

# AMERICAN BAR ASSOCIATION

STANDING COMMITTEE ON ETHICS AND PROFESSIONAL RESPONSIBILITY

## FORMAL OPINION 474

April 21, 2016

### Referral Fees and Conflict of Interest

*Rule 1.5(e) allows lawyers who are not in the same firm to divide a fee under certain circumstances. A lawyer who refers a matter to another lawyer outside of the first lawyer's firm and divides a fee from the matter with the lawyer to whom the matter has been referred, has undertaken representation of the client.*

*Fee arrangements under Model Rule 1.5(e) are subject to Rule 1.7. Unless a client gives informed consent confirmed in writing, a lawyer may not accept a fee when the lawyer has a conflict of interest that prohibits the lawyer from either performing legal services in connection with or assuming joint responsibility for the matter.*

*When one lawyer refers a matter to a second lawyer outside of the firm and the first lawyer either performs legal services in connection with or assumes joint responsibility for the matter and accepts a referral fee, the agreement regarding the division of fees, including client consent confirmed in writing, must be completed before or within a reasonable time after the commencement of the representation.*

The question presented is under what circumstances lawyers may divide a fee when one lawyer refers a matter to another lawyer outside the firm.<sup>1</sup> Our analysis starts with Model Rule 1.5(e), which reads:

A division of a fee between lawyers who are not in the same firm may be made only if:

- (1) the division is in proportion to the services performed by each lawyer or each lawyer assumes joint responsibility for the representation;
- (2) the client agrees to the arrangement, including the share each lawyer will receive, and the agreement is confirmed in writing; and
- (3) the total fee is reasonable.

Comment [7] to Rule 1.5 explains that lawyers in different firms may divide a legal fee. This practice is often used when the fee is contingent and the division is between a referring lawyer and a trial lawyer.<sup>2</sup>

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1. This opinion is based on the ABA Model Rules of Professional Conduct as amended by the ABA House of Delegates through February 2016. The laws, court rules, regulations, rules of professional conduct, and opinions promulgated in individual jurisdictions are controlling.

Model Rule 1.5(e)(1) establishes two different standards for such division of fees: either the division must be in proportion to the services performed or the lawyers must assume joint responsibility for the representation.<sup>3</sup> Thus the Rule permits a lawyer to associate with another lawyer (often a trial lawyer) in a different firm, refer a client to that lawyer, and divide a fee either in proportion to the services performed by each lawyer, or by having each lawyer involved in the representation assume joint responsibility for the matter, provided that the client agrees to the participation of all lawyers involved, including the share each lawyer will receive, the agreement is confirmed in writing, and the total fee is reasonable.<sup>4</sup>

Joint responsibility is not defined by the black letter of Model Rule 1.5(e). However, Comment [7] to Rule 1.5 provides guidance noting that “Joint responsibility for the representation entails financial and ethical responsibility for the representation as if the lawyers were associated in a partnership.”<sup>5</sup> Implicit in the terms of the fee division allowed by Rule 1.5(e) is the concept that the referring lawyer who divides a legal fee has undertaken representation of the client.<sup>6</sup>

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2. MODEL RULES OF PROF'L CONDUCT R. 1.5 cmt. [7] (2016). *See also* MODEL RULES OF PROF'L CONDUCT R. 1.1 (2016), which requires a lawyer to provide competent representation. Comment [6] to Rule 1.1 notes that “before a lawyer retains or contracts with other lawyers outside the lawyer’s own firm to provide or assist in the provision of legal services to a client, the lawyer should ordinarily obtain informed consent from the client and must reasonably believe that the other lawyers’ services will contribute to the competent and ethical representation of the client. . . . The reasonableness of the decision to retain or contract with other lawyers outside the lawyer’s own firm will depend upon the circumstances, including the education, experience and reputation of the nonfirm lawyers; the nature of the services assigned to the nonfirm lawyers; and the legal protections, professional conduct rules, and ethical environments of the jurisdictions in which the services will be performed, particularly relating to confidential information.”

3. There is wide variation in state adoptions of Model Rule 1.5(e). Some states have eliminated the specific requirement of proportionality or joint responsibility, simply requiring client consent and a reasonable total fee. *See, e.g.*, CALIFORNIA RULES OF PROF'L CONDUCT R. 2-200; CONNECTICUT RULES OF PROF'L CONDUCT R. 1.5(e); DELAWARE RULES OF PROF'L CONDUCT R. 1.5(e); MICHIGAN RULES OF PROF'L CONDUCT R. 1.5(e); OREGON RULES OF PROF'L CONDUCT R. 1.5(d). A limited number of states either prohibit referral fees altogether or have declined to adopt any version of subsection (e). *See, e.g.*, COLORADO RULES OF PROF'L CONDUCT R. 1.5(e) & WYOMING RULES OF PROF'L CONDUCT R. 1.5(f). LOUISIANA RULES OF PROF'L CONDUCT R. 1.5(e) requires the provision of substantive legal services to justify a fee division, which would also appear to preclude fee division solely for a referral. Other states require that a fee division always be accompanied by ongoing joint responsibility, or joint financial responsibility, for the matter. *See, e.g.*, ARIZONA RULES OF PROF'L CONDUCT R. 1.5(e); ILLINOIS RULES OF PROF'L CONDUCT R. 1.5(e); WISCONSIN RULES OF PROF'L CONDUCT R. 20:1.5(e).

