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Editor's Note:

State Bar Ethics Opinions cite the applicable California Rules of Professional Conduct in effect at the time of the writing of the opinion. Please refer to the California Rules of Professional Conduct [Cross Reference Chart](#) for a table indicating the corresponding current operative rule. There, you can also link to the text of the current rule.



ISSUE:

Must an attorney comply with the fee-splitting requirements of rule 2-200 of the California Rules of Professional Conduct when the attorney hires an outside lawyer and when the attorney discloses a rate to a client but pays the outside lawyer less than the amount disclosed.

DIGEST:

The provisions of rule 2-200(A) of the California Rules of Professional Conduct regarding division of fees with lawyers are applicable when an outside lawyer who is not an employee is paid a portion of the fee paid by the client to the attorney for her services. However, the provisions of rule 2-200 are not applicable where (1) the amount paid to the outside lawyer by the attorney is compensation for work performed and must be paid whether or not the attorney is paid by the client; (2) the amount paid by the attorney to the outside lawyer is neither negotiated nor based on fees which have been paid to the attorney by the client; and (3) the outside lawyer does not receive a percentage fee.

In general, the attorney must inform the client of the outside lawyer's involvement. This must be done whenever the outside lawyer's involvement constitutes a significant development in the matter pursuant to rule 3-500 of the California Rules of Professional Conduct and Business and Professions Code section 6068(m).

AUTHORITIES

INTERPRETED:

Rule 2-200 and 3-500 of the California Rules of Professional Conduct.

Business and Professions Code section 6068(m).

STATEMENT OF FACTS

The committee has been requested to consider the application of the California Rules of Professional Conduct¹ to the following relationships:

Outside lawyer is periodically used by principal law office to assist in specific matters for the principal law office's clients.² Outside lawyer may work on a single matter or may work generally for the office for a limited period, typically to meet temporary staffing needs or to provide special expertise not available in the office and needed for work on a specific matter. The outside lawyer may work exclusively for the law office during a period of temporary employment or may work simultaneously on other matters for other law offices. Other than working on particular matters, the outside lawyer has no other formal relationship with the law office or the client, and neither the law office nor the outside lawyer contemplate a permanent relationship.

The outside lawyer is directly compensated by the law office. The law office includes the outside lawyer's time as part of its ordinary periodic fee billings to its clients. The law office's client bills disclose the identity of the outside lawyer as one of the attorneys that has provided services and the nature of those services. The law office compensates the outside lawyer in one of the following ways:

Method 1: Outside lawyer is paid a portion of the fee that is paid by the client to law office. For example, the client pays \$1,500 for a project and the outside lawyer receives 30 percent of that amount.

Method 2: Outside lawyer is paid an hourly rate that is less than the hourly rate for the outside lawyer's services billed to the client. For example, the outside lawyer is paid \$50 an hour but is billed at \$70 per hour to the client.

Method 3: Outside lawyer is paid a flat rate per day or week. For example, the outside lawyer is paid \$150 per day.

Method 4: Outside lawyer is paid the amount billed to the client for her time as the fees are paid by the client. For example, the outside lawyer's hourly rate is \$100 per hour for a project and every dollar paid to the law office for work performed on that project is immediately paid to the outside lawyer.

The law office does not disclose the amount of the compensation arrangement to its clients.

INTRODUCTION

Rule 2-200 addresses the issues involved in financial arrangements between lawyers and states the general prohibition against division of fees between lawyers who are not partners, shareholders or associates of the same firm. Rule 2-200(A) provides:

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 not increased solely by reason of the provision for division of fees and is not unconscionable as that term is defined in rule 4-200.

The applicability of rule 2-200 in this case turns on whether the outside lawyer is an associate.³ Rule 1-100(B)(4) defines an "associate" as "an employee or fellow employee who is employed as a lawyer." The California Rules of Professional Conduct do not establish a criteria for determining when a lawyer is an employee. The determination of status as an "employee" is a legal question that the committee will not address in this opinion. If the outside lawyer is an employee, then the requirements of rule 2-200(A)(1) do not apply if the law office is splitting its fees with the outside lawyer. If the outside lawyer is not an employee then the requirements of rules 2-200(A)(1) and 2-200(A)(2) will apply in such situations. For purposes of this opinion, the committee will assume that the attorney is not an employee of the principal law office.⁴

DISCUSSION

A. Determining a Division of Fees

Assuming the outside lawyer is not an employee, the question is whether the four methods of payment described above constitute a division of fees. If they are not a division of fees, the requirements of rule 2-200(A) do not apply. If any of them constitute a division of fees, then the criteria in rule 2-200(A) must be satisfied.

Rule 2-200 does not define what is meant by a division of fees, and no court in California has analyzed this issue. On the one hand, the term can be read broadly to encompass virtually any expenditure by a lawyer, since in most cases, a lawyer's sole income will be generated through client fees. On the other hand, the term can be construed more narrowly to focus on the splitting of particular fees paid by a client. However, the rule itself provides no guidance concerning which of these constructions was intended.

