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The prospect of law practices for sale is one that lawyers seem to either love or hate.

One of the earliest critics of such sales was Henry Drinker, Philadelphia lawyer and longtime chairman of the ABA Ethics Committee. Drinker stated that such sales would be improper, explaining that “clients are not merchandise nor is a law practice the subject of barter.” He believed that “selling a man a client is not a legal service.”

At the other end of the spectrum, one professor of legal ethics has argued that the “law ought to reflect commercial realities and not be held hostage to narrow, dated business views.” The professor, Stephen Kalish of the University of Nebraska, has been quoted as saying that “it is increasingly obvious . . . that a law practice is commercial. It is big business . . . . The concept that it is beneath a lawyer’s dignity to sell her practice probably reflects the attitudes of a past generation.”

Until recently, this debate was principally a theoretical one. Courts and ethics committees routinely condemned the sale of law practices. Lawyers generally avoided outright sale of their practices. Now, however, the debate has taken a very practical turn. On May 27, 1989, California became the first state to have on its books an ethical rule explicitly allowing lawyers or their estates to sell a law practice.

Following California’s lead, the American Bar Association voted at its February 1990 Midyear Meeting to revise the Model Rules of Professional Conduct to permit the sale of law practices.

The Pennsylvania Committee on Legal Ethics and Professional Responsibility already has been asked to consider adopting the ABA’s new Model Rule 1.17. Thus, Pennsylvania lawyers shortly must decide whether to follow the lead set by the ABA and California and recommend to the Pennsylvania Supreme Court an amendment to the Pennsylvania Rules of Professional Conduct that would permit the sale of law practices.

The ABA’s New Rule

The ABA’s new Model Rule of Professional Conduct 1.17 is captioned “Sale of a Law Practice.” This rule was sponsored by the State Bar of California and the ABA sections on General Practice and Law Practice Management. In their report accompanying this rule, these sponsors offered two justifications. First, they viewed the changes as “consumer protection measures” designed to ensure that client matters are attended to when sole practitioners leave law practice. Second, they concluded Rule 1.17 was necessary to avoid the unfair financial treatment of sole practitioners. Unlike partners of a law firm, sole practitioners cannot capture any of the “goodwill” of their law practice upon retirement. This is particularly unfair during a divorce, because sole practitioners may be liable to their spouses for the goodwill in their practices.

ABA Rule 1.17 was proposed and adopted within a relatively short period of time. At the August 1988 ABA Annual Meeting in Toronto, the State Bar of California recommended that the ABA Model Rules of Professional Conduct be amended to include a provision comparable to the California rule permitting law-practice sales. (The California State Bar Board of Governors had approved such a rule three months earlier, in May 1988, following nine years of study. The California Supreme Court approved the rule in November 1988 and it became effective May 27, 1989.) After objections, California withdrew its recommendation.

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in order to discuss the amendment further with the ABA Standing Committee on Ethics and Professional Responsibility and other interested entities. Approximately a year and a half later, the State Bar of California, together with the ABA General Practice and Law Office Management sections, again submitted a recommendation. This time Rule 1.17 and the accompanying changes were adopted.

ABA Model Rule of Professional Conduct 1.17 permits a lawyer or law firm to sell or purchase a law practice provided four conditions are met:

- First, the seller must be ceasing private legal practice in either the specific geographic area or the state. (The ABA left this choice up to the adopting jurisdiction.) According to Rule 1.17’s comment, this condition is satisfied when the lawyer leaves private practice for government service or to serve as in-house corporate counsel.
- Second, the practice must be sold as an entirety. Thus, lawyers may not purchase only profitable client matters.
- Third, notice must be given to all of the seller’s clients, notifying them of the proposed sale, the terms of any proposed change in fee agreements, their right to retain other counsel or take possession of files, and the fact that consent to the sale will be presumed if they do not object or otherwise act within 90 days.
- Finally, the fees charged clients may not be increased by reason of the sale, although the buyer may refuse to undertake representation unless the client agrees to pay the buyer fees at a rate not exceeding the fees charged by the buyer (before the sale negotiations) for substantially the same services.

Although the language of ABA Model Rule 1.17 and the California rule are quite different (the ABA language is much simpler), the two provisions are substantially similar. Unlike the California rule, the ABA rule explicitly requires the seller to cease private legal practice in the area.

In addition to adopting a new Rule 1.17, the ABA amended Model Rules 5.4 and 7.2(c) and the comment to Rule 5.6 by adding an exception for Rule 1.17 law-practice sales. Without these changes, such sales would have been either improper or practically impossible. For example, Rule 5.4, which permits a lawyer to share fees with a lawyer’s estate only with respect to work already completed, arguably prohibited a lawyer from purchasing “goodwill” or clients from a lawyer’s estate. Similarly, Rule 5.6 prohibits restrictive covenants in partnership and employment agreements and the added comment clarifies that a buyer may obtain from the seller a covenant not to compete as a condition of the sale. And finally, without amendment Rule 7.2(c) would have prohibited the seller from recommending to clients that they accept the buyer’s services. (This rule prohibits a lawyer from giving anything of value to a person for recommending the lawyer’s services.) A lawyer might not purchase a practice without such a recommendation.

