Alternative Approaches to Secretarial Support

Presented by
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Alternative Approaches To Secretarial Support
(Session LI32)
April 5, 2017

SB2 Consultants
Experience Matters

Introductions

SB2 Consultants
- Gera Vaz
- Mark Santiago
- Doug Benson

Alternative Secretarial Approaches to Legal Support
- When I was......

What happened to that world
- Technology
- Changing role of legal secretaries
2008 Happened
Lehman Brothers

In 2007 law firm seminars were talking about:

- $200,000 first year associates
- Unlimited growth in revenue
- Increased partner profits
- Law schools were not training enough lawyers

Since 2008

- AmLaw 200 firms have laid off more than 12,500 administrative staff
- AmLaw 200 firms have laid off more than 7,000 lawyers
- 20 AmLaw 100 firms have smaller gross revenue today than in 2008
- Total attorney count grew by 3.7%; equity partners by .2%

12,500?

Probably more and mostly secretaries

- 1980’s 1 attorney = 1 secretary + text editors (word processors)
- 1990’s firms were at 2 attorneys = 1 secretary + text editors

Now

- 3, 4 or 5 attorneys = 1 secretary + text editors is common

Soon

- 8 – 10 attorneys = 1 secretary + text editors + concierge staff
How Do You Do That?

One Librarian’s Approach

**SB² Methodology**
1. Define the firm’s administrative support objectives
2. Document critical processing requirements and attorney needs
3. Develop skill set profile and “Best and Highest Use” matrix
4. Design new administrative support structure
5. Test new support structure, evaluate and modify if required
6. Firm-wide implementation
7. Monitor performance and continuously adjust

Program Objectives

**Alternative Approaches to Legal Support**

**Process for Establishing a New Legal Support Structure**

**Voluntary Early Retirement Programs**

**Communication and Execution Plan Strategies**
Latham & Watkins

Latham launched a FAST program in fall 2013
- Hired newly minted college graduates
- Established a First Year Associate Team (FAST) program to support Fall & Summer Associates
- Team members were rotated through various support departments
- Dispersed throughout offices and may perform assignments remotely – 25%
- Easy to Hire – Easy to train

Results:
- Firm Associate Support Team - First and Second year associates and summers. Second years asked to stay on FAST team

Orrick Herrington & Sutcliff

Established an Administrative Resources Center (“ARC”) in Wheeling, West Virginia
- Embedded knowledgeable Orrick staff within the ARC
- Marketing campaign - ARC members visited practice offices to explain services and “provide a face to the voice”
- ARC provides general administrative services to the other administrative support departments as well as attorneys

Orrick outsourced the ARC in 2009
- Better at managing text editing function
- Cost savings
- Better workflow technology
Other AmLaw 200 Firms

Paul Hastings
➢ Moved secretarial functions to an outsourced ARC like facility in Arizona

Wilmer Hale
➢ Moved majority of text editing and switchboard services to Dayton, Ohio. Provided support to administrative departments throughout the firm.

Recent SB₂ experience in two mid-sized (200 attorney) law firms

Implemented Legal Support Teams

Legal Administrative Assistant Position Established

Team Approach Allows Attorneys Access to Multiple Professionals to do their Work

Key Role is the Workflow Coordinator
**Alternative Attorney Support Structure Advantages**

**Improved service levels to attorneys**
- Easy to submit work
- Allows scheduling flexibility with early morning/evening availability
- Knowledge base of those understanding an attorney’s work is broader
- Right person with the strongest skill set completes assignments

**Expense savings**
- Achieved through improved ratios and lower cost Administrative Assistants (5 to 1 or more secretarial ratio)

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**Alternative Attorney Support Structure Advantages**

**Career Path**
- Provides outstanding Legal Secretaries promotional opportunity into Workflow Coordinator/Lead position
- Provides Administrative Assistants with opportunity to transfer to other support departments or be promoted into Legal Secretarial positions
Alternative Attorney Support Structure Advantages

Establish easy ways for attorneys to submit work
- One mailbox, IM's, telephone or in person
- Use of a drop down menu to select task that needs to be performed

Work submitted is monitored and picked up for completion within a specified timeframe

Robust Reporting
- Enhances ability to monitor productivity and performance for continuous process improvement.

How Do You Establish An Alternative Attorney Support Structure?
Define Objectives

Why is your firm undertaking this project?
- Save money?
- Improve Support Services?
- Both?

Improve secretarial support ratios? Do you have a specific ratio in mind? Or is it to just be better than you currently are?
- What is your current ratio?
- What is your target ratio?
- When do you want to achieve the target ratio?

Define Objectives

What level of support will you provide to:
- Partners
- Associates
- Paralegals
- Other Professionals

When do you want/need results?

