

ARIZONA 2021 LEGAL SERVICES:

***ABS Entities, Paying Referral Fees,
Legal Paraprofessionals, and Advertising Rule Changes***

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I. 2021 Changes in the Regulation of Legal Practice in Arizona - Overview

The Arizona Supreme Court approved amendments to the Arizona Rules of Professional Conduct, Ariz. R.S.Ct. 42 (“ERs”), and Arizona Supreme Court Rules 31 and 33 (“Rules”) that permit (among other things), *effective January 1, 2021*²:

- a) A new category of licensed non-lawyer legal service provider (Legal Paraprofessionals)
- b) nonlawyer ownership, investment in, and/or officers of law firms that become certified alternative business structures (“ABS”)
- c) fee-sharing with *anyone*
- d) paying referral fees for client referrals

This article will focus on the ABS regulations and advertising rule changes, with the following brief summary about non-lawyer legal service providers in Arizona.

II. Legal Paraprofessionals (a quick explanation):

The “practice of law” in Arizona is governed by Arizona Supreme Court Rules 31 – 33. Only lawyers and others specifically authorized by those Rules may provide legal services – including representing clients before tribunals, giving legal advice, negotiating legal matters, and preparing legal documents for others.

Arizona authorized the licensing of “certified legal document preparers” (“CLDPs”) to prepare legal documents in 2003. As of January, 2021 there are approximately 700 licensed CLDPs in Arizona. While the licensing of CLDPs was intended to assist with filling the need for modestly priced document services, CLDPs are not

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² The Advertising Rule changes are in Ariz. S.Ct. Order No.R-20-0030 (8/27/2020) and the ABS certification authorization, LP licensing authorization, and other amendments to the Arizona Rules of Professional Conduct are in Ariz. S.Ct. Order No. R-20-0034 (8/27/2020).

permitted to appear on behalf of customers in any court proceedings, they are not permitted to give legal advice, and are not authorized to work with lawyers or through law firms.

To address the still unmet need for representation of individuals in certain court matters and administrative proceedings the Arizona Supreme Court approved licensing a new category of legal service providers – legal paraprofessionals (“LPs”). LPs will be licensed to provide legal services in certain family law, criminal law (not involving possible incarceration), civil justice court matters, and administrative proceedings.

The licensing criteria and code of conduct for LPs is located in the Arizona Code of Judicial Administration (“ACJA”) 7-210, available on the Arizona Supreme Court webpage: <https://www.azcourts.gov/Licensing-Regulation/Legal-Paraprofessional-Program> .

Applicants must *first* pass the LP exams (one exam on core skills and one for each of the four practice areas) created by the Supreme Court. After successful completion of the exams, candidates may file an application with the Supreme Court’s Board of Nonlawyer Legal Service Providers.

Eligibility requirements include *either* 7 years of law-related work experience or a variety of educational requirements, including law school, paralegal courses, undergraduate degree in a legal field, etc. along with character and fitness standards.

LPs may be employed by lawyers or work independently. This means that law firms may employ LPs to represent clients and the LPs do not need to be supervised by an attorney.

LPs may appear in court on behalf of clients – but only in the four practice areas noted above. LPs must maintain trust accounts and pay into a Client Protection Fund and must comply with the Rules of Professional Conduct.

LPs will be affiliate members of the State Bar of Arizona and subject to discipline investigation for violations of their code of conduct, including the Rules of Professional Conduct. Licensed LPs will be listed on the State Bar of Arizona website database.

Communications between LPs and their clients will be considered “privileged” according to Arizona Rule of Evidence 513.

