New York State Bar Association

Committee on Professional Ethics

Opinion 755 – 4/10/02

Topics: Ancillary business organizations; transactions between lawyer and client; solicitation

Digest: The provisions of DR 5-104(A), relating to business transactions between a lawyer and client, should not apply to a lawyer's recommendation that the client employ a distinct lawyer-owned ancillary business, where the lawyer takes steps to ensure that the client understands that the protections of the attorney-client relationship do not apply to the non-legal services, as provided for in DR 1-106(A). The rules on solicitation do not prevent the lawyer-owned ancillary business from referring existing customers to the lawyer for legal services, including by in-person or telephone contact, but no referral fee may be paid therefor.

Code: DR 1-102(A); DR 1-106; DR 1-107; DR 2-101(C); DR 2-102(A), (B); DR 2-103(A), (B); DR 5-101(A); DR 5-104(A); EC 1-9; EC 1-10; EC 1-11; EC 1-12; EC 1-14.

QUESTIONS

A lawyer is the sole shareholder of a company providing non-legal services to clients or other persons. Where the company provides services to clients of the lawyer, and the lawyer informs the clients in writing in accordance with DR 1-106(A)(4) that the services provided by that business are not legal services and that the protection of the attorney-client relationship does not exist with respect to the non-legal services:

1. To what extent do the disclosure rules and substantive restrictions of DR 5-104(A), relating to business transactions between a lawyer and a client, apply to the non-legal services or to the lawyer's recommendation that the clients employ the non-legal business?

2. To what extent can the lawyer permit the non-legal business to recommend employment of the lawyer by in-person or telephone contact without violating DR 2-103(A)?

OPINION

On July 23, 2001, the Appellate Divisions adopted new rules on multidisciplinary practice, effective November 1, 2001. One of those rules, DR 1-106 (22 NYCRR §1200.5-b), addresses the responsibilities of lawyers or law firms providing non-legal services to clients or other persons that are "distinct" from legal services being provided to that person, or are provided through a separate entity. The rule provides, in effect, that the disciplinary rules of the Code of Professional Responsibility will not apply to the non-legal services if the lawyer ensures that the client understands that the non-legal services are not the subject of an attorney-client relationship. The rule provides a procedure for the lawyer to give the client written notice to that effect, which serves to obviate a presumption that would otherwise arise that the client believes the services are the subject of an attorney-client relationship.[1]

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[1] DR 1-106 provides:

A. With respect to lawyers or law firms providing non-legal services to clients or other persons:

1. A lawyer or law firm that provides non-legal services to a person that are not distinct from legal services being provided to that person by the lawyer or law firm is subject to these Disciplinary Rules with respect to the provision of both legal and non-legal services.

2. A lawyer or law firm that provides non-legal services to a person that are distinct from legal services being provided to that person by the lawyer or law firm is subject to these Disciplinary Rules with respect to the non-legal services if the person receiving the services could reasonably believe that the non-legal services are the subject of an attorney-client relationship.

3. A lawyer or law firm that is an owner, controlling party or agent of, or that is otherwise affiliated with, an entity that the lawyer or law firm knows to be providing non-legal services to a person is subject to these Disciplinary Rules with respect to the non-legal services if the person receiving the services could reasonably believe that the non-legal services are the subject of an attorney-client relationship.

4. For purposes of DR 1-106(A)(2) and DR 1-106(A)(3), it will be presumed that the person receiving non-legal services believes the services to be the subject of an attorney-client relationship unless the lawyer or law firm has advised the person receiving the services in writing that the services are not legal services and that the protection of an attorney-client relationship does not exist with respect to the non-legal services, or if the interest of the lawyer or law firm in the entity providing non-legal services is de minimis.

B. Notwithstanding the provisions of DR 1-106(A), a lawyer or law firm that is an owner, controlling party, agent, or is otherwise affiliated with an entity that the lawyer or law firm knows is

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In N.Y. State 752 (2002), we considered one aspect of the effect of DR 1-106 in situations in which a company owned or controlled by a lawyer wishes to provide non-legal services to persons who are also clients of the lawyer. We concluded that compliance with the written notice provisions of DR 1-106(A)(4) does not provide a "safe harbor" from all disciplinary rules that could limit the non-legal service provider's ability to provide services to the lawyer's clients. In particular, we concluded that the lawyer's financial interest in certain non-legal businesses – such as brokerages – could make it impossible under the rule governing personal conflicts of interest, DR 5-101(A), for the lawyer to render unconflicted professional services in matters where the non-legal business is involved.

