

## Utah Ethics Opinions

1999.

99-07. USB EAOB Opinion No. 99-07

Utah State Bar

Ethics Advisory Opinion Committee

Opinion No. 99-07

Approved December 3, 1999

**Issue:** 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?

**Opinion:** 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.

**Facts:** A lawyer and an investment advisor enter into an agreement under which the investment advisor agrees to pay a commission to the lawyer for the lawyer's referral of the lawyer's client to the investment advisor.

The lawyer will not charge the client any fee in connection with making the referral and will disclose to the client in writing that, if the client uses the services of the investment advisor, the investment advisor will pay a percentage of his regular commission to the lawyer. (fn1) The client would not pay the investment advisor any additional fee or commission as a result of the referral. The client will be asked to sign the disclosure statement acknowledging the referral-fee arrangement between the lawyer and the investment advisor.

**Analysis:** Rules 1.7(b) and 1.8(a) of the Utah Rules of Professional Conduct are directly applicable to this situation. (fn2)

### *Considerations Under Rule 1.7*

Rule 1.7 provides that a lawyer may not represent a client under circumstances in which that representation may be materially limited by the lawyer's own interest unless the lawyer reasonably believes the representation will not be adversely affected and the client consents. This rule is directly applicable to the present situation.

The Committee observes that this rule does not establish a

*per se* prohibition against representation of a client in a situation in which a lawyer has a separate interest, but leaves the situation open for careful analysis. In connection with such an analysis, the comments to Rule 1.7 emphasize the importance of a lawyer's accepting and maintaining loyalty to her clients and preserving independence in order to properly represent the client's interests rather than the lawyer's personal interests:

Loyalty to a client is also impaired when a lawyer cannot consider, recommend or carry out an appropriate course of action for the client because of the lawyer's other responsibilities or interests. . . . A possible conflict does not itself preclude the representation. The critical questions are the likelihood that a conflict will eventuate and, if it does, whether it will materially interfere with the lawyer's independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the client. Consideration should be given to whether the client wishes to accommodate the other interest involved. (fn3)

The Rule 1.7 comment goes on:

The lawyer's own interests should not be permitted to have adverse effect on representation of a client. For example, a lawyer's need for income should not lead the lawyer to undertake matters that cannot be handled competently and at a reasonable fee. See Rules 1.1 and 1.5. If the probity of a lawyer's own conduct in a transaction is in serious question, it may be difficult or impossible for the lawyer to give a client detached advice. A lawyer may not allow related business interests to affect representation, for example, by referring clients to an enterprise in which the lawyer has an undisclosed interest. (fn4)

Applying Rule 1.7(b) and the related comments to specific situations can be difficult. Indeed, similar questions have been considered in a number of other states and have resulted in a split of authority, some state bars finding this type of conduct to be *per se* unethical and the remainder finding that the conduct may be ethical under some circumstances.

States finding the practice *per se* unethical under Rule 1.7 include Arizona, (fn5) Kentucky, (fn6) Nevada (fn7) and New York. (fn8) In essence, these states conclude that no amount of disclosure can overcome the conflict in interest between the lawyer and client in this type of situation.

For example, New York determined that no meaningful consent could be given by a client because of the direct and substantial conflict between the client's and lawyer's interests inherent in accepting a referral fee from an

investment advisor. The New York opinion concluded that there is a possibility that the lawyer might give the client different or inferior legal advice due to her financial interest.

Kentucky concluded that the prospect of a lawyer's compensation, supplementary to the legal fee already being paid by a client is likely to interfere materially, on a continual basis, with the lawyer's independent professional judgment in objectively considering the client's best interests. Moreover, the Kentucky opinion concluded that in many instances the situation could involve the lawyer in matters beyond her professional competence. This would make it difficult or impossible for the lawyer to disclose fully and fairly to the client the consequences of pursuing the recommended course instead of other alternatives that the lawyer is unlikely to have evaluated or considered. The Kentucky opinion noted that, if the client suffered a loss of assets under management by the investment advisor, the lawyer could be challenged to explain satisfactorily that her advice was based upon independent professional judgment and was not clouded by the pecuniary interest in the fees generated by the investment advisor.

The Arizona opinion focused on the duty of loyalty, concluding that loyalty is impaired when a lawyer has other interests. First, the client may feel that the lawyer is not providing unbiased advice or counsel based on the monetary interest the referral represents. Second, the lawyer's professional judgment may be affected, perhaps unconsciously, by the knowledge that each referral will result in a payment from the investment advisor. With this monetary incentive, it is possible that the lawyer may refer a client to the investment advisor despite the fact that the client's financial interests would be better served through other means. Moreover, if the client received deficient or inappropriate advice from the investment advisor, the lawyer might be placed in an ethically impermissible position of attempting to mediate, litigate or remedy the situation for the client. Third, the client might be reticent to be candid with the lawyer because of the fear that the client's information would be imparted, perhaps inadvertently, to the investment advisor.

