Utah Ethics Opinions

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Utah State Bar

Ethics Advisory Opinion Committee

Opinion No. 98-13

Approved December 4, 1998

Issue: What are the ethical obligations and considerations that govern a law firm's acceptance of a financial interest such as stock in a client company in return for performing legal services for that company?

Opinion: A law firm's acquisition of a financial interest such as stock ownership in a client, whether the investment is made directly by the law firm or through a blind trust, holding company, investment partnership or other investment vehicle, and whether the interest is acquired in exchange for legal services or whether the client's primary attorney is involved in investment decisions concerning the client's stock, is not *per se* unethical. However, in all such arrangements, counsel must comply with the requirements of Rules 1.5, 1.7(b) and 1.8(a) of the Utah Rules of Professional Conduct.

Factual background: It is reportedly common for a law firm for example, those representing high-tech, start-up companies in California to acquire financial interests in its clients in connection with legal services rendered to those firms. This may take the form of the client company's payment of common stock to a law firm for its legal services. Payment arrangements might also be structured as formal purchases of the client company's stock by the law firm, with an agreement that the cash paid for the purchase price be used by the company to pay legal fees charged by the law firm as services are rendered over time.

There are other variations on this general approach, including the use of mechanisms such as blind trusts, investment partnerships and other vehicles that operate in such a way that the client's primary attorney is not involved in the firm's decision on whether to invest in a client.

Analysis: Utah Rules of Professional Conduct 1.5 provides that a lawyer shall not enter into an agreement for, charge or collect an illegal or clearly excessive fee. A fee is clearly excessive when, after a review of the facts, a lawyer of ordinary prudence would be left with a definite and firm conviction that the fee is in excess of a reasonable fee.

This Committee has previously issued Opinion 97-05, (fn1) in which it reached the conclusion that accepting payment for legal services in a form other than money is not *per se* unethical. Nothing in the rules requires that payment be in money. The fundamental requirement is that the fee be reasonable.

We reach the same conclusion with regard to the application of Rule 1.5 to the present question. However, in addition to the factors specifically listed in Rule 1.5 that must be considered to determine the reasonableness of the fee, (fn2) the Committee believes that other factors should be considered by the lawyer in determining whether a fee in the form of equity ownership of a client is reasonable. These other factors include: (a) the liquidity of the client's stock, including whether the client's stock trades publicly at the time of the fee agreement and, if the stock is not publicly traded, the risk that the client's stock will not be publicly traded in the future; (b) the present and anticipated value of the client's stock, including the risks that a proposed patent or trademark may not be granted, that necessary government approvals (such as FDA approvals) may not be received; (c) whether the stock is subject to restrictions after the law firm receives it, and which affect the value of the stock to the lawyer; (d) the quantity of stock owned by the lawyer and whether the lawyer may exercise voting control over the client after receipt of the stock; and (e) any restrictions placed by the lawyer on the consideration paid for the stock.

Certainly, the analysis of whether the fee is reasonable will be more easily made when the client is a corporation whose stock is publicly traded, because the value of the consideration paid by the client can be readily determined. However, it is likely that most instances where the law firm takes the client's stock in payment of fees will occur with corporations whose stock is not publicly traded. In these instances, determining the value of the consideration paid by the client for the legal fees will be more difficult.

The lawyer and his firm should take steps to avoid confusion about whether the firm is acting as an independent legal advisor or as a business partner. Of course, the law firm must abide by any applicable securities regulations and requirements. In addition, the law firm should consider whether the client should be advised to seek independent counsel concerning the terms of the proposed arrangement for the payment of legal fees to the firm.

It is also true that a simple trade of stock for legal services is more easily assessed for reasonableness than is a

purchase of stock with a restriction that the client purchase an equivalent value of legal services. In the latter case, the lawyer receives both the stock and payment for legal services.

The law firm must also take care that any such arrangement does not run afoul of Rule 1.7(b), which provides in pertinent part: "A lawyer shall not represent a client if the representation of that client may be materially limited . . . by the lawyer's own interest, unless: (1) The lawyer reasonably believes the representation will not be adversely affected; and (2) Each client consents after consultation."