We address in this opinion the rules governing mutual referral of business between lawyers and affiliated non-legal service providers in situations where the conflict rules permit the firms to act. In particular, we consider the extent to which the rules on business transactions between lawyers and clients and the rules on in-person solicitation apply to reciprocal referral arrangements between lawyers and ancillary businesses if the notice provisions of DR 1-106 are complied with.[2] The businesses as to which this inquiry has arisen are various, including lawyer-owned companies that provide fiduciary, mortgage brokerage and abstract title services for title insurance companies.[3]

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providing non-legal services to a person shall not permit any non-lawyer providing such services or affiliated with that entity to direct or regulate the professional judgment of the lawyer or law firm in rendering legal services to any person, or to cause the lawyer or law firm to compromise its duty under DR 4-101(B) and (D) with respect to the confidences and secrets of a client receiving legal services.

C. For purposes of DR 1-106, 'non-legal services' shall mean those services that lawyers may lawfully provide and that are not prohibited as an unauthorized practice of law when provided by a non-lawyer.

[2] Similar questions, particularly with respect to solicitation, arise under DR 1-107 involving reciprocal referral arrangements between law firms and non-legal professional service firms that are not commonly controlled. That disciplinary rule, which was promulgated at the same time as DR 1-106, must be taken into account in considering these questions, but our primary focus in this opinion is referrals between affiliated legal and non-legal businesses under DR 1-106.

[3] The question arises in numerous other contexts as well. The Special Committee that proposed DR 1-106 noted a wide range of non-legal businesses that are conducted by law firms or by entities owned by law firms. Among them were: lobbying, economic or scientific expertise, appraisal services, accounting, financial planning, real estate and insurance brokerages, title insurance, various consulting businesses (management, human resources, environmental, etc.), and private investigation. Report of the NYSBA Special Committee on the Law Governing Firm Structure and Operation, *Preserving the Core Values of the American Legal Profession: The Place of Multidisciplinary Practice in the Law Governing Lawyers* 98-103 (2000) [hereinafter, the "MacCrate Report"].

Referrals by the lawyer to the non-legal business. We begin with the question of referrals by the lawyer to the non-legal business. While a referral can arise independent of any legal services being provided, it will most commonly occur where the lawyer is engaged to give legal advice on a matter and desires to refer the client to a related non-legal service provider in connection with that matter.

As we found in N.Y. State 752, there is little question that DR 5-101(A) applies to the referral. That rule provides for a waiver, with informed consent, of the conflict created by the lawyer's interest in the business to which the lawyer is referring the client. We have issued extensive opinions governing the disclosure necessary when a lawyer recommends employment of a business in which the lawyer has a financial interest. *See, e.g.*, N.Y. State 595 (1988) (abstract title company: "a lawyer has a duty to make . . . alternative[] [services] known to the client to the extent they exist" and must disclose "the nature of the abstract company's fee structure and the law firm's proprietary interest in the abstract company"). These rules are not the application of the disciplinary rules to the non-legal business, but rather interpret the kind of disclosure and consent required when a lawyer, exercising his or her professional judgment, considers recommending the employment of a service company that happens to be owned (in whole or in part) by the lawyer.

DR 5-104(A) is a more specific conflicts rule that addresses business transactions between lawyers and clients and provides specific disclosure requirements and substantive fairness limitations applicable to such transactions. The rule states:

> A lawyer shall not enter into a business transaction with a client if they have differing interests therein and if the client expects the lawyer to exercise professional judgment therein for the protection of the client, unless:
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> > (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 that can be reasonably understood by the client;
> >
> > (2) The lawyer advises the client to seek the advice of independent counsel in the transaction; and
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> > (3) The client consents in writing after full disclosure, to the terms of the transaction and to the lawyer's inherent conflict of interest in the transaction.[4]

[4] Prior to 1999, this provision required only that the lawyer obtain informed consent to the business transaction, and did not have the requirements of independent counsel, written terms, and substantive fairness and reasonableness. It thus essentially duplicated the protections offered by the personal conflicts rule in DR 5-101(A).

