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"Generous referral fees paid per State Bar rules"

WRITTEN ASSOCIATION OF COUNSEL AND REFERRAL-FEE AGREEMENTS, APPROVED BY THE CLIENTS, ARE ESSENTIAL FOR RECOVERING ATTORNEYS' REFERRAL FEES

Rule 2-200 of the Rules of Professional Conduct ("Rule 2-200") states:

(A) A *member shall not divide a fee for legal services with a lawyer who is not a partner of, associate of, or shareholder with the member unless*: [¶] (1) The client has *consented* in *writing* thereto *after* a full disclosure has been made in writing that a division of fees will be made *and* the terms of such division; and [¶] (2) The *total fee* charged by all lawyers is no*t increased solely by reason of the provision for division of fees and is not unconscionable* as that term is defined in rule 4-200. (Emphasis added.)

Rule 4-200 (Fees for Legal Services) provides, in pertinent part, (A) A member shall not enter into an agreement for, charge, or collect an illegal or unconscionable fee. (B) Unconscionability of a fee shall be determined on the basis of all the facts and circumstances existing at the time the agreement is entered into except where the parties contemplate that the fee will be affected by later events. Among the factors to be considered, where appropriate, in determining the conscionability of a fee are the following:

(1) The amount of the fee in proportion to the value of the services performed.

(2) The relative sophistication of the member and the client.

(3) The novelty and difficulty of the questions involved and the skill requisite to perform the legal service properly.

(4) The likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the member.

(5) The amount involved and the results obtained.

(6) The time limitations imposed by the client or by the circumstances.

(7) The nature and length of the professional relationship with the client.

(8) The experience, reputation, and ability of the member or members performing the services.

(9) Whether the fee is fixed or contingent.

(10) The time and labor required.

(11) The informed consent of the client to the fee.

Rule 22 was the original rule against "fee splitting," and it required that any fees paid to another lawyer (non-partner/associate) were to be in proportion to the services performed or responsibility assumed. (See, *Altschul v. Sayble* (1978) 83 Cal.App.3d 153, 164; compare, DR 2-107.) Rule 22 became former Rule 2-108, which is essentially the same as Rule 2-200, but *before* 1972, it prohibited "*pure referral fees*." (See, *Scolinos v. Kolts* (1995) 37 Cal.App.4th 635.)

In 1972, the Rules of Professional Conduct were changed to permit referral fees that did not reflect (any) work done by the referring attorney. "Permitting attorney's fees to be shared promotes referrals by "less capable lawyers to ... experienced specialists...." (*Moran v. Harris* (1982) 131 Cal.App.3d 913, 922.) Thus, the client can benefit from the referral, as can both the experienced attorney, and "the conscientious, but less experienced lawyer [who] is subsidized to competently handle the cases he retains...." (*Ibid.*; see also, *Margolin,* 85 Cal.App.4th at 894, fn. 2.)

A review of case law, starting with *Margolin*

Margolin is a "pure" referral-fee case. The referring attorney sued the attorney to whom the case was referred, who ultimately recovered $450,000 in fees from the referred client, without the referring attorney doing any of the work or advancing costs. (*Id.*, 85 Cal.App.4th at pp. 894-895.) The case was tried to a jury, but the trial court entered a *directed verdict* in favor of the handling attorney, and against the referring attorney, on the basis that the fee agreement between the attorneys (and client) did not comply with Rule 2-200 of the Rules of Professional Conduct. (*Ibid.*)

Margolin alleged she relied on an *oral agreement* with the handling lawyer to provide the referred client with a written disclosure of the referral arrangement as was required by Rule 2-200, and to obtain the referred client's written *consent* to the referral fee. Margolin alleged that she was to receive 50 percent of any fee that was earned by the lawyer to whom the case was referred. As noted, the handling attorney ultimately recovered $450,000 in fees, and did not make any payment, relying upon Margolin's violation of Rule 2-200.

Margolin's evidence included that she was (primarily) a family law practitioner and she learned that a husband committed certain acts that could form the basis of a tort lawsuit by her client, the wife. Margolin referred the matter to a lawyer she had known for 20 years and believed him to be competent. She discussed the facts of the case with the attorney before he met with her client.

