SALVAGING SWEAT EQUITY

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When I perform a practice management audit of a law firm, I always ask certain questions. When the firm has a sole owner, or owners of the same age, important questions focus on how much good will the firm has established. I can determine this by exploring such things as the sources that generate new cases for the firm. For example, when word of mouth and former client referrals produce a substantial percentage of new cases, I know the firm has built up a significant level of good will.

When I establish that the attorney has built up a significant amount of good will, I want to make sure that the attorney is thinking ahead toward retirement. Otherwise, the equity or value of that good will, which has been established through hard work and sacrifice over the years—often appropriately referred to as sweat equity—will likely be lost when the attorney retires.

Rule 1.17 (Sale of a Practice) didn't really assist the retiring solo attorney in Pennsylvania until recently. Fortunately, it is now possible for a solo attorney to sell his/her practice upon death, disability, or retirement. But sale isn't always a desirable or obtainable option. There are other strategies as well, but to employ other strategies to salvage one's sweat equity upon retirement, you must think about retirement well in advance. Some consultants advise beginning the strategic planning as far as ten years ahead of your anticipated retirement date.

I am frequently contacted on the hot line by attorneys contemplating retirement. Some call a year or so ahead, but most call months ahead of the date they want to retire. That isn't even enough time to deal with all the notifications, disposition of client files and so forth, let alone how to get out some portion of your sweat equity. Attorneys expect me to deliver a miracle, but unfortunately I cannot.

The problem that all of the solos face is *how* to close up. Unless sufficient planning has occurred, all you can do is stop taking on cases, finish or refer out those still open, sell off the physical assets like furniture, computers, and books, and turn off the lights and close the doors. As you scale back, maybe practice area by practice area, you must send your loyal and trusting clients elsewhere. Your income dwindles as you cut back. And of course the value of any good will you have built up over the years is lost in the process.

The alternatives for those who plan sufficiently ahead will have a much better financial impact on the retiring attorney, and often serve the clients better as well.

One alternative is to merge your practice with another firm. You must provide sufficient time to allow your clients to feel comfortable and establish relationships with partners at your new firm. Then you can slowly scale back, while gradually transitioning your clients to other partners at the firm. In turn, your written agreement with the firm will provide for a retirement payout to you for a specified period of time. This retirement payout is your “return” for the good will you have transferred to your new firm.

Another alternative is to hire a young attorney who can grow at your firm and eventually become a junior partner to whom you can transfer your clients and ultimately sell the physical assets of your practice. Again, an agreed upon retirement payout can return your sweat equity, after you have been paid for the physical assets. The mistake many attorneys make is in not being very clear about intentions, and in not making sure the young attorney is on the same page. Too often I am contacted by a senior partner who has spent anywhere from 7 to 10 years nurturing and mentoring a young attorney, only to find out that the attorney has no desire to take over the practice. Many of today’s young lawyers do not want the headache of running a law practice. They just want to practice law. You must find this out early on, before you have wasted precious years training the wrong person to take over your practice.

Yet another alternative is to take on a partner with substantial experience who is willing to transition your clients over gradually, and give you a chance to ease into retirement with a retirement payout. Sometimes this is less successful because the new partner’s personality and style of practice may not meld with yours, and the clients may not accept the new partner as readily as you want.

In both circumstances, whether bringing aboard a young associate or a seasoned partner, you will have to make your intentions clear about your anticipated retirement date, and show progress toward cutting back and transitioning clients as the date approaches. You may be like many small firm and solo practitioners who are workaholics, and simply won’t retire, even with the best of intentions. That can leave the other attorney frustrated when you continue to make the decisions and the profits continue to go to you as well. It is especially frustrating when there is really no guarantee you will retire any time soon, or that clients will stay after you do. If you drag your feet too long, you will lose the other attorney, probably a few clients that have already transitioned, and the possibility of salvaging your sweat equity. So when you make a commitment to retire be realistic, and keep your word.

How do you determine the value of your good will? There are a number of good articles written on this topic. One excellent article on this topic entitled "Determining the Value of a Lawyer's Practice" was written by consultant Joel Rose (www.joelarose.com). In it he states, ". . .a legal practice with a reasonable expectation of a continuing practice could be worth perhaps a year's gross income or two year's net income for the lawyer whose qualification is acceptable to the clientele on his/her succession to the practice."

If you're one of the aging baby boomers, and in a solo practice, or in practice with one or more partners your own age or greater, you should begin thinking now about your retirement strategy. With proper planning you should be able to recover not just the fair market value of the physical assets of your practice, but much of the value of your sweat equity as well.

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