least three years before retirement. This policy should contain incentives for a retiring partner to comply and should encourage suitable successors to make the necessary commitment to the process. Finally, the firm should define the criteria for qualifying as a transitioning practice (not all practices transition.

Transition Period Marketing Costs

Enhanced marketing activities during the transition period can promote the relationship transfer from the retiring partner to the successor partner or team. For example, more frequent visits to client offices to support relationship building with the replacement partner (s) can enable a smoother transition.

Additional activities aimed increasing awareness of the value provided by other lawyers on client files can also help build value in staying with the firm after the current partner retires.

Partners who do not benefit directly from a client's origination profits may resist additional marketing spending connected to a transition plan. They instead may prefer allocating these costs within the transition agreement. Adopting a policy for handling transitional marketing costs can remove another obstacle to a smooth client transfer.

Origination Sharing Policies

Most firms compensate partners based on business originations. Law firms sometimes try to disguise the weight that originations have in their compensation formula, but more orientations typically lead to more money. An essential part of any transition plan is a policy for sharing originations during the transition period.

Some firms may choose to underwrite all or part of the compensation cost during a transition period by guaranteeing a certain level of compensation during the transition period. Other law firms require the partner inheriting the client account to absorb transitioning partner compensation costs.

For example, assume retiring partner A agrees to a three-year transition period with origination credit declining by 1/3 each year. As such, Partner B would receive no origination credit for the applicable clients in year 1, 1/3 credit in year 2, 2/3 credit in year 3, and full credit in year 4. An actual origination sharing agreement would depend on profitability, the role of the retiring partner, and the commitment of the successor partner.

Regardless of whether the firm (the remaining partners) underwrites the transition costs or the successor partner absorbs these costs, a smooth transition requires an origination sharing agreement.

Policies Needed

- Mandatory retirement with and without a transition
- Transition period incentives and requirements
- Transition period marketing activities and costs
- Origination sharing policy

* Addressing retirement issues in advance of any immediate pressure enables a process oriented approach and an orderly transition of practices from one generation to the next.

Orderly Transfer of Equity

Equity transfers are typically more complicated in smaller law firms. Firms that include founding members also can have difficulty when founding members want compensation for the risks they took to start the business, deferred income in the start-up years, and the value of the organization they help build. Without a process for reallocating equity, senior partners are often unwilling to surrender ownership, which can cause a crisis.

We recommend that every law firm develop a process for transferring equity on a systematic basis. We also recommend developing a standard approach to valuing equity as it is reallocated among the partners.

Policies Needed:

- Basis for transferring equity between partners
- New partner equity policy
- Lateral partner equity policy
- Capital requirements tied to ownership
- A valuation approach to firm assets

* Transferring equity is more complex when it is a primary basis for compensation. Regardless of compensation implications, a process for transferring ownership among partners is essential to an orderly transition.

Removing Retiring Partners from Leases and Debt Guarantees

Debt guarantees and office leases can pose problems. For example, banks typically require equity partners secure all or a part the firm's notes. A challenge may arise of the bank guarantees do not adjust with changes in ownership in the firm. Additionally, the creditworthiness of the partners may differ and require senior partners to support junior partner guarantees.

Office leases are often a firm's largest debt obligation, but may not require personal guarantees. Regardless of security requirements, law firms do not disregard their obligations. In some instances, law firms have separate agreements among the partners regarding lease obligations.

Whether liabilities are spread to all partners evenly or in proportion to their ownership interests or a combination of both, accounting for changes in ownership is a requirement of any transition plan.

Post Retirement Compensation

Partners who retire from equity ownership may still want to practice on a reduced basis. Affording retiring partners a post-retirement option can ease a partner into a transition. In some instances, however, issues can arise when the retiring partner remains involved in transitioned clients.

Clients may revert to their old habits of calling the retired partner with their assignments, which can cause resentment among the partners who have assumed the lead role. If these issues are not present, retired partners can maintain a small client base or provide expertise to firm clients.

Another situation may arise when retired partners decide to keep a practice for their account. If the partner has received or is receiving compensation from their former firm, an agreement that governs competitive behavior is required.

Policies Needed:

- Post retirement compensation
- Post retirement separate law practice

* Considering post-retirement scenarios in advance enables the firm and the retiring partner to continue a smooth working relationship and supports maximum cooperation with the transition plan.

Return of Capital and Interests in Billing Assets

Retiring partners who have a material amount of fixed capital and undistributed prior earnings invested in the firm are typically due to these monies upon surrendering their ownership. Several capital scenarios can occur, but firms that adjust ownership percentages and capital accounts using orderly process have an advantage.

It is not uncommon to encounter a delayed payment schedule for the return of fixed capital, but payment for undistributed earnings typically occurs over a shorter period.

Billing Assets (WIP and AR), and Interests in Continent Cases

If a firm is structured to pay retiring partners for their interests in the firm's net assets (primarily billing assets), a process for valuing these assets is necessary. For example, not all AR and or WIP is collectible, and the valuing billing assets must consider uncollectible amounts.

A good transition plan coupled with the orderly transfer of equity interests can significantly reduce the amount of fixed capital a retiring partner may have remaining in the firm immediately before retirement

Regardless of the approach to managing fixed and floating capital, we recommend creating policies that govern the return of capital to retiring partners.