**November 29, 2021 Update: Ten applicants who passed both the core skills and family law exams were approved for licensure by the Board of Nonlawyer Legal Service Providers and are now listed on the State Bar of Arizona website as “LPs”! Court administration will continue to offer testing in the core skills, family law, civil law, and criminal law areas each month and is in the process of drafting the administrative law exam.*

III. The Regulatory Framework for ABS Certification

**January 11, 2022 Update: As of this month the Arizona Supreme Court has certified 15 ABS applicants and the Committee approved two for certification.*

ABS	Practice Areas	Compliance Lawyer	Investors
Arete Financial Solutions (f/k/a MLR Professional Tax Services)	Accounting, tax, legal, financial planning	Edwin Ashton	Mary Lue Reha, Edwin Ashton, Esq., Kevin McCloud will each own 33%
BOSS Advisors (formerly Payne Huebsch, LLC)	Accounting, tax, legal	Michael Payne	Michael Payne, Esq. 50% and Chad Huebsch 50% (through Huebsch Financial LLC)
Bridgemont Group, ABS (formerly Wall and Olson, LLC)	Mass tort	Stephen Wall	Stephen Wall, Esq. 50% and Mark Olson 50%
eLegacy Law, LLC	Estate planning	Ryan Crandall	Ryan Crandall, Jeff Crandall, and John Powers (marketing company Veritas Consulting)
ElevateNext US, LLC	Corporate	Patrick Lamb	Affiliated with ElevateNext UK ABS; 100% owned by Elevate Services Inc.
Elias Mendoza Hill Law Group, LLC	Immigration	Elias Mendoza	51% Jim Hill and 49% Elias Mendoza, Esq.
Esquire Law Group, LLC	Personal injury and workers comp	Richard Stagg	Steiner, Greene & Feiner (FL lawyers) entity will own and will seek additional outside investment
Hive Legal, LLC	Estate planning	Peter Robinson	51% lawyer owned, 49% by Chris Brown (marketing professional)
KWP Estate Planning, LLC	Estate planning	Leah Ellsworth	Ellsworth, Esq. 50% and John Hagensen (Keystone Wealth Partners) 50%
LegaFi Law, LLC	Class actions	Camille Bass	Scott Hardy 85% (topclassactions.com), Camille Bass, Esq. 10%, Steve Williams 5%
Legal Help Partners, PLLC	Personal injury and mass tort	Stephanie Long	Long, Esq. 10%, Mark Rinehard 45%, Mark Sullivan 45%; Rinehard and Sullivan also own marketing business Key Contacts LLC
LZ Legal Services, LLC	Legal Zoom services	Don Bivens	100% owned by LegalZoom.com
Motion Law, LLC	immigration	Natalia Artemieva	100% nonlawyer owned by Andrew Haywood
Radix Professional Services, LLC	General corporate and litigation	Jonathan Frutkin	33% Andy Kvesic (holding as nonlawyer even though AZ lawyer); 2/3 ownership will be held back for future investment
Singular Law Group, PLLC	Bilingual services for small businesses	Mary Ellen Juetten	Mary Ellen Juetten, Esq. 50% and 50% Allen Rodriguez (through Justice Forward and his company One400 will provide marketing)

Trajan Estate, LLC	Estate planning and financial planning	Kent Phelps	Kent Phelps, Esq. 50% and Jeff Junior 50% (through Leola Marketing)
Vantage Law Firm	Mass torts	Bob Goldwater	Paul Cody 22.4%, Megan Payne 22.4%, Steve Mingle 22.4%, Todd Kushman 22.4%, Bob Goldwater, Esq. 10%, Quinn DeAngelis, Esq. .25%

Another 15 applications for certification currently are pending.

A. What Is An ABS?

As noted above, the Arizona Supreme Court will continue to regulate who may practice law in Arizona. The definition of the “practice of law” has NOT changed. The preparing of legal documents, negotiating legal matters for others, representing someone in a tribunal, and giving of “legal advice” are all still the “practice of law” according to Arizona Supreme Court Rule 31.2.

Any entity that “includes nonlawyers who have an economic interest or decision-making authority as defined in ACJA 7-209 may employ, associate with, or engage a lawyer or lawyers to provide *legal services to third parties* only if” it is certified as an ABS and legal services are provided by someone authorized to do so. Arizona Supreme Court Rule 31.1(c).

A certified ABS entity is not authorized to practice law.

An ABS must employ someone who is an active member of the State Bar of Arizona, pursuant to Rule 31.1(c)(1), to practice law and supervise the ABS (the ABS “Compliance Lawyer”).

