Part I: How Ethical is Your Compensation?

Ethical Considerations on Compensation for Estate Planning Professionals

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Fairness is making a big come back these days. In the name of fairness, clients and a variety of regulatory bodies are increasingly demanding heightened corporate and professional accountability at all levels. If you are a professional who provides services or sells products used in the estate planning process, the odds are that your profession has a code of ethics regulating or addressing the fairness of your behavior.

As discussed in the June 2004 Trusts & Estates article, Do the Right Thing, the areas of professional behavior commonly governed by codes of ethics are best summarized by "The Five Cs", which are: confidentiality, conflicts of interest/disclosure, competence, compliance, and compensation. Compensation is an area replete with ethical subtleties and stumbling blocks that, in recent times, have too often led to the downfall of fairness.

With this in mind, the Ethics Committee of the Philadelphia Estate Planning Council (the "PEPC") dedicated its time during this past council year to exploring the ethics of compensation for estate planning professionals. To that end, it held two Ethics Forums, one in December 2004 and the other in April 2005, devoted to raising issues pertaining to compensation and discussing how professionals deal with the variety of compensation-related situations that they confront in the daily course of providing services and/or products to their clients. Much of this article will focus on the discussion from the December Ethics Forum.

At the December Ethics forum, prior to introducing the three panelists (an estate attorney, an insurance professional and a trust officer), Ron Duska, Professor of Ethics at the American College in Bryn Mawr, PA, told a story to get the Forum attendees in the proper state of mind for a discussion involving fairness and the ethics of compensation.

Ron told of an experience when as a young graduate student in New York City, he rented a room in a house near Jamaica, Long Island. It was his habit to visit the grocery store near the train station to get food for the evening. One night, Ron's landlady, Ms. Thompson, asked Ron if he could pick up some steak for her from the local grocery store. At the store, he requested the steak for his landlady and also ordered some steak for himself. He then realized he needed the orders put it into two packages. The grocer had already wrapped and priced a single package and was handing it to Ron, who was just starting to ask the grocer to break the order into two. The grocer grimaced and asked why, and Ron simply said that one package was for Ms. Thompson. The grocer then broke the order into two packages and took out his pencil and recalculated the price - giving the package intended for Ms. Thompson a better price!

Ron recalled that they lived in an area of Jamaica where there were no prices on goods. He would only later discover that whenever you went into a store in that area, you haggled. After some time, he learned how it worked and eventually found it to be a wonderful kind of experience. He would go into a bookstore, for instance, and ask how much the shopkeeper wanted for a certain book. The shopkeeper would state his price, and Ron would tell him that it was too much and walk out the door. He would either come back later to renegotiate, or go elsewhere in search of a better price. In that general fashion, a price would be negotiated and deals would be made.

However, back at the grocery store, prior to Ron learning "how things worked" in that neighborhood, when it first hit him that the grocer was giving his landlady a better price than him, it struck him as unfair. Ron concluded his story about buying steak for Ms. Thompson by saying that years after the incident at the grocery store, upon reflection, he came to believe that it was his ignorance of the way that things were done that led him to think that it was unfair. So, was it unfair or was it not unfair?

One of the issues pertaining to the fairness of compensation, if we can use that expression, is the need for disclosure. If the general public does not know the rules of the game, similar to Ron buying steak for Ms. Thompson from the grocer, should a professional disclose those rules? Should clients know whether or not they have to haggle over the price, or should there be more disclosure in the industry?

After the introductory remarks made by Professor Duska, the Forum turned its attention to the subject of attorney compensation. The legal profession throughout its history has much too often faced ridicule for its billing practices. Professional incompetence, greed and financial pressures have often led attorneys to stray into the murky

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waters of unreasonable compensation. Accordingly, a sound understanding and practice of the ethical principles governing compensation is a must for every attorney if the integrity of the profession is to be preserved.
The Forum's discussion began with a description of the types of fee arrangements commonly used by attorneys. Among these arrangements are: the fixed fee, hourly rate fee, and contingency fee. The fixed fee provides the client with a description of the legal services he will receive and the benefit of knowing upfront how much that service will cost. The downside of the fixed fee is that it may be inflated to compensate the attorney for the uncertainty of the amount of time required to complete the assignment. Additionally, an attorney might be inclined to spend less time on a case if he has secured a fixed fee. One end result of said neglect could be a lower quality of service to the client.

The hourly rate, perhaps the most popular billing method among attorneys, generates a fee which is a product of the number of hours and the accompanying rate. The most obvious benefit of this fee structure is the incentive for the attorney to devote a maximum amount of time to his client's cause to generate the largest possible fee. Unfortunately, it has become common practice that an attorney will spend more time than is needed on a case. Worse than that, some attorneys might even exaggerate the amount of hours spent serving the client. In today's competitive legal marketplace, they may feel compelled to pad their bills to keep pace with market forces.

Perhaps the most celebrated and maligned method of compensation for attorneys is the contingency fee. Under the contingency fee an attorney will be paid if a particular result is obtained. In many countries contingent fees are prohibited. In the United States contingent fees are permitted in some form in all fifty states. The contingent fee, unlike other fee structures, allows the client to obtain legal representation at no cost to himself. Many who would not otherwise have access to a lawyer are able to gain legal counsel through the contingency fee. Proponents of contingent fees argue that this greater access to legal services is beneficial to society. The many adversaries of the contingent fee argue that it breeds frivolous lawsuits and promotes unethical behavior on the part of attorneys.

Much of the Forum's attorney compensation discussion involved fee division and referral fees. While the splitting of legal fees with non-attorneys is strictly forbidden, the receipt of referral fees from other attorneys is generally accepted by the legal community and is a significant source of income for some lawyers. The ABA Model Code of Professional Responsibility addresses the issue of fee division among lawyers in DR 2-107 which permits said division only if: (1) the client agrees to the engagement of the other attorney after a complete disclosure that a splitting of fees will be made; (2) the fee is divided "in proportion to the services performed and responsibility assumed" by each attorney; and (3) the total amount of the fee is not unreasonable compensation for all legal services rendered to the client. The division of fees among lawyers is permitted largely under the theory that a client's best interests are being served by giving attorneys incentive to refer work to their most competent peers.

Rule 1.5(a) of the ABA Model Rules of Professional Conduct states simply: "A lawyer's fee shall be reasonable ...." That which is considered reasonable today may not be considered reasonable tomorrow. The courts and legislatures together with the legal community are constantly defining and redefining what is just compensation. Without a doubt, the subject of attorney compensation will always be a source of great controversy.

Following the discussion on attorney compensation, the Ethics Forum addressed issues facing insurance professionals. Insurance and investments are typically focused more on the product side of the estate planning process. Insurance agents' compensation is often based on a multi-tiered system. There are premiums (the larger the premium, the higher the compensation), there is variable compensation (the more the agent produces for the company, the higher the agent's commission percentage), and there are incentives and bonuses paid through travel and gifts. How does the anticipation and temptation for tiered compensation impact a professional's behavior? ■