

Ethics Advisory Opinion Committee

Opinion No. 18-05

Issued November 29, 2018

ISSUES

1. To whom are the duties of professional conduct owed?
2. May a Registered Investment Advisory (“RIA”) firm hire an attorney to provide estate planning services for the clients of the RIA?
3. May the RIA pay the attorney’s fees out of the amounts that they collect as advisory fees for their clients so that the clients will not be charged extra if they use the lawyer’s estate planning services, nor less if they do not?
4. May the RIA pay the attorney higher fees when the attorney has brought the client to the RIA firm?

OPINION

1. The client. The duties of professional conduct are owed to the client.¹
2. Yes. A non-client may pay the attorney’s fees for a client provided the requirements of Rule 1.8(f) are met -- the arrangement is fully described to and consented to by the client, confidentiality is maintained with the client, and the person paying the fees does not interfere with the attorney’s professional judgment.

¹ This opinion assumes the attorney is representing only the estate-planning client. Representing both an RIA and the estate-planning client presents a multitude of conflict issues. As a practical matter, it would be impossible ethically to represent the estate-planning client without advising RIA in the fact pattern posited in this request.

3. No. Such an arrangement would violate Rule 5.4 that prohibits an attorney forming a partnership with a nonlawyer if any of their activities will include the practice of law and that prohibits splitting fees with a nonlawyer.

4. No. Such an arrangement would violate Rule 7.2 by giving something of value for a referral and may violate Rule 1.5 against “unreasonable fees.”

The arrangement described here is almost certain to violate the rules against fee-splitting and against the lawyer charging an unreasonable fee for services performed. Both issues arise from the proposed method of computing the attorney’s fee as a percentage of the fee collected by the RIA firm. Because the fee will vary substantially based on factors unrelated to the work performed by the attorney, whether the legal fee is reasonable will vary in a case-by-case basis. Further, because the total fee is split between the lawyer and the RIA, the request has not identified any principled method of determining the value of the legal services provided, and the client does not separately negotiate a fee for the legal services, the splitting of the overall fee constitutes fee-splitting. Finally, the fact that the lawyer charges the RIA a lower fee when the client is new to the lawyer likely means that the reduced fee represents an unethical referral fee paid by the lawyer to the RIA for recommending the lawyer’s services.

The employment arrangement also makes compliance with the Rules of Professional Conduct difficult if not impossible. The lawyer cannot form a partnership with the RIA without compromising the lawyer’s professional independence. If the lawyer is an employee or independent contractor it is almost inevitable that the lawyer will have to choose between offering independent and candid advice to the client and advancing the interests of the lawyer’s employer, the RIA.

BACKGROUND

A Registered Investment Advisory firm manages investments for many clients. The RIA firm clients often need estate planning services that make sense in light of their investments. An estate planning attorney will often recommend changes in how assets are held by a couple or family or in the mix of assets as part of the estate plan.

The RIA firm proposes to employ an estate planning attorney and make that attorney's legal services available to the RIA firm's clients. This arrangement will not require the clients to pay anything additional to receive these estate planning services. The RIA proposes to pay the attorney a percentage of the fee charged to the RIA firm's clients, but to pay a higher percentage when the attorney has referred the client to the RIA firm.

ANALYSIS

The first issue is who the client is. While an attorney could work for an RIA and advise the RIA, this contemplates the RIA hiring an attorney to represent its clients. Such an arrangement will result in the attorney and RIA client forming an attorney-client relationship with all the attendant responsibilities. This requires that attorney and client actually form an attorney-client relationship, that the attorney ensure that this representation does not present any conflicts of interest.

Third Party Payment of Attorney Fees

Lawyers are often hired by third parties to represent the interests of clients. This happens in various contexts, including: insurance companies defending their insureds, employers hiring attorneys to represent their employees, family members paying for the representation of their children, and in numerous other situations. There is nothing wrong with a third party paying an attorney to provide services for a client. However, for an attorney ethically to provide services

under a third-party payment arrangement, the attorney must comply with the terms of Rule 1.8(f). The rule requires that the client give informed consent to the third party's payment, that the payor not interfere with the lawyer's professional judgement, and that the lawyer maintain the confidentiality of the client's information.

Thus, if the RIA firm wished simply to hire an independent lawyer to represent any of the RIA firm's clients who requested the service on a client-by-client basis, there would be no problem, so long as the clients understood the arrangement, the lawyer was not influenced or controlled by the RIA firm, and the lawyer kept the client's confidences. We note that informed consent would require the lawyer to inform the client the amount of the fee they received for the representation.

However, the request here suggests a different arrangement than hiring an independent third-party lawyer. Specifically, though the proposed arrangement is never described in great detail it appears that the RIA firm that wishes to employ an in-house lawyer to perform legal services for the RIA firm's clients. The request explains that the lawyer may be hired as an employee of the RIA firm, or possibly as an independent contractor by the RIA firm. The request also explains that the lawyer will be paid, not based on an hourly fee or some other objective measure of the value of the legal work performed, but as a percentage of the RIA firm's advisory fees generated from the client, which is often calculated as a percentage of assets under management with some possibility of increasing the fee if the investments perform well. Also, the lawyer will get a higher percentage of the fee when the lawyer is the one who introduced the client to the RIA in the first instance.

