Profit-Sharing, Ethics and Employee Compensation

Lawyers' offices just don't look like they used to when I started practicing law in the 1960s. We had partners, associates, an office manager, a receptionist, secretaries and a couple of ladies in a back office who kept track of the lawyers' time and did the billing. There are now a host of other people working in law firms, many of them professionals in their own right, whose responsibilities include marketing, recruiting, lateral hiring, information technology, and the ever-expanding and important roles given to legal assistants or paralegals. We can give these nonlawyer employees business cards, assign them private offices, put their names on our office stationery and provide them with covered parking, but we are ethically limited in the compensation and other monetary incentives for them that we can otherwise freely provide the firm's lawyers.

It isn't hard to "bonus" non-lawyer employees as long as any amount paid is based on all-over firm profitability and not on the amount of a single fee.

There are two ethical rules that must be considered when we explore ways to compensate, encourage and reward nonlawyer employees. ER 5.4 (Professional Independence of a Lawyer)[1] provides that a lawyer or law firm shall not share legal fees with a nonlawyer, except that a "lawyer or lawyer 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." ER 5.4(a)(3). It is obvious that all of a law firm's expenses, including rent, insurance, library costs and staff salaries, are paid with money the firm receives from the fees it charges clients. The ethical rule is not intended to interfere with the normal operation of a law firm but is intended, in the nonlawyer employee context, to avoid the possibility that a nonlawyer employee might attempt to interfere with the lawyer's responsibilities to serve the client's interests exclusively and not the economic interests of that employee in maximizing a fee that he or she might otherwise share with the firm were it not for the rule.

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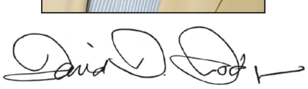

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The other rule that needs to be considered is ER 7.2 (Advertising). This rule provides in pertinent part that a lawyer shall not give anything of value to a person (this would include a nonlawyer employee) for recommending the lawyer's services. ER 7.2(b). Nonlawyer employees, particularly those involved in marketing efforts, often refer new business to the firm that employs them, and questions have arisen whether some sort of bonus arrangement would be appropriate in these circumstances. The authorities in this area are not exactly uniform and range from the pragmatically lenient to the somewhat strictly conservative.

My favorite example of the latter is an ethics opinion from the Philadelphia Bar Association that holds a law firm is prohibited under the rule from giving a nonlawyer employee a paid day off for referring a new client to the firm.[2] Compare this to an Arizona ethics opinion that holds it is permissible for lawyers to give gift certificates worth a *de minimis* amount, say $100 or less, to a "non-attorney" as an expression of gratitude for bringing in a new case.[3] As long as the independent judgment of the lawyer to whom the client was referred is not affected or influenced thereby, a modest "thank you" in some form is acceptable.

The two rules address different concerns: Giving a nonlawyer employee a paid day off may violate ER 7.2 in Philadelphia but wouldn't violate ER 5.4 because there was no division of a single fee. On the other hand, if a lawyer were to say "Bring this case in and I'll give you 10 percent of my fee," that would violate both rules.

This topic has generated some interesting judicial and ethics opinions concerning what you as a lawyer can do to reward your nonlawyer employees in given situations. Thus, you *may* pay nonlawyer employees (1) monthly bonuses based on a percentage of the firm's gross revenues,[4] (2) bonuses based on the firm's earnings in excess of preset levels of income or net profits,[5] (3) a salary based on the income generated from all the cases in which the employee appeared before a given tribunal, such as the Social Security Administration,[6] and (4) a bonus based on "extraordinary efforts" on a particular case or over a specific time period, but the bonus may not be tied to the number of hours worked on the case or during that time period.[7]

There are at least five opinions pertaining to marketing employees. They state generally that you may make bonus payments to marketing personnel based on a percentage of the firm's total profits, but not on a percentage of any profits from just the cases they refer.[8] Included in this group is Arizona Ethics Opinion 90-14 (Professional Independence of a Lawyer) (October 1990), which holds that a law firm may pay its nonlawyer marketing director incentive compensation measured by a percentage of the

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firm's increased revenues.[9] Aside from the marketing people, you *may not* pay nonlawyer employees (1) based on the number of bankruptcy petitions they work on for the firm,[10] (2) through a profit-sharing arrangement based on the volume and type of cases they work on,[11] or (3) a bonus based on fees the firm receives from a specific case or series of related cases. But you may pay an employee a bonus contingent upon the firm's overall profitability or that of a particular department.[12]

We are all comfortable with rewarding the lawyers in a firm with a percentage of the new business they bring in. There are no ethical limitations on how lawyers in the same firm agree to pay themselves.[13] But when it comes to nonlawyer employees in the very same firm, the rules are quite different. Bringing in new business is just one of the ways that nonlawyer staff can contribute to the success of a law firm, so it's important that their efforts be encouraged and rewarded when appropriate. It isn't hard to "bonus" nonlawyer employees as long as any amount paid is based on all-over firm profitability and not on the amount of a single fee.

And because we aren't in Philadelphia, a day off for exceptional effort probably wouldn't hurt either.

endnotes

1. Rule 42, ARIZ.R.S.CT.
2. Phila. Bar Ass'n Op. 2005-81 (June 28, 2005).
3. Ariz. Ethics Op. 02-01 (Advertising; Solicitation; Gifts; Referrals; Referral Fees) (Jan. 2002); and *see* Comment [5] to ER 7.2.
4. *In re Formal Advisory Opinion 05-4*, 642 S.E.2d 686 (Ga. 2007).
5. Colo. Informal Ethics Op. 00/01-02 (2001).
6. N.C. Ethics Op. 2005-6 (2005).
7. Fla. Ethics Op. 02-1 (2002).
8. Phila. Bar Ass'n Op. 04-3 (2004); N.Y.S. Bar Ass'n Ethics Op. 887 (2011); N.Y.S. Bar Ass'n Ethics Op. 917 (2012); Del. Ethics Op. 2009-1 (2009).
9. There were several dissents to this opinion based on the notion that the exception to the rule against fee-splitting applied to pure profit-sharing plans and not to regular compensation arrangements. The opinion is over 15 years old, and my guess is that there would be fewer dissents today if the question were to be revisited.
10. *In re Bass,* 227 B.R. 103 (Bankr. E.D. Mich. 1998).
11. *Doe v. Condon,* 532 S.E. 2d 879 (S.C. 2000).
12. N.Y.S. Bar Ass'n Ethics Op. 887, *supra* note 8.
13. *See Sharing Fees, Unintended Consequences*, ARIZ. ATT'Y (Oct. 2016) at 8.