NEW HAMPSHIRE BAR ASSOCIATION
Ethics Committee Formal Opinion #1989-90/9
Employee Leasing - Law Firm Partners
July 25, 1990

RULE REFERENCES:

*Rule 1.2(a)
*Rule 1.4
*Rule 1.5(f)
*Rule 1.6
*Rule 1.7
*Rule 1.7(b)
*Rule 1.8
*Rule 1.8(f)
*Rule 1.9
*Rule 1.10
*Rule 2.1
*Rule 5.1
*Rule 5.3
*Rule 5.4
*Rule 5.4(a)
*Rule 5.4(b)
*Rule 5.4(c)
*Rule 5.4(d)
*Rule 5.5
*Rule 7.1
*Rule 7.5
*Rule 7.5(d)
*Rule 8.4(c)

CODE REFERENCES:

*DR3-102
*DR5-107(c)

STATUTORY REFERENCES:

*RSA 294-A:5
*RSA 294-A:8
*RSA 311:7
*RSA 311:11

SUBJECTS:

*Adverse Effect on Professional Judgment
*Attorney-Client Privilege
*Business Activities
*Confidentiality
*Conflict of Interest
*Fees
*Independent Judgment
*Law firms

ANNOTATIONS:

A law firm may lease some or all of its lawyers from an employee leasing company so long as the following conditions are met: (i) the existence of the leasing arrangement and, where necessary or appropriate, of its pertinent terms and conditions, are fully disclosed and explained to the clients of the firm and of its leased lawyers, to the leasing company's insurer(s), and to the creditors (including the taxing authorities) or the firm and of the leasing company; (ii) the lawyers retain complete and independent judgment in rendering legal services to client; (iii) the firm does not, directly or indirectly, share legal fees with the leasing company; and (iv) the lawyers and the firm rigidly adhere to and take reasonable steps to assure ongoing compliance with all provisions of the Rules of Professional Conduct in the delivery of legal services. (see, Rule References above; Rule 5.4(d))

The purpose of Rule 5.4(d) is to (1) assure that the client retains control of the representation; and (2) to enhance the lawyer's ability to exercise professional independence. To permit a non-lawyer to have a financial stake, or managerial control in the lawyer's practice would frustrate those purposes. (Rule 5.4(d))

The rules do not expressly prohibit the leasing of lawyers from or by a business not engaged in the practice of law. (Rule 5.4)

Any permitted lawyer-leasing arrangement could not involve a sharing of client fees, or a sharing of profits by the law firm with a nonlawyer. (Rule 1.5(f); Rule 5.4(a); Rule 5.4(d))

Any permitted lawyer-leasing arrangement must permit the complete and unfettered authority for the leased attorneys to exercise independent judgment for and on behalf of all their clients. (Rule 2.1; Rule 5.4(c); Rule 5.4(d)(3))

Any permitted lawyer-leasing arrangement must also insure preservation of client confidences and avoidance of conflicts of interest. (Rule 1.6; Rule 1.7)

The lawyer-employee would have to make a full and adequate disclosure to existing and prospective clients as to the leasing arrangement and those responsible for representing the clients' interests. (Rule 1.2 (a); Rule 1.4(b); Rule 1.8(f); Rule 7.1)

I. QUESTIONS PRESENTED:

A. Would a law firm violate Rule 5.4(d) or other rules of the New Hampshire Rules of Professional Conduct if it leases its employees from a company not engaged in the practice of law?

B. Assuming that lawyer-leasing is not prohibited per se by Rule 5.4(d), what restrictions would be imposed on such an arrangement by Rule 5.4 and other provisions of the Rules of Professional Conduct?

II. BRIEF RESPONSE:

A law firm may lease some or all of its lawyers from an employee leasing company so long as (i) the existence of the leasing arrangement and, where necessary or appropriate, of its pertinent terms and conditions, are fully disclosed and explained to the clients of the firm and of its leased lawyers, to the leasing company insurer(s), and to the creditors (including the taxing authorities) of the firm and of the leasing company; (ii) the lawyers retain complete and independent judgment in rendering legal services to client; (iii) the firm does not, directly or indirectly, share legal fees with the leasing company; and (iv) the lawyers and the firm rigidly adhere to and take reasonable steps to assure ongoing compliance with all provisions of the Rules of Professional Conduct in the delivery of legal services.

