New York State Bar Association

Committee on Professional Ethics

Opinion 765 – 7/22/03

Topic: Reciprocal referral arrangements with nonlegal professionals.

Digest: A lawyer or law firm may enter into a nonexclusive reciprocal referral agreement with a securities broker or insurance agent, with appropriate disclosure of the relationship.

Code: DR 1-106; DR 1-107; DR 1-107(A), (B), (C), (D); DR 2-103(B)(1); DR 5-101(A); EC 1-14; EC 1-16.

QUESTIONS

1. Under the amendments to the New York Code of Professional Responsibility (the "Code") effective November 1, 2001, may a lawyer enter into and maintain a contractual relationship with an insurance or securities agent/broker which involves the law firm and the insurance/securities agent/broker referring clients to each other?

2. If this were merely a reciprocal referral agreement rather than a contractual relationship would the answer be any different?

OPINION

On July 23, 2001, the Appellate Divisions adopted new rules on multidisciplinary practice, effective November 1, 2001. The amendment added two new rules to the Code, DR 1-106 and DR 1-107, and made conforming changes to a number of other rules. In general terms, DR 1-106 addresses the provision of legal and nonlegal services by lawyers or law firms themselves (or by entities owned, controlled or affiliated with lawyers or law firms); DR 1-107 addresses contractual arrangements between lawyers or law firms on the one hand and separate entities providing nonlegal services. We first addressed DR

1-106 in our Opinions 752, 753 and 755. This opinion is our first to deal at length with DR 1-107.[1]

The questions addressed by this opinion concern two provisions of DR 1-107: the provision in DR 1-107(A) that permits a lawyer to enter into and maintain "a contractual relationship with a nonlegal professional or nonlegal professional service firm for the purpose of offering to the public, on a systematic and continuing basis, legal services . . . as well as other nonlegal professional services"; and an exception in DR 1-107(C) for "relationships consisting solely of nonexclusive reciprocal referral agreements or understandings" between a lawyer and nonlegal professional, or their firms. These questions focus on the difference between a "contractual relationship" calling for reciprocal referrals and an "agreement or understanding" calling for the same. While the difference in terminology is important, the essence of the distinction in the rule is in the extent of interconnection provided for by the contract, agreement or understanding.

Contracts under DR 1-107(A) can include reciprocal referral arrangements, EC 1-16 ("The contractual relationship permitted by DR 1-107 may provide for the reciprocal referral of clients by and between the lawyer or law firm and the nonlegal professional or nonlegal professional service firm."), as well as sharing of costs, (DR 1-107[D]), joint advertising (DR 2-101[C][3]), and joint premises (EC 1-14). The relationship may not, however, include the sharing of fees. DR 1-107(A)(2).

A lawyer who wishes to enter into a DR 1-107(A) contract with a nonlegal professional may do so only in accordance with the rule. Among other things, the rule requires the lawyer to make certain specified disclosures to clients (including a prescribed "Statement of Client's Rights in Cooperative Business Arrangements") and limits the professions with which lawyers can so contract to those professions on a list designated by the Appellate Divisions. The rule also sets forth in DR 1-107(B) the requirements for a profession to be included on the Appellate Division list (*i.e.*, Bachelor's degree, licensing, and a comparable ethical code). As of now the list includes only (1) architects, (2) certified public accountants, (3) professional engineers, (4) land surveyors, and (5) certified social workers.

By the terms of DR 1-107(C), if an agreement with a nonlegal professional is limited to reciprocal referrals – and does not include, for example, joint advertising, sharing of premises and expenses, and the like – DR 1-107(A) "shall not apply." The implication of DR 1-107(C) is that "relationships consisting solely

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[1] The text of DR 1-107 is reprinted as an appendix to this opinion.

of non-exclusive reciprocal referral agreements or understandings" between lawyers and nonlegal professionals are carved out of the regulation of DR 1-107 entirely and are left to other rules.[2] The other relevant rule is DR 2-103(B), which provides, in relevant part:

> A lawyer shall not compensate or give anything of value to a person or organization to recommend or obtain employment by a client, or as a reward for having made a recommendation resulting in employment by a client, except that:
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> (1) A lawyer or law firm may refer clients to a nonlegal professional or nonlegal professional service firm pursuant to a contractual relationship with such nonlegal professional or nonlegal professional service firm to provide legal and other professional services on a systematic and continuing basis as permitted by DR 1-107, provided however that such referral shall not otherwise include any monetary or other tangible consideration or reward for such, or the sharing of legal fees; . . . .