The enabling regulations for ABS certification and the code of conduct are codified in the Arizona Code of Judicial Administration (“ACJA”) 7-209. The regulations, application forms, and Committee information are available on the Arizona Supreme Court website: <https://www.azcourts.gov/Licensing-Regulation/Alternative-Business-Structure> .

An ABS is defined in ACJA 7-209A. as:

a business entity that includes nonlawyers who have an economic interest *or* decision-making authority in the firm and provides legal services in accord with Supreme Court Rules 31 and 31.1(c).

The ACJA 7-209 provisions define both “decision-making authority” and “economic interest”:

- “Economic interest” means (1) a share of a corporation’s stock, a capital or profits interest in a partnership or limited liability company, or a similar ownership interest in any other form of entity, or (2) a right to receive payments for providing to or on behalf of the entity management services, property, or the use of property (including software and other intangible personal property) that is based, in whole or in part, on the firm’s gross revenue or profits or any portion thereof. Notwithstanding the foregoing, “economic interest” does not mean employment-based compensation pursuant to a plan qualified under the Internal Revenue Code of 1986, as hereafter may be amended, or any successor rule, or discretionary bonuses paid to employees.”

- “Decision-making authority” in an ABS means the authority, by operation of law or by agreement, to directly or indirectly:
 - Legally bind the ABS;
 - Control or participate in the management or affairs of the ABS;
 - Direct or cause the direction of the management and policies of the ABS; or
 - Make day-to-day or long-term decisions on matters of management, policy, and operations of the ABS.

Clarification: Note that while the definition of “decision-making authority” may seem to encompass the job descriptions of traditional law firm administrators/managers, it was not the intent of the Arizona Task Force on the Delivery of Legal Services that made these recommendations to include traditional law firm administrators. Again, the Task Force *did not intend to have traditional law firms required to apply to be ABS entities* if the law firm is not changing the responsibilities of a traditional firm administrator – even if the administrator has an ex-officio title of “officer” or “director” of the firm.

Caution: The definition of “economic interest” is fairly broad and could be interpreted to cover regular lending agreements where a bank or other lender loans money to a law firm in exchange for a percentage of fees. While the Task Force did not intend to extend ABS certification requirements to traditional litigation funding arrangements between law firms and lenders, there are not yet any advisory opinions or disciplinary cases interpreting the scope of the reach of the “economic interest” definition.

In addition to adopting the Supreme Court Rule changes to permit certification of ABS entities, the Court also amended several Arizona Rules of Professional Conduct, Ariz. R.S.Ct. 42 (“ERs”) and other Supreme Court Rules to address these concepts. These changes include eliminating ER 5.4, the Ethical Rule that prohibited sharing legal fees with nonlawyers and giving equity/ownership interests in a law firm to a nonlawyer. A complete list of the Ethical Rules amended follows *infra*.

B. *The ABS Review Committee*

The Arizona Supreme Court appointed a Committee on Alternative Business Structures, comprised of lawyers, judges, and nonlawyers. The Committee reviews applications for entities seeking ABS certification. Rule 33.1 and ACJA 7-209D.5 define the role and responsibilities of the Supreme Court’s Committee in reviewing and making recommendations to the Court on certification of ABS entities and renewal of certification licenses.

The Committee’s review of applications will consider regulatory objectives as set forth in ACJA 7-209E.2.a:

- (1) Decisions of the Committee must take into consideration the following regulatory objectives:
 - (A) protecting and promoting the public interest;
 - (B) promoting access to legal services;
 - (C) advancing the administration of justice and the rule of law;
 - (D) encouraging an independent, strong, diverse, and effective legal profession;
and
 - (E) promoting and maintaining adherence to professional principles.

(2) The Committee shall examine whether an applicant has adequate governance structures and policies in place to ensure:

- (A) lawyers providing legal services to consumers act with independence consistent with the lawyers' professional responsibilities;
- (B) the alternative business structure maintains proper standards of work;
- (C) the lawyer makes decisions in the best interest of clients;
- (D) confidentiality consistent with Supreme Court Rule 42 is maintained; and
- (E) any other business policies or procedures do not interfere with a lawyers' duties and responsibilities to clients.

Note that each ABS application must explain how the applicant will satisfy one or more of the "regulatory objectives."

