

## **Taking Down Your Shingle: Ethics Rule Sets Forth Duties**

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The practice of law is an aging profession. The median age of a lawyer in this country has risen from 39 in 1980 to 49 in 2005.<sup>1</sup> In 1980, 12 percent of all lawyers were between the ages of 55 and 64, while 15 percent of all lawyers were under the age of 29.<sup>2</sup> By 2005, those numbers had changed dramatically, with 21 percent of lawyers between the ages of 55 and 64, and a meager 4 percent of lawyers below the age of 29.<sup>3</sup> The American Bar Association predicts that over the next decade, approximately 400,000 attorneys nationwide will be at or above the retirement age.<sup>4</sup>

New York State has the highest number of attorneys in the nation—a whopping 172,630 lawyers according to the ABA.<sup>5</sup> Given the aging lawyer population, it is likely that New York will also have the most retiring attorneys in the United States in the years to come.

Against this backdrop stands Rule 1.17 of the New York Rules of Professional Conduct, "Sale of Law Practice." The rule addresses various duties that lawyers owe both their clients and the profession upon the sale of their law practice. In addition to providing guidance to lawyers selling their law practice, the rule delineates certain obligations owed by lawyers who are prospective purchasers of a law practice. The rule is particularly applicable to sole practitioners, who account for 49 percent of private practitioners.<sup>6</sup>

This article will analyze the contours and scope of Rule 1.17. Lawyers seeking to sell their law practice in New York should heed the myriad of ethical duties outlined in the rule before packing their boxes, closing their office door, and taking down their shingle.

### **Creation of Rule 1.17**

An article in the New York State Bar Journal once observed that "the practice of law was, perhaps, the only professional practice in which its practitioners were prohibited from realizing financial value from all of the decades of hard work they put into their careers."<sup>7</sup> Indeed, for most of the history of the legal profession, a lawyer's clients and reputation were regarded as non-vendible commodities. Thus, when a solo-practitioner or firm wanted to wind up shop, they were only permitted to sell tangible assets of their practice, such as furniture, office equipment and books.

In 1996, things changed dramatically upon the adoption of the rule (at the time, Disciplinary Rule 2-111). Much to the delight of New York lawyers, the new rule rejects the traditional prohibition on the sale of a law practice, permitting such transactions under certain, specific conditions. In addition, the rule allows retiring attorneys to realize financial gain from intangible assets, more commonly known as 'goodwill.' N.Y. State Bar Op. 961 (2013) defines 'goodwill' as "the intangible asset of an enterprise that arises from the reputation of a business and its relations with its customers."<sup>8</sup>

Rule 1.17 gives sole practitioners the same ability to legally and ethically sell their practice as departing attorneys at multi-partner law firms, who can assign matters to other lawyers at the firm. However, the rule may have created some legal and practical quandaries. For instance, it not only permits a retiring sole practitioner to sell his or her practice, but also seemingly permits a multi-partner law firm to sell a portion of its practice to a lawyer outside the firm if any member of the selling firm retires.<sup>9</sup>

Additionally, the rule is vague on who may qualify as a prospective purchaser of a law practice, including whether a prospective purchaser may be from out-of-state. Presumably, one must be licensed in New York to purchase a law practice in this state, but that may not be the case where the clients of the law practice are international or from out-of-state.

Further, and not addressed in either the rule or the Comments, is the effect of the rule when the seller and purchaser are located in different states with incompatible Rules of Professional Conduct. For instance, Rule 1.17 in New York provides for 90 days to object to a transfer of files in connection with a written notice of sale, while the equivalent rule in New Jersey provides 60 days for a client's response after actual notice of the sale has been given.<sup>10</sup> Where the seller is a New York firm and the purchaser is a New Jersey or multi-office firm, which state's ethics rules apply? The rule does not specify.

### **Unpacking Rule 1.17**

Under Rule 1.17, when a lawyer or entire firm ceases operation, departing partners are entitled to compensation for the reasonable value of the law practice. The entire practice or practice area must be sold, which prevents prospective purchasers from being selective about the clients they wish to represent.<sup>11</sup> Indeed, an attorney selling his or her practice or purchasing another practice must remember that "the practice of law is a profession, not merely a business" and that "clients [are] not commodities [that can] be bought and sold like goods."<sup>12</sup> As such, there are a number of ethical obligations set forth in Rule 1.17 that differentiate the sale of a law firm from the sale of any other business.

The three main obligations set forth in Rule 1.17 are: (i) the buyer's and seller's duty to protect confidential information; (ii) the buyer's duty to perform appropriate conflicts checks; and (iii) the seller's and buyer's duty to timely provide "actual written notice" of the sale to each client.<sup>13</sup> These three obligations are meant to safeguard the fundamental principle that the drafters of the rule sought to achieve: client protection.

