LJN LAW JOURNAL NEWSLETTERS

Accounting and Financial Planning FOR LAW FIRMS®

An ALM Publication

Volume 27, Number 2 • February 2014

The Death Benefit Only Program

By Lawrence L. Bell

The Death Benefit Only (DBO) program provides non-qualified deferred compensation, and death benefits. The DBO program can be used by employers without regard to corporate and qualified plan limitations and may be provided by employers on a permissibly discriminatory basis. The DBO program, when structured properly, can accept elective or non-elective contributions on an individual employee basis. The benefits can also be used as Golden Handcuffs to retain valued employees.

Structure of The DBO Program

The DBO Program™ can be applied to an existing deferred compensation plan as well as new wealth accumulation plan. This approach will be flexible to the employer and largely estate and income tax free to the covered employee. The accrued benefit to the employee can be safeguarded from claims of creditors of the employer and employees and upon withdrawal by the employee can be accessed in an economically efficient manner. The death benefit need not be an asset on the books of the practice or subject to the claims of creditors. Additionally, the employer can institute The DBO Program as a

continued on page 4

The Dimensions of 'Goodwill' in a Law Practice Sale

By Ed Poll

One of the thorniest issues in selling a law practice involves the issue of goodwill and how to value it. "Goodwill" is the reputation, client base and client loyalty that have been created over the life of the practice. Every firm represents an investment of years of hard work and financial resources in growing the practice and building goodwill. Goodwill is both an accounting term and a qualitative dimension. Understanding both helps the average lawyer better understand the sale of a law practice.

Qualitative Dimensions

At the end of the day, the value of a law practice is based on a lawyer's success and the many people that success has touched over the years. This is a significant legacy that contributes to organizational goodwill on retiring from the practice. It involves a lawyer's reputation, practice management system and way of doing business — all the intangible elements that made the practice successful and provides the selling lawyer with what is most valuable to sell. The better a lawyer's reputation, the more value the law practice will have. A firm with positive, provable goodwill shows that a lawyer has been focused and passionate about the practice of law, and effective at client service. By contrast, firms with bad publicity, a declining client base, or malpractice and disciplinary matters have little goodwill.

An increasingly important qualitative issue for small practices is technology. Many small firm lawyers, facing financial pressure, resist buying or updating technology because they are overwhelmed by the high up-front expense. They may have software and hardware that is going on 10 years old, or may not be using any case management software or document assembly software, or may not be backing up and storing client electronic files at all. Lawyers who do not use adequate technology may be committing malpractice *per se*, by failing to provide

continued on page 2

In This Issue

PERIODICALS

Goodwill

continued from page 1

competent representation when measured as the standard of care in the local community. And such malpractice directly and negatively impacts goodwill. This "local community" is increasingly becoming global.

By the same token, the lawyer who *has* done the right things with practice technology — kept hardware and software up to date, invested in training to ensure staff uses technology effectively, maintained strong functional capabilities through knowledge management and client relationship management databases — should be sure to communicate those facts up front. Their value may not be easily quantifiable, but they definitely support the firm's goodwill. The decision to sell a practice is no time to be modest, or to assume that the firm's virtues are self-evident.

Ethical Dimensions

Another qualitative factor involves ethical considerations. Several years ago, new marketing regulations adopted by the New York State Bar asserted that "a lawyer in private practice shall not practice under a trade name." Rules of Professional Conduct 7.5 (http://bit.ly/1f9GiK3). If lawyers' names must be used in the title of a firm, as this could be said to require, any lawyer who would be interested in purchasing a law firm would either have to "retire" the selling lawyer (and keep the name in the firm "trade name" since the rule enables the name of a deceased or retired member of the firm to be retained), or change the firm name.

If the firm name is changed, deleting the previous lawyer's name, one might question whether the value of the firm's goodwill is decreased or even destroyed. Many buyers assert that clients will not remain with the firm once its proprietor leaves, and thus offer a lower purchase price. The selling lawyer then is left to assert that goodwill infers that the reputation of the firm continues beyond the removal of any one individual. The client list, the phone number and the on-going nature of the practice (with staff and systems in place) comes with that reputation. To account for this issue, negotiations that are already complex may become even more so as the parties have to work around the "trade name" restriction.