We address the application of this rule in two parts: first, whether it applies to the rendition of the non-legal services as such, where they are rendered to a lawyer's client by a business owned or controlled by the lawyer; and second, even if the rule does not apply to those services, whether the lawyer must nevertheless comply with the requirements of the rule in referring the client to the non-legal business.

A central limitation of DR 5-104(A) is that it applies only to transactions if "the client expects the lawyer to exercise professional judgment therein for the protection of the client." This provision is closely parallel to the operative language of DR 1-106, which is that the disciplinary rules apply to non-legal services rendered by a distinct, lawyer-owned business "if the person receiving the services could reasonably believe that the non-legal services are the subject of an attorney-client relationship." DR 1-106(A)(2), 1-106(A)(3). That is, if the person receiving the services could not reasonably believe that the non-legal services are the subject of an attorney-client relationship, it would seem that that person should not expect the lawyer to exercise professional judgment for the protection of the client with respect to those services.

DR 1-106 provides some instruction on how to ensure that the client does not reasonably believe that the non-legal services are the subject of an attorney-client relationship. First, the rule permits that conclusion only where the non-legal services are distinct from legal services provided to the client, or are offered through a separate entity. Second, while a client will ordinarily be presumed to believe that the non-legal services are the subject of an attorney-client relationship, that presumption will not apply if the lawyer advises the client in writing "that the services are not legal services and that the protection of an attorney-client relationship does not exist with respect to the non-legal services." We conclude that if a lawyer satisfies the requirements of DR 1-106, so that the client does not reasonably believe that the protections of the attorney-client relationship apply to the delivery of non-legal services, those non-legal services will not constitute a business transaction in which the client expects the lawyer to be exercising professional judgment for the protection of the client within the meaning of DR 5-104(A).

We recognize that there is authority that the mere statement by the lawyer, "I am not representing you in this matter," may not be sufficient to cause a client to understand that the lawyer will not be exercising professional judgment for the benefit of the client, because in the context of a long-term attorney-client relationship the "full legal import [of that statement] will escape most laymen." *In re Neville*, 708 P.2d 1297, 1303 (Ariz. 1985). We are not suggesting by this opinion that the mere statement, even in writing, to that effect is an automatic safe harbor, and DR 1-106 does not say so. The writing serves to reverse the presumption against the lawyer that would otherwise exist. It is possible that in certain circumstances, such as where the client is unsophisticated and has had a long relationship with the lawyer and where, despite the existence of a separate entity, the non-legal services are not completely separated from the rendition of legal services, the writing would be insufficient to disabuse the client of a reasonable belief that the lawyer would be acting to protect the client. We conclude only that satisfaction of the test in DR 1-106(A)(2) or (A)(3) will also satisfy the threshold test of DR 5-

104(A) – that is, that if a client has a reasonable belief that non-legal services are not the subject of an attorney-client relationship, then in the ordinary case, the client will not expect that professional judgment will be exercised in the delivery of the non-legal services for the protection of the client. *See* N.Y. State 687 (1997) (DR 5-104[A] does not apply to non-estate-planning lawyer selling insurance to clients where lawyer "take[s] care to clarify" that he or she is acting as broker and not lawyer and "the client should not expect the lawyer to exercise professional judgment for the client's protection").

Turning now to the second part of the question, where the lawyer-client relationship predates use of the non-legal service, what of the initial recommendation that the client use the services of the lawyer's company?

There is support for applying DR 5-104(A) to that recommendation in a comment to Model Rule 5.7, which was one of the provisions from which DR 1-106 was derived. *See* MacCrate Report at 326-36.[5] The Model Rule comment states that Rule 5.7 applies to a recommendation by a lawyer that a client use an ancillary business controlled by the lawyer:

> When a client-lawyer relationship exists with a person who is referred by a lawyer to a separate law-related service entity controlled by the lawyer, individually or with others, the lawyer must comply with Rule 1.8(a) [which addresses business transactions between lawyers and clients].[6]

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[5] Model Rule 5.7 provides:

> (a) A lawyer shall be subject to the Rules of Professional Conduct with respect to the provision of law-related services, as defined in paragraph (b), if the law-related services are provided:
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> (1) by the lawyer in circumstances that are not distinct from the lawyer's provision of legal services to clients; or
>
> (2) by a separate entity controlled by the lawyer individually or with others if the lawyer fails to take reasonable measures to assure that a person obtaining the law-related services knows that the services of the separate entity are not legal services and that the protections of the client-lawyer relationship do not exist.
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> (b) The term 'law-related services' denotes services that might reasonably be performed in conjunction with and in substance are related to the provision of legal services, and that are not prohibited as unauthorized practice of law when provided by a nonlawyer.