Clarification: The ABS Committee may request to see an applicant's proposed policies and procedures, Bylaws, and Operating Agreement to assure the applicant is contemplating sufficient structures to conform with the regulatory objectives. Applicants should anticipate this request and create appropriate employee manuals and policies to confirm that lawyers will be able to provide legal services in conformity to their obligations under the Rules of Professional Conduct and that nonlawyers will be trained in those ethical obligations as well as restricted in their access to confidential client information.

C. ABS Application Disclosures

To apply for certification as an ABS entity in Arizona that provides legal services, four applications must be submitted and are available on the Arizona Supreme Court website:

- an ABS application describing the business and its services,
- a Designated Principal for the ABS,
- a Compliance Lawyer application, and
- applications for each person or entity that fits the definition of an "Authorized Person."

The initial ABS application must be completed online on the Arizona Supreme Court website. Then individual links are sent to each "authorized person," "designated principal," and "compliance lawyer" to complete their own online forms.

There also is an application fee, as listed in the ACJA 7-209.

Note that while an ABS applicant does not need to form the business entity prior to filing an application for certification, the applicant must provide at least draft documents, explaining how the applicant anticipates forming the business entity, if approved. The business entity does not have to be an Arizona corporation/LLC/PLLC, etc.

Note also that applicants SHOULD NOT advertise ABS services prior to certification!

ACJA 7-209 will require that each application for ABS certification disclose:

- Every person with decision-making authority in the ABS *or* anyone (including an entity that holds the interest) holding a 10% or more “economic interest” in the ABS (collectively “authorized persons”).
- All business affiliations with parent companies, officers, directors, etc. and all subsidiaries operating in the state.
- The “compliance lawyer” designated to be responsible under ER 5.3(d) for ABS compliance with all rules and regulations.
- Whether or not the ABS is covered by professional liability insurance.
- An entity representative and statutory agent
- Letters of good standing from the Arizona Corporation Commission.
- That the entity meets the “objectives” listed in Rule 33.1(b)(assuring ethical requirements for lawyers and legal clients).

Applicants should anticipate being asked for resumes for each “authorized person” as the Committee has expressed an interest in learning the business backgrounds of the individuals who may be making decisions for the ABS.

The Committee “shall” recommend denial of an ABS application for a number of reasons set forth in ACJA 7-209E.2.d, including if any authorized person or the entity has:

- Material misrepresentations or omissions in the application
- Felony convictions
- Convictions of a misdemeanor involving legal services
- Disbarred lawyers, individuals denied admission in any state ,and individuals currently suspended from the practice of law in any state
- Other professional license discipline “relevant” to ABS licensure
- Civil liability or court rulings involving misrepresentation, fraud, theft, or conversion
- Violations of any court orders
- Business record of conduct involving dishonesty or fraud

The Committee’s recommendation to deny an application is appealable.

Clarification: While the application will require the disclosure of only those individuals (lawyers and nonlawyers) who have decision-making authority *or* hold an economic interest of 10% or more, a law firm that will have *any* nonlawyer ownership (even less than 10%) must apply for ABS certification. For instance, a law firm that wants to give its paralegal a 1% equity interest in the firm must apply to be an ABS, but the application will not require that the paralegal be listed as an “authorized person” because the paralegal will have less than a 10% interest.

Even if a nonlawyer has less than a 10% ownership interest (and therefore does not need to be disclosed on the ABS application), firms still should conduct robust due diligence of all potential equity owners, to assure that they meet the ACJA7-209 criteria listed above.

D. ABS Compliance Attorney

Every certified ABS must designate an Arizona “compliance lawyer.” Rule 31.1(c)(1).

The compliance lawyer must be at least an employee or manager of the ABS and a member in good standing with the State Bar of Arizona.

The compliance lawyer must “possess credentials and experience in the legal field to ensure that the ethical obligations, protection of the public, and standards of professionalism are adhered to.” (ACJA 7-209F.3.a.) The current ABS application for Compliance Lawyers does not require a specific number of years of experience for the Compliance Lawyer but applicants should anticipate that a designated Arizona Compliance Lawyer needs sufficient familiarity in their prior jobs to demonstrate supervisory and management skills.

