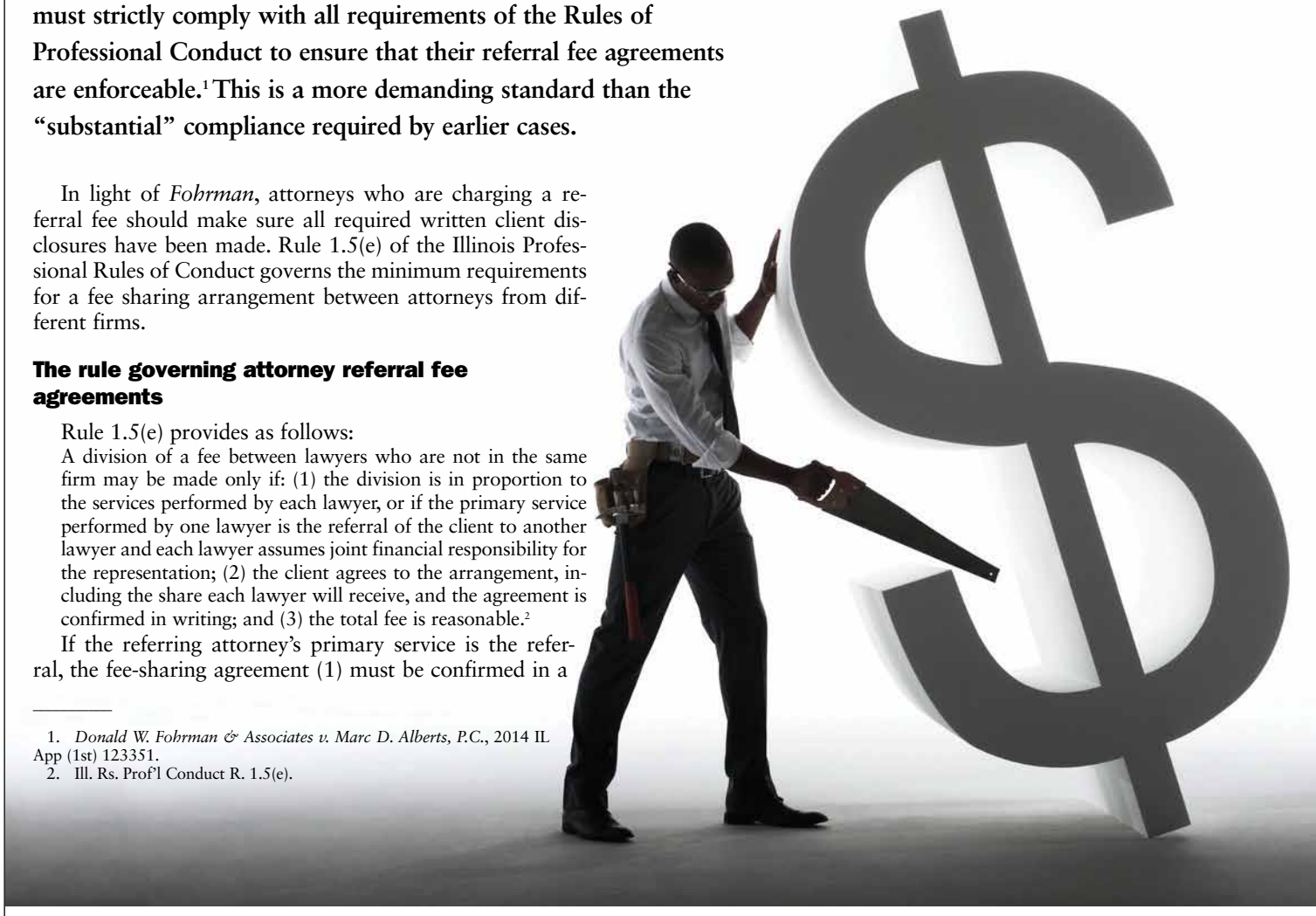
By Jeffrey C. Blumenthal

Beware the New, Stricter Standards for Referral Fee Agreements

Will the court enforce your referral fee agreement? A recent case ups the ante by requiring strict, not merely "substantial," compliance with the requirements of the Rules of Professional Conduct.

