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Fee Sharing under the Model Rules of Professional Conduct and the Bankruptcy Code

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On August 19, 2013, the the Standing Committee on Ethics and Professional Responsibility of the American Bar Association (the "ABA") issued Formal Opinion 464 ("Opinion 464"). Opinion 464 seeks to clarify the scope of Rule 5.4(a) of the Model Rules of Professional Conduct (the "Model Rules"), which, except in limited circumstances, prohibits lawyers from sharing or splitting legal fees with nonlawyers. Opinion 464, in particular, addresses the division of legal fees with other lawyers or law firms practicing in jurisdictions whose rules allow the sharing of fees with nonlawyers. As will be explained below, the ABA has opined that:

Lawyers subject to the Model Rules may work with other lawyers or law firms practicing in jurisdictions with rules that permit sharing legal fees with nonlawyers. Where there is a single billing to a client in such situations, a lawyer subject to the Model Rules may divide a legal fee with a lawyer or law firm in the other jurisdiction, even if the other lawyer or law firm might eventually distribute some portion of the fee to a nonlawyer, provided that there is no interference with the lawyer's independent professional judgment.[1]

A. Brief Overview of Model Rules 1.5(e) and 5.4(a)

Model Rule 1.5(e) permits the division of legal fees between lawyers who are not in the same firm, but only if three conditions are satisfied. Those three conditions are:

1. the division is in proportion to the services performed by each lawyer or each lawyer assumes joint responsibility for the representation;
2. the client agrees to the arrangement, including the share each lawyer will receive, and the agreement is confirmed in writing; and
3. the total fee is reasonable.

Model Rule 5.4(a) prohibits lawyers from sharing or splitting legal fees with nonlawyers unless the following conditions are satisfied:

1. an agreement by a lawyer with the lawyer's firm, partner, 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 purchases the practice of a deceased, disabled, or disappeared lawyer may, pursuant to the provisions of Rule 1.17, pay to the estate or other representative of that lawyer the agreed-upon purchase price;
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 a profit-sharing arrangement; and
4. a lawyer may share court-awarded legal fees with a nonprofit organization that employed, retained or recommended employment of the lawyer in the matter.

B. Opinion 464 Clarifies Interaction Between Model Rules 1.5(e) and 5.4(a)

Model Rules 1.5(e) and 5.4(a) appear straightforward in application. However, not all jurisdictions subject lawyers to the restrictions of Model Rules 1.5(e) and 5.4(a). The ABA cites the District of Columbia as one such example in Opinion 464. The District of Columbia's Rule 5.4(b) of the Rules of Professional Conduct expressly allows "an individual nonlawyer who performs professional services which assist the organization in providing legal services to clients" to hold a financial interest in or exercise managerial authority in a law firm.

Thus, there may be instances when a client may require the legal services of a lawyer, who is in a jurisdiction that follows Model Rule 5.4, and the legal services of a lawyer in a District of Columbia law firm, which is in a jurisdiction that follows a variant of Model Rule 5.4. In this situation, if the requirements of Model Rule 1.5(e) are satisfied, the ABA explains in Opinion 464 that the lawyer who is subject to the Model Rules will not violate Model Rule 5.4(a).[2] This is because Model Rule 1.5(e) allows lawyers to share fees with another lawyer; and so, "[a]ny concerns of the lawyer subject to the Model Rules regarding inter-firm division of legal fees should end at that point."[3] The fact that it may be permissible for the other lawyer to share its fees with nonlawyers (as may be the case in the District of Columbia, for example), does not result in a violation of Model Rule 5.4(a).[4]

The ABA further explains that Opinion 464 is consistent with the Model Rules because the sharing of legal fees between lawyers from different firms and jurisdictions under Model Rule 1.5(e) does not implicate the underlying concerns of Model Rule 5.4(a).[5] Model Rule 5.4(a) addresses the professional independence of lawyers and is intended to safeguard against any undue influence from nonlawyers on the judgment of lawyers. The ABA reasons that a nonlawyer, in the District of Columbia for example, is not likely to influence the judgment of a lawyer who practices in another jurisdiction at a different firm and is subject to the Model Rules.[6]

Although Opinion 464 clarifies that lawyers may share fees with lawyers or law firms who are subject to different rules concerning nonlawyers, the ABA cautions and reminds lawyers that the requirements under Model Rule 5.4(c) for professional independence remains immutable. "[T]he prohibition against improper nonlawyer influence continues regardless of the fee arrangement."[7]

C. **Fee Sharing in the Context of a Bankruptcy Case**[8]>

The relevance of Opinion 464 on fee sharing in the context of a case commenced under title 11 of the United States Code (the "Bankruptcy Code") requires a quick review of some of the applicable provisions of the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules").