A lawyer holding stock in a client may be asked to advise the client on matters that may affect the value of the lawyer's own stock. The official comment to Rule 1.7(b) advises a cautious approach under such circumstances:

Loyalty to a client is also impaired when a lawyer cannot consider, recommend or carry out an appropriate course of action for the client because of the lawyer's other responsibilities or interests. The conflict in effect forecloses alternatives that would otherwise be available to the client. Paragraph (b) addresses such situations. A possible conflict does not itself preclude the representation. The critical questions are the likelihood that a conflict will eventuate and, if it does, whether it will materially interfere with the lawyer's independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the client. Consideration should be give to whether the client wishes to accommodate the other interest involved.

If the lawyer's representation of a corporate client may be materially limited by the lawyer's interest as a shareholder of the client, the lawyer must not undertake the representation or provide legal advice, unless the lawyer reasonably believes the representation or advice will not be adversely affected, and the client consents after a full disclosure to the client of the possibly adverse consequences of the lawyer's ownership of the client's stock. The lawyer should consider whether stock ownership would disqualify the lawyer from representing the client in any existing matters.

Whether the law firm accepts stock in payment of legal fees or actually buys stock in the client, with the funds paid to the client for the purchase earmarked for the payment of legal fees to the client, the law firm must also comply with Rule 1.8(a), which provides:

a. A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

1. The transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which can be reasonably understood by the client; and

2. The client is given a reasonable opportunity to seek the advice of independent counsel in the transaction; and

3. The client consents in writing thereto.

The Comment to Rule 1.8 states that "Paragraph (a) does not, however, apply to standard commercial transactions between the lawyer and the client for products or services that the client generally markets to others, for example, banking or brokerage services, medical services, products manufactured or distributed by the client and utility services."

It could be argued that the acquisition of a client's stock for cash, or in exchange for legal services valued at the customary and reasonable hourly rates of the lawyer, for the stock price the client generally sells the stock to others is a "standard commercial transaction" not requiring compliance with Rule 1.8(a). However, the Committee believes that Rule 1.8(a) was intended to apply to any transaction with a client in which the lawyer acquires an ownership interest in the client.

Rule 1.8(a) requires that: the transaction be fair and reasonable to the client; the terms of the transaction be fully discussed with the client and transmitted in writing to the client in understandable terms; the client be given a reasonable opportunity to obtain the advice of independent counsel in the transaction; and the client consent to the transaction in writing.

The Committee believes that the same factors discussed above with regard to Rule 1.5 would also apply in determining whether the law firm's purchase of stock in a client comports with the requirement of Rule 1.8(a) that the terms of the transaction be reasonable and fair.

While owning the stock in a blind trust, holding company, investment partnership or other investment vehicle results in the law firm's being one step removed from its client, the same analysis must be applied under Rules 1.5, 1.7(b) and 1.8(a). The fee charged must still be reasonable. The lawyer must reasonably believe that the representation of the client will not be adversely affected by the firm's stock ownership through an investment vehicle, and the client must consent after consultation to the representation. A transaction under which the firm obtains ownership in the client through the firm's investment vehicle must still be fair and reasonable to the client; the client must be given a reasonable opportunity to seek the advice of independent counsel in the transaction;

and the client must consent in writing to the transaction. Furthermore, whether the client's primary attorney is involved in the investment decision and whether the funds paid for the stock are earmarked for payment of the firm's fees, while factors in any Rule 1.5, 1.7 and 1.8 analysis, will not be determinative of whether the fee is reasonable, whether there is an impermissible conflict, or whether the transaction between the law firm and client is fair and reasonable to the client.

In other words, the law firm must comply with Rules 1.5, 1.7(b) and 1.8(a), regardless of whether the firm owns the stock outright or through an investment vehicle, whether the client's primary attorney is involved in the law firm's investment decision, or whether the firm receives stock directly in payment of fees or buys the stock with the purchase funds earmarked for payment of fees.

Footnotes

1. Utah Ethics Advisory Op. No. 97-05, 1997 WL 223851 (Utah State Bar).

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(1) The time and labor required, the novelty and difficulty of the questions involved and the skill requisite to perform the legal service properly; (2) The likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer; (3) The fee customarily charged in the locality for similar legal services; (4) The amount involved and the results obtained; (5) The time limitations imposed by the client or by the circumstances; (6) The nature and length of the professional relationship with the client; (7) The experience, reputation and ability of the lawyer or lawyers performing the services; and (8) Whether the fee is fixed or contingent.

Utah Rules of Professional Conduct 1.5(a).

Rules Cited:

1. 5

1.7(b)

1.8(a)