4. MODEL RULES OF PROF'L CONDUCT R. 1.5 cmt. [7] (2016).

5. MODEL RULES OF PROF'L CONDUCT R. 1.5 cmt. [7] (2016). Comments do not add obligations to the Rules but provide guidance. *See* MODEL RULES OF PROF'L CONDUCT, PREAMBLE AND SCOPE [14] (2016). The Ethics 2000 Commission is the source of the current language of Comment [7]. *See* A LEGISLATIVE HISTORY: THE DEVELOPMENT OF THE ABA MODEL RULES OF PROFESSIONAL CONDUCT, 1982-2013, at 99 (Art Garwin ed., 2013). The Ethics 2000 Commission relied on ABA Comm. on Ethics & Prof'l Responsibility, Informal Op. 85-1514 for the amendments.

6. *See generally* Connecticut Bar Association Prof'l Ethics Comm., Informal Op. 2013-04 (2013); Maine Bd. of Bar Overseers Op. 145 (1994).

Because the client is represented by both the referring lawyer and the lawyer to whom the client was referred, a referral fee arrangement under Model Rule 1.5(e) subjects both lawyers to the conflict provisions of Rule 1.7.<sup>7</sup> Model Rule 1.7(a) reads:

(a) 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:

(1) the representation of one client will be directly adverse to another client; or

(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.

### **Illustration by Hypothetical: Part One**

Application of Rule 1.5, and the relationship between Rules 1.5 and 1.7, can be illustrated using a hypothetical. Assume the following situation: for many years, Lawyer has represented The Flower Shoppe Inc., which is jointly owned by Daisy and Rose. Rose was in a car accident while on a personal errand driving a car owned by The Flower Shoppe. Rose, as a co-owner of the Shoppe, had permission to use the Shoppe vehicle to perform the errand. Rose was not at fault but was injured in the accident. Knowing Lawyer does not practice personal injury law, Rose asked Lawyer to refer her to a personal injury trial lawyer. Lawyer will not assist the trial lawyer in preparation of the case. Rose would like Lawyer to receive a referral fee, and Lawyer wants to accept joint responsibility for the matter. When Rose requests the referral, Lawyer reasonably believes that The Flower Shoppe will not be a party to the matter. Before assuming joint responsibility for the matter, Lawyer must determine whether a conflict of interest exists under Rule 1.7(a).

On the facts presented here, Lawyer can proceed with the referral to the trial lawyer because there is no conflict of interest under Rule 1.7(a). The representation of one client is not directly adverse to another client and there is not a significant risk that the referral of Rose will be materially limited by Lawyer's responsibility to The Flower Shoppe. Thus, the requirements of 1.7(a) are satisfied.<sup>8</sup>

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7. The Commission on Evaluation of Professional Standards (commonly referred to as the Kutak Commission) explained, "A fee arrangement [envisioned by this paragraph of Rule 1.5] is subject to the conflict provisions of Rule 1.7 and 1.8." See PROPOSED FINAL DRAFT, MODEL RULES OF PROFESSIONAL CONDUCT 37 (1981). See also Illinois State Bar Ass'n, Advisory Op. 90-26 (1991); Massachusetts Bar Ass'n Op. 80-10 (1980); State Bar of Michigan, Informal Op. RI-116 (1992).

8. We assume that when Lawyer conducted the conflict check, Lawyer determined that Lawyer's representation was also not limited by Lawyer's responsibilities to another client, a former client or a third person, or by a personal interest of Lawyer.

### Illustration by Hypothetical: Part Two

Assume again that for many years, Lawyer has represented The Flower Shoppe Inc., which is jointly owned by Daisy and Rose. Rose was in a car accident while on a personal errand driving a car owned by The Flower Shoppe. Rose, as a co-owner of the Shoppe, had permission to use the Shoppe vehicle to perform the errand. Rose was injured. Fault is in dispute. Rose asked Lawyer to refer her to a personal injury trial lawyer. Lawyer will not assist the trial lawyer in the representation. Rose would like Lawyer to receive a referral fee, and Lawyer wants to accept joint responsibility for the matter.

