Office of Government Ethics

99 x 24

Letter to a Private Attorney dated December 14, 1999

This is in response to your letter to the Office of Government Ethics (OGE), dated October 26, 1999, in which you inquired whether a proposed compensation plan for certain former Government employees at your firm would be permissible under 18 U.S.C. § 203. Based on the facts set out in your letter, as well as in a subsequent telephone conversation between you and a member of my staff, we have concluded that the proposed compensation plan would pose a potential problem under section 203 for one of the former employees about whom you inquired, but not for the others.

FACTS

Former Federal employees sometimes are hired by your firm as “contract partners” for a certain period of time after they leave Government service. Contract partners have the same voting rights and other privileges as “equity partners,” but they have a different compensation plan. Compensation for these contract partners is fixed according to a projection of what partners of similar experience are expected to receive for the calendar year. The basis for this projection is the firm’s annual budget, which includes an estimate of revenues and expenses for the following year. The firm budget is calculated each year for reasons other than the establishment of compensation for contract partners, although it is used for the latter purpose as well. Past experience indicates that this budget, which is a function of general trends perceived at the firm, is very imprecise, owing largely to the relative unpredictability of revenues. (Expenses are somewhat more predictable.) Consequently, the budget is revised every year around September, based in part on historical data concerning actual revenues received through July of the same year. At the same time, a corresponding adjustment is made to the compensation level for new contract partners. In 1999, the mid-year adjustment yielded an 11.5% increase in the compensation level.

Your firm hired one former Government employee in June 1999, prior to the September adjustment. In September, the firm also hired two other attorneys from the same Government agency as the first. The second two attorneys were automatically covered by the new compensation level, as they were hired after the 11.5% increase became effective. In the interest of "equity," your firm now proposes to increase the compensation level for the first attorney by 11.5%, "to ensure that he is treated equitably as compared to the compensation rate of other, similarly situated attorneys in our firm with fixed compensation."

You did not indicate that the possibility of a mid-year compensation adjustment was discussed with the first attorney at the time he was hired. You stated that this question typically would not arise. On the one hand, when a contract partner begins work early in the year, there is no adjustment based on revised budget projections, and the lawyer receives the compensation as originally calculated. On the other hand, when the contract partner begins work later in the year, near the time of the mid-year budget correction, the compensation level is set according to the revised projections. In the instant case, the first attorney just happened to have started in June, which was neither early in the year nor after the actual budget revision, and he happened to come from the same agency as two attorneys who started in September and would benefit from the 11.5% increase.[1]

DISCUSSION

[1] You did indicate that the firm has some contract partners who are not former Government employees, such as attorneys who have joined the firm mid-year from other firms. For these contract partners, there is actually a year-end re-evaluation of the compensation rate. In such cases, there is a comparison of the projection-based compensation figure with the actual income received by the firm and the resulting partnership distributions received by partners of comparable experience. Where the compensation level set according to the earlier budget projection is particularly low in proportion to actual firm income, the compensation is revised upward. However, because of 18 U.S.C. § 203, the firm does not perform such a year-end adjustment for any contract partners coming from the Government, and it does not propose to do so.

18 U.S.C. § 203 prohibits an employee from receiving, either directly or indirectly, "any compensation for any representational services" in connection with a particular matter in which the United States is a party or has a direct and substantial interest. Section 203 applies equally to representational services rendered by the employee personally and to representational services rendered by another person, provided that the employee shares in the compensation for those services. The prohibition attaches if the covered representational services were provided at a time when the individual was still a Government employee, regardless of when the employee actually receives the compensation.

Pursuant to section 203, therefore, a former Government employee who joins a law firm may not share in any fees attributable to representational services provided by the firm while the individual was still employed by the Government. *See*, *e.g.*, OGE Informal Advisory Letter 93 x 31. This means, among other things, that the compensation plan may not be dependent on actual firm profits, where such profits result in any part from covered representational services. *See* 4B Op. O.L.C. 603 (1980). For example, a former employee may not receive a partnership interest that includes a share of fees generated from covered representational services rendered prior to the individual's termination from Government service. *See* OGE Informal Advisory Letter 90 x 10. Likewise, a former employee may not receive a bonus that is "calculated in any part based upon the firm's receipt of such fees." OGE Informal Advisory Letter 90 x 3. Where a firm calculates partnership income or bonuses based on actual receipts of fees, there must be a deduction to account for any income otherwise attributable to the firm's covered representational services. Moreover, in such cases, the firm "may not make up any resulting disparity so that [the individual does] not suffer any economic loss." OGE Informal Advisory Letter 84 x 3.