Contingent Cases and Liabilities

A consideration of any retiring partner interests in contingent case recoveries or hard cost losses is necessary. As contingent recoveries and losses are often difficult to value before case conclusion, an agreement for splitting the actual net proceeds when realized is needed.

Contingent liabilities may occur in some cases. For example, a malpractice action that exceeds insurance policy limits. When contingent liabilities are present, the remaining partners must consider if an indemnification of the retiring partner is possible and warranted.

To ensure that no impediments to retirement exist and to minimize the possibility of a disagreement with a retired partner, we recommend the following policies.

Policies Needed:

- Return of fixed capital
- Payout of AR and WIP interests, if applicable
- Contingent case policy Contingent liability agreement, if necessary

* Planning and managing the firm's cash flow and capital resources to enable the payouts to retired partners can ensure that the firm does not overextend itself and create a perilous situation.

Operating Agreement

Many of the policies needed to ensure a smooth retirement of partners become provisions in the law firm partnership or operating agreement. While many firms can handle the development of an operating agreement internally, many are better contracting with outside counsel.

Our approach is to identify areas that may impact a smooth retirement process and engage with our client's legal counsel to ensure the provisions accomplish the firm's objectives.

9. Partnership/ Operating Agreement Revisions

Updating or creating an operating agreement (operating agreement and partnership agreement are used synonymously) that supports long-term strategic objectives is necessary. New partner entries, leadership transitions, future equity adjustments, addressing non-performing partners, changes in compensation, retirement and buyout provisions, and most other significant actions require changes to partnership agreements.

It is also important to support strategic initiatives with the weight of a legally binding agreement. For example, if a transition plan requires the admission of new partners, a provision governing the orderly transfer of equity is necessary. Binding the most important elements of the transition plan with a written and legally binding agreement bolsters confidence in the firm's ability to implement the necessary changes.

Operating and partnership agreements are mature documents, and much of their content is standard. Most of the accords we have read contain some references to retirement but mostly in the context of withdrawal.

Frequently, we see agreements that include outdated buyout methodology. Often these provisions contemplate a valuation of the firm that does not comport with reality, which can create unfunded liabilities that can result in a crisis for the remaining partners.

In some instances, partners leave to avoid paying an unrealistic retirement cost.

Additionally, firms that do not have provisions allowing for an orderly transfer of equity can become stagnant if too much power in concentrated in the hands of partners with a short-term viewpoint.

To ensure that your operating agreement contains the right provisions that support the eventual transitioning of the firm, we recommend the following requirements:

Timing and Approach

- Mandatory retirement age
- Transition plans and timing
- Qualifying for a transition plan

Depending upon the size of the firm, we recommend a mandatory age for surrendering equity ownership percentages. Retirement age equity partners may choose to continue practicing in an Of Counsel status, but an agreement as to role and client connection is necessary.

Inserting these types of policies into an operating agreement before actual retirements begin removes the difficulty of opening a dialogue with a senior partner at what may feel like an arbitrary time. For example, a firm may approach a senior partner about retiring when he is 65, which may offend him if he is planning to work several more years.

Mandatory retirement age, transition plan qualification, plan substance, and timing are necessary components of an operating agreement.

We recommend declaring an age that triggers a retirement planning process. For example, an operating agreement provision that requires all partners to indicate their retirement intentions (approach and timing upon the attainment of age 60.

Creating a retirement window, for example, that enables a partner to entirely or partially retire between the ages of 65-70 can create a transition period that spans up to 5 years, depending upon any mandatory retirement provision.

Provisions to deal with underperforming partners who are close to retirement are also necessary. Transition plans may not apply to all partners. An expedited process for partners who have no clients or key client relationships or unique expertise is needed.

For example, a firm may have an initial mandatory retirement age that is binding unless extended by a supermajority of voting interests.

Return of capital and net asset interests

- Return of capital timing and amount
- Payout of AR and WIP interests, if applicable

The capital a retiring partner may have invested in the law firm typically consists of fixed capital and undistributed earnings. As undistributed allocated income has been previously taxed or subject to tax in the current period, most firms pay undistributed earnings on an expedited basis. Depending upon the amount of fixed capital, the payout period can extend for several months or even years.

When the return of capital also includes an amount for a retiring partner's interest in Accounts Receivable and Work in Progress, a valuation process and payment schedule are necessary.

A delayed payment that corresponds to the collection of accounts receivable and unbilled fees is typical. In some instances, however, firm members may agree to longer payment period to allow time to defray any retiring partner replacement costs.

Advance agreement regarding payments of amounts due to retiring partners enables a firm to plan and manage cash resources.

Post retirement liability obligations

- Lease and debt guarantee policy upon retirement
- Contingent liability agreement (if necessary)

Some obligations, especially those to third parties, may need special handling by the remaining partners. For example, a large bank loan that is personally guaranteed by all equity partners will require a release of guarantee for the retiring partner. Loan agreements that require a retiring partner's net worth as collateral are particularly challenging.

Managing a bank guarantee can include several options, but may force a capital call or a pledge of additional collateral from the remaining partners. If the remaining partners are unable to capitalize the firm adequately, concern about the firm's future viability can arise.

Additional complexities may arise when a contingent liability exists for an action that happened during the retiring partner's membership. For example, an impending malpractice suit that may exceed the policy limits of the firm's error and omissions policy.