Do you refer cases to other attorneys and take a share of the fee? If so, be aware that a new appellate case, *Donald W. Fohrman & Associates v. Marc D. Alberts, P.C.*, holds that referring lawyers must strictly comply with all requirements of the Rules of Professional Conduct to ensure that their referral fee agreements are enforceable.[1] This is a more demanding standard than the "substantial" compliance required by earlier cases.



In light of *Fohrman*, attorneys who are charging a referral fee should make sure all required written client disclosures have been made. Rule 1.5(e) of the Illinois Professional Rules of Conduct governs the minimum requirements for a fee sharing arrangement between attorneys from different firms.

The rule governing attorney referral fee agreements

Rule 1.5(e) provides as follows:

> 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 if the primary service performed by one lawyer is the referral of the client to another lawyer and each lawyer assumes joint financial 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.[2]

If the referring attorney's primary service is the referral, the fee-sharing agreement (1) must be confirmed in a

1. *Donald W. Fohrman & Associates v. Marc D. Alberts, P.C.*, 2014 IL App (1st) 123351.
2. Ill. Rs. Prof'l Conduct R. 1.5(e).

writing, (2) must disclose that the referring attorney is getting a fee primarily for making the referral, (3) must disclose the referring attorney's share of the fee, and (4) must disclose that the referring attorney assumes joint financial responsibility for the representation (i.e., is liable for the representation as if the lawyers were partners). Further, while doing so is apparently not required by the rules, it's best practice that the agreement be signed by the client, the lawyer to whom the case is referred (the "receiving attorney"), and the referring attorney, unless a contingent fee is involved, in which event there has to be a written agreement signed by the client pursuant to Rule 1.5(c).[3]

The attorney referral fee agreement in *Fohrman*

In *Fohrman,* a law firm that concentrates in worker's compensation cases ("Fohrman") filed a complaint alleging an oral joint venture agreement for sharing fees based on referrals of personal injury cases by Fohrman to the defendant Smith & Alberts law firm or its successors ("Alberts").[4] In its amended complaint, Fohrman alleged that for each referred case there was an executed written fee agreement between Alberts and the underlying client, which provided that Fohrman was co-counsel on the case and that the lawyers were to be paid 1/3rd of what was recovered. However, as Alberts pointed out, the written agreement did not inform the client: (1) that the primary service performed by Fohrman was the referral to Alberts; (2) whether Fohrman and Alberts were assuming joint financial responsibility for the representation; or (3) how the fees were to be split.

Fohrman contended that Alberts assured it that the agreements it prepared for the underlying clients to sign complied with all applicable supreme court rules governing disclosure of co-counsel arrangements. Fohrman further alleged that it was in a joint venture with Alberts in the subject cases and the fee agreements that Alberts caused the underlying clients to sign were in substantial compliance with Rule 1.5.[5]

At various times after the initial complaint was filed, the trial court dismissed with prejudice Fohrman's counts for breach of contract, breach of fiduciary duty, accounting, fraud, injunction/receivership, unjust enrichment, promissory estoppel, and tortious interference with economic advantage. The court also entered summary judgment on Fohrman's remaining count on the attorneys' liens that had been filed.

Rule 1.5(e) and 'substantial compliance'

In affirming the trial court's ruling, the appellate court rejected the contention that substantial compliance with Rule 1.5(e) was sufficient, even though that argument had been accepted in a few cases under the predecessor rule governing fee splitting (i.e., Rule 2-107 of the Rules of Professional Responsibility).

