

## Utah Ethics Opinions

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UTAH STATE BAR

Ethics Advisory Opinion Committee

Opinion 04-05

December 2, 2004

**Issue:** Do the Utah Rules of Professional Conduct preclude a lawyer from forming a cooperative organization that offers certain non-legal, but law-related, services such as trust administration and investment management; referring clients to that organization; and participating in the organization's profit sharing?

**Opinion:** It is not per se unethical for a lawyer to refer a client to a cooperative organization created by the lawyer to provide non-legal services and for the lawyer to participate in the organization's profit sharing. If the lawyer complies with the following, then the arrangement is permissible: (1) objectively concludes that any identifiable conflicts between the lawyer and the cooperative organization would not materially affect the representation of that client; (2) affirms in writing to the client that the referral will not compromise the client's interests in any way; (3) fairly concludes that the services provided by the cooperative organization are being provided at fair and reasonable fees; (4) discloses that the lawyer will receive a share of profits from the cooperative organization; (5) advises the client to seek independent counsel as to the referral; and (6) secures the client's consent.

**Facts:** A group of Utah lawyers proposes the formation of a cooperative organization (the "Co-op") to offer certain non-legal, but law-related, foundation and charitable trust services and products, such as plan designs, administration, wealth enhancement, insurance and investment management (the "services" and "products") for a fee or for customary compensation where products are involved. The Co-op would serve as the provider. A lawyer-member of the Co-op would refer a client to the Co-op's staff, who would, in turn, arrange to provide the desired services and/or products.

Although the lawyers would be members of the Co-op, the legal services they would provide to the clients would be independent from the Co-op. The lawyers would provide and bill for their legal services through their respective law

firms. The billed legal services would not involve the Co-op in any way. The lawyer-members would receive a proportionate share of the Co-op's profits.

**Analysis:** The most relevant rules to the issue at hand are Rules 1.7 and 1.8 of the Utah Rules of Professional Conduct and ABA Model Rule of Professional Conduct 5.7,1 which provide in pertinent part:

### [Utah] Rule 1.7. Conflict of Interest: General Rule

(b) A lawyer shall not represent a client if the representation of the client may be materially limited by the lawyer's responsibilities to another client or to a third person or by the lawyer's own interest, unless:

(1) The lawyer reasonably believes the representation will not be adversely affect; and

(2) Each client consents after consultation. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation to each client of the implications of the common representation and the advantages and risks involved.<sup>2</sup>

**[Utah] Rule 1.8. Conflict of Interest: Prohibited Transactions** (a) A Lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security, or other pecuniary interest adverse to a client unless:

(1) The transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which can be reasonably understood by the client; and

(2) The client is given a reasonable opportunity to seek the advice of independent counsel in the transaction; and

(3) The client consents in writing thereto.<sup>3</sup>

**[ABA Model] Rule 5.7. Responsibilities regarding Law-Related Services** (a) A lawyer shall be subject to the Rules of Professional Conduct with respect to the provision of law-related services, as defined in paragraph (b), if the law-related services are provided:

(1) by the lawyer in circumstances that are not distinct from the lawyer's provision of legal services to clients; or

(2) in other circumstances by an entity controlled by the lawyer individually or with others if the lawyer fails to take reasonable measures to assume that a person obtaining the law-related services knows that the services are not legal

services and that the protections of the client-lawyer relationship do not exist.

(b) The term "law-related services" denotes services that might reasonably be performed in conjunction with and in substance are related to the provision of legal services, and that are not prohibited as unauthorized practice of law when provided by a nonlawyer.<sup>4</sup>

Here, quite clearly, representation "may be materially limited," within the meaning of Rule 1.7(b), because of at least two potential conflicts. First, there is a potential conflict between the lawyer's representation of the client and the lawyer's interest in receiving compensation for referrals to the Co-op. Second, there is a potential conflict between the client's interest and a "third person"—namely, the Co-op. The threshold question, then, is under what circumstances, if any, could a lawyer reasonably seek consent under Rule 1.7(b)(2). The follow-up question is what disclosures or representations should the lawyer make to the client, assuming the lawyer can reasonably seek the client's consent for the referral to the Co-op.