### **Attaining Client Protection**

The first obligation aimed at ensuring client protection is securing confidential information during negotiations concerning the contemplated sale.<sup>14</sup> Rule 1.17(b) prohibits both sellers and prospective buyers from exposing any attorney-client privileged information. Rule 1.17(b)(2) permits the seller to disclose certain limited information that may otherwise be protected by Rule 1.6 ("Confidentiality of Information").

At the same time, Rule 1.17(b)(3) restricts a seller's alienability of confidential client information by imposing certain procedural bars. Moreover, Rules 1.17(b)(4) and 1.17(b)(5) together curtail the prospective buyer's access to confidential information by prohibiting the disclosure of certain

information and requiring the buyer to maintain the same degree of client confidentiality as required of the seller.

The second obligation aimed at achieving client protection relates to conflicts of interest. The various requirements aimed at avoiding conflicts of interest during negotiations for the sale of a practice are laid out in Rule 1.17(b)(3). Specifically, Rule 1.17(b)(3) requires that a seller provide sufficient information to a prospective buyer such that the buyer can identify any potential conflicts of interest.

Rule 1.17(b)(3) must be read jointly with Rule 1.17(d), which prohibits a buyer from representing a client if, during the course of the conflict checks required by Rule 1.17(b)(3), the purchaser identifies a waivable conflict and does not obtain the necessary waiver(s) in writing. In addition, Rule 1.17(b)(3) imposes strict compliance requirements upon a prospective buyer, requiring the prospective buyer to stop reviewing a file immediately upon the discovery of a conflict of interest, unless the seller has obtained the client's consent in accordance with Rule 1.6(a)(1).

The third obligation, referenced in Rule 1.17(c), concerns the notice of sale that both seller and buyer are jointly required to provide to every client regarding the proposed sale. While there is no requirement of express client consent to the sale of a law practice, a lawyer has a continuing duty under Rule 1.4 ("Duty to Communicate") to advise his or her clients of information material to a decision in connection with the representation. Rule 1.17(c)(2) affords the client 90 days to object to the sale of the law practice or take other action before the client's consent to the sale will be presumed.

Rule 1.17(c) lays out five specific pieces of information that must be jointly provided to the seller's clients. Among the most important of these is Rule 1.17(c)(4), which requires the seller to disclose to the client any proposed fee increases. Rule 1.17(c)(4) explicitly references Rule 1.17(e), which prohibits fee increases by reason of the sale, unless such an increase is permitted by the seller's retainer agreement or the client specifically agrees to the fee increase.

### **Cessation of Practice by Seller**

ABA Formal Opinion 468 (2014) discusses certain ethical obligations of the seller and the buyer, among them the cessation of private practice by the seller.<sup>15</sup> Both ABA Model Rule 1.17 and New York's Rule 1.17 require the seller to cease engaging in the private practice of law upon the sale of his or her practice. However, neither ABA Model Rule 1.17 nor New York's Rule 1.17 addresses the precise timing of when a seller must stop practicing. Prior to ABA Opinion 468, some suggested that the "cessation of [] private practice" must occur instantaneously upon the sale of practice, while others suggested that a transition period is beneficial as it allows a seamless switch of client matters.<sup>16</sup>

ABA Opinion 468 concludes that "the transition of pending or active client matters from a selling lawyer or firm to a purchasing lawyer or firm need not be immediate or abrupt." Moreover, during this transition period, "neither the selling lawyer or law firm nor the purchasing lawyer or law firm may bill clients for the time spent only on the transition of matters." This is consistent with New York's Rule 1.17(e), which prohibits a client's fee from being "increased by reason of the sale." While the ABA Opinion provides some insight into the logistical aspects of Model Rule 1.17, it

punts on the question of the length of the transition period permitted by the rule, instead suggesting that length of the period "will necessarily depend on the circumstances."

### **Interaction With Other Rules**

In *Keinz v. Peter M. Hobaica*,<sup>17</sup> the Appellate Division, Fourth Department, held that the seller of a law practice was no longer entitled to "share in any fee for legal services rendered by [the purchaser]," despite the fee sharing arrangement agreed upon by the two parties. This decision illustrates the tension between Rule 1.17, "Sale of Law Practice," and Rule 1.5, "Fees and Division of Fees." Essentially, Rule 1.5(g) limits the ability of an attorney to share legal fees with another unassociated attorney, unless certain exceptions apply.

