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Referral Fees and Networking Organizations

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Introduction and Scope

As a general rule, a Colorado lawyer may not pay or accept a referral fee. However, lawyers may pay the “usual charges” of a not-for-profit lawyer referral service or legal service organization. Lawyers and law firms also may engage in cooperative marketing with other firms and may refer clients to each other informally. Law firms may represent clients jointly and share the fees under appropriate circumstances. This opinion is designed to help the lawyer determine the permitted scope of participation in referral services, legal service organizations, and cooperative marketing arrangements with lawyers outside the lawyer’s firm. This opinion does not address cooperative marketing arrangements between lawyers and nonlawyers outside of the referral service context. Internet-based lawyer marketing programs are discussed in CBA Formal Ethics Opinion 122, (March 10, 2010, rev. October 16, 2010).

Syllabus

Rule 1.5(e) of the Colorado Rules of Professional Conduct (Colo. RPC or Rules) prohibits referral fees. Therefore, a Colorado lawyer may neither pay nor accept a referral fee. A lawyer may not give anything of value to a person for recommending the lawyer’s services in most circumstances, although certain exceptions exist. Colo. RPC 7.2(b)(2) sets forth the longstanding exception permitting a lawyer to pay the usual charges of a not-for-profit lawyer referral service or legal service organization. The Colorado Supreme Court has not clearly defined a “not-for-profit lawyer referral service.” Therefore, the lawyer must determine whether a referral service in fact is a legitimate not-for-profit referral organization. A “legal service organization” generally is considered to be a legal aid society or prepaid legal service plan.

The lawyer must evaluate a referral service or legal service organization to assure that the lawyer can represent referred clients competently and must decline representation if necessary to comply with the Rules. The lawyer also must ensure that the lawyer’s professional judgment remains independent, that confidentiality requirements are not compromised, and that conflicts of interest are avoided. Furthermore, the lawyer’s payment of fees to a referral service must not result in unreasonable fee payments by clients or improper division of fees, either between lawyers or between lawyers and nonlawyers. The lawyer also must use reasonable efforts to ensure that companies purporting to provide advertising of the lawyer’s services are not in fact improper referral agencies and that any advertising of the lawyer’s services complies with the Rules.

Discussion

A Colorado lawyer may neither pay nor accept a referral fee. Colo. RPC 1.5(e) explicitly prohibits referral fees. The Colorado Bar Association Ethics Committee (Committee) has opined informally that an attorney licensed to practice law in Colorado may not accept a referral fee from a lawyer in another state that permits such fees. CBA Ethics Comm. Abstract, Second Inquiry, 24 *The Colorado Lawyer* 755 (April 1995). Nor may a lawyer accept a referral fee from a nonlawyer such as a bank that offers to pay “a percentage of commissions generated” when a client invests funds with the bank on the lawyer’s recommendation.

Furthermore, a lawyer may not pay or offer to pay a referral fee. Colo. RPC 7.2(b) provides:

A lawyer shall not give anything of value to a person for recommending the lawyer’s services, except that a lawyer may:

- (1) pay the reasonable cost of communications permitted by this Rule;
- (2) pay the usual charges of a not-for-profit lawyer referral service or legal service organization;
- (3) pay for a law practice in accordance with Rule 1.17; and
- (4) refer clients to another lawyer or a nonlawyer pursuant to an agreement not otherwise prohibited under these Rules that provides for the other person to refer clients or customers to the lawyer, if
 - (i) the reciprocal referral agreement is not exclusive, and
 - (ii) the client is informed of the existence and nature of the agreement.

Comment 5 to Colo. RPC 7.2(b) explains that:

[l]awyers are not permitted to pay others for channeling professional work. Paragraph (b)(1), however, allows a lawyer to pay for advertising and communications permitted by this Rule, including the costs of print directory listings, on-line directory listings, newspaper ads, television and radio airtime, domain-name registrations, sponsorship fees, banner ads, and group advertising. Colo. RPC 7.2.

The comments further explain that “[a] lawyer may pay the usual charges of a legal service plan or a not-for-profit or qualified lawyer referral service. A legal service plan is a prepaid or group legal service plan or a similar delivery system that assists prospective clients to secure legal representation.” Colo.RPC 7.2, cmt. [6].

What Is a “Lawyer Referral Service”?

Although not defined in the Rules, a “lawyer referral service” has been described in other states as an individual or entity that operates for the direct or indirect purpose of referring potential clients to lawyers, regardless of whether the term “referral service” is used. *See* Cal. Bus. and Prof. Code, § 6155; Tex. Rev. Civ. Stat. art. 320d.

