SUMMARY OF DSBA COMMITTEE ON PROFESSIONAL ETHICS: OPINION 2009-1

Rules Discussed: 5.4 and 7.2

Compensation of a Law Firm's marketing professional may not be based upon a percentage formula based on total revenues received from new or old clients, or revenues specifically obtained through the efforts of a marketing professional.

RKB/msj
09999-0144; Doc. 1888

DELAWARE STATE BAR ASSOCIATION

COMMITTEE ON PROFESSIONAL ETHICS

Opinion 2009-01

February 2, 2009

This opinion is merely advisory and is not binding on the inquiring attorney, or the Court, or any other tribunal.

ISSUE PRESENTED

The Inquiring Delaware Law Firm (the "Firm") is considering hiring a nonlawyer to market legal services. Such proposed individual is referred to herein as the "Marketing Professional." The Marketing Professional would not be a director, officer or partner of the Firm.

The Firm would provide the Marketing Professional with a compensation package that the Firm hopes will conform with the prohibition against fee sharing contained in Rule 5.4 of the Delaware Lawyers' Rules of Professional Conduct (hereinafter "DLRPC"). The compensation package would consist of three components: (i) salary, (ii) benefits, and (iii) incentive bonuses. The amount of incentive bonuses would be determined by a formula that would include the following four factors:

1. Increase in the Firm's total revenues;
2. Increase in revenues received by the Firm from existing clients;
3. Revenues received by the Firm from new clients;
4. Percentage of revenues received by the Firm from the new clients through the efforts of the Marketing Professional.

Not all of the above-described factors would receive equal weighting. However the fourth factor, which is the factor most directly tied to the Marketing Professional's efforts in attracting new clients for the Firm, would never be weighted in such a way as to constitute more than 50% of all factors.

A material part of the Marketing Professional's duties would include solicitation of prospective clients for the Firm. As required by Rule 7.1, the Firm advises that it would stress to the Marketing Professional the importance of refraining from any false or misleading communications about the Firm, its lawyers or their services. Also, in accordance with Rule 7.3(a), the Marketing Professional would only conduct in-person, live telephone or real-time electronic contact to solicit employment from prospective clients with individuals who are either lawyers themselves or who have a family, close personal, or prior professional relationship with the Marketing Professional or lawyers in the Firm [and except under the circumstances set forth in Rule 7.3(b)].

The Marketing Professional would be supervised by one or more partners of the Firm, in accordance with Rule 5.3(a) and (b). Specifically, one or more of the Firm's partners will make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that the person's conduct is compatible with the professional obligations of the lawyer. In addition, at all times one or more partners will exercise direct supervisory authority over the Marketing Professional and will make reasonable efforts to ensure that the Marketing Professional's conduct is compatible with the professional obligations of the lawyer. In this regard the Firm will, among other things, educate the Marketing Professional on the applicable Rules and periodically monitor the Marketing Professional's communications.

The Committee is of the opinion that the inquiry involves the following provisions of the Delaware Lawyers' Rules of Professional Conduct:

DLRPC 5.4 **Professional Independence of a Lawyer**

(a) A lawyer or law firm shall not share legal fees with a nonlawyer, except that:

…

(4) a lawyer or law firm may include nonlawyer employees in a compensation or retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement; and

…

(c) A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.

DLRPC 7.2 **Advertising**

(a) Subject to the requirements of Rules 7.1 and 7.3, a lawyer may advertise services through written, recorded or electronic communication, including public media.

(b) Except as permitted by Rule 1.5(e), a lawyer shall not give anything of value to a person for recommending the lawyer's services except that a lawyer may…

CONCLUSION

It is the opinion of this Committee that the proposed structure is violative of DLRPC 5.4(a) and 7.2(b) since it involves a sharing of legal fees with a nonlawyer.

DISCUSSION

Rule 5.4

The increased use of marketing teams and specialists, and the issue of compensation packages for such persons, is of increasing relevance.

DLRPC 5.4(a) prohibits a law firm from sharing legal fees with a nonlawyer. The basic issue presented here is whether the Rule prohibits a compensation package that is in any way based upon a percentage of revenue. The Comment section of DLRPC 5.4(a) makes it clear that the purpose of the Rule is to protect the “lawyers’ professional independence of judgment,” and to assure that a third party does not direct or regulate the professional judgment of the lawyer. The Rule does not just proscribe improper or unethical fee sharing with nonlawyers, it proscribes all fee sharing with a nonlawyer. While many marketing professionals may perform the task with the utmost good faith and professionalism, and may not be swayed by any desire to increase fees, the Rules simply do not permit such a person to share legal fees.

