

Referral Fees and the Effect of Disciplinary Rule 2-107

The various forms of model rules of attorney conduct formulated by the American Bar Association have been consistent in making referral fees between lawyers unethical. Canon 34 of the Canons of Professional Ethics provided that:

No division of fees for legal services is proper except with another lawyer, based upon the division of service or responsibility.¹

Its more recent counterpart, Disciplinary Rule 2-107 states that:

A) A lawyer shall not divide a fee for legal services with another lawyer who is not a partner in or associate of his law firm or law office unless:

- 1) The client consents to employment of the other lawyer after a full disclosure that a division of fees will be made
- 2) The division is made in proportion to the services performed and responsibility assumed by each
- 3) The total fee of the lawyers does not clearly exceed reasonable compensation for all legal services they rendered the client

B) This Disciplinary Rule does not prohibit payment to a former partner or associate pursuant to a separation or retirement agreement.²

In typical form, a referral fee arrangement arises when an attorney meets with a client, and after an interview, advises the client to engage the services of another attorney that he specifically recommends. The client ultimately executes an agreement with the second attorney for his services. The referring attorney then enters into an agreement with the client's subsequent attorney under which he is to receive a percentage (usually one-third) of the fee collected by the second attorney. Consequently, a significant amount of the fee assessed to the client goes to a lawyer who at

1. CANONS OF PROFESSIONAL ETHICS OF THE AMERICAN BAR ASSOCIATION, CANON 34.

2. MODEL CODE OF PROFESSIONAL RESPONSIBILITY [hereinafter ABA CODE] DR 2-107 (1980).

least arguably performed little or no service for him.

Generally, courts have been predisposed to refuse to enforce referral fee contracts, either as directly contrary to a state rule of professional conduct (often similar or identical in form to either Disciplinary Rule 2-107 or Canon 34), as contrary to public policy,³ or on conventional contract law principles such as past or insufficient consideration.⁴ Courts appear reluctant to base a decision on a finding that the overall fee charged to a client was unreasonable, and consequently, invalidations of referral fee contracts are grounded either in a finding that the division of the fee between the attorneys was improper in light of the service performed by each or that the client had not consented to the arrangement.⁵ The next two sections of this article consider how various jurisdictions have dealt with these two elements.

Division of Service and Responsibility:

The American Bar Association has expressed a marked distaste for any sort of detailed inquiry into the apportionment of a fee between two lawyers. Its opinions make no attempt to assign a quantitative value to the service performed by a lawyer.

In as much as the amount of a lawyer's fee presents no ethical question, unless it is flagrantly excessive . . . it is not the province of this committee to measure the service rendered or responsibility assumed or incurred by the respective lawyers who may become so associated or to apportion a fee charged therefor.⁶

This language should not, however, be taken to mean that no inquiry should be made unless the total fee charged by the attorneys is excessive. Language from the same opinion makes it clear that at least some cursory examination of the division of services is appropriate. "Where an attorney rendered no legal service and assumed no responsibility in connection with a case, any division of fees with another lawyer would be improper."⁷ Thus, the standard

3. *Altschul v. Sayble*, 83 Cal. App. 3d 153, 147 Cal. Rptr. 716 (Cal. Ct. App. 1978).

4. *Fleming v. Campbell*, 537 S.W.2d 118 (Tex. Civ. App. 1976).

5. Note *Attorneys: The Referral Fee: A Split in Opinion* 33 OKLA. L. REV. 628 (1980).

6. ABA Informal Op. No. 932.

7. *Id.*

which the American Bar Association applies to referral fee agreements appears to require a division of the fee that is not grossly disproportionate to the division of services and responsibility.⁸ Their opinions indicate that they disfavor only those agreements in which a lawyer receives a fee solely for referring the client and not those in which the referring attorney has done some minimal amount of work⁹ such as obtaining copies of records pertinent to the case,¹⁰ and ostensibly stands ready to assume some further responsibility in the case if asked to.¹¹

The courts generally have been more willing to delve into the facts and determine just how much service a lawyer rendered for the compensation he received. Courts typically use a factual analysis to invalidate a referral agreement on the basis that the attorney involved had done an insufficient amount of work for the fee he had received and thus by implication, the client had been charged a substantial amount just for the referral.