The history behind rule 2-200 and its predecessor, rule 2-108, indicate that the rule was intended to address concerns related to forwarding or referral fees, typically found in contingency fee situations. In the referral fee situation, one lawyer receives a portion of a fee for referring a client to a second lawyer to handle the case. Courts recognized the "pure referral" as one " . . . which compensates one lawyer with a percentage of a contingent fee for doing nothing more than obtaining the signature of a client upon a retainer agreement while the lawyer to whom the case is referred performs the work" (*Moran v. Harris* (1982) 131 Cal.App.3d 913, 921 [182 Cal.Rptr. 519], quoting *Dunne &*

Gaston v. Keltner (1975) 50 Cal.App.3d 560, 566-567 [123 Cal.Rptr. 430] [conc. opn. of Thompson, J].) Rule 2-200 and its predecessors were designed to provide consumer protection by regulating the practice of "brokering" cases through disclosure to the client and a prohibition on increasing a client's fee to compensate the referring lawyer who does not work on the matter. (See Kopp, letter to the Editor (1972) 47 State Bar J. 71; see also Kohlman, *An Equitable Contingency Fee Contract* (1975) 50 State Bar J. 268, 271.)

Unlike the case involving the referring lawyer, here the law office retains control and supervision of the outside lawyer's involvement in the representation as it would in the case of an associate. Put another way, the law firm vouches for the work of that outside lawyer just as it would for one of its associates. There is nothing in the history of rule 2-200 that indicates it was targeted at compensation arrangements involving outside lawyers functioning on a particular matter essentially on the same basis as an employee of the law office.

In light of these considerations, the committee believes that the criteria for determining whether a compensation method constitutes a division of fees should focus on the division of specific fees paid by a client rather than on compensation arrangements which are not directly tied to a client's payment of fees. Accordingly, the committee concludes that the criteria to determine whether there is a division of fees is whether (1) the amount paid to the outside lawyer is compensation for the work performed and is paid whether or not the law office is paid by the client; (2) the amount paid by the attorney to the outside lawyer is neither negotiated nor based on fees which have been paid to the attorney by the client; and (3) the outside lawyer has no expectation of receiving a percentage fee. If all three criteria are met, there is no division of fees.

This standard is consistent with the approach taken by the Los Angeles County Bar Association, the American Bar Association and at least one out-of-state court. In a series of opinions, the Los Angeles County Bar Association has adopted the same standard. (L.A. Cty. Bar Assn. Formal Opn. Nos. 467, 470 & 473.) In formal opinion No. 88-356, the American Bar Association concluded that a firm's reasonable compensation of a temporary lawyer which was not passed on to the client as a disbursement did not constitute a division of fees. In reaching this conclusion the American Bar Association observed:

Rule 1.5(e), [of the American Bar Association, Model Rules of Professional Conduct] relating to division of a fee between lawyers, does not apply in this instance because the gross fee the client pays the firm is not shared with the temporary lawyer. The payments to the temporary lawyer are like compensation paid to nonlawyer employees for services and could also include a percentage of firm net profits without violation of the Rules or the predecessor Code. *See* ABA Informal Opinion 1440 (1979).

If, however, the arrangement between the firm and the temporary lawyer involves a direct division of the actual fee paid by the client, such as percentage division of a contingent fee, then Rule 1.5(e)(1) requires the consent of the client and

satisfaction of the other requirements of the Rule regardless of the extent of the supervision.⁵

The Appellate Court of Illinois reached the same conclusion in *In Re Marriage of Carol V. Ziemann* (1991) 214 Ill.App.3d 988 [574 N.E.2d 767]. In that case, the court determined that it was not a division of fees to pay a non-employee lawyer a flat hourly rate based on hours worked and which did not depend on whether the law office received payment from the client. In so doing, the court relied on the foregoing analysis in American Bar Association Formal Opinion Number 88-356.

All of these authorities reflect the same standard that the committee adopts here to determine what constitutes a division of fees.

B. Application to Compensation Methods One, Two and Three

Under the standard the committee adopts, method one is a division of fees while methods two and three are not. Method one is based on and paid as a portion of the fee paid by the client. It is a direct division of the fee paid by the client. Where the outside lawyer is paid a percentage of the fee collected from the client, or a percentage division of a contingent fee, the arrangement between the law office and the outside lawyer involves a direct division of the actual fee paid by the client and conditions (1) through (3) above are not satisfied. The law office must satisfy the requirements of rule 2-200, requiring the consent of the client to the existence and amount of the compensation arrangement. (See L.A. Cty. Bar Assn. Formal Opn. No. 467.) Moreover, rule 2-200(A)(2) requires that the total fee charged by all lawyers not be increased solely by reason of the provision for division of fees.

