Is your referral-fee agreement ethical and enforceable?

California is the land of the "pure referral fee." The agreed fee is not necessarily commensurate with work done on the case

By Ji-In Lee Houck

You represent a client in a personal-injury lawsuit arising from a car crash that has put your client in a wheelchair. While going over responses to form interrogatories with your client, you learn that your client's employer fired them for what sounds like a ridiculous reason after refusing to reasonably accommodate their new disability. Since you have never touched an employment case, you call on an employment lawyer in your network. They agree to take the case and you agree to a referral fee of a percentage of the attorneys' fees earned. Years later, the employment lawyer wins a big verdict at the disability discrimination and wrongful-termination trial and you collect hundreds of thousands of dollars in fees without having to do much more than forward your client's contact information to the employer lawyer. *Is this ethical?*

Lawyer answer: It depends.

Such referral fee agreements among lawyers who are not in the same law firm are commonplace in our state and among our membership. However, most states prohibit lawyers from collecting a percentage of the fee that is not proportional to the work done on the case. Most states follow ABA Model Rule 1.5(e), which requires such a division to be "in proportion to the services performed" by each lawyer, or alternatively, each lawyer must assume "joint responsibility" for the representation.

California is not most states.

The "pure referral fee"

California is one of the few states that permit a "pure referral fee" that compensates a lawyer for referring a matter to another lawyer without requiring the referring lawyer to work on the matter. (See *Moran v. Harris* (1982) 131 Cal.App.3d 913, 921-22.) In *Moran*, an attorney referred a medical malpractice case to a med-mal specialist who later transferred the case to a third lawyer who agreed to be bound to the original referral fee agreement. The third attorney settled the case but refused to pay the referral fee to the first attorney. The Court of Appeal held that such referral fee agreements, also known as fee-forwarding agreements, are not against public policy, and that the agreement should be enforced. The Court explained the public policy considerations for permitting such agreements:

> if the ultimate goal is to assure the best possible representation for a client, a forwarding fee is an economic incentive to less capable lawyers to seek out experienced specialists to handle a case. Thus, with marketplace forces at work, the specialist develops a continuing source of business, the client is benefited and the conscientious, but less experienced lawyer is subsidized to competently handle the cases he retains and to assure his continued search for referral of complex cases to the best lawyers in particular fields.

(*Moran*, 131 Cal.App.3d at 922.)

While permitted, California has also recognized the potential ethical pitfalls to such fee-sharing agreements, including the potential to create perverse incentives for recovery that are not in the client's best interests. Therefore, the California State Bar's governing Board of Trustees has adopted, and the California Supreme Court has approved, the following rules to regulate fee-sharing agreements to protect the public and to promote respect and confidence in our legal profession.

Rules regulating fee-sharing agreements

The California Rules of Professional Conduct regulate an attorney's sharing of fees with lawyers and nonlawyers. While fee-sharing with nonlawyers is beyond the scope of this article, Rule of Professional Conduct 5.4(a) generally prohibits it outside some narrow exceptions that mostly relate to the death or retirement of lawyers. If you are considering a financial arrangement that even remotely resembles fee-sharing with a nonlawyer (yes, that means paralegals, too), you need to understand Rule 5.4(a) and should consult with ethics counsel.

If you are paying or receiving a referral fee from lawyers who are not at your firm, you must comply with Rules of Professional Conduct 7.2(b)(4) and 1.5.1.

Rule 7.2(b)

(b) A lawyer shall not compensate, promise or give anything of value to a person for the purpose of recommending or securing the services of the lawyer or the lawyer's law firm, except that a lawyer may: …

(4) refer clients to another lawyer or a nonlawyer professional pursuant to an arrangement not otherwise prohibited

under these Rules or the State Bar Act that provides for the other person to refer clients or customers to the lawyer, if:

(i) the reciprocal referral arrangement is not exclusive; and

(ii) the client is informed of the existence and nature of the arrangement

(Rule of Professional Conduct 7.2(b) (asterisks for defined terms omitted).)

Rule 1.5.1 Fee Divisions Among Lawyers

(a) Lawyers who are not in the same law firm shall not divide a fee for legal services unless:

(1) the lawyers enter into a written agreement to divide the fee;

(2) the client has consented in writing, either at the time the lawyers enter into the agreement to divide the fee or as soon thereafter as reasonably practicable, after a full written disclosure to the client of:

(i) the fact that a division of fees will be made;

(ii) the identity of the lawyers or law firms that are parties to the division; and

(iii) the terms of the division; and

(3) the total fee charged by all lawyers is not increased solely by reason of the agreement to divide fees.