This Committee has addressed and decided this issue as applied to lawyer referrals to investment advisors in Opinion 99-07.<sup>5</sup> The issue in Opinion 99-07 was, "May a lawyer refer a client to an investment advisor for investment and financial planning and take a referral fee from the commission paid by the client to the investment advisor?" The Committee concluded, "It is not per se unethical for a lawyer to refer a client to an investment advisor and take a referral fee from the commission paid to that advisor, although the lawyer has a heavy burden to insure compliance with applicable ethical rules."

In our analysis in Opinion 99-07, we identified multiple potential conflicts that may arise under such circumstances, and the analysis, disclosures and consent the lawyer must undertake and secure to comply with Rule 1.7.

For example, notwithstanding having given written approval for the transaction, the client may later have concerns that the lawyer is not providing unbiased advice or that loyalty to the client is compromised by the financial arrangement with the investment advisor. It is possible that the lawyer's professional judgment might be compromised by a motivation, overt or subconscious, to preserve the advisor's fee-sharing arrangement, even though a change in the client's financial interests might suggest some other arrangement. It is possible a lawyer might be motivated to give the client different or inferior legal advice due to the pecuniary interest involved with the financial advisor. There is a potential conflict if the lawyer were asked to mediate, litigate, or otherwise remedy a problem due to deficiencies on the part of the financial advisor. There is the

possibility that the client might have been able to negotiate a lower commission had the lawyer not been receiving a commission from the investment advisor, and hence the arrangement might not be fair to the client. For example, a lawyer performing estate-planning services for the client might be in a position that is more likely to exert undue influence than a lawyer providing entirely unrelated legal services. Additional issues arise if the investment advisor is also a client of the lawyer.<sup>6</sup>

Opinion 99-07 notes that some jurisdictions have concluded such referral arrangements are strictly prohibited, while others have found them acceptable under carefully circumscribed conditions. States prohibiting such referrals include New York, Kentucky, and Arizona,<sup>7</sup> which conclude that the lawyer's fee arrangement is likely to interfere materially with the lawyer's independent judgment. Other states, including Connecticut and Missouri, conclude that the potential for conflict, although high, does not establish a per se prohibition against such referral arrangements.<sup>8</sup> Our Committee agreed that application of Rule 1.7(b) did not result in a per se proscription and outlined the conditions under which lawyers—after careful consideration—might enter into such arrangements.

Opinion 99-07 also found that the referral transaction described there was a "business transaction with a client" subject to Rule 1.8(a). Neither the rule nor Opinion 99-07 expressly defines what constitutes a "business transaction with a client," but we assume, for purposes of this opinion, that the lawyer referral to a Co-op as described above is a business transaction and thus falls within the scope of Rule 1.8 (a).

Our analysis of Rule 1.8 (a) in Opinion 99-07 cited favorably to the lawyer's "to do list" set forth in a Connecticut Bar Association opinion that conditionally approved such relationships. The Connecticut Bar's requirements were that the lawyer should:

(a) determin[e] that the obligations to the client would not be compromised in any way; (b) assur[e] that the terms of the transaction under which the lawyer acquires the interest are fair and reasonable to the client; (c) mak[e] full disclosure to the client in writing to consider seeking the advice of an independent counsel; and (e) giv[e] the client a reasonable opportunity to do so. The lawyer must also clarify in writing whether she is performing legal services in making the referral.<sup>9</sup>

Our analysis of Opinion 99-07 is important here because the Co-op arrangement described above is less likely to produce a non consentable conflict of interest under Rule 1.7(b) or 1.8(a) than direct compensation to a lawyer for referrals to investment advisors. This is because the

lawyer's compensation from the Co-op is indirect and generated from the Co-op's general profits; not from an identifiable and direct single referral. For example, the referring lawyer's compensation will not have a direct connection with the particular non legal professional who provides the Co-op services and products when (a) the referral to the Co-op does not involve a particular named professional<sup>10</sup> or (b) the net profit payouts to the Co-op<sup>11</sup> member are not directly associated with the particular clients that the lawyer had referred to the Co-op. Hence, compliance with our admonitions in Opinion 99-07 would necessarily satisfy ethical concerns in the Co-op arrangement.