By contrast, there is no division of fees under methods two and three because the amount paid to the outside lawyer is not tied to specific legal fees received by the law office. The law office must pay the outside lawyer whether or not the client pays the law office.⁶ The payments to the outside lawyer are thus similar to compensation paid to non-lawyer employees such as law students and paralegals. For such non-lawyer employees, the law office may bill these services to the client at whatever rates are specified in the contract between law office and client, so long as these rates are accepted by the client, and conform to rule 4-200. (See L.A. Cty. Bar Assn. Formal Opn. No. 457.)

C. Application to Compensation Method Four

The committee believes that the fourth compensation method is not a division of fees because the outside lawyer receives all the fee that is charged. Since the law office is not receiving any portion of the fee, there is no division. The law office acts merely as a clearinghouse to centralize the billing and collection functions for the client.

In California State Bar Formal Opinion Number 1986-88 we recognized that "of counsel" arrangements whereby the client compensates the "of counsel" member or law office indirectly through the principal without any share paid to the principal law office does not

constitute a "division of fees." We reaffirm that conclusion under rule 2-200 with respect to the fourth method of compensation.

D. Disclosure to the Client

Rule 3-500 provides: "A member shall keep a client reasonably informed about significant developments relating to the employment or representation and promptly comply with reasonable requests for information." (See also Bus. & Prof. Code, § 6068 (m) [which similarly provides that an attorney has the duty to ". . . keep clients reasonably informed of significant developments in matters with regard to which the attorney has agreed to provide legal services."].)

Depending on the circumstances, rule 3-500 and Business and Professions Code section 6068 (m) will generally require the law office to inform the client that an outside lawyer is involved in the client's representation if the outside lawyer's involvement is a significant development.⁷ In general, a client is entitled to know who or what entity is handling that client's representation. However, whether use of an outside lawyer constitutes a significant development for purposes of rule 3-500 and Business and Professions Code section 6068 (m) depends on the circumstances of the particular case. Relevant factors, any one of which may be sufficient to require disclosure, include the following: (i) whether responsibility for overseeing the client's matter is being changed; (ii) whether the new attorney will be performing a significant portion or aspect of the work or (iii) whether staffing of the matter has been changed from what was specifically represented to or agreed with the client.⁸ (See L.A. Cty. Bar Assn. Formal Opn. No. 473.) The listed factors are not intended to be exhaustive, but are identified to provide guidance.

Assuming there is no division of fees, and that the law office does not charge the outside lawyer's compensation to the client as a disbursement, the law office has no obligation to reveal to the client the compensation arrangement with the outside lawyer whether that attorney is paid by salary or on an hourly basis. (See ABA Formal Opn. No. 88-356.)

This opinion is issued by the standing Committee on Professional Responsibility and Conduct of the State Bar of California. It is advisory only. It is not binding upon the courts, the State Bar of California, its Board of Governors, any persons or tribunals charged with regulatory responsibilities, or any member of the State Bar.

¹ All rule references are to the Rules of Professional Conduct of the State Bar of California unless otherwise noted.

² As used throughout this opinion, the term "law office" includes sole practitioners as well as a "Law Firm" as that term is defined in rule 1-100(B).

³ Outside lawyer is also not a partner or shareholder for purposes of rule 2-200(A), since outside lawyer holds no ownership interest in law office. (See rule 1-100(B)(5) [defining shareholder].)

⁴ It is the duty of an attorney, under Business and Professions Code section 6068(d) "[t]o employ . . . such means only as are consistent with truth . . ." Therefore, an attorney must not misrepresent an outside lawyer's employment status to a client.

⁵ ABA Formal Opinion Number 88-356 pages 901:123-124.

⁶ Where the outside lawyer is paid by a firm that does not have the means to pay the attorney except as fees come in, the compensation is more closely tied to specific legal fees received by the firm. There is still no division of fees if, once the outside lawyer has performed services, the law office has an obligation to pay the outside lawyer regardless of whether law office is paid by the client. An analogous situation is found under rule 4-210 which prevents lawyers from advancing client litigation expenses except in certain situations. In California State Bar Formal Opinion Number 1976-38, this committee concluded that the rule did not prohibit a lawyer from advancing expenses for which the client is responsible, even when there is a substantial likelihood the client did not have the means to pay them. The same principle applies to the situation where a lawyer, most often a solo practitioner with a small income or client base, needs to pay for outside lawyer services. In that situation the lawyer remains contractually obligated to pay the outside lawyer even though the lawyer must wait to receive income from legal services rendered before having the means to pay the outside lawyer.

⁷ Of course, the bills will or have already disclosed the outside lawyer's name and billing rate. (See the Statement of Facts.)

⁸ It would be prudent for the law firm to include the disclosure to the client in the attorney's initial retainer letter or make that disclosure as soon thereafter as the decision to hire is made.