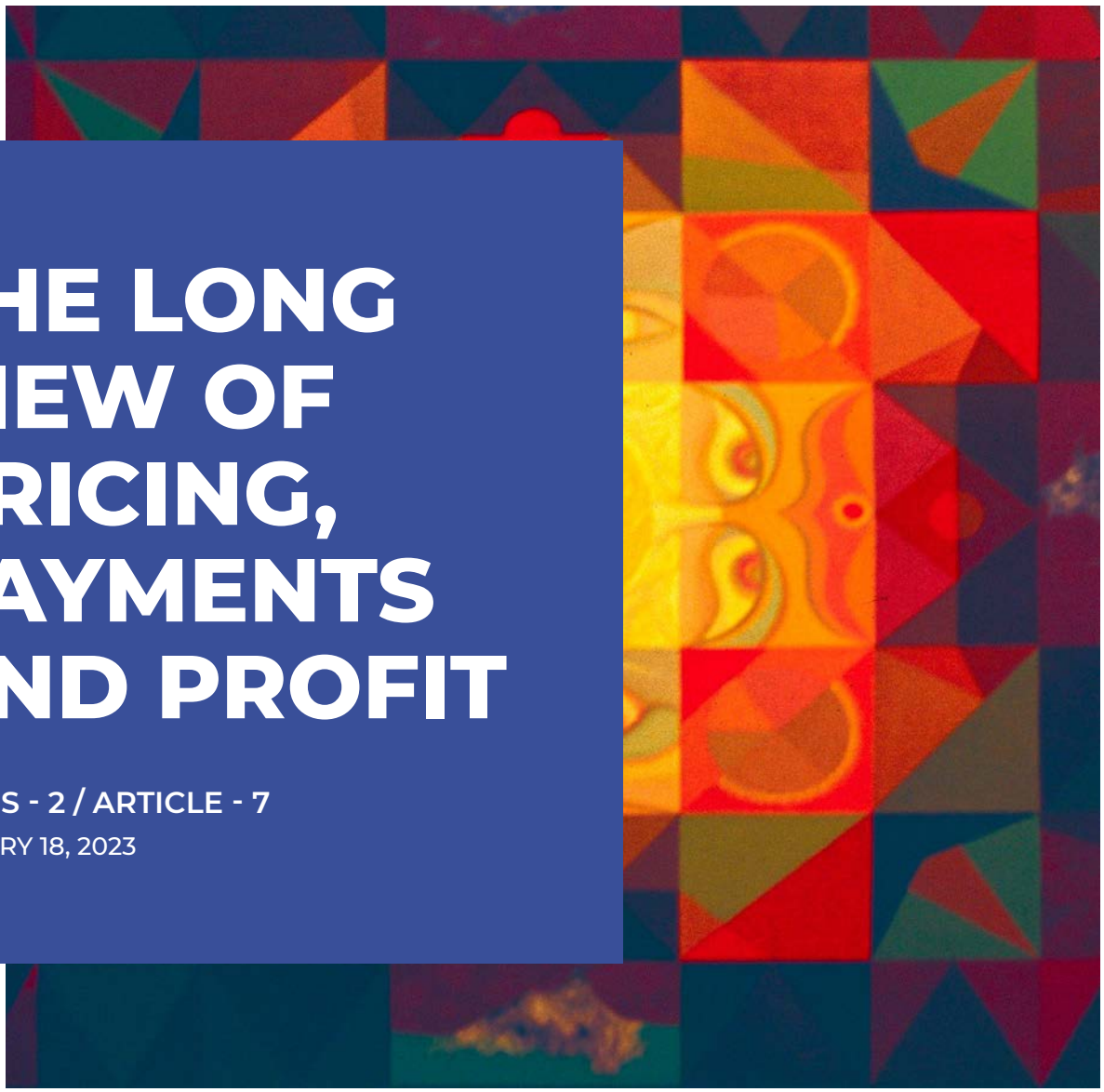
NON-TRADITIONAL CLIENT COMPENSATION



THE LONG VIEW OF PRICING, PAYMENTS AND PROFIT

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The notion of a lawyer taking his or her fee in the form of stock in a client's company is not a new one. However, this method of compensation became much more widespread with the advent of the Silicon Valley start-up phenomenon of the 1980s and 1990s. For some lawyers, the move was a wise one leading to unforeseen riches, while for others, both the company—and the remuneration— went bust. It didn't take long before the American Bar Association (ABA), as well as state bar associations, 'took stock' of what was going on the field of stock-for-legal services agreements and decided to explore the ethics of such an arrangement. The rules have now been broadened to include not just investing in lieu of legal fees but also the issues surrounding investment in a client's business, even outside the attorney-client context.

