IN THE SUPREME COURT OF TEXAS

Misc. Docket No. 03– 9207

PROPOSED RULE 8a OF THE TEXAS RULES OF CIVIL PROCEDURE

ORDERED that:

1. For reasons explained below, the January 1, 2004 effective date of proposed Rule 8a of the Texas Rules of Civil Procedure is suspended pending further order of the Court.

2. The Clerk is directed to:

   a. file a copy of this Order with the Secretary of State;

   b. cause a copy of this Order to be mailed to each registered member of the State Bar of Texas by publication in the *Texas Bar Journal*;

   c. send a copy of this Order to each member of the Legislature; and

   d. submit a copy of the Order for publication in the *Texas Register*.

SIGNED AND ENTERED this 29th day of December, 2003.

Thomas R. Phillips, Chief Justice

Nathan L. Hecht, Justice

Priscilla R. Owen, Justice

Harriet O'Neill, Justice

Wallace B. Jefferson, Justice

Michael H. Schneider, Justice

Steven Wayne Smith, Justice

J. Dale Wainwright, Justice

Scott A. Brister, Justice

PER CURIAM

On October 9, 2003, in Miscellaneous Docket No. 03-9160, the Court proposed to amend the Texas Rules of Civil Procedure by adding Rule 8a, "Referral Fees,"[1] effective January 1, 2004, and invited public comment. Since then the Court has received extensive comments, including a letter from the Executive Committee of the Board of Directors of the State Bar of Texas requesting that the effective date of the proposed rule be postponed to allow time for further study.[2] The Court grants this request. Many of the people who have submitted comments have asked for information regarding the development of the proposed rule and its intended purpose. This Order responds to those comments. In addition, as requested by the leadership of the Bar[3], this Order sets out some of the issues that should be included in its study.

I. A Brief History of the Regulation of Referral Fees in Texas, 1909–1990

"Referral fees" are defined in proposed Rule 8a.1, but for present purposes we use the term more generally to mean fees paid by one lawyer to another, not in the same firm, merely for referring or forwarding a case. The practice in the American bar of paying referral fees predates the twentieth

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[1] See Appendix A.

[2] See Appendix B.

[3] On December 3, 2003, MEMBERS of the Court met with Betsy Whitaker, President, Kelly Frels, President-Elect, Kim J. Askew, Chair of the Board, and Tony Alvarado, Executive Director.

century.[4] Henry S. Drinker, regarded as the foremost authority on legal ethics in his day, wrote in his 1953 treatise:

> There was long at the bar a practice or custom whereby, when a lawyer, with authority from his client, forwarded a case to another lawyer for attention in the latter's jurisdiction, or merely recommended one, the forwarding lawyer was allowed one-third of the fee earned by his correspondent. This was in the nature of a "Finder's Fee," and was payable irrespective of any real service performed or responsibility assumed by the forwarding lawyer.[5]

But the practice has long been controversial.[6] In 1928, the American Bar Association amended the Canons of Professional Ethics it had first adopted in 1908 to include Canon 34, which, as finally amended in 1937, stated:

> No division of fees for legal services is proper except with another lawyer, based upon the division of service or responsibility.[7]

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[4] *See* JULIUS H. COHEN, THE LAW: BUSINESS OR PROFESSION 226 (1916) ("This system of solicitors and solicitors' agents — the 'town' solicitor taking charge and the 'country' solicitor doing a large part of the work — a joint service, with a joint reward, is probably the origin of the system existing in this country of 'forwarders' and 'receivers' sharing the one fee in the proportion of one-third to the forwarder and two-thirds to the receiver. But in England as in this country, where both receiver and forwarder are lawyers, the sharing of the fee is based upon a relationship of correspondents, who, for the purposes of the case, have associated themselves in a joint task."); Thomas J. Hall & Joel C. Levy, *Intra-Attorney Fee Sharing Arrangements*, 11 VAL. U. L. REV. 1, 2 (1976) ("The genesis of such a referral or finder's fee in America may well be traceable to the practice of countryside solicitors in England who, when faced with litigation, would associate London solicitors as agents. An agent would in turn retain a barrister from the Inns of Court to take full charge of the litigation, with the custom being that the referring solicitor would share in one-third of the resulting fee.").

[5] HENRY S. DRINKER, LEGAL ETHICS 186 (1953).

[6] *See* 1 ROBERT L. ROSSI, ATTORNEYS' FEES § 4:2, at 219 (2d ed. 1995) ("There has been much controversy over the years with respect to the payment of referral or forwarding fees . . . .").

[7] 62 ABA REPORTS 350, 352, 765 (1937); 58 ABA REPORTS 163, 166, 176 (1933); 53 ABA REPORTS 119, 124, 130 (1928).

In a 1940 formal opinion, the ABA Committee on Professional Ethics stated that under Canon 34, "where a lawyer merely brings about the employment of another lawyer *but renders no service and assumes no responsibility in the matter*, a division of the latter's fee is improper."[8] As Drinker later noted, "[i]t was obviously the purpose of Canon 34 to condemn" the payment of referral fees when the referring attorney retains no responsibility for the matter.[9]

Lawyer-ethics rules in Texas, as in all states, have been heavily influenced by ABA model rules. The voluntary Texas Bar Association adopted the original 1908 ABA Canons in 1909[10] and later-added canons, including Canon 34, in 1934[11] and 1938.[12] In 1939, the Legislature created the "mandatory" State Bar of Texas,[13] and the following year, pursuant to that statute, this Court first adopted Canons of Ethics as part of the State Bar Rules that were then approved in a referendum of

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[8] ABA Comm. on Prof'l Ethics, Formal Opinion 204 (1940) (emphasis in original).

[9] DRINKER, *supra* note 5, at 186; *see also* Curtis L. Cornett, *Ohio Disciplinary Rule 2-107: A Practical Solution to the Referral Fee Dilemma*, 61 U. CIN. L. REV. 239, 241 (1992).