The opinions of the New York courts are somewhat difficult to reconcile, but it appears that the courts generally take a position on the review of the division of services between lawyers that is only slightly stricter than that of the American Bar Association.¹² When the lawyers have been jointly retained by the client, the New York courts are very deferential to fee division agreements. Not only have they refused to look beyond the terms of the agreement, but if there is no specific agreement to the contrary they will infer that the two lawyers are "special partners" or "joint venturers" and must divide the fee equally.¹³ In *Bohm v. Holzberg*,¹⁴ the court held that two lawyers handling the same case would be

8. Hall and Levy, *Intra-Attorney Fee Sharing Arrangements*, 11 VAL. U.L. REV. 1 (1976); ABA Informal Op. No. 936.

"Canon 34 would be involved . . . if the division of services and responsibilities between you does not warrant the 33- $\frac{1}{3}$ % — 66- $\frac{2}{3}$ % division of the fee, or the cooperation between you and the forwarding attorney was no more than the referral."

9. Hall and Levy, *Intra-Attorney Fee Sharing Arrangements*, 11 VAL. U.L. REV. 1 (1976).

10. ABA Informal Op. No. 723.

11. *Id.*

12. Hall and Levy, *Intra-Attorney Fee Sharing Arrangements*, 11 VAL. U.L. REV. 1 (1976).

13. *Orenstein v. Albert*, 39 Misc.2d 1093, 242 N.Y.S.2d 505 (N.Y. Sup. Ct. 1963).

14. 69 Misc. 2d 469, 329 N.Y.S.2d 907 (N.Y. Sup. Ct. 1972).

treated as "special partners" if "there was *some* division of services and responsibility, and the party seeking to enforce the agreement actually performed some substantial services."¹⁵ In this case, the court allowed enforcement of an agreement for an equal division of the fee even though one of the lawyers had done at least eighty percent of the work.¹⁶

In *Matter of the Adoption of E.W.C.*,¹⁷ the court held that a Florida lawyer was not entitled to any percentage of the fee received by a New York attorney to whom he referred a client when the only services he rendered prior to the referral was "social counseling" to the client, who was expecting a child that she wished to place for adoption.¹⁸ The level of review applied seemed to be more rigorous than in cases in which the lawyers were jointly retained. However, such a dichotomy was specifically disclaimed in *Orenstein v. Albert*.¹⁹ In *Orenstein*, the court observed that the past cases dealing with referral fee agreements could be appropriately considered in special partnership cases.²⁰ In reading the special partnership cases together with some decisions on referral fee agreements, it appears that a referral fee contract might be enforced by the court irrespective of the proportion of work performed by each attorney, provided that each had performed some bona fide legal services to the client.

California courts are more likely to closely scrutinize the work performed by each attorney. Though like New York they also require a showing that a referring attorney has rendered a "substantial" amount of legal services to a client prior to referral, they apply the standard more rigorously. A California court of appeals, applying the "substantial" service standard, held in *Altschul v. Sayble*²¹ that an attorney was not entitled to ten percent of the fee collected by the attorney to whom he forwarded a client, even

15. *Id.* at ___, 329 N.Y.S.2d at 909.

16. *Bohm v. Holzberg*, 69 Misc. 2d 469, 329 N.Y.S.2d 907, 909 (1972).

17. 89 Misc. 2d 64, 389 N.Y.S.2d 743 (Surr. Ct. 1976).

18. *Id.* at 77, 389 N.Y.S.2d at 72. A similar result was reached in *Palmer v. Breyfogle*, 217 Kan. 128, 535 P.2d 955 (1975), in which it was held that "keeping a client happy" while her litigation was handled by another attorney did not constitute performance of a legal service so as to entitle the referring attorney to part of the fee collected from the client.

19. 39 Misc. 2d 1093, 242 N.Y.S.2d 505 (1963).

