

STATE BAR ASSOCIATION OF NORTH DAKOTA

ETHICS COMMITTEE

OPINION NO. 96-13

OCTOBER 31, 1996

COPY

The committee has been asked to issue an opinion regarding whether a law firm can ethically enter into an agreement that provides for payment of certain fees to a nonlawyer entity.

FACTS

The law firm has been contacted by a nonlawyer company that has put together an electronic medium through which insurance companies can pass information regarding files to law firms (and vice-versa). The company charges a fee for the use of the system to both law firms and insurance companies.

The fee to the law firm is charged on a replication theory. Replication occurs when the law firm dials into the company and receives information concerning the case that the law firm is handling. It is anticipated that much or all of the communication between the law firm and the insurance company on any given matter will be handled through this system.

Fees would be charged on a per replication basis. The company has agreed to limit the charges that can be incurred on any one case to ten percent of the legal fees on that case. The replication fees would not be a cost that the firm would be charging back to the client.

The law firm would pay a fee for the right to be the sole

North Dakota firm in this system. Although the insurance companies using this system are free to choose other attorneys, it is anticipated that the insurance companies will want to use the attorneys who have signed onto the system, to get the full benefit of the system.

DISCUSSION

The critical question raised by these facts is whether the payments to the nonlawyer company constitute a sharing of fees or an ordinary firm expense.

If the payments constitute a sharing of legal fees, Rule 5.4(a) of the North Dakota Rules of Professional Conduct applies. Rule 5.4(a) states:

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

(1) An agreement by a lawyer with the lawyer's firm, partners, or associate may provide for the payment of money, over a reasonable period of time after the lawyer's death, to the lawyer's estate or to one or more specified persons;

(2) A lawyer who undertakes to complete unfinished legal business of a deceased lawyer may pay to the estate of the deceased lawyer that proportion of the total compensation which fairly represents the services rendered by the deceased lawyer; and

(3) 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 the profit-sharing arrangement.

See also Ethics Committee Opinion 93-01 at 2-3 (North Dakota 1993). None of the exceptions outlined in subparagraphs (1) through (3) are applicable. Therefore, if the payments constitute a sharing of fees, they are not allowed.

In considering whether the arrangement is a sharing of fees, it is important to go beyond the formal structure of the payments, to determine the actual purpose for which the payments are made. See, e.g., In re: Weinroth, 495 A.2d 417 (N.J. 1985) (attorney's returning of a portion of fees to client with knowledge that client would pay this amount to nonlawyer for his referral to the attorney warranted discipline); ABA/BNA Lawyers' Manual on Professional Conduct, Ethics Opinions (1991-1995) at 1001:6503 (New York County Opinion 697) ("A lawyer may not enter into a percentage lease agreement whereby her office rent is computed as a percentage of her firm's gross revenues."), 1001:7351 (Pennsylvania Opinion 95-106) ("A lawyer may not participate in an arrangement whereby the lawyer rents office space in a building where medical services are available, with patients to be referred to the lawyer, whose rent will be a percentage of the receipts generated at that location."); 1001:7922 (South Carolina Opinion 94-34) ("A lawyer may not participate as a member in a business exchange group where the lawyer would provide legal services to other members and would receive credit for the amount of the lawyer's usual rate fees, the credit would be used to purchase goods and service from other group members, and the lawyer would be required to pay a 10 percent commission to the exchange. Members are actually paying 10 percent more for legal services, the surcharge is paid to non-lawyers, and the lawyer would in effect be paying nonlawyers a commission to funnel work to the lawyer."); 1001:8733 (Virginia Opinion 1632) ("A lawyer may not participate in an arrangement with a 'lender service

bureau' run by lawyers who do no legal work, but assign work to area firms and [charge] a service fee for the work). Therefore, the fact that the above-described payments are nominally made "on a replication basis" does not end the inquiry.

