THE LAW SOCIETY OF SINGAPORE

PRACTICE DIRECTION 5.1.1

[Formerly PDR 2013, para 103]

EQUITY IN LIEU OF FEES

A. General Considerations for an Arrangement to Accept Equity in Lieu of Fees

[Formerly Council's Practice Direction 1 of 2000]

1. Introduction

The Council of the Law Society has been requested to give guidance on the issue of members accepting equity in lieu of fees. This was referred to the then Ethics Committee (currently the Advisory Committee of the Professional Conduct Council), which studied the guidance standards/opinions of the Law Society of England and Wales and the American Bar Association before making its recommendations to the Council. In making these recommendations, the Ethics Committee considered the fact that circumstances in Singapore differ in many respects and as such, the rules and guidance standards of other jurisdictions, while informative, do not necessarily apply in the Singapore context.

After careful consideration, the Council of the Law Society had accepted the recommendations of the Ethics Committee.

The expression 'Law Practice' in this Practice Direction includes a legal practitioner, a sole proprietorship, partnership, law corporation and its directors, shareholders or employees.

(a) What is an arrangement to accept equity in lieu of fees?

It is an arrangement where a client offers and a Law Practice accepts shares or share options in the client company itself or in any other company owned by the client either in full satisfaction for legal services provided by the Law Practice or as part of the remuneration for such services. Subject to the matters set out below, in principle, Council does not see any objection to a Law Practice accepting equity in lieu of fees for legal services provided by the Law Practice.

(b) Issues a Law Practice should consider when accepting equity in lieu of fees

Council recognises that the pressure to accept equity in lieu of fees is not self-motivated but rather requested by certain clients. It is a matter, which involves very careful consideration with full recognition of the commercial risks involved apart from any ethical considerations. The Law Practice will have to consider, *inter alia*, the following issues:

(i) contingency fee arrangements;
(ii) overcharging;
(iii) conflict of interest; and
(iv) secret profits.

(i) Contingency fees

A distinction must be drawn between contentious and non-contentious work. There is no prohibition against contingency fee arrangements for non-contentious matters and as such a Law Practice may accept equity in lieu of fees for non-contentious work, even if doing so amounts to a contingency fee arrangement.

However, in contentious matters, a statutory prohibition exists by virtue of section 107 of the Legal Profession Act (Cap 161, 2009 Rev Ed) ('LPA'). A Law Practice cannot enter into an agreement to accept equity in lieu of fees in a contentious matter where such an agreement amounts to a contingency fee arrangement. Whilst not all agreements to accept equity in lieu of fees are necessarily contingency fee arrangements, the Law Practice should consider whether their specific fee arrangement with the client amounts to one.

One of the factors which may give rise to a contingency fee arrangement is where the value of the shares or share options given to the Law Practice depends upon the successful outcome of the matter on which the Law Practice is instructed to act. It is obviously not possible to exhaustively define all situations, which would give rise to a contingency fee agreement. Each case would depend on its own facts.

An agreement where the acquiring of shares is contingent on the outcome of a contentious matter or where the shares are themselves the subject matter of the litigation, would amount to contingency fee arrangement under section 107 of the LPA.

In addition to the above, Council reminds members of the restriction in section 107(3) of the LPA in relation to the law of maintenance and champerty.

(ii) Overcharging

A Law Practice must consider the requirement of reasonableness of any fee arrangement whether in contentious or non-contentious matters. The equity that a Law Practice receives in lieu of fees must be reasonable. Section 109 of the LPA refers and particular attention is drawn to sections 109(1), 109(3), 109(4), 109(5) and 109(6) of the LPA.

In determining reasonableness the following factors, *inter alia*, should be considered:

(a) the quantity of shares to be owned by the Law Practice;
(b) the liquidity of the shares, including whether the shares are traded publicly at the time of the fee agreement and if the shares are not traded, the probability of such shares being publicly traded in the future;
(c) the present and anticipated value of the shares; and
(d) whether the shares offered are subject to terms which may affect the value of the shares to the Law Practice.