III. RESPONSE

A. Facts.

A management company (the "Company") that is owned exclusively by non-lawyers provides certain payroll and accounting services to its clients. The Company provides these and other services to its clients essentially by becoming the employer of some (or all) of a client's employees and leasing the client's former employees back to the client. The Company also offers certain fringe benefits to various employees who are leased out in this manner that may be more attractive than the benefits previously offered by a particular client.

Law Firm X (the "Firm"), a registered professional association under RSA 294-A, is considering becoming a "client" of the Company. Lawyer-shareholders and presumably associate lawyers of the Firm would become employees of the Company, which would then lease the services of all such lawyers back to the Firm.

The Company would thereby assume the Firm's accounting and payroll functions, and be able to provide the leased employees with enhanced or at least more varied fringe benefits. The leased attorneys would plan on continuing to practice law using the Firm name and otherwise hold themselves out to the public as representatives of the Firm.

The Committee has not received any information about how the Firm would compensate the Company for the value of the leased services. It has been suggested that the structure and valuation of those compensation payments might depend on the permissibility of any leasing arrangement under Rule 5.4. For the purposes of this opinion, the Committee assumes that the Company will value the services of the lawyer-employees and establish the compensation to be charged therefor to the Firm without

regard to fees billed or received by the Firm during any particular fiscal period and without regard to the Firm's profitability.

B. Rule 5.4(d)

Rule 5.4(d) provides as follows:

(d) A lawyer shall not practice with or in the form of a professional corporation or association authorized to practice law for a profit, if:

(1) a nonlawyer owns any interest therein, except that a fiduciary representative of the estate of a lawyer may hold the stock or interest of a lawyer for a reasonable time during administration;

(2) a nonlawyer is a corporate director or officer thereof; or

(3) a nonlawyer has the right to direct or control the professional judgment of a lawyer.

C. Its Interpretation

(i) Language of the Rule.

Technically, this rule only prohibits lawyers from joining non-lawyers in a for-profit organization when the business of the organization involves the practice of law. Therefore, a lawyer is ethically permitted to (i) enter into business relationships with non-lawyers that do not involve the practice of law; and (ii) work with a non-profit organization controlled by non-lawyers in rendering legal services to clients associated with such organization. See United Transportation Union v. State Bar of Michigan, 401 U.S. 576 (1971).

Assuming that the Company in this inquiry is a for-profit organization, the initial question is whether the business of the Company involves the practice of law. We assume that the Company's primary purpose would not be deemed to involve the practice of law merely because the Company employs lawyers as employees. Similarly, neither the Company nor its non-lawyer employees would be authorized to practice law under Rule of Professional Conduct 5.5 or NH RSA 311:7 or 311:11. Therefore, we believe that the mere existence of an employment or business relationship between the Company and the Firm's current employees would not violate Rule 5.4(d).

However, in light of the following analysis regarding the performance of the lawyer-employees' duties while employed by the Company, we believe that Rules 5.4(a-d) and other pertinent Rules would place substantial financial restrictions on such an employment relationship, as set forth in Part III.D below.

(ii) Purposes.

Even though the literal language of Rule 5.4(d) would not be violated by the formation of an employment relation between that Company and the Firm's lawyer-employees, we do not believe this ends the inquiry in light of the purposes of the Rule. The New Hampshire rule, entitled "Professional Independence of a Lawyer," is one of several rules designed to assure that a lawyer represents the client's interests free of interference from, or obligations to, a non-lawyer who stands outside the lawyer-client relationship. See, e.g., Rule 1.2(a) (client controls representation); 1.7(b) (lawyer shall not represent a client if a representation is limited by lawyer's responsibilities to third party); 1.8(f) (restricting lawyer's acceptance of compensation from third party); and 2.1 and 5.4(c) (lawyer shall exercise independent professional judgment).

Thus, the purpose of Rule 5.4(d) is two-fold: to assure that the client retains control of the representation; and to enhance the lawyer's ability to exercise professional independence on behalf of each client. The rule impliedly assumes that the potential for frustration of these purposes, and thus harm to the client's interests, would be too great if a non-lawyer was permitted to have a financial stake, or managerial control, in a lawyer's practice. Compare Rule 5.4, New Hampshire Comments ("[t]he subcommittee has adopted the policies of DR 3-102 of the prior New Hampshire Code) and former DR 3-102 (prohibition against sharing of fees with non-lawyers is intended to insure the loyalty of the lawyer to the client unimpaired by intervening and possibly conflicting interests). See generally, ABA/BNA Lawyers' Manual on Professional Conduct 91:401 (1989). The standard adopted by the Committee, which is set forth in Part III.D below, is consistent with these purposes of Rule 5.4 and former Disciplinary Rule 3-102.