20. *Id.* at 1093, 1094, 242 N.Y.S.2d at 506.

21. 83 Cal. App.3d 153, ___, 147 Cal. Rptr. 716, 722 (1978).

though he had visited the client several times in the hospital, interviewed him about his accident, hired an investigator, and wrote a letter to another attorney regarding the case.²² The court recognized a general reluctance to look into the sufficiency of consideration given in a contract, but felt justified in doing so in this case because "the contract itself is disfavored because it is only a fee splitting agreement between attorneys."²³ Subsequent to this decision, the opinion in *Breckler v. Thaler*²⁴ (noting and distinguishing the *Altschul* case) provided an example of "substantial" services performed by an attorney before he referred the client. The court determined that the attorney provided substantial services when he filed suit, obtained relief under some government statutes, gave settlement advice to the client, was responsible for the pleadings filed in the case, and agreed to serve as co-counsel in the trial of the case if one became necessary.²⁵

Though these two decisions seem to clearly evince a more stringent position than that of the New York courts, the *Breckler* opinion purports to reject this perceived difference. It cautions that requiring trial courts to closely assess the facts of each case could result in a deluge of litigation, and, citing *Bohm v. Holzberg*, declares that "[w]here there is substantial division of services and responsibility, the agreed division of fees should be controlling."²⁶ It appears that the divergence between the California and New York courts may be narrowing in favor of more lenient review of fee splitting arrangements.

A more perplexing problem than determining the quantity of a lawyer's services is trying to assess when a lawyer has assumed sufficient "responsibility" in a case to justify his right to some portion of the fee collected by the subsequent lawyer. Webster's Third International Dictionary defines responsibility as "a moral, legal or mental accountability."²⁷ Given this definition, Canon 34 could conceivably have been interpreted to allow a lawyer to claim a fee for referring a client simply because some legal liability might attach to him.²⁸ Such a construction was specifically rejected in *Mc-*

22. *Id.*

23. *Id.*

24. 87 Cal. App. 3d 189, 151 Cal. Rptr. 50 (1978).

25. *Id.* at —, 151 Cal. Rptr. at 54, 55.

26. *Id.*

27. WEBSTER'S THIRD INTERNATIONAL DICTIONARY 1869 (14th ed. 1961).

28. See Note: *Attorneys: The Referral Fee: A Split in Opinion*, 33 OKLA. L.

Farland v. George.²⁹ The court held that "the word 'responsibility' as used in the rule means the doing of something. Any other meaning of the word would render the rule meaningless."³⁰ This language treats the word "responsibility" in such a way as to blur it into the word "service" and makes the terms virtually redundant. Other courts have similarly refused to draw a distinction between service and responsibility in their application of Canon 34 by summarily concluding that on a given set of facts an attorney did or did not perform services and assume responsibility to a sufficient extent to justify a share of the fee collected by the attorney to whom he referred the client.³¹

The spirit of this approach was adopted by the American Bar Association when DR 2-107, which requires a division of both service and responsibility, succeeded Canon 34.³² It now appears that whether a jurisdiction has adopted The Canons of Professional Ethics or The Code of Professional Responsibility, any difference of opinion about the meaning to be given to the word "responsibility" is of no practical significance.

Client Consent

Another area of significance in the decisions on referral fee contracts centers around DR 2-107's requirement that the client consent to any division of his fee between lawyers of different firms. This requirement is an outgrowth from the fiduciary relationship between the lawyer and the client.³³ To insure the client's confidence that he will be treated fairly and not subjected to excessive charges, the attorney should disclose how the client's fee is to be used.³⁴ Moreover, requiring a client's consent to a referral arrangement has been said to ensure that he is able to exercise control over who will represent him.³⁵

REV. 628 (1980).

29. 316 S.W.2d 662 (Mo. Ct. App. 1958).

30. *Id.* at 671.

31. *Palmer v. Breyfogle*, 217 Kan. 128, 535 P.2d 955 (1975); *Fleming v. Campbell*, 537 S.W.2d 118 (Tex. Civ. App. 1976).