Depending upon the magnitude of a contingent liability, a range of options may exist, but it is virtually impossible to plan for unknown liabilities in advance. The best approach is to recognize that the potential for contingent liabilities exists and if they arise, take steps to consider the impact on a retiring partner.

Post retirement compensation

- Post retirement compensation options
- Retiring partner buy-out provisions
- Contingent case policy
- Post retirement practice a law

Most law firm compensation systems are designed to pay partners contemporaneously, which results in little residual value accruing to retiring partners except for transitioned client relationships. While retired partner buyouts are difficult in any circumstance, it is particularly difficult to justify post-retirement payments to partners who were not able to transition clients to other partners in the firm.

Although less common in contemporary times, some firms may pay retired partners a stipend for a stated period post-retirement. Typically, these payments fractionally correlate to historical compensation or are based on a previously agreed arbitrary amount.

Transition agreements with retired partners that contain an economic foundation, which is most often related to client transfers, are preferable and easier for the remaining partners to underwrite.

If a firm does have a universal post-retirement compensation option, it is important to create an annual collar based on a percentage of cash net income. For example, limiting the total annual cost of retired partner buyouts to 5% of net income.

Depending upon the size of a partner retirement stipend, it is limiting the payment period to one or two years is recommend. Without a finite time and a material transfer of value(clients), it is hard for the remaining partners to justify reduced earnings for retired partner buyouts. Eventually, the remaining partners will grow weary and may join a competitor or start a new firm.

Depending upon the terms of an operating agreement, retiring partners can sometimes force a liquidation, which is almost never preferable.

Firms that chose to pay all retiring partners a stipend would do well to ensure them the economic burden to the remaining partners is less than the cost to start a new firm.

Agreeing on the type of post-retirement practice of law is necessary. Retiring from one firm and joining another is difficult if a partner is still receiving compensation from a former firm. Addressing post-retirement competition is recommended.

A compensation plan for paying partners who retire from the equity partnership but want to remain active on a part-time basis is necessary. Post retirement pay is typically based on a sharing of worked and generated fees, assuming there is not conflict with a transition plan.

We prefer a transition plan approach with partners who can transfer business. Some firms, however, prefer to pay all partners a retirement benefit and including these provisions in an operating agreement is necessary.

Finally, to the extent that a firm may have contingent cases in progress when a partner retires, a provision governing the distribution of any eventual recoveries is also required.

Orderly transfer of equity interests and capital requirements

- New partner equity policy
- Lateral partner equity policy
- Capital requirements tied to ownership

An orderly process for transferring equity interests among members is beneficial and supportive of firm longevity and growth. When ownership impacts compensation, transferring equity among members is more difficult. Concentrated ownership interests can make admitting new partners harder.

Untying all or a substantial part of compensation from equity percentage can also make it easier to reallocate a retiring or transitioning partner’s ownership units. Performance-based compensation also allows a firm to employ a conservative approach to assigning beginning ownership levels to lateral partners.

We recommend tying capital retained by the firm to the equity interest of each partner. For example, if a firm maintains $300,000 in capital reserves a 10 percent partner will have $30,000 invested in the firm. Tying capital to equity ensures that influence and dollars at risk are aligned.

The orderly transfer of equity and sensible capital management provisions help to ensure that membership interests held by retiring partners are indicative of their current contributions to the law firm.

Firm valuation provisions

- A valuation approach to firm assets
- Interest in firm assets and liabilities

Valuing a law firm beyond book value is tough. Most law firms have no value beyond the lawyers and the clients. The value of a going concern is one possible approach, but a more relevant approach may consider startup value.

For example, how much would it cost if the remaining partners were to liquidate the existing firm and start a new law firm?

Some of the nuanced law firms are creating platforms that may ultimately have value to successor owners. For example, an efficient overhead structure, cutting edge technology, top quality fee earners and staff, a marketing process, client binding mechanisms and proven leadership and management teams may have market value.

For most law firms, many these factors are not present, and book value concepts are most accurate. Provisions are necessary for valuing the firm if retiring partners are going to receive payments based on their equity interest in net assets.

Supporting Policies

- Compensation policies
- Partnership admission policies

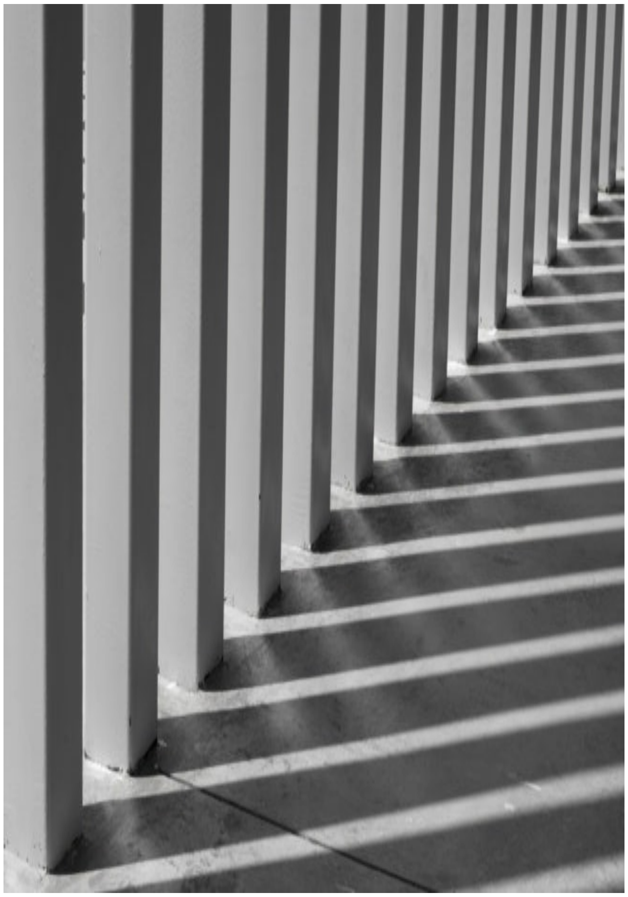
Many firms include their compensation system as an exhibit to their operating agreements. We recommend including definitions and examples of formula based systems. Thoroughly documenting subjective pay systems where possible is also recommended.