Beyond these "macro" ethical considerations, there is a "micro" one involving goodwill if an older lawyer sets out to groom a successor to whom the practice is sold. That grooming process should take place over a period of several years, during which there is a transition process as the successor is introduced to clients, who are assured that the successor will continue the same quality of service and counsel they have come to expect.

There is the risk, often inevitable, of such preparation in grooming and transitioning a successor from inside the firm. While eliminating discord if an associate so ingratiates him- or herself with clients, such a lawyer may start his/her own practice and take the clients along, leaving the former firm high and dry. Ensuring that the future successor understands how reaping the benefit of the firm's accumulated goodwill is a personal benefit only when done through a planned succession can minimize or eliminate the danger from such "freelancing."

Accounting Dimensions

Although there is no definitive way of calculating goodwill in an accounting or a valuation sense, appraisers often use the "excess earnings" model in which goodwill is defined to be a differential advantage resulting from the individual

continued on page 8

Ed Poll, J.D., M.B.A., CMC, principal of LawBiz® Management, is a coach, law firm management consultant, and author. His latest book, *Life After Law: What Will You Do for the Next 6,000 Days?* (http://bit.ly/1bBhD0A) deals with pre-retirement planning issues. Poll can be reached at 800-837-5880 or edpoll@lawbiz.com.

Accounting and Financial Planning For Law Firms®

Accounting and Financial Planning for Law Firms®
(ISSN 1548-6699) is published by Law Journal Newsletters,
a division of ALM.
Telephone: (877) 256-2472
Editorial e-mail: jgromer@alm.com
Circulation e-mail: customercare@alm.com
Reprints: www.almreprints.com

Accounting and Financial Planning for Law Firms P0000-231
Periodicals Postage Pending at Philadelphia, PA
POSTMASTER: Send address changes to:
ALM
120 Broadway, New York, NY 10271

Published Monthly by:
Law Journal Newsletters
1617 JFK Boulevard, Suite 1750, Philadelphia, PA 19103
www.ljnonline.com

ALM
Insights. Innovation. Connected.

Data Analytics

A New Approach to Profit Management in the Legal Business

By Christopher Petrini-Poli and Scott Springer

Data analytics, the same data mining and interpretive analysis used for decades in other professions, is bringing change to the core business side of the legal profession — and in the process, revealing great potential for increased efficiency, cost-savings and new ways of managing risk.

Strategic investing, financial analytics and expense management continue to be themes for law firms looking to maximize profitability. The emerging tools and methodologies used to reach deeper levels of analytics also delve into areas such as legal project management and competitive assessment, which are key to driving long-term value and profitability. But how law firms reach their full profit potential is a topic of conversation and debate among firms' executive leaders.

What relevant competitive analysis exists to help determine billing rates? How should law firms staff a given matter to meet or exceed client expectations while maximizing profits (an especially important topic when working with law departments)? What are the process improvements that firms should implement? How can law firms maximize their use of internal data to drive existing strategic sourcing or procurement initiatives?

Data analytics are answering questions like these and providing an underpinning for a developing business model in the legal industry. Some of the most revealing answers are found through robust data analytics.

Law Departments Use Data To Gain Pricing Insights

Benchmarking and comparative pricing are two areas in which data analytics present a unique advantage. Law departments in particular are driving analytics to better understand and approach spending. With data analytics, law departments gain insight into what firms are billing, how matters are staffed, how the rates vary for a given activity, and how to determine what alternative sources may be available that are not currently in use. All topics that enable better discussions with law firm partners.