This Committee is of the opinion that the method of compensation cannot be dependent upon a percentage of the fees of the firm, whether such fees are based upon total revenues, revenues from existing clients, revenues from new clients, or new clients generated by the marketing professional.

DLRPC 5.4(a) does provide a specific exception to the general prohibition of sharing fees with a nonlawyer, but that exception is not applicable here. DLRPC 5.4(a)(4) only permits sharing legal fees with nonlawyer employees in a compensation or retirement plan that is based “…in whole or in part on a profit-sharing arrangement.” Therefore, the Committee is of the opinion that a compensation package may be based upon a percentage of <u>profits</u>, but cannot be based upon a percentage of <u>revenue</u> from legal fees from any source.

As noted above, the policy behind the prohibition is to discourage a nonlawyer employee from interfering with the professional discretion of the attorney(s) to, for example: take a case, settle a case, not settle a case, charge larger fees, or encourage excessive billing.

<u>Court Rulings</u>

Courts considering similar arrangements have found them to be violative of rules similar to the applicable DLRPC. In <u>Trotter v. Nelson</u>, 684 N.E.2d. 1150 (Ind. 1997), the Supreme Court of Indiana found there was an impermissible fee splitting arrangement between an attorney and his paralegal, wherein the paralegal was alleged to be due 5% of any fees resulting from a personal injury or worker's compensation case which the paralegal had a role in referring to the attorney. The court found the philosophy behind the prohibition of Rule 5.4, and the basis for the decision, to be that such an arrangement would provide incentives for a nonlawyer to recommend an attorney's services for the nonlawyer's own pecuniary interest, rather than the interest of the client; the disincentive to the attorney to devote its time and energy to the client, as the attorney must share fees with another, who may have done little to earn it; and it might interfere with the attorney's "professional independence of judgment." The paralegal argued the proposed compensation was within the purview of Rule 5.4(a)(3), the counterpart to DLRPC Rule 5.4(a)(4). However, the court held the facts do not involve a present profit-sharing plan, and that a nonlawyer's compensation may not be based upon the receipts of a particular legal fee, even though it may be permissible to calculate compensation based upon <u>profits</u>. The court also found the proposed compensation violated Indiana Rules of Professional Conduct 7.3(f), which is similar to DLRPC 7.2(b).[1]

[1] Indiana's Rule 7.3(f) provides, "A lawyer <u>shall not</u> compensate or give anything of value to a person or organization to recommend or secure his employment by a client, or as a reward for having made a recommendation resulting in his employment by a client…"

Similarly, a compensation plan that paid a $5.00 bonus to a nonlawyer employee when the clients paid a fee and executed a retainer agreement, or completed and returned bankruptcy questionnaires, and/or when clients signed Living Wills and/or Durable Powers of Attorney, was found to be violative of Rule 5.4(a) of the Mississippi Rules of Professional Conduct. Holmes v. Crowe, 304 B.R. 292 (Bankr. N.D. Texas 2004). Although the bonuses were nominal in amount, they were impermissible, and served an incentive to a nonlawyer to encourage a client to file for bankruptcy, and also to execute the Living Wills and/or Durable Powers of Attorney. This was also found not to be permissible as within the exception of Rule 5.4(a)(3) [the same as DLRPC 5.4(a)(4)], because it was not based on profit, but was on a per occurrence basis.

Rulings from Other Ethics Committees

Ethics committees from other jurisdictions have also opined on the acceptability of similar arrangements. The Professional Ethics Committee of the Florida Bar, in Opinion 89-4, has opined that a law firm may not allow its nonlawyer marketing director to be paid commissions based on a percentage of fees generated by business brought to the firm by such marketing director. See Also: Philadelphia Bar Association, Opinion 2004-3 (Opining favorably on a plan to share the net profits of a firm with a nonlawyer, where the compensation was tied to profits and not gross proceeds from clients, developed by the nonlawyer; and noting that if a bonus plan is limited to a percentage of the profits generated from fees earned solely on cases referred by the marketing director, the compensation plan would be a sophisticated fee-sharing arrangement, and would be prohibited.); Rhode Island Supreme Court Ethics Advisory Panel, Opinion No. 2000-05 (Opining that an attorney should be able to provide fee-sharing for non-profit organizations, the Rhode Island version of Rule 5.4 did not provide an exception similar to DLRCP Rule 7.2(d)(2).); New York State Bar Association Committee on Professional Ethics, Opinion #565 (Retention of outside public relations and marketing firm paid a commission or percentage of the annual fee, would be impermissible, and would tend to give the marketing firm a pecuniary interest in the success of the solicitation and could potentially lead to "hard-sell tactics" and other improprieties.) See also, Ethics Committee of the Colorado Bar Association, Opinion 2007.

