BBA ETHICS COMMITTEE OPINION 1999-B:
Ownership of an Affiliated Business Entity by a Law Firm

Summary of Opinion

A law firm may own an affiliated business entity that provides law-related services to customers who may or may not be clients of the law firm. The law firm may co-own such an ancillary business with a nonlawyer, but co-ownership will bar the ancillary business entity from practicing law, and therefore requires separation of the law firm's functions from the ancillary business's functions. If the business is owned solely by lawyers, no such separation is necessary, so long as those customers of the business who are not also clients of the law firm understand fully that the services they receive are not protected by an attorney-client relationship. The law firm's duties regarding confidentiality, conflicts, and advertising may also be affected by its ownership of the business. Finally, the relationship between the law firm and any owned ancillary business must account for the provisions of the Massachusetts Rules governing business transactions between a lawyer and her client, which will apply in some instances.

Background and Factual Summary

A law firm has inquired of the Ethics Committee for advice regarding a proposed business arrangement. The law firm has developed expertise in the field of human resources (HR) and employer/employee relations. It works closely and regularly with an individual, not a lawyer, who possesses extensive experience and qualifications in the area of human resources ("the HR specialist"). The law firm wishes to establish a business entity with the HR specialist to provide HR services to customers who may or may not be clients of the law firm. The resulting business will permit the law firm to offer a comprehensive, full-service package of benefits to employers. The law firm wishes to know whether the new Massachusetts Rules of Professional Conduct limit its freedom to establish such a business. In particular, the law firm prefers, if the Rules permit, to provide its nonlawyer HR specialist with an equity interest in the HR business, and asks whether that arrangement would be permitted.

Opinion

1. Ancillary Business Principles Generally[1]

The Massachusetts Rules of Professional Conduct ("the Rules") permit law firms to develop ancillary businesses, subject to two important limitations. First, the entity which practices law may not permit any ownership interests to be held by any nonlawyer; and second, the businesses may not share legal fees with a nonlawyer. The new Rules, while more explicit and explanatory than the predecessor Code of Professional Responsibility on these questions, continue a long-standing prohibition within the legal profession against nonlawyers owning, or sharing in the profits of, a law practice.

We begin our analysis with Rule 5.7. Under that provision's definitions, the HR services offered by the law firm (whether supplied directly by the law firm or through an affiliated entity) qualify as "law related services," described as

> services that might reasonably be performed in conjunction with and in substance are related to the provision of legal services, and that are not prohibited as unauthorized practice of law when performed by a nonlawyer. (Rule 5.7(b).)

The HR services satisfy this definition. The law firm in question has provided HR services as part of its legal representation in the past, presumably in order to offer a fuller and more comprehensive "one-stop shopping" benefit to its clients. HR services, though, can lawfully be provided by nonlawyer specialists in various aspects of employer-employee relations. HR services are, therefore, "law-related services" for purposes of Rule 5.7.

Rule 5.7 assumes, rather than declares, that a law firm may provide law-related services to individuals who may or may not be clients of the law firm.[2] The Rule's purpose is to define which customers purchasing the ancillary services ought to be treated as clients of the firm, and which customers are not deemed clients. In short, customers will be treated as clients when the law firm provides the law-related services in a manner which is not distinct from its legal services, as well as when the services are provided through an affiliated business without making clear to the customers of that business that they are not clients of the lawyers. Rule 5.7(a)(1), (2).

With Rule 5.7 as our guidance, we easily conclude that the inquiring law firm may provide HR services either through the firm itself, or through an affiliated separate entity which the law firm controls. That conclusion in turn raises several professional ethics questions. In this Opinion we address the following:

> a) Under what circumstances may the nonlawyer HR specialist own an interest in the ancillary business?
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> b) Under what circumstances are "customers" of the HR business also "clients" of the law firm?
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> c) Does a referral of a client by a law firm lawyer to the HR specialist constitute a "business transaction" between the lawyer and her client, triggering the provisions of Rule 1.8?
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> d) What are the confidentiality obligations of the HR specialist?
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> e) Can HR business "customers" trigger conflict of interest and disqualification obligations for the law firm?
>
> f) How do the advertising, solicitation, and referral rules implicate the law firm/HR business operations?