This Committee has not squarely addressed whether a non-exclusive reciprocal referral relationship between a lawyer and a nonlawyer constitutes the prohibited "compensat[ion]" or "giv[ing] of value" to the nonlawyer to recommend employment. Our prior opinions that have considered the question have involved situations in which there was a payment to the referring nonlawyer or a sponsoring organization as well as an understanding of a reciprocal referral. N.Y. State 741 (2001) ("Because the attorney is required to pay substantial dues to the organization in exchange for membership that entitles the attorney to referrals from other members and is required to make referrals to those members, the attorney would be transferring something 'of value' to obtain referrals, which is prohibited by DR 2-103[B]"); N.Y. State 566 (1984) (lawyer may not pay a real estate brokerage firm to endorse or recommend the lawyer).

Prior to the adoption of DR 1-107 and to the 2001 amendments to DR 2-103, the Nassau County Bar Association ethics committee opined that mutual

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[2] The Appellate Divisions specifically amended DR 1-107(C) after its initial adoption to change the reference in the rule from DR 1-107(A)(1) to DR 1-107(A). Joint Order of the Appellate Divisions, *New York Law Journal* at 11 (December 26, 2001). This brought the rule into line with the language that had been proposed by a New York State Bar Association Special Committee on multidisciplinary practice that had proposed DR 1-106 and DR 1-107. *See* Report of the New York State Bar Association 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* 353 (2000)(the "MacCrate Report").

referral arrangements were prohibited. Nassau County 97-8 ("While a mutual referral arrangement may not be as obvious a form of compensation as a referral fee, it is 'of value', and a lawyer may not enter into such an agreement in order to obtain referrals.").[3] The conclusion that even a nonexclusive undertaking to make referrals constitutes the giving of "value" is consistent with the language of DR 2-103(B)(1) viewed in isolation, but it leads to anomalies in light of DR 1-107. In particular, while DR 2-103(B) provides that reciprocal referral agreements are permissible, it limits the scope of that permission to those agreements permitted by DR 1-107, and DR 1-107 expressly exempts from its scope certain such agreements that, as discussed below, raise the least concerns. Thus, reading DR 2-103(B)(1) to bar "naked" reciprocal referral arrangements would mean that a nonexclusive agreement with an accountant to provide mutual referrals (on a systematic and continuing basis) would be barred as the giving of value, but if the arrangement included some other element – such as shared expenses or joint advertising – it would be permitted.

Nothing in the language or background of DR 1-107 suggests such a result. The language of DR 1-107(C) – that DR 1-107(A) shall not apply to relationships consisting "solely" of nonexclusive referral agreements – suggests that the assumption was that such relationships would be permitted but for the restrictions in DR 1-107(A). In addition, the careful distinction between the language of DR 1-107(A) permitting "contractual relationships" and the language of DR 1-107(C) exempting "agreements or understandings" suggests that the drafters contemplated that the "agreements or understandings" were at best of limited value. Indeed, as discussed further below, any such undertaking to provide referrals must be non-exclusive and qualified by the lawyer's duty to exercise independent professional judgment in making the referral.

Moreover, the New York State Bar Association special committee report that recommended the adoption of DR 1-107 found that nonexclusive reciprocal referral arrangements were not in themselves particularly dangerous, although it said that "some might argue" that they were barred by "the letter of the ethical prohibitions":

> What the interprofessional alliance represents is the contractual formalization of *a reciprocal relationship wherein two businesses mutually agree that they can serve their clients, and benefit*

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[3] The Nassau County ethics opinion also noted that the arrangement was barred by DR 2-103(C), which at that time barred lawyers from requesting a person or organization to recommend or promote the use of the lawyer's services other than by permissible advertising or approved lawyer referral services. Those restrictions were deleted in 1999 along with certain other restrictions on advertising and solicitation.