The compliance lawyer will be responsible under revised ERs 5.1 and 5.3 and ACJA7-209F.3.b for:

- Appropriately supervising nonlawyers in the ABS to assure compliance with the ERs and ABS Code of Conduct;
- Establishing policies and procedures in the firm to, among other things, protect client confidential information and avoid conflicts of interest
- Ensure all “authorized persons” in the ABS comply with the Code of Conduct
- Notify the State Bar if the compliance lawyer ceases to serve as the compliance lawyer and/or of any facts that the compliance lawyer reasonably believe demonstrate a violation of the regulations
- “prevent nonlawyers in a firm from directing, controlling, or materially limiting the lawyer’s independent professional judgment on behalf of clients or materially influencing which clients a lawyer does or does not represent.” ER 5.3(a)(1)(*see attached full text of Rule*).

Clarification: While the Rules do not *require* that the Arizona Compliance Lawyer have an ownership interest in the ABS, it seems advisable that the Compliance Lawyer have some equity or at least contractual authority in the ABS, because an employee of a firm may not have sufficient authority within the entity to enforce the policies and procedures required under the Rules. It is unclear whether a lawyer may be the “Compliance Lawyer” for more than one ABS, but if a lawyer was, presumably client conflicts would be imputed between the two firms.

Operating Agreements and ABS Company Policy Manuals should at least identify that the Compliance Lawyer will be the ultimate authority for decisions regarding clients, legal services, and case management.

E. ABS Code of Conduct

The ABS Code of Conduct is set forth in ACJA 7-209K. and applies not only to the entity ABS but also is the responsibility of all lawyers who are members of the ABS. The Code includes:

- Complying with all ABS certification requirements
- Avoiding conflicts of interest under the Rules of Professional Conduct
- Not taking any action “that interferes with the professional independence of lawyers or others authorized to provide legal services”
- Ensure legal services are provided diligently
- Refrain from misleading clients, courts or others
- Comply with ER 1.15 and Rule 43 regarding safeguarding property
- Maintain financial viability or begin an orderly wind-down

- “maintain effective governance structures, arrangements, systems, and controls to ensure” everyone complies with the Ethical Rules.

F. ABS Discipline

Complaints about ABS violations of the Code of Conduct will be investigated by State Bar Counsel, with recommendations for sanctions going to the Attorney Probable Cause Committee of the Supreme Court.

Hearings on misconduct will be conducted by the Presiding Disciplinary Judge and discipline imposed by the Supreme Court, the Presiding Disciplinary Judge, Hearing Panels, or the Probable Cause Committee.

Sanctions for violations of the Code of Conduct include: revocation or suspension of the ABS license, reprimand, admonition, probation, and monetary penalties. ACJA 7-209H. Those are the sanctions against the ABS entity, but separate violations may be found against the Compliance Lawyer for either violations of the ACJA provisions or the Rules of Professional Conduct.

IV. 2021 Ethical Rule Changes in Arizona Permitting Fee Sharing and Referral Fees

A. Amendments to the Rules of Professional Conduct

Regardless of whether a lawyer will work in an ABS or in a traditional law firm, many of the Arizona Ethical Rules changed in 2021.

Here is a summary of the changes:

- ER 1.0 – Terminology – Amended to define a “firm” and other clarifications for business transactions with clients.
- ER 1.5 – Fees – Amended paragraph (e) regarding fee sharing among lawyers in different firms.
- ER 1.6 – Confidentiality - Added Comment 22 language to assure confidentiality preserved in an ABS
- ER 1.7 – Conflicts of Interest – Added new paragraph (c) specifying that law firms with any common management or ownership (of 10% or more owners) may not represent adverse parties when party is asserting a “claim” against the other party.
- ER 1.8 – Conflicts - Added new paragraph (m) regarding disclosure of financial interests in firm transactions (to clarify that if a legal client is referred to another professional within the ABS the lawyer may receive a financial benefit from those other services being provided to the client and must obtain an ER 1.8(a) waiver).
- ER 1.10 – Imputed Conflicts - Conflicts of interest within an ABS are imputed to all lawyers and nonlawyers (and vice versa) unless they can be screened for a personal interest conflict; Added new paragraph (f) regarding nonlawyer personal interest conflicts are not imputed to entire firm unless the nonlawyer is an owner/partner/manager.
- ER 1.17 - Sale of Practice - Amended to clarify the necessary client disclosures and how fees cannot be increased to pay for the purchase

