New York State Bar Association

Committee on Professional Ethics

Opinion 961 (3/13/13)

Topic: Can a retiring attorney sell a law practice and retain the right to receive a portion of fees for legal services that will be provided after the sale date?

Digest: A retiring lawyer may sell his or her law practice contingent upon receipt of a percentage of legal fees collected by the purchaser for services provided after the sale where the payment is in proportion to the services performed by the selling lawyer prior to the sale or fairly represents the value of the "goodwill" of the retiring lawyer. A provision requiring payment of fees for business that the selling lawyer refers to the buying lawyer after the sale is not permitted.

Rules: 1.5(g); 1.5(h); 1.17; 5.4; 7.2.

QUESTIONS

1. May a retiring lawyer sell his or her law practice contingent on receiving a percentage of the legal fees earned for legal services provided after the date of sale with respect to each of the following categories of client matters:

a. Existing clients with pending actions and a retainer agreement that provides for a contingent fee upon amounts collected;

b. Existing clients with claims contemplated in future years after the date of sale of the law practice and a retainer agreement that provides for a contingent fee upon amounts collected;

c. New clients who retain the purchasing attorney after the date of the sale, where the new client is a separate entity but has common principals with existing clients of the selling attorney as of the date of sale and a retainer agreement that provides for a contingent fee upon amounts collected; and

d. New clients who retain the purchasing attorney after the date of the sale, with no common principals with selling attorney's existing clients, but where the new client is referred to the selling attorney by other attorneys and in turn referred by the selling attorney to the purchasing attorney?

OPINION

2. This inquiry requires us to address a tension between two rules in New York's Rules of Professional Conduct (the "Rules"): Rules 1.5(g) (Fees and Division of Fees) and 1.17 (Sale of Law Practice). Rule 1.5(g) provides, in relevant part, that "[a] lawyer shall not divide a fee for legal services with another lawyer who is not associated in the same law firm unless (1) the division is in proportion to the services performed by each lawyer or, by a writing given to the client, each lawyer assumes joint responsibility for the representation."[1] Rule 1.17 (a) provides that "[a] lawyer retiring from the private practice of law … may sell a law practice, including goodwill, to one or more lawyers or law firms, who may purchase the practice." The tension arises from the phrase "including goodwill" in Rule 1.17(a). "Goodwill" is the intangible asset of an enterprise that arises from the reputation of a business and its relations with its customers[2] In a law firm context, goodwill reflects, among other things, "the likelihood that satisfied existing clients will use the firm again when new matters arise" and "the likelihood that new clients will come to the lawyer or firm because of the firm's reputation." Roy Simon, *Simon's New York Rules of Professional Conduct Annotated* ("*Simon's*") 764 (2013 ed.).

3. By its nature, the inclusion of "goodwill" in a sale of a law practice entails a payment on account of legal fees that the buyer is expected to receive in the future. There is no question that the parties to the sale could attempt to assign a present value to that flow of fees and include that value in a lump-sum purchase price. That kind of indirect link between legal fees to be earned by a lawyer and the payment to another lawyer is not prohibited by Rule 1.5(g). But it can be very difficult to assign a present value to an on-going book of business of a law practice, and even more difficult to estimate what value will flow from new business that may come to the law practice on account of the reputation and contacts built up by the selling lawyer over time. And young lawyers who are the typical buyers of law practices often do not have access to capital to provide upfront payments for goodwill in any case. The question presented is the extent to which lawyers can structure the payment for the law practice as a payout over time measured by the actual fees earned by the practice after the sale.

4. We conclude that Rule 1.17 must be viewed as an exception to Rule 1.5(g) – that is, that the payment for "goodwill" that is explicitly permitted by Rule 1.17 permits a payment that is made in the future after the fees that reflect "goodwill" are earned. We reach this conclusion for several reasons. First, we think that Rule 1.17 should be viewed as the more specific of the two rules – targeted as it is to a particular setting in which lawyers might wish to share fees – and thus subject to the interpretive principle favoring the more specific rule over the more general. Second, a lump-sum payment for goodwill is intended to be economically identical to the present value of the actual fees earned over time. The rules should be as transparent and rational as possible, so in the absence of a strong reason to the contrary, parties to a sale of a law practice should be able to use a method of payment that is the economic equivalent of one that is clearly permitted.

