

# **REFERRAL FEE TASK FORCE**

## **PRELIMINARY REPORT**

In accordance with the *per curiam* Order of the Supreme Court of Texas (Misc. Docket No. 03-9207), the Referral Fee Task Force (the “Task Force”) submits this Preliminary Report to the State Bar Board of Directors (the “Board”) and the Supreme Court of Texas.

A final report and recommendation regarding any proposed changes to the referral fee and/or advertising rules will be submitted to the Court and the Board on or before May 23, 2004.

On March 27, 2004, after the record was closed, the Task Force began reviewing the evidence adduced from the hearings and written comments. The Task Force decided to identify those issues that should be resolved in order to make final recommendations regarding any changes to the existing rules regarding advertising and referral fees. If any member of the Task Force objected to a proposed preliminary recommendation, that issue was identified as one requiring further discussion. The issues and the Task Force’s preliminary recommendations appear in Sections VI and VII.

### **I. The Referral Fee Task Force**

On October 9, 2003, the Court proposed (Misc. Docket No. 03-9160), to amend Texas Rules of Civil Procedure by adding Rule 8a, “Referral Fees,” effective January 1, 2004. The Court invited public comment through December 31, 2003.

The officers and directors of the State Bar of Texas were immediately inundated with calls from bar members concerning the proposed rule. The majority of the concerns were related to two issues: 1) the Court’s perceived failure to follow the referendum procedure established in Tex. Gov’t Code § 81.024; and 2) the placement of professional conduct rules in rules of procedure rather than the Texas Disciplinary Rules of Professional Conduct. The Court received

more than 250 letters concerning proposed Rule 8a, the overwhelming majority of which oppose the implementation of the rule.

On November 6, State Bar officers (acting on action by the Executive Committee) sent a letter to the Court asking that it withhold implementation of proposed Rule 8a and allow a task force to be appointed to review this proposal and other related advertising issues.

By Order dated December 23, 2003, the Supreme Court suspended implementation of the proposed rule pending the appointment of a special task force, which would be appointed by the State Bar to study the issue and submit final recommendations on a timeline, established in the order.

The State Bar Board, at its regularly called meeting on January 23, 2004, appointed the 19-person Task Force.<sup>1</sup> Richard Hile of Austin was appointed to chair the Task Force. The Board authorized the Task Force to: 1) conduct public hearings in Austin, Dallas, El Paso, Harlingen, Houston, and San Antonio; and 2) conduct a survey of Texas lawyers to better understand the referral practice in Texas. The Task Force was asked to make a preliminary report of its findings to the Board at its April 16 regular Board meeting and to submit a final report at least 30 days prior to its June 24 meeting.

## **II. The Public Hearings**

The Task Force began the public hearings in El Paso on January 28, 2004 and continued with the process through the final hearing in Austin on March 26, 2004. A total of six public hearings were held throughout the State. Lawyers in West Texas were provided the opportunity to present live testimony by videoconference from Texas Tech University School of Law at the March 26<sup>th</sup> hearing. A verbatim record and video recording was made of the hearings.

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<sup>1</sup> See Exhibit "A" list of Task Force members.

Prior to each public hearing, the State Bar Public Information office notified local media as well as lawyer organizations of the hearings and the issues under consideration by the Task Force. In addition, Richard Hile attended the January 16, 2004 meeting of the State Bar of Texas Council of Chairs and encouraged State Bar sections to inform their members of the hearings and the opportunity to provide live or written comments to the Task Force. Finally, the dates of the public hearings and the deadline for submitting written commentary were published in the February issue of the Texas Bar Journal (*p.125*) and made available on the State Bar website, [www.texasbar.com](http://www.texasbar.com).

A total of 50 individuals testified in person or by videoconference at the public hearings. The number of people appearing before the Task Force included 12 in Austin; 14 in Dallas; 2 in El Paso; 7 in Harlingen; 12 in Houston; 2 in San Antonio; and 1 by videoconference from Lubbock. Texas lawyers, members of the public, and representatives of the media also attended but did not testify at each of the public hearings. Most of the lawyers who testified or submitted written comments were plaintiff lawyers.