- ER 5.1 – Supervisory Lawyers – Revised duties of lawyers who are owners, managers or supervisors to establish internal controls and level of supervision needed with firms over other lawyers
- ER 5.3 – Responsibilities Regarding Nonlawyers (*full text of revised Rule is attached*) – Revised specific duties to supervise nonlawyers in a firm including adding paragraph d) requiring firms to designate one responsible lawyer if firm has nonlawyer
- ER 5.4 – DELETED (professional independence of a lawyer)
- ER 5.7 – DELETED (law-related services)
- ER 7.1 – Advertising – Amended to move into Rule requirements on: 1) disclosing firm name and contact information from ER 7.2; 2) “Certified Specialist” requirements from ER 7.4; and 3) comments related to firm names from ER 7.5
- ER 7.2 – DELETED (requirements for “contact information” and firm name moved to ER 7.1)
- ER 7.3 – Solicitation – Amended to define “solicitation,” deletes the “ADVERTISING MATERIAL” disclaimer and filing requirements for written solicitations, and adds a new category of individuals that can be directly solicited in person or by phone for business people who regularly hire lawyers for business legal services.
- ER 7.4 – DELETED (requirements for “certified specialists” moved to ER 7.1)
- ER 7.5 – DELETED (explanatory comments about firm names moved to ER 7.1)
- ER 8.3 – Reporting Misconduct – added reporting misconduct of ABS entities and LPs.

B. Advertising Rule Changes That Apply to ALL Arizona Law Firms

As noted above, the Rules regarding advertising, ERs 7.1 through 7.5, changed January 1, 2021. These changes apply to all lawyers and law firms – not just ABS entities. The Rules were consolidated, with only amended ER 7.1 and revised ER 7.3 on solicitation remaining. The changes will be significant, with respect to permitting the payment of referral fees – to anyone. The following are some specific topics to consider.

1. Still no false or misleading communications

Lawyers are responsible for all advertising, websites, and marketing. ER 8.4(a). This means a lawyer cannot have someone else do something that the lawyer could not do directly. The Arizona Rules still provide:

- No “false or misleading” advertising. ER 7.1
- All advertising must include the firm name and contact information. ER 7.1(c)
- Firm names must not be misleading. ER 7.1
- Lawyers may identify themselves as “certified specialists” only if they *are certified*. ER 7.1(b).

2. No direct solicitation of potential clients (with some exceptions)

Amended ER 7.3 includes a definition of “solicitation” and continues to prohibit direct, in person or real time communication with potential clients except:

- 1) friends;
- 2) family;
- 3) former/current clients/business associates;
- 4) other lawyers; and/or
- 5) (NEW) businesses that regularly use the legal services offered by the lawyer.

Solicitation letters sent to specific individuals/homes do NOT need to be marked “advertising material” and DO NOT need to be sent to the State Bar anymore.

Cautions:

- Lawyers CANNOT have referral sources solicit in person if the lawyer could not. *See ER 8.4(a)*
- There is even some ambiguity about whether a referral source may solicit the source’s own friends and family (since they are not the *lawyer’s* friends or family). Caution referral sources, including existing clients, law firm employees, and others to refrain from soliciting strangers in person (or by telephone or real time electronic means) – at all.
- Lawyers may pay anyone for referrals but be extremely careful to warn the referral sources about the restrictions on in-person solicitation, truthfulness in statements about the lawyer, and asking the potential clients to contact the lawyer (not the other way around).
- Lawyers need to explain to referral sources that the mere fact that a potential client speaks with the lawyer is “confidential” information under both ER 1.6 and ER 1.18, which means that lawyers cannot pay referral sources for a referral in reference to a specific new client *unless the client consents to the disclosure of that information*.
- Again, lawyers must obtain client consent to disclose that the client has contacted the lawyer. This means at least getting client consent to send “thank you” notes to the referral source (with or without a referral fee!).