Entrance....and Exit

It is not uncommon for venture capital investors and initial employees of a startup to take equity in a new company because they are anticipating that by helping the company succeed, they will earn a significant reward at the time of a hoped-for short-term exit. The potential, of course, seems quite high at the beginning, especially for tech stocks, and an aggressive growth plan is a major attraction for seed money and beyond. However, if the client's business is based on a slow growth scenario or the intention to own and operate long term, then investment by the lawyer who takes equity rather than a present-value cash fee might make less sense. There is also the hybrid scenario whereby the lawyer takes a fee part in cash and part in securities, thus hedging his or her risk. However, even an acceptance of part of a fee by way of securities in a client's company raises the same ethical issues as if the lawyer were fully compensated in that manner.

A 2019 report on the top five startup law firms in Silicon Valley found that the average value of legal services expended by startups (excluding any litigation or significant IP issues) was $40,000. Before risking such a sum via investment in the client, the lawyer should seriously evaluate whether the motivation for taking securities over a traditional currency fee is to actually receive a fee—albeit deferred— for legal services rendered or, to simply invest in and help the client's entrepreneurial venture get off the ground.

ABA Formal Opinion

In July 2000, the ABA weighed in on the issue of lawyers taking securities from a client's business in lieu of a traditional fee. The ABA's Standing Committee on Ethics and Professional Responsibility issued Formal Opinion 00-418, which concluded that receiving stock in a client's company, either in payment of legal fees or even as an investment, did not violate the Model Rules of Professional Conduct. However, in all cases of investment in a client's business enterprise, the lawyer must make certain that Model Rule 1.8(a) is complied with. The Rule prohibits business transactions with a client unless:

(a) the deal is fair and reasonable to the client;

(b) its terms are fully disclosed to the client in writing;

(c) the client is advised in writing to consult independent legal counsel and given a reasonable opportunity to do so; and

(d) the client gives informed consent, in writing, to the transaction and the lawyer's role in it, including whether the lawyer is representing the client in the transaction.

"WHILE SOME LAW FIRMS UNDOUBTEDLY INVESTED SOLELY BECAUSE THE FIRM RECOGNIZED A PROMISING OPPORTUNITY TO MAKE MONEY, THE MAJORITY APPEAR TO HAVE ACTED OUT OF A CONCERN RELATED TO THE PRESERVATION AND NURTURING OF THE ATTORNEY-CLIENT RELATIONSHIP."

—Mary C. Daly, Professor of Legal Ethics at Fordham Law, and Chair, Committee on Professional and Judicial Ethics, Association of the Bar of the City of New York.

Notably, a lawyer who takes stock in the payment of legal fees or even invests with a client is deemed to have entered into a business relationship with that client.

