ADVISORY ETHICS OPINION 1998-08

SYNOPSIS:

A lawyer may not accept a fee from an investment advisor for referring clients to the advisor even with prior disclosure and consent by the client. Clients view recommendations to other professionals as part of their representation by their lawyers and expect their lawyers to act independently of any underlying financial interest in such a referral.

QUESTION:

May a lawyer accept a referral fee for referring clients to an investment advisory service ("investment advisor") after disclosure to the client of the agreement between the lawyer and the investment advisor and the fee arrangements contemplated by this referral?

FACTS:

An investment advisory firm ("advisor") proposes to associate with a Vermont attorney, paying that attorney a referral or solicitor's fee for referring potential clients to the advisor. The fee paid would be a percentage of the fee paid by the client to the advisor. The services to be performed by the attorney would be limited to distribution of materials, attending initial meetings, assisting in directing the services that best fit the client's investment needs and receiving copies of periodic statements for monitoring the client's program involvement. The client would initially be provided a written disclosure setting out information concerning the investment advisor, the attorney, and the compensation arrangement. For purposes of this decision, all conduct undertaken by the attorney would be in compliance with applicable registration requirements or exceptions to the Vermont Securities Act and the Investment Advisor's Act of l940. The attorney requests an opinion on the appropriateness of this proposed arrangement.

DISCUSSION:

Other state bar advisory committees considering whether a lawyer may ethically receive a fee or compensation simply for referring clients to a certain investment company have differed on both the analysis of the issue and the propriety of the fee arrangement. Connecticut (Op. 97-l6, 6/4/97), Illinois (Op. 97-4, undated), and Missouri (Op 96-0l24, undated) have issued opinions approving this arrangement after full prior written disclosure and client consent to the payment of a fee for soliciting the referral, not practicing law. The approving jurisdictions acknowledge a presumption of undue influence upon the client on the part of the attorney as well as potential client confusion over the role the attorney plays in the lawyer/client relationship, and the investment advisor's role following the referral. The Missouri Committee directed that referrals should be based upon objective criteria and warned that the potential for a conflict of interest between zealous representation of the client and financial self-interest of the attorney is "quite high in this situation".[1]

The decisions which disapprove of this type of fee arrangement have generally based their reasoning upon the inherent financial conflict of interest this arrangement creates in violation of DR 5-l07.

DR 5-l07 Avoiding Influence by Others Than the Client.

(A) Except with the consent of his client after full disclosure, a lawyer shall not:
  (l) Accept compensation for his legal services from one other than his client.
  (2) Accept from one other than his client any thing of value related to his representation of or his employment by his client.

They also note the violation of the lawyer's duty to maintain independent professional judgment and avoid a conflict of interest prohibited by DR 5-l05.

DR 5-l05 Refusing To Accept or Continue Employment if the Interests of Another Client May Impair the Independent Professional Judgment of the Lawyer.

(A) A lawyer shall decline proferred employment if the exercise of his independent professional judgment in behalf of a client will be or is likely to be adversely affected by the acceptance of the proferred employment, or if it would be likely to involve him in representing differing interests, except to the extent permitted under DR 5-l05(C).

[1] Missouri (Op. 96-0l24).

It is unethical to divide legal fees with a non-lawyer under DR 3-l02.

DR 3-l02 Dividing Legal Fees With a Nonlawyer.

(A) A lawyer or law firm shall not share legal fees with a nonlawyer, except that:

(l) An agreement by a lawyer with his firm, partner, or associate may provide for the payment of money, over a reasonable period of time after his death, to his estate or to one or more specified persons.

(2) A lawyer who undertakes to complete unfinished legal business of a deceased lawyer may pay to the estate of the deceased lawyer that proportion of the total compensation which fairly represents the services rendered by the deceased lawyer.

(3) A lawyer or law firm may include nonlawyer employees in a retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement.

It may be unclear to a client whether the attorney in referring the client would be rendering legal services or investment advice. While the fees are attempted to be characterized as something other than "legal fees", the arrangement expressly provides for dividing fees with the non-lawyer advisor and paying the fee for referring the client, not for providing legal services.

The Illinois Appellate Court summarized its displeasure with an arrangement for the attempted contractual referral and exchange of clients from law firm to law firm by stating that . . .

> "profiting from the solicitation of professional employment is injurious to the legal profession and to the public. As the various authorities reveal, this practice is injurious to the legal profession since the public loses confidence in those who treat clients as merchandise in a market place rather than the recipients of the attorney's skills and abilities. More important, the best interest of the clients are jeopardized by the arrangements when it becomes more profitable for attorneys to sell clients than to give them a legal service."

The New York State Bar Association, in Opinion 682, noted that investment advice and services vary substantially among providers and that a referral fee or percentage of the investment service fee in future years cannot be objectively determined by the transaction.[2] The Committee further noted that clients view recommendations of other professionals simply as part of their representation by the lawyers and expect their lawyers to act as fiduciaries in making such recommendations.

Our Opinion 94-l disapproved of a somewhat related proposed arrangement whereby the attorney participated in financial planning arrangements, gathered information to prepare estate documents, and proposed an association with a financial planning organization, citing DR 3-l0l (Aiding Unauthorized Practice of Law), DR 3-l02 (Dividing Legal Fees With a Nonlawyer), and DR 5-l07 (Avoiding Influence by Others than Client).

CONCLUSION:

For these reasons, and to engender public confidence and client trust in the rendering of all attorney services, the Committee concludes that it is improper for an attorney to receive a commission or a fee for referring clients to an investment advisor.

[2] Corti v. Fleisher, 93 Ill. App 3d 5l7, 4l7 NE 2d 764 (Ill. App Ct. l98l).