(b) This rule does not apply to a division of fees pursuant to court order.

(Rule of Professional Conduct 1.5.1 (asterisks for defined terms omitted).)

Rule 1.5.1 became effective November 1, 2018, and contains two material changes from former Rule 2-200 that it replaced. First, the fee-sharing agreement between the lawyers must be in writing. There was no such express requirement in the former Rule 2-200. Second, the client must consent to the division after full disclosure either "at the time the lawyers enter into the agreement to divide the fee" or "as soon thereafter as reasonably practicable." (Rule of Professional Conduct 1.5.1(a)(2).) Previously, under the former Rule 2-200, the client could consent to the fee division any time before the lawyers actually divided the fees. (*Mink v. Maccabee* (2004) 121 Cal.App.4th 835.)

The Commission for the Revision of the Rules of Professional Conduct (the "Commission") stated that the changes were made because an underlying reason for the rule regulating fee divisions among lawyers is to assure that the client's representation is not adversely affected. (See Executive Summary of Rule 1.5.1.) The Commission explained that "deferring disclosure and client consent to the time the fee is divided denies the client a meaningful opportunity to consider the concerns the rule is intended to address." (*Ibid.*)

The California Supreme Court explained that the purpose of the rules governing fee-sharing agreements is to "protect the public and to promote the respect and confidence in the legal profession." (*Chambers v. Kay* (2002) 29 Cal.4th 142, 145.)

> Just as a client has a right to know how his or her attorney's fees will be determined, he or she also has a right to know the extent of, and the basis for, the sharing of such fees by attorneys. Knowledge of these matters helps assure the client that he or she will not be charged unwarranted fees just so that the attorney who actually provides the client with representation on the legal matter has 'sufficient compensation' to be able to share fees with the referring attorney. Disclosure of these matters to the client should be in writing because the client should not be expected to mentally retain such information throughout the pendency of the case. Moreover, [r]equiring the client's written consent to fee sharing impresses upon the client the importance of his or her consent, and of the right to reject the fee sharing.

(*Chambers*, 29 Cal.4th at 156-57, quoting *Margolin v. Shemaria* (2002) 85 Cal.App.4th 891, 903 (quotations and internal citations omitted).)

In *Chambers*, the attorneys failed to obtain written consent of the fee division from the client under former Rule 2-200. The California Supreme Court held that this failure precluded not only recovery for breach of the fee-sharing agreement but also precluded a quantum meruit award predicated upon an apportionment of the contingent fee. (*Chambers*, 85 Cal.App.4th at 162-63.)

Is my fee-sharing agreement enforceable?

To have an enforceable fee-sharing agreement, you must meet each of the following requirements:

- **Written fee agreement between the lawyers.** Have all the lawyers receiving a fee sign the client's retainer agreement or other writing acknowledging the fee division.
- **Written disclosure to client.** Let the client know in writing (1) that there will be a division of fees, (2) the identity of the lawyers or law firms that will be receiving a fee, and (3) the terms of the fee division.
- **Client's written consent.** Have the client sign the retainer agreement or other writing containing the requisite disclosures. Silence to a proposed fee-sharing agreement, oral consent, and even a written acknowledgement that a client has read and understood the contents of a letter describing a fee division between lawyers is *not* sufficient. (*Reeve v. Meleyco* (2020) 46 Cal.App.5th 1092, 1098-99.) Noncompliance or insufficient compliance can result in an unenforceable fee-sharing agreement and dismissal of a lawyer's action for breach of contract. (*Id.*, 46 Cal.App.5th at 1100.)
- **Total fee charged is not increased solely because of the fee-sharing agreement.** The agreement must be to share the fees earned and cannot increase the overall fee the client must pay as a result.

• **Total fee is not unconscionable.** While Rule 1.5.1 deleted the phrase from former Rule 2-200(A)(2) prohibiting unconscionable fees, the unconscionable fee provision in Rule 1.5(a) applies to any fee agreement, including a fee-sharing agreement.