The Traditional Ban

The ABA’s action stands in stark contrast to the position historically taken on this issue by the courts and ethics committees. Although neither the Model Code of Professional Responsibility nor the Model Rules of Professional Conduct (nor the Pennsylvania Rules of Professional Conduct) has contained a binding prohibition, the selling of the goodwill of a law practice, as opposed to its tangible assets, has been routinely condemned in the past.

This condemnation has appeared in discipline cases brought against lawyers involved in law-firm sales; in suits between the parties to such sales; and in other types of cases, such as accounting actions or divorce cases, where the prohibition was mentioned in dictum or by way of analogy. In addition, many ethics committees have concluded that law practices could not be sold as going concerns. Leading treatises and other authorities routinely recited that goodwill could not be sold.

As recently as 1989, the Illinois Supreme Court invalidated the sale of a lawyer’s goodwill. See O’Hara v. Ahlgren, Blumenfeld and Kempster, 127 Ill.2d 333, 537 N.E.2d 730 (1989). O’Hara involved a suit by a lawyer’s widow to recover the balance owed on the sale of her husband’s law practice. The contract gave Mrs. O’Hara a certain percentage of client fees for five years and specified that the parties intended to sell the goodwill in Mr. O’Hara’s practice. (Mrs. O’Hara had not been represented by counsel during this sale.) The trial court granted summary judg-
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ity in treatment between a sole practitioner's clients, who can be left stranded after a lawyer's retirement, and the clients of law firms, whose matters are routinely passed on within the firm after a lawyer's death or retirement. The implicit assumption underlying this argument is that unless lawyers or their estates have a financial incentive for promptly transferring files, such files will be left unprotected.

In a variation of the "consumer protection" argument, proponents assert that sole practitioners have evaded the sales prohibition by overvaluing tangible assets or by engaging in sham or "quickie" partnerships, which allow them to receive retirement or death benefits from new "partners." Citing this phenomenon, proponents argue that it is better to have such "sales" in the open so that they can be scrutinized.

Proponents of allowing sale of law firms also stress the issue of fairness, raising three separate points.

First, they point to the disparate treatment of sole practitioners compared to lawyers practicing in partnerships. Although a partner, or a partner's surviving spouse, may receive payments upon the lawyer's retirement or death, a sole practitioner cannot sell the ongoing value or good will in a law practice in order to receive payments during retirement or after death. Barry Martin, commenting on the new California rule, wrote in The California Lawyer magazine that this treatment and its justifications "made sole practitioners feel like second-class citizens."

A second argument is that it is unfair to prohibit sole practitioners from selling the good will in their practices since that same good will may be treated as an asset in a divorce in some states. (In Pennsylvania, however, good will is not an asset subject to division during a divorce.)

Third, proponents claim that it is unfair to distinguish between lawyers, who cannot sell their good will, and other professionals, such as doctors, dentists, and accountants, who are allowed to sell the good will in their practices.

The final argument is the assertion that mechanisms such as legal malpractice and discipline can control any abuses that might occur as a result of such sales. Not surprisingly, opponents of allowing sale of law practices cite different policy concerns. (In the past, opponents often argued that good will was personal and therefore a retiring or deceased lawyer had no good will worth selling. This argument was undercut, however, by the economic fact that lawyers were willing to purchase such good will.)

Opponents challenge the idea that sales will operate as consumer-protection measures. They believe clients will be harmed, not helped. They contend that sellers will have an incentive to turn over a case not to the most competent successor, but to the successor who is willing to pay the highest price. (Some opponents further speculate that the lawyers who will pay the highest price probably are not the most competent.) Opponents suggest that a sole practitioner's clients may be relatively unsophisticated and most in need of protection.

They also argue that clients will not be protected because sales will lead to increased client fees. They believe the buyers inevitably will charge their clients not just for future services rendered, but also for past services, as reflected in the value of the goodwill. Again, they say, the seller's clients may be unsophisticated and in need of protection from such fee increases.

Opponents also argue that buyers are likely to want a restrictive covenant in a sales agreement. They argue that public interest requires that clients have an unfettered right to select legal counsel.

As a final policy argument, many opponents agree with Drinker's statement that lawyers should not be in the business of selling clients. They argue that it is unprofessional and inappropriate.

Applicable Ethics Provisions

In addition to these policy disagreements, the debate between those for and against law-practice sales has included discussions of specific ethics provisions. Although the arguments address specific ethics provisions, they mirror the general policy concerns previously articulated.