Darryl Hair, vice president of Legal Operations at DaVita HealthCare Partners Inc., explains how law departments are using advance tools to study their spending and reach into how matters are managed, how to staff them internally, and how to best disperse work to external providers. "Data provides us with the fact-based analysis to make the right decisions," Hair says. "It helps us determine which options make better financial sense in matters such as whether or not to utilize in-house or outside counsel. We can determine the quality of the outcome and leverage legal spend in the best way possible."

The principles of data analytics are fundamentally changing how law departments view outside counsel costs and will continue to put pressure on firms to ensure they can measure how the work is handled on their end. "Analytics allow us to define how much a matter costs," Hair adds. "We are able to negotiate from a position of better knowledge. It lets us know what work costs have been historically vs. relying on law firms to tell us."

Another key area from the law department perspective is e-billing, which provides mountains of data resulting in powerful information. However, most e-billing platforms are limited in the way they supply information to the law department buyer and are more focused on the transactional nature of the platform.

"We're getting better with e-billing which, looking ahead, will have a greater impact in how we determine spend," Hair adds. As law departments make further progress in benchmarking facts from e-billing data, they will possess even greater leverage in determining pricing and alternative fee structures.

Legal Project Management

Data analytics enables law firms to harness existing data collections that will guide them on everything from finding profitable efficiencies to making important decisions in case strategy. The data can provide detailed assessments of prior matters, help support billing arrangements, predict the viability of new cases, and monitor workflow — all of which are central to developing a progressive legal project management plan.

Toby Brown, director of Strategic Pricing and Analytics at Akin Gump, says that modeling fee structures for profitability is a key component of its client evaluation process. After running their due diligence and building out a budget and scope, they build models to assess profitability, which involves a certain degree of analytic evaluation. "If we change x or y, we determine whether or not we can be more profitable," Brown says. "Monitoring can take many different shapes and forms, but it helps keep a close eye on leverage."

Firms continue to implement business intelligence models that gather, aggregate and export expansive amounts of data. "We're rolling out a dashboard that's a high-level profitability tool," Brown says. "It can point at any data source and show real-time profitability."

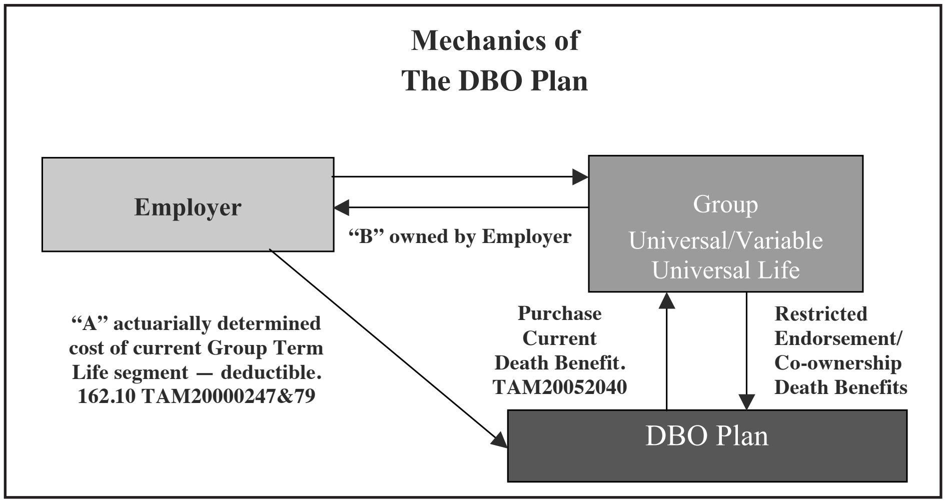
In fact, tools such as this are becoming vital to the LPM practice. A firm with offices and attorneys in multiple cities benefits from having a centralized data repository that includes everything from attorney names, rates and third-party costs, to technology and real estate expenses

continued on page 6

Christopher Petrini-Poli is Chief Executive Officer of HBR Consulting. He oversees the firm's practice groups, the development and execution of its growth strategies, and its operational support functions. **Scott Springer** is a director in the Global Strategic Sourcing and Business Operations Practice at the firm.