[10] 28 TEXAS BAR ASS'N, PROCEEDINGS OF THE ANNUAL SESSION 47, 85 (1909); *see* Cullen Smith, *The Texas Canons of Ethics Revisited*, 18 BAYLOR L. REV. 183, 184 (1966).

[11] 53 TEXAS BAR ASS'N, PROCEEDINGS OF THE ANNUAL MEETING 189, 201, 213 (1934); *see* Smith, *supra* note 10, at 187.

[12] 57 TEXAS BAR ASS'N, PROCEEDINGS OF THE ANNUAL SESSION 82, 83 (1938); *see Report of the Texas Bar Ass'n Professional Ethics Committee*, 1 TEX. B.J. 191 (1938).

[13] Act of April 6, 1939, 46th Leg., R.S., ch. 1, § 4, 1939 Tex. Gen. Laws 64, 65.

Texas lawyers.[14] ABA Canon 34 (prior to its 1937 amendment) was proposed as Texas Canon 35,[15] but the language was amended to expressly permit, not prohibit, referral fees, and adopted as Canon 31:[16]

> No division of fees for legal services is proper, except with other lawyers, based upon a division of service or responsibility, *or with a forwarding attorney.*[17]

In the jurisdictions that adopted it, ABA Canon 34 was not always followed. In 1951, one writer observed:

> The so-called forwarding fee of 33-1/3 percent has been transmitted for so many years and in such a large number of communities that it has come to have been accepted by the Bar as an accepted practice. . . . Moreover, it seems to be common throughout the country.[18]

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[14] *See* 3 TEX. B.J. 187 (1940); *see also* John F. Sutton, Jr., *Guidelines to Professional Responsibility*, 39 TEX. L. REV. 391, 403-404 (1961).

[15] *See* 2 TEX. B.J. 362, 373 (1939).

[16] *See* Smith, *supra* note 10, at 190.

[17] Order of the Supreme Court of Texas dated Feb. 22, 1940 (emphasis added); *see* 10 TEX. B.J. 142, 146 (emphasis added).

[18] Robert T. McCracken, *Report on Observance by the Bar of Stated Professional Standards*, 37 VA. L. REV. 399, 416-417 (1951).

Sixteen years later, another reported that lawyers overwhelmingly believed that payment of referral fees either was not unethical or at least should not be sanctioned.[19] A third, in 1971, referred to ABA Canon 34 as "[p]robably the most often violated canon of ethics".[20]

Notwithstanding the acceptance of referral fees in the bar, when the ABA replaced the 1908 Canons of Ethics with the Model Code of Professional Responsibility in 1970, it strengthened the prohibition against referral fees. The Model Code provision on fee-splitting, DR 2-107(A), required that a division of fees be based on services performed *and* responsibility assumed, not one or the other, as Canon 34 had allowed.[21] Moreover, DR 2-107(A) added two new requirements: that the client consent to the employment of all lawyers, and that the total fee not exceed reasonable compensation for legal services rendered.[22] Model DR 2-107(A) stated:

> A lawyer shall not divide a fee for legal services with another lawyer who is not a partner in or associate of his law firm or law office, unless:
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> (1) The client consents to employment of the other lawyer after a full disclosure that a division of fees will be made.

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[19] JOEL F. HANDLER, THE LAWYER AND HIS COMMUNITY 97-98 (1967).

[20] Charles O. Brizius, *Advice to the Young Lawyer on Building a Practice*, 17 PRAC. LAW. no. 2, at 13, 31 (Feb. 1971); Murray H. Gibson, Jr., *Attorney-brokering: An Ethical Analysis of the Model Rules of Professional Conduct and Individual State Rules Which Allow This Practice*, 19 J. LEGAL PRAC. 323, 324 (1994) ("While the acceptance of referral fees is a practice that has long been disfavored by the governing bodies of the American legal community, it is a practice that has flourished and enjoyed widespread acceptance by the individual attorneys engaged in the day-to-day practice of law.").

[21] MODEL CODE OF PROF'L RESPONSIBILITY DR 2-107(A)(2) (1969).

[22] *Id.* at (A)(1), (3).

(2) The division is made in proportion to the services performed and responsibility assumed by each.

(3) The total fee of the lawyers does not clearly exceed reasonable compensation for all legal services they rendered the client.[23]

The following year, this Court adopted the Texas Code of Professional Responsibility, based on the ABA Model Code, as recommended by the State Bar of Texas and later approved by referendum of the members of the Bar.[24] Disciplinary Rule 2-107(A) of the Texas Code was identical to the Model Code provision except for the addition of the phrase at the end of paragraph (2), "or is made with a forwarding lawyer."[25] The effect of the addition was to continue to allow referral fees [26] subject only to the added requirements of client consent and a limit on the total fee.

The requirement of client consent in paragraph (1) was carefully limited. Both the ABA and Texas rules required that a client be told only "that a division of fees will be made," not the terms of the division. The limit on the total fee in paragraph (3) was consistent with the ABA provision's prohibition of fee-splitting except "in proportion to the services performed and responsibility assumed". Because lawyers could divide the fee only on this basis, each would receive reasonable compensation for participating in the representation, and the total could not exceed "reasonable

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[23] *Id.* at (A).

[24] Order of the Supreme Court of Texas dated Dec. 20, 1971, *reprinted in* 473-474 S.W.2d (Texas Cases) xxiii, xxxiii (1972).

[25] *Id.* at xliii.

[26] *See* Franklin Jones, Jr., *The Texas Code of Professional Responsibility — the "Texanization" of the A.B.A. Code*, 18 BAYLOR L. REV. 689, 690-691 (1972).

compensation for all legal services they rendered the client." But under the Texas provision, which allowed fee-splitting with a forwarding lawyer who neither rendered legal services nor assumed responsibility for the representation, the limitation on the total fee had a different effect. Because the total fees of both the referring lawyer and the handling lawyer could not "clearly exceed reasonable compensation for all legal services they rendered the client", the referral fee would have to be subtracted from the reasonable compensation for the legal services. Thus, the handling lawyer might well receive less than a reasonable fee for legal services performed so that the referring lawyer could be paid without performing legal services.