Documenting compensation policies and including them in the firm's operating agreement can promote stability and maximum predictability.

New partner admission standards and guidelines are typically not incorporated into an operating agreement, but referencing their existence is helpful. Most operating agreements do contain provisions that govern the admission of new partners as it relates to voting.

We recommend investing the time to create an operating agreement that includes all the necessary policies related to retiring partners. Retirement policies that are well thought out, financially sound, and practical can make a firm sustainable from one generation to the next.

10. Orderly Transfer of Ownership Interests



Transferring equity interests is typically more challenging in smaller or first generation firms than those that are larger or more mature. Firms that include their founding members may have even more difficulty with transitioning a law firm. Founding partners often want compensation for the start-up risks they took, along with their reduced income in early years and the going concern value of the organization they helped to build.

As law firms fully allocate profits to current partners each year, younger partners frequently resist the notion that founding or senior partners should receive compensation for prior risks.

We believe that senior partner goodwill payments that are tied to real residual contributions (book of business) are best compensated as part of a transition plan.

Our experience is that each situation is different and much of the tension relates to the degree of compensation. In practical terms, if the founding members want a payment level that is greater than the cost of starting a new firm, younger partners are then inclined to start a new firm.

Additionally, equity interests based primarily on tenure can leave highly productive partners without a comparable level of influence on firm priorities, which is a risk. Law firms that can balance these realities with their long-term needs can ensure their most productive partners stay and can create advancement opportunities for talented younger partners.

How can a firm transfer ownership to the right people in an orderly way?

Consider the following recommended objectives for any systems that allocate membership units to members:

- Ensuring that those partners who are consistently contributing profits to the firm have a commensurate influence on firm strategy, policy, and management;

- Ensuring that units are available for new partners without a disproportionate impact on the productive partners;

- To facilitate the transition of firm ownership from one generation to the next; and

- To ensure that the most consistently productive partners have the votes to protect the culture of the firm.

Many firms decouple ownership from compensation to help ensure fair pay. Typically, paying partners is accomplished using a bonus plan or some other formulaic approach. Some firms consider management contributions when adjusting equity, but recommend compensating managerial with income rather instead of ownership.

New model firms view partnership equity from an investment perspective. In many instances, a single owner capitalizes the firm initially and owns all the equity. These firms concentrate on building value in their platforms that new partners, when invited, can purchase at am agreed upon valuation upon entry.

Inevitably, however, a traditional law firm structure requires a process for the orderly transfer of equity. While not the only approach, we believe that the best way to meet our recommended objectives is to transfer ownership based on a 3-year rolling average of contributed profits. Our clients employ other viable methods for managing equity interests, but the most successful firms, regardless of their approach, recognize the relationship between consistent performance and ownership.

Smart senior partners realize that if they do not make room for others in a timely way, they risk partner defections and the eventual extinction of the firm. Ultimately, most partners want a positive legacy and do not want to be known as the person who presided over the demise of the firm.

11. Financial Plan

A law firm transition plan can span over several years, requiring substantial investments from the remaining partners. Quantifying the potential impact on the firm's profits and, ultimately, the income of the partners, informs plan development.

Healthy firms that have the right information can expedite the process. Firms that lack profitability and/or have weak financial reporting may need remedial action before committing to a transition plan.

The elements of a transition-oriented financial plan are as follows:

1. Cash flow, debt and equity over the transition period
2. Effect of transition comp on earnings for the firm and for assuming partners
3. Profitability of transitioned work
4. Effect of multiple transitions occurring simultaneously
5. Scenario planning at various levels of transitioned work
6. Exit costs in the event of a failed implementation

1. Cash flow, debt and equity

The capital structure of many firms is reliant upon a combination of trade credit, bank and other interest bearing debt obligations, and members' equity. Members' equity consists of fixed or paid in capital plus any undistributed profits.

Depending upon the amount and duration of retiring partner payments, a firm may need to secure additional capital. Preparing partners for the eventuality of the firm incurring more debt, withholding current earnings, or requiring more paid in capital from partners ensures that sufficient cash is available to make retiring partner payments.

Firms that skip this step are asking for trouble and potentially inviting instability.

2. Effect of transition compensation

The effect of a retiring partner's compensation is either borne by all partners or only those partners participating in the transition plan. In most situations, a hybrid is also possible that includes a share that all partners absorb and a share that the benefiting partners pay.

