



## ATTORNEY'S REPORT

### COMPENSATION ISSUES

## Tips for Incentivizing Non-equity Partners

Here's a common scenario: You have strong performers (maybe even over achievers) who are delivering a solid book of business. But perhaps their contributions are not quite enough to top the threshold for becoming an equity partner. You certainly don't want to lose these solid contributors. But, how do you reward them — and incentivize them to continue adding to your firm's bottom line?

The solution may be a compensation plan specifically for non-equity partners. Of course, the partners should discuss any bonus plan to determine whether it is consistent with your firm's thinking. But, in general, an effective bonus program rewards non-equity partners for:

- 1) Hard work that results in a high level of fees collected.
- 2) Generating profits for the firm.
- 3) Originating business that can be delegated to others.

The following two bonus formulas come from the New York State Bar Association's Committee on Law Practice Management, courtesy of management consultant Joel Rose.

### Working Attorney Bonus Formula

**Goal:** Incentivize high-producing, non-equity partners to generate significant fees from the work they perform, regardless of who generates the business. Such a formula encourages non-equity partners to generate strong profit for themselves and for the benefit of equity partners who may have originated the work being performed.

#### The formula:

- Fees collected by working attorney
- Salary, plus a 25% factor for payroll taxes and benefits
- An allocation for general overhead
- A 10% profit factor for compensation and overhead

---

Non-equity partner receives 33% of the result as a year-end bonus

### Originating Attorney Bonus Formula

**Goal:** Reward non-equity partners for generating business that is then delegated to others. Obviously, non-equity partners must originate fees in excess of their own working attorney collections to participate. This formula considers any shortfall in working attorney collections that must be overcome before participating in this bonus.

#### The formula:

- Fees collected by originating attorney
- Fees collected as working attorney
- Any shortfall from the working attorney bonus calculation

---

Non-equity partner receives 10% of the result as a year-end bonus

---

***The basic purpose of a compensation system is to attract and keep the right people in your firm.***

---

### Remember the Basics

The basic purpose of a compensation system is to attract and keep the right people in your firm. But that's where the basics end. Systems run the spectrum from objective to subjective, and what ultimately works best for any firm is the system that best fits that firm's culture and strategy.

*An objective outsider can provide invaluable feedback on the often prickly subject of compensation. Contact your Mueller Prost advisor at 314.862.2070 to learn how we can help.*

## FORENSIC ACCOUNTING:

### Establishing Value in Dissenting Shareholder Cases

Some but not all states have provisions for dissenters' rights in their Corporation Acts. The purpose of these statutes is to protect the property rights of dissenting shareholders from actions by majority shareholders that alter the character of their investment.

Dissenting shareholder issues can be incredibly complex matters. To strengthen their cases, many attorneys enlist the services of a forensic accountant. An experienced forensic accountant essentially serves as a "financial specialist" for attorneys, providing litigation support that involves the quantification of economic damages using accounting and auditing techniques.

Yet, as you will see in the cases that follow, a favorable decision can hinge on having a financial specialist who can analyze, explain and present financially complex issues in a manner that is helpful to the courts and the parties involved.

A thorough understanding of the standard of value is vitally important when performing any type of valuation — especially in dissenter rights cases.

#### Dollar Thrifty Shareholder Litigation

The Dollar Thrifty Shareholder Litigation involved an April 2010 merger between Hertz Global Holdings, Inc. ("Hertz") and Dollar Thrifty Automotive Group, Inc. ("Dollar Thrifty"). The parties entered into an agreement whereby Hertz would acquire the Dollar Thrifty stock at a price of \$41 per share and Dollar Thrifty would pay a \$200 million cash dividend to its shareholders.

As Plaintiffs, a group of Dollar Thrifty shareholders claimed that the Defendant, the Dollar Thrifty board of directors, had not fulfilled its duty to seek maximum value for shareholders.