[6] Ethical opinions under the Rules similarly conclude that a law firm must comply with Rule 1.8(a), or similar provisions, when it refers clients to a lawyer-controlled service provider, although none of the states in question appear to have adopted any provision like DR 1-106 or Model Rule 5.7. *See* N.J. 657 (1992) (lawyer may refer clients to medical-legal consulting business and divorce mediation service owned by lawyer if lawyer complies with Rule 1.8(a), advises client that alternatives exist, and recommends independent counsel); S.C. 93-05 (law firm that provides legal services to retirement plans may own interest in, and refer clients to, ancillary business that provides other services to them if, *inter alia*, law firm com-
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There are, however, textual and practical difficulties with applying DR 5-104(A) to a referral to a business that is otherwise exempt from the disciplinary rules. First, such an interpretation requires that the recommendation alone be deemed to be a "business transaction" between lawyer and client.[7] That is a strained reading of that term: the recommendation as such is advice; the relevant "business transaction" is the contemplated transaction with the non-legal business, which under this hypothesis is supposed to be exempt from the application of the rules. Further, if DR 5-104(A) applies to the recommendation, the "transaction and terms" – presumably the terms of the contemplated business transaction – must be disclosed in writing and are subject to scrutiny for fairness and reasonableness. This means, first, a significant intrusion into the conduct of the supposedly exempt ancillary business; second, the lawyer-recommended client would be treated differently and have advantages not necessarily provided to other customers of the business; and third, it would be necessary in businesses involving ongoing relationships to identify a point in time when the terms would no longer be subject to that scrutiny (for example, would later changes in the terms of an architect or engineer's retention for a major project be subject to fairness-and-reasonableness review under the lawyer's code and, if so, when would that end?).

Whether or not we would reach the same conclusion under the Model Rules, we conclude that a different result is called for under DR 1-106 and DR 1-107. Although the substance of other of the Model Rule comments was incorporated into the ECs that were prepared at the same time as the new rules, *compare, e.g.*, Model Rule 5.7 comments 1-3, 5 with EC 1-9, 1-10, 1-11, 1-12, the comment quoted above was not included. Moreover, in addition to the textual and practical difficulties already noted, applying DR 5-104(A) to the referral of a client to a lawyer-owned non-legal business would create anomalies with more-or-less equivalent relationships where those protections would not apply. In particular, DR 1-107 provides for contractual relationships between law firms and non-legal professional service firms for the purpose of offering legal and non-legal services "on a systematic and continuing basis." The relationships may provide for reciprocal referrals as well as "the sharing of premises, general overhead, or administrative costs and services on an arm's length basis." EC 1-14. Where the non-

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plies with Rule 1.8); Calif. 1995-141 (terms under which lawyer refers client to ancillary business must be fair, reasonable, and fully disclosed in writing); Ill. 97-7 (1998) (lawyers may form company to provide legal notices in local newspapers for clients as long as they comply with simpler version of Rule 1.8). *See also* Mich. RI-135 (1992) (lawyer/insurance agent recommendation with respect to insurance needed must comply with Rule 1.8(a)); Utah 146A (1995) (lawyer employed as insurance agent (not through separate entity) may sell insurance products to existing legal clients after complying with Rule 1.8(a)). *See also* Restatement (Third) of the Law Governing Lawyers § 126 comment c (2000) ("[W]here a lawyer engages in the sale of goods or services ancillary to the practice of law, for example, the sale of title insurance, the requirements of this Section [the business-transaction section] do apply.").

[7] Model Rule 1.8 uses the term "business or financial transaction," which is no different for these purposes.

legal professional firms are not owned or controlled by the law firm, there is no basis to apply DR 5-104(A) to such referrals, because that rule only applies to business transactions with the lawyer. It is difficult to see why there is a greater danger of overreaching when the referral is to a lawyer-owned business than when it is to an unaffiliated business subject to a close, ongoing referral relationship with the lawyer.