Any fee-sharing or referral agreement among lawyers of different firms that does not comply with Rule 1.5.1, is *void and unenforceable* on public policy grounds. (*Reeve*, 46 Cal.App.5th at 1092.) If an attorney fails to obtain a client's written consent after providing the requisite written disclosures, the attorney would instead only be entitled to quantum meruit recovery for the reasonable value of legal services rendered (and not predicated on an apportionment of the contingent fee per *Chambers*, *supra*), which is governed by a two-year statute of limitations. (*Huskinson & Brown, LLP v. Wolf* (2004) 32 Cal.4th 453, 459 (decided under former rule); Code of Civ. Proc., § 339.) Also, while this rule does not apply to a division of fees pursuant to court order (CRC 1.5.1(b)), to enforce a fee-sharing agreement in a class action lawsuit, you must disclose it to the court in a class action settlement. (*Mark v. Spencer* (2008) 166 Cal.App.4th 219, 227-28 [attorney's failure to disclose the fee-splitting agreement to the court in a class action lawsuit barred its enforcement].)

Do not rely on the other lawyer's compliance – especially if you are the referring attorney. A violation of Rule 1.5.1 is a defense to a fee-sharing agreement even when the breaching lawyer promised to disclose the fee-sharing agreement to the client and obtain the client's written consent but did not:

> Moreover, if the fee sharing agreement between Margolin and Shemaria is not otherwise enforceable for lack of compliance with rule 2-200, it would be an affront to that rule to permit plaintiffs to recover such fees on the basis that Shemaria breached his promises to Margolin to see to the rule's requirements. The fees would be shared despite the absence of compliance with the rule. Such a result is untenable.

(*Margolin*, 85 Cal.App.4th at 903 [refusing to enforce a fee-sharing agreement when lawyer failed to provide written disclosure and obtain client's written consent].)

When you make the deal to share the fee or as soon thereafter as reasonably practicable, get proof of the client's written consent for your file or get the informed written consent yourself. A clear written disclosure and agreement among the attorneys and client is not just required – it also benefits all parties and will save you from headaches once the money comes in.

What if I hire an outside contract attorney for an assignment?

You must comply with the fee division requirements of Rule 1.5.1 if (1) your law firm is not obligated to pay for the contract lawyer's services if the fees are not charged to or paid by the firm's client, (2) the amount paid to the contract attorney is based on fees paid to the firm by the client, or (3) the contract lawyer is entitled to a percentage of the fee paid by the client to the firm. (Cal. State Bar Form. Opin. 1994-138.) In other words, if the amount paid to the outside lawyer is not tied to specific legal fees received by the law firm or if the law firm must pay the outside lawyer whether or not the client pays the firm, then there is no division of fees and Rule 1.5.1 does not apply. (*Ibid.*)

Sample provisions

If you know from the outset that you will be sharing fees with another lawyer outside your firm, get a written fee-sharing agreement with the referral attorney or co-counsel and put the written disclosure in the retainer agreement:

> **DIVISION OF CONTINGENCY FEES**
>
> Client agrees that Attorney may associate other attorneys to assist in the representation. Client's legal fees under this agreement will not increase by reason of this association. The associated attorneys will receive _____ (fill in fraction or other method) of the fee and this firm will receive _____ (fill in fraction or other method).
>
> By signing this agreement, Client has read and understands the above and confirms his/her/its consent to the terms of the association of counsel and division of fees.
>
> **PAYMENT OF REFERRAL FEE**
>
> Client acknowledges that attorney _____ (fill in name) who referred the case to this Attorney/firm will receive a referral fee of _____ (fill in percentage) of all sums paid in this matter. Client's legal fees will not be increased by reason of the referral fee.
>
> By signing this agreement, Client confirms his/her/its consent to the terms of the payment of the referral fee.

Remember to also obtain a separate written agreement between all the lawyers who are sharing the fee. These and other sample provisions are available on the California State Bar website at http://www.calbar.ca.gov/Attorneys/Attorney-Regulation/Mandatory-Fee-Arbitration/Forms-Resources.

Final thoughts

Referral fees and fee-sharing among co-counsel play an important role in our practice. They incentivize lawyers to seek out or partner with other lawyers to ensure that clients obtain competent representation. For the benefit and protection of the client and lawyers, make sure you have updated your firm procedures for referral fee and other fee-sharing agreements, so they comply with Rule 1.5.1. Compliance will not only save you from professional misconduct and disciplinary action, but it will ensure that you have an enforceable fee-sharing agreement that will hold up in court if a lawyer does not honor their agreement.

Ji-In Lee Houck is the managing partner at Stalwart Law Group, APC, *a boutique litigation firm in Los Angeles. While Ji-In enjoys a diverse litigation and trial practice that includes legal malpractice and commercial litigation, she has a particular passion for employment litigation and fighting for employee rights. Ji-In earned her law degree from the Georgetown University Law Center.*

Houck