

COMMITTEE REPORT: THE MODERN PRACTICE

By **Michael M. Schimel**

Ethical Considerations in the Sale or Merger of a Law Practice

Details may vary from state to state

As many lawyers are keenly aware, the practice of law—especially, it seems, after the Great Recession—is a highly competitive business pursuit. The desire to offer more services and accessibility to clients (for example, a new practice area or an established presence in a different geographic location) in an increasingly cost-effective manner can lead to the desire to merge law practices to leverage resources and stand out among the crowded field of competitors. Alternatively, a practitioner might contemplate selling a law practice when: (1) she’s retiring, or (2) she simply wants an exit from the practice of law entirely. Either way, there are ethical considerations to consider in a merger or sale, all meant to protect the lawyer’s clients (and the legal profession). Let’s explore some of those key considerations.

Jurisdiction’s Ethics Rules

The first resource a practitioner contemplating the sale or merger of a law practice should consult is the applicable jurisdiction’s rules of ethics. Some of these rules provide specific guidance, especially regarding a sale. New York, Florida and California, for example, have specific ethics rules on the sale of a law practice.¹ The Model Rules of Professional Conduct adopted by the American Bar Association (ABA) (the Model Rules), which serve as a national template of legal ethics guidelines, also contain a section on the sale of a law practice.² Although generally modeled on the ABA’s rules, the state ethics rules regarding the sale of a law practice vary somewhat, making it all the more important for practitioners to

check the relevant jurisdiction’s rules.³ For purposes of this article, I’ll mostly refer to the Model Rules for ease of reference and consistency. Although the Model Rules don’t contain a specific section regarding the merger of law practices, many of the same ethical issues that arise in a sale apply to mergers.

Sale of a Law Practice

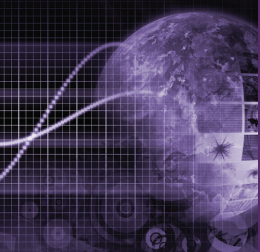
Model Rule 1.17 is titled “Sale of Law Practice” and is categorized under a division of the Model Rules concerning the “Client-Lawyer Relationship.” The rule requires the selling lawyer to no longer engage in the private practice of law, or in the specific practice area sold, within the applicable jurisdiction or geographic area where the selling attorney had been practicing.⁴ The ABA’s comments to Model Rule 1.17 clarify the contours of that restriction and allow some flexibility to the general rule, giving as an example a lawyer who sold her practice to become a judge, who then later returns to practice after either losing a judicial election or resigning from the judiciary.⁵

The seller must also sell the entire law practice or the entire practice area, rather than a smaller portion of the overall practice. As explained by the comments to Model Rule 1.17, this is meant to protect clients whose matters are less lucrative and who would have a hard time finding other counsel.⁶ If, under local law or court rules, approval by the court is required for the purchasing lawyer to be substituted for the selling lawyer in a pending action or proceeding, that approval must first be obtained before including the matter in the sale.⁷ Model Rule 1.17 also contains provisions regarding notice to clients regarding the sale and the transfer of the clients’ files.⁸ I discuss these provisions in the client confidentiality section.

One key client protection provision in the rule is that the purchasing lawyer must honor the arrangements



Michael M. Schimel is an associate at Meltzer, Lippe, Goldstein & Breitstone, LLP, with offices on Long Island, N.Y. and in New York City



between the selling lawyer and the client regarding legal fees and the scope of the work to be performed.⁹ This prevents the client from being unfairly taken advantage of in a situation over which the client has no control other than to seek new counsel, which may be a difficult or bad option for the client, especially one who's far along in her matter.

A number of other ethics rules come into play as well. Many lawyers are familiar with Model Rule 1.1, which requires competent representation of clients.¹⁰ In selling a legal practice, the practitioner should undertake due diligence to make sure the purchasing attorney

Lawyers selling their practices should be mindful of the fact that the duty of confidentiality continues even after the termination of their representation.

can competently represent the clients of the practice being sold.¹¹ And, as I'll discuss below, two other key ethics considerations in the sale of a law practice (or a merger) are client confidentiality and the avoidance of disqualifying conflicts of interest.

