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Ready for the handoff? Get a succession plan, or say goodbye to a better retirement.

John DeMoor

Having a successor in place to take over a **solo law** practice can mean a difference of \$100,000 to \$500,000 extra to spend in retirement, **law firm** consultant Dustin Cole says.

Cole, who spoke this month at the **Solo & Small Firm** Conference at the Lake of the Ozarks, said few **solo** and small **firm** practitioners plot out what to do with their practice upon retiring. In the end, most will shut down or sell their book of business to another lawyer. The saddest thing to see is an attorney who worked for 30 years and just closes it and walks away. Or, 'We tried [a successor], and it didn't work out,' he said.

Cole, who has been advising small to large firms for 23 years, says businesses are bought and sold regularly by brokers and consultants based on standard valuation models. But simply selling a legal practice results in a drastically discounted value, he said.

A legal practice is more than a book of business, and few attorneys realize their practice has value based on decades of good will and dedication, he said.

Cole showed how to pass on a practice to a successor in a way that allows lawyers to cash out their full value, step back over time from ownership and management of the firm, and remain in practice with the same firm for an extended period of time.

This allows not only for a larger 'sale' value over time, but also provides additional income and allows them to stay connected with their profession, he said.

He offers the following tips when putting together a succession plan:

Change the compensation structure

A **solo** and small **firm** lawyer ideally should begin switching the **firm's** compensation structure before ever looking for a successor. Part of what attracts a new lawyer is being able to see how a **law firm** business **runs** and that it's an efficient, profitable and a well-oiled machine, he said.

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To accomplish this, Cole emphasizes that the **firm's** compensation structure be split into the following tiers:

- 1) work produced;
- 2) management of responsibilities;
- 3) origination of new business;
- 4) ownership.

Ownership must be converted to shares of stock so there is a way to parse it out to the incoming lawyer over a five-year period. Ownership is about profit sharing, he said, and shouldn't be confused with the everyday work that needs to be compensated.

Once you break down your compensation this way, it works for the new person coming in. It works all the way through the whole transition process, and it works with the transitioning attorney going out, he said.

The buyout is completed over four years. The first year is a test year with no ownership shares offered, but he suggests gifting a small percentage, such as 5 percent, for rewarding the buyer and encouraging the person to stick it out.

After the fifth year, the incoming lawyer will hold all ownership shares, but he or she hasn't completed the buyout to the senior lawyer for another year or two. Cole said it's analogous to I own the car, but I'm still making payments.

Extending the buyout for two more years assures the buying lawyer that the person leaving still has a stake in making sure the firm is producing revenue, he explained, because the value of the firm is mostly the goodwill value, not the files.

So you want to retain the goodwill as long as possible by having the attorney still there, still visible and working his contacts, feeding cases to the firm, he said. Those last two years are the golden handcuffs for the guy leaving.

Identify a successor

* Avoid using the normal hiring practice for associates, and do not look for a mini-me, Cole said.

* Develop a profile of the ideal candidate:

- * Age range
- * Type and level of skills needed
- * Personal character and motivation
- * Relationship to the community and market
- * Personality match

Figure 12 to 18 months to find someone, then three to five years to groom him or her. This timeframe allows for false starts and do overs, he says.

It's important to honor your agreement and not to create false starts by deciding to postpone the transition process, he said. Often, lawyers postpone the transition, leading good succession candidates to look for more reliable opportunities elsewhere.

Detailed timelines for transition

Failure to develop a clear picture for both the lawyer taking over and the retiring lawyer will end up in disaster for the succession process. The No. 1 golden handcuff to keep a new lawyer is that the person knows how the transition will play out, he said.

The main reason lawyers will leave in the middle of succession plan is that the plan is unclear or is not followed. He suggests getting the following information on paper:

- * The timelines for various steps in the ownership transition, and the target completion date;
- * How compensation will change, and what will be the basis of that compensation;
- * What buy-in investment will be required and when;
- * How the incoming lawyer's ownership, and the transitioning lawyer's ownership, will change over time;
- * What performance is expected, and on what benchmarks the incoming lawyer will be judged;

* The timeline for completion of the senior attorney's planned transition out, after ownership has been handed over. All aspects of the **firm's** business structure need to have set timelines for transitioning. Here are a few ideas:

Ownership

Lay out a plan for transitioning ownership shares of the **firm**. (See above.) This allows the owner to cash out the value accumulated in building the **firm**.

The whole purpose of this is to create a transition where the successor is buying me out, but I'm still earning money by participating in the business with my origination and production, Cole said. As I step further out, and I don't really want to do more production, I can still get compensated on origination.

When trying to place a value on the **firm**, a standard valuation of a business usually starts around 2.5 times gross revenues. But that's ridiculous for a **law firm**, he said.

He suggests a more reasonable pricing of 1 to 1.5 times, paid out over three to five years to encourage a buyer.

Although you are valuing the **firm** less than a business would, Cole said, the increased financial value from hiring a successor to bring in more business should more than offset it. This is where structuring compensation around production, origination and management allows the outgoing lawyer to continue to make profit.

Part of the purpose of building up the revenue of the firm is to pay everyone well enough that it doesn't hurt very much for the guy to buy you out, he said.

Management

There are many managerial responsibilities to transfer over, including overseeing financials, hiring and firing, and authorizing purchases. Identify them and develop a timeline to switch over these responsibilities. By defining the roles, it creates a clearer path for growth, he said.

Leadership

Cole says management and leadership are different but interlocked. In sole practices, staff members view the attorney as the spiritual as well as the functional head of the firm. A succession plan must address how to transition the informal role of spiritual leader over time, so that staff accept the succeeding attorney as the authority and do not maintain private allegiance to the outgoing lawyer. This transfer is important because too often staff may abandon the practice as the senior attorney steps back, damaging the practice and the success of the transition, he said.

Business development

The transitioning lawyer typically holds most of the business origination through decades of relationship development and marketing with other professionals.

To protect the firm's current and future health and revenue streams, the plan needs to address transferring these valuable relationships to the successor. This will not be accomplished overnight with simple introductions because the relationships are built upon years of trust.

Client relationships

In assuring the short- and long-term success of the firm, transfer of client responsibility is as essential as the transfer of referral relationships, he said. He suggests a planned and increasing involvement of the new attorney with the clients and their accounts. Review client lists and come up with a plan on transferring each one.

Post transition

When transition is over, create an of counsel agreement that allows the outgoing lawyer to have an office and remain tied to the **firm**.

Things to consider after the transition:

- * How will the **firm** name change?
- * What standards will the outgoing lawyer be held to under new **firm** management?
- * Any bonus/incentive schedule?
- * What will be the **firm** approval process of work brought into the **firm**?
- * How long of a period will the outgoing lawyer work for the **firm**?

In the end, Cole says, the results from a successful plan include more income before the transition and higher sale value of the **firm**.

After the transition, a lawyer can still practice with the **firm** and collect income, he said.

6/26/09 MOLAWWKLY (No Page)

Page 6

Plus you get that nice plum that you get to come in and play, Cole said. You still get to keep the identity of being a lawyer.

---- INDEX REFERENCES ---

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6/26/09 MOLAWWKLY (No Page)

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