According to Margolin, the two lawyers *and* client *met* for "several hours," during which it was agreed that the attorneys would split any recovery for fees equally, and that the attorney to whom the case was referred would memorialize the agreement between the lawyers and client and have it signed. The handling attorney testified the underlying referral fee agreement was not a *50-50*, but *1/3-2/3*, and he also acknowledged the obligation to prepare the fee agreement consistent with Rule 2-200.

While the underlying case was proceeding, the attorney to whom the case was referred wrote a letter to the personal representative of the wife (his client)

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and a copy to the referring attorney. In that letter, the attorney represented the referral fee to the referring attorney as one-third, and that he required a signature from the client to perfect the agreement under the Rules of Professional Conduct. Upon her receipt of the letter, the referring attorney objected that the signature had not already been obtained on an agreement that accurately represented the referral fee. The client never signed and returned the letter – or any other memorandum.

The underlying case went sideways but the Court of Appeal does not give a full exegesis, only a terse description: "Initially wife and husband *struck an agreement* in *both* the family law and tort cases, but in the end, the *couple reconciled*, and ***no*** written *settlement agreement* was ever *executed*." (*Id.*, 85 Cal.App.4th at p. 897.) Following the reconciliation, the handling attorney hired counsel to sue husband and wife for his fees. It settled for $450,000, of which he paid $100,000 in fees to his personal attorney and $20,000 in costs. He did not pay the referring attorney anything.

The Court of Appeal affirmed the trial denying Margolin, the referring lawyer, *any* fees. The failure of the client to sign a writing approving the fee split they agreed to was dispositive. In so holding, the *Margolin* court relied on its earlier decision in *Scolinos v. Kolts* (1995) 37 Cal.App.4th 635.

Scolinos affirmed a summary judgment in favor of an attorney to whom a case was referred, as against a claim by the referring attorney for a portion of his fee, on the basis that the referral-fee agreement was, "void as against public policy because the disclosure and consent requirements of then-Rule 2-108 were not complied with."

The *Margolin* court noted that in *Scolinos,* the Court did not reject the referring attorney's contention on the merits that the attorney to whom the case was referred was responsible for preparing the appropriate agreement and having it signed, because *it was not pleaded* in that case. Therefore, it was *not part of the motion for summary judgment* or resulting decision.

Margolin distinguished *Scolinos* on the basis the defendant attorney to whom the case was referred was responsible for preparing the appropriate paperwork for the client's signature, and because of his breach, the referring attorney was entitled to a full fee.

Margolin claimed the referring attorney was capitalizing on his own breach of Rule 2-200. By his entering into the oral agreement, he violated Rule 2-200 because it was not in writing. However, the Court of Appeal disagreed in a footnote: had the handling attorney *paid* the referring attorney a fee, the *payment* would have established a violation, not merely entering into the agreement.

Margolin also argued that strict compliance with Rule 2-200 would penalize referring attorneys who trusted counsel to whom the case was referred and provide a windfall to those who breached their agreement. *Surely* that was contrary to the purposes of Rule 2-200 in that the client's wishes (as voiced by her *verbal consent* to the fee sharing arrangement) are not carried out.

Phillippe

The *Margolin* court "*declin[ed]* to reverse the judgment" against Margolin based on the same reasoning the Supreme Court used in *Phillippe v. Shapell Industries* (1987) 43 Cal.3d 1247. *Phillippe* involved the assertion of the statute of frauds on a claim for a commission in a real-estate transaction. The *Margolin* Court reasoned, "We find the considerations addressed in *Phillippe* respecting the need for such a writing are equally applicable to the requirement of Rule 2-200 that fee sharing agreements be both explained it to a client in writing and consent [by] the client in writing." (*Margolin*, 85 Cal.App.4th at p. 899.)

In *Phillippe*, the main issue before the Supreme Court was whether equitable estoppel was available to a real estate broker to avoid the statute of frauds on a claim for commissions. The Supreme Court rejected the claim and found the broker's *reliance* on the oral contract *unreasonable* in light of the rule and a realtor's training that a written agreement is *required* by statute. The Court ruled the *broker assumed the risk* of relying on an oral agreement, so there could be no *unconscionable injury*.