An advertising arrangement may be, in fact, a referral service. For instance, if an advertising company offers to provide a lawyer with all personal injury referrals within a particular geographic area in return for a monthly fee, the fee may well be an impermissible referral fee rather than a permissible publication cost. The lawyer must examine such arrangements carefully and assure himself or herself that they are not referral services, or, if they are, that the lawyer may participate without violating any ethical rules.

This Committee informally concluded that a marketing service that published periodic newsletters in which participating lawyers could publish articles, arranged meetings attended by members of business groups to whom participating lawyers could speak, placed ads for participating lawyers in business-related publications, and referred calls to participating lawyers, was a for-profit referral agency. Therefore, a lawyer’s payment of an annual membership fee actually was a prohibited payment to a for-profit legal referral service in violation of Rule 7.2(c) and Rule 1.5. CBA Ethics Comm. Abstract, Second Inquiry, 26 *The Colorado Lawyer* 69 (July 1997).

For-Profit Lawyer Referral Service

Colo. RPC 7.2(b)(2) prohibits a lawyer from giving anything of value to a for-profit organization for recommending the lawyer’s services. *See People v. Zimmermann*, 938 P.2d 131 (Colo. 1997) (lawyer admitted making payments for referrals to unapproved for-profit referral service in violation of Rule 7.2(c)); *People v. Carpenter*, 893 P.2d 777 (Colo. 1995) (lawyer who charged other lawyers \$50-\$75 per month for referrals

admitted he operated an unapproved for-profit lawyer referral service, in violation of then-applicable DR 2-103(D)). However, the American Bar Association (ABA) Committee on Ethics and Professional Responsibility concluded that a lawyer's participation in a for-profit lawyer referral service without payment of a fee to the referral service did not violate then Model Rule 7.2(c)(current Model Rule 7.2(b)), inasmuch as the lawyer did not give anything of value for the referral, even though the referral organization itself was a for-profit business funded by the recipients of its services. ABA Informal Op. 85-1510 (1985).

The Colorado Rules do not expressly prohibit a lawyer's participation in a for-profit lawyer referral service that does not require payment from the lawyer, and it is the opinion of this Committee that a lawyer may participate in such a service, so long as the lawyer's participation does not otherwise violate any of the Colorado Rules.

Not-for-Profit Lawyer Referral Service

Historically, state and local bar associations have operated not-for-profit lawyer referral services, and such services long were considered both ethical and admirable, even before lawyers were permitted to advertise. *See* ABA Comm. on Prof. Ethics and Grievances, Formal Op. 291 (1956). Colorado's predecessor to Colo. RPC 7.2(b), Disciplinary Rule (DR) 2-103 of the Colorado Code of Professional Responsibility, while prohibiting referral fees generally, permitted a lawyer to pay the usual and reasonable fees or dues charged by certain listed organizations, including "a lawyer referral service operated, sponsored or approved by a bar association." In *People v. Taylor*, 799 P.2d 930 (Colo. 1990), the Colorado Supreme Court implicitly held that the Metropolitan Lawyer Referral Service, a non-profit referral organization operated by the Denver Bar Association, to be a proper source of referrals.

Colo. RPC 7.2(b) does not retain the requirement that the lawyer referral service be operated, sponsored, or approved by a bar association, leaving unclear exactly what constitutes a "not-for-profit lawyer referral service."

Colo. RPC 7.2 includes no requirement that a non-profit lawyer referral service be a tax-exempt organization or be operated for a charitable purpose.

If a referral service is not a permissible online directory or other permitted advertising service, a lawyer who intends to use a purportedly not-for-profit referral service not sponsored by a bar association should make reasonable inquiry to verify that the service is in fact a legitimate not-for-profit organization and that it is not a profit-making enterprise masquerading as a non-profit entity.

ABA Informal Opinion 85-1512 (1985) approved a proposal for a not-for-profit lawyer referral service not sponsored by a bar association. ABA Comm. on Ethics and Prof. Resp. Informal Op. 85-1512 (1985). In that opinion, the ABA Committee determined that a lawyer's participation in a proposed not-for-profit Christian religious organization, to be administered by an attorney in private practice, would not violate then-Model Rule 7.2(c) (now Model Rule 7.2(b)). The organization, all of whose members would be lawyers, planned to establish a network of members interested in providing legal services to mission agencies, missionaries, and their dependents. The members of the organization would be required to pay a nominal membership fee, and could elect to register for referrals. No registration fee would be charged, but a registered lawyer would agree to provide an initial consultation at no charge, and to prepare general law-related information materials to be distributed to targeted potential clients.