How much are you willing to invest to achieve the results?
- Money
- Time
Requirements/Attorney Needs and Skill Set Profiles

Analyze Attorney Activity
- Billable Hours
- Practice Group variations
- Individual attorney needs

In Person Meetings
- Selected Interviews with administrative management team
- Selected Partner Interviews
- Focus Groups with Associates
- Focus Groups with Secretaries
- Focus Groups with Paralegals (if assigned to a secretary)

Identify individual secretarial skill set profiles
- Identify superior performers
- Identify individuals with significant institutional knowledge
- Look for leadership

Develop “Best & Highest” use list
- Identify superior performers by skill set and knowledge base
Design, Test and Implement

Design new administrative support structure utilizing:
- Firm Administrative Support Objectives
- Attorney Activity Analysis
- Secretarial Skill Set Profiles

Test support structure, evaluate and modify
- Office
- Floor / Practice Group

Implement firm-wide in phased rollout
- Periodic assessments and adjust as required

What Our Experience Tells Us

Secretarial Assignments
- “In name only” – lack of attorney work
- Associates and Paralegals underserved

Dictation
- Secretary’s perception of time spent
- Transcription Data presented a different story

Word Processing
- Expensive and inefficient use of a legal secretary’s time resulting in significant overtime with little before/after hours coverage
So, my firm has too many legal secretaries. Now what do I do?

Approaches:

Attrition

Reduction In Force ("RIF")

Voluntary Early Retirement Program
Voluntary Early Retirement

Offered to a specific job classification throughout entire firm or a specific office

Combination of Age and Length of Service used to identify those who are eligible

Legal Compliance required – Older Workers Benefits Protection Act

Must be financially attractive – severance, payment of COBRA, outplacement, lump sum offset

Voluntary Early Retirement

Now may be the time to offer this option—

- 401(k) plans are generally “up”
- Affordable Care Act is an alternative to COBRA
Advantages

- Allows employee to make the decision
- Preserves culture of firm to treat employees respectfully
- Allows transition time and transfer of institutional knowledge

Communication/Implementation

- Proper planning/communication is the KEY to success
- Implementation is easy – H/R aspect is hard

Considerations:
- Who are the various stakeholders?
- Who “Champions” this initiative?
- Identification of those who will be resistant – plan an intervention
- Tone and sequencing of communications – imagine it will end up on Above the Law
- FAQ’s provided to firm leadership for consistent responses to questions
Challenges/Obstacles

- Status Quo
  - “Everything works fine”
  - We are making money or a lot of money
- Partner relationship with their individual secretary
- Selecting the right team for the service center
  - Manager is critical
- Familiarizing “new to law firm” Administrative Assistants with the mechanics of how a law firm works
- Processes must be seamless for attorney and easy to get work completed

Why Would You Do This?

500 Attorney East Coast Firm:
  - Savings Opportunity $4.7mm - $6.1mm

550 Attorney West Coast Firm:
  - Savings Opportunity $2.8mm - $4.3mm

100 Attorney East Cost Firm:
  - Savings Opportunity $550,000 - $1.0mm

Significant savings opportunity regardless of geography or firm size
One Last Thing!

Your Opinion Matters!
Please take a moment now to evaluate this session.
Thank You!

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SB²Consultants.com
Over the past year, SB2 Consultants has performed numerous Right Sourcing Business case analysis engagements for law firms located throughout the United States.

Right Sourcing is our moniker for the process of determining who, where and how key administrative services are provided to a law firms’ attorneys. Outsourcing is for Corporate America where most functions can be sent outside the company to a lower cost location and often outside the country.

Right Sourcing is for professional service firms where key administrative activities and institutional knowledge must remain within the firm while other administrative functions can be moved to other geographies within the United States.

The objectives of our Right Sourcing studies were twofold:

1. To compare the cost of providing High Value Add ("HVA") administrative support services such as Accounting and Finance, IT and H/R and Marketing support in a client firm’s headquarters location to lower cost location(s) within the United States.

2. To benchmark the firm’s administrative support structure (i.e. the number of staff performing specific clerical functions such as secretarial support and word processing) against established industry norms to identify potential process re-engineering savings opportunities.
Our numerous studies documented what many management professionals and managing partners of law firms have thought for years. Law firms are inherently inefficient suppliers of administrative service.

In the past, this realization has resulted in most law firms above 100 to 150 attorneys to outsource many of their basic services. Mail, messenger, records and photocopy staff are now commonly supplied by a group of national and regional vendors.

However, one key service that is not supplied by any vendor and in most of our individual business case analysis proved to be one of the most inefficient services that law firms supplied was that of secretarial support.

**Secretarial Compensation Rates are Surprisingly Uniform in Major Metropolitan Areas**

Websites that track these things report that since the 2008 economic crisis more than 15,000 administrative employees have been terminated by law firms. There are no reliable breakdowns as to the number of secretaries within that number but I believe it is accurate to assume that the vast majority of the terminations were secretaries. However, even with that significant reduction in the number of secretaries few law firms’ secretarial support ratios exceed 3 or 4 attorneys to 1 secretary.

Our work also documented a surprising uniformity in secretarial compensation in law firm’s nationwide.