Confidentiality and Other Issues

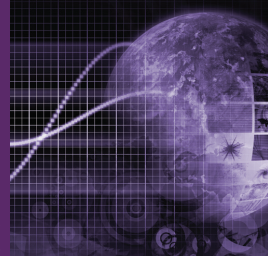
Most lawyers are familiar with the ethical duty of confidentiality, which prohibits lawyers from generally disclosing information regarding the representation of a client, unless the client consents.¹² The rationale for the rule is that it will encourage clients to "communicate fully and frankly with the lawyer even as to embarrassing or legally damaging subject matter."¹³ This full and free exchange between the lawyer and client is necessary for effective representation of the client.¹⁴

In the context of a sale or merger of a law practice, the ethical mandate to preserve client confidentiality intersects with the requirement to avoid conflicts of interest. The two can create an ethical mine trap for practitioners, who should be careful not to violate one

rule in an effort to comply with the other.

Client conflicts can arise in either a sale or merger. In a merger, conflicts checks during preliminary negotiations are absolutely necessary to avoid either of the merging firms potentially having to later withdraw their representation of an important client when, had they known of the conflict, they would have either not gone through with the merger in the first place or would have sought client consent to waive the conflict, if waivable. For this reason, the Model Rules contemplate the sharing of confidential client information, in a limited fashion, to reveal these conflicts. Model Rule 1.6(b)(7) allows a lawyer to "reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary: . . . to detect and resolve conflicts of interest arising . . . from changes in the composition or ownership of a firm, but only if the revealed information would not compromise the attorney-client privilege or otherwise prejudice the client."¹⁵ Similarly, in the context of a sale, a lawyer or law firm purchasing a law practice would want to make sure there are no disqualifying conflicts between her current clients and the prospective clients the purchasing attorney would take on. To the extent there are conflicts that can be waived, the lawyer would first need to seek informed consent from each affected client, in writing.¹⁶ An important first step in either a sale or merger is identifying the potential conflicts to determine whether they jeopardize the transaction from the start.

The Model Rules, then, offer a path to both preserve client confidentiality to the greatest extent possible and allow sharing of information to avoid or address conflicts of interest. The parties to the sale or merger can share information to flesh out conflicts of interest before the transaction is consummated, but only the least amount of information necessary to do so. They should keep everything else confidential. The comment to Model Rule 1.6 states that this sharing of limited information should only take place after "substantive discussions regarding the new relationship have occurred."¹⁷ In any event, the practitioner involved in a sale or merger should first consider whether the disclosure of the information would prejudice her client or violate the attorney-client privilege which, although related to the ethical rule of confidentiality, is a rule of



evidence that can carry consequential significance in legal proceedings involving the client.

If the purchaser wants more detailed information regarding the representation of a client, or even access to the client's file, the client's permission is required.¹⁸ Model Rule 1.17(c) requires written notice of the proposed sale to the seller's clients, which includes informing the client of the client's right to hire a different lawyer or to take possession of his file.¹⁹ If the client doesn't object to the file transfer within 90 days of receiving the notice, then the client's consent is presumed under the rule.²⁰ When a client can't be given notice, the practitioner can't share detailed information or transfer the client's file without a court order.²¹ At all times, including after the consummation of a sale, the client is free to discharge the lawyer who purchased the practice and choose another lawyer to represent him.²²

There doesn't appear to be a similar rule requiring client notice when a merger, rather than a sale, is involved. The distinction might be that a sale is a more abrupt termination of the client-lawyer relationship—the client will no longer work with that particular lawyer or law firm—so there's a lack of continuity, and the client may be stuck with another lawyer or law firm he doesn't want to work with. With a merger, there's arguably a greater sense of continuity than with a sale because, although the ownership of the law practice has changed, the same lawyers may continue to work with that particular client, and the successor firm will presumably continue to operate in a way resembling its former self. In any event, it would be a good idea for merging firms to notify clients, even if not required to do so under the ethics rules.

Lawyers should also consider the possibility of unauthorized access to client information in the context of a merger or sale. Model Rule 1.6(c) requires lawyers to make reasonable efforts to prevent unauthorized access to client information. In either a merger or sale, negotiations will be ongoing, and information (even if limited) is being exchanged. During the course of those negotiations or discussions, the parties involved should make sure that client information is protected from cyberattacks and third parties who may seek to exploit this exchange in an effort to obtain confidential client information.