The answers to these questions may differ depending upon whether the ancillary business is operated "in-house" within the law firm or as a separate organizational entity. This Opinion therefore addresses those two situations separately.[3]

2. In-House Provision of Law-Related Services

We address each of the above questions first in the context of an ancillary HR business operated entirely in-house, as part of the law firm and without a separate organizational entity.

a) Ownership by nonlawyers: If the law firm were to provide HR services from within the law firm itself, the HR specialist cannot be a member, partner, or otherwise own any part of the law firm. Rule 5.4(b) of the Massachusetts Rules of Professional Conduct declares that "[a] lawyer shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law," and Rule 5.4(d) similarly bars corporate ownership of a law firm by a nonlawyer. In addition, Rule 5.4(a) provides that "[a] lawyer or law firm shall not share legal fees with a nonlawyer," subject to certain exceptions (one of which we discuss immediately below). Neither of these provisions precludes the nonlawyer HR specialist from being an employee of the law firm, but both preclude him from owning an interest in the firm.

One of the exceptions listed in Rule 5.4(a), though, permits the law firm to offer to the HR specialist an interest in the profits of the firm if that interest is created through "a compensation ... plan ... based in whole or in part on a profit-sharing arrangement." Rule 5.4(a)(3). We read this exception to permit compensation to the HR specialist tied to the firm's overall net profits, although we agree with other jurisdictions that such a plan cannot calculate the nonlawyer's compensation by reference to any particular fee from any particular client or clients. See, e.g., Laws. Man. on Prof. Conduct (ABA/BNA) 41:803-04 (1990); ABA Comm. on Ethics and Prof. Resp., Informal Op. 1440 (1979); State Bar of Mich. Standing Comm. on Prof. and Judicial Ethics, Op. RI-104 (1991) (1991 WL 519857).[4]

The HR specialist serving as an employee of the law firm cannot exercise control over any lawyer with respect to any matters constituting the practice of law. The law firm must also take measures to comply with Rule 5.3, covering supervision of nonlawyers working in law firms, to ensure that the HR specialist does not engage in the unauthorized practice of law, or engage in activity which would violate the lawyers' professional obligations.

b) "Customers" versus "clients": We now address which consumers of services qualify as "clients" of the law firm. Let us first consider those customers who approach the HR business solely for HR services. In the in-house context, the law firm has a distinct choice. It may treat those HR customers as clients, in which case all of the obligations owed to clients by the law firm will adhere. Alternatively, the law firm may opt instead to treat those customers other than as clients. We understand that choice to leave the customers without "the protections normally afforded as part of the attorney-client relationship." Rule 5.7, Cmt. [1]. Absent obligations arising from other sources, such as the common law of agency or fiduciary duty (about which we may not comment here), the law firm and its nonlawyer employees may charge fees, reveal or use information, represent conflicting interests, and so forth, unconstrained by the Rules of Professional Conduct.

Some customers, though, will receive a package of legal services from the lawyers and law-related services from the nonlawyers (or, perhaps, from the lawyers). We assume that in most instances these "hybrid" customers will be treated by the lawyers as "clients" for all purposes. But that conclusion is not inevitable. We read the Comment to Rule 5.7 as permitting treatment of a hybrid customer as a client for purpose of the legal services but as a "non-client" for purpose

of the non-legal services, with protections arising from the former but lacking in the latter. See Rule 5.7, Cmt [4]. Our opinion is that such arrangements, while not impermissible, are subject to misunderstanding by the customer. Rule 5.7 obligates the entity to warn the customer that certain items within the package of services do not qualify as "legal," and stresses the need for clarity and understanding:

> In taking the reasonable measures referred to [above] to assure that a person using law-related services understands the practical effect or significance of the inapplicability of the Rules of Professional Conduct, the lawyer should communicate to the person receiving the law- related services, in a manner sufficient to assure that the person understands the significance of the fact, that the relationship of the person to the business entity will not be a client-lawyer relationship. The communication should be made before entering into an agreement for provision of or providing law-related services, and preferably should be in writing.

