



Committee on Professional Ethics

Opinion 870 (5/31/11)

Topic: Non-exclusive referral agreement between lawyer and nonlawyer debt reduction company; contingent legal fee based on the amount of debt reduction lawyer obtains for clients.

Digest: A lawyer may enter into a non-exclusive reciprocal referral agreement with a debt reduction company that is also the lawyer's client, provided the referral arrangement is non-exclusive. The lawyer may also enter into a contingent fee agreement with a debtor client for legal services in connection with debt reduction. However, if the lawyer knows that a client is unlikely to have sufficient financial resources to meet the agreed-upon future payment obligations to creditors, then a contingent fee based on the nominal reduction in debt may be excessive.

Rules: 1.5, 1.7, 5.7, 5.8, 7.2.

QUESTIONS

1. The inquirer asks two questions:
 - A. May a lawyer enter into a non-exclusive reciprocal referral arrangement with a debt reduction company?
 - B. May a lawyer represent debtors who are customers of the debt reduction company when they need legal services to assist with their debt reduction efforts, and charge a contingent fee calculated as a percentage of the amount of debt reduction obtained?

FACTS

2. The inquiring lawyer is considering entering into a business arrangement with a debt reduction company (the “Debt Reduction Company” or the “Company”). The lawyer and the Debt Reduction Company will not have any common employees; they will not share offices; and the lawyer will not hold any equity interest in the Debt Reduction Company.

3. From time to time, as the Debt Reduction Company’s needs arise, the lawyer will provide legal services to the Company on a fee-for-services basis. Examples of services the lawyer might provide to the Company include incorporation, licensing, defense of tort and workers’ compensation claims, and other business matters. The lawyer will also represent customers of the Debt Reduction Company when those customers need legal services that the Company cannot provide and the customers ask the lawyer to provide those legal services, but the Company will not pay the lawyer to represent its customers. Rather, the customers will pay their own legal fees.

4. Debt reduction companies are engaged in the business of offering ways for consumers to reduce their debt. Although the services and products of the companies may vary widely, the three most common means for debt reduction are bankruptcy, debt renegotiation, and debt consolidation. Each of these methods may entail legal and nonlegal services.

5. Here, the lawyer and the Debt Reduction Company wish to enter into a non-exclusive reciprocal referral agreement in which each will agree to refer potential clients to the other. If a client initially contacts the lawyer for debt reduction services, the lawyer will ordinarily refer the client to the Debt Reduction Company for nonlegal services if the need for such services appears. Conversely, if the client initially contacts the Debt Reduction Company for debt reduction services, the Company will ordinarily refer the client to the lawyer for any needed legal services. The agreement will provide that referrals in both directions are optional (*i.e.*, the Company will remain free to refer customers to other lawyers, and the lawyer will remain free to refer debtors to other debt reduction companies, or to make no referral at all).

6. The agreement will also provide that the lawyer will refer clients to the Debt Reduction Company only when the lawyer believes the referral to be in the best interest of the client. The lawyer will represent debtor-customers who choose to select the lawyer as their counsel. When the client retains both the lawyer and the Debt Reduction Company, the Company will provide nonlegal services associated with debt reduction. The client will pay a contingent fee to the Debt Reduction Company, measured as a percentage of the debt reduction obtained. At the same time, the lawyer will provide legal services associated with debt reduction to the client. The client will pay a contingent fee to the lawyer, likewise measured as a percentage of the debt reduction obtained. Each of the fees -- the fee to the Debt Reduction Company and the fee to the lawyer -- will be calculated, billed and collected separately.

OPINION

Question A: Is a Non-Exclusive Referral Arrangement Permissible?

7. Under the New York Rules of Professional Conduct (the “Rules”), may the inquirer enter into an agreement with the Debt Reduction Company that will provide for each party to refer clients to the other on a non-exclusive basis? The lawyer will refer clients to the Debt Reduction Company only when the lawyer believes that the referral to Company is in the client’s best interest. If not, the lawyer will either make no referral (because the client does not need debt reduction services) or will refer the client to some other debt reduction service (because another service is better suited to the client’s needs than the Company). In N.Y. State 765 (2003), we approved such an arrangement under DR 1-107(C) and DR 2-103(B).

8. Former DR 1-107(C) is substantively identical to Rule 5.8(c), which provides that the restrictions imposed on relationship between lawyers and nonlegal professional service companies by Rule 5.8 “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.” The introductory language in former DR 2-103(B) is identical to the introductory language in Rule 7.2(a), which provides that 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” (with exceptions not applicable here). Therefore, the reasoning of N.Y. State 765 applies here and the proposed non-exclusive referral arrangement is permitted under the Rules.

9. We also need to ask, however, whether a non-exclusive reciprocal referral relationship makes the lawyer “affiliated” with the Debt Reduction Company within the meaning of Rule 5.7. Under Rule 5.7(a)(3), if a lawyer is “affiliated” with an entity that provides nonlegal services, the nonlegal services will be subject to the Rules if the recipient of the nonlegal services “could reasonably believe that the nonlegal services are the subject of a client-lawyer relationship.” Rule 5.7(a)(4) states that such a reasonable belief is presumed, but that the presumption may be rebutted if the lawyer either (i) has a “*de minimis*” interest in the entity providing the nonlegal services, or (ii) “has advised the person receiving the nonlegal services in writing that the services are not legal services and that the protection of a client-lawyer relationship does not exist with respect to the nonlegal services” Comment [4] to Rule 5.7 points out that even though the presumption of an attorney-client relationship may be rebutted in this manner, the scope of the exemption is not absolute. Only the Rules that are dependent on the existence of an attorney-client relationship may be exempted in this manner.