The chart below identifies (by city) the percent differential there is in base compensation between Denver at 100% (the city with the lowest average secretarial cost of $55,000) and San Francisco at 147% (the city with highest average secretarial cost at $81,000). These are base compensation figures only and do not include any amount for overtime or bonus payments. They also do not include the cost of benefits or allocation for overhead.
As the chart documents, the difference between the top of the first and bottom of the third quartiles is about 15%. We found that the average legal secretary in our sample cities base compensation was $69,600 and the “all in” cost with benefits was over $90,000. In the first quartile cities the all in cost exceeds $100,000.

Our work also documented significant savings potential in the realignment of administrative support services in every geography and firm regardless of size.

- In a 500 attorney firm in Washington we identified more than $6.1mm in annual savings
- In a 550 attorney firm in San Francisco documented savings exceeded $4.3mm
- A 100 attorney firm in New York saved almost a million dollars.

Many firms have recognized the need to realign their secretarial support functions but question how to best achieve the results they want without undue disruption or a dilution of administrative support services.

<table>
<thead>
<tr>
<th>Fourth Quartile</th>
<th>San Francisco 147%</th>
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<tr>
<td></td>
<td>New York 145%</td>
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<td></td>
<td>Washington, DC 141%</td>
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<td>Third Quartile</td>
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<td>Boston 118%</td>
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<tr>
<td></td>
<td>Dallas/ Ft. Worth 118%</td>
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<tr>
<td></td>
<td>Denver 100%</td>
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Improved Service / Reduced Cost

When I was in high school there was a daily after school study hall located in the library. The school librarian (whom we assured each other had kept George Washington after class) insisted on absolute silence as the price of attendance. Her desired level of monistic silence was seldom achieved and periodically she would walk to the center of the room, turn left or right and throw that half of the study hall out. Silent or a chatterbox, it did not matter, you were out. I call this the Gracie T. Hoare methodology and by in large, it does not work.

Many law firms have pursued a similar methodology when they have attempted to reduce their secretarial complement. Downsizing decisions are based on perceptions not annual performance reviews or skill test results. Powerful partners with large books of business get single coverage even though they produce few actual documents. The hard working junior partners and associates who are producing the documents are lumped into shared arrangements or secretarial pools. This approach pleases no one, results in decreased service levels and negatively impacts the moral of the lawyers and the administrative staff.

These forced downsizing efforts also do not recognize the changing nature of the administrative support that attorneys need and want.

How Do You Get to 8 to 1?

To paraphrase the old joke you analyze, analyze, analyze. Our clients who are at or close to that ratio have done it through a thoughtful and deliberative process that:

- Defines the firm’s administrative support objectives
- Documents critical processing requirements and attorney needs
- Develops a skill set profile and “Best and Highest Use” matrix
- Designs new administrative support structure
- Pilot tests the new support structure, re-evaluates and modifies the support structure as required
- Implements support structure firm wide
- Monitors performance and continuously adjusts

The basis for any successful secretarial realignment effort begins with the leadership of the firm setting clear goals and objectives for the effort. Some firms set out to reduce costs and nothing more. While we understand that cost reduction is important (for some firms it may be critical) it is not incompatible with service level improvements or expansions. One of the more innovative trends we have seen is the introduction of "concierge" service providers to augment the support that secretaries provide to attorneys. These less highly skilled workers perform more clerical type functions (filing, reservations and time entry) leaving the more highly skilled secretaries to concentrate on more value added activities. Several firms have increased their support headcount and the service provided while reducing overall compensation expense through the introduction of concierge workers.

Central to the success of a secretarial realignment project is an in-depth understanding of what types of work and the volume of work that the secretaries are currently doing, what the attorneys want them to do and the individual skill sets of your secretaries. We have found that focus groups (attorneys and secretaries separately!) talking about what they do and what they want and the analysis of attorney time records are good data points to start at. The annual attorney evaluations of secretarial performance provide insight into individual skill levels and some firms have mandated skill testing to augment the information provided in the annual reviews.

Armed with the data on what the attorneys want, the secretarial skill levels and the amount of work that is being generated a new secretarial support secretarial structure can be designed. As noted above, the identification of less skill sensitive
tasks will enable a firm to introduce concierge employees who can provide additional services at a reduced cost.

Implementation of the new secretarial support structure design is best done starting with a pilot area (practice, floor or office) which allows for close supervision, early identification and correction of design flaws and building support around the firm. Nothing boosts a projects acceptance like testimonials from secretaries and lawyers alike.

The firm-wide roll out following the pilot should include a heavy communications component, a great deal of management by walking around (so you can spot issues before they mushroom) and a formal evaluation and reporting mechanism so that you can document your hard won success.

Is achieving a 8 to 1 secretarial support ratio an easy undertaking? No it is not! It requires work, persistence and flexibility. But the rewards are significant and for some they be critical.
Alternative Secretarial Approaches to Legal Support

By J. Mark Santiago

Over the past year, SB2 Consultants has performed numerous Right Sourcing Business case analysis engagements for law firms located throughout the United States.