In its ruling, the Court criticized the discounted cash flow (DCF) valuation analysis performed by the Plaintiffs' valuation analyst. The analyst concluded a value significantly higher than that obtained from the Defendant's analysis — primarily due to the inclusion of potential synergies from the proposed merger. The Court ruled that the inclusion of potential synergies did not allow for "a sound DCF valuation" and denied the Plaintiffs' request for an injunction, ruling that there was sufficient evidence to indicate that the Defendant tried to maximize shareholder value.

#### Helfman v. Johnson

Helfman v. Johnson involved a corporation that was formed by the combination of a title examination company and a closing company in 1998. As the real estate

market declined in 2002, the relationship of the business shareholders deteriorated. Eventually, the majority shareholders ("Defendant") attempted to force out the minority shareholder ("Plaintiff") by diluting the minority shareholder's interest from 24 percent to 5 percent.

Both sides presented valuation reports and expert testimony that the trial court found troubling. The Plaintiff's valuation expert used the historical financial statements of the business to establish a proportionate fair value of the going concern business operations at \$1.85 million using an income approach, DCF method. In contrast, the Defendant's valuation expert testified that the business should be valued using an asset approach, using a net asset value method, to conclude a fair value of \$11,000 for the business operations.

The trial court was troubled by the failure of the Plaintiff's expert to take into account the industry decline, as evidenced by the use of prior income results without adjustment for the adverse industry conditions. The trial court was also troubled by the Defendant expert's view of the business, which ignored goodwill, and it did not value the business operations on a going concern premise of value.

The trial court went on to use the income approach, DCF method, to value the business. The trial court relied on Plaintiff's DCF valuation analysis, but it discounted the resulting fair value.

#### The Value of a Specialist

Obviously, a thorough understanding of the standard of value is vitally important when performing any type of valuation — especially in dissenter rights cases. Fair value and fair market value, for example, are two different standards of value and, depending on how they are defined, can lead to vastly different valuation conclusions.

It is also important to understand how the selection and use of various valuation approaches and methods will be perceived. The analysis method itself may very well come under scrutiny to determine any bias in its projections.

*The Mueller Prost team can supply the needed expertise and independence to help strengthen your case in matters of dissenting shareholder issues. Give us a call at 314.862.2070 for more information.*

## RISK MANAGEMENT

### How to Reduce Your Firm's Exposure

Now more than ever, effective risk management is critical to law firm management. The number of large claims brought against U.S. law firms is rising sharply, according to a study from insurance broker Ames & Gough, which polled insurance companies that work with more than 75 percent of large and midsized U.S. law firms.

These insurers note that real estate is the practice area generating the largest number of legal malpractice claims. This is followed by corporate and securities work, which encompasses merger and acquisition activities as well as other corporate finance transactions.

#### Beware the Ripple Effect

A serious claim against a law firm can have a ripple effect that goes well beyond monetary damages. In addition to chewing up time, it can impact client relationships and even strike at the heart of the partnership itself — pitting partners against each other. In fact, the partner most involved in the claim often winds up leaving the firm entirely.

With this in mind, consider these steps for reducing your firm's risk exposure:

- **Visualize.** Create a scenario for each identified risk and then analyze it in that context. For example, what would happen if a wage and hour matter headed south and the DOL came knocking? Next, identify the actions to take should the risk actually occur, as well as the actions you can take to mitigate the possibility of the risk occurring.
- **Look back.** Avoiding costly mistakes in the future starts with studying what has gone wrong in the past. In the context of your existing systems and processes, where have risks occurred? How were they responded to? What needs to change? At the same time, review and update the firm's risk-based documents and processes.
- **Appoint.** Designate an incident management team that swings into action when a major incident occurs.
- **Test.** Routinely "stress test" the firm's risk response. Just like a fire drill, such a test should sometimes come pre-announced — and at other times with the knowledge of just a select few. Have your risk management committee then examine the results of each test.
- **Insure.** Match your firm's risk exposure with the correct amount and type of malpractice coverage. For example, in some practice areas like residential real estate and bankruptcy, the likelihood of a malpractice claim may be higher, but loss payment on any single claim may be lower. Here, it may be appropriate to consider lower per-claim limits and higher aggregate limits.