The propriety of referral fees continued to be a controversial issue. A 1978 conference sponsored by the Roscoe Pound – American Trial Lawyers Foundation found "little or no evidence to suggest that a client might pay a higher bill for legal services under a fee-splitting arrangement."[27] On the contrary, "the conferees felt that a fee-splitting arrangement would tend to work in a client's best interest by giving lawyers the incentive to refer their contingent fee clients to the most competent attorneys." On a divided vote, the conferees concluded that referral fees should be permitted, subject only to the requirement of client consent and the limitation on the total fee

[27] ROSCOE POUND — AMERICAN TRIAL LAWYERS FOUNDATION, FINAL REPORT OF THE ANNUAL CHIEF JUSTICE EARL WARREN CONFERENCE ON ADVOCACY IN THE UNITED STATES 16, 18 (1978).

imposed by ABA Model Code DR 2-107(A)(1) and (3). [28] Others disagreed.[29] In 1983, the ABA replaced its Model Code with the Model Rules of Professional Conduct. Model Rule 1.5(e) significantly relaxed restrictions on fee-splitting:

> A division of a fee between lawyers who are not in the same firm may be made only if:
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> (1) the division is in proportion to the services performed by each lawyer or, by written agreement with the client, each lawyer assumes joint responsibility for the representation;
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> (2) the client is advised of and does not object to the participation of all the lawyers involved; and
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> (3) the total fee is reasonable.[30]

Under this rule, a forwarding lawyer who performed no legal services could share in the fee if he agreed with the client to be jointly responsible for the representation and the total fee was reasonable. The rule required only that the client be advised of the "participation" of the lawyers, not of either the fact or the terms of the fee division.

Professor Geoffrey Hazard, Jr., a leading authority on lawyer ethics, has reported that "[f]ee splitting was one of the most contentious issues in the drafting of the Model Rules and their

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[28] *Id.* at 17-18; *see also* Charles E. Richardson, III, *Division of Fees Between Attorneys*, 3 J. LEGAL PROF. 179, 192 (1978).

[29] *See, e.g.*, Philip H. Blackburn, *Referral Fees: An Abuse of the Public Trust*, 54 FLA. B.J. 235 (1980); Lewis N. Carter, Note, *Attorneys: The Referral Fee: A Split in Opinion*, 33 OKLA. L. REV. 628 (1980).

[30] MODEL RULES OF PROF'L CONDUCT R. 1.5(e) (1983).

subsequent consideration by state rule makers." [31] The *American Bar Journal* published a brief debate on the issue under the heading, *Referral fees: Everybody does it, but is it OK?* [32] One side warned that unrestricted referral fees "would inevitably introduce the temptation for some to refer matters to the highest bidder, rather than to the best qualified lawyer."[33] The other side defended the referral fee as "a vital lubricant in the machinery by which victims are adequately compensated for their injuries"[34] and added:

> The advent of the TV broker attorney presents an offensive situation in which a well-funded lawyer can solicit cases by the airwaves and forward the resulting cases to qualified attorneys for handling. A law degree and an advertising scheme are all that are required to share in a percentage of the resulting fees. As repugnant as this result is, the unrepresented victim may be well served.[35]

The same issue of the *Journal* reported that nearly two-thirds of lawyers polled approved of referral fees.[36] Professor Wolfram, another distinguished authority on lawyer ethics, has summarized:

> The practice of fee splitting and work division among lawyers, through the routine payment of "forwarding fees," is probably both rife and virtually respectable in many communities. The practice appears wasteful because it compensates the forwarding lawyer for doing little more than passing the client's matter on to another lawyer to handle it. But prohibiting referral would probably have the effect of

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[31] GEOFFREY C. HAZARD, JR., ET AL., THE LAW AND ETHICS OF LAWYERING 508 (3rd ed. 1999).

[32] 71 A.B.A. J. 40 (Feb. 1985).

[33] Michael Franck, *No Referral Fee for No Work*, 71 A.B.A. J. 40, 42 (Feb. 1985).

[34] Frederick N. Halstrom, *Referral Fees Are a Necessary Evil*, 71 A.B.A. J. 40, 42 (Feb. 1985).

[35] *Id.* at 44.

[36] Lauren Rubenstein Reskin, *Forwarding Fees Are Fine with Most Lawyers*, 71 A.B.A. J. 48 (Feb. 1985).

encouraging marginally competent lawyers to keep cases in an attempt to bumble through.[37]

Referral fees continued to be debated in Texas as well. [38] This Court did not adopt Model Rule 1.5(e). Instead, the Court adopted Rule 1.04(f) of the Texas Disciplinary Rules of Professional Conduct, effective January 1, 1990, approved by a referendum of the Bar:

> (f) A division or agreement for division of a fee between lawyers who are not in the same firm shall not be made unless:
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> (1) the division is:
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> (i) in proportion to the professional services performed by each lawyer;
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> (ii) made with a forwarding lawyer; or
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> (iii) made, by written agreement with the client, with a lawyer who assumes joint responsibility for the representation;
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> (2) the client is advised of, and does not object to, the participation of all the lawyers involved; and
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> (3) the aggregate fee does not violate paragraph (a).[39]

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[37] CHARLES W. WOLFRAM, MODERN LEGAL ETHICS § 9.2.4, at 510-511 (1986).

[38] *See The Great Debate*, 49 TEX. B.J. 896 (Sept. 1986) (summarizing a debate between Frank B. Davis of Houston and Guy Allison of Corpus Christi, sponsored by the Texas Young Lawyers Association, on the resolution: "Referral fees paid to attorneys who perform no meaningful services to the client (other than the referral itself) should be prohibited").