Lawyer recognizes that sometime in the future the other driver in the accident will file a claim against Rose and may file a claim against The Flower Shoppe as owner of the car. If the other driver adds The Flower Shoppe as a party and Lawyer continues to represent The Flower Shoppe, Lawyer believes that there is a significant risk that Lawyer's representation of Rose will be materially limited by Lawyer's responsibilities to The Flower Shoppe and vice versa.<sup>9</sup>

Therefore, in order to receive a referral fee for referring Rose to a trial lawyer, Lawyer must meet the requirements of Model Rule 1.7(b).<sup>10</sup>

### Illustration by Hypothetical: Part Three

Assume again that for many years Lawyer has represented The Flower Shoppe Inc., which is jointly owned by Daisy and Rose. Rose was in a car accident while on a personal errand driving a car owned by The Flower Shoppe. Rose, as a co-owner of the Shoppe, had permission to use the Shoppe vehicle to perform the errand. Rose was injured. Fault is in dispute. Rose asked Lawyer to refer her to a personal injury trial lawyer. Lawyer will not assist the trial lawyer in the representation. Rose would like Lawyer to receive a referral fee and Lawyer wants to accept joint responsibility for the matter.

The other driver has filed a claim against Rose and The Flower Shoppe, and Lawyer has determined that Rose's interests in the suit are adverse to The Flower Shoppe's interests. While Lawyer does not expect to represent The Flower Shoppe in the suit, The Flower Shoppe will

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9. MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. [8] (2016) explains that a conflict of interest exists "if there is a significant risk that a lawyer's ability to consider, recommend or carry out an appropriate course of action for the client will be materially limited as a result of the lawyer's other responsibilities or interests. . . . The mere possibility of subsequent harm does not itself require disclosure and consent. The critical questions are the likelihood that a difference in interests will eventuate and, if it does, whether it will materially interfere with the lawyer's independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the client." In this hypothetical, the facts provide that Lawyer reasonably believes that there is a significant risk that Lawyer's representation of Rose and The Flower Shoppe will be materially limited by Lawyer's responsibilities to the other. Thus Lawyer's reasonable belief establishes the conflict under Rule 1.7(a)(2).

10. Circumstances at the outset also could make accepting a referral fee improper. Changing a few facts in this hypothetical would prohibit Lawyer from referring Rose to the trial lawyer and receiving a referral fee. For example, if at the outset the other driver sued both Rose and The Flower Shoppe Inc., Lawyer represented The Flower Shoppe in the suit, and Rose and The Flower Shoppe asserted claims against each other, then Lawyer would have a conflict that a client could not consent to. See MODEL RULES OF PROF'L CONDUCT R. 1.7(b)(3) (2016).

continue to be Lawyer's client. Lawyer's representation of Rose, through the referral, is a conflict of interest under Rule 1.7(a)(1).<sup>11</sup>

To receive a referral fee for referring Rose to the trial lawyer, Lawyer must meet the requirements of Model Rule 1.7(b).

### **Informed Consent to the Conflict**

Rule 1.7(b) reads:

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.

Assuming that Lawyer reasonably believes that Lawyer will be able to provide competent and diligent representation to each affected client, that the representation is not prohibited by law, and that at this time the representation does not involve the assertion of a claim by The Flower Shoppe against Rose in the same litigation, then under Rule 1.7(b)(4) Lawyer must still secure the informed consent, confirmed in writing, of each affected client.<sup>12</sup> Under hypotheticals two and three, Lawyer needs the informed consent of both Rose and The Flower Shoppe to refer Rose to the trial lawyer outside the firm and divide the legal fee.

Informed consent is defined by Model Rule 1.0(e) as "the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and

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11. MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. [6] (2016) provides, "Loyalty to a current client prohibits undertaking representation directly adverse to that client without that client's informed consent. Thus, absent consent, a lawyer may not act as an advocate in one matter against a person the lawyer represents in some other matter, *even when the matters are wholly unrelated*. The client as to whom the representation is directly adverse is likely to feel betrayed, and the resulting damage to the client-lawyer relationship is likely to impair the lawyer's ability to represent the client effectively. In addition, the client on whose behalf the adverse representation is undertaken reasonably may fear that the lawyer will pursue that client's case less effectively out of deference to the other client, i.e., that the representation may be materially limited by the lawyer's interest in retaining the current client." (Emphasis added).

12. MODEL RULES OF PROF'L CONDUCT R. 1.0(b) (2016) explains, "'Confirmed in writing,' when used in reference to the informed consent of a person, denotes informed consent that is given in writing by the person or a writing that a lawyer promptly transmits to the person confirming an oral informed consent."

explanation about the material risks of and reasonably available alternatives to the proposed course of conduct.”<sup>13</sup> Comment [6] to Model Rule 1.0 explains:

The lawyer must make reasonable efforts to ensure that the client or other person 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 or other person of the material advantages and disadvantages of the proposed course of conduct and a discussion of the client’s or other person’s options and alternatives . . .