Additional ABA Rules Compliance

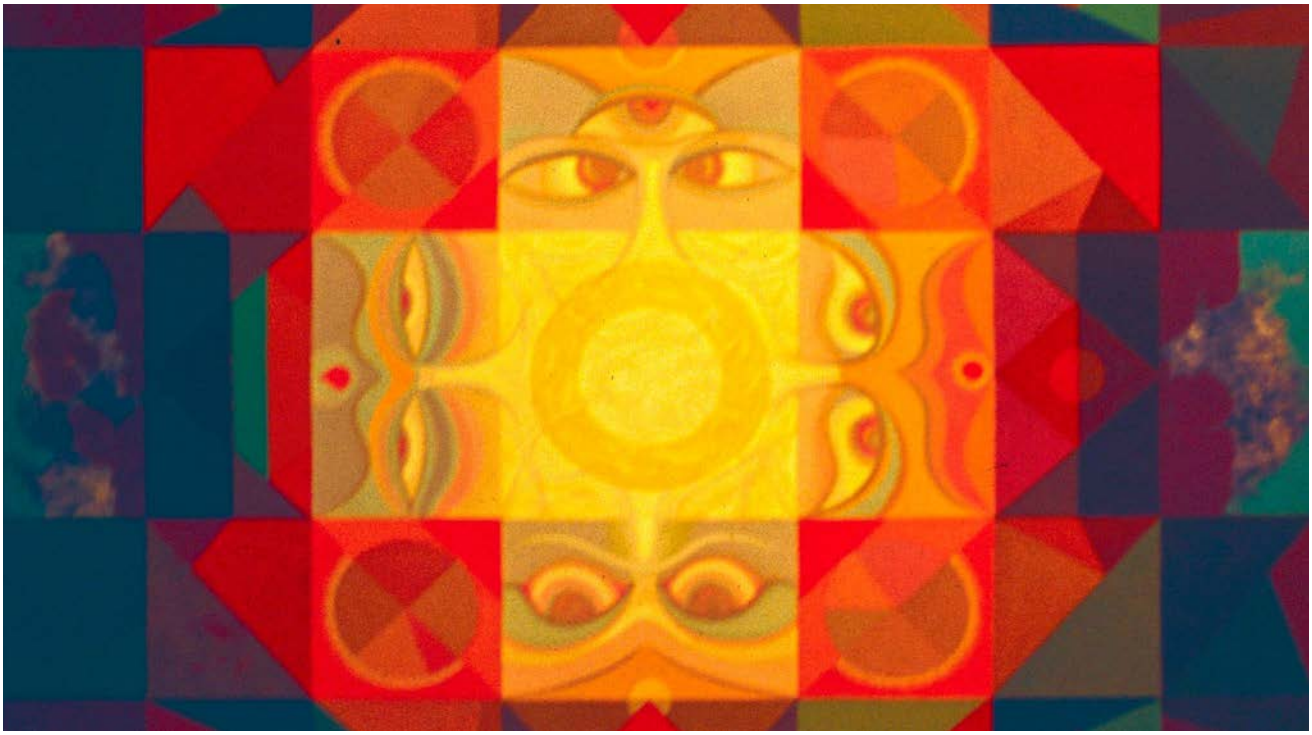
In addition to the ABA's year 2000 Rule 1.8, if the lawyer is representing the client in the business transaction, he or she must additionally comply with Model Rule 1.7 ('Conflict of Interest—Current Clients') governing "material limitation" conflicts. Those arise when the lawyer's financial interest in the transaction raises a 'significant risk' that representation of the client will be materially limited by the lawyer's own interests. Because of concern over real or perceived conflicts of interest, some larger firms actually prohibit their lawyers from investing in their clients' businesses.

Furthermore, when stock is received for legal fees, the lawyer must comply with Rule 1.5(a), which imposes its own reasonableness requirement that takes into consideration the rule's eight enumerated factors. In discussing how Rule 1.5(a) applies, The ABA has drawn an analogy to determining the 'reasonableness of a contingent fee', opining that 'only the circumstances reasonably ascertainable at the time of the transaction should be considered.' Problematically, neither Rule 1.5(a) nor its commentary has addressed when the time of the transaction occurs, leading some observers to conclude that the reasonableness should be measured both at the outset of the representation and when the fee becomes quantifiable.

Disclosure and Consent

Of particular importance is the extent of the lawyer's disclosure to the client when investing in the client's business and the level of informed consent obtained from the client. In addition to being in compliance with the ethics rules, obtaining clear, comprehensive, written confirmation of the terms of the investment will protect the attorney as well as the client, thereby reducing the risk of any misunderstanding arising between the attorney and the client. In compliance with Rule 1.8, the attorney must advise the client—preferably in writing—of the necessity of consulting with independent counsel.

Likewise, as in the case of all potential conflict of interest scenarios, the lawyer must obtain from the client informed consent as to the lawyer's investment with the client.



Risk to Reputation

It is not just the potential for the financial risk that is at stake when a lawyer decides to take stock in lieu of a traditional fee, but what should also be considered is the possibility that if the business venture fails, the client could scrutinize the representation as to deficiencies in the legal services provided. Although a client whose business fails might make such an assertion under any circumstances where the lawyer has invested and provided advice, the lawyer's defense to such a claim can be further complicated.