The prohibition of sharing fees with nonlawyers forbids the payment of referral fees to nonlawyers. See, e.g., Committee on Professional Ethics and Conduct of the Iowa State Bar v. Lawler, 342 N.W.2d 486, 487-89 (Iowa 1984) (disciplining attorney for paying referral fees to nonlawyer); Bar Association of Greater Cleveland v. Protus, 372 N.E.2d 344 (Ohio 1978) (referral fees paid to fire adjusting company were improper sharing of legal fees with nonlawyers); In Re: Lebowitz, 414 N.Y.S.2d 735 (App. Div. 1979) (referral fees paid to nonlawyer who recommended attorney's services to criminal defendants were improper sharing of legal fees); Formal Interpretative Opinion No. 209 of the Mississippi Bar (May 28, 1993) ("A law firm may not share legal fees with a non-lawyer client referral service which has previously entered into a contingency fee contract with the client regarding a potential claim."); South Dakota Ethics Opinion 94-12 (June 15, 1994) ("paying the nonlawyer 5% of the fees generated for tax preparation would be an arrangement sharing legal fees with a nonlawyer which is clearly prohibited under Rule 5.4").

Ultimately, then, the key question is whether the above-described payments are referral fees paid for the considerable benefits of holding the North Dakota territory under the nonlawyer entity's system and retaining access to the electronic

communications system, or simply regular expenses. Under this analysis, the Committee believes that the payments outlined in the facts do not represent mere expenses. Rather, they appear to be fee-sharing referral payments to nonlawyers.

The ten percent cap itself suggests that the fundamental purpose of the payments is a sharing of fees in exchange for the privileges of being the sole North Dakota firm in the system and maintaining access to the system. If the payments were simply reasonable and ordinary payments for the expenses of electronic communication, there would be no need for a cap.

In addition, the facts outlined above suggest that the firm would not treat the replication payments as ordinary expenses. Despite the suggestion in the letter of inquiry that "[t]he replication fee is similar to the fee that is charged for doing computerized legal research," the fees are not similar to computer legal research fees. Unlike computer research fees, which are ordinarily paid by clients, the firm will not be charging the replication fees to the clients. If the replication fees were actually ordinary litigation expenses, the firm might be required to ultimately bill their insurance clients for these expenses in most instances. See Rule 1.8(e)(1) of the North Dakota Rules of Professional Conduct ("A lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter.") (emphasis added); Montana Ethics Opinion 950411 (distinguishing prohibited sharing of a portion of fees in collection actions with skip tracing and asset searching

firm from allowable payments charged to the client "in the same way that other items of expense are charged," quoting ABA Formal Op. 48). Also, computer legal research providers typically make their services available to all interested lawyers and legal researchers, rather than compiling a list of selected firms, each of which has special privileges over a given geographical area. Finally, computer legal research firms do not cap their charges at any percentage of the legal fees paid to law firms.

What the nonlawyer firm is really selling is a spot on its list of selected counsel, access to its electronic communications system, and the insurance work that the firm hopes to generate from its spot on the list and its access to the electronic system. The nonlawyer firm is charging the law firm a referral fee for this access. Although the firm will not be directly charging this fee to its clients, it will presumably have to recoup these fees somehow. This creates the very real possibility that the clients will ultimately be charged higher fees. The prohibition of fee sharing with nonlawyers exists, in part, to prevent such fee increases. See Center for Professional Responsibility, American Bar Association, Annotated Model Rules of Professional Conduct, Rule 5.4, "Legal Background," at 455 (2d ed. 1992), citing ABA Comm. on Ethics and Professional Responsibility, Formal Op. 87-355 (1987) (prohibition of fee sharing with nonlawyers avoids the possibility of a nonlawyer's interference with the exercise of a lawyer's independent professional judgment and ensures that the total fee paid by a client is not unreasonably high).