Other opinions that would similarly prohibit payment to a nonlawyer employee, based upon a percentage of fees, include: Florida Bar Association Ethics, Opinion 89-4 (Nonlawyer marketing director cannot be paid commissions representing a percentage of fees generated from business he has brought to the firm.); Committee on Ethics of the Maryland State Bar Association, Opinion 92-1 (Personal injury lawyer cannot award bonus to nonlawyer who generates fees.); New York County Lawyers' Association Committee on Professional Ethics, Opinion No. 687 (Law firm may employ tax accountant, provided compensation or bonus is not calculated upon the billings; however, such compensation or bonus may be based upon profits, a fixed amount, or a percentage of salary.); New York County Lawyers' Association Committee on Professional Ethics, Opinion No. 720. (A lawyer may use nonlawyer consultant to prepare advertising, provided he complies with the rules on advertising; but compensation may not be tied to success or failure of the solicitation; and compensation may not be on a contingent basis.)

It is important to note that some jurisdictions have reached conclusions that may be viewed as contrary to the opinion expressed herein. In Formal Advisory Opinion 05-4, 642 S.E.2d 868 (Ga. 2007), the Georgia Supreme Court approved a ruling by the Formal Advisory Opinion Board, determining that a lawyer may pay a bonus to a nonlawyer employee based upon the gross proceeds of the firm. It is not clear, however, that there was a specific formula or percentage of the gross proceeds, which was to be paid as such bonus. That court, however, pointed to Georgia's present Rule 5.4(a)(3), permitting nonlawyer employees to participate in both a compensation and retirement plan, whereas the former rule in Georgia permitted nonlawyer compensation only in the context of a retirement plan. Georgia Rule 5.4(a)(3) appears to be the same as DLRPC Rule 5.4(a)(4). Contrary to that decision, this Committee believes DLRPC 5.4(a) is clear in allowing nonlawyer employees to be paid compensation based upon "a profit-sharing arrangement," not a compensation packaged based upon revenues, whether derived directly or indirectly from revenues.

In Opinion 90-14, the State Bar of Arizona Ethics Department considered circumstances in which a firm proposed to retain a marketing director who would receive a base monthly fee and quarterly bonuses. The bonuses would equal a fixed percentage of the increased revenue, to be derived from those areas of practice the marketing director was hired to develop. In that Opinion, the proposed measure of compensation was found to be acceptable. The majority of that Board was of the opinion that the Rule change in 5.4(a)(3) allowed nonlawyer employees to share fees in "…a <u>compensation or</u> retirement plan…." The majority also believed there were adequate safeguards in other rules, to address any potential problems. Specifically, the Arizona Rule 5.4(a)(3) also added the phrase, "…providing such plan does not circumvent another Disciplinary Rule." The majority's opinion specifically assumed that the marketing director had no influence over any lawyer's exercise of professional judgment; and, therefore, the compensation plan was permissible because the nonlawyer was assumed not to control the attorney's judgment. This provision is similar to DLRCP 5.4(c). It should be noted, however, that three-members of the Arizona Committee dissented from the majority opinion. The minority believed a bonus or payment based upon <u>proceeds</u> was improper, and was not the same as that which might be based upon <u>profits</u>. This Committee is again of the opinion, contrary to the State

Bar of Arizona Ethics Department, that under DLRCP 5.4(a)(4), a compensation plan can only be derived from profits, and not gross revenues.

This Committee recognizes one may argue there is little significant difference between compensation based upon profits, as opposed to revenues. First, this Committee believes DLRCP 5.4(a)(4) is clear in its use of the term “profit-sharing arrangement,” and it is not within the authority of this Committee to alter that language. Second, the opinion of this Committee is supported by the majority of opinions on the topic. Finally, the Committee is of the opinion that a formula based upon “profits” must consider a multitude of the factors in the operation of a law firm, which is more consistent with the purpose of DLRCP 5.4 to protect the independent judgment of the lawyer.

In conclusion, compensation of a nonlawyer based upon a formula using a percent of total revenues, increased revenues generally, increased revenues from new clients, and revenues of new clients received by the efforts of the Marketing Professional, would be violative of DLRPC 5.4(a) and 7.2(b). Any other interpretation may lead to conduct that the Rule seeks to prevent.

The Firm’s request indicates its intent to comply with DLRPC 7.1, 7.2, and 7.3, concerning advertising and marketing. The Committee believes the Firm’s request sought an opinion relating to the Compensation Package. This opinion assumes the Firm’s Marketing Professional would comply with all rules regarding advertising and marketing, as well as all rules generally applicable to any employee of a law firm.