The organization proposed to contact various mission agencies throughout the country to advertise its services. A prospective client would be given the names, addresses, and telephone numbers of registered attorney members in the client's geographical area. The lawyer referred by the organization would not be obligated to accept the representation, and the organization would not share in any portion of the fee received. Moreover, the organization would not in any way regulate the lawyer or interfere with the lawyer's independent professional judgment. The Informal Opinion concluded that Model Rule 7.2 would not prohibit the lawyer's participation in this referral program.

The Committee believes that Colo. RPC 7.2 permits a lawyer to participate in a duly-organized, not-for-profit private lawyer referral service, as well as a bar-sponsored referral organization, so long as the private referral agency does not require lawyers to accept referred clients, is not compensated on the basis of fees paid by a referred client, does not interfere with the lawyer's independent professional judgment, and otherwise allows the lawyer to comply with the Rules.

Cooperative Arrangements Among Law Firms

Some law firms have affiliations or relationships with other firms that result in inter-firm referrals. *See* ABA Formal Op. 94-388 (1994) (discussing various examples of such relationships). Relationships between firms with different expertise, or located in different geographical areas, allow lawyers to make their services available to a broader range of clients. Reciprocal referral agreements are permissible if the reciprocal referral agreement is not exclusive" and "the client is informed of the existence and nature of the agreement." Colo. RPC 7.2(b)(4). *See* Colo. RPC 7.2, cmt. [8].

Such law firm relationships must "avoid running afoul of [then-]Model Rule 7.2(c)'s [current Model Rule 7.2(b)'s] prohibition on giving something of value for referrals." ABA Formal Op. 94-388. In general, this means that firms may not contract to refer business to one another (even if they are affiliated") because the exchange of binding promises would itself constitute giving something of value for referrals in violation of current Model Rule 7.2(b). *Id.* However, firms may agree to consider each other for appropriate referrals, and may engage in cooperative marketing that otherwise complies with the Rules. Where affiliated firms agree to undertake joint representation of clients (for example, where one firm handles the client's tax matters and another firm handles its litigation), conflicts, confidentiality, and disqualification rules also must be considered. Iowa Bar Ass'n Ethics Op. 89-1 (1989).

What Is a Legal Service Organization?

The Rules do not define "legal service organization." However, a Comment to Colo. RPC 7.2 indicates that "legal service organization" is meant to encompass legal aid societies and prepaid legal service plans. Colo. RPC 7.2, cmt. [6].

Legal aid societies are entities that provide legal services to the indigent in civil cases. They typically are not-for-profit organizations supported by public funds or funds raised by bar associations or foundations. Legal aid agencies that receive government funding typically are subject to restrictions on the income level of clients and on the types of legal services that may be performed. The Committee is not aware of any attorneys who either pay or receive fees for participating in legal aid societies.

However, a legal service organization, unlike a referral service, may be a for-profit entity. In fact, for-profit organizations generally operate prepaid legal service plans. *See* ABA Comm. on Ethics and Prof. Resp. Formal Op. 87-355 (1987) (then-Model Rule 7.2(c) (current Model Rule 7.2(b)) permits the lawyer to pay fees to a for-profit legal service plan in which members pay monthly fees to plan sponsors, part of which the sponsor keeps for overhead and profit, and part of which the sponsor pays to participating attorneys for plan-covered services); CBA Ethics Comm. Formal Op. 81 (permitting Colorado lawyers to participate in for-profit prepaid legal service plans that can be operated in compliance with applicable ethical rules). A lawyer's participation in a legal service organization must comport with all applicable ethical requirements or the lawyer's participation may be unethical. For example, ABA Informal Opinion 1392 (1977) found unethical a prepaid legal service arrangement whereby a firm sought to form a national network of "resident associates" who would accept referrals and assignments of prepaid legal clients in accordance with a fee schedule. ABA Comm. on Ethics and Prof. Resp. Informal Op. 1392 (1977). The firm required each "associate" to pay a uniform 10 percent fee for each referral, regardless of allocation of work or responsibility. The opinion concluded that notwithstanding the denomination of the referred attorneys as "associates," the relationship was not, in fact, that of members of the same firm sharing fees, so the fee division, being unrelated to each lawyer's work or responsibility, was unethical under then-applicable DR 2-107(A)(2), the predecessor to Rule 1.5(d).