> *themselves, by focusing their referrals on each other to the extent consistent with their professional obligations to their respective clients*. A byproduct, but not an insignificant one for purposes of this discussion, is that the allies generally make efforts to cooperate in rendering their respective services to the mutual clients. *While some might argue that such arrangements fall within the letter of the ethical prohibitions, they are not pernicious in nature because of the responsibility of each of the allies to utilize its best judgment for its clients in selecting the most appropriate "referee."* This is not to say that a rigidly structured agreement could not be viewed as violative of the restrictions on compensating nonlawyers for client referrals. Provisions such as minimum guarantees and exclusive dealing arrangements would transform a symbiotic business relationship into a creature that could have a direct negative impact on clients.

MacCrate Report at 347-48 (emphasis added).[4] The elaborate safeguards that the special committee recommended, including the development of a list of permitted professions, were aimed not at the referral arrangements as such, but at the aspects of DR-1-107 contractual relationships that go beyond nonexclusive reciprocal referral agreements. Thus, it compared the "alliances" of concern to law partnerships between U.S. and foreign lawyers, *id*. at 351 & n.65, and expressed concern that such alliances "could dilute the lawyers' duties to clients," *id*. at 351, a concern that is very attenuated in the case of relationships consisting only of non-exclusive mutual referrals.[5]

The low level of ethical concern raised by nonexclusive referral arrangements is further seen in the August 2002 amendments to the ABA Model

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[4] *See also* N.Y. State 755 at 9 (2002) (noting that the special committee similarly saw little reason to be concerned about lawyers using their lawyer-owned nonlegal businesses as "feeders" to supply them with legal business leads) (quoting MacCrate Report, *supra*, at 339-40).

[5] The special committee at one point quotes a comment in the *Restatement of the Law Governing Lawyers* that arrangements whereby lawyers pay nonlawyers for referrals "would give the nonlawyer referring person the power and an incentive to influence the lawyer's representation by an explicit or implicit threat to refer no additional clients or by appealing to the lawyer's sense of gratitude for the referral already made." *Restatement of the Law Governing Lawyers* § 10 cmt. d (2000) (*quoted in* MacCrate Report, *supra*, at 344). This risk could apply to "payments" in the form of a reciprocal referral understanding, although the real issue is not the lawyer's undertaking to focus referrals on the nonlawyer, but the mere fact of the nonlawyer's stream of referrals. The Code directly addresses the latter risk by prohibiting a lawyer from allowing a third party who recommends the lawyer to direct or regulate the lawyer's professional judgment. DR 5-107(B).

Rules that were designed to track in significant measure the provisions of DR 1-107. The amended Rule provisions expressly contemplate nonexclusive mutual referral arrangements with other professionals. Model Rule 7.2(b)(4) provides:

> A lawyer shall not give anything of value to a person for recommending the lawyer's services except that a lawyer may . . .
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> (4) refer clients to another lawyer or a nonlawyer professional pursuant to an agreement not otherwise prohibited under these Rules that provides for the other person to refer clients or customers to the lawyer, if
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> (i) the reciprocal referral agreement is not exclusive, and
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> (ii) the client is informed of the existence and nature of the agreement.

In short, prohibiting nonexclusive reciprocal referral arrangements – relationships, in the words of the Special Committee, "wherein two businesses mutually agree that they can serve their clients, and benefit themselves, by focusing their referrals on each other to the extent consistent with their professional obligations to their respective clients" – would clearly not be consistent with the provisions of DR 1-107, at least with respect to the professions dealt with in that rule (to date, architects, accountants, engineers, land surveyors and certified social workers).

Securities brokers and insurance agents are not on that list. There is, however, no textual basis for restricting nonexclusive reciprocal referral arrangements to the listed professions. To the contrary, DR 1-107(C) expressly *exempts* such arrangements from the requirements of DR 1-107(A), including the limiting reference to the Appellate Division list of professions. In addition, as noted, in recommending the list mechanism, the special committee focused on far more involved interrelationships than "naked" mutual referral arrangements.

We likewise see little policy basis for limiting a lawyer's mutual referral of business to architects, engineers, accountants, land surveyors and certified social workers. Persons seeking legal help commonly need assistance from a far broader set of service providers in resolving their problem: estate planning clients frequently need insurance and investment advice; real estate clients often need real estate and mortgage brokers and title services. If lawyers at least in some circumstances may refer clients to entities providing these services that are affiliated with the lawyer, and vice versa, as we opined in N.Y. State 753, it is difficult to see why other lawyers cannot likewise choose a reputable provider with which they can exchange referrals. This is not the joint provision of services under common advertising or a common roof, which implicates the concerns of

confidentiality, improper influence and conflicts that motivated the restrictions in DR 1-107(A) and (B).