5. Third, we note that Rule 1.5 itself contemplates payments of fees over time in the closely analogous setting of a lawyer who leaves or retires from a law firm and receives a payment for his or her interest in the firm in the form of a separation agreement or retirement package. Rule 1.5(h) states, without qualification, "Rule 1.5(g) does not prohibit payment to a lawyer formerly associated in a law firm pursuant to a separation or retirement agreement." Likewise, Rule 5.4(a)(1) permits law firms to agree with lawyers in the firm to share legal fees with the estate of a lawyer in the firm, or with anyone else, "over a reasonable period of time after the lawyer's death." If a lawyer leaving a law firm, or the lawyer's estate, may receive a portion of future fees earned on account of the goodwill of the firm that the lawyer helped to build up, we see little reason why a lawyer retiring from a solo practice should be barred from structuring a payment similarly. Comment [1] to Rule 1.17 fortifies this analogy. It states, "Pursuant to this Rule, when a lawyer or an entire firm ceases to practice, and other lawyers or firms take over the representation, the selling lawyer or firm may obtain compensation for the reasonable value of the practice, *as may withdrawing partners of law firms*." (Emphasis added.) Indeed, equalizing the treatment of retiring members of law firms and retiring sole practitioners was the principal purpose of the Rule permitting sales of law firms.[3] One of the impetuses for adopting Rule 1.17 was the previous practice of "quickie partnerships," whereby a solo practitioner would take on a junior partner for a short period before retiring under a retirement package that provided for an extended payout[4]

6. Fourth, we note that the possibility that "goodwill" could be measured either by a lump sum payment or by a payout of a portion of future fees was well recognized in ethics opinions predating the adoption of versions of Rule 1.17 around the country. *See*, *e.g.*, ABA 266 (1945) (barring sale of "good will" "whether by payment of a lump sum or by an agreement to pay a stated percentage of the future receipts, gross or net, from his clients"); N.J. Opinion 48 (1964) (advising that a sale of "good will" was prohibited whether measured by a lump sum approximating the selling lawyer's net income for one year or by paying one third of all net profits from pending cases and any other work for former clients of the retiring lawyer for three years). There is thus good reason to conclude that when Rule 1.17 was adopted, it embodied an understanding that that the sale of goodwill that was to be permitted could be accomplished by either means.

7. We recognize that there are counter-arguments to these points. One could conclude that the express exception for fees paid as part of a separation or retirement agreement, when there is not one for sale of a law practice, means that fees may not be shared in the latter context. We are not persuaded by that counter-argument, however, because, as noted above, we perceive no reason for making that distinction, particularly in light of the policy underlying the Rule to equalize the treatment of retirements from law firms and sales of law practices.

8. We also recognize that the purposes of the prohibition on fee sharing are implicated, at least in part, by any provision for fee sharing after sale. For example, one purpose of the prohibition is to limit the risk of outside influences on a lawyer's independent judgment. A lawyer with an economic interest in a matter who is not sufficiently involved in the work and does not take responsibility for it may press the lawyer handling the matter to cut corners or settle too early. *E.g.*, *Simon's* at 165 (noting risk that even under Rule 1.5(g), a referring lawyer might "pressur[e] the working lawyer to settle or to go to trial or to skimp on costs and expenses to avoid reducing the ultimate fee"). But these policies have often been tempered by other considerations, as demonstrated by the exceptions for retirement plans, separation agreements and agreements for sharing fees with the estate of a lawyer in a law firm[5]

9. We are also aware that Comment [11] to Rule 1.17 states, "Lawyers participating in the sale or purchase of a law practice are subject to the ethical standards applicable to involving another lawyer in the representation of a client." That could be taken to refer to the rule on division of fees, Rule 1.5(g). But we note that the Comment then lists several "[e]xamples" of such Rules – Rules 1.1 (competence), 1.7 (conflicts), and 1.6 and 1.9 (confidentiality) – but not Rule 1.5(g). We note that other states have expressly referred to that Rule in their comments to their analogous rule. *E.g*., Florida Bar Rule 4-1.17 Comment (concluding that the fee-division rule will not apply to fees from matters pending at time of sale but must be satisfied with respect to fees from matters that arise subsequent to the sale).

10. We note as well that ethics opinions in two other states with broadly similar rules concluded that payments for goodwill may not be formulated as payments of a portion of future fees unless the requirements of the fee-splitting rule

are satisfied. Iowa Opinion 96-05 (1996) (structuring payment for purchase of law practice as a percent of revenues from services rendered by purchasing attorney held improper under Iowa analogue of Rule 1.5(g)); Philadelphia. Opinion 96-1 & Supp. Opinion 96-1 (purchaser may pay seller a percentage of revenue over a five-year period *if* requirements of Pennsylvania analogue of Rule 1.5(g), requiring notice to clients of fee splitting, are satisfied). Neither opinion contains an analysis of the issue. *But see* Kansas Opinion 93-14 (concluding, in the absence of a rule analogous to Rule 1.17, that Kansas rule permitting referral fees permits selling lawyer to receive a portion of future fees even if selling lawyer does not work on the matter).[6]