Nevertheless, as your letter recognizes, OGE has held that the payment of a fixed rate of compensation is one means of avoiding the prohibition of section 203 against sharing in compensation for covered representational services. *See*, *e.g.*, OGE Informal Advisory Letter 84 x 6. Where a firm prospectively fixes a rate of compensation (such as a salary or hourly wage), the compensation becomes an obligation of the firm itself to the individual, not an obligation contingent on fees from any particular source or activity, including fees from covered representational services. *See* OGE Informal Advisory Letter

83 x 19. Under such circumstances, the former employee's compensation will not vary according to any fees actually received by the firm, but may be greater or less than a typical partnership share of the fees actually received by the firm.

Based on the facts you have provided, it appears that your firm has attempted to set a fixed compensation level, as opposed to a traditional partnership share. However, it is also true that the formula for determining that fixed compensation level is dependent on the anticipated partnership share of other partners in the firm. This anticipated partnership share, in turn, is dependent on a projection of fees received in the upcoming year, with no deduction or set-off for projected fees for covered representational services. Furthermore, with respect to the former Government employee who joined your firm in June, the initial "fixed" compensation level was revised upward in September, as a result of a new projection of annual revenues based partly on actual historical data concerning fees already received through July of the year, including, presumably, fees already received for covered representational services.

The closest analogy to these circumstances is the situation addressed in OGE 93 x 31. In that case, a law firm proposed to fix the compensation of two former employees based on a projection of estimated receipts from billings, rather than the actual fees received or receivable by the firm for the year. This fixed amount was to be paid regardless of how accurate the estimate ultimately proved. Moreover, the firm specifically proposed to exclude from the calculation any billings for representational services provided during the period that the former employees served in the Government. We concluded that the plan was consistent with section 203, as it eliminated the central concern that former employees "not share specifically in any fees earned by the firm for representations to the Federal Government made during any period in which the individuals were employed by the Federal Government."

Unlike the firm in OGE 93 x 31, your firm does not propose any measure specifically to exclude projected receipts for covered representational services from your calculation of a fixed compensation rate for former Government employees. The budget figures on which the compensation level is based do not discriminate between projected receipts for covered representational services and projected receipts for any other services. However, given the variety and complexity of law firm compensation plans, each proposal must be scrutinized on a case-by-case basis, and the plan described in OGE 93 x 31 is by no means normative. Section 203 does not invariably require a law firm to exclude any projected receipts attributable to covered representational services, for purposes of calculating a fixed, prospective rate of compensation. *See* 4 Op. O.L.C. at 603 (non-partner may receive salary attributable to earnings from representational services, as long as no share in firm profits). Nevertheless, where no such exclusion is made, it is all the more important that the compensation truly be “fixed” and not contingent on firm receipts and profitability. *See* OGE 90 x 10 (“straight” salary); OGE 90 x 3 (same). In this connection, we are mindful that section 203 expressly prohibits an employee from receiving compensation “directly *or indirectly*” from covered representational services (emphasis added).

Under the facts you present, we do perceive a potential section 203 problem with respect to your proposal to adjust the compensation of the former employee who commenced employment with your firm in June. There is a good argument that the mid-year compensation adjustment would allow the former employee to benefit, at least indirectly, from fees actually received by the firm, because the raise is predicated in part on historical data concerning fees actually received through the first seven months of the year. Clearly, the former employee would be allowed to share in the firm’s better than anticipated profitability through the mid-year. One might even analogize the adjustment to a bonus tied to increased firm profitability. Obviously, the question is one of degree: at some point, a compensation adjustment more closely approximates actual receipts, and the failure to calculate any set-off corresponding to receipts for covered representational services begins to look more like an effort to make up any disparity between former Government employees and ordinary equity partners. *See* OGE 84 x 3. With respect to the former employee who joined your firm in June, we cannot say that the September compensation adjustment would not violate section 203.

We do not have such concerns, however, with respect to the other two former employees who joined your firm in September. These attorneys are not subject to any upward adjustment in their compensation because they began employment after the mid-year increase was established. Even though their compensation has been determined on the basis of total projected firm income, with no set-off for projected fees from covered representational activities, their compensation level is truly fixed. The amount to be received by these attorneys will not vary depending on actual firm profitability during the course of their employment.

Conclusion

To summarize, we perceive no problem under 18 U.S.C. § 203 with respect to the two former Government employees who joined your firm after the adjusted compensation level became fixed. However, we believe that the proposed adjustment would raise serious concerns under section 203 for the attorney who already had been employed at a lower rate, because his compensation would not be sufficiently fixed but rather contingent on increases in firm profitability, attributable in part to fees for covered representational services.

Sincerely,

Stephen D. Potts
Director