10. The very limited arrangement proposed here does not make the lawyer “affiliated” with the Company under Rule 5.7. In our view, something more than a non-exclusive referral arrangement is needed to rise to the level of an affiliation under that Rule. Here, the only connections between the lawyer and the Debt Reduction Company are the non-exclusive referral agreement and that each – independently – intends to

calculate their fee based on a percentage of the debt reduction attained. The lawyer and the Debt Reduction Company have no common employees; they do not share offices; the lawyer has no *equity interest* in the Company; and we accept the lawyer's representation that the referral arrangement will be non-exclusive both in name and in fact. Under these circumstances, we conclude that the lawyer is not "affiliated" with the Debt Reduction Company within the meaning of Rule 5.7.

11. Even though we conclude that Rule 5.7 does not apply to this very limited relationship, and even though the referrals are to be made on a non-exclusive basis, the lawyer may need to disclose the relationship with the Company to the lawyer's clients or prospective clients, and obtain their informed consent, before referring them to the Company or accepting them as clients based on referrals from the Company. The disclosure and consent may be necessary to comply with Rule 1.7(a) (governing representations involving "differing interests" and representations where the lawyer's financial or other person interests create a "significant risk" that the lawyer's professional judgment will be "adversely affected"). See N.Y. State 765 ("a reciprocal referral arrangement would generally constitute a conflict of interest ... such that the relationship would need to be disclosed and consent obtained before the lawyer made the referral"). Here, the need for disclosure is heightened because the reciprocal referral relationship is with one of the lawyer's clients (the Company). Even without the reciprocal referral relationship, Rule 1.7 might require the lawyer to disclose to debtor clients that he is referring them to another client (or that they have been referred to him by another client), and to obtain their informed consent before making a referral to the Company (or accepting a referral from the Company).

12. In addition, while Rule 5.7(a)(4) does not require the lawyer to disclose to clients that the services rendered by the Debt Reduction Company are not legal services and therefore do not enjoy the protection of a client-lawyer relationship, the lawyer may still consider it prudent to make this disclosure to avoid confusion or surprise on the part of clients who might otherwise believe that the Company is providing legal services.

Question B: May the Lawyer's Fee Be a Percentage of the Debt Reduction?

13. Rule 1.5(c) authorizes a fee contingent on the outcome of a matter unless a contingent fee is prohibited by Rule 1.5(d) or other law. In N.Y. State 390 (1975), we recognized that contingent fees are permitted unless prohibited by statute, rule, regulation or ordinance. In N.Y. State 697 (1997), we approved a hybrid fee (a combination of an hourly fee and a contingent fee) provided the fee was not excessive. We are not aware of any prohibition on charging a contingent fee for legal services that produce a debt reduction. Based on that understanding, we conclude that the proposed fee arrangement is proper, assuming that the fee is not excessive or illegal. See N.Y. State 705 (1998) ("if the lawyer may receive a fee contingent on the amount by which taxes are reduced, the lawyer may receive a fee that is a percentage of the tax reduction company's fee, where that fee is itself a percentage of the amount by which taxes are reduced").

14. The lawyer should consult Rule 1.5(a)(1)-(8) for a list of factors to consider when evaluating whether the contingent fee is excessive in all of the circumstances. In this connection, we note that, in many cases involving nonlawyer debt reduction companies,

it has been reported that the client is expected to pay a percentage fee based on the amount of debt reduced, as reflected in an agreement with creditors. In some cases that debt reduction is contingent on the debtor meeting all of the obligations of the agreement in the future. If the lawyer knows that a particular client is unlikely to have the financial resources to meet those obligations, then the nominal amount of debt reduction obtained may significantly overstate the amount of the debt reduction ultimately attained, and hence may overstate the value of the legal and nonlegal services to the debtor. In such a case, the proposed contingent fee based on a percentage of the nominal debt reduction may produce an “excessive” fee, which would be prohibited under Rule 1.5(a). (We express no opinion on the propriety of the fee arrangement between the client and the Debt Reduction Company, since our jurisdiction is limited to interpreting the Rules of Professional Conduct as they apply to lawyers.)

CONCLUSION

15. A lawyer may enter into a non-exclusive referral agreement with a debt reduction company, provided the arrangement is non-exclusive in fact. Although the very limited relationship at issue here does not make the lawyer “affiliated” with the Debt Reduction Company within the meaning of Rule 5.7, the lawyer would nevertheless be prudent to provide clients with the disclaimer set out in Rule 5.7(a)(4). In addition, to comply with Rule 1.7, the lawyer may need to disclose the non-exclusive reciprocal referral arrangement to clients and prospective clients, and obtain their informed consent, before referring clients to the Debt Reduction Company or accepting clients referred by the Debt Reduction Company.

16. A lawyer may enter into a contingent fee agreement for legal services in connection with debt reduction work. However, if the lawyer knows that a particular client is unlikely to have adequate financial resources to meet the reduced obligations, a contingent fee based on the nominal reduction in debt (as opposed to the actual reduction ultimately attained) may be excessive.

(31-10)