The Supreme Court also ruled that the "mere failure of a principal to pay for a broker's services under an unenforceable oral contract is *not unjust enrichment* sufficient to give rise to a valid claim of equitable estoppel." (*Id*., 43 Cal.3d at pp. 1263-1264.) It would be inconsistent or in conflict with holdings in prior cases that brokers were not permitted to circumvent the statute of frauds by asserting a theory of quantum meruit. (*Id*.)

Phillippe also rejected equitable estoppel in situations such as where the broker's principal promised to execute a writing confirming the contract at a later date because it was "*not sufficiently reasonable*." (Emphasis added.) (*Id.* at p. 1270.)

The Court emphasized a legislative preference for *written* contracts by citing multiple examples of consumer contracts that were required in writing: "The Legislature has demonstrated with increasing frequency its desire to provide consumers with the security and certainty of written contracts and a wide variety of transactions…" (*Id.* at p. 1265.)

> Faced with a clear legislative desire for written contracts in a wide variety of contexts and the special significance of real estate transactions, we cannot conclude that section 1624(d) is a legislative anachronism that should be judicially swept away. In *Buckaloo v. Johnson* [1975] 14 Cal.3d 815, which also involved a licensed broker's commission, the court made clear that, '[t]he statute of frauds conclusively establishes that brokerage contracts with either the vendor or the vendee must be in writing. We have neither the authority nor the inclination to circumvent that declared policy ....' (*Id*. at 827.) Our view has not changed. (*Phillippe* at p.1267.)

Based on *Phillippe*, and its holding that equitable estoppel could not be used to circumvent the statute of frauds, "reliance on Shemaria's promise to prepare the appropriate paperwork was not sufficiently reasonable to afford plaintiff's release from the requirements of

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Rule 2-200." (*Margolin*, 85 Cal.App.4th at p. 901.) Accordingly, there is no unconscionable injury to the referring attorney. No fees were owed to Margolin.

Chambers

In *Chambers v. Kay* (2002) 29 Cal.4th 142, a unanimous Supreme Court ruled that whether the situation is a "pure referral" or a "joint venture," or an admixture, *unless the client assented* to the fee arrangement *in writing*, the lawyer without a fee agreement has no remedy.

Chambers involved two lawyers with separate practices who had teamed up as associate counsel in a few cases over the (two) years they were using the same office. One of those cases was *Weeks v. Baker & McKenzie*. Both lawyers were listed on the pleadings as plaintiff's counsel, and the pleadings identified Chambers' office address, but it is unclear if a formal association of counsel was filed. Chambers advanced approximately $3,500 in costs over the course of his involvement in the case. He also met with the client, conducted discovery and appeared in court on her behalf in pretrial proceedings.

The two lawyers had a falling out during discovery with Kay notifying Chambers he was removed effective immediately *with the client's approval*. Kay represented in a letter that Chambers would receive a graduated percentage of the fees and reimbursement of all costs when the case concluded. But Kay never sought or obtained a written or oral consent to the proposed fee division with Chambers.

The *Weeks* case was tried to a large verdict of compensatory and punitive damages, augmented by an award of attorney's fees with a lodestar multiplier. When it came time to settle-up, Kay accused Chambers of failing to perform services and an improper accounting for the services he had performed. Kay offered to resolve the matter for $200 per hour for the total number of hours in Chambers' billing statement. Chambers declined Kay's offer and proposed mediation of their fee dispute.

Following affirmance of the *Weeks* judgment in 1998, it was satisfied and Kay was paid his fees. Chambers filed a lawsuit against Kay for breach of contract and a common count. The trial court granted summary judgment against Chambers because the parties' alleged fee agreement was an unlawful division of fees that violated Rule 2-200. In addition, the trial court ruled the claim for quantum meruit was barred by the statute of limitations. The Court of Appeal affirmed that the rule violation excused payment on the agreement, but reversed on Chambers' claim for quantum meruit.

Chambers petitioned for review. He asserted the decisions governing Rule 2-200 were distinguishable because they related to "*pure referral fees,*" and in his case, his efforts were not insubstantial. Even if Rule 2-200 applied, Chambers claimed he was a de facto partner or associate of the member performing services, and therefore his claim was within an express exception to the rule against fee splitting. He also asserted that noncompliance with Rule 2-200 did not render the fee splitting agreement invalid and unenforceable. Regarding quantum meruit, he asked the Supreme Court to reverse the Court of Appeal's finding that it could not be predicated on an apportionment of the contingency fee paid to Kay.