To ensure it had as much information as possible about the referral and advertising issues under consideration, the Task Force invited several experts to testify. Professors Geoffrey Hazard, Charles Wolfram, and Stephen Daniels were invited to the Austin hearing. Geoffrey Hazard was the chief reporter for the ABA Commission on Professional Ethics, which developed the Model Rule of Professional Responsibility (2003). Charles Wolfram, a law professor at Cornell University School of Law, was the chief reporter for the American Law Institute's *Restatement of the Law Governing Lawyers* and numerous articles regarding legal ethics. Stephen Daniels, a Senior Research Fellow at the American Bar Foundation and adjunct professor of law at Northwestern University, co-authored *It was the Best of Times, It Was the*

*Worst of Times: The Precarious Nature of Plaintiffs' Practice in Texas*, 80 Tex. L. Rev. 1781 (2002), a study of Plaintiffs practices in Texas based on interviews with more than 100 Texas plaintiffs lawyers regarding their law practices.

Professor Wolfram could not testify at the public hearing but did appear by videoconference at the March 27, 2004 meeting of the Task Force. Professor Daniels appeared at the March 26, 2004 public hearing in Austin. Professor Hazard was not able to appear at the public hearing or the Task Force meeting.

### **III. Written Comments**

In addition to collecting testimony at the public hearings, the Task Force agreed to accept written comments from any interested party concerning proposed Rule 8a and other advertising issues. As of the March 26 deadline, the Bar had received written comments from 36 individuals. The written comments have been catalogued and made a part of the official record of the Task Force.

### **IV. Referral Practices Survey**

Because no surveys or other empirical data was available regarding the scope and nature of referral fee practices in Texas, the Task Force coordinated with the State Bar of Texas Research and Analysis Department to construct a valid research tool to establish such a measure. Lisa Kalakanis, director of the Research and Analysis Department, worked with the Task Force to develop a valid survey, determine the number of participants necessary for the survey to be scientifically valid, and identify a random sample of Texas lawyers to be surveyed. It was decided that 4,000 members of the State Bar would be asked to participate in the survey.

The Task Force provided a list of issues to be included in the survey. Ms. Kalakanis drafted the questionnaire to ensure the questions were as unbiased as possible. To test the survey,

Ms. Kalakanis conducted a pilot survey and then interviewed participants. Revisions were made to the survey based on the input received from the pilot survey. The survey was also rebuilt and tested online. On March 23, 2004, e-mails were sent to about 3,600 Texas lawyers who were asked to complete the survey online. Paper copies of the survey were mailed to the remainder of the selected participants (individuals who had not provided the State Bar an e-mail address). Follow-up letters and e-mails were sent to participants who have not responded by April 2, 2004. The deadline for filing responses to the survey is April 9, 2004. The Research and Analysis Department will then tabulate the results and submit a summary of pertinent findings.

## **V. Summary of Testimony**

The attorney testimony that was offered will be detailed in the Task Force's final report, but its most salient features are summarized below, because they have influenced the Task Force's preliminary recommendations.

A substantial majority of the attorneys who testified were opposed to: (1) placing the rule regulating referral fees in the Texas Rules of Civil Procedure; (2) capping referral fees; (3) publicly disclosing referral fee agreements, and (4) discontinuing the current Texas practice that permits forwarding fees. A substantial majority of the attorneys who testified also claimed that: (1) client fees were not increased by the Texas forwarding fee practice; (2) clients were benefited by the forwarding fee practice, since it resulted in clients being placed with the best lawyer; and (3) altering the timing, nature of extent of disclosures given to clients would improve the rule and practice in this area. On the subject of advertising, the testimony was mixed on the use of client testimonials, especially when actors were used, and on the question of whether advertisements should include results obtained for clients.

The Task Force also heard testimony that rejected the continued use of the Texas forwarding fee practice. The Task Force will consider this testimony together with the substantial body of law in other jurisdictions rejecting such a forwarding fee practice before it makes its final recommendations.