Lawyers selling their practices should be mindful of

the fact that the duty of confidentiality continues even after the termination of their representation.²³ With just a few limited exceptions, they can't use information learned during the representation to the disadvantage of the former client.²⁴

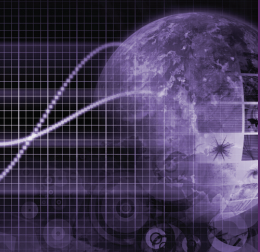
Safeguarding Client Funds

One other ethical obligation lawyers should think about in the context of a sale or merger of a law practice is the duty to keep client funds separate from the lawyer's own funds and to safeguard them for the client.²⁵ Although this basic duty to maintain escrow accounts for client

For now, it appears that there's still an ethical mandate against including nonlawyers as law firm partners or recipients of legal fees.

funds seems obvious, the parties to a merger or sale should make sure that the rules in this regard have been followed. Practically speaking, this requires accurate and detailed records.

Without accurate records of what funds belong to the client and what funds belong to the lawyer, a party to a merger or sale could inherit a very messy accounting problem at best (and possible legal and ethical violations at worst). As part of their due diligence, the parties to a sale or merger should ensure that client funds are segregated, clearly marked and safeguarded for eventual disbursement in accordance with the applicable arrangement or the client's instructions. Consider the case of a small practice of a solo lawyer who handles a large volume of real estate transactions. At any given moment, the lawyer may have custody of a large number of client funds (representing down payments for the purchase of real estate, for example). If that lawyer's health was failing and he needed to sell the practice before those real estate sales closed, the purchasing lawyer would need to know exactly which funds belong to the client and which belong to the law practice being purchased.



This is where carefully kept records are extremely valuable and can help avoid problems down the road for the successor lawyer or law firm taking over the client's matter.

Pending Matters

The applicable ethics rules recognize that a significant change like a sale or merger of a law practice can be unnerving for a client in the midst of a pending matter. For that reason, they provide guidance on a number of things to keep in mind during the transition.

As explained above, clients should expect their arrangements with the selling attorney regarding fees and the scope of work to continue, as required by Model Rule 1.17.²⁶ This should presumably provide some level of comfort to the client. The lawyer also has an ethical obligation to act competently²⁷ and diligently²⁸ in the representation of a client. This means that the parties to a merger or sale should familiarize themselves with the acquired client matters quickly and take note of upcoming deadlines, court dates and other matters requiring immediate attention. The lawyer should address each of these to provide seamless representation to the client, as best she can. By the same token, the lawyer should also commence regular communication with the client to comply with the ethical obligation to keep the client informed about the status of the matter.²⁹

Sharing of Legal Fees

The rampant change in the delivery of legal services and legal service providers has created new ethics questions for practitioners who may seek to partner with nonlawyers as part of their business. This could be through a merger with a business not exclusively engaged in the practice of law (for example, to form a multi-disciplinary practice providing legal and accounting services) or the sale of their law practice to a nontraditional legal service provider. Ethics rules on this topic have traditionally prohibited nonlawyers sharing in the practice of law, whether as a nonlawyer business partner or the recipient of a portion of the legal fees collected. This is an area that will likely change as the legal industry is further transformed by recent changes taking place in the delivery of legal services, but for now it appears that there's still an ethical mandate against including nonlawyers as law firm partners or recipients of legal fees.

Model Rule 5.4 is titled "Professional Independence of a Lawyer."³⁰ It contains fairly stringent provisions

regarding the lawyer's business association with nonlawyers in the practice of law. For example:

- A lawyer or law firm shall not share legal fees with a nonlawyer, subject to a few limited exceptions set forth in Model Rule 5.4;³¹
- A lawyer shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law;³²
- A lawyer shall not practice with or in the form of a professional corporation or association authorized to practice law for a profit, if:
 - a nonlawyer owns any interest therein, except that a fiduciary representative of the estate of a lawyer may hold the stock or interest of the lawyer for a reasonable time during administration;
 - a nonlawyer is a corporate director or officer thereof or occupies the position of similar responsibility in any form of association other than a corporation; or
 - a nonlawyer has the right to direct or control the professional judgment of a lawyer.³³

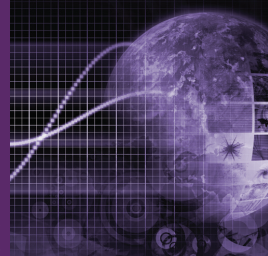
The official comment to Model Rule 5.4 explains that the rule's provisions are "to protect the lawyer's professional independence of judgment." Nonlawyers aren't subject to the professional legal ethics rules and—the argument goes—may try to influence the judgment of lawyers working for them, who are subject to those rules. Having only lawyers as owners of law firms who share in the profits insulates the firm's lawyers from the outside influences of others not subject to the lawyer's ethical duties.