The appellate court discussed *Davies v. Grauer*,[6] where the attorneys orally agreed to jointly represent two clients in products liability suits and equally split the one-third contingency fees. The clients' signed contingent fee agreements with the defendant that did not refer to the plaintiff attorney or to any agreement to split fees. *Davies* held that "a standard of substantial compliance" with Rule 2-107 was sufficient because "it comports with practical realities."[7]

In *Davies*, the record showed that both clients were informed of the fee-sharing arrangements and knew the fees would be split equally. The *Davies* court found that the aims of Rule 2-107 had been fulfilled and reasoned that was sufficient. It further ruled that the plaintiff attorney had stated a claim for breach of fiduciary duty with the lawyer to whom he had referred the cases based on his claim to have had an oral joint venture agreement for the two attorneys to try those two cases together.

In light of *Fohrman*, attorneys who are charging a referral fee should make sure all written client disclosures required by Rule 1.5(e) have been made.

The *Fohrman* court effectively rejected the ruling in *Davies* – and *Phillips v. Joyce*,[8] on which *Davies* relies – stating as follows:

> First, of course, these cases interpreted Rule 2-107 and Rule 1.5(e) applies here. Second, this case is factually distinct from *Phillips* and *Davies*. For example in *Phillips*, the defendant admitted that he had agreed to the fee-sharing arrangement and to drafting a compliant agreement. Defendants here have not made such admissions. In *Davies*, the evidence showed the clients had been informed about the fee arrangement and the division of fees. Again there is no such evidence in the instant case. Finally, and most importantly, we observe these decisions turn on a concept of "practical realities." It is our understanding that the fee-sharing provisions of the Rules are not guide posts, but mandatory. The "prac-

3. An earlier version of what is now PRC 1.5(e) (formerly designated PRC 1.5(f)) required that the client sign a writing authorizing any fee splitting agreement. Accordingly, in *In re Storement*, 203 Ill. 2d 378, 398 (2002), the supreme court determined that the fee splitting agreement involved in that case violated the differently worded forerunner of what is now PRC 1.5(e) because the client had not signed a writing authorizing the fee splitting agreement, even though that case did not involve a contingent fee agreement. Because agreements to pay referral fees are almost always made part of the underlying receiving attorney-client retainer agreement and "often [are] used when the fee is contingent," in the ordinary course the receiving attorney and the client will sign the writing confirming the referral fee arrangement. Ill. Rs. Prof'l Conduct R. 1.5 at Comment 7. While PRC 1.5(e) does not appear to require that the referring attorney also sign the writing confirming the referral fee agreement, this is the "best" practice since it "minimizes uncertainties and disputes" as to what was agreed to by all of the parties and should eliminate any claim by the referring attorney that there was no assent to assuming joint financial responsibility for the representation were that to become an issue at a later date. *Storement*, 203 Ill. 2d at 398.

4. *Fohrman*, 2014 IL App (1st) 123351.

5. The court made a point of noting that Fohrman's Amended Complaint did not allege that: (1) Fohrman had assumed joint financial responsibility for the referred cases; (2) Forhman performed any work on the cases; or (3) that the clients knew or were told as to how fees between the attorneys were to be divided. *Id.* at ¶ 15.

6. *Davies v. Grauer*, 291 Ill. App. 3d 863 (1st Dist. 1997).

7. *Id.*

8. *Phillips v. Joyce*, 169 Ill. App. 3d 520 (1st Dist.1988).

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tical realities" concept is contrary to this principle and the public policy of protecting the clients which is behind the rules.[9]

Strict compliance is now required

In making its ruling, the *Fohrman* court focused on cases interpreting Rule 1.5(e) that demanded strict compliance with its requirements to enforce a fee-sharing agreement. Importantly, it held that "Rule 1.5(e) does not place the responsibility of disclosure solely on the receiving attorney, and the disclosure must be made that the referring attorney *will* receive the fee."[10]

In affirming the trial court's ruling, the appellate court rejected the contention that substantial, as opposed to strict, compliance with Rule 1.5(e) was sufficient.