What Are “Usual Charges”?

The Rules do not define the phrase “usual charges” in Rule 7.2(c). Conn. Informal Opinion 87-9 (1987) states that the phrase means “fees which are openly promulgated and uniformly applied.” Conn. Bar Ass’n Prof. Ethics Comm. Informal Op. 87-9 (1987). The opinion stated a very broad definition in the context of analyzing fee arrangements for a bar-sponsored lawyer referral service. The definition alone does not address the numerous issues surrounding referral fees that must factor into determination of an appropriate “usual charge.”

Reasonableness Issues

A lawyer’s fee always must be “reasonable.” Colo. RPC 1.5(a). Typically, referral agencies and legal service plans require the lawyer participant to agree to limit his or her fees in some manner, such as by providing a free initial consultation or a reduced hourly rate. The issue usually is not excessive fees, but rather whether the lawyer can provide the thorough, competent representation required by Colo. RPC 1.1 within the required fee parameters. If the lawyer cannot do so, even by appropriately limiting the scope of representation as permitted by Colo. RPC 1.2(c), the lawyer should not participate in the referral organization or the legal service organization.

Fee Division Issues

Colo. RPC 5.4(a) strictly prohibits division of fees between lawyers and nonlawyers. Colo. RPC 1.5(d) governs division of fees between lawyers not in the same firm, and prescribes the manner in which fees may be divided. It prohibits such divisions unless the client consents to the employment of an additional lawyer after a full disclosure of the division of fees to be made, the total fee is reasonable, and the division is set forth in writing and signed by the lawyers and by the client with informed consent. If referral fees or fees paid to a legal service organization are based on fees generated by representation of a referred client, one of these rules may be implicated.

Early lawyer referral arrangements typically were bar-sponsored lawyer referral plans, financed by reasonable registration charges to lawyers participating in the plan, or by a reasonable percentage of fees collected by participating lawyers from plan referrals. ABA Comm. on Prof. Ethics, Formal Op. 291 (1956). (Note that Formal Opinion 291 simply stated, without authority, that a percentage fee payment to a bar-sponsored lawyer referral service would not violate the prohibition against fee division.) ABA Comm. on Professional Ethics, Informal Opinion 1076 (October 8, 1968) endorsed Formal Opinion 291 and permitted, in addition, the return of all or part of the lawyer’s initial consultation fee to support the referral service. Many state ethics opinions over the years have relied on ABA Formal Opinion 291 to conclude that a percentage fee arrangement is a proper and ethical way to finance a bar-sponsored lawyer referral program. *See* Conn. Bar Ass’n Prof. Ethics Comm. Informal Op. 87-9; Maine Bar Ethics Comm. Op. No. 133 (1993); New York State Bar Ass’n Ethics Op. 651 (1993); Tenn. Bd. of Prof. Resp. Op. 88-F-115 (1988); Wisconsin Comm. on Prof. Ethics Formal Op. E-88-8 (1988).

According to one commentator, the term “usual charges” as used in former Model Rule 7.2(c)(2) (current Model Rule 7.2(b)) “incorporated the various methods for compensating lawyer referral services then in existence and included flat enrollment charges as well as percentage fees. . . .” Franck, “Percentage Fees: Available and Ethical,” 6 *Lawyer Referral Network* 1 (Spring 1993). Therefore, one could argue that a percentage fee payment to a referral service is proper, notwithstanding the prohibitions of Colo. RPC 5.4(a) and 1.5(d). However, this Committee believes that payment of a percentage fee to a non-bar-sponsored lawyer referral service is problematic. Neither the Colorado legislature nor the Colorado Supreme Court has exercised regulatory authority over lawyer referral services, and, in the Committee’s view there likely are more opportunities for impropriety with private referral agencies than with bar-sponsored referral agencies.

Other Ethical Considerations

A lawyer who wishes to participate in a lawyer referral service or a legal service organization also must ensure that participation will not result in the lawyer's violation of any other ethical rules. The lawyer's nondelegable ethical responsibility to protect the client's interests requires that the lawyer give particular consideration to the rules involving confidentiality, competence, independence of professional judgment, conflicts of interest, and advertising.

Confidentiality Issues

Colo. RPC 1.6 requires the lawyer to maintain in confidence information relating to the representation of a client. The lawyer should scrutinize carefully a referral agency's intake procedures in this regard. The information disclosed to the referral service at intake should be limited to facts necessary for the referral.