All remaining members typically underwrite retirement payments not tied to a transition plan. Firms that link retiring partner compensation to the transfer of client relationships can either allocate transition costs to all partners or only to the benefiting partners.

As an example, a firm that uses a profitability driven compensation approach or considers originations in compensation may allocate a retiring partner's transition costs to the partners receiving post-transition origination credit.

A firm may also withhold assigning client credit to any partner until the transition period is complete. In these instances, the partners benefiting from the client transfer defer any compensation increase until after the transition period.

Regardless of the approach, calculating a pro forma effect on the remaining partners' compensation adds to the transparency of the process.

3. Profitability of the transitioned work

Understanding the profitability of a client relationship before a transition is useful, but it is more important to project profit post-transition. Future profit models allow a firm to determine the amount of net income available for transition compensation.

Additionally, a firm must consider the impact of changes in the staffing mix. Assume that the retiring partner worked a high number of billable hours on a client account, but the replacement partner plans to use a more leveraged model. Client considerations aside, what is the impact of that decision?

What if the opposite were true and the replacement partner plans to work many of the hours that were performed by others in a leveraged model?What if the replacement partner is planning to staff the account differently altogether? If the transition plan calls for a retiring partner to receive compensation based on client profits over a period, these considerations are important.

4. Effect of multiple transitions happening simultaneously

Depending upon the size to the firm, simultaneous transitions can overtax the resources of the firm. Additional factors include the term of any payout or return of capital. Some firms cap combined transition costs or retiring partners' costs at a percent of net income.

When transitions are essentially agreements between individual partners, they are easier to accommodate. In these instances, the firm has an interest in ensuring that transition arrangements are well understood by the parties and are feasible. A weak agreement will inevitably become a problem for the entire firm. We recommend partnership approval of all transition agreements.

5. Scenario planning at various levels of transitioned work

We recommend modeling a best and worst case scenario. Worst case planning prompts a firm to consider a process for managing a failing transition. Several considerations become relevant including:

- Who assumes the risk of a successful transition?
- Is there a role for the firm if the transition is not working?
- What monitoring tools are necessary to detect issues in a transitioning account?

Modeling or a best-case scenario is also important. Client relationships are fragile, and a firm may want to allocate additional short run resources to ensure that service levels remain high. A firm may also incur higher marketing and training costs. Recruiting fees may also apply.

In these instances, it is necessary to consider the costs of these additional resources in the transition plan.

6. Exit costs in the event of a failed implementation

Firms should also consider the possibility of failure. This is difficult to do with such a forward-looking action as transitioning a retiring partner's successful practice.

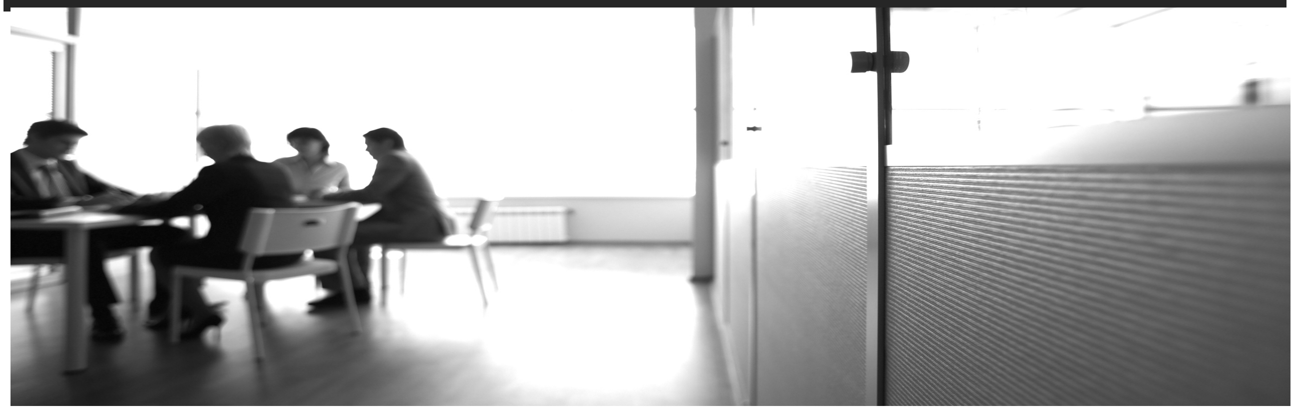
While the retiring partner will likely want compensation in a failing transition, the firm will not have the underlying economic base to make these payments. Correspondingly, a firm or the assuming partner will not want to pay the retiring partner if the clients chose to hire another law firm. Basing compensation to the retiring partner on future receipts diminishes the cost of a failing transition.

Regardless of the approach, quantifying exit costs in the transition agreement is recommended.

A credible process

Transition plans can include several components and a substantial investment. Understanding these costs and adequately preparing for contingencies will add credibility to a firm's practice transition process. A credible process that is repeatable is a competitive advantage.

12. Implementation Support



Ensuring that process moves from planning to implementation is vital to the long-term interests of the firm. A progressive approach to executing a transition plan requires a sustained focus, which is often difficult for administrators and lawyers who must manage daily business demands and be pressing client service issues. Firms tend to lose momentum after the written part of the process is completed. In too many instances implementation falters.

Outside support, working in conjunction with in-house resources, ensures that the planning process remains focused and deliberate. Like planning, implementation requires a process and not a single point in time. It is important for firms to involve those who will be most affected by the change in the process of actually making the changes happen.