Council notes that there is no judicial guidance as to whether the courts would look at the value of the shares/share options at the time these are granted to the Law Practice or their ultimate value. This uncertainty could have a bearing on the outcome of taxation proceedings under section 109 of the LPA or when assessing the reasonableness of the agreement to accept equity in lieu of fees.

It would therefore be prudent that any agreement between a Law Practice and client for equity in lieu of fees should be in writing. This would reduce the risk of challenge that the agreement was unfair and/or unreasonable.

The risk of challenge will also be reduced if the client is advised to obtain independent legal advice on the terms of any proposed agreement. At the very least the Law Practice should suggest to the client that they should consider taking independent advice and the reasons for doing so. Council notes that several law firms in America have been held liable for failing to advise their clients to obtain independent legal advice before entering into such arrangements.

(iii) Conflict of interest

The shareholding in the company may affect the future professional dealings between the Law Practice and the client. The shareholding may put the Law Practice in a position of conflict of interest such that the Law Practice may have to consider if it can provide impartial representation or advice to the client. Council notes that the risk of potential conflict of interest has been the source of greatest concern in other jurisdictions and has, in some cases, given rise to litigation between the client and the Law Practice.

Where a Law Practice agrees to accept equity in lieu of fees, it should ensure that by doing so it does not thereby put its commercial interests above the interest of the client. The Law Practice should not allow its judgement, objectivity and loyalty to the client to be compromised in any way by reason of its equity involvement.

The acceptance of a non-executive directorship in the company is not prohibited. Again, in view of the equity participation, a Law Practice including individual members of the Law Practice will have to consider issues of personal and professional conflict of interest.

The Council would discourage a Law Practice from receiving a substantial share ownership in the company. This will potentially cause a clear conflict of interest.

Rules 20–22 of the Legal Profession (Professional Conduct) Rules 2015 (S 706/2015) on conflict of interest are relevant and should be carefully considered.

(iv) Secret profits

Because of its fiduciary relationship with the client, the Law Practice should ensure that there is no risk of it receiving any profits which may be construed as secret profits.

(c) Other matters

The Law Practice should also bear in mind the prohibition against sharing of profits with an unqualified person. This prohibition would apply equally to shares received by the Law Practice in lieu of fees. Council would therefore prohibit a Law Practice from holding its equity ownership of shares received in lieu of fees in a separate or distinct investment partnership/company if such an arrangement amounts to sharing of profits with an unqualified person.

Nothing herein will prohibit a Law Practice from selling any shares received in lieu of fees to any third party for valuable consideration in an arm's length transaction. The Law Practice should also carefully consider the income tax and goods and service tax implications of receiving equity in lieu of fees.

B. Forming of Holding Company to Hold and Receive Equity Ownership Taken by the Firm in Lieu of Fees

[Formerly Council's Practice Direction 2 of 2000]

The Council issued Part A of this Practice Direction for the guidance of members on the issues to be considered when accepting equity in lieu of fees.

The Law Society's Ethics Committee was requested to give guidance on the issue of members forming a holding company to hold and receive equity ownership taken by the Law Practice in lieu of fees and whether to do so would amount to sharing of fees with an unqualified person.

The Council does not see any difficulty in members forming such a holding company purely as a vehicle to hold equity received in lieu of fees subject to the following:

(a) All the shares in the holding company must be legally and beneficially owned by legal practitioners who have valid practising certificates. All the directors of the holding company must also be legal practitioners who have in force practising certificates.

(b) Legal practitioners who have valid practising certificates must beneficially own the equity in lieu of fees (to be vested in the holding company).

(c) The above requirements must be complied with at the time the agreement to accept equity in lieu of fees is entered into and when the entitlement to receive such equity, pursuant to the agreement, arises.

Members should make appropriate arrangements to comply with the above in the event of a member ceasing practice and/or upon death.

Date: 31 January 2019

THE COUNCIL OF THE LAW SOCIETY OF SINGAPORE