Death Benefit

continued from page 1



new benefit plan and fund "as you go" rather than creating a liability for employer needs. The DBO Program alternatively, may be reflected as an asset on the practice's books for audit accounting purposes and not create a charge to earnings. This tool complies with both GAAP accounting as well as IAS 19.

Limitations of The DBO Program

Because this has a death benefit component, there is no maximum limitation of death benefits or asset accumulation. IRC Section 457(f)(2)(iii) (1986). The program provides a current death benefit for covered employees. This is an actuarial based structure for an employer that maximizes the benefits to the employer while providing a selective benefits program for qualifying employees. This creates a versatile tool that is ideal for Golden Handcuffs, employment contracts, funds to help offset future employer financial obligations and covenants not to compete. The employer may use this tool in transactions to reduce the cost of funding employee or shareholder buy outs or future compensation packages. The employer may fund the executive benefit providing the same amount of funding and the selected employees will receive more benefit than the traditional deferred compensation method or the employee will reduce the amount of funding and the selected employees will receive equivalent benefit. The DBO Program also avoids the Golden Parachute limitations and excise tax. Unlike the 457(f) rules, there is no immediate taxation upon termination of risk of forfeiture, and properly designed, income and estate taxes may be totally avoided. Also unlike the traditional benefit plans that have a substantial risk of forfeiture of §457(f), §409A or §83, The DBO Program has no contribution limitation. The arrangement also avoids the risk of forfeiture tests. The benefit program complies with the most recent legislative rules IRC §101(j), COLI Best Practices Act of 2005 and as an exception under §72(k)(2)(B)(ii) and the American Jobs Creation Act of 2004 IRC §409A and Notice 2005-1.

How The DBO Program Works

The DBO Program is based on well-established death benefit, economic benefit and constructive receipt rules successfully utilized since the early 1960s. It complies with all proposed regulatory rules, and the tax shelter rules as presented which further assures positive results. The arrangement is not a tax shelter, a listed transaction or a reportable transaction. The arrangement complies with the economic substance test as proposed in Congress as well as set forth in case law and proposed legislation. The employer's contribution is actuarially determined and that amount is deductible. (Sec. 79, Treas.Reg 1.162.10 TAM 200002047 and 20050204). The employer can utilize a current death benefit arrangement with an employment or non-competition agreement to provide benefits that may reduce income and estate tax to the employee. This arrangement complies with the deferred compensation rules of §409A because it is a death benefit plan qualifying

continued on page 7

Table 1

The budget is $250K for deferred comp, using a
tax adjusted $280K to fund for the 11 selected participants.
The total contribution is allocated proportionately based on salaries.
Funding thru retirement age provides the following results:

Name And Age	Premium To 65	Face	Annual Distribution	Total Distribution
VH 43	$50,400	$2,000,000	$133,725	$2,675,000
FK 56	$42,000	$578,861	$28,512	$501,334
BH 56	$34,360	$1,576,474	$128,176	$2,563,526
PP 47	$27,160	$1,024,178	$54,592	$1,091,833
VM 39	$24,920	$1,302,251	$91,577	$1,831,147
LJ 51	$24,920	$562,327	$32,459	$649,185
RL 45	$27,440	$951,894	$60,720	$1,214,425
KH 36	$17,920	$1,334,726	$85,089	$1,701,780
RF 52	$15,680	$324,586	$18,440	$368,803
BB 56	$18,200	$254,059	$12,531	$216,869
TH 42	$7,896	$424,008	$23,144	$462,872
Total	**$5,082,258**			**$13,276,774**

Lawrence L. Bell, JD, LTM, CLU, ChFC, CFP®, AEP, a member of this newsletter's Board of Editors, has served as Tax Bar liaison to the IRS for 10 years. He has received patents in actuarial product fields dealing with COLI, GASB, FASB, IASB and OPEB solutions. He authors articles and speaks nationally about Decision Trees on COLI Best Practices, 409A and Benefit Planning.