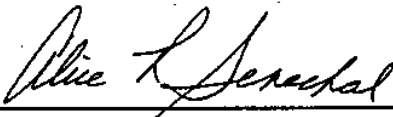
CONCLUSION

To the extent that the payments to the nonlawyer entity operating the electronic information exchange between law firms and insurance companies, capped at ten percent of the attorneys' fees generated in any case, constitute fee sharing in exchange for the privileges of access to the system and serving as designated North Dakota counsel in the nonlawyer's system of referring attorneys to insurance companies, not ordinary firm expenses, these payments would constitute improper fee sharing under Rule 5.4(a) of the North Dakota Rules of Professional Conduct.

This opinion is provided pursuant to Rule 1.2(B) of the North Dakota Rules for Lawyer Discipline. This Rule states:

A lawyer who acts with good faith and reasonable reliance on a written opinion or advisory letter of the ethics committee of the association is not subject to sanction for violation of the North Dakota Rules of Professional Conduct as to the conduct that is the subject of the opinion or advisory letter.

This opinion was drafted by Stephen D. Easton and was approved by a unanimous vote by the Committee on October 31, 1996.



Alice R. Senechal, Chair

[REDACTED]

[REDACTED]

September 6, 1996

Ethic Committee
c/o Sandi Tabor
Executive Director
State Bar Association
P.O. Box 2136
Bismarck, ND 58505

Re: Ethics Opinion

Dear Members of the Ethics Committee:

The [REDACTED] Law Firm represents numerous insurance companies as a part of its regular practice. The firm has recently been contacted by a company which has put together an electronic medium through which insurance companies can pass information regarding files in the company's system through to a law firm. The company which created the electronic medium charges a fee for the use of this system to both law firms and the insurance companies.

The fee to the law firm is charged on a replication theory. Replication occurs when the law firm dials into the company and receives information concerning the case that the law firm is handling. It is anticipated that much or all of the communication between the law firm and the insurance companies will be handled through the company which developed the system.

The replication fee is similar to the fee that is charged for doing computerized legal research. In an effort to cap the fees that could be assessed on any one file, the company which developed this system has agreed to limit the charges that can be incurred on any one case to 10 percent of the legal fees on that case.

The law firm recognizes that Rule 5.4 of the North Dakota Rules of Professional Conduct provides that a law firm is not to share legal fees with a non-lawyer, except in certain conditions not relevant here. The [REDACTED] Law Firm believes that any fee it would pay to the company for replication costs should be viewed in the same light as payment for a Lexus or West Law research. However, the [REDACTED] Law Firm requests that the Ethics Committee consider whether a program which caps its fee based upon a percentage of the

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total legal fees on a case might somehow be a violation of the Rules of Professional Conduct.

The [REDACTED] Law Firm would be pleased to provide any further information necessary to address this question.

Yours very truly,

[REDACTED]

10/2/96

[REDACTED]

September 19, 1996

[REDACTED]

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VIA FACSIMILE

Ethic Committee
c/o Sandi Tabor
Executive Director, State Bar Association
P.O. Box 2136
Bismarck, ND 58505

Re: Ethics Opinion

Dear Members of the Ethics Committee:

Sandi Tabor has asked me to supplement the information I presented to you in my recent letter of September 6, 1996. This letter is an effort to more fully describe the situation.

The company which created the system has approached both insurance companies and law firms in an effort to market their system. The insurance company theoretically benefits by purchasing the company's litigation management system and by having the company which created the system act as a hub for all communications between the insurance company and the law firm.

The law firms benefit since each firm pays a fee for the right to represent a territory, in this case the State of North Dakota. Although the insurance companies are free to choose other attorneys, it is anticipated that the insurance companies will want to use the attorneys who have signed on to the system, so that the insurance companies can get the full benefit of the system.

As I indicated in my prior letter, the law firms will be paying fees for the replication of information receive from the insurance company. For purposes of issuing the ethics opinion, you should assume that this replication fee is not a cost which we as the firm will be charging back to the client. This fee could be as high as ten percent of all fees earned on a particular case, but will be charged based on a per replication basis.

Please let us know whether you need any further information.

Yours very truly,

[REDACTED]