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Money for nothing? Best practices for referral and fee splitting agreements

By Tracy L. Kepler

It is an everyday occurrence. Attorneys refer cases to one another and then collect the fees for those same referrals. Client referrals and the income generated from fee splitting agreements are not only an important revenue stream, but also serve to assist those clients in need of quality legal representation when the attorneys are unable to take on all prospects themselves as a result of unavailability, retirement, or differing practice areas. However, these fees are not simply easy and risk-free money; there are strict requirements that the referring attorney must satisfy in order to collect the referral fee, and proactive risk management pertaining to fee splitting agreements is critical. The failure to meet these requirements may result in an ethical violation, may cause the loss of the fee, and may result in vicarious liability being placed upon the referring attorney for the misdeeds or negligence of the working attorney ultimately involving the referring attorney in a legal malpractice matter or disciplinary proceeding.

Why Refer?

Referral fees and fee sharing agreements play an important role. They incentivize lawyers to seek out or partner with other lawyers to ensure that clients obtain competent representation. They make good business sense in that an attorney cannot and should not try to handle every case that walks through the door. The attorney may have more work than she can handle at the time, the matter may be beyond the attorney's current skill level or expertise, or perhaps the matter requires upfront costs that the attorney may not be in the financial position to bear on behalf of the client. Declining business is never easy, and the temptation to take on that representation can be difficult to resist. However, doing so may precipitate both disciplinary and legal malpractice problems. In order to derive income from the client matter, referral of the matter to another counsel and entering into a fee splitting agreement generally represents an acceptable approach. Here are some examples of situations when a fee splitting agreement between attorneys may be appropriate:

Example 1: A solo practitioner has more cases than she can handle, so she refers some of the overflow cases to a colleague in another solo practice. She continues to handle some of the investigation and discovery on the cases, but the other attorney files all the pleadings and appears in court on behalf of the client.

Example 2: A recently licensed attorney cannot take on the new client because he lacks sufficient experience in the practice area or the financial wherewithal to advance the upfront costs that will be required for discovery. He refers the case to a more experienced, financially stable law firm.

Example 3: The client matter is basic and does not require the expertise or skill level of the attorney. The attorney refers the case to a new attorney who is just starting his practice.

When the attorney has determined that a referral to another attorney may be the best solution, the rules regulating these fee splitting agreements must be understood.

Rule 1.5(e) of the ABA Model Rules of Professional Conduct

Rule 1.5(e) of the American Bar Association's ("ABA") Model Rules of Professional Conduct sets forth the following requirements for fee splitting agreements between attorneys who are not in the same firm: (1) the division of fees must be in proportion to the services performed by each attorney or each attorney assumes joint responsibility for the representation; (2) the client agrees to the arrangement, including the share received by each attorney, and the agreement is confirmed in writing; and (3) the total fee must be reasonable. In addition, the referral fee must be paid to a lawyer, not a layperson, and cannot be shared with or paid to an attorney who is prohibited by the ethics rules from undertaking the representation. For example, where a conflict of interest exists, or the attorney is suspended or disbarred, a referral may not be affected. In addition, Comment [7] to ABA Model Rule 1.5 explains that an attorney may refer a client only when there is a reasonable belief that the new attorney is competent to handle the matter and that joint responsibility "entails financial and ethical responsibility for the representation as if the lawyers were associated in a partnership."

Not all jurisdictions have adopted the ABA Model Rule with respect to fee splitting agreements. Some states do not require the division of fees to be proportional to the work performed by each attorney, and others have added their own additional specific requirements. In the District of Columbia, for example, the written agreement must not only state that the fees are to be divided between the attorneys, it also must identify the lawyers participating in the representation, the division of responsibilities, and the "effect of the association of lawyers outside the firm on the fee to be charged," i.e., price differential, if any, as a result of the association. It is

important to consider your jurisdiction's rules before entering into any referral or fee splitting agreement as well as the jurisdictional rules of professional conduct that will apply to the agreement.

What Does Joint Responsibility Mean?

Joint responsibility implies that both the referring and receiving lawyers may be held liable for any claim of legal malpractice. In some jurisdictions, it is sufficient for a referring lawyer to simply state the responsibility in the referral agreement. Others require that the referring attorney must actually do something other than just making the referral. Still others construe this joint responsibility to be legal and even impose financial responsibility on both lawyers in the event of a legal malpractice claim on the part of the referring or receiving attorney. Although a referring attorney may not be required to supervise the day-to-day activities on a client matter, such as docketing/calendaring applicable statutes of limitations, filing deadlines and confirming that a brief, response or complaint has actually been timely filed by the receiving attorney, monitoring the status of the matter represents a best practice. In addition, regular, albeit brief, contacts with the client, or an occasional review of relevant documents, may be helpful in order to keep all parties involved and aware. Finally, if the client matter is in an area of practice with which the attorney lacks familiarity, it may be best to forgo a fee splitting agreement as the referring attorney may become vulnerable to legal malpractice liability. Lacking the relevant experience, the referring attorney may not recognize the potential legal malpractice exposures.