11. While we approve in concept that goodwill in a sale of a law practice under Rule 1.17 may be measured by future fees as actually earned, we believe that there are necessarily limits to such arrangements. The extent of fee sharing must bear a reasonable and bona fide relationship to the value of the "goodwill" involved. Even the most well-known lawyer's reputation and connections fade over time. Any provision for fee sharing must therefore be limited in amount and in time. The parties might agree, for example, that the selling lawyer will receive 20% of the seller's net income for three years. If that is a reasonable estimate of the value of the "goodwill" of the practice, then Rule 1.17 permits it.

12. Turning to the types of provisions suggested by the inquirer, we have no hesitation in concluding that a portion of the fees earned from matters pending at the time of the sale (beyond those fees attributable to the work the selling lawyer did on the matter before the sale),[7] and (b) new matters for the seller's existing clients, can fairly be said to reflect the selling lawyer's reputation and client connections. Provision (c) would require fee sharing as to matters for entity clients that retain the purchasing lawyer after the date of the sale where the entity is controlled by "common principals" of existing clients. Because the relevant question is the effect of the selling lawyer's reputation on the minds of the persons making the decision which lawyer to retain, these nominally "new" clients should be treated like new matters for existing clients that are the subject of scenario (b).

13. Provision (d) would require fee sharing with respect to new clients who have been referred by the selling lawyer. While the fact that a new client may have approached the selling lawyer after the sale may be due to the lawyer's reputation, we are concerned that permitting sharing of fees if the selling lawyer refers the business to the buying lawyer implicates the different set of policies barring payments for referrals under Rule 7.2. A retired lawyer should not be given a monetary incentive to refer new business to the buying lawyer in particular without consideration of which lawyers would be the best for the job. *Restatement (Third) of the Law Governing Lawyers* § 10 Comment d (2000). Put another way, we do not see a payment for business referred after the sale as simply a convenient method of measuring the value of the goodwill of the practice, but rather more as a payment for the new service of making the referral, and such a payment is barred.

14. One further point to address, although we do not definitively decide it, is whether a retired lawyer could receive fees from matters handled by the buying lawyer not as payment for work done prior to the sale under the first clause of Rule 1.5(g)(1), and not as payment for "goodwill" under Rule 1.17(a), but by assuming joint responsibility for the representation in a signed writing to the client under the second clause of Rule 1.5(g)(1).[8] A Comment to this Rule says, "'Joint responsibility' for the representation entails financial and ethical responsibility for the representation as if the lawyers were associated in a partnership. *See* Rule 5.1 [referring to the obligations of partners and other lawyers in a firm to supervise other lawyers in the firm]." Rule 1.5, Cmt. [7]. The question is whether a retired lawyer can ever take "joint responsibility" for a matter.

15. The Comment's citation of Rule 5.1, and its reference to "ethical responsibility ... as if the lawyers were associated in a partnership," suggest that the selling lawyer would need to supervise, at least to some extent, the work of the buying lawyer. *But see* N.Y. County 715 (1996) (concluding, prior to adoption of Comment [7], that the joint responsibility required by the predecessor rule "is financial and does not create an ethical obligation of the referring lawyer to supervise the activities of the receiving lawyer"); *Aiello v. Adar*, 750 N.Y.S.2d 457 (Sup. Ct. Bronx Cty. 2002) ("the rule does not create an ethical obligation to supervise the receiving attorney's work"). There is at least a question whether such supervision would be consistent with retirement for purposes of Rule 1.17. The term "retirement" contemplates that the attorney will completely cease practicing law for compensation. Nassau County 2-12 (2012).[9] But we do not resolve this issue in response to the present inquiry, because the inquirer (presumably as would be the case for many retiring lawyers) does not seek to take joint responsibility for the work of the buying lawyer. We do not foreclose the possibility that, under some factual circumstances, a retiring lawyer could meet those requirements. *See* Rule 5.1(c) ("the degree of supervision required is that which is reasonable under the circumstances").

CONCLUSION

16. Under Rule 1.17, a retiring lawyer selling a law practice may collect fees (above the fees in proportion to the services performed by the selling lawyer before the sale), as described in provisions (a) to (c) raised by the inquirer, if those fees fairly reflect the value of the selling lawyer's "goodwill." The retiring lawyer may not condition future

referrals on payment of a portion of the fees earned from the referred matters (provision (d)).