## **VI. Referral Fees**

### **A. Rules Regarding Division of Fees Should Remain Part of Disciplinary Rules**

Rules regarding referral fee practices have historically been addressed in disciplinary rules and should remain part of the Texas Disciplinary Rules of Professional Conduct (hereafter “Rule(s) of Conduct”). The Task Force unanimously recommends that this practice continue. Continuing this practice will ensure that a lawyer’s conduct will be measured by the same principles regardless of where or whether a suit is filed. Moreover, failure to comply with the standards imposed by these rules will subject each lawyer who does not follow the rules to the same disciplinary procedures and penalties.

### **B. Division Proportional to Service Performed**

The current practice of allowing lawyers to divide fees in proportion to the services performed should be continued. Both the ABA Model Rule 1.5(e) (2003) and Rule of Conduct 1.04(f) authorize a division of a fee based on services performed.

The Task Force recommends retaining the division of fees contained in Rule of Conduct 1.04, but that cmt.11 be revised to clarify what is meant by “proportion of services performed” and to further identify the proper standard for determining whether the agreed allocation is appropriate.

An agreement to divide fees in proportion to services performed assumes that each lawyer will “have performed services beyond those involved in initially being engaged by the client.” RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 47, comment (c), p. 333. Although no Texas court has specifically addressed when a division is considered proportional, the Task Force believes that the best approach would be to follow “the majority of courts that have decided the issue [by] permit[ting] the lawyers’ agreed allocation to control where there is a substantial and good-faith division of services or responsibility. *E.G., Macurdy v. Sikov & Love*, P.A. 894 F.2d 818 (6<sup>th</sup> Cir. 1990).” *Id.* at 337. This approach requires that there be a reasonable correlation between the amount of services rendered and responsibility assumed and the share of the fee received. *See In re Potts*, 718 P.2d 1363, 1369 (Or. 1986). While an agreement entered into “at the outset of the representation will be upheld if it reasonably forecasts the amount and value of effort to be expended . . . ,” an agreement that defers the allocation

until the end of representation “must reasonably correspond to services actually performed.” RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 47 at 333.

### **C. Division Pursuant to Joint Responsibility**

The Task Force recommends the continued inclusion of “assuming joint responsibility” as a basis for fee-splitting. Rule of Conduct 1.04, cmt. 11, should be revised to ensure that it accurately describes the ethical and financial obligations assumed by the referring lawyer. The comments to ABA MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.5(e) (1983) were revised in 2003 and now state, “Joint responsibility for representation entails financial and ethical responsibility for the representation as if the lawyers were associated in a partnership.” This approach is contrary to that taken in the present disciplinary rules, where standards of civil liability are generally viewed as beyond their scope. *See* Preamble: Scope ¶ 15, which expressly provides that “[t]hese rules do not undertake to define standards of civil liability of lawyers for professional conduct . . . .” Texas courts have held, however, that a lawyer’s violation of a Rule of Conduct may be evidence of a breach of the applicable standards of conduct. *See Two Thirty Nine Joint Venture v. Joe*, 60 S.W.3d 896 (Tex. App. - Dallas 2001, rev. granted). Lawyers should therefore be fully informed of the obligations they assume by electing to be jointly responsible in accordance with this rule.

### **D. Client Disclosure**

Lawyers have a responsibility to ensure that clients are fully informed of the terms and conditions of all fee agreements. Rule of Conduct 1.04(f) presently requires a written agreement only where a lawyer assumes joint responsibility. *See* Rule of Conduct 1.04(f)(1)(iii). Otherwise, a client need only be advised of the participation of all lawyers and not object to the participation of the lawyers. *See* Rule of Conduct 1.04(f)(2). An affirmative act of consent is not required, nor is a disclosure to the client that he or she has a right to object to or otherwise withhold consent to the arrangement. Moreover, it is not clear that the present rule requires client non-objection or consent at the front end of the referral process, rather than at some later point in time, and it also appears to be the case that lawyers need not disclose the terms of their fee division to the client in order for whatever non-objection or consent they obtain to be effective. Finally, the present rule does not clearly state which lawyer (the referring lawyer, the handling lawyer, or both) is required to take whatever steps are necessary under the rule. The Task Force also noted that no writing is required if the division of fees is based on the proportion of services provided or made with a forwarding lawyer.