A final ethical consideration relates to the direct services that may be provided to clients by Co-op personnel. To the extent that such services would be "law-related," as that term is defined in ABA Model Rule of Professional Conduct 5.7, Utah Ethics Advisory Opinion 98-08 concluded that "a law firm [may] wholly own an accounting practice subsidiary for the lawyer's clients and others," with the caveat that "the law firm will be subject to the Utah Rules of Professional Conduct with respect to the provision of these law-related services in certain circumstances."<sup>12</sup>

The requesting party here assumed that Co-op services would not be law-related within the meaning of Opinion 98-08. However, we assume that they are law-related, because the Co-op services, such as trust administration, "might reasonably be performed in conjunction with and in substance are related to the provision of legal services."<sup>13</sup> Our conclusion, however, does not turn on this assumption.

**Summary:** It is not per se unethical for a lawyer to refer a client to a cooperative organization formed by the lawyer and other lawyers to provide non-legal services and for the lawyer to participate in the organization's profit sharing. However, compliance with Rule 1.7 and Rule 1.8 will be ensured if the Co-op lawyer making the referral is certain that the following itemized check-list is satisfied:

(1) Objectively conclude that any identifiable conflicts between the lawyer and the cooperative organization would not materially affect the representation of that client;

(2) Affirm in writing to the client that the referral will not compromise the client's interests in any way;

(3) Conclude that the services provided by the cooperative organization are being provided at fair and reasonable fees;

(4) Disclose that the lawyer will receive remuneration based on the profitability of the cooperative organization;

(5) Advise the client to seek independent counsel as to the referral;<sup>14</sup> and

(6) Secure the client's consent.<sup>15</sup>

#### Footnotes

1. Utah has not yet adopted ABA Model Rule 5.7, although two Utah ethics opinions have favorably cited that rule. Utah Ethics Advisory Op. 98-08, 1998 WL 716635 (Utah St. Bar); Utah Ethics Advisory Op. 02-04, nn. 6-7, 2004 WL 448569 (Utah St. Bar).

2. Utah Rules of Professional Conduct 1.7 (b) (2004).

3. Utah Rules of Professional Conduct 1.8 (a) (2004). We note that the current ABA Model Rule of Professional Conduct 1.8(a) requires that notice to the client to seek advice of independent counsel *must be in writing* and that the client *must sign* any informed consent. Utah has not yet adopted the new Model Rules, but the process of considering their adoption, including ABA Model Rule 1.8, is currently under way. Lawyers are advised to check the current version of the rule.

4. Annotated Model Rules of Professional Conduct 5.7 (ABA 5th ed. 2003).

5. Utah Ethics Advisory Op. 99-07, 1999 WL 1167097 (Utah St. Bar).

6. *Id.*

7. N.Y. Comm. on Prof. Ethics Op. 682, 1996 WL 74860 (N.Y. State Bar Ass'n); Ky. Bar Ass'n Ethics Comm. Formal Op. E-390 (July 1996); Ariz. Jud. Advisory Op. 98-02, 1999, WL 667267 (Ariz. Sup. Ct. Jud. Ethics Advisory Comm.).

8. Conn. Ethics Op. 94-25, 1994 WL 780842 (Conn. Bar Ass'n); Mo. Bar Office of Chief Disciplinary Counsel, Informal Adv. Op. 960124 (1996).

9. Conn. Ethics Op. 97-16, 1997 WL 700650 (Conn. Bar Ass'n).

10. Where the referring lawyer would not specify a particular investment advisor, for example, but the Co-op would provide a list of investment advisors from which the client chooses.

11. That is, once the lawyer sends the client to the Co-op, the amount of revenue to the Co-op from the client would not generally be known to the individual referring lawyer.

12. Utah Ethics Advisory Op. 98-08, 1998 WL 716635 (Utah St. Bar).

13. Annotated Model Rules of Professional Conduct 5.7 (ABA 5th ed. 2003). We note here, as we did in Opinion 98-08, that certain aspects of this opinion are consonant

with the provisions of Model Rule 5.7. However, the conclusions of this opinion are drawn from our analysis of the existing Utah Rules of Professional Conduct. We do not necessarily endorse Model Rule 5.7; adoption of any such rule is within the purview of the Utah Supreme Court.

14. *See note 3, supra.*

15. *See note 3, supra.*

Rules Cited:

1.7

1.8