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[1] The remaining requirements of Rule 1.5(g) are: "(2) the client agrees to employment of the other lawyer after a full disclosure that a division of fees will be made, including the share each lawyer will receive, and the client's agreement is confirmed in writing; and (3) the total fee is not excessive."

[2] Collins Dictionary ("an intangible asset taken into account in assessing the value of an enterprise and reflecting its commercial reputation, customer connections, etc."); Oxford Dictionary (US English) ("the established reputation of a business regarded as a quantifiable asset, e.g., as represented by the excess of the price paid at a takeover for a company over its fair market value"); Dictionary.com ("an intangible, saleable asset arising from the reputation of a business and its relations with its customers, distinct from the value of its stock and other tangible assets").

[3] The initial report of the Special Committee to Review the Code of Professional Responsibility, proposing adoption of what became Rule 1.17, stated that the amendment was "designed principally to address the disparate treatment of sole practitioners and members of law firms with respect to the 'good will' of their respective law practices. Under existing legal and ethical principles, retiring members of law firms and estates of deceased law firm members have been able to receive benefits, including an allotment for that lawyer's share of the firm's good will, while sole practitioners and their estates cannot obtain the same benefit. The proposed amendments will eliminate this inequality ...."

NYSBA Special Comm. to Review the Code of Prof. Resp., *Proposed Amendments to the New York Lawyer's Code of Professional Responsibility* 1 (Sept. 26, 1995). *See also* American Bar Association, Report to the House of Delegates 8A for the ABA 1990 Midyear Meeting at 4 (Feb. 1990) ("ABA 1990 Report") ("The rule also puts sole practitioners in a financial position equal to members of firms regarding the value of the 'good will' of the practice."); American Bar Association Center for Prof. Resp., *The Development of the ABA Model Rules of Professional Conduct, 1982-2005: A Legislative History* 368 (2006)(the rule was intended to "put[] sole practitioners in a financial position equal to members of firms regarding the value of the 'good will' of the practice").

[4] *Simon's*, *supra*, at 761 ("Once the partnership was formed, the retiring lawyer could ethi-cally introduce his new young partner to all of the clients, and could enter into a partnership agreement under which the retiring lawyer would receive a generous portion of future fees."); Dennis A. Rendleman, "The Evolving Ethics of Selling a Law Practice," 29 GP Solo no. 4 (July/Aug. 2012) (*available at* http://www.americanbar.org/publications/gp_solo/2012/july_august/evolving_ethics_selling_law_practice.html) ("Thereafter, Old Practitioner might become 'of counsel' or withdraw from prac-tice entirely, while the name remains a part of the firm and a continuing financial benefit flows to Old Practitioner."). *See also* ABA 1990 Report at 4 ("In order to ensure that unfinished client matters would be taken care of and to avoid losing compensation for the 'good will' of the law practice, some solo practitioners entered into 'quickie' partnerships prior to leaving the practice. Often, clients do not benefit from such hastily assembled arrangements.").

[5] Rule 5.4(a)(3) provides an additional exception, permitting sharing of fees with nonlawyer employees pursuant to compensation or retirement agreements based in whole or in part on a profit-sharing arrangement.

[6] Our Committee has once before considered whether a retiring lawyer could receive a stream of fees from future business. We concluded that the lawyer could not do so, but in that case the lawyer was moving to the judiciary and we based our conclusion entirely on the Code of Judicial Conduct. We said that the arrangement "would provide an inducement to the judge to assist the acquiring firm in retaining the favor of former clients" in violation of Canons prohibiting the appearance of impropriety and certain financial and business transactions with lawyers likely to come before the court. N.Y. State 699 (1997). We did not mention the rule against fee splitting.

[7] Fees for work done prior to the sale are not for goodwill, but simply for services delivered by the selling lawyer. That sharing of fees is expressly permitted by Rule 1.5(g).

[8] Note that when proceeding under either portion of Rule 1.5(g)(1), the lawyer must disclose to the client that a

division of fees will be made, including the share that each lawyer will receive; the client must have agreed to the division of fees in an agreement confirmed in writing; and the total fee must not be excessive. Rule 1.5(g)(2), (3).

[9] In the context of lawyers' biennial registration requirements, 22 N.Y.C.R.R. § 118.1(g) defines "retired" as follows: "An attorney is 'retired' from the practice of law when, other than the performance of legal services without compensation, he or she does not practice law in any respect and does not intend ever to engage in acts that constitute the practice of law." In turn, the regulation defines "practice of law" as "the giving of legal advice or counsel to, or providing legal representation for, a particular body or individual in a particular situation in either the public or private sector in the State of New York or elsewhere."