D. **Section 504 of the Bankruptcy Code**

Section 504 of the Bankruptcy Code governs the sharing of compensation. In general terms, section 504 prohibits persons of different firms from sharing fees with one another in a case.[9] This prohibition is applicable to any "person receiving compensation or reimbursement under section 503(b)(2) or 503(b)(4)" and includes trustees, ombudsmen, examiners, attorneys, accountants, appraisers, auctioneers, and other professional persons employed under section 327 or 1103 of the Bankruptcy Code.[10] This prohibition even extends to the use of subcontractors by professionals retained by the debtor.[11] As one court put it in discussing section 504: "Could there be a provision of the Code less susceptible to misunderstanding? Not likely."[12]

Policy reasons behind section 504 include preserving the integrity of the bankruptcy process, protecting against the potential for outside influences that the court has no knowledge of or control over, and protecting against the potential for the inflation of fees to make up for the amount shared.[13]

These policies indicate that the statute was promulgated to prevent certain forms of fee sharing agreements that undermine the integrity of the bankruptcy proceeding, most commonly involving the sharing of compensation between two parties when one party is given a referral fee, or when one party appointed by the court hires another party to work on the case without court approval.[14]

E. **Section 329 of the Bankruptcy Code**

Section 329 of the Bankruptcy Code addresses certain disclosures concerning compensation paid or agreed to be paid to the debtor's attorney.[15] If compensation was paid or an agreement to be paid was made within a year prior to the date the bankruptcy petition was filed, then the debtor's attorney is required to file a statement detailing the compensation paid or agreed to be paid for "services rendered or to be rendered in contemplation or in connection with the case," as well as the source of funds for the compensation.[16] The disclosure is mandatory regardless of whether the attorney applies for compensation and is a continuing requirement.[17]

F. **Bankruptcy Rule 2016**

Bankruptcy Rule 2016 implements the requirements of sections 329, 330 and 331 of the Bankruptcy Code and sets forth the general procedures relating to applications for compensation of services or reimbursement of expenses. Among other things, Bankruptcy Rule 2016 requires the applicant to include a statement "whether any compensation previously received has been shared and whether an agreement or understanding exists between the applicant and any other entity for the sharing of compensation received or to be received for services rendered in or in connection with the case, and the particulars of any sharing of compensation or agreement or understanding therefor[.]"[18] In addition, every attorney representing a debtor, regardless of whether the attorney applies for compensation, must file the statement required under section 329 of the Bankruptcy Code, including whether the attorney has shared or agreed to share the compensation with any other entity and the particulars of the same.[19]

G. **Opinion 464 in the Context of Bankruptcy Case**

Based on the foregoing, it is evident that the Bankruptcy Code and the Bankruptcy Rules generally mandate the disclosure of, and the prohibition of, fee sharing in connection with the bankruptcy case. The ABA's recent clarification of Model Rules 1.5(e) and 5.4(a) in Opinion 464 does not appear to change that.

First, even though Opinion 464 clarifies that lawyers may share fees with lawyers or law firms who are subject to different rules concerning nonlawyers, section 504 of the Bankruptcy Code is more restrictive and expressly prohibits, except in limited circumstances, a person who seeks the allowance of compensation or reimbursement as an administrative expense under section 503(b)(2) or 503(b)(4) from sharing or agreeing to share the compensation or reimbursement with a person from another firm. Therefore, it is of no moment that applicable state rules of professional conduct may allow the sharing of fees with an attorney from another firm. The prohibitions of section 504 remain in force and relying on fee sharing and fee arrangements is ill-advised.[20] In short, the prudent course of action is for professionals to file separate retention applications. On the other hand, if an attorney is not required to seek a court's approval for its employment or for the allowance of compensation or reimbursement because he/she/it represents, for example, an ordinary creditor in the case, then concerns of fee sharing by that attorney do not appear to be within the purview of sections 329 and 504 of the Bankruptcy Code and Bankruptcy Rule 2016.

Second, to the extent fees were shared or an agreement to share exists, the attorney seeking compensation is still required to comply with section 329 of the Bankruptcy Code and Bankruptcy Rule 2016 concerning the disclosure of any fee sharing and any agreements to share. The Model Rules do not excuse nondisclosure and the failure to disclose can lead to disgorgement.[21] Therefore, the fact that an attorney may share fees with another lawyer, who may permissibly share its fees with nonlawyers, does not alter that attorney's disclosure obligations.

