

State Bar of South Dakota

Ethics Opinion 96-6

April 26, 1996

- *Rule 1.7, 1.8*
- *Subject: Client referrals from third parties*
- *Summary: An attorney should not accept a fee or other remuneration for referrals to non-clients. See In the Matter of Estate of Shuldt, 428 NW2d 251 (SD 1980). See EO 93-14.*

FACTS

Company A is broker-dealer and registered investment advisor, licensed under the securities laws of the United States and authorized to do and doing business in South Dakota. Company A is qualified to act as an investment adviser and broker-dealer on a nationwide basis through its network of associated investment adviser representatives (“IAR”).

Company A seeks to offer its IAR a fee-based asset management program utilizing referrals from professionals, including attorneys licensed in South Dakota (“the Program”). Under the Program, a participating lawyer will identify legal clients who need financial management assistance, and will refer those clients to an IAR who will manage the client’s investment portfolios. The IAR has the exclusive responsibility for managing the advisory account. The lawyer in his or her role as the referring party is not authorized to manage or assist the IAR in management of the client’s account. The attorney refers the client to the IAR, is paid an ongoing fee for referral if the account is opened and thereafter monitors the client’s account as the attorney deems appropriate. The referral fee is a split of the investment management fee in an amount agreed upon by the attorney and the IAR.

Written disclosure of the relationship between the attorney and the IAR and the amount of the referral fee payments made by the IAR to the attorney is contained in written disclosure documents provided to and signed by the client upon opening the advisory account.

The investment advisory laws in South Dakota also apparently require licensing for an individual who refers clients to an IAR and receives a portion of the management fee for the referral. Therefore, to participate in the Program, the attorney will need to obtain an investment advisory license.

Based on these facts, you have asked whether or not this Committee believes it is permissible for attorneys licensed in South Dakota to accept referral fees under the Program.

OPINION

It is the opinion of this Committee that this situation is controlled by Ethics Opinion 93-14. In Ethics Opinion 93-14, the issue posed was whether or not it would be ethical for a South Dakota attorney to accept a finders fee for the referral of trust business to a bank or trust company in South Dakota. This Committee opined that an attorney in this state may not accept such a finders fee for

the referral of trust business to a bank or trust company. It was the opinion of the Committee that an attorney's acceptance of such a finders fee would constitute a breach of the South Dakota Rules of Professional Conduct, more particularly, Rule 1.7(b) which provides that a lawyer may not represent a client if the representation of that client may be materially limited by the lawyer's own interest. Further, this Committee went on to articulate that the comment to Rule 1.7 provides that loyalty to a client is impaired when the lawyer cannot consider, recommend, or carry out an appropriate course of action for the client because of the lawyer's other interests. This Committee felt that the payment of a referral fee or finders fee is designed to create loyalties, not to the client but to the entity paying the fee. Under such a circumstance, the lawyer could not reasonably believe that the representation will not be adversely affected.

In Ethics Opinion 93-14, this Committee further went on to cite with approval In the Matter of Estate of Shuldt, 428 NW2d 251 (SD 1980). In Shuldt, the South Dakota Supreme Court disapproved of the payment of a real estate brokers fee to an attorney for an executor stating that it was concerned about the message that the business relationship would send to the public. The South Dakota Supreme Court noted that such an arrangement would remove that public confidence which the legal profession must have if its integrity is to be maintained. The Shuldt court further noted its disfavor of relationships where a lawyer puts economic interests ahead of his or her promised loyalty to his or her clients.

Finally, in Ethics Opinion 93-14, this Committee cited with approval the commentaries to the Model Rules of Professional Conduct prepared by the American College of Trust and Estate Counsel which provide in pertinent part:

The lawyer should not accept any rebate, discount, commission, or referral fee from a non-lawyer or a lawyer not acting in a legal capacity in connection with the representation of a client. Even with full disclosure to and consent by the client, such an arrangement involves too great a risk of over searching by the lawyer and the potential for actual or apparent abuse. The client is generally entitled to the benefit of any economies that are achieved by the Lawyer in connection with the representation. The acceptance by the lawyer of a referral fee from a non-lawyer may involve an improper conflict of interest. [citing, Rule 1.7, 1.8(f)]

All of the above cited principles are equally applicable to the fact situation that your request raises. It is the opinion of this Committee, therefore, that it is not permissible for attorneys licensed in South Dakota to accept referral fees under your proposed program.

*Michael S. McKnight*  
Chair, Ethics Committee  
State Bar of South Dakota