$1,000 Per Hour Isn't Rare Anymore

NLJ Billing Survey Results: Nominal Billing Levels Rise, But Discounts Ease Blow

By Karen Sloan

As recently as five years ago, law partners charging $1,000 an hour were outliers. Today, four-figure hourly rates for in-demand partners at the most prestigious firms don't raise eyebrows — and a few top earners are closing in on $2,000 an hour.

These rate increases come despite hand-wringing over price pressures from clients amid a tough economy. But ever-rising standard billing rates also obscure the growing practice of discounts, falling collection rates, and slow march toward alternative fee arrangements.

Nearly 20% of the firms included in *Accounting and Financial Planning for Law Firms*' ALM sibling *The National Law Journal*'s annual survey of large law firm billing rates last year had at least one partner charging more than $1,000 an hour. Gibson, Dunn & Crutcher partner Theodore Olson had the highest rate recorded in our survey, billing $1,800 per hour while representing mobile satellite service provider LightSquared Inc. in Chapter 11 proceedings.

Certainly few law firm partners claim Olson's star power — his rate in that case is nearly twice the $980 per-hour average charged by Gibson Dunn partners, and three times the average $604 hourly rate among partners at NLJ 350 firms. Gibson Dunn chairman and managing partner Ken Doran says Olson's rate is "substantially" above that of other partners at the firm, and that the firm's standard rates are in line with its peers.

Karen Sloan writes for *The National Law Journal*, an ALM sibling of *Accounting and Financial Planning for Law Firms*. She can be reached at ksloan@alm.com.

"While the majority of Ted Olson's work is done under alternative billing arrangements, his hourly rate reflects his stature in the legal community, the high demand for his services and the unique value that he offers to clients given his extraordinary experience as a former solicitor general of the United States who has argued more than 60 cases before the U.S. Supreme Court and has counseled several presidents," Doran says.

The data was compiled by ALM Legal Intelligence, the research arm of *A&FP*'s parent, ALM Media LLC. This year, the survey took a new approach, asking each firm on the NLJ 350 — *NLJ*'s survey of the nation's 350 largest firms by attorney headcount — to provide their highest, lowest and average billing rates for associates and partners. We supplemented those data through public records. All together, the 2013 survey includes information for 159 of the country's largest law firms and reflects billing rates as of October 2013.

The figures show that, even in a down economy, hiring a large law firm remains a pricey prospect. The median among the highest partner billing rates reported at each firm is $775 an hour, while the median low partner rate is $405. For associates, the median high stands at $510 and the low at $235. The average associate rate is $370.

Multiple industry studies show that law firm billing rates continued to climb during 2013 despite efforts by corporate counsel to rein them in. TyMetrix's 2013 Real Rate Report Snapshot found that the average law firm billing rate increased by 4.8% compared with 2012. Similarly, the Center for the Study of the Legal Profession at the Georgetown University Law Center and Thomson Reuters Peer Monitor found that law firms increased their rates by an average 3.5% during 2013. *See*, "2014 Report on the State of the Legal Market," http://tmsnrt.rs/1dyWXlq.

Rates charged by firms on paper don't necessarily reflect what clients actually pay. Billing realization rates — which reflect the percentage of work billed at firms' standard rates — have fallen from 89% in 2010 to nearly 87% in 2013 on average, according to the Georgetown study. When accounting for billed hours actually collected by firms, the realization rate falls to 83.5%.

"What this means, of course, is that — on average — law firms are collecting only 83.5 cents for every $1.00 of standard time they record," the Georgetown report reads. "To understand the full impact, one need only consider that at the end of 2007, the collected realization rate was at the 92[%]level."

In other words, law firms set rates with the understanding that they aren't likely to collect the full amount, says Mark Medice, who oversees the Peer Monitor Index. That index gauges the strength of the legal market according to economic indicators including demand for legal services, productivity, rates and expenses. "Firms start out with the idea of, 'I want to achieve a certain rate, but it's likely that my client will ask for discounts whether or not I increase my rate,'" Medice says.