Rule 5.7, Cmt [6]. We echo and emphasize that concern. The Comments also conclude that under some circumstances "the legal and law-related services may be so closely entwined that they cannot be distinguished from each other," and therefore the lawyers may not suggest that part of the package is devoid of protection. Rule 5.7, Cmt [8].

c) Referrals and Rule 1.8: When the law-related services are provided to clients in-house, and not through a separate entity, the law firm need not comply with Rule 1.8(a) regarding business transactions with clients. Comment [5] to Rule 5.7 requires compliance with Rule 1.8(a) only in the case of a referral to "a separate law-related service entity controlled by the lawyer, individually or with others ...." We read this language as not implicating 1.8(a) when law-related services are provided within the law firm as part of an on-going attorney-client relationship. Of course, the law firm must, as always, comply with Rule 1.7(b) regarding conflicts of interest caused by the lawyer's financial interests. Depending on the facts of a given transaction, a referral by a lawyer to its in-house HR specialist may implicate Rule 1.7(b).

d) Confidentiality: The law firm owes full confidentiality duties to all "clients," and no such duties (subject to substantive law commitments) to its HR services "customers." With respect to the duty of confidentiality owed to the firm's clients, the HR specialist operating in-house is a firm employee, who may have general access to firm confidences and files (absent some specific client request) and owes a duty of confidentiality to all firm clients, just as any secretary, paralegal, or other employee. See Rules 1.6, Cmt [8]; 5.3(a).

e) Conflicts of interest: If a law firm treats its customers not as clients, an implication arises that those customers trigger no conflict of interest responsibility under Rules 1.7 and 1.9. We agree. Those Rules can have no applicability to non-client customers, although we do not consider whether the common law of agency would suggest a different answer. We disagree with Michigan ethics opinion to the contrary. See State Bar of Mich. Standing Comm. On Professional and Judicial Ethics, Op. RI-135 (1992) (1992 WL 510826).

f) Advertising and solicitation: Here we reach the question of how the firm's ancillary business communicates with the persons before they transact business. We offer the following observations.

i) Advertising: A law firm with an in-house ancillary business must comply with Rule 7.2 as it advertises its multiple functions. See Rule 5.7, Cmt [10]. It is acceptable for the law firm to indicate its association with the ancillary business on its (the law firm's) advertising or its letterhead. See State Bar of Mich. Standing Comm. On Prof. and Judicial Ethics, Op. RI-135 (1992) (1992 WL 510826); but see N.J. Sup. Ct. Advisory Comm. on Prof. Ethics, Op. 657 (1992) (1992 WL 257816) (joint advertising not permitted).

ii) Solicitation: Lawyers or nonlawyers engaged in law-related business may solicit customers for that business without regard to Rule 7.3, but may not solicit clients for law business in violation of Rule 7.3. To the extent that Comment 10 to Rule 5.7 implies anything to the contrary, we choose to harmonize that Comment with the text and plain intention of the Rule.

3. Provision of Services Through a Separate Entity

Instead of providing ancillary services in-house, a law firm may opt to establish a separate affiliated business through which to provide law-related services. By "separate" we mean organizationally separate, even if the entity is located physically within the same space as the law firm. An example may help: Assume that the law firm established a separate corporate entity with the trade name "HR Services, Inc." That entity could be owned wholly by the law firm, or in conjunction with the HR specialist. We address the above questions in this context. We note, though, that the applicable rules and standards (and hence our comments) apply only to the law firm, and not to a separate business entity. The suggestions that follow are therefore aimed at the law firm and its responsibilities when affiliated with an ancillary business.

a) Ownership by nonlawyers: As a separate entity, HR Services, Inc. could be owned wholly by the law firm lawyers or, alternatively, by the lawyers and the HR specialist. Nothing prohibits the HR specialist from owning an interest in the ancillary business. The choice of ownership model, though, affects the work that the business could do.