The Court concluded that in light of the rule's history precluding any referral fees until 1972, and because lawyers from different firms were always to seek approval from the client in the written fee agreement, the claim was legally untenable. Recognizing an exception for a "joint venture," would stretch the rule's exemption to cover situations that were not contemplated by it. (*Chambers*, 29 Cal.4th at 152, *citing*, *Jorgensen v. Taco Bell Corporation* (1996) 50 Cal.App.4th 1398, 1401.)

The Court ruled decisively there was no compliance with Rule 2-200. The termination letter Weeks received from Kay to Chambers, about his fee percentage and costs, did *not* raise a triable issue of fact regarding compliance with Rule 2-200. "The letter furnishes no basis whatsoever for inferring compliance with the rule's written consent requirement. Notably, nothing in the record contradicts Kay's evidence that no one ever sought or obtained Weeks's oral or written consent to the fee sharing, or suggests that Weeks was even aware of her right of consent." (*Chambers*, 29 Cal.4th at p. 156.)

Chambers's attempt to recover outside of the rule was also snubbed.

> Rule 2-200 unambiguously directs that a member of the State Bar "shall not divide a fee for legal services," unless the rule's written disclosure and consent requirements and its restrictions on the total fee are met. Yet Chambers, in effect, seeks the aid of this court in dividing the fees of a client without satisfaction of the rule's written consent requirement. We decline such aid.

(*Chambers*, 29 Cal.4th at 156.)

> Our decision to affirm the importance of written consent is consistent with *Scolinos* [] and *Margolin* [] which denied recovery for breaches of referral fee agreements where there was no compliance with the disclosure and consent requirements of rule 2-200 and its predecessor, former rule 2-108.

(*Chambers*, 29 Cal.4th at 158.)

Chambers was unable to persuade the Court there was a distinction in his case and the *Scolinos* and *Margolin* cases, because the latter cases only involved "pure" referral fees, without active work by the referring attorney. (*Chambers*, at 159.) In response, the Court ruled the amount of work that Chambers did was "*irrelevant*," because of the absence of a signed agreement by the client regarding the division of fees. (*Ibid*.)

The *Chambers* Court abruptly dispatched Chambers' contention the Court of Appeal erred by permitting the quantum meruit claim to proceed: "We perceive no legal or policy justification for finding that the fee the parties negotiated without the client's consent furnishes a proper basis for a quantum meruit award in this case." (*Id*. at p. 162.)

The Court was plainly not moved by the fact this dispute was between attorneys, only, and not a client. "Chambers

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could have protected his interests, and at the same time fulfill the beneficial purposes of the rule and acted in Weeks's best interests, by requesting proof of her written consent of the fee division before committing himself to her case." (*Id*. at 162-163.)

Before turning to the practical implications of *Chambers*, it is important to note that *fraud* is an exception. "An attorney may be equitably estopped from claiming that a fee-sharing contract is unenforceable due to noncompliance with Rule 2-200 or Rule 3.769, where that attorney is responsible for such noncompliance and has unfairly prevented another lawyer from complying with the rules' mandates." (*Barnes, Crosby, Fitzgerald & Zeman, LLP v. Ringler* (2012) 212 Cal.App.4th 172, 174.) In other words, the handling attorney cannot prevent the referring attorney from receiving consent from the client. In *Ringler*, the lead class-action clients were allegedly changed to prevent contact and the referring attorneys from recovering a referral fee. That interference is not privileged.

Quantum meruit recovery for contingency-fee attorneys

In 2004, the California Supreme Court clarified the issue of quantum meruit recovery for attorneys who were terminated after performing services on a contingency fee case without a referral-fee agreement or direct contract with the client in *Huskinson & Brown v. Wolf* (2004) 32 Cal.4th 453. There, the referring attorney sued the handling attorneys for failing to pay 25 percent of the attorney's fees they earned on a $250,000 judgment in favor of the client. The trial court acknowledged there was no breach of contract because the attorneys failed to comply with Rule 2-200, but awarded $18,497.91 for unjust enrichment, the same amount that would have been paid under the referral-fee agreement. Alternatively, the trial court awarded $5,800 for quantum meruit. The Court of Appeal agreed contract was unavailable but also concluded unjust enrichment was error because it violated Rule 2-200. It also vacated the award for quantum meruit for the same reason.