[39] Order of the Supreme Court of Texas dated October 17, 1989, *reprinted in* 777-778 S.W.2d (Texas Cases) xxxi, xlv (1990).

Paragraph (1) allows a division of fees on the same two bases stated in Model Rule 1.5(e)(1) but adds a third: that the fee is divided with a forwarding lawyer. Thus, a forwarding lawyer in Texas can continue to receive a referral fee without performing any legal services or agreeing to assume any responsibility for the representation. The minimal client consent is the same in both rules. While Model Rule 1.5(e)(3) requires that the total fee be reasonable, Texas Rule 1.04(f)(3), by referring to Rule 1.04(a), requires only that the total fee not be unconscionable. Under Rule 1.04(a), "[a] fee is unconscionable if a competent lawyer could not form a reasonable belief that the fee is reasonable."

II. Current Regulation of Referral Fees in the Other Forty-Nine States and the District of Columbia

The rules relating to referral fees in other jurisdictions are set out in Appendix C, [40] and a chart comparing the differences is shown in Appendix D. That chart and the following discussion are based on the language of the rules. No attempt has been made to canvass judicial decisions or administrative opinions construing the rules.[41]

Five states effectively prohibit referral fees. Colorado does so expressly. Iowa and Nebraska retain the more restrictive Model Code DR 2-107(A). Hawaii and Wyoming follow the form of

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[40] *See also* ABA/BNA LAWYER'S MANUAL ON PROFESSIONAL CONDUCT 41:701-:704 (2001) (summarizing rules on referral fees in United States jurisdictions and analyzing differences); STEPHEN GILLERS & ROY A. SIMON, REGULATION OF LAWYERS: STATUTES AND STANDARDS 61-70 (2002 ed.) (same).

[41] *See generally* Caroll J. Miller, *Validity and Enforceability of Referral Fee Agreement Between Attorneys*, 28 A.L.R.4th 665 (1984 & Supp. 2003); J. D. Emerich, *Attorney's Splitting Fees with Other Attorney or Layman as Ground for Disciplinary Proceeding*, 6 A.L.R.3d 1446 (1966 & Supp. 2003); L. S. Tellier, *Division of Fees or Compensation Between Co-operating Attorneys*, 73 A.L.R.2d 991 (1960).

Mode Rule 1.5(e) but make the conditions of performing legal services and assuming joint responsibility in paragraph (1) conjunctive rather than disjunctive. In a sixth state, Arizona, a lawyer receiving a portion of the fee need not perform legal services but must assume joint responsibility for the representation.

Twenty-one states have the less restrictive Model Rule 1.5(e).[42] Eleven others and the District of Columbia have the Model Rule with the following variations, additions, or exceptions. In Nevada, the notice to the client of all lawyers' participation must be in writing. In New Hampshire, a lawyer's assumption of responsibility need not be in writing but the client must be advised that fees will be divided. Minnesota and North Carolina require that the terms of the fee division must also be disclosed to the client, and Illinois and Ohio[43] require that disclosure to be in writing. In the District of Columbia, the client must be told in writing of the effect on the fee of the participation of outside lawyers, and in Wisconsin the client must be told whether the involvement of other lawyers will increase the fee. In New York, the client must be told that fees will be divided, and the total fee must not exceed reasonable compensation for all legal services rendered, a requirement taken from the Model Code provision. New York also requires that agreements for and payments of contingent fees in personal injury cases be reported to the Office of Court Administration. Washington follows the Model Rule except for payments to an authorized lawyer

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[42] Alaska, Arkansas, Georgia, Idaho, Indiana, Kentucky, Louisiana, Maryland, Mississippi, Missouri, Montana, New Jersey, New Mexico, North Dakota, Oklahoma, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Vermont.

[43] *See also* Cornett, *supra* note 9, at 258-259 (arguing that pure referral fees are prohibited by statute in Ohio).

referral service, which are unrestricted. West Virginia follows the Model Rule except in contingent fee cases in which the referring lawyer is "regularly engaged in the full time practice of law" and the referral is to a lawyer more experienced in the area, in which event the client must also be told that fees will be divided. Florida's rule adds that the basis for the fee division must be disclosed to the client, but Florida also regulates contingent fee percentages and requires that in personal injury cases the primary lawyer must receive at least 75% of the fee and the secondary lawyer no more than 25%, unless modified by the court.[44]

Twelve states do not require that fees be divided based on services performed or joint responsibility. In two of them, Maine and Oregon, the total fee must not exceed compensation for all legal services rendered. In Maine the client must also consent to the terms of the division, but in Oregon the client must be told only that fees will be divided. In Pennsylvania, the total fee must not be illegal or clearly excessive for all legal services rendered, and the client must consent to the participation of all the lawyers. In six of the twelve, the total fee must be reasonable. Four of them — Connecticut, Kansas, Massachusetts, and Virginia — have no other requirement except that the client be told of the division of fees. In the other two — Delaware and Michigan[45] — the client need only be told of all the lawyers' participation. Alabama has adopted the Model Rule except in contingent fee cases, where the total fee must not be clearly excessive and the client must be advised

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[44] *See* Herman J. Russomanno, *Referral Fee Agreements in Contingent Fee Cases*, 2001 ATLA-CLE 883, at n.26 and accompanying text.

[45] *See* Sean M. Carty, Note, *Money for Nothing? Have the New Michigan Rules of Professional Conduct Gone Too Far in Liberalizing the Rules Governing Attorney's Referral Fees?*, 68 U. DET. L. REV. 229 1991).

that fees will be divided. In California, the total fee must not be unconscionable and must not be increased solely by the division, and the client must consent in writing to the terms of the division. In Texas, the only restrictions are that the total fee not be "unconscionable", as defined in Rule 1.04(a), and that the client consent to the participation of all the lawyers.

