

Waiting For The Courts To Amend The Code

BY ROY SIMON

The New York State Bar Association recently forwarded to the Appellate Divisions a proposed new Disciplinary Rule, DR 1-107, to govern contractual relationships between lawyers and non-legal professionals, including so-called “side-by-side” arrangements and “strategic alliances.” At the same time, the State Bar proposed amendments to several of the advertising and solicitation rules, including DR 2-101(C), DR 2-102(A)-(B), and DR 2-103(B). But those amendments may be a long way off. (When the NYSBA sent the courts a package of amendments in March of 1997, it took nearly two years and four months for the courts to act on them.)

What can you ethically do in your relationships with nonlawyer professionals until the amendments are adopted (or if they are never adopted)?

Let’s approach this through a hypothetical. Suppose one of your most entrepreneurial partners, M.D. Prak, approaches your firm’s Ethics Committee with big plans. He wants to combine legal and non-legal professional services in new ways. He knows a good small accounting firm that occasionally refers clients to your law firm, and he has several ideas for creating a closer relationship between the accountants and your law firm.

Plan A: Prak’s first choice is to offer the accountants partnership status in your law firm. The accountants will provide accounting services for clients and others who need accountants to help with their tax returns, estate plans, investment decisions, or other matters. The firm will change its name to include the names of the accountants.

Plan B: If partnership for the accountants won’t work, Prak wants your firm to hire them as employees and compensate them with (a) a salary, (b) a share of the legal fees for all new clients that they refer to your law firm, (c) participation in the firm’s profit-sharing retirement plan, (d) a year-end cash bonus based on the overall profitability of the law firm; and (e) an occasional bonus for outstanding assistance in particular matters. The accountants will be listed on your firm’s letterhead, but your law firm will not change its name.

Plan C: If your firm cannot reach an agreement with the accountants on the terms of their employment, Prak’s fallback position is to enter into a mutual referral relationship with the accountants. Your law firm will refer all clients who need accounting services to the accountants, and the accountants will refer all of their clients who need legal services to your law firm.

Which of Prak's plans (if any) may your law firm carry out now?

Plan A - Partnership: Under the ethics rules that prevail in New York today, partnership for non-lawyers at a law firm is out of the question. DR 3-103, the shortest rule in the Code of Professional Responsibility, says simply: "A lawyer shall not form a partnership with a non-lawyer if any of the activities of the partnership consist of the practice of law." Last June, the New York State Bar Association House of Delegates voted overwhelmingly not to recommend any changes to this rule. Plan A is out.

Plan B - Employment: Can your law firm hire the accountants and compensate them with (a) a salary, (b) a share of fees for clients they refer to the firm, (c) participation in the firm's profit-sharing retirement plan, (d) a year-end cash bonus based on the firm's overall profitability; and (e) bonuses for outstanding assistance in particular matters?

Taking first things first, your firm may certainly employ the accountants. Nothing in the Code of Professional Responsibility prohibits lawyers from hiring non-lawyer professionals. But employing non-lawyer professionals at a law firm can cause many problems. The lawyers cannot permit the non-lawyers to solicit business in ways prohibited to lawyers (e.g., in person or through deceptive claims), and under DR 1-104(D) the lawyers in the firm may be held responsible for any improper solicitation by the non-lawyers.

Indeed, the problems of in-person solicitation will arise even before the accountants begin working at your firm. How will the accountants persuade their existing clients to follow them to your law firm? Will the accountants suggest that their clients use your law firm for legal services as well as accounting services? If the accountants recommend the services of your law firm, they may be engaging in improper in-person solicitation.

In addition, when lawyers refer clients to the in-house accountants, the lawyers must observe the conflict of interest rules. That is a subject for another article, but the essence of DR 5-101(A) is that for each such referral: (a) first, the referring lawyer must determine whether the law firm's financial interest in the accountants' fees will or may reasonably affect adversely his professional judgment about which accounts to recommend - and the answer will almost certainly be yes; (b) next, the referring lawyer must determine whether a "disinterested lawyer" would believe that the representation of the client will not be adversely affected by the conflict; and (c) if the referring lawyer satisfies the "disinterested lawyer" test, the lawyer must still obtain the client's consent to the conflict "after full disclosure of the implications of the lawyer's interest."