Indeed, firms bill nearly all hourly work at discounts ranging from 5% to 20% off standard rates, says Peter Zeughauser, a consultant with the Zeughauser Group. Discounts can run as high as 50% for matters billed under a hybrid system, wherein a law firm can earn a premium for keeping costs under a set level or for obtaining a certain outcome, he adds. "Most firms have gone to a two-tier system, with what is essentially an aspirational rate that they occasionally get and a lower rate that they actually budget for," he says.

Most of the discounting happens at the front end, when firms and clients negotiate rates, Medice says. But additional discounting happens at the billing and collections stages. Handling alternative fee arrangements and discounts has become so complex that more than half of the law firms on the Am Law 100 have

continued on page 6

Billing Survey

continued from page 5

created new positions for pricing directors, Zeughauser says.

The Role of Geography

Unsurprisingly, rates vary by location. Firms with their largest office in New York had the highest average partner and associate billing rates, at $882 and $502, respectively. Similarly, TyMetrix has reported that more than 25% of partners at large New York firms charge $1,000 per-hour or more for contracts and commercial work.

Washington was the next priciest city on the survey, with partners charging an average $748 and associates $429. Partners charge an average $691 in Chicago and associates $427. In Los Angeles, partners charge an average $665, while the average associate rate is $401.

Pricing also depends heavily on practice area, Zeughauser and Medice say. Bet-the-company patent litigation and white-collar litigation largely remain at premium prices, while practices including labor and employment have come under huge pressure to reduce prices.

"If there was a way for law firms to hold rates, they would do it. They recognize how sensitive clients are to price increases," Zeughauser says. But declining profit margins — due in part to higher technology costs and the expensive lateral hiring market — mean that firms simply lack the option to keep rates flat, he says.

See an interactive chart with data from the survey at http://bit.ly/1jqB6oD.

—❖—

Analytics

continued from page 3

associated with the firm's cases. The resulting output provides executives (or senior leadership) with holistic, evidence-based data to determine the types of cases resulting in the highest profitability.

Changing Dynamics

While some embrace what data analytics has to offer, others remain on the fringe. Historically, law firms focused on the top line. It wasn't a sector that was built on economies of scale or operational efficiencies to create a sustainable competitive advantage. This can be traced back perhaps to two drivers: 1) expense composition was highly comprised of people and mostly revenue generating individuals; and 2) operating margins and growth relative to other sectors.

As dynamics in the market over the past decade have changed, firms seek to adjust strategies, expectations, and operating models to match current market realities. As Brown sees it, clients are more aggressive about pursuing alternative pricing and are trying to gain a better understanding of existing data. "Clients are trying to come up with numbers to validate costs," Brown says. He suggests that law firms need to better meet the expectations through data analytics: "We're not going to get better unless we have analytics."

Profitability, Procurement And Analytics

Data analytics should not be misinterpreted as the only driver to improved profitability. Rather, it should be viewed as a strategic advantage, and a way to continue to drive value after initial rounds of expense management efforts have taken place.

An example of data analytics solving profitability concerns is derived from insights into cost-savings measures. It is often surprising to hear that non-salary, third-party costs compose 25% to 35% of gross revenue. These costs span everything from standard office supplies, technology and equipment to real estate. Firms are now starting to take a more critical look at cost containment by deploying tools, technology, metrics, and dashboards to monitor spending and stay within budget.

Operating expense tools is an area that has been underserved in the legal space. Most business intelligence tools in the legal space have historically been focused on matter management — revenue and pricing. Today, there are more data-driven tools available and more firms use them in areas such as contract management, budgeting and usage tracking/commodity metrics. These tools not only help ensure that prior efforts are sustained, but also help identify new opportunities.

Firms have reported using such tools to identify all the third-party contracts the firm had with early pay discounts. With all of the contract and spend data being collected in a central platform, they are able to immediately value the benefit of taking advantage of these terms. In the past identifying opportunities such as these would have been cost prohibitive.