32. Note: *Attorneys: The Referral Fee: A Split in Opinion*, 33 OKLA. L. REV. 628 (1980).

33. *Corti v. Fleischer*, 93 Ill. App. 517, 417 N.E.2d 764 (1981).

34. See *Blackburn, Referral Fees: an Abuse of the Public Trust*, 54 FLA. B.J. 235, 237 (Mar. 1980).

35. *Baron v. Mullinax, Wells, Mauzy and Baab, Inc.*, 623 S.W.2d 457 (Tex.

The opinions of the American Bar Association and various courts attach differing degrees of importance to the element of client consent to a referral arrangement. American Bar Association Informal Opinion 353 indicates that client consent to a referral fee agreement might prevent that agreement from being considered unethical under Canon 34, regardless of the amount of services performed by the respective attorneys.³⁶ This is particularly interesting since Canon 34 makes no mention of any requirement of consent. This opinion, when considered along with the language of Canon 34, is further indication that the American Bar Association prefers to defer to the good faith of the attorneys participating in fee splitting agreements in all but the cases in which it is apparent that the client has been unjustly treated.³⁷ Though the American Bar Association considers the client's consent to a referral agreement to be vital, Disciplinary Rule 2-107 does not require that the client be advised of the *apportionment* of the divided fee, only that a division will occur.³⁸ Several jurisdictions have rendered opinions which deal with the element of client consent under DR 2-107, though often these decisions are not on referral fee contracts per se. Nevertheless, an examination of these opinions is informative since few words are devoted to the discussion of consent in most opinions on referral fees.

In *Corti v. Fleisher*,³⁹ an Illinois Appellate Court refused to enforce an agreement under which an attorney was to have certain files he had worked on as an associate at a law firm transferred to his exclusive control when he left the firm. The decision relied heavily on the lack of the clients' consent to the transfer of their case files. The court said that enforcement of such an agreement would run contrary to public policy as being inconsistent with the nature of the attorney-client relationship:

It is a basic tenet of law that a fiduciary relationship exists between an attorney and his client, and all transactions arising out of such a relationship are subject to the closest scru-

Civ. App. 1981).

36. ABA Informal Op. No. 353: "When the client specifically agrees that the forwarding lawyer shall receive one-third and the forwarder two-thirds contingently, Canon 34 is not violated."

37. Hall and Levy, *Intra-Attorney Fee Sharing Arrangements* 11 VAL. U.L. REV. 1 (1976).

38. ABA CODE Rule 1.5d Comment (1981).

39. 93 Ill. App. 517, 417 N.E.2d 764 (1981).

tiny. . . . The burden of proof is upon the attorney to show the fairness of the agreement, the utmost good faith, complete disclosure on his part and a full understanding of all the facts and legal consequences on the part of his client.⁴⁰

In a similar situation,⁴¹ a Texas Court of Civil Appeals upheld an agreement under which a former associate of a law firm was to be forwarded certain cases that he had begun work on while at the firm. In return, he was to give the firm one-third of the fees he collected on those cases. The court held that the fact that the consent of the clients had not been obtained prior to referral of the cases did not make the agreement unethical or void as a matter of public policy.⁴² The court concluded that the clients were not affected by this arrangement and need not have been informed of it. The opinion indicates that if the effect on the client is not unjust, a fee splitting arrangement should not be set aside. "Disciplinary Rule 2-107 should not be too readily construed as a license for attorneys to break their promise, go back on their word, or decline to fulfill an obligation, in the name of legal ethics."⁴³ Earlier in that same year, the court's decision in *Kuhn, Collins & Rash v. Reynolds*⁴⁴ upheld an agreement under which an attorney originally retained by an accident victim was to receive one-third of the fee collected by the victim's second attorney after he was dismissed from the case. After retaining attorney Reynolds, the client decided that he preferred to have the firm of Kuhn, Collins & Rash represent him. He entered into a contingency fee agreement with Kuhn, Collins & Rash which specifically provided that one-third of the fee was to compensate Reynolds, who had forwarded his case file to the firm. The court made little mention of the division of fees in relation to the service performed by Reynolds,⁴⁵ and held that since the client knew of the arrangement due to the terms of the fee agreement made with the firm, and the total fee charged to

40. *Id.* at ___, 417 N.E.2d at 768.