Multidisciplinary Partnership

All of these aspects of the proposed arrangement suggest that what the lawyer and the RIA firm are actually proposing is a multidisciplinary partnership engaged in the practice of law in violation of Rule 5.4.²

Rule 5.4 has at least two provisions implicated by the request:

- A lawyer or law firm shall not share legal fees with a nonlawyer (Rule 5.4(a));
and,
- A lawyer shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law (Rule 5.4(c)).

Ethical Implications of The Fee Arrangement

While the request writes in a conclusory fashion that “the RIA firm will not share in any of the legal fees,” this is a distinction of semantics, not substance. The RIA firm’s clients will not negotiate a separate fee with the lawyer for the lawyer’s services. Rather, the clients will pay a single fee, which the RIA firm and the lawyer will later divvy up. In other words, what the request calls “legal fees” is decided by the lawyer and the RIA after the fact after the client has committed to pay a certain amount for all services the client will receive from the RIA and the lawyer. If the rule against fee splitting is to have any meaning at all it cannot be circumvented by calling the fees to be split something other than legal fees and designating as legal fees only the portion to be held by the lawyer.

This problem is made all the worse by the fact that the portion of the aggregate fee that will be “legal fees” will be influenced by factors other than the complexity of the legal work.

² This Opinion is strictly confined to the Rules of Professional Conduct applicable to lawyers and does not address any rules that may govern whether this arrangement may also violate the ethical or legal obligations of the RIA under the laws of Utah, the United States, or under any government or Self-Regulatory Organization rules or regulations.

Most problematic is the plan to change the fee split percentage based on who first introduced the client to the RIA. Under these facts we believe that the fee arrangement necessarily involves fee-splitting in violation of the Rules of Professional Conduct.

The Arrangement Presents Substantial Risk of An Unreasonable Fee

This leads to another problem with the arrangement that does not seem to have been contemplated by the request made here. Under Rule 1.5, a lawyer cannot make an agreement for, charge, or collect an unreasonable fee. Here the fee for legal services is proposed to be a percentage of the fee charged by the RIA firm to the RIA firm's (and lawyer's) client. There are two aspects of this arrangement that may violate Rule 1.5.

First, if the lawyer's fee is calculated based on how much the client has under management with the RIA, that method of calculating a fee is likely to lead to unreasonable differences in fees charged to different clients. While the request for an opinion is silent on the issue of how the RIA will calculate its fee, it is typical in the RIA industry to charge a fee based on a percentage of assets under management, perhaps with an additional fee paid based on performance of the investments. So, for example, an RIA may charge 2 percent of assets under management and 20% of the returns generated by the RIA for the client. A client who has \$10,000,000 in assets under management would pay the RIA \$200,000 per year, plus a percentage of the gains achieved by the investments directed by the RIA. An otherwise identical client with \$1,000,000 in assets under management by the RIA would pay only \$20,000 per year, again plus a percentage of the gains achieved by the investments directed by the RIA. Since the lawyer proposes to be paid a fee of "a percentage of the RIA Firm's advisory fees" in this situation the lawyer would be charging the client with \$10,000,000 under management a fee ten times greater than the lawyer charges the client with \$1,000,000 under management by the RIA

firm. There is a substantial risk that calculating a fee in this manner will lead to the lawyer arranging for and collecting unreasonable fees. Rule 1.5 lists a number of factors that are to be considered in determining whether a fee is reasonable (See rule 1.5(a)(1)-(8)); none of those factors would justify charging a larger fee calculated solely as a function of how much money the client has on deposit with the RIA firm.³ Charging a client a fee ten-times greater for what is likely similar work merely because the client has more money on deposit with the RIA is an unreasonable fee. Nor is it likely that amount of money under management will always be a reasonable analog for complexity of legal work.

The problem of an unreasonable fee would be compounded if the fee were shared in perpetuity. Typically, the RIA fee is charged each year as a percentage of assets under management that year. It is not clear from the request whether the lawyer would share in the fees collected each year for RIA clients for whom the lawyer had done legal work in the past. In other words, if a lawyer creates an estate plan in one year, and then receives a share of the RIA fees for subsequent years, even if no legal services are provided in those years, the amounts paid in subsequent years would seem to be unreasonable fees.

This problem is easily illustrated by considering two identically situated clients, each with \$5,000,000 in assets under management. Both clients ask for and receive estate planning services in year one. Client 1 stays with the RIA firm for 10 years but never again receives additional legal services. Client 2 leaves at the end of year 1. If the lawyer continues to receive a percentage – for our purposes we assume the same percentage – for 10 years, the legal fee for the same estate planning services will be ten times as large for Client 1 as for Client 2, even though

³ Rule 1.5(a)(4) does list as a permissible factor “the amount involved and the results obtained” however given that the amount of the fee charged in the question is based solely on the amount of funds on deposit at the RIA, and not the amount at stake in the estate as a whole, it is not clear that that factor actually applies here.

the legal services performed for both are the same. This would amount to an unreasonable fee. To be clear the request did not specify that a fee would be collected in perpetuity, but did not suggest that it would not be shared in future years.