Before Rose or The Flower Shoppe can provide informed consent to the conflict of interest, Lawyer must provide both with information about the conflict of interest. For example, if Lawyer is representing The Flower Shoppe in the suit as noted in hypothetical two, and if after Lawyer has referred Rose to the trial lawyer the other driver sues both Rose and The Flower Shoppe Inc. resulting in Rose and The Flower Shoppe Inc. asserting claims against each other, then a conflict under Model Rule 1.7(b)(3) would prohibit representation.<sup>14</sup>

### Rule 1.5(e) Fee Disclosures

Rule 1.5(e) requires that a client agree to the fee division and that the agreement be confirmed in writing.<sup>15</sup> The agreement must describe in sufficient detail the division of the fee between the lawyers including the share each lawyer will receive.<sup>16</sup> Rule 1.5(e)(3) mandates that the total fee be reasonable. If a contingent fee is divided between a referring lawyer and another lawyer, the total fee cannot be increased because of the referral.<sup>17</sup>

Rule 1.5(e)(2) uses the future tense in the phrase “including the share each lawyer *will receive*” to describe what the fee division agreement must include, and Comment [7] to Rule 1.5 explains “the client must agree to the arrangement, including the share that each lawyer *is to receive* . . . .” The use of the future tense envisions that the fee division agreement will precede the division of fees. Such an agreement should not be entered into toward the end of such a relationship. Instead, the division of fees must be agreed to either before or within a reasonable time after commencing the representation.<sup>18</sup>

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13. MODEL RULES OF PROF’L CONDUCT R. 1.0(e) (2016).

14. This opinion does not address whether Lawyer would be required to withdraw from representing both Rose and The Flower Shoppe in hypothetical two, if such a conflict did arise. *See* MODEL RULES OF PROF’L CONDUCT R. 1.7 cmt. [29] (2016). Nor does this opinion address under what circumstances Lawyer might also be required to repay a referral fee that was already paid to and received by the Lawyer.

15. MODEL RULES OF PROF’L CONDUCT R. 1.5(e)(2) (2016).

16. *Id.*

17. *See, e.g.,* Illinois State Bar Ass’n, Advisory Op. 90-18 (1990).

18. At least two courts have questioned the efficacy of fee division agreements signed after settlement. *Wagner & Wagner, LLP v. Atkinson, Haskins, Nellis, Brittingham, Gladd & Carwile, P.C.*, 596 F.3d 84, 92 (2d Cir. 2010) (rejecting referring lawyer’s argument that “technical” requirement of joint responsibility letter required by

## Conclusion

Rule 1.5(e) allows lawyers who are not in the same firm to divide a fee under certain circumstances. A lawyer who refers a matter to another lawyer outside of the first lawyer's firm and divides a fee from the matter with the lawyer to whom the matter has been referred, has undertaken representation of the client.

Unless a client gives informed consent confirmed in writing, a lawyer may not accept a fee when the lawyer has a conflict of interest that prohibits the lawyer from either performing legal services in connection with or assuming joint responsibility for the matter.

When one lawyer refers a matter to a second lawyer outside of the firm and the first lawyer either performs legal services in connection with or assumes joint responsibility for the matter and accepts a referral fee, the agreement regarding the division of fees, including client consent confirmed in writing, must be completed before or within a reasonable time after the commencement of the representation.

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New York Rule DR 2-107 could be satisfied by complying "before fees have been paid"; court explained that fee division provision "clearly anticipates compliance with its requirements early on in the representation. . . . Moreover, the undertaking of joint responsibility is difficult (to say the least) to accomplish, other than as a charade, after a settlement with the defendant has been reached."); *Saggese v. Kelley*, 837 N.E.2d 699, 706 (Mass. 2005) (while affirming the enforcement of an agreement to divide fees that client agreed to "toward the end of the attorney-client relationship," court holds that after the issuance of the decision, referring lawyer required to disclose fee sharing before the referral is made and secure client's consent in writing). *But see* *Cohen v. Brown*, 93 Cal. Rptr. 3d 24, 38 (Ct. App. 2009) (California's Rule 2-200 "requires only that the client's consent to a division of fees be given prior to the actual *division* of the fees. It does not require client consent prior to the commencement of work by the associated-in attorney/law firm."). *See also* MODEL RULES OF PROF'L CONDUCT R. 1.1 cmt. [6] (2016) "before a lawyer retains or contracts with other lawyers outside the lawyer's own firm to provide or assist in the provision of legal services to a client, the lawyer should ordinarily obtain informed consent from the client . . . ."

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