(iii) Functional Role of Lawyer-Employee.

In light of these twin purposes of the rule, the correct test to determine whether the business of the Company or any of its lawyer-employees in this inquiry would "involve the practice of law" under Rule 5.4(d) is the same test set forth in Rule 5.4(b): whether "any of the activities of the lawyer-employee consist of the practice of the law". (emphases supplied).

Determination of this issue depends on the nature of the lawyer's function as an employee of the Company[1]. Applying a functional interpretation of Rule 5.4(d), the rule would be implicated if a business organization (owned or managed by non-lawyers) holds its lawyer-employees out in their capacities as lawyers, or when the services of the lawyer-employees include activities that, when performed by a lawyer for an independent client, would constitute the practice of law.

(iv) Lawyer Leasing Opinions from other Jurisdictions.

a. Rulings Prohibiting Lawyer Leasings.

This functional approach under Model Rule 5.4(d) has been applied by at least two other jurisdictions to prohibit a law firm from leasing its employees, including

former members of the firm, from an employee leasing company. See, e.g., North Carolina Ethics Opinion 365 (1985); Alabama Ethics Opinion 87-151 (1988). Cf. Maryland State Bar Association Committee on Ethics, Opinion 86-45 (1986) (consulting firm, comprised of lawyer and non-lawyer members, that would provide counseling and legal services to clients and pay lawyers' salaries from clients' litigation recoveries, is likely to violate rules of ethics). In North Carolina, the ruling was based primarily on two grounds: (i) that the public might or would be misled about the business and professional relationship amongst the leased lawyers, in violation of Rule 7.1 and 7.5(d); and (ii) that a lawyer receiving compensation from a contract service company would lose his independent professional judgment. In Alabama, an arrangement whereby a firm that leased lawyers remitted the fees received from the firm's clients to the leasing company (in exchange for salaries, bonuses and reduced-rate health insurance) was ruled to violate the prohibition of Rule 5.4(a) against the sharing of fees with non-lawyers.

b. Rulings Permitting Lawyer Leasing.

Prior to a recent liberalization of the District of Columbia's rules (discussed infra), the District of Columbia's Ethics Committee had allowed a law firm to "rent" the services of a consulting firm's employee lawyers (some of whom had also been partners in the law firm), where the consulting firm, although it paid the salaries and fringe benefits of the lawyers, (i) was not permitted to realize a profit from the arrangement or even collect a portion of its general overhead from revenues generated by its lawyer-employees, and (ii) took other steps to prevent the improper non-lawyer involvement in the professional activities of the lawyer-employees or the delivery of legal services to their clients. District of Columbia Ethics Opinion 182 (1987). Accord, New Jersey Supreme Court Advisory Committee on Professional Ethics, Opinion 631 (1989). Cf. Oliver v. Kentucky, 779 S.W.2d 212 (Ky. 1989) (firm may hire temporary lawyer from referral agency if the agency fee is fixed or determined as percentage of temporary lawyer's salary and if firm takes steps to preserve client confidences and protect against conflicts of interest); and ABA Committee on Ethics and Professional Responsibility, Formal Opinion 356 (1988) (temporary attorney services approved subject to guidelines to avoid ethical problems).

Rule 5.4(b) of the District of Columbia's Rules of Professional Conduct was recently amended, effective as of March 1, 1990, expressly to permit certain qualifying non-lawyers to have a financial interest or managerial authority in a law firm ("Qualifying Persons") subject to significant restrictions, including the following: (i) the firm must have as its sole purpose the provision of legal services to clients; (ii) the Qualifying Persons must perform professional services for the firm which assist the firm in providing legal services to clients; (iii) the Qualifying Persons must undertake to abide by the rules of professional conduct; (iv) the lawyers who are partners, shareholders or managers of the firm must be responsible for the Qualifying Persons to the same extent as if they were lawyers; and (v) the firm and the Qualifying Persons must agree to these conditions in writing.