This rule on lawyer independence means that parties to a sale or merger of a law practice should be careful if a potential purchaser or merging firm isn't a traditional law practice or law firm. For now, the sale or merger should only involve other lawyers and law firms practicing law to comply with the ethics rules.

Keep Up With Changes

The legal ethics rules surrounding the sale or merger of a law practice are varied, and the practitioner has a lot to keep in mind. The details of many of those rules will vary state by state, but a general understanding will help the practitioner navigate the issues that arise.

Just as important will be the need to stay abreast of the changes in this area as the nature and delivery of



legal services adjust to the modern practice of law in the current economic environment. As clients demand more services and begin to seek out multi-disciplinary practices or alternative providers of legal services, the potential rise of multi-disciplinary practices combining legal, accounting, financial advisory and insurance services may bring about change in the ethics rules regarding nonlawyer ownership of law practices and the sharing of legal fees. This could vastly alter the future landscape of law practice mergers and sales and the ethical considerations that arise from them. 

Endnotes

1. See New York Rules of Professional Conduct, Rule 1.17 (Sale of Law Practice); Florida Rules of Professional Conduct, Rule 4-1.17 (Sale of Law Practice); California Rules of Professional Conduct, Rule 1.17 (Sale of a Law Practice).
2. American Bar Association (ABA), Model Rules of Professional Conduct, Rule 1.17 (Sale of Law Practice).
3. See *supra* note 1.
4. *Supra* note 2, Rule 1.17.
5. Specifically, the comments state that "Return to private practice as a result of an unanticipated change in circumstances does not necessarily result in a violation. For example, a lawyer who has sold the practice to accept an appointment to judicial office does not violate the requirement that the sale be attendant to cessation of practice if the lawyer later resumes private practice upon being defeated in a contested or a retention election for the office or resigns from a judiciary position." Model Rules of Professional Conduct, Rule 1.17, Comment [2].
6. *Supra* note 2, Rule 1.17, Comment [6].
7. *Ibid.*, Rule 1.17, Comment [12].
8. *Ibid.*, Rule 1.17.
9. *Ibid.*, Rule 1.17, Comment [10].
10. *Ibid.*, Rule 1.1.
11. *Ibid.*, Rule 1.17, Comment [11].
12. *Ibid.*, Rule 1.6.
13. *Ibid.*, Rule 1.6, Comment [2].
14. *Ibid.*
15. *Ibid.*, Rule 1.6(b)(7).
16. *Ibid.*, Rule 1.7.
17. *Ibid.*, Rule 1.6, Comment [13].
18. *Ibid.*, Rule 1.17, Comment [7].
19. *Ibid.*, Rule 1.17.
20. *Ibid.*
21. *Ibid.*
22. *Ibid.*, Rule 1.17, Comment [9].
23. *Ibid.*, Rule 1.6, Comment [20].
24. *Ibid.*, Rule 1.9. Such information can be used if the ethics rules permit or require it with respect to the client or if the information has become generally known.
25. *Ibid.*, Rule 1.15.
26. State ethics rules on this can vary. Note that the New York rule, for example, adheres to this general rule, but permits an increase in the fee if permitted by the retainer agreement or otherwise agreed to by the client. New York Rules of Professional Conduct, Rule 1.17(e).
27. *Supra* note 2, Rule 1.1.
28. *Ibid.*, Rule 1.3.
29. *Ibid.*, Rule 1.4.
30. *Ibid.*, Rule 5.4.
31. *Ibid.*, Rule 5.4(a).
32. *Ibid.*, Rule 5.4(b).
33. *Ibid.*, Rule 5.4(d).



SPOT LIGHT

Face Your Fears

Brown Eggs by Jean-Michel Basquiat sold for \$5,389,500 at Sotheby's Contemporary Art Evening Auction on Nov. 14, 2019 in New York City. Basquiat's rise from a broke and homeless graffiti artist to a prosperous master of his craft happened quite quickly. The skull-like head in the drawing at hand was a precursor to what would become a regularly recurring figure in his work.