Based on these considerations, we conclude that a nonexclusive mutual referral arrangement between a lawyer and an insurance agent or securities broker is permitted by DR 1-107(C) and DR 2-103(B)(1). We note that securities brokers and insurance agents both are educated service providers; are commonly involved in legal matters and lawyers have long experience working with them; and are referred to in the special committee report that led to the adoption of the rule.[6] The relationship cannot, however, go beyond a relatively loose reciprocal referral arrangement to include joint advertising or sharing of expenses, for these closer relationships are reserved to professions on the Appellate Division list.

It is important to emphasize that whether or not accompanied by other features, any reciprocal referral understanding, agreement or contract between a lawyer and nonlegal professional must be nonexclusive. That is, a lawyer can never agree to refer all clients, or a specified quota, to the insurance or securities brokerage entity, because the lawyer must continue to exercise professional judgment on behalf of the client in making the referral. EC 1-16 states:

> The contractual relationship permitted under DR 1-107 may provide for the reciprocal referral of clients by and between the lawyer or law firm and the nonlegal professional service firm. When in the context of such a contractual relationship a lawyer or law firm refers a client to the nonlegal professional or nonlegal professional service firm, the lawyer or law firm shall observe the ethical standards of the legal profession in verifying the competence of the nonlegal professional or nonlegal professional services firm to handle the relevant affairs and interests of the client. Referrals should only be made when requested by the client or deemed to be reasonably necessary to serve the client. Thus, even if otherwise permitted by DR 1-107, a contractual relationship may not require referrals on an exclusive basis.

In addition, although the specified disclosures set forth in DR 1-107(A)(3) are not required with respect to relationships consisting only of reciprocal referral

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[6] The special committee report refers to a wide range of professionals with whom lawyers have long cooperated on a routine basis via "referrals and working relationships [as] part of everyday professional life," including "accountants, financial advisors, investment bankers, engineers, *brokers*, social workers, and others." MacCrate Report, *supra*, at 98 (emphasis added).

arrangements,[7] a reciprocal referral arrangement would generally constitute a conflict of interest under DR 5-101(A) such that the relationship would need to be disclosed and consent obtained before the lawyer made the referral. As the special committee report stated:

> *Even under current ethical principles*, depending upon the economic importance of the relationship to the lawyer, the lawyer must disclose the existence and nature of the interprofessional contractual relationship to clients so that they can make an informed judgment regarding the services of both the nonlegal ally and the lawyer. This is because, as the Restatement notes, the desire of the lawyer to perpetuate the stream of referrals from the ally, if sufficiently significant to the lawyer, may constitute a business or personal interest that could conflict impermissibly with the lawyer's duty to exercise independent professional judgment on the client's behalf. Clearly, a law firm that subsists on referrals from a particular nonlawyer consulting firm, the loss of which would be harmful to the lawyers in the firm, has a strong interest in reciprocation that could tend to convert what would otherwise be a presumption in favor of cross-referrals to the consultants into a mandatory or automatic practice that disregards the particular needs of the client. Informed client consent to such conflict of interest would be essential.

MacCrate Report at 348 (footnotes omitted) (emphasis added). *See also* EC 1-14 (even contractual relationships permitted by DR 1-107 could create a conflict of interest if "the law firm's interest in maintaining an advantageous relationship with the nonlegal professional service firm might . . . adversely affect the independent professional judgment of the law firm").

The nature of the disclosure required by DR 5-101(A) will depend on such factors as the terms or nature of the reciprocal referral arrangement; the extent of the lawyer's experience or acquaintance with the work of the nonlegal professional; the amount of the lawyer's business that is currently or expected to be derived from the nonlegal professional's referrals; and any other factor that might reasonably be considered by a disinterested lawyer to affect the lawyer's professional judgment in making the referral. A prudent lawyer will ordinarily disclose to the client any such reciprocal referral arrangement or understanding

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[7] As noted above, in an amendment to the original rule, the Appellate Divisions changed DR 1-107(C)'s reference to the section that does not apply from DR 1-107(A)(1) to DR 1-107(A).

with a nonlawyer professional to whom a referral is made. In some circumstances, the disclosure might go no further than a statement that "I have worked with X for years and X and I have an arrangement to refer clients to each other when it is appropriate." In other cases the disclosure might need to be more elaborate to satisfy the requirement under DR 5-101(A) that client consent be obtained only after "full disclosure of the implications of the lawyer's interest."