3. Lawyers may pay referral fees – to anyone – but be careful

ER 5.4, which prohibited sharing legal fees with nonlawyers, is deleted. ER 7.2(b), that previously prohibited giving “anything of value” to anyone for recommending a lawyer’s services or referring someone to a lawyer, also is deleted.

This means that Arizona lawyers may pay:

- A fee to a referral website for each potential client sent to the firm.
- A fee to a traditional referral source, such as an existing client, a banker, doctor, accountant, social worker, or realtor for each client sent to the lawyer.

- A fee to law firm employees or former clients for referrals
- A referral fee to anyone – and that fee may be a percentage of the legal fee earned by the lawyer.

Yes, this is a significant change. Yes, the referral fee paid to nonlawyers may be either a flat fee or a percentage of the legal fees earned by the lawyer (saying this at least twice because it is important!).

Lawyers do not need to disclose in the client fee agreement that the lawyer is going to pay a referral fee to a nonlawyer. But lawyers do need client consent to confirm to a referral source that someone is a client. Also be careful about not disclosing the amount of a contingent fee the firm may earn, as that could disclose how much the client may be receiving, and unless the lawyer has the express informed consent of the client to disclose that information, it should be kept confidential. Also note that many settlement agreements that contain confidentiality provisions restrict disclosures to others about the terms, which a referral fee payment could violate.

Cautions:

- It is unclear how other states will view Arizona's open referral fee options. For instance, will an out-of-state lawyer be found to have violated her state's anti-referral fee rules if she agrees to co-counsel on a case with an Arizona lawyer and the out-of-state lawyer *knows* that the Arizona lawyer paid a referral fee for the case? Does the answer depend on whether the Arizona lawyer was advertising for cases in that other state? The New York City Bar Opinion 2020-1, which permits a New York lawyer to co-counsel with an Arizona lawyer, even if the Arizona lawyer is an ABS, suggests that at least New York lawyers could co-counsel with an Arizona lawyer who pays referral fees to others (even though New York lawyers cannot). Another caution: In order to have a "co-counsel" arrangement the New York lawyer and Arizona lawyer would need to be in separate law firms, to share a fee under ER 1.5(e). If they are in the *same* firm, that could be problematic for the New York lawyer.
- If a lawyer is admitted in *both* Arizona and another jurisdiction, there also may be some question about whether other jurisdictions will permit the lawyer to pay for referrals. Presumably there should be a good faith argument that if the lawyer is entering into attorney/client relationships (and fee agreements) through the lawyer's Arizona license (and office), then the Arizona Rules of Professional Conduct apply to the relationship – including what the lawyer can do with the fees. If the lawyers can demonstrate that the "predominant effect" of the representation is with Arizona, then under ER 8.5(the choice of law Rule), there is an argument that Arizona's Ethical Rules should apply to the matter.
- These and many other ethics issues still need to be addressed by other jurisdictions. Lawyers in other jurisdictions should seek ethics advice in their jurisdictions regarding these issues.

4. Paying a referral fee to another lawyer

- Yes, Arizona lawyers may now pay a referral fee to another Arizona lawyer for sending them a client.
- Flat fee: If the payment is a flat amount that is not part of the legal fees that will be earned, presumably the receiving lawyer may pay the flat amount to the referring lawyer without any notice to the client in the fee agreement.
- Percentage of Fees Earned: Arizona lawyers may pay a referral fee to another Arizona lawyer for sending them a client and that referral fee may be a percentage of the fees earned on the case. However,

there is some ambiguity about whether ER 1.5(e) must be followed if a referring lawyer will not remain jointly responsible but just wants a percentage of the fees earned for the referral. Revised ER 1.5(e) provides:

(e) Two or more firms jointly working on a matter may divide a fee paid by a client if:

- (1) the firms disclose to the client in writing how the fee will be divided and how the firms will divide responsibility for the matter among themselves;
- (2) the client consents to the division of fees in a writing signed by the client;
- (3) the total fee is reasonable; and
- (4) the division of responsibility among firms is reasonable in light of the client's need that the entire representation be completely and diligently completed.

