

KENTUCKY BAR ASSOCIATION
Ethics Opinion KBA E-390
Issued: July 1996

Question: May a lawyer, after disclosure to and consent by the client, receive compensation, structures as a percentage share of a recurring account management fee, for the lawyer's referral of the client to an investment advisor?

Answer: No.

References: KRPC Rule 1.1, 1.7, 1.8, 2.1 and 5.4; KBA E-264 (1982)

OPINION

A questions has been raised whether a lawyer may ethically affiliate with an investment advisor in an arrangement whereby the lawyer refers the client to the investment advisor in exchange for a percentage share of the investment advisor's recurring management fees (based on the amount of client's assets under management), even assuming arguendo, the lawyer has fully disclosed the referral fee arrangement and has obtained the client's written consent. In the opinion of the Committee, this arrangement presents a serious conflict of interest and is likely to involve circumstances where it is impossible for the lawyer to make sufficient disclosure to properly inform the client's consent.

The referral fee arrangement raises concerns under a number of KBA Rules, including, among others, Rules 1.1 (requirement of competent counsel), 1.7(b) (prohibition of representation that may be materially limited by the lawyer's own interests), 1.8 (prohibition of business transactions with the client), 2.1 (requirement of professional independence) and 5.4 (prohibition of fee-sharing with non-lawyers). The prospect of the lawyer's referral compensation, supplementary to the legal fee already being paid by the 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, in many instances the lawyer's affiliation with the investment advisor and the resultant client referrals could involve the lawyer in matters beyond his professional competence, and, indeed, raises difficult questions regarding state and federal investment advisor registration and examination requirements. *See, e.g.*, KRS 292.330; 808 KAR 10:260. Consequently, it would be difficult, if not 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. These issues obviously become even more troublesome in the common situation where the client requests advice in the investment of funds obtained during the representation, funds which in many instances constitute the bulk of the client's personal assets. Should the client suffer the loss of these assets, the lawyer will be challenged to explain satisfactorily that his advice was based on his independent professional judgment and was not in any sense clouded by his own pecuniary interest in the management of the client's assets by the particular investment advisor to whom he referred the client.

In conclusion, reference should be made to KBA E-264, which states that a lawyer could not ethically participate in an arrangement in which the lawyer would refer clients to a bank in exchange for a percentage fee based on the amount of deposited by those clients in bank-sponsored Individual Retirement Accounts. The opinion provides, “whether they are called referral fees or commissions or even kickbacks, they have one common 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.”

Note to Reader

This ethics opinion has been formally adopted by the Board of Governors of the Kentucky Bar Association under the provisions of Kentucky Supreme Court Rule 3.530 (or its predecessor rule). Note that the Rule provides: “Both informal and formal opinions shall be advisory only; however, no attorney shall be disciplined for any professional act on his part performed in compliance with an opinion furnished to him on his petition, provided his petition clearly, fairly, accurately and completely states his contemplated professional act.”