Right Sourcing is our moniker for the process of determining who, where and how key administrative services are provided to a law firms’ attorneys. Outsourcing for Corporate America is where most functions can be sent outside the company to a lower cost location and often outside the country. Right Sourcing is for professional service firms where key administrative activities and institutional knowledge must remain within the firm while other administrative functions can be moved to other geographies within the United States.

The objectives of our Right Sourcing studies were twofold:

1. To compare the cost of providing High Value Add (HVA) administrative support services, such as accounting and finance, IT, and HR and marketing support in a client firm’s headquarters location with lower cost location(s) within the United States.

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Valuation of a Law Firm and a Law Practice

Part One of a Two-Part Article

By James D. Cotterman

Lawyers leaving a law practice have an economic interest in monetizing their career-long investment in building a client portfolio and a referral network. They have invested time, knowledge and care into relationships created to solve clients’ problems, advance clients’ interests and navigate clients’ legal and regulatory responsibilities. They have devoted much effort to establishing professional credentials and a visible presence for their particular experience and expertise. How each lawyer has accomplished this depends on his or her particular practice, market and style. But while the means may vary, the results are the same — access to clients who have legal needs. And this is the value the acquirers wish to capture.

Part One of this article discusses the current state of law firm valuation, how to determine what it is that is being transferred, and a few of the methods used for valuing a law firm.

Changing Landscape

With a changing marketplace for legal services, many of the old rules for valuing a law firm or law practice need to be reexamined. Due diligence must be more thorough and conducted with greater skepticism. The market of sellers (reiring lawyers from the Boomer generation) is growing rapidly. At the same time, the market of buyers (the successor lawyers) have become more experienced with the challenges of transferring practices. And those clients and referral networks (the assets being monetized) have become more unpredictable. Clients are more willing to seek alternatives to the traditional, longstanding relationship with a single trusted advisor for their legal and regulatory needs. Add rapidly changing advances in technology which change how the profession works and where it works; which affects the lawyer-client relationship and ultimately the value of that relationship. And finally, potential buyers and sellers should take note of

Continued on page 2
Law Firm Valuation
continued from page 1

the liberalization of standards in the UK and elsewhere that, for the first time, have allowed outside investment in law firms by non-lawyers. A similar change in the U.S. would be a potential game changer for firm valuation.

Even without the liberalization of ownership standards, the valuation landscape has changed — and generally not for the better from a seller’s perspective. Buying professional practices is recognized as a much more difficult activity today than it was a decade ago. Pricing models, and reasonable hopes and expectations for pricing conversion and future pricing increases are vastly different today.

Traditionally the opportunity to sell a small firm or for a sole practitioner to join a larger firm as part of a transition and exit strategy was predicated upon the assumption that clients would stay with the new firm after a short (one to three year) transition period, that the new firm subsequently would be able to convert those clients to its higher pricing models, and that the year-over-year rate increases historically achieved would be repeated in the future. All three of those assumptions must be examined far more critically today. Clients may not “go along” with the handoff and it’s likely they will be much less willing to accept an upsell in pricing. And the rate increase patterns pre-recession are unlikely to return in the current environment. In fact, a market has developed for practitioners leaving larger, higher-priced firms to go to smaller, less costly firms where they can reduce pricing to keep clients who have become quite cost-conscious.

Current pricing models, along with the likelihood of client retention, successful pricing conversion and future pricing increases are all critical elements to consider in determining the value of a practice. Recent changes have complicated valuation and altered the best means to achieve a positive outcome for all parties (seller, buyer and client).

Valuing a business concern is a specialty service, built on proper experience and knowledge, good tools and data. There are accrediting organizations that provide training and credentialing for those who wish to develop a valuation practice. Such organizations include the AICPA (American Institute of CPAs; www.aicpa.org) and NACVA (National Association of Certified Valuators and Analysts; www.nacva.com). And there are networks, such as the ABA (no, not the American Bar Association, but American Business Appraisers (www.businessval.com)) who have a network of professionals credentialed in various aspects of valuation.

When searching for someone to assist with monetizing the value of your law practice, recognize that the practice you have built is deeply specialized. It is a closely-held business where the valuation and transfer task is complicated by several factors. Within the category of closely held businesses, it is a professional practice which further complicates the task. And finally it is in the field of law, where the task becomes most difficult of all. What is the fair value of a lifetime of work building a law practice? This article discusses the issues and methods to answer that question.

WHAT’S BEING VALUED — AND WHAT’S BEING TRANSFERRED?

This very simple question is often the one most overlooked. One cannot value a law practice without the continued on page 3
answer of what’s being transferred, although many people try.

The seller is providing the accumulated efforts of establishing trust-based relationships with clients, building relationships with contacts and referral sources, creating a market presence professionally and among desired clients, and developing the infrastructure to deliver legal services.