Implementing a transition plan does not need to be a complicated process. Helping law firms to use a detailed process, a specific timeline and open communication have yielded excellent results.

13. Building a Platform (Going Concern Value)

Law firm transition planning is trying enough to firms. The process is often further complicated when determining the value of a firm as a going-concern. Senior partners are often dismayed at the unwillingness of junior partners to attribute any value to the firm beyond asset value, including AR and WIP, less any debt.

Most transitions are dependent upon keeping a retiring partner's clients and on having junior partners willing to share a portion of future profits of any transitioned clients. Beyond future income sharing, going-concern value, if any, is typically limited to the amount it would cost the remaining partners to start a new firm and possibly a convenience factor.

It is helpful to organize the valuation process into components as follows:

- Net realizable value of the firm's assets less liabilities;
- A convenience factor related to a functioning firm;
- The value of ongoing client relationships;
- Going concern value which is the value of a firm's intellectual property, systems, processes, procedures, and trained staff, reputation, surviving panel counsel appointments, and any unique distinctions*.

**Adapted from http://www.businessdictionary.com/definition/going-concern-value.html*

Valuation techniques are discussed separately in the valuation section and our purpose now is to answer the following question:

What can a law firm do to create more going-concern value?

To start, a law firm can build repeatable processes that encourages consistent client service and practice efficiency. As an example, a client of ours is adapting a popular cloud-based application and related plugins to manage client case communications and internal case management. Using this automated communication workflow, the firm's lawyers and staff communicate significant case developments in real time and simultaneously enable a consistent case handling and client communication process.

Marketing automation software is another example of how a firm can lessen its reliance on the relatively few lawyers who develop business. Good marketing automation software contains built-in best practices and marketing tools that can raise the level of the firm's marketing competence.

These systems enable all lawyers to contribute to the firm's marketing effort. A junior lawyer can increase her visibility by developing content that is relevant to a target audience. This audience can eventually become followers and contacts.

Dedicating a portion of the firm's resources to building a competent marketing and business development system is another important step in creating going concern value.

Creating going concern value requires modernizing the firm's business processes to the point that they become a platform. Many firms suffer from business processes, procedures, and systems that are ad hoc and intermittently efficient. Most firms struggle to invest the time and money to create any real institutional value.

Firms who fail to invest in building repeatable processes can only claim minimal going concern value. In instances where technology, process and personnel skills are outdated, negative going concern value is indicated.

If the company can create a platform with a value that extends beyond any one client relationship, institutionalizing many of the current administrative processes is necessary. Adopting cloud-based technologies and software applications that can provide needed structure are recommended.

We recommend the following applications for consideration:

- Client case management and engagement software;
- Cloud-based email and Office;Automated Forms and Electronic Signature Application;
- Integrated Document Management with Secure Email Transfer;
- Web Development;
- Automated Planning Software;
- CRM Software; and
- Marketing Automation Software.

Each of these applications can transform the company's ad hoc process and create going concern value. Building a perpetuating firm will require institutionalizing many of the manual processes and procedures. It will also require a substantial knowledge transfer from the senior partners. The idea is to institutionalize as much of this knowledge as possible. Combined with talented lawyers and staff, a firm can significantly increase the chances of a successful leadership transition.

The right software applications can capture best practices and turn them into repeatable processes. Building going concern value that transcends the reputation and referral network of the senior partners is an essential element in the creation of going concern value (something worth buying).

Client engagementapplications, when adapted, are designed to create a consistent interface for clients, lawyers, and staff. Creating service levels and tracking performance can lead to insightful performance metrics. Automated workflows can provide clear and timely communication. Escalation workflows ensure that service levels remain high.

Combined with competent lawyering, a firm can become an easier choice for clients, which is a deterrent to switching to another law firm.

Cloud-based emailand Office (Work, Excel, PowerPoint, Skype, etc.) applications ensure that the firm's licensing and software versions are all up to date. Additionally, as all email is in the cloud, a much simpler disaster recovery process is available.

Many firms have already converted to cloud-based email and Office applications. Firms that are using non-Microsoft applications can enjoy the same benefits. Lawyers and staff benefit from the most current versions of the most popular office applications. Once fully converted, a firm can redirect resources into higher impact areas.

Automated forms, templates, and electronic signature applications create consistent processes where they to do not presently exist. Uniform document templates, forms, and electronic signatures will significantly reduce paper filing and enable fast and efficient workflows

Once created, this collection of forms, templates, and document signature workflows will create a compelling reason to maintain the current firm. Recreating these processes during a new law firm start-up or lateralling to another firm could require a prohibitive amount of time and cost.

Integrated document management and secure email applications provide encrypted email, robust document storage, advanced file sharing and basic to complex document management. Cloud-based systems eliminate the need for most in-house servers, which can improve functionality and reduce IT expense and downtime.

Integrating a fully functional document management system with the firm's other client service applications also creates a strong argument for enhanced going concern value. It also increases the risk and complexity of starting a new firm.

Bootstrapping or recreating these processes, assuming they are competitively superior, is expensive and challenging. Clients would likely notice a negative difference, which can create an opportunity for competitors.