41. *Baron v. Mullinax, Wells, Mauzy and Baab, Inc.*, 623 S.W.2d 457 (1981).

42. *Id.* at 461.

43. *Id.* at 462.

44. 614 S.W.2d 854 (Tex. Civ. App. 1963).

45. *Id.* at 858. The court noted that they did not examine the consideration given under the contract because the defendant did not deny and prove at trial that none was given. The court did state, however, that they believed the contract was supported by sufficient consideration.

him was reasonable, the fee splitting agreement was valid.⁴⁶

Once a court ascertains whether the consent of a client has been obtained by the attorneys involved in the referral fee arrangement, there will generally be little if any further discussion of the matter in the opinion. The cryptic treatment of this issue, however, belies its importance in the cases. Indeed, it is conceivable that the presence or lack of the client's consent is pivotal in a great many referral cases. The element of consent goes right to the heart of one of the primary purposes of the rules regulating attorneys' conduct—assurance of fair treatment of the client. If the client is informed of the arrangement and consents to it, there appears to be little reason for further examination of the facts by the reviewing court. After all, no one is better able to decide what sort of fee arrangement is fair to the client than the client himself. This is the sort of reasoning that seems to underlie the decision in *Graham v. Safir*,⁴⁷ in which the court allowed enforcement of a referral fee agreement without any inquiry into the amount of work done by the two attorneys involved. The court held that "the corporation [client] had the power to acquiesce in, and thereby ratify, the payment of a forwarding fee to defendant attorney by the retained attorneys, although the fee was not based upon a division of service and responsibility and there was no prior disclosure."⁴⁸ Though the court made it clear that they did not condone referral fee arrangements, it is noteworthy that they permitted the ultimate determination of the matter to rest with the person most affected by the agreement, the client.

Regardless of the policy justifications in making the client's consent controlling, such an approach appears virtually mandated in any jurisdiction that generally refrains from any searching examination of the division of services between the attorneys. Certainly if a court is not willing to inquire into the relative value of the proportion of services performed by each attorney, they will not scrutinize the reasonableness of the fee the client has been charged since that determination is probably even more subjective in nature.⁴⁹ Therefore, once the client's consent is found to be pre-

46. *Id.* at 857.

47. 19 A.D.2d 600, 240 N.Y.S.2d 614 (1963).

48. *Id.*

49. Note: *Attorneys: The Referral Fee: A Split in Opinion*, 33 OKLA. L. REV. 628 (1980).

sent, there appears to be no alternative but to enforce the contract and admonish the attorneys in dictum as the *Graham* court did.

Making the client's consent dispositive might possibly allow courts to handle referral fee cases in a way that better squares with the American Bar Association's recommendation that "[w]hen two lawyers have participated in an unethical agreement, one of them should not, where no one else is involved, set up the unethical agreement against the other."⁵⁰ A reasonable reading of the qualifying phrase "where no one else is involved" is that it means "where no one else is adversely affected," since obviously a client will be involved in every referral agreement. Therefore, enforcing consensual referral fee agreements would have the double benefit of both allowing the client to be in control of his fee arrangement with his attorneys and preventing an attorney from being able to dishonor his agreement with another in a situation in which enforcing it would seemingly do no harm.⁵¹

The Effects of Referral Fees

There has been considerable debate as to whether referral fees actually increase the cost of legal services. It has been noted that the vast majority of referral fee contracts are made in cases in which the client is billed on a percentage contingency basis.⁵² Therefore, as long as a client was charged a percentage fee that was consistent with that charged by the legal community at large, it is unlikely that the division of the fee actually resulted in higher charges to the client.⁵³ However, this conclusion is by no means universally accepted. Others argue that increases in the percentage of the client's recovery customarily charged by lawyers working on a contingency basis represent inflation necessitated by the need both to make a profit and pay the overhead represented by referral charges from another attorney.⁵⁴ The United States Supreme

50. ABA Informal Op. No. 870.

51. In *Altschul v. Sayble*, 83 Cal. App. 3d 153, 147 Cal. Rptr. 716 (1978), the California court of appeals took the view that both attorneys were in *pari delicto*, thus no suit on the fee splitting contract should be entertained.