The buyer is looking for an ongoing stream of income that is represented primarily by the client base and referral sources of the seller. The buyer is hopeful that (s)he can assume the trust position with clients and market presence of the seller. In addition, there are hard (often called tangible) assets and intangibles, such as an established business operation, that make up the practice’s infrastructure.

The clients are looking for consistent advice, steady counsel and retention of their institutional knowledge; more directly, they are looking for solutions to problems or issues from someone who understands them and their needs; from someone they trust.

In essence, what’s being transferred can be separated into two components which will be valued separately: The business entity and the law practice. Each is described briefly below.

**The Business**

For valuation purposes, the business consists of the operating intangibles and the hard assets less any outstanding debt or lease obligations that are a part of the business entity.

Such assets and obligations may include:

- Cash, deposits and prepaid expenses;
- Land, building and improvements thereto (or more likely a long-term facility lease);
- Technology and communication infrastructure (probably a mix of owned, leased and outsourced services);
- Library and reference materials (in those few practices that have maintained the investment even though the knowledge is accessed electronically today — not a source of value unless it is some specialized circumstance);
- Furnishings and fixtures;
- Accounts receivable (fees and client costs advanced);
- Unbilled fees and client costs advanced but not yet billed;
- Accounts payable and accrued expenses not yet paid;
- Loans and capital lease obligations (leasing rules are likely to change placing more operating leases on the balance sheet, but even if not, a careful examination of all operating leases is needed);
- Client funds held in trust both an asset and an offsetting liability confirmed to bank and client records; and
- Unrecorded liabilities or contingent liabilities arising from off the books agreements that may contain current and future obligations and claims of current and/or past employees, clients and creditors that may or may not be insured.

The practice of law is not a capital intensive business. Large land holdings are not required. There is minimal investment in raw materials (unless you consider the cost of attending law school!). The inventory is modest, amounting to a few months of the lawyer’s time value expended on client matters (except possibly in certain contingent fee practices). There is no need for expensive equipment (as in many medical practices). Yet what investments there are have grown more expensive and require more rapid replenishment — that typewriter for your secretary that lasted 20 years is now a notebook/tablet/smartphone combo for the lawyer and an all-in-one computer for the assistant — both (the equipment) needing replacement every couple of years. Today, communication bandwidth and security to support massive data transfer and storage, remote functionality, and state-of-the-art video conferencing make up a vastly different world than the multi-line telephone with voice mail and a dedicated fax line.

The business is valued at a point in time starting with the firm’s cash basis balance sheet and adjusting from there. These adjustments are normally done in several intermediate steps: cash to accrual, then unrecorded and contingent items, then current value/obsolescence, then items excluded from the transaction (if any) and finally items required by the agreement at closing, such as minimum guaranteed working capital or net worth.

**The Practice**

The practice is comprised of the source of the immediate stream of revenues, as well as the network of contacts and referrals that assist in generating the future stream of revenues. Access is the first step and their trust is the ultimate requirement. This is where there is significant value, or not. And it is the area where there is the most difficulty determining what value there is and how much of it can be transferred from seller to buyer. This last question — the transfer — requires seller, buyer and client to make happen. This is a further reason why law practices have less value than comparably sized businesses in different settings.

A further complication arises if one looks to other professions where there is data on purchases and sales. Such transactions, often expressed as a multiple of earnings (compensation of individual partners) or revenues, may be based on different valuation parameters. For example, the balance sheet may be valued separately or subsumed within the multiples being quoted. Further, the balance sheet may or

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**Law Firm Valuation**

*continued from page 2*

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may not include accrual adjustments (the most notable likely unbilled time and accounts receivable). The earnings generally are reflective of partner compensation, but cash or fully loaded total compensation? CPAs generally use cash compensation; lawyers generally use total compensation. These are nuances that must be understood before applying market data to a specific situation. Unfortunately, there are no databases of comparable transactions for law firms. The only available guidance is the surveys that look at the buy-out and retirement of partners, which represent an okay, but not ideal, proxy for valuation. One must separate the buy-out of an ownership interest from any retirement benefit funded by the firm. In most instances these are co-mingled and not readily separable.

**Special Valuation Problems of Law Practices**

If, in essence, the most valuable asset conveyed in the transfer of a law practice is the ongoing and future access to contacts, referral sources and clients, along with the trust they have in the seller, then essentially what is conveyed is the professional goodwill of the lawyer. The courts remain divided on this issue. And the complexity is seen in the various cases where goodwill has, and has not, been recognized. Clearly, in some fact situations there may be an ongoing concern that is independent of the seller. It is also clear that fact situations exist where this is not the case.

Historically, the profession and the courts held that as a matter of public interest and policy, clients are not property and could not be sold, and that clients are ultimately free to select and change their legal representative at any time.

In matrimonial matters, both equitable distribution and community property jurisdictions have been inconsistent in their treatment of goodwill and value of practice, but this is the general area in which goodwill has traditionally been found; often embodied in the value of the professional license.