Particularly in light of the stresses placed on businesses over the court of the COVID-19 pandemic, the present environment for taking stock in lieu of a traditional fee is, at best, an uncertain one. For all of the foregoing reasons, the lawyer considering the same should proceed with caution.

Executive Summary

1. The Issue

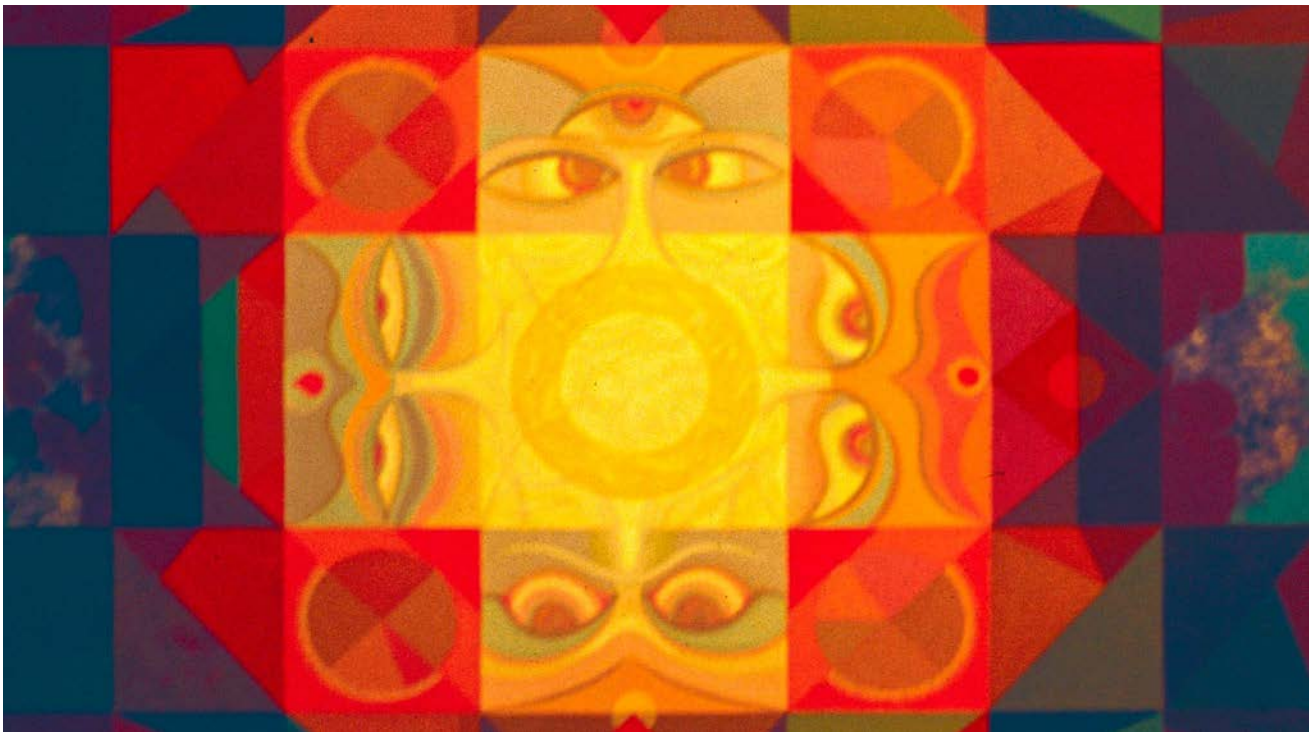
What are the ethical and risk considerations in taking stock in lieu of a traditional fee for legal services?

2. The Gravamen

Although not considered unethical to do so, the lawyer must strictly comply with the various Model Rules and State Bar Rules before undertaking a stock-as-fee arrangement.

3. The Path Forward

With the burgeoning number of startups requiring representation by lawyers, opportunities abound for taking stock as remuneration; however, those opportunities must be weighed against the potential for financial as well as professional risk.



Action Items:

1 Familiarity with Model Rules:

It is essential to fully understand not only the ABA Model Rules addressing the issue of taking stock in a client's venture but also one's State Bar Rules, which may not necessarily converge.