It appears from our review of the rules of other states and the District of Columbia that none is as permissive of referral fees as Texas.[46]

The ABA Ethics 2000 Commission has proposed, and the ABA has adopted, revisions to Model Rule 1.5(e) that would require the client to agree in writing to the fee share each lawyer would receive:

> (e) A division of a fee between lawyers who are not in the same firm may be made only if:
>
> (1) the division is in proportion to the services performed by each lawyer or each lawyer assumes joint responsibility for the representation;
>
> (2) the client agrees to the arrangement, including the share each lawyer will receive, and the agreement is confirmed in writing; and
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> (3) the total fee is reasonable.[47]

The American Law Institute's *Restatement of the Law Governing Lawyers* contains a similar rule:

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[46] *See* Samuel V. Houston III. *Comment: In the Interest of the Client: Why Reform of Texas's Rules Regarding Referral Fees Is Necessary*, 33 ST. MARY'S L.J. 875 (2002).

[47] MODEL RULE OF PROF'L RESPONSIBILITY R. 1.5(e) (2002).

A division of fees between lawyers who are not in the same firm may be made only if:

> (1) (a) the division is in proportion to the services performed by each lawyer or (b) by agreement with the client, the lawyers assume joint responsibility for the representation;
>
> (2) the client is informed of and does not object to the fact of division, the terms of the division, and the participation of the lawyers involved; and
>
> (3) the total fee is reasonable (see § 34).[48]

III. Events Leading to Proposed Rule 8a

In response to concerns raised about referral fees, this Court in 1997 asked the Texas Disciplinary Rules of Professional Conduct Committee of the State Bar of Texas for advice on whether Rule 1.04(f) of the Texas Rules of Disciplinary Conduct should be more restrictive of referral fees. The Committee presented its report to the Court on May 20, 1998. [49] The report reviewed the arguments for and against referral fees and found the following:

> At present, the economic incentives surrounding referral fees have two substantial flaws. The first is that they encourage the lawyers involved to tell the client as little as possible about their arrangement. The second is that they encourage forwarding lawyers to refer cases to the handling lawyer paying the most generous referral fee rather than to the handling lawyer best qualified to handle the matter.[50]

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[48] RESTATEMENT OF THE LAW GOVERNING LAWYERS § 47 (2000).

[49] See Appendix E.

[50] *Id.* at 3.

The report indicated that "the outright abolition of lawyer forwarding fees might be not only too extreme but futile as well".[51] "[T]he Committee believes instead," the report continued, "that consideration should be given to instituting regulatory measures short of outright abolition that would retain the salutary aspects of referrals while curbing abuses."[52] After setting out a number of options to be considered, the report concluded:

> If the discussions in our Committee are any indication, the question of what measure[s] if any should be taken with respect to attorney referral fees raises many issues over which reasonable persons will differ. The proper resolution of those issues involves both political and public policy questions that go well beyond the ethical concerns that are the purview of this Committee. Those broader questions need to be debated at length in a more open and more representative forum than our Committee provides. The views of attorneys and others who are most knowledgeable about current practices and who stand to be most directly affected by any changes in those practices are especially important.
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> Once that debate has occurred, it will be time to undertake those actions that appear to be in the best interests of the Bar and the public it serves. At that time, should the Court request that it do so, the Texas Disciplinary Rules of Professional Conduct Committee will be prepared to assist in drafting any amendments to the disciplinary rules found to be desirable.[53]

In December 1998, the Court referred this report to the Board of Directors of the State Bar of Texas, and no further action was taken.

Still, concerns in the bar over referral fees continued. A few months later, in March 1999, the *Texas Lawyer* contained a lengthy article entitled *Referrals Get Rough Around the Edges;*

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[51] *Id.* at 2.

[52] *Id.*

[53] *Id.* at 5.

Referral Fees Are Big Business for the Highest Bidder, But What About the Client?[54] The article cited a number of highly experienced Texas lawyers who voiced concerns about referral fees. The article reported that "[m]any lawyers now use mass advertising to dredge in and sign up clients just to refer them out en masse — even shopping them to the highest bidder."[55] "At times," it continued, "the clients are like cattle being auctioned off to the highest bidder."[56] Richard Mithoff of Houston was quoted as saying:

> When you have lawyers whose only credentials are a law license and enough money to take out an advertisement, then you have a situation ripe for abuse . . . . They don't even know the clients they sign up, much less have their best interest at heart.[57]

The article reported that Kenneth T. "Tommy" Fibich of Houston had also expressed concerns:

> Fibich believes the practice of shopping for high referral fees has diluted the overall quality of the plaintiffs bar.
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> "There are less cases out there, so there is more competition to get good ones," he says. "That has led to more advertising, which leads to shopping for fees, which causes lawyers to bend to the fees because they want to get the cases."
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> When lawyers overbid for fees, he says, they are induced to settle quickly — perhaps for less than a case's full value — rather than run up costs.[58]

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[54] Nathan Koppel, *Referrals Get Rough Around the Edges: Referral Fees Are Big Business for the Highest Bidder, But What About the Client?*, TEX. LAW., March 29, 1999, at 1.

[55] *Id.* at 36.

[56] *Id.*

[57] *Id.*

[58] *Id.* at 38.