- There is an argument that ER 1.5(e) does *not* apply to paying a percentage of fees earned merely for a referral, because the two lawyers are not “jointly working on a matter”. As a risk management recommendation, however, until there is further clarification of this Rule (*an advisory opinion is being requested of the Arizona Supreme Court’s Attorney Ethics Advisory Committee*), lawyers should either decline a fee split with another firm or comply with ER 1.5(e) and explain, in the written fee agreement with the client, the percentage the referring lawyer will receive and that she will not be responsible for the legal work performed but is merely receiving a fee for the referral.
- *Caution:* If the referring lawyer is sending an existing *client* to another lawyer for separate legal services and the referring lawyer will get a referral fee from that referral (i.e., the referring lawyer will make money from the referral), the referring lawyer must disclose this financial benefit to their client in the form of an ER 1.8(a) WRITTEN AND SIGNED business transaction disclosure. An ER 1.8(a) written disclosure statement is required because clients are entitled to rely on the fiduciary obligations of their lawyers to give them objective recommendations of other service providers.
- *Caution II:* These Rule changes apply only to Arizona lawyers. If a lawyer from another jurisdiction refers a case to an Arizona lawyer (or vice-versa) the Arizona lawyer should inform the out-of-state referring attorney that they must confirm if their state’s rules permit referral fees.

C. *Some specific ABS ethics questions.*

The following are *initial* answers to some of the more frequent ethics questions associated with ABS entities.

1. *Can an ABS owner (lawyer or nonlawyer) own interests in firms that are representing opposing parties in litigation?*

No – new ER 1.7(c). Opposing law firms in litigated matters cannot have common ownership – either of lawyers or nonlawyers.

2. *What if an ABS nonlawyer owner/partner has an ownership interest in an opposing party the ABS lawyer is suing on behalf of a client?*

If the interest in an opposing party is held by an owner/manager/partner of a law firm – whether they are a lawyer or a nonlawyer, that ownership interest could be imputed to the lawyers in the ABS, per amended ER 1.10.

3. *Can an Arizona ABS have partners (or employees) who are lawyers admitted and working in other states?*

This will depend upon whether the other state permits their lawyers to have partnerships with nonlawyers. At this point, only D.C. and the Utah Supreme Court’s Regulatory Sandbox permit their lawyers to partner with nonlawyers or have nonlawyers holding an equity interest in a law firm. Lawyers admitted in jurisdictions other than Arizona, D.C. or Utah should check with the licensing jurisdiction’s ethics committee on guidance about whether or not they can practice law in partnership with nonlawyers.

The American Bar Association issued ABA Op. 499 (September, 2021), which concluded that lawyers admitted in other jurisdictions may have some *passive investment* interest in an Arizona ABS (i.e., they just invest but do not practice law with or through the ABS). A “passive investment” would mean just investing money in an ABS and not practicing law through an ABS or holding themselves out as lawyers practicing through an ABS. Note that while ABA Opinions are not binding on lawyers, they are deemed by many states as persuasive.

However, even if out-of-state lawyers cannot have an ownership interest in an ABS, they *may* be able to fee-share with an ABS lawyer in a co-counsel arrangement, as discussed above, where the out-of-state lawyer is not a partner/attorney/employee in the same firm as the ABS lawyer, per ER 1.5(e). *See ABA Op. 13-464; NYC Op. 2020-1; FL Op. 17-1; but see MD. Op. 2012-12 (Maryland lawyer may not serve as co-counsel to DC lawyer if DC lawyer has nonlawyer partners)*. In other words, for instance, a lawyer in a New York firm may co-counsel with an Arizona lawyer on a case-by-case basis, even if the Arizona lawyer happens to work in an ABS. The fee sharing agreement between co-counsel will be governed by ER 1.5(e).

Another option: If a lawyer admitted in another jurisdiction also is admitted to practice law in Arizona and they place their other state license on “inactive” or “retired” status, and practice *exclusively* through their Arizona law license, while working/owning an ABS, that might be permissible with other state regulators. *See NYSBA Op. 1234 (Dec. 2021)*. “Might” is the operative word at this point...check with applicable licensing authorities!

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Page 15 of 15

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