ABA Formal Opinion 474 (2016) – Referral Fees

By Gilda T. Russell[1]

I. Introduction.

The American Bar Association Standing Committee on Ethics and Professional Responsibility ("Committee") recently issued *ABA Formal Opinion* 474 (April 21, 2016) concerning referral fees. Specifically, the Committee held referral fees under ABA Model Rule 1.5(e) are subject to conflicts of interest rules, have to be confirmed in writing, explained in detail as to the division of the fee, be reasonable and not increased because of the referral, and entered into before or within a reasonable time of commencement of the representation.

ABA Model Rule 1.5(e) allows the division of fees between lawyers in different firms, e.g., referral fees, in the following circumstances:

> "A division of a fee between lawyers who are not in the same firm may be made only if:
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> (1) the division is in proportion to the services performed by each lawyer or each lawyer assumes joint responsibility for the representation;
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> (2) the client agrees to the arrangement, including the share each lawyer will receive, and the agreement is confirmed in writing; and
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> (3) the total fee is reasonable."

Hence, under the ABA Model Rule, a referral fee to a lawyer in a different firm is not allowed unless the division of the fee between the lawyer and the outside lawyer is proportional to the services performed by each lawyer or each lawyer assumes joint responsibility for the matter.[2]

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[2] While such is the approach of ABA Model Rule 1.5(e), there is a wide variation in jurisdictional approaches to referral fees. A number of states follow the requirements of proportionality or joint responsibility. *See e.g.,* District of Columbia Rule Prof. Cond. 1.5(e); Florida Rule Prof. Cond. 4-1.5(g); Illinois Rule Prof. Cond. 1.5(e); New York (New York Rule Prof. Cond. 1.5(g); and Texas Disc. Rule Prof. Cond. 1.04(f). Other states do not have any such proportional division or joint responsibility provisions for referral fees, but, rather, require only client consent and that the total fee is reasonable. *See e.g.,* California Rule Prof. Cond. 2-200(A);

II. Referral Fee Arrangements Under ABA Model Rule 1.5(e) Must Comply with the Conflict of Interest Provisions of ABA Model Rule 1.7.

The primary holding of ABA Formal Opinion 474 is that referral fee arrangements under ABA Model Rule 1.5(e) must comply with the conflict of interest provisions of ABA Model Rule 1.7 in order for the referring lawyer to collect a referral fee. Inasmuch as a referring lawyer could not perform proportional services for a client under ABA Model Rule 1.5(e) if there was a conflict of interest prohibited by ABA Model Rule 1.7, the Committee reasoned that the same principle should apply if the referring lawyer assumes joint responsibility for a matter.

The Committee noted that "[i]mplicit in the terms of the fee division allowed by [ABA Model] Rule 1.5(e) is the concept that the referring lawyer who divides a legal fee has undertaken representation of the client." As such, the Committee stated that *both the referring lawyer and the lawyer to whom a client is referred* must comply with the conflict of interest provisions of ABA Model Rule 1.7.[3]

ABA Model Rule 1.7(a) provides:

> "Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:
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> (1) the representation of one client will be directly adverse to another client; or
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> (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer."

In order to illustrate how conflicts of interest can arise in referral fee situations, the Committee applied the provisions of ABA Model Rule 1.7(a) to the following three part hypothetical circumstances:

Massachusetts Rule of Prof. Cond. 1.5(e); Michigan Rule Prof. Cond. 1.5(e); Oregon Rule of Prof. Cond. 1.5(d). And some states bar referral fees altogether. *See e.g.,* Colorado Rule of Prof. Cond 1.5(e).

[3] State bar ethics committees have similarly held that the conflict of interest rules apply to referral fee provisions. *See e.g., Wisconsin State Bar Ass'n Standing Comm. Prof. Ethics Formal Op. EF-10-02 (2002); New York State Bar Ass'n Ethics Op.* 745 (2001); *Illinois State Bar Ass'n Advisory Op*. 90-26 (1990); *Massachusetts Bar Ass'n Ethics Op*. 80-10 (1980).

Hypothetical Part One. Lawyer has represented a company for many years, which company is owned by two individuals, D and R. While running a personal errand and driving a car owned by the company, R is in a car accident. R, who had permission to use the vehicle, is not at fault, but is injured in the accident. R asks Lawyer to refer her to a personal injury attorney. R wants Lawyer to receive a referral fee and Lawyer wishes to accept joint responsibility for the matter. Lawyer does not believe that the company will be a party to the matter.

The Committee concluded that, in such circumstances, there would not be a conflict of interest under ABA Model Rule 1.7(a) because the "representation" would not be directly adverse to another client and there would not be a significant risk that the referral of R would be materially limited by the Lawyer's responsibility to the company.

Hypothetical Part Two. The Committee assumed the same facts as in Part One with the following differences. The question of fault is in dispute. Lawyer recognizes that in the future the other driver may file claims against both R and the company.