The Task Force viewed all of these features of the current rule as problematic and recommends that Rule of Conduct 1.04 (f) be revised accordingly. Without meaning to be exhaustive, the changes contemplated will require that the client agree to any arrangement regarding the division of a fee, including the share each lawyer will receive, that the agreement be in writing and signed by all parties, and that such an agreement be entered into at the time of the referral. However, while the agreement must be obtained

in advance of the rendering of legal services, it may provide that the allocation not be made until the end of the representation. (*See* Par. B).

#### **E. A Lawyer Should Not Recover a Referral Fee Without Obtaining the Client's Consent**

The Texas Supreme Court, in *Mandell & Wright v. Thomas*, 441 S.W.2d 841 (Tex. 1965), held that an attorney may recover the full amount owed under the contract of employment when a client, without good cause, discharges the attorney before the attorney's engagement has been completed. The practical effect of this ruling, in the context of referrals, is that dissatisfied clients will not be able to discharge their lawyer, even though they object to the referral, because of the potential of having to pay full attorneys' fees to two different sets of lawyers. The Task Force recommends that a lawyer be prohibited from receiving a referral fee if a client does not consent in writing to the referral of the case and division of the fee in accordance with the requirements discussed in Par. D above, and that, if the client either is not presented with such an agreement in a timely manner or does not consent to it, that any power of attorney or other arrangement entered into between the referring lawyer and the client be voidable at the option of the client.

#### **F. The Specialized Services Exemption**

Rule of Conduct 1.04, cmt. 10, states that a lawyer who retains another lawyer for consultation and advice on a specialized aspect of a matter does not have to comply with the provisions of the rule if that consultation will not necessitate the disclosure of confidential information, and the hiring lawyer both absorbs the entire cost of the second lawyer's fees and assumes all responsibility for the advice ultimately given the client. The Task Force believes that this exemption has been used to avoid compliance with the provisions of Rule of Conduct 1.04(f). More importantly, a client should be fully informed of any arrangement involving the division of a fee between lawyers representing a client's interests. Consequently, the Task Force recommends that this provision be deleted from the comment regarding Division of Fees.

#### **G. Division of Fees with Certified Lawyer Referral Services**

The State Bar of Texas, in accordance with the Texas Lawyer Referral Service Quality Act, Tex. Occ. Code 952.001, *et. seq.*, has certified nineteen Lawyer Referral Services. Lawyer Referral Services typically require lawyers who are referred matters to agree to the payment of a referral fee. The testimony at the public hearings indicates that the referral fee is typically 25% of the gross recovery (generally the referral fee is payable on amounts over some established amount, i.e., \$500). Rule 1.04 does not exempt Lawyer Referral Services from the provision of this rule, but the Task Force believes that it should. Consequently, the Task Force proposes that Rule 1.04(g) be revised as follows:

Paragraph (f) of this Rule does not prohibit payment to: 1) a former partner or associate pursuant to a separation or retirement agreement; or 2) a lawyer referral program certified by the State Bar of Texas in accordance with the Texas Lawyer Referral Service Quality Act, Tex. Occ. Code 952.001, *et. seq.*

## **H. Forwarding Fee**

Texas is the only jurisdiction whose disciplinary rules expressly allow the payment of a fee merely for referring or forwarding a case. As noted above, the overwhelming majority of witnesses testifying at the public hearings or submitting written comments who addressed this issue argued that the pure forwarding fee not only poses no harm to clients, but also ultimately insures greater protection of clients as lawyers have a financial incentive to refer the case to the most competent lawyer. Nonetheless, almost all scholarly commentaries, as well as the disciplinary rules of almost every other jurisdiction, condemn that practice.

When asked to describe their individual referral practices, the description of services provided by many of the lawyers who testified would constitute assuming joint responsibility under existing rules. Moreover, when specifically asked whether they would object to assuming joint responsibility, many indicated that they would not.

As Professor Charles Wolfram, American Law Institute's chief reporter to the RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS pointed out, Texas is the only state that permits a pure forwarding fee. Also, a number of Committee members have expressed support for adoption of the ABA MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.5(e) (2003), which does not permit pure forwarding fees. There is not unanimous agreement within the Task Force concerning whether the pure referral or forwarding fee should be retained in the Rules of Conduct.