Other states, including Connecticut (fn9) and Missouri, (fn10) have found that Rule 1.7 does not establish a *per se* prohibition against this type of conduct, although they observe that the potential for conflict is quite high. These jurisdictions reason that, although the payment of a referral fee by an investment advisor causes the lawyer to have an interest that raises issues under Rule 1.7, it may be possible for her to determine that there is no conflict of interest and that her interest will not adversely affect the client or the lawyer's duty of loyalty to the client.

### *Considerations Under Rule 1.8*

The Committee finds that Rule 1.8 is also applicable to the question presented. Rule 1.8 provides that a lawyer may not enter into a business transaction with a client or acquire a pecuniary interest adverse to a client unless the transaction is fair and reasonable to the client; the terms are fully disclosed in writing in a manner the client can reasonably understand; the client is given a reasonable opportunity to seek the advice of independent counsel; and the client consents in writing to the business transaction. (fn11)

Connecticut (fn12) and Illinois (fn13) have also relied on Rule 1.8 in their related consideration of the question presented. Illinois determined that referring a client to an investment advisor in return for a percentage of the advisor's fee is a business transaction with the client. The lawyer may nevertheless charge a fee for providing business services to the client, provided the lawyer complies with Rule 1.8 and applicable case law. The Illinois opinion asserted that case law provides that there is a rebuttable presumption of undue influence over a client when a lawyer enters into a business transaction with the client. Under these circumstances, it was concluded that the lawyer must introduce clear and convincing evidence to rebut the presumption of undue influence. This would need to include a showing that the client consented to the arrangement after full disclosure. Full disclosure would include informing the client about the risks of the transaction and the fact that the lawyer would not be involved in any way to protect the client's interest but would continue to receive a portion of the advisor's fee.

Connecticut determined that the referring lawyer could meet the obligations of Rule 1.8 by: (a) determining that the obligations to the client would not be compromised in any way; (b) assuring that the terms of the transaction under which the lawyer acquires the interest are fair and reasonable to the client; (c) making full disclosure to the client in writing in a way which the client can reasonably understand; (d) advising the client in writing to consider seeking the advice of an independent counsel; and (e) giving 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. Finally, the client must consent to the arrangement in writing.

### *The Committee's Conclusion*

The Committee finds Rules 1.7 and 1.8 both to be applicable, and both must be satisfied. We share the worries expressed by the states that have declared *per se* prohibitions against a lawyer's receiving compensation for making a client referral to an investment advisor. Nevertheless, we find more persuasive the rationale set forth in the opinions permitting a reasoned analysis of all of

the facts of the particular situation.

Many issues need to be considered in reaching an objective conclusion that there is no conflict of interest that is adverse to the client's best interests. The Committee's view is that the affected lawyer should commence the analysis of these issues with a strong concern that the lawyer may exert undue influence over the client or that the duty of loyalty could be impeded. In addition, the lawyer must consider other relevant factors before determining that it is appropriate to receive a commission from an investment advisor to whom a referral is made.

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 a 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.

In view of these concerns, the Committee believes it will be very difficult for a lawyer to maintain independence while taking a percentage of an investment broker's services due to a client referral. Nevertheless, the Committee concludes the spirit and specific language of Rules 1.7 and 1.8 require that individual lawyers involved in this type of situation be permitted to consider all of the facts and reach a determination whether a conflict of interest exists. As long as such a determination meets the specific requirements of Rules 1.7 and 1.8 and is objectively reasonable in view of concerns expressed in this Opinion, there will be no ethical violation.

## APPENDIX I

### *Rule 1.7. Conflict of Interest: General Rule. . . .*

(b) A lawyer shall not represent a client if the

representation of that 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 affected; 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.

### *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.

## Footnotes

1. As originally posed to the Committee, the inquiry characterized the lawyer's commission as a share of the commission charged to the client by the investment advisor. This Opinion applies as well to any form of commission or payment that the lawyer receives.

2. Rules 1.7(b) and 1.8(a) are attached as Appendix I.

3. Utah Rules of Professional Conduct 1.7, cmt. ("Loyalty to a Client").

4. *Id.* ("Lawyer's Interests").

5. Ariz. Jud. Advisory Op. 98-09, 1999 WL 667267 (Ariz. Sup Ct. Jud. Ethics Advisory Comm.)

6. Ky. Bar Ass'n Ethics Comm. Formal Op. E-390 (July 1996).

7. State Bar of Nev. Comm. on Ethics and Prof. Responsibility Formal Op. 24 (June 18, 1997).

8. N.Y. Comm. on Prof. Ethics Op. 682, 1996 WL742860 (N.Y. State Bar Ass'n).

9. Conn. Ethics Op. 94-25, 1994 WL 780842 (Conn. Bar Ass'n).

10. Mo. Bar Office of Chief Disciplinary Counsel, Informal Adv. Op. 960124 (1996).

11. *See* App. I.

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

13. Ill. State Bar Ass'n Op. on Prof. Conduct 97-04 (1997).

**Rules Cited:1.7(b)1.8(a)**