Other lawyers, such as Hartley Hampton of Houston, were reported as expressing concerns that changes in referral fees could result in clients being represented by less qualified lawyers.[59]

In 2001, the Supreme Court requested Joseph D. Jamail of Houston to chair a task force that would study a number of issues related to civil litigation, including referral fees. On August 24, 2001, in Misc. Docket No. 01-9149, the Court created the Supreme Court Task Force on Civil Litigation Improvements, to be chaired by Mr. Jamail. Members of the Task Force were Charles L. (Chip) Babcock of Dallas, Professor Elaine Carlson of Houston, Ricardo G. Cedillo of San Antonio, James E. Coleman of Dallas, Tommy Jacks of Austin, Dee Kelly of Fort Worth, Harry Reasoner of Houston, and Steve Susman of Houston. The creation of the Task Force and the scope of its charge was announced to the Supreme Court Advisory Committee at its next meeting in the fall of 2001 and was reported in the *Texas Lawyer* in November.[60]

The members of the Task Force conducted extensive research on the issues before them and met a number of times in 2001 and 2002 to discuss those issues. In March 2003, Mr. Jamail reported the recommendations of the Task Force to the Court in person. Among those recommendations was a Rule of Civil Procedure relating to referral fees. The Court transmitted the Task Force report to the Supreme Court Advisory Committee for its study and comment. The Task Force

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[59] *Id.* at 37.

[60] Mary Alice Robbins, *Fix-It Committee to Look at How Guardian Ad Litem Fees Calculated*, TEX. LAW., Nov. 26, 2001, at 7 ("Another issue to be studied by the new task force involves the sharing of fees among lawyers for case referrals. . . . 'To me, it's a blatant buying of cases,' Jamail says. 'We're going to look at it.'")

recommendations were reported in the *Texas Lawyer*[61] and posted on the Advisory Committee's internet website. The Advisory Committee discussed the proposed rule regarding referral fees at its May meeting and again at its August meeting. The Advisory Committee recommended that no rule be adopted but also debated what provisions should be included in any rule that might be adopted.

After considering the Task Force report and the Advisory Committee recommendations, the Court issued an order on October 9 adopting Rule 8a of the Texas Rules of Civil Procedure, effective January 1, 2004, subject to public comment.

IV. Response to Public Comment

The Court has received a large number of comments from lawyers and others, many of which have been beneficial. Some oppose any changes in rules relating to referral fees, some favor changes different from proposed Rule 8a, and some favor the rule as proposed. The Court continues to consider these comments. Without attempting to resolve the issues that have been raised, our purpose here is to summarize these comments and respond briefly to them.

A. Issues Related to Process

A range of issues related to the rule-making process have been raised.

One issue is whether referral fees can be regulated without improperly infringing on private parties' right to contract and should be subject only to market forces among attorneys and clients. Our research has not revealed an American jurisdiction that has accepted this view. On the contrary,

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[61] Brenda Sapino Jeffreys, *Changes to Class Actions, Referral Fees Proposed*, TEX. LAW., April 14, 2003, at 1.

the position of every jurisdiction of which we are aware has long been that the fees that an attorney may charge must be limited by ethical rules, just as they have been in Texas.

Another issue is whether any regulation of referral fees is properly a matter for the Legislature. Payment of referral fees in Texas has always been addressed in rules adopted by the Supreme Court in conjunction with the Bar, and this appears to be true in almost all, if not all, other states.[62] The Legislature could certainly consider statutory control of attorney fees generally and referral fees specifically, and several bills on these subjects have been introduced in past sessions.[63] While these bills have not passed, there is some indication that others will be introduced in future sessions, and the concerns they have raised warrant study and response in anticipation of such legislation.

Some comments have questioned whether the recommendations of the Court's Advisory Committee should be given more weight. Careful consideration must be given to those recommendations, as well as the Task Force recommendations and public comments, but none can

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[62] *See also* Cornett, *supra* note 9, at 258-259 (arguing that pure referral fees are prohibited by statute in Ohio).

[63] *See, e.g.*, S.J. OF TEX., 78th Leg., R.S. 2808, 2811-2812 (2003) (Floor Amendment No. 4, seeking to place language of Model Rule 1.5(e) into the omnibus State Bar Sunset bill, CSHB 599, defeated by a vote of 17 to 14); Tex. H.B. 2550, 78th Leg. R.S. (2003) (regulating contingent fees); Tex. S.B. 1721, 78th Leg., R.S. (2003) (same); Tex. H.B. 24, 77th Leg., R.S. (2001) (limiting contingent fees after settlements); Tex. H.B. 37, 76th Leg., R.S. (1999) (same); Tex. S.B. 27, 74th Leg., R.S. (1995) (same).

be considered binding. The Order appointing the Advisory Committee states: "The Court is not bound by the Committee's recommendations."[64]

Another issue is whether any rules regarding referral fees should be adopted as Rules of Disciplinary Procedure, with a referendum of the bar, rather than as Rules of Civil Procedure. Comments have pointed out that proposed Rule 8a would not affect cases settled before suit is filed or cases filed in federal court. At least one comment has suggested that referral fees pose both procedural and disciplinary issues. We commend this issue to the Bar for continued study in light of all of the comments we have received.

Finally, a number of comments have asserted that proposed Rule 8a is nothing other than politically motivated tort reform. This is simply not true. The proposed rule was recommended by a Task Force of some of Texas' best lawyers, appointed without regard to political affiliation and in fact politically diverse, chaired by Joe Jamail. Comments both supportive and critical have been received from lawyers with varying practices and experience, as well as from non-lawyers. While the subject of referral fees has long been controversial inside and outside the bar, as the history of debate we have briefly summarized shows, nothing in that history indicates that the ongoing debate has been influenced by politics or polarized along practice lines.

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[64] Order of the Supreme Court of Texas dated Feb. 18, 2003, Misc. Docket No. 03-9023 ("The Supreme Court Rules Advisory Committee, first created in 1940 and reconstituted at various times since then, assists the Supreme Court in the continuing study, review and development of rules and procedures for the courts of Texas, taking into consideration the rules and procedures of other courts in the United States and proposals for changes from whatever source received. The Committee drafts rules as directed by the Court; solicits, summarizes and reports to the Court the views of the bar and the public on court rules and procedures; and makes recommendations for change. The Court is not bound by the Committee's recommendations.").