2 Full Disclosure:

An attorney's disclosure to the client should be in writing and thoroughly confirm the terms of the investment, thereby mitigating any claims of irregularity in the future.

3 Client's Informed Consent:

The client must be encouraged, in writing, to obtain independent advice regarding the lawyer's investment, and acknowledge the lawyer's recommendation—in writing— as part of the client's informed consent.

4 Financial Advice:

It is recommended that a lawyer engage the services of a financial professional in order to ascertain the value of the stock involved, thereby avoiding the possibility of an excessive fee resulting.

Further Readings

1. https://www.dentons.com/en/insights/newsletters/2018/march/21/practice-tips-for-lawyers/what-attorneys-should-know-about-investing-in-their-clients
2. https://www.nhbar.org/resources/ethics/ethics-corner-practical-ethics-articles/2000-11
3. https://www.lawpracticetoday.org/article/taking-equity-in-your-clients-as-a-legal-services-provider/
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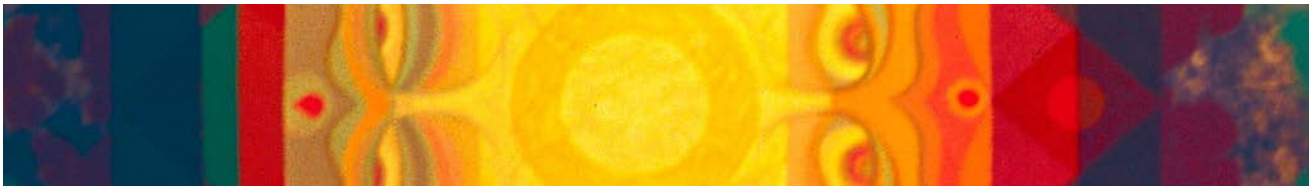

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After receiving his Juris Doctor degree from The John Marshall Law School in Chicago, Mr. Brochin served as an Administrative Law Judge with the Illinois Department of Labor for six years where he presided over cases dealing with job separation issues and matters pertaining to contested Unemployment Insurance claims. He also co-wrote the agency's administrative rules, and periodically served as a 'ghost writer' for Board of Review decisions. Following that position, he was Director of Development for a Chicago-area non-profit college where he was responsible for High Net Worth donations to the institution. For the next eighteen years he practiced as a solo practitioner attorney with an emphasis in the fields of Real Estate law and Commercial Contracts transactions, and was an agent for several national title insurance agencies.

In 2003 he was recruited to head up a U.S. title insurance research office in Israel, a position he held for four years, and between 2007-2017 he participated in litigation support for several high-profile cases. He has taught Business Law as a faculty member of the Jerusalem College of Technology, and has authored a wide variety of legal White Papers and timely legal articles as a professional legal content writer for GPL clients. Separate from his legal writing, he has co-authored academic articles on Middle East security topics that have been published in peer-reviewed publications.

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William Anderson is Managing Director and Head of Law & Compliance. He leads the GreenPoint practice in providing regulatory, legal, and technology solutions to law firms, legal publishers, and in-house law departments around the world, overseeing our team of experienced US attorneys and data and technology experts. Will has over 25 years' experience working with corporations to improve the management of their legal and corporate compliance functions. Will began his legal career as a litigator with a predecessor firm to Drinker, Biddle LLP. He then served as in-house counsel to Andersen Consulting LLP, managing risk and working with outside counsel on active litigation involving the firm.

Will has leveraged his legal experience interpreting regulations and appearing before federal (DOJ, SEC, FTC) and state agencies (NYAG) to oversee research and other areas at Bear Stearns. In this capacity, he counseled analysts on regulatory risk and evolving compliance requirements. Will also consulted on the development of a proprietary tool to ensure effective documentation of compliance clearance of research reports. Will then went on to work in product development and content creation for a global online compliance development firm pioneering the dynamic updating of regulated firms' policies and procedures from online updates and resources. Will holds a Juris Doctorate with High Honors from the Washington University School of Law in Saint Louis and is admitted to state and federal bars. He lives in Pawling, NY, with his wife and daughter.

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About GreenPoint Global

- GreenPoint Global provides litigation support, finance and technology solutions to insurers, law firms, banks, and in-house law departments through our subject matter experts and process specialists.
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