If the law firm owned HR Services outright, customers of HR Services could receive legal and non-legal services in an integrated way. Any charges for the various services could be combined if the entity so chose, since there would be no need to segregate legal fees from non-legal fees. Because the entity would be wholly owned by lawyers, it could practice law if it so chose (subject to the risk that the HR specialist's activity might be deemed to be the practice of law if sufficient care is not taken). The fact that this partly law-practicing entity employs the trade name "HR Services" would not be a problem under the new Rules, "so long as [the trade name] is not misleading." Rule 7.5, Cmt [1].[5]

If the law firm instead owned HR Services along with the HR specialist, the entity could not offer any legal services to its customers through HR Services. All legal work would need to be performed by the original law firm, with separate billings by the law firm for the legal work. This option permits some control by the law firm of the affiliated business and some equity

interest for the HR specialist, but requires rigorous separation of the provision of services. While lawyers may provide the HR services through this entity, we note that some ethics opinions have concluded that certain law-related work that would not ordinarily constitute the practice of law if performed by nonlawyers alone may constitute the practice of law if lawyers are associated with the nonlawyers in the performance of the work. See New York State Bar Ass'n Comm. on Prof. Ethics, Op. 633 (1992 WL 348745) (financial planning and debt consolidation); Maine Board of Bar Overseers Prof. Ethics Comm., Op. 158, reprinted in 13 Laws. Man. on Prof. Conduct (ABA/BNA) 137 (May 28, 1997)(lobbying).

b) "Customers" versus "clients": If HR Services, Inc. were owned in part by the HR Specialist, the business could not practice law, so no customer would be a "client" absent a separate independent agreement with the law firm. If HR Services, Inc. were owned solely by the law firm, by contrast, the same principle applicable to the in-house arrangement would apply here. As in Part 2(b) of this Opinion above, we emphasize here the critical obligation on the part of the business to ensure that all customers appreciate that no attorney-client protections apply, and the consequences arising therefrom. See Rule 5.7, Cmt. [6].

c) Referrals and Rule 1.8: Comment [5] to Rule 5.7 requires compliance with Rule 1.8(a) in the case of a referral to "a separate law-related service entity controlled by the lawyer, individually or with others ...." Thus, unlike in the in-house context, Rule 1.8 is triggered by a referral from the law firm to HR Services, Inc. This obligation *only* applies to the lawyers with an interest in the HR business. If a group of lawyers in a firm owns HR Services, Inc., and a different lawyer in that firm refers her client to the business, she need not comply with Rule 1.8, for she has not, under these facts, "enter[ed] into a business transaction with a client." Rule 1.8(a). The Comment to Rule 5.7 arrives at the same conclusion: "When a client-lawyer relationship exists with a person who is referred by a lawyer to a separate law-related service entity controlled by the lawyer, individually or with others, the lawyer must comply with Rule 1.8(a)." Rule 5.7, Cmt [5].

d) Confidentiality: With a separate entity, the scope of the duty of confidentiality will turn on the employment status of the nonlawyers. A separate organization staffed by employees of the law firm must be treated as a part of the law firm for confidentiality purposes. A separate organization staffed by employees who are not also employees or owners of the law firm cannot be considered part of the law firm for purposes of Rule 1.6, Cmt [8], and therefore, absent express client consent, information may not be shared by the law firm with those individuals. We note that one ethics opinion has concluded that a law practice must be kept physically distinct from lawyers' other businesses (N.J. Sup. Ct. Advisory Comm. on Prof. Ethics, Op. 657 (1992) (1992 WL 257816)), but we do not believe that any authority in the Massachusetts Rules requires such separation as a matter of professional obligation.

e) Conflicts of interest: The principles applicable to the in-house context above apply with equal force here. Clients will trigger conflicts duties, while customers will not.

f) Advertising and solicitation:

i) Advertising: A separate, distinct entity ought to be able to advertise its law-related services without reference to Rule 7.2 if it does not practice law. While the language of Comment 10 to

Rule 5.7 implies that Rule 7.2 applies to all ancillary business arrangements, we disagree with that conclusion as probably not intended, as it is unsupported by any text within Rule 5.7.

