Referral Fees and Conflicts of Interest

In a previous column,[1] we looked at Arizona's recently revised rule on fee sharing and some of the problems that can arise if the rule is not strictly followed. A recent ethics opinion from the American Bar Association[2] reminds us that there is another dimension to the rule—that is, the fee-sharing rules need to be read with, and may occasionally be affected by, the rules regarding conflicts of interest.[3]

Referral fees are most often used when the fee is contingent and the referral is made by a lawyer to a "trial specialist," or when a lawyer refers the matter to a lawyer in another jurisdiction. ER 7.2(b) generally prohibits the payment of anything of value to a person for recommending the lawyer's services. ER 1.5(e) provides an exception to that rule, as long as the referring lawyer (a) receives no more than the proportional amount his work bears to the total fee earned or (b) assumes joint responsibility for the representation with the lawyer to whom the case is referred.[4]

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In the following paragraphs, we discuss two of the conflict of interest rules. ER 1.7(a) prohibits the representation of a client when that representation is directly adverse to another client, or when there is a significant risk that the representation 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. ER 1.8(a), the so-called business transaction rule, regulates attempts by lawyers to acquire "pecuniary interests" affecting their clients.

Be careful before seeking a referral fee for sending a case to another lawyer. The price for the peace you gain may be the inability to share fees.

All of this becomes important when the person or entity is referred to another lawyer because the referring lawyer has a conflict of interest that prevents him from taking or continuing in the case. If a referral is made simply because the referring lawyer seeks counsel better able to handle the matter, or because the case needs to be prosecuted in a jurisdiction where the lawyer is not licensed, there presumably would be no conflict of interest issues, and referral fees may be appropriate if ER 1.5(e)'s requirements are met. But if the referring lawyer is faced with a situation where one of her clients wants to sue another one of her clients and the referral is made because the referring lawyer is ethically prohibited from representing one client against another, the dynamic changes if the referring lawyer wants a referral fee. Because the fee-sharing rule requires either that the referring lawyer work on the case or have some continuing duty toward the representation, she may be unable to share fees because she can't meet the requirements of ER 1.5(e) without jeopardizing her complete removal from the case as required by the conflict of interest rules.

Stated another way, the distance required from the representation by ER 1.7(a) after a conflict is determined tends to negate the closeness to the representation and the ongoing responsibilities required of the referring lawyer by ER 1.5(e). The referring lawyer obviously can't ethically participate in litigation against a client under the "proportion of services performed" branch of the fee-splitting rule. If the lawyer agrees to remain jointly responsible for any malpractice liabilities and to accept the other responsibilities implied under the second branch of the rule,[5] an argument can be made that this continuing relationship

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will put the referring lawyer at risk of not having distanced himself far enough away from the case so as to avoid being accused of still representing the referred client against his other client and of therefore being in violation of the conflict of interest rules.

There doesn't seem to be much of a consensus on this issue among other jurisdictions. Some claim that when the referring lawyer has withdrawn as required by the conflict of interest rules, ongoing responsibilities contemplated by the fee-sharing rule cannot be met and referral fees are not allowed.[6] Other authorities seem to disagree.[7]

As a practical matter, it is hard to imagine a situation where an existing client of a referring lawyer would agree to allowing that lawyer to share in a fee with another lawyer based on how much the referred client won against the other client in a tort case, or how much the referred client was awarded in attorneys' fees in a contract case. Although it's the referred client that has to agree to and sign the referral fee arrangement as provided in ER 1.5(e), it's the other client that would be required to give permission under ER 1.8(a), the rule that sets forth fairly strict requirements whenever a lawyer attempts to acquire a "pecuniary interest adverse to the client," one requirement of which is that the client gives its informed consent to the transaction. That may be exactly the case when the referring lawyer attempts to acquire rights to a fee that one of his clients may ultimately have to pay for losing a lawsuit.[8]

The lesson here is that you need to be careful before seeking a referral fee for sending a case to another lawyer because you don't want to be on either side in a controversy between two present or former clients. You are required to refer the case to another lawyer to avoid potential disqualification motions and/or malpractice claims for violating the conflict of interest rules, but the price for the peace you gain may be the inability to meet the requirements necessary to be able to share fees under ER 1.5(e).

endnotes

1. *Sharing Fees, Unintended Consequences*, Ariz. Att'y (Oct. 2016) at 8.
2. ABA Formal Op. 474 (Referral Fees and Conflicts of Interest) (April 21, 2016).
3. ERs 1.7 (Conflict of Interest: Current Clients), 1.8 (Conflict of Interest: Current Clients: Specific Rules) and 1.9 (Duties to Former Clients), Ariz.R.Prof.Conduct, found at Rule 42, Ariz.R.S.Ct.
4. In Arizona, this means that the referring lawyer must assume financial responsibility for any malpractice that occurs during the course of the representation, as well as assure that the referral is made to a lawyer believed to be competent, and be ready to take appropriate steps if he learns that the other lawyer has violated the ethical rules. *See* Ariz. Ethics Op. 04-02 (Lawyer Referral Fees; Division of Fees with Lawyers; Gifts) (March 2004); and *Referring Clients to Other Lawyers*, Ariz. Att'y (October 2006) at 10.
5. *See* Ariz. Ethics Op. 04-02, *supra* note 4.
6. *Evans & Luptak PLC v. Lizza*, 650 N.W.2d 364 (Mich. Ct. App. 2002); Mich. Informal Ethics Op. RI-116 (Feb. 19, 1992); Maine Ethics Op. 145 (Taking Fee for Referral When Conflict Bars Representation) (Sept. 27, 1994).
7. Philadelphia Bar Ass'n Op. 2008-4 (April 2008).
8. *See Evans & Luptak PLC,* 650 N.W.2d at 373.