52. Note, *Attorneys: The Referral Fee: A Split in Opinion*, 33 OKLA. L. REV. 628, 630 (1980).

53. *Id.* at 631.

54. Blackburn, *Referral Fees: an Abuse of the Public Trust*, 54 FLA. B.J. 235 (Mar. 1980).

Court took substantially the same view in *Weil v. Neary*.⁵⁵ "Certainly there would be a temptation (to both Untermeyer and Weil) to seek to increase the allowance as to secure a generous provision for both. Motive for excessive allowance could hardly be more direct."⁵⁶

A corollary to this consideration is the argument that referring a client to another is a "service" that warrants some compensation.⁵⁷ This concept of referral as a service in itself refers not to random selection of an attorney known to concentrate his practice in the field in which the client needs assistance, but an exercise of "intelligence, discretion, and experience in the selection of an attorney who will handle the case competently and adequately."⁵⁸

Perhaps the chief objections to such a liberal characterization of legal service are the possible effects on the public's perception of the lawyer and the lawyer's treatment of his clients. The language in the *McFarland v. George*⁵⁹ opinion typifies the misgivings held by many on the subject of a more permissive stand on client referral; "[s]uch a practice, if approved would make the lawyer a mere broker and would destroy the professional standing of lawyers as such and in time would tear down the wall that separates them from non-professional groups. Such a practice would make them tradesmen in the marketplace."⁶⁰ The courts consider the legal profession to be a more noble calling than "mere business," and to insure that this image is perpetuated, consistently condemn practices that are endemic to commercial trade rather than an occupation in which service to others is the paramount consideration. This notion of down playing the profit making objectives of law practice may have some justification. The *Corti v. Fleisher* opinion pointed out two possible undesirable effects of allowing lawyers to freely exchange clients for pecuniary gain:

As the various authorities reveal, this practice is injurious to the legal profession since the public loses confidence in those who treat clients as merchandise in a marketplace rather than the recipients of the attorney's skills and abilities. More importantly, the best interests of the clients are jeopardized by the

55. 278 U.S. 160 (1928).

56. *Id.* at 172.

57. 1 SPEISER, ATTORNEYS FEES § 6:5 (1973).

58. *Id.*

59. 316 S.W.2d 662 (Mo. Ct. App. 1958).

60. *Id.* at 672.

arrangements when it becomes more profitable for attorneys to sell clients than to give them a legal service.⁶¹

Conclusion

Though the terms of DR 2-107 are more detailed, and therefore seemingly more restrictive than Canon 34, both rules seem to have been applied in substantially the same way by the courts. DR 2-107 does, however, offer potential for improved handling of the referral fee case. By employing DR 2-107 a court can use the consent requirement to avoid highly subjective examinations of the reasonableness of the fee and the division of service between the attorneys, without having to either make questionable decisions on those matters or uphold some agreements that are patently unfair to the client. Moreover, emphasizing the consent element moves the court away from excessive involvement in the interaction and bargaining between lawyer and client.

Due to the limited number of decisions on the subject, it is still highly speculative whether DR 2-107 will have this impact. Whether it does will doubtlessly depend in large part on the prevalence of referral fees within the reviewing court's jurisdiction and the reviewing court's view of the ethical ramifications of referral fee agreements. DR 2-107 does, however, appear to offer a court an opportunity to position itself between the two extremes of wholesale rejection or affirmation of referral fee agreements while still maintaining a modicum of predictability in its decisions.

W. Perry Webb

61. 93 Ill. App. 517, —, 417 N.E.2d 764, 775 (1981).