This liberalization of Model Rule 5.4(d) in the District of Columbia is nonetheless fairly narrow in its scope. It permits lawyer and other non-lawyer professionals to collaborate in the provision of legal services without relegating the non-lawyers to the role of an employee if certain conditions are satisfied. This new D.C. Rule does not permit an individual or entity to acquire all or any part of the ownership of law firm for investment or other purposes. Nor would it permit a corporation or any other person, as an investor, to entitle itself to all or any portion of the income or profits of a law firm. Even if the amended D.C. Rule 5.4(b) was in effect in New Hampshire, it would not expressly permit the lawyer-leasing arrangement contemplated by the Company and the Firm.

D. Application of Test to Firm's Inquiry.

The Rules of Professional Conduct do not expressly prohibit the leasing of lawyers from an organization not itself engaged in the practice of law. There is not a consensus among other jurisdictions as to whether lawyer leasing is consistent with the purposes and policies of Rule 5.4.

The Committee believes that the more reasonable interpretation of Rule 5.4 is the one suggested by the rulings in the District of Columbia, New Jersey and Kentucky. The Committee believes that lawyer-leasing services that are contracted for in exchange for the bona fide purpose of providing or reducing the cost of fringe benefits are permissible when such services are provided in compliance with guidelines necessary to avoid ethical problems. In reaching this conclusion, we assume that the financial arrangement between the Company and the Firm would not involve, directly or indirectly, the sharing of fees or client recoveries. For example, the Firm could contract to pay the Company a fixed charge, or a charge based on some percentage or multiple of each lawyer's salary, fringe benefits and other direct and indirect costs. With other appropriate guidelines and restrictions, the rationale for the negative rulings in North Carolina and Alabama disappears.

The Committee predicates its interpretation of Rule 5.4(d) in this manner on the assumption that, by entering into the leasing arrangement, the Company and the Firm can assure compliance with Rule 8.4(c). In particular, none of the Company, the Firm nor the lawyer-employees may misrepresent, either directly or by implication, the nature and conditions of the employment relation to any of (i) the clients of the Firm and of the lawyer-employees; (ii) the Company's insurer(s); and (iii) the creditors (including the taxing authorities) of the Firm and the Company. The Committee expresses no opinion as to whether compliance with rule 8.4(c) can be assured simply by disclosing to such third parties the existence of the lawyer-leasing arrangement. In view of the Committee's interpretation of the requirements of Rule 5.4(c), 5.4(d)(3) and 2.1 and the Committee's recommendations to assure compliance with those Rules (as summarized in paragraph no. 4 below), additional disclosures may be appropriate and/or necessary pertaining to the terms and conditions of the employment and leasing relation between the Company, the Firm and the lawyer-employees.

Applying this flexible test and in light of the purposes of Rule 5.4, the Committee believes that the Firm may lease its former lawyers from the Company if each of the Company, the Firm and the lawyer-employees observes the following restrictions in connection with all of the following practices: the administration of the Company as it relates to the employment of the lawyer-employees leased to the Firm; the management, supervision, and provision of legal services by lawyer-employees employed by the Company; the compensation of lawyer-employees by the Company; and the utilization of lawyers' client revenues:

(1) Each of the Company, the Firm and the lawyer-employees must take all reasonable steps, including appropriate disclosures to third parties, to assure that the lawyer-leasing arrangement does not violate Rule 8.4(c).

(2) Neither the Company nor any non-lawyer director, officer or employee of the Company may become a shareholder or otherwise receive an ownership interest in the Firm. The Firm must continue to be owned only by qualifying lawyers. Rule 5.4(d)(1); RSA 294-A:8.

(3) Neither the Firm nor any lawyer-employees of the Company may share or agree to share, in whole or in part or directly or indirectly, with the Company, any specific or other readily-identifiable fees, client recoveries or other forms of compensation or reimbursement from such lawyers' clients. Rules 5.4(a), 5.4(d) and 1.5 (f). It is the opinion of this committee that this limitation would include a prohibition against a sharing of profits by the Firm with the Company. All profits of the Firm must be retained and shared by the lawyer-shareholders of the Firm. Id.

(4) Lawyer-employees of the Company must, as a condition of their employment in a express written agreement, have complete and unconditional authority to exercise independent judgment for and on behalf of all their clients, and the Company may not in any circumstances interfere or attempt to interfere, directly or indirectly, with the exercise of such judgment by any lawyer-employee. Rules 5.4(c), 5.4(d)(3) and 2.1.