Furthermore, it is not uncommon for a legal service organization to collect legal fees from the client and remit them to the lawyer after deducting the organization's fees, or for a referral agency to request documentation of fees in order to verify the percentage fee owed by a participating lawyer. The lawyer must be cognizant of circumstances in which a referral service or legal service organization may obtain confidential client information in connection with billing information or other reporting requirements. *But see* Maine Bar Ethics Op. 133, in which the limited disclosure to a bar-sponsored referral agency of fees charged to a referred client was found not to violate the requirement that client confidences and secrets be protected because the percentage fee arrangement is a "usual and reasonable" way of funding a bar association referral service. The Maine opinion assumes that the bar association referral service, as a matter of institutional policy, maintains the confidentiality of the fee amounts reported to it, and that these arrangements are disclosed to prospective clients.

Competence and Independent Professional Judgment

As discussed above, a lawyer who accepts referrals or participates in a legal service organization must be competent to handle the legal problems referred to him or her. The lawyer, therefore, must have the necessary legal knowledge and skill and be able to provide competent representation (Colo. RPC 1.1) even if the scope of the representation is limited pursuant to Colo. RPC 1.2(c).

Implicit in Colo. RPC 7.2(b), and explicit in various opinions such as ABA Informal Opinion 85-1512, is that a referral agency or legal service organization may not interfere with the lawyer's professional judgment in rendering legal services to the client. Because a lawyer may not allow interference with professional judgment, the lawyer may not participate in a referral agency or legal services organization that attempts such interference. Colo. RPC 5.4(c). For this reason, the lawyer should be wary of attempts to limit or audit the lawyer's fees which could adversely impact the lawyer's independent professional judgment.

Conflicts of Interest

A conflict of interest can arise if a lawyer's representation of a client may be materially impaired by the lawyer's responsibilities to a third person, in this case the referral service or legal service organization from which the lawyer anticipates future business. Colo. RPC 1.7(b). The conflict may be waivable if the lawyer reasonably believes the representation will not be adversely affected and the client gives informed consent confirmed in writing. Colo. RPC 1.7(b). In order to obtain informed consent, it may be necessary to disclose to the client the relationship between the referral agency or legal service organization and the lawyer's firm.

This type of conflict also may arise when firms make informal referrals to each other, or belong to a "network" of firms that cross-refer matters on an ad-hoc basis. Where there is no sharing of clients, confidences, fees, or professional engagements, the relationship between the firms would not, as a general proposition, materially limit the client representation, even where the firms advertise their relationship to each other. ABA Comm. on Ethics and Prof. Resp. Formal Op. 94-388. However, where the firms share clients, or have close business or financial ties that might materially limit the ability of one firm to oppose the other firm's clients, the conflict potential increases, as do the obligations of disclosure to the clients.

Advertising

Colo. RPC 7.1(a) prohibits a lawyer from making false or misleading communications about the lawyer or the lawyer's services. Colo. RPC 7.1(e) requires the lawyer to refrain from knowingly permitting, encouraging, or assisting others to make communications in violation of Colo. RPC 7.1 and the other advertising rules, Colo. RPCs 7.2 through 7.4. Therefore, any lawyer who uses a referral service or is a member of a legal service organization must take reasonable steps to assure that the referral service or legal service organization does not engage in false or misleading communications about the lawyer or the lawyer's services.

ABA Formal Opinion 94-388 advises that law firms involved in an "affiliation" or "network" must provide certain information to avoid misleading the client about the nature of the relationship between the firms. The opinion requires the firm to give the following information to clients and prospects for whom the relationship between firms is relevant:

- (a) whether any professional personnel from the other law firm(s) may be involved in providing the professional services;
- (b) whether any part of the fee the client pays will be shared with the other firm(s);
- (c) whether profits of the firm the client originally retained will be shared with the other firm(s);
- (d) whether the law firms in the relationship conduct common training programs and/or share strategies or expertise; and
- (e) whether the firms in the relationship conduct any other common operations or, by contrast, the relationship simply is a common marketing device.

Conclusion

Lawyer referral services perform the laudable tasks of providing information to potential clients about available legal services and helping clients locate competent counsel to assist them with their legal problems. Similarly, legal service organizations make legal services more widely available to clients. Although these arrangements may cause ethical dilemmas, careful design and implementation of referral programs and legal service organizations should enable lawyers to participate ethically.