Conversely, practice areas like corporate and securities, patent or entertainment law may need considerable per-claim limits, as these areas typically see less frequent but potentially larger claims.

#### Forewarned Is Forearmed

Ultimately, firms that have an effective risk management structure are less likely to have claims. They practice defensively and have policies that are well considered and then carried through. When problems occur, they are well structured to withstand these difficulties.

*Managing risk can be tricky business for law firms. Contact Mueller Prost at 314.862.2070 for guidance in managing your firm's risk exposure.*

- **Make it matter.** Instead of viewing risk management as a burdensome, necessary evil, make it part of your firm's culture. Strategic firms often find a way to use their experience and expertise in managing their own risk as selling points to their clients.
- **Staff up.** Create a risk management committee and staff it with members from across the firm's leadership team. Have your managing partner chair it, and charge the committee with meeting at least quarterly.
- **Break it down.** Consider your risks systematically by breaking them down into four general categories:
  1. Regulatory
  2. Operational
  3. Professional
  4. Financial

As you assess your risk, seek input from members of the firm at all levels, as well as a representative sampling of clients and key suppliers.

- **Prioritize.** Prioritize each identified risk using a scoring system that reflects a) the likelihood of the risk occurring, and b) the impact on the firm should it occur.

## Estate Tax Update: Portability Extended

Married couples received an estate planning windfall this spring with the recent extension of a tax break related to a concept known as "portability." Portability allows surviving spouses to add the unused portion of their deceased spouse's basic estate tax exclusion to their own, increasing the amount of assets they can transfer to their heirs tax-free. For 2014, the lifetime exclusion from estate and gift taxes is \$5.34 million.

In Revenue Procedure 2014-18, the Internal Revenue Service has extended the portability break, allowing a surviving spouse to elect portability treatment of the estate of a spouse who died during the 2011, 2012 or 2013 calendar year. The deadline to take advantage of this extension is December 31, 2014.

Previously, taxpayers who may have benefited from the portability election either were unaware of the rule or thought it would not apply to their situation (i.e., they didn't expect the surviving spouse's estate to exceed the basic exclusion amount).

In order to elect portability, an estate tax return (IRS Form 706) must be filed on behalf of the estate of the deceased spouse. The normal deadline for doing so is nine months after the death, plus six months if an extension is requested. The IRS instructs those taking advantage of the ruling to write at the top of the form, "Filed Pursuant to Rev. Proc. 2014-18 To Elect Portability Under § 2010(c)(5)(A)."

The Revenue Procedure announcement also allows for the credit or refund of any taxes overpaid as the result of failure to elect portability. To correct such an overpayment, notice must be made within three years of filing IRS Form 706 or two years from the payment of the tax, whichever comes later.

*Mueller Prost's tax professionals can help you and your clients navigate the complexities of estate planning and tax impact. Call our office at 314.862.2070.*

*The articles in this newsletter are general in nature and are not a substitute for accounting, legal, or other professional services. We assume no liability for the reader's reliance on this information. Before implementing any of the ideas contained in this publication, consult a professional advisor to determine whether they apply to your unique circumstances.*  
© 2014

**Mueller Prost** offers practical solutions and insightful advice to individuals, businesses, and non-profit organizations, providing a full range of audit, tax, accounting, and business advisory services. The experience of our more than 90 accountants, engineers, operations leaders and former business owners gives us a unique and comprehensive perspective to address the needs of growing organizations. In addition, we leverage our membership in PKF North America (an association of more than 100 legally independent accounting and consulting firms) to enhance our national and international capabilities. For more information, visit [www.muellerprost.com](http://www.muellerprost.com).

**The firm offers a full range of professional tax, audit, accounting and management advisory services and collaborates with attorneys to meet client needs.**

For more information, please contact [Mike Prost, CPA/ABV/CFE, CVA, ASA](mailto:mprost@muellerprost.com) at 314.862.2070 or [mprost@muellerprost.com](mailto:mprost@muellerprost.com).