**ABA Guidelines**

Before 1990 the ABA position was that it was unethical to sell a law practice. And that was the position adopted by the state bar associations. In 1990, the ABA adopted Rule 1.17, Sale of Law Practice (http://bit.ly/1p7Gw5R). The Rule provides for the purchase of a law practice, or an area of a law practice, by one or more lawyers or firms if certain conditions are met. The rule further provides for the recognition of goodwill in such transactions. The primary conditions to be met are that the lawyer sell the entire practice or area of practice, the seller ceases practicing law at least in the substantive area of the practice(s) sold, the seller notifies each client in writing of the proposed sale, and the buyer does not raise fees by reason of the sale. Lawyers should also check their State’s rules as they may vary from the ABA’s guidelines.

The ethical considerations present problems and risks for both the seller and the buyer and center on protecting clients’ rights, property and confidences. Ethical considerations cover a broad gamut of issues, including: client communication, lawyer of record, client confidences, client files/property, client funds, conflicts of interest, competency, misrepresentation by the seller of purchaser’s qualifications, errors of selling lawyer discovered by the buyer and other issues.

Financial aspects covered in the rules that are important in the negotiation of the transfer are the right to have a covenant not to compete and the requirement that the seller must sell an entire practice or an entire practice area, thus preventing the cherry picking of the best work and clients to the detriment of other clients.

**Valuing Partner/Shareholder Interests (The Internal Transfer)**

The spectrum of law firm valuation and withdrawal entitlement theory can be characterized by two polar positions. The first considers the firm as a means to generate income (i.e., compensation), with modest, if any, value beyond the cash basis

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<th>Valuation Factor</th>
<th>Multiplier Points Low Range</th>
<th>Multiplier Points High Range</th>
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<tr>
<td>Base multiplier:</td>
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<td>1.50</td>
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<tr>
<td>Positive factors:</td>
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<td></td>
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<tr>
<td>Core client group is stable and obtained through direct contact</td>
<td>.15</td>
<td>.25</td>
</tr>
<tr>
<td>Seller is young enough to effect an orderly succession</td>
<td>.20</td>
<td>.30</td>
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<tr>
<td>Practice has been consistently profitable</td>
<td>.50</td>
<td>.75</td>
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<tr>
<td>Senior partner (and then firm) are known as the “go to” firm for these services</td>
<td>.75</td>
<td>1.00</td>
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<td>Negative factors:</td>
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<td>Remaining partners too reliant on senior partner for rainmaking and leadership</td>
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<td>-.45</td>
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<td>Firm is tied to a bad regional economy</td>
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Law Firm Valuation

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...capital account. This is the current dominant view in the profession and has resulted in the vast majority of firms valuing only the cash basis balance sheet for internal withdrawal rights. The second considers the firm as an investment, much like most other commercial endeavors.

There is readily acknowledged value in the establishment of a business enterprise. Starting a business involves creating business contacts, banking relationships, vendor relationships, designing and outfitting space, finding and training staff, creating forms and procedures and generating cash flow. These items comprise institutional goodwill. Any individual who has started a business understands the value of an ongoing entity. It is for this reason that many firms will still provide something to founders beyond the cash basis capital account upon retirement. At times, the cost of buying out the founders is spread across two or three generations in order to facilitate the transfer.

When this is done for founders and in those firms that still provide some form of unfunded buy-out, the typical methodology is to establish the adjusted net cash-basis book value of the firm plus a multiple of some average of past earnings. At a minimum, this multiple will recognize the proportional value of unbilled time and accounts receivable that are not shown on the balance sheet. In some circumstances, and with higher multiples, some recognition of the goodwill or going concern value of the business will be factored into the buyout.

The buyers, in this instance, have an advantage in that they know the seller, the clients, the infrastructure required to serve those clients, and the practice methodologies being acquired. The clients should know, and have relationships with, some of the acquiring partners (at least if succession was planned properly which unfortunately is not done as frequently or effectively as one might expect), resulting in a more likely successful transition. This is essentially the exclusive means by which law firms handled the retirement of partners before the tax law changes in the early 1980s permitted qualified pension programs for partnerships.

The Earnings Multiple
(The Traditional Look-Back Method)

The earnings multiples for service businesses are lower than for manufacturing concerns. In professional service firms, the multiples are lower yet; and law firms generally even lower than other professional service firms. Manufacturing concerns typically have ongoing franchises and productive machinery to sustain them. Sustaining the profitability of a law firm, however, greatly depends upon whether the firm is able to retain and develop its base of clients and the lawyers responsible for attracting them.

Value in a law practice is largely personal to the lawyer and that individual’s ability to attract and retain clients. The lawyer has knowledge, experience, skill, judgment, and reputation — all elements of professional goodwill. As long as clients primarily hire lawyers, as opposed to firms, this will remain a guiding principle in valuing law practices. This is not to say that some firms have not created a “brand identity” that is separate and distinct to the institution. And in larger practices, the servicing team (including other partners and other practice specialties) influence the client’s selection decisions. It is just that those firms are rare (and larger practices are not the subject of this article).