The Proposed Fee Calculation Results in An Unreasonable Fee In Part Because It Also Involves Paying a Referral Fee.

Second, the request for an opinion makes clear that the lawyer would be paid a higher legal fee if he originally referred the client to the RIA firm. This means that the lawyer will charge one client more for the same work than another client based solely on who referred the client to the RIA, which referred the client to the lawyer. This calls into question whether the fee charged to clients that the lawyer referred to the RIA is reasonable, since the lawyer is willing to perform legal work for RIA clients that he did not refer to the RIA at a lower rate than clients that he did refer to the RIA. Again, imagining two identical clients, each with \$5,000,000 under management illustrates the problem. If Client 1 was referred by the lawyer to the RIA firm, and Client 2 came to the RIA through other channels, the lawyer would charge Client 1 more in legal fees than Client 2. Again, the factors in Rule 1.5(a)(1)-(8) explain some factors that a lawyer may consider in what to charge the client, but the factor driving the fee difference here is not listed as a permissible factor in determining a reasonable fee.

Another way of looking at this same problem is that it represents an unethical referral fee. Under Rule 7.2 a lawyer may not “give anything of value to a person for recommending the lawyer’s services.” However, since the lawyer charges less when the RIA refers a client with whom the lawyer did not previously have a relationship, this discount can be interpreted as something of value given to the RIA for recommending the lawyer’s services. Since the RIA is the one paying the fee, this discount given by the lawyer when clients are referred to the lawyer

by the RIA is “anything of value” paid to the RIA to induce the RIA to refer clients to the lawyer in violation of Rule 7.2(b)

Ethical Implications of The Employment Relationship

The request does not make clear exactly what arrangement the lawyer and the RIA will have. For example, the RIA firm and the lawyer could become partners, which we assume is the de facto reality of this arrangement, even if it is formally structured differently. If the lawyer and the RIA form a partnership, the lawyer is in violation of Rule 5.4(b). That rule provides that a lawyer “shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law.” Here it is clear that at least some part of the services of the RIA will be providing legal services related to estate planning. So, if the arrangement is a partnership, the lawyer will be in violation of the Rules of Professional Conduct.

The request suggests that the actual arrangement will be something closer to an employer-employee relationship. We have some concern that the label applied by the parties will less reflect the reality of the relationship than an opportunistic structure to attempt to operate a multi-disciplinary practice. However, taking at face value the request’s description of the relationship as an employer-employee or employer-independent contractor relationship, such a relationship will be unlikely to solve any problems since the lawyer’s professional judgment will be affected by the lawyer’s duties to his employer. If the lawyer is an employee of the RIA firm and the RIA firm “pays the lawyer to render legal services for another” the lawyer cannot allow the RIA to “direct or regulate the lawyer’s professional judgment in rendering such legal services.” Rule 5.4(c). The problem with this arrangement will arise whenever the lawyer might offer advice contrary to the business interests of the lawyer’s employer, the RIA firm. For example, the lawyer may determine that the client would be better served by making investments

not available within the context of the RIA or that the client could make the same investments at a lower overall cost through some entity other than the RIA. Since the lawyer is obligated to “exercise independent professional judgment and render candid advice” (Rule 2.1), the lawyer would be obligated to disclose these facts to the client, even if it results in the RIA – the lawyer’s employer – losing a client. Of course, the lawyer would know that such a pattern would not be tolerated for long and therefore a significant risk may arise that the lawyer may materially limit the lawyer’s representation of the client in order to protect his personal interest in continuing to have a job with the RIA. This would implicate Rule 1.7(a).

Simply put, the lawyer will occasionally, and perhaps often, face a situation in which the client’s best interests diverge from the best interests of the lawyer’s employer, the IRA. Whenever this happens the lawyer will face a conflict of interests and will be at least tempted to compromise the client’s interest to advance the lawyer’s interests or the RIA’s.

Other Concerns

The proposed relationship poses additional concerns. Because each client of the RIA would be a de facto client of the lawyer, the lawyer would be required to conduct conflict checks prior to the RIA accepting each new client. Conflicts could arise in the context of various family members who all use the RIA. For example, if a child tells the lawyer that the child expects a large inheritance from a parent, but the lawyer knows that the parent has not made a bequest to the child, the lawyer will have conflicting duties of confidentiality to the parent, and candor to the child. See, Rules 1.7(a); 1.9; 2.1. However, these potential conflicts will be difficult to determine and are unlikely to be considered by the RIA as the RIA brings on new clients. This will lead to a likelihood of concurrent conflicts of interest that the lawyer is unable to identify or obtain informed consent for prior to the conflict arising.

CONCLUSION

The arrangement discussed in the request is likely to violate various rules of professional conduct because it involves fee-splitting, a multi-disciplinary practice that would compromise the lawyer's professional independence, and conflicts of interest between the RIA (the lawyer's referral source and employer) and the lawyer's clients.