Many commentators cite Rule 1.6 (or its Code counterpart) in opposition to such sales. Rule 1.6 prohibits a lawyer from disclosing client confidences. Opponents contend that it would breach confidentiality for a seller to turn over information about clients before a sale or client files after. The ABA has addressed this concern by providing the third con-

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dition of Rule 1.17 and the accompanying comment. These state that only generalized information need be released initially, and that before client-specific information can be turned over, client consent must be obtained. Proponents also respond that confidences will be better protected by a sales rule than by the traditional ban, because the ban is circumvented through "sham" partnerships. They also have argued that clients may see no functional difference between disclosures by a sole practitioner to a successor and disclosures by "their" lawyer to an unknown, "new" lawyer in a law firm.

The rule opponents also have cited Rule 1.5(a), which requires that fees be reasonable (the ABA Model Rule) or not clearly excessive (the Pennsylvania Rule). They have argued that a buyer is likely to violate this provision because the buyer must charge each client enough to recoup the purchase price. The new ABA Rule 1.17 responds to this concern by requiring that the fees of the buyer-lawyer not be increased because of the transaction. The ABA rule and the comment stress that the buyer may not charge the new clients higher fees than the buyer charges other clients and thus may not single out unprofitable clients or finance the purchase by increasing client fees. (It should be noted, however, that the ABA rule and comment do not address the situation where the buyer has no ongoing practice and thus no fees with which to compare the fees charged the "purchased clients.")

Proponents argue that any fee abuses could be addressed after the fact through discipline or civil action. They also argue that, just as the mere threat of abuse was not sufficient to justify a ban on lawyer advertising, the mere threat of abuse should not be sufficient to justify a ban on the sale of law firms.

A third ethics provision the sale opponents point to is Rule 1.7. They contend that both buyer and seller are likely to have conflicts of interest. They believe that such conflicts are especially likely to occur in smaller communities. A seller may have a conflict because the seller's interest in maximizing the sales price can conflict with the client's interest in receiving the best possible referral. Similarly, the seller will have an incentive to reveal confidential information in order to maximize the sales price. The buyer may have conflicts arise among existing clients and new clients. Furthermore, if the buyer obtains too much public information concerning the potential new client and if there is a conflict between the potential new client and an existing client, then the buyer will have to withdraw from representation of the existing client, regardless of whether the sale goes through.

Proponents do not deny these possibilities, but do not believe these potential conflicts justify an outright sales ban. The comment to the ABA's new Rule 1.17, for example, addresses this problem by reminding lawyers that they are subject to both the conflict of interest provisions and the competency provision, the latter of which requires competent identification by the seller of a buyer qualified to assume the practice and competent representation by the buyer. Specific proposals that have been offered over the years to decrease the likelihood of such conflicts or to minimize their effect on clients include tying the sales price to the buyer's future revenues so the seller will have an incentive to select a competent buyer; requiring the seller to remain responsible for ongoing matters; or re-
quiring the seller to purchase insurance in order to protect clients from incompetent buyers. Others have argued that if lawyer training were improved, we would be able to assume the competency of any licensed lawyer who purchased a practice.

A fourth ethics rule opponents cite is Rule 1.16(d), which concerns withdrawal or termination of representation. Rule 1.16 requires a lawyer to protect the client’s interest when terminating the relationship. If a lawyer recommends a successor to clients because of the sale of a practice, rather than because it is in the clients’ best interests to use this lawyer, the lawyer arguably has violated this provision. Proponents again argue that such problems are covered by existing disciplinary rules and that an outright ban is not justified.

Thus, for each specific ethics provision opponents cite, proponents have a response they believe undermines the need for a total ban. How one resolves the specific ethics arguments undoubtedly reflects one’s evaluation of the competing policy arguments. If not this year, then certainly in the next few years, Pennsylvanian lawyers will have to evaluate these arguments and decide whether to follow the ABA’s lead and permit the sale of law practices.

Further Reading on this Issue

The arguments for and against the traditional ban on sale of law firms consist of both general policy arguments and arguments that are framed in terms of specific ethical rules. In addition to ABA Rule 1.17, its comment and the accompanying report, these “pro” and “con” arguments are best summarized in three articles: Sterrett, The Sale of a Law Practice, 122 U. Pa. L. Rev. 306 (1972); Minkus, The Sale of a Law Practice: Toward a Professionally Responsible Approach, 12 Golden Gate U. L. Rev. 353 (1982); and Kalish, The Sale of a Law Practice: The Model Rules of Professional Conduct Point in a New Direction, 39 U. Miami L. Rev. 471 (1985). According to Karen Betzner, who supervised the lengthy public comment process for California’s new Rule 2-300, “If you’ve read these three articles, you’ve pretty much covered the field with respect to the arguments for and against the sale of a law practice.”

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