Web development is necessary to improve the company's website and online presence. Creating a website that is a resource for clients and prospective clients can lead to more business and can keep the firm competitive in an increasingly more digital market. Successful web development requires an ongoing commitment.

Building value in a website is a primary consideration in going concern value. Building out a great website takes hundreds of hours of time and significant monetary resources. An effective website can solidify a firm's competitive position in search relevance, elevate the visibility of the lawyers and draw prospective client traffic. It also serves as a strong reassurance to current clients that their buying decision is a correct one.

Automated planning software, especially in sales and marketing can enable a consistent planning process. It can also improve the effectiveness of the sales and marketing personnel. Firm-wide planning software is most useful.

An automated planning process the promotes collaboration among the firm's lawyers, and management can ensure the efficient application of marketing resources. A well-formed plan that includes clear goals and actions is more likely to receive funding and other resources. Management can then gauge the plan's effectiveness recommend improvements.

Firms that can add to a lawyer's personal marketing success can demonstrate a higher going concern value. Alternatively, creating or plugging into a new planning process is disruptive and can stall momentum.

CRM (Client Relationship Management) software ensures the consistent maintenance of client and prospective client relationships. Automated workflows are available to provide regular communication. A detailed mailing list, buyer personas, indications of client interests, important dates, and contact histories are all components of an efficient marketing process and add to going concern value.

Many law firms are uncomfortable with the active pursuit of new clients. For good reasons, law firms are careful with any direct solicitation. Creating a way of engaging prospective clients on a level dictated by them is most effective.

For example, if a firm creates informative content and experiences high-interest levels (tracked by the marketing automation software), it may decide to create a seminar or webinar and invite the interested prospective clients to participate.

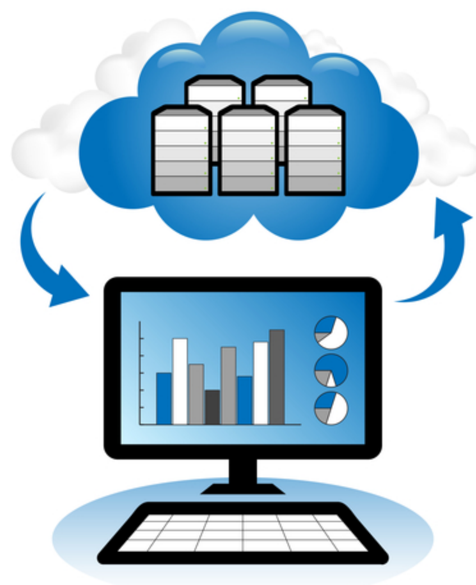
Again, much trial and error are necessary to perfect a procurement strategy, but once completed, the addition to going concern value is significant.

Marketing automation software (MAS) is a powerful tool for lifting a company's image and raising awareness among a larger group of prospective clients. MAS applications are the heart of a digital marketing strategy and management of a company's web presence, social media, client communications, and marketing cost effectiveness.

The right application can provide the best practices, training, support, functionality, workflows and analytics that can transform a firm's marketing. A properly implemented and well-maintained marketing automation system can lift the performance of the average lawyer.

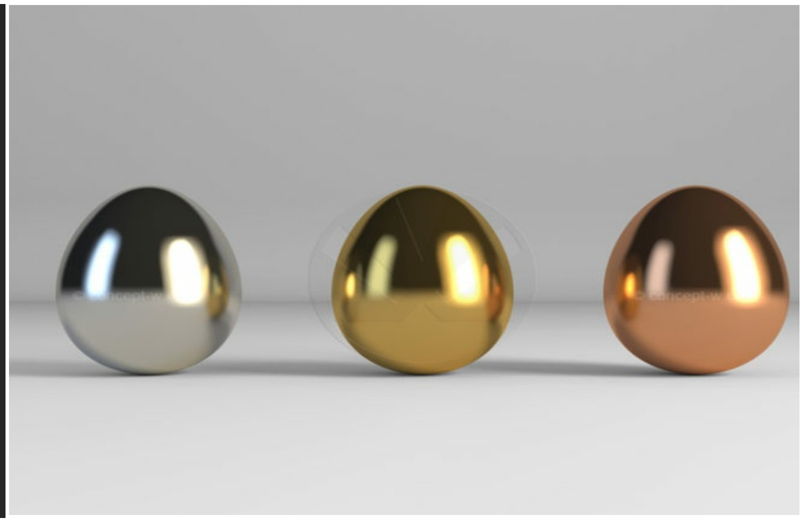
Firms that can offer their lawyers an automated and perfected marketing process coupled with an equally good procurement system will have the highest going concern value.

Cloud-based technologies that enable advanced workflow and document management, marketing automation, and practice specific applications are improving at a rapid pace. Technology can allow a firm to expand to virtually any place in the world with an internet connection. A distributed workforce enabled by technology can expand a firm's reach and reduce overhead at the same time. New technologies can improve client service and enhance competitiveness.



Generating more going-concern value requires focusing on repeatable processes and institutionalizing as much knowledge as possible. Creatively adapting presently available cloud-based applications can transform a firm and increase going concern value. Firm's that rely solely on the relationships and talents of their lawyers and staff have no real going concern value beyond a relatively minimal convenience factor.

14. Valuing a Law Practice



As any other business, a law firm can have market value to the remaining partners. Determining its actual value can help a firm to make informed decisions involving transition planning.