In conclusion, Opinion 464 clarifies a fee sharing issue: lawyers may share fees with lawyers or law firms who are subject to different rules concerning nonlawyers. The conclusion reached by the ABA in Opinion 464 does not disrupt or otherwise change the current limitations on, and the necessary disclosures of, fee sharing and agreements to share that are set forth in the Bankruptcy Code and Bankruptcy Rules, to the extent applicable.

1. *Opinion 464*, at p. 1.

2. In an earlier opinion ("Opinion 91-360"), the ABA addressed the issue over which rule governs a lawyer's conduct when: (1) the lawyer is admitted to practice in the District of Columbia and is a partner in a District of Columbia firm that has nonlawyer partners, and (2) the lawyer is also admitted to practice in another jurisdiction that abides by Model Rule 5.4(b). Opinion 91-360, however, did not directly address fee sharing issues that may arise when a lawyer in a jurisdiction following the Model Rules represents a client in a matter that involves another lawyer or law firm in a jurisdiction that does not follow the Model Rules.

3. *Opinion 464*, at p. 3.

4. *Id.*

5. *Opinion 464*, at p. 4.

6. *Id.*

7. *Id*.

8. Because Opinion 464 is directed to attorneys, the analysis herein is likewise limited to attorneys and their obligations with respect to fee sharing under the Bankruptcy Code and Bankruptcy Rules.

9. Limited exceptions are provided for the sharing of fees between (i) persons within the same firm and (ii) attorneys contributing professional services in the filing of an involuntary bankruptcy petition. 11 U.S.C. §§ 504(b)(1), 504(b)(2). The fee sharing prohibition also does not apply to sharing with bona fide public service attorney referral programs operating in accordance with non-Federal laws regulating attorney referrals and with state rules of professional responsibility. *Id*. at § 504(c). 11 U.S.C. § 504(a).

10. The term "person" is defined in section 101(41) of the Bankruptcy Code.

11. 11 U.S.C. §§ 327(a) (requiring court approval of all professionals rendering services to debtor); and 330 (empowering court to award compensation to professionals employed under sections 327 or 1103); *see In re ACandS, Inc.*, 297 B.R. 395, 404-05 (Bankr. D. Dela. 2003) (finding professional violated section 504 by sharing fees with own subsidiary under subcontracting arrangement and that subsidiary was separate entity requiring separate retention application); *In re United Cos. Fin. Corp.*, 241 B.R. 521, 528 (Bankr. D. Dela. 1999) (holding parties may not avoid section 327(a) by using subcontracting arrangements because approval of such arrangements would "allow a third party (rather than the debtor or the Court) to determine who should render professional services for the estate.").

12. *In re Egwu*, No. 10-30652, 2012 Bankr. LEXIS 4930, at *13 (Bankr. D. Md. Oct. 19, 2012).

13. *See In re Egwu*, 2012 Bankr. LEXIS 4930, at *12-13; *In re Winstar Communications, Inc.*, 378 B.R. 756, 760 (Bankr. D. Del. 2007).

14. *In re Winstar Communications, Inc.*, 378 B.R. at 760.

15. 11 U.S.C. § 329(a).

16. *Id*.

17. *Id*.

18. Fed. R. Bankr. P. 2016(a).

19. Fed. R. Bankr. P. 2016(b).

20. *See In re AGE Refining, Inc.*, 447 B.R. 786, 798-99 (Bankr. W.D. Tex. 2011) ("Importantly, the prohibition on fee sharing applies even though such fee sharing (or fee-splitting) might otherwise be authorized under the state bar rules applicable to the professionals."); *Goldberg v. Vilt (In re Smith)*, 397 B.R. 810, 818-19 (Bankr. E.D. Tex. 2008) ("[A] professional cannot escape the reach of § 504 by relying upon the fact that such a fee-sharing arrangement with attorneys outside of his firm may be acceptable in other circumstances in other jurisdictions.").

22. *See, e.g., In re Futuronics Corp.,* 5 B.R. 489, 499-500 (S.D.N.Y. 1980), *aff'd*, 655 F.2d 463 (2d Cir. 1981) (denying all of attorneys' fees because of nondisclosure of fee sharing arrangement between two law firms); *In re Egwu*, No. 10-30652, 2012 Bankr. LEXIS 4930, at *13 (Bankr. D. Md. Oct. 19, 2012) (court denying fee application because of attorney's failure to disclose fee sharing arrangement in violation of "non-waivable, independent duty on attorneys to disclose their fee arrangements").