If a separate business entity wishes to indicate its affiliation with the law firm in its advertising, the affiliated law firm must ensure that any such advertising will not mislead customers about the nature of the services provided. The Committee concludes that the law firm must require, through a contractual arrangement or otherwise, a separate business affiliated with it to provide each customer with a detailed explanation, in some form of written communication delivered to the customer prior to the commencement of services, of the extent, if any, to which the law firm will be providing legal services. Furthermore, if the separate entity's advertisement serves also as advertising for the law firm, the rules governing law firm advertising must be followed.

ii) Solicitation: Just as noted above in the in-house context, lawyers or nonlawyers engaged in law-related business may solicit clients for that business without regard to Rule 7.3, but may not solicit clients for law business in violation of Rule 7.3.

Footnotes

[1]The interpretations developed here assume a continuing ban on direct forms of multidisciplinary practice (MDP), to which Massachusetts, like all 50 states, currently adheres through its Rules 5.4 and 5.7. We note that the ABA's 1999 Commission on Multidisciplinary Practice unanimously recommended an end to that ban, endorsing a limited form of MDP which would permit sharing of fees by non-lawyers and ownership by non-lawyers of firms engaged in the practice of law. The Commission's recommendations were deferred for "further study" in their entirety by the ABA House of Delegates in 1999, however. We anticipate that the MDP question will receive considerable attention within the Massachusetts legal profession in the near future, and that the current ban on MDP practice may not survive that scrutiny. This opinion takes no position on that larger question.

[2]Compare the 1991 version of ABA Model Rule 5.7, repealed the following year by the ABA House of Delegates, which stated flatly: "A lawyer shall not practice law in a law firm which owns a controlling interest in, or operates, an entity which provides non-legal services which are ancillary to the practice of law, or otherwise provides such ancillary non-legal services," unless such services were provided solely to clients as part of the law firm's practice of law. ABA Model Rule 5.7(a)(1991)(repealed 1992).

[3]Our discussion of ancillary businesses does not, of course, exhaust the full variety of arrangements by which a law firm might employ non-lawyers (such as paralegals, accountants, economists, researchers, actuaries, or investigators) to assist firm lawyers in providing legal advice. Such arrangements, in which the law firm has not established an ancillary business as such, but where non-lawyers work under the direct supervision of lawyers in connection with the giving of advice to firm clients, have long been accepted as appropriate, even under the former Code of Professional Responsibility. See, e.g., ABA Formal Op. 316 ("A lawyer can employ lay secretaries, lay investigators, lay detectives, lay researchers, accountants, lay scriveners, non-lawyer draftsmen or non-lawyer researchers."); ABA Informal Op. 1445 ("The necessity for engaging non-lawyers to assist in the preparation of complex legal work has been recognized by

this Committee for some time."); MBA Committee on Professional Ethics Op. 73-2 (lawyer may employ non-lawyer to prepare probate court pleadings, inventories and accounts, state and federal tax returns, and to assist in various real estate and corporate matters under the lawyer's personal supervision). Our consideration of other scenarios here is not meant to cast any doubt on the continued propriety of such traditional models. We do note that, in utilizing the services of such non-lawyers, the lawyers themselves are engaged in the practice of law, are wholly subject to the Rules of Professional Conduct, and their agents are derivatively subject to those Rules.

[4]The Massachusetts Bar Association Committee on Professional Ethics, in Opinion 84-2, disagreed with the ABA's conclusion in Informal Opinion 1440, and decided that compensation based on net profits constituted unauthorized fee-splitting. MBA Op. 84-2 was based upon DR 3-102(a) of earlier Massachusetts Code of Professional Responsibility, which at that time permitted profit-sharing in retirement plans only (unlike the ABA Code, which had been amended to include "compensation" plans as well). The MBA Ethics Committee implied that even with the amendment it would bar such a plan. We respectfully disagree with the MBA and follow ABA and all other jurisdictions in concluding that profit-sharing based upon net profits is consistent with the plain language of Rule 5.4(a)(3).

[5]Under this scenario the HR specialist could not own any part of the entity, subject to the profit-sharing arrangements described above.