Complicating this task is the fact that even when client relationships are transferred, it is ultimately the new lawyer’s personal ability and relationship with the client that determines whether the client will stay or leave. Therefore the transfer of a practice is a complex blend of seller, buyer and client interaction. It is for these reasons that multiples are so low.

Buy-outs beyond the return of cash basis capital in a law firm can be valued and paid in many different ways. Some plan designs are simple, while others are very complex. This variety makes comparisons of buy-outs among firms difficult. However, a present value analysis allows the various plans to be reduced to a common, comparable stated amount. Once that amount is calculated, a comparison can be made between that amount and partner earnings at withdrawal. The result is a standard multiple of compensation (earnings) that is common in the legal profession for a buy-out.

Once the standard multiple is determined, it is adjusted up or down to reflect the facts and circumstances of that firm, that practice and that market. Here are the common factors to consider when adjusting the multiple:

- Market demographics and location;
- Stability and quality of the client base;
- Source of clients and referral sources;
- Nature of relationships (institutional or transactional);
- Ability of remaining lawyers to perpetuate the business;
- Name recognition and reputations (firm and lawyers) in the community served;
- Type of practice and pricing/billing/payment norms;
- Concentration of revenues;
- Profitability of practice relative to comparatives;
- Size of firm;
- Stability of partner group;
- Profits reinvested into the firm to fund growth;
- Level of risk undertaken; and
- Quality of infrastructure.

The process of establishing an adjusted multiple is both subjective and judgmental. There is more art

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than science in the assessment and valuation of positive and negative factors of a specific situation.

Generally, earnings multiples fall within a range of 0.50 to 3.33 (See, Appendix 1 below). That means the value of the practice is in a range from a half-year of normalized annual earnings to three and one-third times normalized annual earnings. A second multiple often referred to is a multiple of revenues. Generally ranging from .25 to 1.00 in value, such multiples are considered less appropriate because they ignore risk and return — two critical elements of value. Appendix 2, below, has a conversion chart for comparing revenue multiples to adjusted earnings multiples at various profit margins.

The table on page 4 depicts how one might assign factors and points for a hypothetical small law firm to arrive at a reasonable multiple. First, you establish a base multiplier principally by size of firm, practice specialty and location. Then you assess and value positive and negative factors that should adjust the base multipliers. Based on this hypothetical example, the adjusted multiplier should be 2.15 to 3.10 times earnings.

In this instance the seller (retiring partner) would receive two payments for a buy-out. The first payment would be for the cash basis capital account, adjusted upward for any additional sums owed to the partner and downward for any debt the partner owed to the partnership. This amount will most likely be paid over a short one to three year period, which is also most often the same amount of time granted new partners buying in to the practice.

The second payment would be the earnings multiple. The definition of earnings can vary but most common is an average of three to five years of total compensation. There are variations on this theme. For example, you might use the average of the highest three of final five years, or of the last five years, dropping the highest and lowest and averaging the middle three. Total compensation includes all taxable income (wages, fringe benefits, employer paid pension and employer paid payroll taxes for those practicing in a professional corporation setting).

This payment would most often be amortized over a three to seven year period of time. For example, if the high multiple were used over seven years then the partner would receive 44% of his or her average total compensation for each of the next seven years. In addition most firms would condition such payments on the actual retirement of the partner from the practice of law.

Sellers (retiring partners) should not forget to have the firm acquire a tail errors and omissions insurance policy in addition to the payments for capital and retirement. And if the partner has retired before age 65 or has a spouse under age 65, some provision for health insurance continuation should be provided. Often this would be done with the premiums paid by the retired partner. But it may complicate the mechanics of the transaction in order to comply with the insurance carrier’s contract.

A special note for estate and contingent fee practices or firms with a material amount of estate or contingent fee work. These practices require extra care and special analysis as there is future potential value that must be considered arising from past services.

Part Two, next month, will examine a possible solution to the differing valuation methods and look at issues that arise in an external transfer when someone outside of the firm is interested in buying it.
Legal Support
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2. To benchmark the firm’s administrative support structure (i.e., the number of staff performing specific clerical functions such as secretarial support and word processing) against established industry norms to identify potential process re-engineering savings opportunities.

Our numerous studies documented what many management professionals and managing partners of law firms have thought for years: Law firms are inherently inefficient suppliers of administrative service.

In the past, this realization has resulted in most law firms above 100 to 150 attorneys to outsource many of their basic services. Mail, messenger, records and photocopy staff are now commonly supplied by a group of national and regional vendors.

However, one key service that is not supplied by any vendor — and in most of our individual business case analysis proved to be one of the most inefficient services that law firms supplied — was that of secretarial support.

SECRETARIAL

COMPENSATION RATES

SURPRISINGLY UNIFORM

Websites that track these things report that since the 2008 economic crisis, more than 15,000 administrative employees have been terminated by law firms. There are no reliable breakdowns as to the number of secretaries within that number, but I believe it is accurate to assume that the vast majority of the terminations were secretaries. However, even with that significant reduction in the number of secretaries, few law firms’ secretarial support ratios exceed three or four attorneys to one secretary.