B. Issues Related to Substance

The history of the regulation of referral fees in the United States, the observations of scholars and practitioners along the way,[65] the discussions of the Task Force and the Advisory Committee, the comments on proposed Rule 8a, and the deliberations of the Court have identified these issues, which we commend to the Bar for study, among others that may be raised:

1. Will restrictions on referral fees impair what has been viewed as their beneficial purpose of obtaining the best representation for clients? The principal justification for referral fees historically is that they benefit clients by assuring that the best representation is obtained. But lawyers already have an ethical obligation to decline representation beyond their competence. [66] Should lawyers be paid merely for referring a case or client, or should they perform that service without payment,[67] as other professions, such as the medical profession,[68] are expected and required

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[65] *See* Carty, *supra* note 45, at 236-241; Cornett, *supra* note 9, at 250-256; Gibson, *supra* note 20, at 331-335; Houston, *supra* note 46, at 883-904; POUND, *supra* note 27, at 17-19; Richardson, *supra* note 28, at 192-197; Jay Tuley, *Fee Sharing Agreements and Their Enforceability Without Client Consent*, 22 J. LEGAL PROF. 375, 380-385 (1998).

[66] TEX. DISCIPLINARY R. PROF'L CONDUCT 1.01(a) ("A lawyer shall not accept or continue employment in a legal matter which the lawyer knows or should know is beyond the lawyer's competence [except in limited instances].").

[67] *See* Cornett, *supra* note 9, at 250.

[68] *See* COHEN, *supra* note 4, at 217 ("'Fee-splitting,' as it is called, has been long recognized in the medical profession as one of its darkest sins."); Geoffrey C. Hazard, Jr., *Realities of Referral Fees Here to Stay*, NAT'L L.J., Nov. 16, 1987, at 13 ("The objection to referral fees is similar to the object on to 'kickbacks' paid by surgeons to doctors practicing general medicine who refer surgical cases to them. If the professional who makes the referral cannot himself competently perform the necessary professional service, ethical tradition requires him simply to forward to case to one who can. He should not exploit his knowledge about competent specialists to collect a fee from a client who happens to have come his way.").

to do?[69] Why should lawyers not refer cases solely for the best interests of clients, and not for compensation? Why should a referring lawyer who accepts a fee not be required to assume joint responsibility for the representation? Is the historical justification for referral fees still valid? If so, do evolving circumstances — including increased advertising and "brokering" of cases and clients,[70] and increases in referral fees from the historical one-third[71] — require further regulation of referral fees? If so, what regulations would continue to serve legitimate purposes of referral fees?

2. *Do referral fees harm clients?* It is not clear how a handling lawyer can, over time, render the same service in cases in which he receives the entire fee as he does in cases in which he receives a fraction of the fee.[72] As one writer put it decades ago: "Do you want your cook to trade with the

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[69] *See* Lawrence Durbin, *Ethics*, 15 STUDENT LAWYER 38, 38 (Feb. 1987) ("If incompetent lawyers must have an economic incentive to refuse cases, why should the profession support these lawyers at all?").

[70] *See* Hall & Levy, *supra* note 4, at 25 ("the brokerage of clients and legal business is unprofessional, and any argument supporting the practice of bare referral or finder's fees can be based only upon purely economic self-interest").

[71] *See* Blackburn, *supra* note 29, at 235 ("In most such arrangements, the referring attorney will do almost nothing to justify any fee, although it will usually be decided in advance that he (she) will eventually receive 40-50 percent of the total attorneys' fees.").

[72] *See* Brizius, *supra* note 20, at 31-32 ("The type of referral fee ['where the only service provided by the lawyer receiving the unearned portion is the act of referring the case'] is obviously unethical. The specialist who does the work must either raise the total fee to the client so as to be able to pay the referring lawyer, or he must shortchange the client with a hasty, impersonal job so that the working lawyer can make this piece of business profitable enough to maintain his operation. This is obviously unprofessional."); Blackburn, *supra* note 29, at 237 ("A number of media and political groups have attacked the contingency fee concept. What they fail to realize is that the concept is perfectly fair, but in many cases the contingency percentage is too high because of the built-in 'overhead' item represented by the referral fee. To the personal injury lawyer, it is a cost of doing business that is passed on to the client, and to his (her) great detriment."); Cornett, *supra* note 9, at 251 ("Stated simply, as referral fees become more common and more expensive, the personal injury lawyer is obligated to raise the client's contingency percentage accordingly. Thus, a 'societal cost' is exacted from all users of the legal system, whether they are referred clients or not."); W. Perry Webb, *Referral Fees and the Effect of Disciplinary Rule 2-107*, 8 J. LEGAL PROF. 225, 234 (1983) ("There has been considerable debate as to whether referral fees actually increase the cost of legal services."); Sheryl Zeligson, *The Referral Fee and the ABA Model Rules of Professional Conduct: Should States Adopt Model Rule 1.5(e)*, 15 FORDHAM URBAN L.J. 801, 817, 820

butcher that gives her the largest commission? You know*you* will pay in the end."[73] The difference between the ABA Model Code Rule DR 2-107(A)(3) and ABA Model Rule 1.5(e)(3) suggests that a referral fee must either be paid over and above the reasonable fee for legal services rendered, in which case it must have some independent justification, or else must be deducted from the handling lawyer's reasonable fee. Are lawyers improperly motivated to increase the fee to the client, as was suggested in the 1999 *Texas Lawyer* article?[74] The United States Supreme Court observed long ago in a similar context:

> Certainly there would be a temptation to [the referring and handling lawyers] to seek so to increase the allowance [of attorney fees] as to secure a generous provision for both. Motive for excessive allowance could hardly be more direct.[75]

Is this observation valid? Is there empirical or other evidence that referral fees do or do not increase costs to clients?[76] Are they different from fees paid to lawyers in firms in recognition for referrals of business to others in the same firm? Do constraints in a firm setting operate differently than those in an open market for the referral of cases? Why are referral fees considered beneficial in the legal profession but not in the medical or other professions?