CONCLUSION

A lawyer or law firm may enter into a non-exclusive reciprocal referral agreement or understanding with a securities broker or insurance agent and, with appropriate disclosure and client consent under DR 5-101(A), can refer clients to the securities broker or insurance agent.

APPENDIX

DR 1-107 Contractual Relationships between Lawyers and Nonlegal Professionals

A. The practice of law has an essential tradition of complete independence and uncompromised loyalty to those it services. Recognizing this tradition, clients of lawyers practicing in New York State are guaranteed "independent professional judgment and undivided loyalty uncompromised by conflicts of interest."[1] Indeed, these guarantees represent the very foundation of the profession and allow and foster its continued role as a protector of the system of law. Therefore, a lawyer must remain completely responsible for his or her own independent professional judgment, maintain the confidences and secrets of clients, preserve funds of clients and third parties in his or her control, and otherwise comply with the legal and ethical principles governing lawyers in New York State.

Multi-disciplinary practice between lawyers and nonlawyers is incompatible with the core values of the legal profession and, therefore, a strict division between services provided by lawyers and those provided by nonlawyers is essential to protect those values. However, a lawyer or law firm may enter into and maintain a contractual relationship with a nonlegal professional or nonlegal professional service firm for the purpose of offering to the pubic, on a systematic and continuing basis, legal services performed by the lawyer or law firm, as well as other nonlegal professional services, notwithstanding the provisions of DR 5-101(A), provided that:

1. The profession of the nonlegal professional or nonlegal professional service firm is included in a list jointly established and maintained by the Appellate Divisions pursuant to section 1205.3 of the Joint Appellate Division Rules;

2. The lawyer or law firm neither grants to the nonlegal professional or nonlegal professional service firm, nor permits such person or firm to obtain, hold or exercise, directly or indirectly, any ownership or investment interest in, or managerial or supervisory right, power or position in connection with the practice of law by the lawyer or law firm nor, as provided in DR 2-103(B)(1), shares legal fees with a nonlawyer or receives or gives any monetary or other tangible benefit for giving or receiving a referral; and

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[1] "Statement of Client's Rights," 22 NYCRR Part 1210.

3. The fact that the contractual relationship exists is disclosed by the lawyer or law firm to any client of the lawyer or law firm before the client is referred to the nonlegal professional service firm, or to any client of the nonlegal professional service firm before that client receives legal services from the lawyer or law firm; and the client has given informed written consent and has been provided with a copy of the "Statement of Client's Rights In Cooperative Business Arrangements" pursuant to section 1205.4 of the Joint Appellate Division Rules.

B. For purposes of DR 1-107(A):

1. Each profession on the list maintained pursuant to a joint rule of the Appellate Divisions shall have been designated *sua sponte*, or approved by the Appellate Divisions upon application of a member of a nonlegal profession or nonlegal professional service firm, upon a determination that the profession is composed of individuals who, with respect to their profession:

   a. have been awarded a Bachelor's Degree or its equivalent from an accredited college or university, or have attained an equivalent combination of educational credit from such a college or university and work experience;

   b. are licensed to practice the profession by an agency of the State of New York or the United States Government; and

   c. are required under penalty of suspension or revocation of license to adhere to a code of ethical conduct that is reasonably comparable to that of the legal profession.

2. The term "ownership or investment interest" shall mean any such interest in any form of debt or equity, and shall include any interest commonly considered to be an interest accruing to or enjoyed by an owner or investor.

C. DR 1-107(A) shall not apply to relationships consisting solely of non-exclusive reciprocal referral agreements or understandings between a lawyer or law firm and a nonlegal professional or nonlegal professional service firm.

D. Notwithstanding DR 3-102(A), a lawyer or law firm may allocate costs and expenses with a nonlegal professional or nonlegal professional service firm pursuant to a contractual relationship permitted by DR 1-107(A),

provided the allocation reasonably reflects the costs and expenses incurred or expected to be incurred by each.

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