Conclusion

Law firms, and the legal industry as a whole, continue to implement data analytics and business intelligence as a means to improve operational efficiency and develop legal service logistics. Analytics offers a powerful advantage to law firms that invest in the right approach, particularly in the areas of legal project management, overall profitability and benchmarking.

Increased competition, commoditization, legal outsourcing and pressure from clients to cut costs have led law departments and law firms to seek better insights into their own businesses. These findings have begun to change the way both view and use resources, expertise and human capital.

The entire industry has started to shift its focus and a lot of progress has been made. That said, firms of all shapes and sizes all along the expense management continuum are looking for opportunities to discover what data analytics can do for them.

—❖—

Death Benefit

continued from page 4

under 31.3121(v)(2)-1(b)(4)(iv)(A). The IRS announced in the proposed regulations that Code §83 is applicable to an insurance arrangement between an employer and a participant. According to the regulations, not only is the value of current annual life insurance protection (Table I) includible as taxable compensation to the insured participant each year but, in addition, in line with Rev. Proc. 2003-25 and Section 72, the cash surrender value of the policy would not be subject to income tax nor be a reportable event if the policy is not surrendered. This is further in line with Reg. 105885-99. The flow chart on page 4 demonstrates how The DBO Program works.

Implementing The DBO Program

1. The employer would create or amend its non-tax qualified deferred compensation plan to add a feature pursuant to which all or selected participants would be given an opportunity to elect to relinquish their rights to receive accrued deferred compensation benefits in pre-409A grandfathered account in return for the employer's contribution to The DBO program providing for a current death benefit on the life of the participant (the Policy) co-owned by or the employee or employer depending upon the circumstances.
2. Employees desiring to avail themselves of this opportunity would elect, prior to the time benefits under the deferred compensation plan become payable, to relinquish those benefits and have the employer contribute the cost of such benefits.
3. An employee, his or her assignee, or the employer would apply for, obtain and own a permanent life insurance benefit. The employee or the employer would enter into a co-ownership life insurance agreement providing that the Employer pay for the current death benefit. This is actuarially determined in line with qualified asset account limits. The co-owner (the employee or the employer) would pay for the remainder of the premiums and retain all other rights to the policy.
4. Unless the co owner fails to maintain the policy (as provided in number 5 below) or breaches certain obligations to the employer, the current death benefit is provided to employees thru the plan so long as the participant is in the plan.
5. Upon an employee participant withdrawing from the plan, or upon plan termination, the co-ownership agreement is terminated, the employer no longer funds the plan and the co-owner retains all right, title and interest in the coverage.

See Table 1 on page 4 for an example of implementing The DBO Program.

Conclusion

This approach will comply on both a legal and accounting basis and may be a tremendous economic solution to this funding and compliance situation .In addition, this tool will allow the employer to retain equity within the business and relieve the employees from having to use personal assets to fund current death benefits and financial obligations. See the sidebar, "Planning Opportunity," above, for a real-life example of The DBO Program.

—❖—

Planning Opportunity
Car Dealer 52 Death Benefit Only Plan

1. Principal (CD52) owns Car Dealership (ER) — operating company wants to:
   - Provide death benefits to employees while employed;
   - Comply with §409A and COLI Best Practices;
   - Pre-fund for corporate benefits and def comp; and
   - Avoid claims of creditors of ER and CD52.
2. ER enters into an agreement to provide death benefits for its employees. Administrative agreement between ER & Advisors, LLC.
3. Advisors LLC annually obtains value of costs of death benefit life segment. An executive carve out plan as allowed under TAM200002074 integrates permanent and current coverage. Valuation is based on death benefits as permitted under §3131.21. Face amount of death benefit for HCE CD52es ($5 MM) not exceed face amount for Rank and file (50RF = $100K GTL). We can have spouse be the employee.
4. ER deducts the amount actuarially determined using the stable value $225K.
5. Bonus out the other $25K to CD52, tax $10K annually. Moves $2.5MM over 10 years. Total tax cost = $100K.
6. Table I tax CD52 $13,524, offset by supplemental funding of $25K + no tax on Table I.
7. GB pulls out $274K annually over 20 yrs. Total = $5.491M tax free.
8. COLI Best Practices are followed because employees name beneficiary as long as employed.
9. §409A and Notice 2005-01 Final 409 A regs TD 9321 exempt death benefit only plans under 31.3121.
10. Asset acts like COLI product for tax advantaged build up and possible tax-free distributions.

