

Opinion 3 of 2008

Committee approval

This formal opinion is disseminated in accordance with the charge of the ISBA Legal Ethics Committee and is advisory in nature. It is intended to guide the membership of the State Bar and does not carry the weight of law.

Issues

Can a lawyer who refers a client to a brokerage firm/financial advisor receive compensation through a percentage share of the recurring brokerage/financial advisor fee?

Conclusion

No, a lawyer cannot receive compensation through a percent share of a recurring fee charged by a brokerage firm/financial advisor.

Hypothetical facts

A program is established whereby attorney refers attorney's clients to a brokerage firm/financial advisor. The brokerage firm/financial advisor then pays a percent to the attorney of the recurring brokerage firm/financial advisor's fee that is charged to the client on an ongoing basis.

Analysis

The question here is whether or not it is a violation of Indiana's Rules of Professional Conduct for an attorney to receive a percent of the fee charged by a brokerage firm/financial advisor in exchange for the lawyer's referral of lawyer's client to the brokerage firm/financial advisor. For the reasons below, the committee believes this arrangement creates serious conflicts and limitations as to the attorney's ability to represent the client.

It is fundamental that an attorney provide competent counsel. Ind.R.P.C. 1.1. Competent representation requires that the attorney

Prohibition on fee sharing between brokerage firm and attorney

can perform the analysis needed and be properly prepared to advise the client. *See* Cmt 5 to Ind.R.P.C. 1.1. It is also fundamental, as set forth in Ind.R.P.C. 2.1, that the attorney exercise independent professional judgment and render candid advice. The possibility that the lawyer will not or be perceived as not being able to fully advise the client of alternatives is quite real in this situation. If the client suffers from negative financial results through the brokerage firm/financial advisor, the lawyer will likely face serious questions about independence of judgment. Comment 4 of Ind.R.P.C. 2.1 notes the reality that during the course of representation an attorney may need to look to other professions in order to properly represent the client.

The comment goes on to note that a lawyer should make a recommendation where consultation is needed in another profession. However, such recommendations should not go so far as to create a conflict of interest and/or impermissible fee splitting.

Ind.R.P.C. 1.7(a)(2) indicates that a conflict of interest exists when there is "significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer." Ind. R.P.C. 1.7(b) allows a lawyer to represent a client where a conflict of interest exists under 1.7(a)(2) if the client

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gives informed consent. Comment 10 notes that “ 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 financial interest.” Comment 10 refers to Ind. R.P.C. 1.8. Comment 13 further discusses payment to the lawyer for his/her legal services from any source other than the client. This Comment notes that if this situation presents a significant risk that the lawyer’s representation will be materially limited by the lawyer’s own interest, then the lawyer must comply with 1.7(b) by determining if the conflict is consentable and, if so, ensuring that the client has adequate information about the material risks of the representation. Additionally, Ind.R.P.C. 1.8 prohibits lawyers from knowingly acquiring an ownership, possessory, security or other pecuniary interest adverse to the 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 in a manner

that can be reasonably understood by the client;

(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and

(3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer’s role in the transaction, including whether the lawyer is representing the client in the transaction.

Ind.R.P.C. 1.8.

The issue presented has been considered by applicable bodies in other states with differing results. The Kentucky Bar Association Ethics Opinion KBA E-390, issued July 1996,¹ serves as a template for this Indiana opinion. KBA E-390 is instructive, and the Kentucky Bar Association in addressing a percentage fee scenario analogous to our hypothetical stated, “[w]hether they are called referral fees or commissions or even kickbacks, they have one characteristic, they are payments to an attorney for allowing that person or organization to make a profit from his client, and

attorneys are cautioned that a presumption exists that such referral fees are, even with full disclosure to the client and with his consent, unethical because they lend themselves to the appearance of impropriety.” Kentucky Bar Association, KBA E-390. The Florida Bar has stated that “[a] lawyer may not enter into a referral arrangement with a nonlawyer who is a securities dealer to refer the lawyer’s clients to the securities dealer, who then pay the lawyer a portion of the advisory fee for the clients referred.” Florida Bar, Opinion 02-8 (Jan. 16, 2004). Opinions issued by the Texas Professional Ethics Committee and the Ohio Board of Commissioners on Grievances and Discipline, the Professional Ethics Commission of the Board of Overseers of the Bar for Maine, and the Iowa Supreme Court Board of Professional Ethics and Conduct add further support to a conclusion that such an arrangement is a violation of the Rules of Professional Conduct. *See* Tx. Eth. Op. 536 (2001), Maine Opinion #184, Iowa Opinion 99-04 (1999) and Oh. Adv. Op. 2000-1 (2000).²