## **I. Should Referral Fees be Capped**

Proposed Rule 8a of the Texas Rules of Civil Procedure limits the amount that a lawyer may recover as a referral fee if the referring lawyer does not provide substantial professional services, to the lesser of \$50,000 or 15% of the attorney fees. The issue of capping fees garnered much debate during the public hearings. As a general rule, members of the Task Force do not support limitations or caps on referral fees, other than with respect to pure forwarding fees. If the current practice of allowing pure referrals is continued, some members of the Task Force would support limiting fees in the pure referral fee situation. Until a final decision is made regarding the use of pure referral fees, this issue will remain under discussion.

## **J. Public Disclosure of Referral Fee Agreements**

Proposed Rule 8a also provides that lead counsel must file with the court a notice disclosing every referral fee paid or agreed to be paid with respect to the party. Once

again, as noted above, the overwhelming majority of witnesses opposed public disclosure of referral fee agreements. Most witnesses asserted that agreements between clients and their attorneys should remain private. Others asserted that disclosures would a) violate the attorney-client privilege; b) result in disclosure of attorney-work product; and c) result in satellite litigation. Others argue, however, that, absent disclosure, lawyers will be able to evade the Rules of Conduct regarding referral fees. This issue remains open at this time.

## **VII. Advertising**

### **A. Major Advertising Issues**

The majority of the testimony and questions regarding lawyer advertising involved 1) the use of actors or models portraying a client; 2) discussions involving the results obtained on behalf of a client, such as the amount of a damage award or the lawyer's record in obtaining favorable settlements or verdicts; and 3) whether a lawyer should be allowed to advertise for cases if the lawyer knows or should know at the time of the advertisement that such will likely be referred to another lawyer.

### **B. Proposed Recommendations**

The Task Force believes that significant problems exist in the present rules governing testimonials. Written disclaimers that are presently required in television advertisements (which include testimonials or client endorsements), have little, if any, impact on viewers. The inclusion of the dollar amount recovered by a client appears to be inherently misleading and creates unjustified expectations on behalf of viewers. All of these problems are greatly exacerbated when the advertisements involved are made by lawyers or law firms who referred the matter to which the testimonial or award relates, rather than handling it.

The Task Force has not reached any agreement concerning these problems and is considering the following:

1. a complete ban on the use of client testimonials;
2. prohibiting an actor or model from portraying a client of the lawyer or law firm;
3. prohibiting discussions regarding results obtained on behalf of a client;
4. requiring full disclosure of the nature of a case and injuries in advertisements that reference recoveries obtained on behalf of a client;
5. requiring advertisements, which include results obtained by clients, to indicate the gross amount recovered, expenses and fees charged to the client, and the net amount recovered by the client;
6. requiring that certain, especially problematic uses of "results obtained" be prohibited, as where the lawyer who is advertising referred the matter in question and so did not obtain the result, or where the result advertised

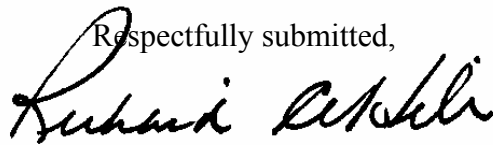
was overturned or reduced in amount on appeal, or where the result obtained was later compromised for a lesser amount; or  
7. requiring that disclaimers, such as “results obtained depend on facts of each case” or similar statements or disclaimers, be presented in the same media (*i.e.*, auditory and/or visual) with equal prominence as the statement of results obtained.

### **VIII. Conclusion**

All of the above-referenced recommendations are preliminary and subject to revision by the Task Force. The Task Force will submit its final report, including responses to the questions posed by the Supreme Court in its Order of December 23, 2003 and any final recommendations, on or before May 23, 2004. It is anticipated that the Task Force’s Final Report will address each of the issues articulated by the Supreme Court in its order of December 23, 2003.

Dated this 6<sup>th</sup> day of April 2004.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Richard C. Hile". The signature is written in a cursive style with a large initial 'R'.

Richard C. Hile, Chair  
Referral Fee Task Force

# **Referral Fee Task Force 2004**

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**\*Resigned 02/04/2004**