What is Client Consent and a Reasonable Fee?

In most jurisdictions, the rules require that the client be informed of the fee splitting agreement and that there is a direct communication with the client. Although the ABA Model Rule requires that the agreement be confirmed in writing, consulting your jurisdiction's additional requirements is important before entering into such an agreement. The client also must consent to the fee splitting agreement. Consent requires more than notifying the client that a fee splitting agreement exists. For example, in In re: Hart, 605 S.E.2d 532 (S.C. 2004), an attorney failed to place his standard 50/50 fee split with the referring lawyers in writing in 70 cases. Although no client complained, all of the clients consented to the agreement and the attorney self-reported, the court entered a discipline finding.

Regarding the reasonableness of the fee, the determination can vary widely across the country with little precedent or clarity in this area. Of course, the total fee can be no greater than it would have been if there had been no fee splitting agreement. In other words, the contingent fee percentage, or the hourly rate, must be the same as it would have been if there had been a single lawyer or law firm working on the case. When making this decision on the fee split, an attorney should first consult the provisions of ABA Model Rule 1.5(a) which provide guidance on this issue. In addition, one noteworthy case where the reasonableness of the fee was considered is Corcoran v. Northeast Illinois Regional Commuter RR Corp. 9 In that matter, the court upheld the referring attorney's request for enforcement of a fee splitting agreement of 40% of the receiving attorneys' 25% contingency fee because all of the requirements of the Rule 1.5(a) of the Illinois Rules of Professional Conduct had been met. In addition to obtaining the client's consent, the agreement may serve to protect the interest of the referring attorney rather than the handshake "gentlemen's agreement" of the past.

Best Risk Management Practices on Referral and Fee Splitting Agreements

From a legal malpractice perspective, the referring and the receiving attorneys in a fee splitting agreement remain jointly responsible for the matter, with consequential inherent risks in the joint representation. Following some best practices at the outset and during the referral arrangement can go a long way in mitigating the risk.

- If the matter involves a client request for a referral or recommendation, provide a minimum of three options. Clients should understand that they must perform their own research and make the ultimate decision going forward. This approach will help to avoid an allegation of a negligent referral if the subsequent attorney-client relationship does not go well and professional liability allegations arise.
- Refer to an attorney that you know, trust and is competent in all respects to partner on the matter. If you have not worked with the prospective receiving attorney on a prior case, and do not know her practice, you will wish to inquire about her reputation in the legal community and research her background to ensure that she is competent to represent your client. Check with attorney regulatory agencies, ask the prospective receiving attorney whether she has lawyers professional liability insurance coverage, whether the attorney has been the subject of any recent legal malpractice claims or disciplinary complaints, confirm that the attorney has some experience handling the type of matter being referred and that the attorney has the capacity and/or staff to handle the matter competently.
- From the start, clarify expectations for both the benefit of the client and the referring and receiving attorneys and ensure that the fee splitting agreement specifically indicates what services each attorney is going to provide on the matter and who is the primary contact. Ensure that the client is aware of this division of labor. This clarification will eliminate confusion and misunderstanding.
- Be specific on the terms of the fee split. How much will the referring and receiving attorney receive? Who is responsible for upfront costs? If the referring attorney will not perform any legal services on the client matter, ensure that the client is aware that the referring attorney will not be working on the case and will not be involved in the oversight of the client matter.
- Consider the value of the case and your lawyers professional liability insurance coverage. If the case involves a large damage exposure, the referring attorney may not have sufficient coverage if a legal malpractice action is brought as a result of the receiving attorney's violation of the standard of care. Finally, if a solo practitioner is preparing for retirement, it is imperative that all referral fees are accepted before the practice is closed.

Conclusion

Referral and fee splitting agreements can represent an important stream of revenue for your practice. However, they are not without risk. Being proactive in the referral process, compliant with the Rules of Professional Conduct in your jurisdiction, and specific in the terms of the fee splitting agreement will help you avoid possible disciplinary action or a legal malpractice matter, and also ensure that you have a successful fee splitting agreement that benefits both the clients and the attorneys involved. ■

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