(1987) (stating that while there is no "tangible evidence to show that referral fees increase the cost of legal services", nevertheless "[i]t is not suggested that a bare referral fee paid for no work is proper").

[73] COHEN, *supra* note 4, at 220.

[74] *See* Koppell, *supra* note 54, at 36-39.

[75] *Weil v. Neary*, 278 U.S. 160, 172 (1929).

[76] *See* Stephen J. Spurr, *Referral Practices Among Lawyers: A Theoretical and Empirical Analysis*, 13 LAW & SOC. INQUIRY 87 (1988); *see also* Stephen Daniels and Joanne Martin, *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).

3. *Do referral fees adversely affect the profession?* Historically, a major justification for prohibiting or restricting referral fees has been the protection of the integrity of the legal profession.[77] What importance does this consideration continue to have?[78] How do advertising practices affect this consideration?

4. *Should referral fees be capped by rule?* Existing rules cap fees generally by prohibiting unconscionable fees. Other states' rules require that total fees be reasonable, or that referral fees not affect the total fee. At least one state, Florida, imposes specific percentage caps. Should rules impose specific caps on fees? If so, are the caps in proposed Rule 8a unreasonable?

5. *Should referral fees be disclosed to the client and public?* The ABA Model Code required that the client be told that the fee would be divided, but the ABA Model Rule did not. The ABA Ethics 2000 project requires that the client consent in writing to the basis for the fee division. What reasons are there not to fully disclose the terms of any fee division to the client, as many states

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[77] *See* Panel Discussion, *The Determination of Professional Fees from the Ethical Viewpoint — A Panel Discussion*, 7 U. FLA. L. REV. 433, 434 (1954) ("It makes the law too much of a business if you are practicing the way you would as a broker. The lawyer is not supposed to get paid for anything but legal services that he renders, and selling a man, a client is not a legal service. I think it is beneath the dignity of the profession to take money for something that is not a legal service.").

[78] *See* Carter, *supra* note 29, at 631-632 (stating that some argue "that fee splitting will further damage the already vulnerable reputation of the legal profession. The client may feel that he is being passed around the legal profession as if he were merchandise or an article of trade, while the lawyers run up their fees accordingly."); Hall & Levy, *supra* note 4, at 22 ("a mere referral coupled with a willingness to 'consult' . . . opens the legal profession to criticism of being solely a 'money-getting trade'").

require?[79] Proposed Rule 8a would require public disclosure of referral fees in court pleadings. New York has long required disclosure of referral fees, and contingent fees generally, as an administrative matter that is not public.[80] Several comments suggest that insurance defense lawyers may be reluctant to refer cases if their clients would disapprove. Other comments suggested that plaintiffs reasonably expect that their private arrangements with their lawyers will not be disclosed. Some comments suggest that disclosure of all the lawyers financially interested in a case may be necessary in order to determine whether a judge should be asked to recuse. Other comments suggest administrative disclosure to the State Bar or some other agency rather than public disclosure may be appropriate to provide information on referral fee practices without impinging on privacy concerns. The issues are complex and warrant continued study.

6. What adverse collateral consequences will a referral fee rule have? A number of comments warn that lawyers will refuse to follow or attempt to circumvent restrictions on referral fees,[81] and that restrictions on referral fees will prompt more lawyers to advertise, and that lawyer

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[79] *See* COHEN, *supra* note 4, at 218 ("If fee splitting is defensible on any score, there can be no reason for secrecy".); Hazard, *supra* note 68, at 14 ("Lawyers understandably fear that clients would feel exploited if they knew the referring lawyer will get 10 percent of a $100,000 settlement for what may be at most a few hours' work."); WOLFRAM, *supra* note 37, at 513 ("Forwarding is justifiable on public policy grounds only if it enhances the ability of a client to receive superior legal services. Leaving the client as far in the background as the Code and Model Rules do is either paternalistic or ignores that policy.").

[80] See Appendix C.

[81] *See* POUND, *supra* note 27, at 17; Richardson, *supra* note 28, at 197 ("Until its proponents can marshal cogent, demonstrable reasons for its existence, DR 2-107 will be ignored by the bar and only consistently enforced in cases of clear violations, and even then, only on the few occasions when a reluctant bar chooses to litigate the issue.").

referral services that charge significant referral fees will be adversely affected by any restrictions.[82] These issues should be included in the Bar's study.

7. What specific problems does proposed Rule 8a have? Comments on the provisions of proposed Rule 8a question: whether the core "substantial" standard in 8a.1(b)(1) should be defined, given the serious consequences a violation of the rule may have;[83] whether the rule would permit defendants to use the disqualification penalty for delay; whether the rule would enable entrepreneurial "referral fee hijackers" to attempt to induce clients to seek forfeiture of referral fees; and whether the hearing procedure will unduly burden litigation.

V. The Proposal of the State Bar

The State Bar's written proposal, attached as Appendix B, has been further explained by the Bar leadership in their meeting with the Court.[84] The proposal calls for the Bar to appoint a special task force with diverse representation that will conduct public hearings in five cities in January and February and solicit input through other means. A verbatim record will be made of these hearings. It is likely that the task force will also consider related advertising issues. The task force will present the State Bar Board of Directors with a preliminary report on April 16, 2004, and a final report at least thirty days before the Board's meeting on June 23-24, 2004. The task force and the Board will

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[82] *See* TEX. OCC. CODE § 952.001-.203 (regulating referral services).

[83] *Cf.* Cornett, *supra* note 9 at 245-246 (noting that a major reason for the erratic enforcement of rules regarding referral fees has been uncertain standards).

[84] See note 3, *supra*.

regularly apprise the Court of their progress. As soon as the Board has acted on the report, it will present its recommendations to the Court. Those recommendations, which may be modified by the Court, will then be submitted to a referendum of the members of the Bar in the fall of 2004. If this process satisfactorily addresses the issues that have been raised, proposed Rule 8a will be withdrawn.