Another conflict problem may arise if the accountants urge their existing clients to follow them to the law firm (and surely that is what your law firm hopes will happen, because it's a lot harder to find clients than to find accountants). Will the accounting clients be clients of the accountants only, or will they be clients of your law firm? If they will be clients of your law firm, then they need to be added to your law firm's data base of current clients for conflicts checks. If they will be clients of the accountants only-which may be the case if the accountants continue their accounting practice part-time under a separate name your law firm may still have to check for conflicts under DR 5-101(A), especially if one of the accountants' clients is an adverse party. How will you feel if you are opposing one of your in-house accountant's clients in litigation and the accountant says to you, "My client says you are being unreasonable in your settlement demands"?

Compensating The Accountants

What about the various compensation proposals? Are they ethical? Certainly it is proper to pay the accountants a salary, but does DR 3-102 allow the firm to share legal fees with the accountants if those fees are generated by new clients that the accountants have referred to your law firm? The general rule stated in DR 3-102 is: "A lawyer or law firm shall not share legal fees with a non-lawyer..." Under this general principle, it is definitely improper to share legal fees with the accountants even if the clients followed the accountants to the law firm. Moreover, DR 2-103(B) provides that a lawyer "shall not compensate or give anything of value to a person or organization to recommend or obtain employment by a client or as a reward for having made a recommendation resulting in employment by a client." Splitting fees with clients referred by the accountants would squarely violate that rule. Finally, §491 of the judiciary law makes it "unlawful" for non-lawyers to share in legal fees. Thus, it is no surprise that N.Y. State 733 flatly says that "a non-lawyer may not be paid a percentage of fees attributable to matters referred by the employee."

But the retirement plan and bonuses may fare better. DR 3-102(A)(3) contains an exception that provides as follows:

A lawyer or law firm may compensate a non-lawyer employee, or include a non-lawyer employee in a retirement plan, based in whole or in part on a profit sharing arrangement.

This exception reflects an important 1999 amendment. Before 1999, the rule allowed profit sharing with non-lawyers only as part of a retirement plan. The 1999 amendment broadened the exception by "allowing non-lawyer employees of a lawyer or law firm to participate in a profit-sharing plan with respect to their salaries and bonuses and otherwise to be compensated, in whole or in part, based on the profitability of the lawyer or law firm." Thus, even before the exception, your law firm could include the accountants in the firm's profit-sharing retirement plan. The amended exception makes it proper to base a year-end cash bonus to the accountants on the overall profitability of the law firm.

However, bonuses for outstanding assistance in particular matters remain problematic. Bonuses to non-lawyers for outstanding work in general pose no problem, but bonuses to non-lawyers tied to particular cases may pose a problem. The thinking is that if a non-lawyer has a financial interest in a particular matter, whether that interest is a share of the fees or the hope of a bonus, the non-lawyer may try to influence the independent professional judgment of the lawyers who are handling the matter. On the other hand, if a non-lawyer's bonus is tied to outstanding individual performance (e.g., reliability, long hours, quality of work) rather than to the result of the matter (e.g., how many dollars are won, or the terms on which a transaction closes), there would seem to be only minimal danger that the non-lawyer would interfere with the lawyer's independent professional judgment, and the bonus might encourage better work on behalf of the client. Given this split in the policies underlying amended DR 3-103(A)(3), it is not surprising that N.Y. State 733 left the question open. A footnote says: "Whether and under what circumstances a lawyer may now compensate a non-lawyer employee based on the profitability of a particular client matter is where the payment is not compensation for a referral is beyond the scope of this opinion."

As for the letterhead, the accountants may be listed on your firm's letterhead, just as paralegals may be listed, but the letterhead must make clear that the accountants are not partners in the firm and not licensed to practice law.

Plan C - Mutual Referrals: Krak's fallback plan is to encourage mutual referrals - your law firm would agree to refer all clients to the accountants who need accounting services, and the accountants would agree to refer all of their clients who need legal services to your law firm. This may sound good, but it isn't ethical. Under DR 2-103(B), a lawyer "shall not compensate or give anything of value to a person or organization to recommend or obtain employment by a client or as a reward for having made a recommendation resulting in employment by a client." Based partly on this rule, N.Y. State 733 said that a law firm could not share legal fees with a non-lawyer. The same principle prohibits mutual referral agreements. Everyone knows that lawyers sometimes refer matters to accountants and accountants sometimes refer matters to lawyers, but there cannot be a quid pro quo - a formal understanding or agreement or contract to refer matters to each other. A mutual referral agreement with the accountants would be giving something, of value" to the accountants as an inducement to make (or a reward for having made) referrals to the law firm.

How much will this all change if the courts adopt DRs 1-106, 1-107, and the other proposed amendments to the Code? A lot - but that's the subject of another whole article. Don't touch that dial.