To understand the conflict, Rule 1.17 and Rule 1.5(g) must be compared. Rule 1.5(g) prohibits a retiring attorney from conditioning future referrals—essentially the goodwill of a law practice—on payment of a portion of the fees earned from the referred matters. However, Rule 1.17 explicitly permits the sale of "goodwill." Moreover, upon retirement, the exceptions under Rule 1.5(g) that would allow an unassociated attorney to share fees would no longer apply, because the retiring attorney would not be practicing anymore, and thus cannot work on, or jointly assume responsibility for, a matter.

In an effort to reconcile the tension between Rule 1.17 and Rule 1.5(g), the New York State Bar Association Committee on Professional Ethics published Opinion 961 in March 2013. The opinion explains that "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."<sup>18</sup> Accordingly, the committee "conclude[d] 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."

There are several Comments to Rule 1.17 that make explicit cross-reference to other Rules of Professional Conduct. For example, Comment [12] references Rule 1.16, "Declining or Terminating Representation," and requires that if approval of the substitution of the purchasing lawyer for the selling lawyer is required by a tribunal in which a matter is pending, such approval must be obtained before that matter can be included in the sale. Additionally, because a seller is required to cease his or her private practice of law in a geographic area following the sale of the practice, Comment [2] directs the seller to Rule 5.6, "Restrictions on Right to Practice."<sup>19</sup>

Comment [6] to Rule 1.17 requires that the seller's entire practice be sold, and prohibits a prospective buyer from "cherry-picking" the most lucrative matters, practice areas, or most significantly, clients. Of course, any sale remains subject to a client's objection, though under Rule 1.17(c)(2), the client's consent will be presumed if the client does not take any action or otherwise object within 90 days of the sending of the notice.

### **Winding Down, Ethically**

It has been said that lawyers die at their desk.<sup>20</sup> For thousands of New York attorneys contemplating retirement or a career change, particularly sole practitioners, Rule 1.17 offers hope for a better eulogy. If New York lawyers adhere to the strict ethical obligations outlined in the rule,

the rule will benefit both clients, who are more fully protected by the rule, and lawyers, who can more fully realize the fruits of their labor.

**Endnotes:**

1. ABA Lawyer Demographics, Year 2015, [http://www.americanbar.org/content/dam/aba/administrative/market\\_research/lawyer-demographics-tables-2015.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/market_research/lawyer-demographics-tables-2015.authcheckdam.pdf) (last visited Nov. 19, 2015).
2. Id.
3. Id.
4. Nat Wasserstein, "Can You (and Should You) Buy Or Sell a Law Firm in N.J.?" NEW JERSEY LAW JOURNAL, Sept. 4, 2014.
5. National Lawyer Population Survey, Lawyer Population by State 2015, [http://www.americanbar.org/content/dam/aba/administrative/market\\_research/national-lawyer-population-by-state-2015.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/market_research/national-lawyer-population-by-state-2015.authcheckdam.pdf) (last visited Nov. 19, 2015).
6. fn 1, supra.
7. New York State Bar Journal, 86 DEC N.Y. St. B.J. 41 (2014).
8. New York State Bar Ass'n Comm. on Prof'l Ethics, Op. 961 (2013).
9. Roy D. Simon, Simon's New York Rules of Professional Conduct Annotated, 912-14 (2015 ed.).
10. Compare New York Rules of Prof'l Conduct R. 1.17(c) (2013) (providing ninety-day requirement before presuming acceptance of consent), with New Jersey Rules of Prof'l Conduct R. 1.17(c) (2015) (providing sixty-day requirement before presuming acceptance of consent).
11. New York Rules of Prof'l Conduct R. 1.17 cmt. [6] (2013).
12. New York Rules of Prof'l Conduct R. 1.17 cmt. [1] (2013).
13. New York Rules of Prof'l Conduct R. 1.17 cmt. [7] (2013); New York Rules of Prof'l Conduct R. 1.17(c)(2).
14. New York Rules of Prof'l Conduct R. 1.17(b) (2013).
15. ABA Standing Comm. on Ethics and Prof'l Responsibility, Formal Op. 468 (2014).
6. Id; See also James Podgers, Set Sale, 101 A.B.A. J., 1, 86 (2015).
17. *Keinz v. Peter M. Hobaica*, 114 A.D. 3d 1250, 1250-51 (Feb. 14, 2014).
18. New York State Bar Ass'n Comm. on Prof'l Ethics, Op. 961 (2013).

19. New York Rules of Prof'l Conduct R. 1.17 cmt. [2] (2013).

20. Dolly Setton, The Berkshire Bunch, FORBES (Oct. 12, 1998),  
<http://www.forbes.com/forbes/1998/1012/6208110a.html> (last visited Nov. 19, 2015).

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