In contrast, the Pennsylvania Bar Association, the Rhode Island Bar, the Utah State Bar, and the California State Bar find such arrangement generally permissible but with qualifications. Pa. Eth. Op. 2000-100 (2000), RI-317 (2000), Ut. Ethics Op. 99-07 (1999), Ca. Eth.Op. 1999-154 (1999).³ The opinion by the Pennsylvania Bar, relying on RPC 1.7 and 1.8, concluded that “ ... the strict letter of the Rules permit a lawyer to accept a referral fee from a service provider, provided that the lawyer is scrupulous in determining under the particular circumstances that payment of the referral fee will not impact the lawyer-client relationship or the lawyer’s exercise of independent professional judgment and that the client consents to the

arrangement on the basis of full disclosure and consultation.” Pa. Eth. Op. 2000-100 (2000). To sum these various opinions up, the Arizona Bar issued an opinion in 2005 with a strong dissent, which opinion addressed much of the issue at hand. The Arizona Committee “reversed” a prior opinion when it opined on the ethical implications of a lawyer contracting with an investment advisory firm to provide investment-related services where the investment firm would pay the lawyer a fee for referring customers to the investment firm. The Committee found this to be permissible so long as the clients understood that they were not receiving legal services by the attorney and the “heavy burden” of complying with 1.7 and 1.8(a) was met. The strong dissent expressed the view that lawyers should be *per se* prohibited from accepting money from third-party professionals in exchange for referring law clients to the third-party professional. Az. Bar 05-01(2005).

While the fee arrangement in the Arizona opinion is somewhat different than the scenario presented here,⁴ the analysis is insightful. In this opinion, the Arizona Bar provided some relevant guidance. First, the lawyer must bear the burden of showing that the lawyer’s compensation was reasonable under the circumstances and that the client was not taken advantage of by the lawyer (relying on Cal. Op. 1995-140), and additionally the lawyer is obliged to show that any fees or commissions received are reasonable. Az. Bar 05-01 (2005). All of this leads us back to the opinion by the Texas Bar, which opinion focused on the lawyer providing independent advice and not being limited by his own interest as perceived by a disinterested attorney. The Texas Bar concluded that it is a violation for a lawyer to receive fees from an investment

advisor while the client continues to receive services from the investment advisor since the lawyer will be limited by his own financial interests and his business obligations to the investment advisor. Tx. Eth. Op. 536.

In reviewing the opinions of the various jurisdictions and noting the strength of the dissents and the qualifications that have been stated in those opinions, this committee has been persuaded by the reasoning of the Kentucky and Texas Bar opinions. In light of this and considering the underlying purpose of the consent requirements contained in 1.7 or 1.8, the scenario we are addressing leads to the reasonable conclusion that informed consent may not be sufficient to prevent a violation under the rules.

Adding to the foregoing, the restrictions contained in Ind.R.P.C. 5.4 do support the reasonable conclusion that the arrangement described herein creates a highly risky limitation that in most circumstances would not be consentable by the client. Ind.R.P.C. 5.4 prohibits a lawyer from sharing fees with a nonlawyer subject to a

few exceptions not applicable here. For the foregoing reasons, it is this committee’s belief that there is a risk of serious conflicts and limitations such that the arrangement is impermissible even with the fully informed consent of the client.

Conclusion

It is a violation of Ind.R.P.C. 1.1, 2.1, 1.6, 1.8 and 5.4 for a lawyer to receive compensation from a brokerage firm/financial advisor based upon the lawyer referring a client to such and thereafter receiving a portion of the fees paid to the brokerage firm/financial advisor by the client. ⚠

1. This opinion was issued to “affirm” a 1982 opinion that had been rendered prior to Kentucky, adopting the Model Rules of Professional Conduct. Like Kentucky, Indiana’s Rules of Professional Conduct are adopted from the Model Rules of Professional Conduct.
2. The states of Maine, Iowa and Ohio follow the Model Code as opposed to the Rules of Professional Conduct.
3. The state of California has adopted the Model Code.
4. Because all of the opinions cited herein are confined to the fact scenarios presented to that particular committee, each must be relied upon with that caveat. The opinions of various other states cited here illustrate the complexity of the issue.