Our work also documented a surprising uniformity in secretarial compensation in law firm’s nationwide.

The chart above identifies (by city) the percent differential in base compensation between Denver at 100% (the city with the lowest average secretarial cost of $55,000) and San Francisco at 147% (the city with highest average secretarial cost at $81,000). These are base compensation figures only and do not include any amount for overtime or bonus payments. They also do not include the cost of benefits or allocation for overhead.

As the chart documents, the difference between the top of the first and bottom of the third quartiles is about 15%. We found that the average legal secretary in our sample cities base compensation was $69,600 and the “all in” cost with benefits was over $90,000. In the first quartile cities, the all in cost exceeds $100,000.

Our work also documented significant savings potential in the realignment of administrative support services in every geography and firm regardless of size:

- In a 500 attorney firm in Washington, we identified more than $6.1M in annual savings;
- A 550 attorney firm in San Francisco documented savings exceeded $4.5M;
- A 100 attorney firm in New York saved almost a million dollars.

Many firms have recognized the need to realign their secretarial support functions but question how to best achieve the results they want without undue disruption or a dilution of administrative support services.

IMPROVED SERVICE/
REDUCED COST

When I was in high school, there was a daily after-school study hall located in the library. The school librarian (whom we assured each other had kept George Washington after class) insisted on absolute silence as the price of attendance. Her desired level of monistic silence was seldom achieved and periodically she would walk to the center of the room, turn left or right and throw that half of the study hall out. Silent or a chatterbox, it did not matter, you were out. I call this the Gracie T. Hoare methodology and by in large, it does not work.

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Legal Support
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Many law firms have pursued a similar methodology when they have attempted to reduce their secretarial complement. Downsizing decisions are based on perceptions, not annual performance reviews or skill test results. Powerful partners with large books of business get single coverage, even though they produce few actual documents. The hard working junior partners and associates who are producing the documents are lumped into shared arrangements or secretarial pools. This approach pleases no one, results in decreased service levels, and negatively impacts the morale of the lawyers and the administrative staff.

These forced downsizing efforts also do not recognize the changing nature of the administrative support that attorneys need and want.

**How Do You Get to 8:1?**

To paraphrase the old joke you analyze, analyze, analyze. Our clients who are at or close to the 8:1 ratio have done it through a thoughtful and deliberative process that:

- Defines the firm’s administrative support objectives;
- Documents critical processing requirements and attorney needs;
- Develops a skill set profile and “Best and Highest Use” matrix;
- Designs new administrative support structure;
- Pilot tests the new support structure, re-evaluates and modifies the support structure as required;
- Implements support structure firm wide; and
- Monitors performance and continuously adjusts.

The basis for any successful secretarial realignment effort begins with the leadership of the firm setting clear goals and objectives for the effort. Some firms set out to reduce costs and nothing more. While we understand that cost reduction is important (for some firms it may be critical), it is not incompatible with service level improvements or expansions. One of the more innovative trends we have seen is the introduction of “concierge” service providers to augment the support that secretaries provide to attorneys. These less highly skilled workers perform more clerical type functions (filing, reservations and time entry), leaving the more highly skilled secretaries to concentrate on more value-added activities. Several firms have increased their support headcount and the service provided while reducing overall compensation expense through the introduction of concierge workers.

Central to the success of a secretarial realignment project is an in-depth understanding of what types of work and the volume of work that the secretaries are currently doing, what the attorneys want them to do, and the individual skill sets of your secretaries.

Is achieving an 8:1 secretarial support ratio an easy undertaking? No it is not! It requires work, persistence and flexibility. But the rewards are significant, and for some they may be critical.

Central to the success of a secretarial realignment project is an in-depth understanding of what types of work and the volume of work that the secretaries are currently doing, what the attorneys want them to do, and the individual skill sets of your secretaries. We have found that focus groups (attorneys and secretaries separately!) talking about what they do and what they want and the analysis of attorney time records are good data points to start. The annual attorney evaluations of secretarial performance provide insight into individual skill levels and some firms have mandated skill testing to augment the information provided in the annual reviews.

Armed with the data on what the attorneys want, the secretarial skill levels and the amount of work that is being generated, a new secretarial support structure can be designed. As noted above, the identification of less skill-sensitive tasks will enable a firm to introduce concierge employees who can provide additional services at a reduced cost.

**Conclusion**

Implementation of a new secretarial support structure design is best done starting with a pilot area (practice, floor or office) which allows for close supervision, early identification and correction of design flaws and building support around the firm. Nothing boosts a project’s acceptance like testimonials from secretaries and lawyers alike.

The firm-wide roll out following the pilot should include a heavy communications component, a great deal of management by walking around (so you can spot issues before they mushroom), and a formal evaluation and reporting mechanism so that you can document your hard won success.

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