In addition, the somewhat rigid protections of DR 5-104(A) have little place in the kind of ongoing referral arrangements contemplated by DR 1-107 and, as a practical matter, by commonly owned businesses under DR 1-106. Under the new rules, these businesses can now advertise the availability of the two or more services "under one roof." DR 2-101(C)(3); DR 2-102(A)(3). It would be artificial in such circumstances to urge the customer to obtain "independent counsel" before using the services that were jointly advertised and are routinely provided, often at standard, published rates.

In short, we conclude that the protections established by DR 5-101(A), requiring the disclosures noted above, and by DR 1-106(A)(2) and (3), requiring that the lawyer ensure that the client understands that the protections of the attorney-client relationship do not apply to the ancillary business, are sufficient protection when a lawyer refers a client to an ancillary business owned or controlled by the lawyer. The referral is not a "business transaction," it is merely advice, and ensuring the integrity of legal advice is the core concern of DR 5-101(A).

We are confident that those provisions are sufficient to allow disciplinary authorities to prevent a lawyer from taking advantage of the attorney-client relationship in making the referral. First, where a client referred by the lawyer enters into an unfair or unreasonable relationship with a lawyer-owned ancillary business, it is likely that a strong presumption will arise that there was insufficient disclosure of the terms and available alternatives, as required by DR 5-101(A). Further, whether or not the specific obligations of DR 5-104(A) apply, the courts and disciplinary authorities have long asserted a common law right to ensure that lawyers do not take advantage of their clients in any circumstances.[8] We conclude only that no independent ethical violation should arise from failure to observe the protocols of DR 5-104(A) in these circumstances.

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[8] Under the old version of DR 5-104(A), which included only the informed consent provisions of DR 5-101(A), courts and disciplinary authorities imposed an obligation, based on common-law fiduciary principles, that the lawyer who engaged in business with a client show that the lawyer "took no advantage of the client-lawyer relationship." Charles W. Wolfram, *Modern Legal Ethics* 481 (2d ed. 1986). *See also In re Wong*, 275 A.D.2d 1, 5, 710 N.Y.S.2d 57, 60 (1st Dep't 2000) (noting courts' "inherent power" to regulate conduct and disciplining of attorneys); *NYSBA Lawyer's Code of Professional Responsibility*, Preliminary Statement:

> No codification of principles can expressly cover all situations that may arise. Accordingly, conduct that does not appear to violate the express terms of any Disciplinary Rule nevertheless may be found by an enforcing agency to be the subject of discipline on the basis of a general principle illustrated by a Disciplinary Rule or on the basis of an accepted common law principle applicable to lawyers.

Referrals by the non-legal business to the lawyer. Where the client's relationship with the non-legal business precedes the retention of counsel, under what circumstances may the non-legal business recommend the employment of the lawyer? This is the reverse of the situation considered above in which the lawyer recommends the ancillary business to an existing client. The new rules on multidisciplinary practice expressly address certain aspects of the problem. As noted above, they permit the lawyer to advertise the fact of the affiliation with the ancillary business and the nature and fees of those businesses. DR 2-101(C)(3), 2-102(A), (B). The rules also contemplate ongoing referral arrangements between legal and non-legal businesses, although the lawyer is barred from providing a fee to the ancillary company for providing the referral. *See* DR 1-107(A)(2), (B); DR 2-103(B).

The Special Committee that drafted the new rules recognized that these provisions would be a change from existing law:

> [E]thics committee opinions in New York and other jurisdictions have expressed the concern that lawyers should not use nonlegal business operations as a "feeder" to supply them with legal business leads, and have gone so far as to prohibit lawyers from advertising the fact that they provide such services. In our view, such precautions are unnecessary and contrary to the public interest in receiving accurate and relevant information relating to the abilities, qualifications and services offered by lawyers. Any lingering concern that the public will be harmed by permitting lawyers to inform the public that they also offer nonlegal services would be allayed through the adoption of proposed DR 1-106 and its accompanying Ethical Considerations. [9]