(A) At a minimum, the requirement of independent judgment mandates that the Firm have the right to control all activities of the Company's lawyer-employees that are involved in the practice of law. The Committee recommends that the Firm exercise this right to control not only in connection with representation of clients but also with respect to hiring, promotion and/or termination decisions for all lawyer-employees of the Company.

(5) Lawyer-employees of the Company may not be influenced, in the exercise of independent judgment on behalf of a client, by the short- or long-term financial consequences to the Company. Rules 5.4(a), 5.4(d)(1), 2.1 and 1.8(f).

(A) The Committee recommends that the Firm should maintain at all times the right, in the Firm's discretion (with or without cause), to terminate its contract with the Company, subject only to a final accounting.

(6) The Firm must make certain that the compensation to be paid by the Company to each lawyer employee is adequate to satisfy the Firm that the firm may expect the work of each lawyer-employee to be performed competently for the Firm's clients. Rule 5.1(a). A corollary of this requirement is that the Firm must make certain the Company has adequate financial resources to meet its payroll obligations to each lawyer-employee.

(7) Lawyer-employees of the Company must take due care to establish and to monitor, on an ongoing basis, the implementation of procedures to supervise the efforts of subordinate lawyers at the Firm, Rule 5.1, and of non-lawyer employees of the Company who assist such lawyer-employees in the provision of legal services to a client or otherwise assist in the practice of law. Rule 5.3

(8) Lawyer-employees of the Company must take reasonable efforts to ensure that the Company and the Firm each has in effect measures to assure (i) that the company and its non-lawyer employees preserve client confidences and the attorney-client privilege, Rule 1.6, (ii) that conflicts of interest are avoided, Rule 1.7, and (iii) that such person(s) conduct is otherwise compatible with the professional obligations of the lawyer-employee and the Rules of Professional Conduct. Rule 5.3

(A) The potential for unexpected conflicts of interest for the Firm and its lawyers would seemingly be greater than that presented in the normal context where a firm employs its own lawyers, in light of the possibilities, for example, that the Company may employ lawyers from more that one law firm, or that the Company may employ representatives of an adversary to one of the Firm's clients. In addition to setting up procedures to identify these prospective conflicts, the Firm and the Company's lawyer-employees must rigidly adhere to the conflict of interest provisions of Rules 1.7 - 1.10, inclusive.

(9) Lawyer-employees of the Company and the Firm each must take all reasonable steps to assure that no employee of the Company engages in the unauthorized practice of law. Rule 5.5; RSA 294-A:5.

(10) Lawyer-employees of the Company may, when dealing with their legal clients, only practice under their own names or the name of the Firm. Rules 7.1 and 7.5. Lawyer-employees may not practice under the corporate name of the Company. Id.; RSA 311:11.

(A) We express no opinion as to whether the Firm could, consistently with rule 7.5, list the lawyer-employees of the Company on its letterhead, but there is at least a substantial question as to whether any such listing would comply with the requirements of Rules 7.1 and 7.5, absent the disclosures required by 1.2(a), 1.4(b) and 1.8(f).

(11) No lawyer-employee of the Company may become an owner of the Company or hold himself out to be a partner of any of the non-lawyer owners of the Company. Rules 7.1, 5.4(b) and (d), and 7.5(d).

(12) All lawyer-employees of the Company must make full and adequate disclosure to existing and prospective legal clients of such lawyers as to the nature of the lawyers' relationship within the Firm and the persons responsible within the Firm and, if applicable, at the Company, for representation of such clients' interests. RulesÊ7.1, 1.2(a), 1.4(b), and 1.8(f).

(13) These restrictions are of particular relevance in view of the proposed leasing arrangement between the Firm and the Company. In addition to observing these restrictions, the Company and its employees, together with the Firm, must observe and comply, in connection with the provision of all legal services, with all other obligations, limitations and restrictions imposed or otherwise set forth in the New Hampshire Rules of Professional Conduct.

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[1] A functional definition has been applied with approval by ethics committees in other jurisdictions in interpreting former model disciplinary rule DR 5-107(c) (which is identical in all material respects with New Hampshire Rule 5.4(d). See ABA Formal Ethics Opinion 297 (1961); Michigan Informal Ethics Opinion C1-1117 (1986); New York City Ethics Opinion 80-25.