The Supreme Court granted review and clarified that the *Chambers* decision's comment on quantum meruit was limited to the observation that to the extent quantum meruit is available, the fee agreement between the attorneys (and client) does not serve, "as a proper basis for calculating the amount of recovery." (32 Cal.4th at 458, and fn. 2.) The Court decided that quantum meruit awards did *not* constitute a division of fees within the ambit of Rule 2-200. "[When] based on the reasonable value of [professional] services, such an award involves no apportionment of the fees that the client paid or has agreed to pay and therefore is not at fee division subject to Rule 2-200's client disclosure and consent requirements." (32 Cal.4th at 459.)

Quantum meruit claims, where attorneys have no fee agreement with co-counsel, appear to be limited to *attorneys only*. In *Strong v. Beydoun* (2008) 166 Cal.App.4th 1398, the court denied recovery to an attorney in quantum meruit where she sued the client and not the attorney. This was an issue of first impression that was decided against the lawyer because of the violation of Rule 2-200. (See also, *Olsen v. Harbison* (2010) 191 Cal.App.4th 325 [litigation privileged and fraudulent misstatements; no quantum meruit recovery] and *Hart v. Larson* (S.D.Cal. 2017) 232 F.Supp. 3d 1128 [litigation privilege not impediment to proving quantum meruit].)

Best practice

The best practice includes a letter to the attorney referring the matter stating the terms of the referral and countersigned by the client. This can be a simple one-paragraph letter that explains the detail of any fees that will be paid and how it does not affect the client's recovery.

Referring attorneys are not without "power" to contact the client, and they can memorialize the terms of the referral and ask for the letter to be countersigned and returned, with a copy sent to the lawyer by whom the case will be handled. If clients have any questions, they are urged not to sign (and return) the letter until they seek clarification with a call to counsel.

Knowing that a referring lawyer has no tenable claim without a signed agreement should provide some incentive for the handling lawyer to get the agreement confirmed promptly, as soon as the client relationship commences. That will end awkward exchanges about the case as well as allow the handling attorney to get to the business of resolution.

When a contingency-fee lawyer is called in by another contingency-fee lawyer to help or associate into the case for a limited time for all purposes, and assuming it is not gratis, the rule requires a letter that accomplishes the same purpose: explaining the terms of the engagement and securing client approval. The issue is disposed of from that point forward.

By taking care of the details at the outset of the relationship, neither side will be disappointed with the outcome and there will be fewer reasons for a dispute to occur and spoil a good relationship with counsel and the client. Even if the client is completely uninvolved, there will be recriminations in any fee dispute. Prevention is the best medicine.

Proposed Fee Agreement Provision

It is important to modify a contingency fee agreement when the attorney expects to pay a referral fee. The following is a sample provision:

> It is understood and agreed by Attorney and Client(s) that John Doe, Esq. referred Client(s) and/or Matter to Attorney, and s/he will be compensated exclusively by Attorney, in the sum/amount of __ %, from any Attorneys' fees that are collected in this Matter. John Doe, Esq., will not be involved in the day-to-day handling of the case, and neither is he obligated to pay any costs of the claim or litigation. However, it is lawful and customary for contingency-fee attorneys to pay a percentage of the fees they earn to the referring attorney, subject to the Client's (your) approval. This payment of Attorneys' fees does not affect the Client's recovery whatsoever. In order

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to facilitate the referral-fee agreement, a letter from Attorney to John Doe, Esq., with Client's signature, confirming Client approval will follow.

David Hoffman is in private practice in Woodland Hills emphasizing all aspects of major tort litigation, including medical malpractice, insurance bad faith and civil rights violations. Mr. Hoffman is a former firefighter and has tried over 100 cases to verdict. He has been a member of the CAALA Board of Governors since 1993, receiving the Association's Presidential Award in 1993, 1996, 2000 and 2012. He is a co-founder of the L.A. Bench-Bar Coalition, served a term on the LACBA Judicial Appointments Committee, and has spoken at numerous MCLE programs. Mr. Hoffman graduated from UCLA in 1984 and received his J.D. from Southwestern University School of Law in 1988.