Valuing a law firm can seem complicated, but mainly, it comes down to three elements:

1. Book Value of Equity
2. Platform Value (going concern value)
3. Value of any transitioned business

1. Book Value of Equity

Book Value of Equity is the easiest of these to calculate and most firms can get to this number without too much difficulty. To calculate, a law firm needs:

- An updated A law firm needs an updated balance sheet as of the valuation date
- Current accounts receivable
- Unbilled Sub-ledgers

Most small and mid-sized law firms maintain their books on a cash or modified cash basis. Revenues are recognized when received, and expenses are recognized when paid. Income and expense accruals beyond the current year pension liability are rare.

Book Value of Equity is a simple calculation the includes subtracting total liabilities from total assets.

Most firms reflect this difference in each member's capital account. Given the tax structure of the typical small and mid-sized law firm, all income is allocated each year and flows through to the individual members.

The equity section of a typical law firm balance sheet includes any fixed capital contributions and the undistributed earnings (income less draws and payments on behalf of partners) of the members. Accounts receivable and unbilled fees are typically not included unless a firm prepares an accrual basis financial statement.

Many firms have provisions governing dissolution, withdrawal, disability, retirement, and death in their operating agreements. In our experience, the most common approaches to handling unallocated book value at retirement include:

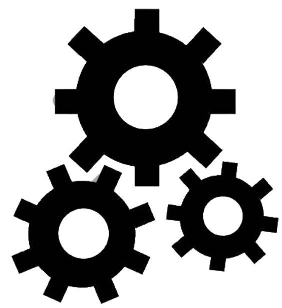
- None (no buy in /no buyout);
- Stated amount (agreed value among the partners);
- Based on retirement year equity; or
- Based on a measure of originations or profit.
- Regardless of the method, allocating book value is the easiest to understand.

2. Platform Value (going concern value)

Assigning a value to a law firm as a going concern can include tangible and intangible assets. Admittedly, valuing a law firm is not likely to follow traditional business valuation approaches, and will probably lack any fair market value comparable. Paying retiring partners for anything beyond book value and shares of future client receipts is rare, but in some instances, we believe there is a legitimate case for paying for the value of a going concern.

Comparing the costs to start a new firm, which includes cash outlays and lost time, to the cost of buying retiring partners interests is an initial starting point. One challenge can include the reality that the existing platform is inefficient and lacking in competitive advantage. In these instances, it is necessary to include modernization costs and difficulties into the analysis.

The items that can add going concern value include:



- Any client master service or panel agreements that can potentially survive a transition;
- Marketing automation system contacts, workflows, blogs, resources, infographics and any other unique client or contact engagement data;
- Website and SEO rankings;
- Billing and financial histories;

- Document management infrastructure, document histories, and document creation templates and utilities;
- Efficient accounting and billing systems;
- Trained staff;

- Branding and name recognition;
- Reputational advantages with clients and judiciary;
- Office leases;
- Difference between the book value of equipment and the cost of buying new equipment;

- Established trade credit and banking relationships;
- Repeatable processes and procedures; and
- Ability to buy increase errors and omissions insurance.

While this list is not all-inclusive, it does indicate several potential advantages for evaluation. Firms who have built an efficient platform can offer junior partners compelling reasons for paying retiring partners for going concern value. Firms who do not score well in these areas have a difficult time convincing junior partners to assign a value premium to the going concern.

Assigning a value to a going concern requires a careful analysis and comparison with the benefits and costs of starting a new firm. Developing a 3-year profitability model that compares the results of maintaining the current platform to those associated with starting a new law firm.

As mentioned previously, paying a retiring partner for going concern value is not an exact science. Each situation will differ and depend on the clarity of advantages.

3. Value of Transitioned Client Accounts

Paying retiring partners for clients that a firm retains is handled in several ways, but in small and mid-sized firms, we prefer individual agreements between retiring partners and those benefiting from the transitioned client relationships.

For example, if a retiring partner facilitates a client transfer to a junior partner, the junior partner would absorb the cost any compensation paid to the retiring partner for any transferred clients. If more than one partner benefits from a retiring partner's clients, each partner will participate in defraying the cost of the retiring partner's compensation in proportion to the benefit they receive.

Firms that have client and matter profitability readily available have an advantage and can negotiate sustainable agreements retiring partners.

A firm can set guidelines on how much a partner receives on a percentage basis and the duration of the payouts, but each retiring partner agreement can differ.

Other approaches to paying retiring partners include:

- **historical compensation based formulas,**
- **arbitrary stipends, no benefit,**
- **founder's bonuses,**
- **and other guaranteed payments.**

Additionally, most small and mid-sized firm partners receive performance-based compensation throughout their careers, and many firms do believe that additional post-retirement compensation is justified. In these instances, partners are likely only to receive their capital account balances.

Transitioning clients requires planning and active participation on the part of a retiring partner. Creating the right incentives can increase the likelihood of perpetuating the firm.

A progressive approach to developing and executing a transition plan requires a sustained focus, which is often difficult for administrators and lawyers who must manage daily business demands and be pressing client service issues. Outside support, working in conjunction with in-house resources, ensures that the planning process remains focused and deliberate.

PerformLaw for Your Firm

You have probably worked long, hard hours and made many sacrifices to build a great career and organization. You do not want to let your investment and all of your hard work to end up benefiting your competitors.

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