What of in-person solicitation? DR 2-103(A) by its terms bars a lawyer from soliciting professional employment from a prospective client "by in-person or telephone contact, except that a lawyer may solicit professional employment from a close friend, relative, former client or current client." This rule was not changed when DR 1-106 was adopted, but we conclude that it does not prevent a lawyer's affiliated business from referring a customer to the lawyer by in-person or telephone contact. Any other result would mean that the lawyer could orally refer clients to a distinct business but the business controlled by the lawyer could refer customers back to the lawyer only in writing. That would be anomalous, particularly in the context of the close relationships contemplated by the new rules. It would mean that the employees of the business (including possibly the lawyer him- or herself) could not mention the offering of legal services by

[9] MacCrate Report at 339-40. The opinions referred to appear to include N.Y. State 709 (1998), N.Y. State 636 (1992), N.Y. State 536 (1981), and N.Y. County 693 (1992). *See* MacCrate Report at 333 n.23. These opinions were issued under the old version of DR 2-103, which did not have the specific prohibitions of in-person or telephone solicitation that were added in 1999, and the opinions consequently did not address the specific question relating to such solicitation discussed below.

the affiliated law firm even though the sign out front and the business cards and announcements on the desk did so. *See* DR 2-101(C)(3); DR 2-102(A). Further, were DR 2-103 to require the lawyer-owned business to use only written referrals, we would probably require the same of unaffiliated professional service firms that have a contractual relationship with the lawyer under DR 1-107 – *see* DR 1-102(A)(2) ("A lawyer or law firm shall not . . . [c]ircumvent a Disciplinary Rule through actions of another") – but this would, we think, clearly go too far in regulating how an unaffiliated service firm conducts its business.

This interpretation applies only to referrals made in the context of the operation of the ancillary business and does not give a lawyer affiliated with an ancillary business free rein to approach customers or former customers of the ancillary business in person or by telephone contact to suggest retention of the lawyer. We are not suggesting, in other words, that the lawyer may make the contacts suggested because the affiliated businesses' customers are "close friend[s], . . . former client[s] or current client[s]" within the meaning of DR 2-103(A), a question we do not address in this opinion.[10]

We recognize that two opinions from Pennsylvania after the adoption of that state's version of Rule 5.7, on which DR 1-106 was modeled,[11] conclude that in-person solicitation of the clients of an ancillary business would be barred by Rule 7.3 (the analogue to DR 2-103[A]). Penn. Inf. Op. 98-20; Phila. 97-11. Pennsylvania does not appear to have adopted, however, provisions recognizing ongoing reciprocal referral arrangements like DR 1-107 and EC 1-14, or the broad permission to engage in joint advertising in DR 2-101(C) and DR 2-102(A) that was adopted at the same time. As noted, the Special Committee that drafted the new rules in New York went beyond the provisions in Pennsylvania in part to do away with "precautions" designed to prevent the use of non-legal business operations as a "feeder" to supply legal business leads. MacCrate Report at 339. *Cf.* Penn. Inf. Op. 93-114 (1994) ("there are a number of ethics opinions . . . that state that a lawyer may not use a nonlegal business as a 'feeder' for the lawyer's legal business").

CONCLUSION

A lawyer owning or operating a separately incorporated or distinct non-legal business who adequately informs the client that the non-legal business is not subject to the protections of the attorney-client relationship under DR 1-106(A)(2) and (3) may re-

[10] Virtually every ethics opinion to have considered the analogous provision of the Model Rules, Rule 7.3, has concluded that a lawyer and client must have a "prior professional relationship" – the language of the Rule – in the lawyer's capacity *as a lawyer*, and not through some ancillary business. Penn. Inf. Op. 98-20; Phila. 97-11; S.C. 96-04; Calif. 1995-141; Utah 146A (1995); Penn. Inf. Op. 93-114; S.C. 93-05; Mich. RI-135 (1992). *But see* N.C. 2000-9 ("If a prior professional relationship was established with a client of the accounting firm, Attorney may call or visit that person to solicit legal business.").

[11] MacCrate Report at 326-36.

fer clients to the non-legal business without complying with the specific terms of DR 5-104(A). Under DR 5-101(A), however, the lawyer must ensure that the client is fully informed of the lawyer's interest in the non-legal business and of the availability of alternatives. There is no bar on the ancillary business or the lawyer advertising the availability of the dual roles or referring existing customers or clients to the other by in-person or telephone contact, but no referral fee may be paid for that referral.

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