The Committee stated that if Lawyer continues to represent the company, Lawyer may believe there to be a significant risk that the representation of R will be materially limited by the Lawyer's responsibilities to the company and vice-versa. In such case, there would be a conflict of interest under ABA Model Rule 1.7(a)(1)(2).

Hypothetical Part Three. The Committee assumed the same facts as in Part One with the following differences. The question of fault is in dispute. The other driver has filed a claim against R and the company. Lawyer has determined that R's interests are adverse to those of the company. Lawyer does not expect to represent the company in the claims. Yet, the company will continue to be Lawyer's client in other matters.

In this situation, the Committee concluded that Lawyer's "representation" of R in the referral would be directly adverse to the company, creating a conflict of interest under ABA Model Rule 1.7(a)(1).

The Committee addressed next the question whether the provisions of ABA Model Rule 1.7(b) could be satisfied (in other words, the conflicts waived), so that the Lawyer could accept a referral fee in Hypothetical Parts Two and Three. ABA Model Rule 1.7(b) provides:

> "Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing."

The Committee concluded that, in both Hypothetical Parts Two and Three, a referral fee could be accepted assuming that the Lawyer reasonably concluded he or she would be able to provide competent and diligent representation to both R and the company, the representation was not prohibited by law, the representation would not involve the assertion of a claim by the company against R in the same litigation, and both R and the company provided Lawyer with informed written consent.

The Committee cited ABA Model Rule 1.0(e) in defining "informed consent." ABA Model Rule 1.0 (e) states that informed consent "denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct."

The Committee found that, in the circumstances of Hypotheticals Parts Two and Three, the Lawyer would have to explain to both clients the conflicts of interest before the clients could give informed written consent. The Committee cited Commentary to ABA Model Rule 1.0(e) regarding such explanation:

> "The lawyer must make reasonable efforts to insure that the client …possesses information reasonably adequate to make an informed decision. Ordinarily, this will require communication that includes a disclosure of the facts and circumstances giving rise to the situation, any explanation reasonably necessary to inform the client …of the material advantages and disadvantages of the proposed course of conduct and a discussion of the client's …options and alternatives." ABA Model Rule 1.0(e), Comment 6.

III. Additional Requirements of Fee Agreements Under ABA Model Rule 1.5(e)—Confirmation in Writing, Detail as to Division of Fee, Reasonableness, and Timing.

The Committee ended Formal Opinion 474 with a brief discussion of the additional requirements of fee agreements under ABA Model Rule 1.5(e) with

regard to confirmation in writing, detail as to division of the fee, reasonableness, and timing. ABA Model Rule 1.5(e)(2) requires that:

> "(2) the client agrees to the arrangement, including the share each lawyer will receive, and the agreement is confirmed in writing; and
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> (3) the total fee is reasonable."

The Committee determined that the written referral fee agreement must describe the division of the fee "in sufficient detail." In addition, the total amount of the fee has to be reasonable and cannot be increased because of the referral.

In conclusion, the Committee stated that the fee agreement should "precede the division of fees." The Committee held that "the division of fees must be agreed to either before or within a reasonable time after commencing the representation."[4]

IV. Summary.

In sum, ABA Formal Opinion 474 held with regard to referral fees under ABA Model Rule 1.5(e):

- A referral fee is not allowed under ABA Model Rule 1.5(e) unless the division of the fee between the referring lawyer and the lawyer to whom the client is referred is proportional to the services performed by each lawyer or each lawyer assumes joint responsibility for the matter.

- Referral fee arrangements are subject to the conflict of interest provisions of ABA Model Rule 1.7.

- Both the referring lawyer and the lawyer to whom a client is referred must comply with the conflict of interest provisions of ABA Model Rule 1.7.

- A conflict of interest may arise concerning the referral arrangement because of direct adversity between clients or material limitation on the referring lawyer's responsibilities to involved clients.

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[4] The Committee cited authorities in support of and against this position. *See, e,g., Wagner & Wagner LLP v. Atkinson, Haskins, Nellis, Brittignham, Gladd & Carwile, P.C.*, 596 F. 3d 84, 92 (2d Cir. 2010)(Fee division "clearly anticipates compliance with its requirements early on in the representation.") and *Cohen v. Brown*, 93 Cal.Rptr. 3d 24, 38 (Ct. App.2009)(Client's consent is required "prior to the actual *division* of the fees," and not prior to commencement of work.)

- If a conflict of interest arises under ABA Model Rule 1.7(a), the referral fee can still be accepted if the requirements of ABA Model Rule 1.7(b)(1)-(4) are met. (E.g., the conflict is waived).

- Informed consent under ABA Model Rule 1.7(b)(4) must be confirmed in writing and requires lawyer to have communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct.

- Additionally, under ABA Model Rule 1.5(e)(2), referral fee agreements must be:

  -- confirmed in writing,

  -- explained in detail as to the division of the fee,

  -- reasonable and cannot be increased because of the referral, and

  -- entered into before or within a reasonable time of commencement of the representation.