Goodwill

continued from page 2

lawyer's skill, reputation and special talent. Typical steps to calculate are:

- Ascertain average annual earnings of the firm over the previous five years.
- Fix the amount by which the law practice exceeds what an employee of comparable qualifications would earn, using local, not national, statistics.
- Compute a fair return on investment in physical assets used in the practice.
- The amount by which the five-year average earnings of the practice, less the fair return on physical assets, exceeds the fair compensation figure of a comparable attorney is the amount of excess earnings.
- Capitalize this amount as a function of the risk of retaining the clientele, the stability of the firm's earnings during the time period chosen, and the competitiveness of the practice.

Lawyers typically do not understand this financial calculus and cannot comprehend even the possibility that their many years of effort may actually have produced a monetary value of some significance. This value can enhance their retirement, as a measure of organizational goodwill.

This value of goodwill can be passed on to a lawyer's family and heirs when monetized through a practice sale. After investing years of hard work and financial resources in growing the practice, a well-planned practice sale allows any lawyer to reap the benefits of that value and realize the legacy that a years-long investment of time and effort created.

It is true that the issue of whether goodwill exists mainly has been limited to the selling negotiations. Typically smaller firms understand the value of their client relationships and reputations and, when negotiating for the sale of a practice, discuss compensation for goodwill. However, larger firms argue that there is no goodwill and will walk away from a transaction if the "seller" wants to be compensated for their goodwill. The parties may not talk about goodwill; they may say there will be no deal if the seller insists on goodwill. Oftentimes, however, there is a "credit" for a factor that might be analogous to goodwill in terms of the cost of the capital buy-in. There has to be some adjustment for this factor, irrespective of what it is called.

What is common to all lawyers is that goodwill does exist and, to whatever degree necessary, should be taken into account for a practice sale.

Of course, goodwill issues are just one illustration that a business is worth only what someone is willing to pay for it, and time is an important consideration. The value may be different at different points in time — and valuation and price may not be the same thing. But, in the context of buying a business, even a law practice, one must look at the future. When valuing a law practice, one should also look to the expected future earnings of the practice. Many people believe that the price to be paid must be based only on this figure generated by the existing practice, but there can also be an inclusion of future earnings that may be based on the buyer's talents brought to bear on the purchased practice in some cases.

Given this concern, it's generally preferable to sell (and buy) on a fixed, set sum. There can be bonuses and payment terms that take into account the buyer's legitimate concerns. Purchasing attorneys may well prefer to take advantage of their own efforts to increase the revenue and reap the rewards, usually with an appropriate involvement of the selling attorney during a transition period. While many lawyers believe there should be a percentage of revenues paid and not a fixed fee, this approach locks both sides into an agreement that allows no upside for a buying lawyer. Both parties' concerns can be addressed with a fixed sum. And this also moves away from ethical concerns about selling files, which is not ethically permitted.

Conclusion

This discussion is not intended to be an exhaustive review of all aspects involved with goodwill in the valuation of a lawyer's assets after years of practicing. Practice realities make the definition of goodwill different for every lawyer. What is common to all lawyers is that goodwill does exist and, to whatever degree necessary, should be taken into account for a practice sale. Lawyers who fail do so in effect are throwing away the value of the goodwill they have established, in the process relinquishing their life's work without getting value in return. Lawyers should not ignore the fact that their life in the law is what has created the value of their estates as measured in goodwill. For virtually every lawyer, the value is there. After investing years of hard work and financial resources in growing the practice, effective consideration of goodwill allows any lawyer to reap the benefits of that value and the extensive investment of time and effort that created it.

—❖—