Accordingly, it is not enough to allege that the receiving attorney is responsible for making the required disclosures to the underlying client. If the attorney to whom the case was referred did not make the required disclosures, the court may shift its focus to what disclosures the referring attorney made. In *Fohrman*, the court ultimately held as follows:

> Because there was not complete compliance with Rule 1.5(e), and Fohrman failed to meet its own fiduciary duty of disclosing the referral agreement, we find the circuit court properly dismissed the amended complaint with prejudice and granted summary judgment in favor of Alberts as to the unenforceability of the attorney liens.[11]

Fohrman signals a continuing shift on fee-sharing agreements from "substantial" to "full" compliance under Rule 1.5(e). Under *Fohrman*, a lawyer accused of breaching a fee-splitting agreement can raise noncompliance with Rule 1.5(e) as a defense even if the defendant lawyer's actions caused or contributed to the rule infraction. In fact, the *Fohrman* court specifically "reject[ed] an argument that the referral agreement should be enforced because of the defendant's 'nefarious' conduct."[12]

The *Fohrman* court's rationale is that the focus of Rule 1.5(e) is on protecting the client. The court wants to ensure that the fee-splitting agreement expressly provides the client with the protections called for by the rule. Since the court views a noncompliant agreement as a breach of fiduciary duty by both the referring attorney and the attorney to whom the matter is referred, it has effectively decided that it will no longer help the referring attorney collect its share of a referral fee in that "unclean hands" situation.

Document the referral, review the retainer agreement with the client

Fohrman underscores the importance of appropriately documenting any referral. As part of the documentation process, the referring attorney should require that the attorney to whom the referral is being made promptly provide a fully executed copy of an underlying client-attorney retainer agreement that strictly complies with the requirements of Rule 1.5(e).

Since *Fohrman* effectively conditions judicial enforcement of a fee-sharing agreement on compliance with Rule 1.5(e), the referring attorney needs to go one step further and actually review the signed client-attorney retainer agreement to make sure it complies. The maxim is that an ounce of prevention is worth a pound of cure. Here, an ounce of prevention ensures the possibility of a "cure" should it be needed at a later date. ■

9. *Fohrman*, 2014 IL App (1st) 123351, ¶ 39 (citations omitted).
10. *Id*. at ¶ 53 (emphasis in original).
11. *Id*. at ¶ 56.
12. *Id*. at ¶ 49.

More on referral fees

You'll find links to these and other resources on the ISBA Practice Resource Center at http://www.isba.org/practiceresourcecenter/referrals.

Articles

- **Fee Not-So-Simple: Referral Fee Dos and Don'ts**
  By Helen Gunnarsson, *Illinois Bar Journal*, May 2005
  It's permissible to refer cases to other lawyers and share in the fee, as long as all the requirements are met. But just because you can share a fee doesn't necessarily mean you should.
- **Putting Your Firm on the Web**
  By Mary Katherine Danna, *Illinois Bar Journal*, November 2005
  Includes a discussion of client referral services.
- **Referral Fees**
  Illinois Attorney Registration and Disciplinary Commission
  Question # 9 from *Ten Ethics Questions from Young Lawyers*

ISBA Advisory Opinions on Professional Conduct

- **03-06** Referral Fees; Retaining Responsibility for Matter after Leaving Law Firm
- **99-06** Conflicts of Interests
- **98-02** Independent Contractors
- **92-23** Computerized for Profit Referral Services
- **90-26** Conflicts
- **90-18** Referral Fees; Division Between Referring and Receiving Lawyers
- **90-11** Division of Fees with Referring Attorney
- **840** Referral Networks
- **776** Of Counsel Relationships/Referral Fees

Illinois Rules of Professional Conduct

- **Rule 1.5 – Fees**
  Discusses fee splitting and fees in general.