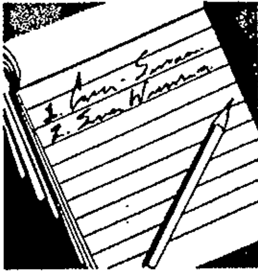

Avoiding the Pitfalls in Attorney Referrals

By Edward J. Rolwes

Though many lawyers overlook the risk of vicarious liability posed by referrals to outside counsel, these relationships often present real danger for unexpected malpractice exposure. Also, lawyers sometimes fail to fully comply with — or pay any heed to — ethical rules governing attorney referrals. This article examines the two basic types of referrals, "fee" and "no fee," and offers a number of suggestions and tips for avoiding unexpected vicarious liability in referring cases.

Often attorneys are approached by someone whom they can't serve because they don't have time or lack expertise in the area. In these instances, referring the case to outside counsel provides a valuable service to the potential client, but it must be done with care.

Obviously, you are liable for your own malpractice and that of your agents, assuming the agent is acting with actual or apparent authority. Familiar agency relationships between lawyers are the "partner to partner" and "partner to associate" situations. Partners are liable for other partners' negligent acts since employment of one firm member is generally considered employment of the entire firm. This is true whether the firm is organized as a traditional partnership or a professional corporation. Whether a referral creates an agency relationship generally depends on whether it's "fee" or "no fee."

"Fee" Referrals

A "fee" referral occurs where the first attorney, or "Attorney A," enters into an agreement with both the client and the subsequent attorney under which Attorney A will receive a fee for the primary service of referring the suit.

Requirements

The recently adopted Illinois Rules of Professional Conduct contain provisions governing fee referrals. In all instances two requirements, and in most cases a third, must be met.

First, Rule 1.5 requires that the client sign a written consent to the employment of the "other lawyer." That consent must disclose three things: 1) that fees will be divided; 2) the basis for the division, including the economic benefit to the other lawyer; and 3) the responsibility assumed by the other lawyer for performing the legal services.

Second, where the primary service performed by Attorney A is referring the client to the subsequent attorney, the Rules require Attorney A to agree to "assume the same legal responsibility for the performance of the services in question as would a partner of the receiving lawyer."

Because attorney referrals often involve contingent fees, Rule 1.5(c) comes into play. All contingent fee agreements must be in writing and state how the fee will be determined, including the percentages going to the lawyers.

Arguably, a client's written consent to the referral containing the necessary referral disclosure language also complies with the separate written contingency fee rule. But to be on the safe side in contingent fee cases, attorneys should either expressly incorporate the consent language into the contingent fee agreement or, if Attorney A already has a contingency fee agreement before contacting subsequent counsel, obtain a separate written consent to the referral arrangement.

Effects of proper fee referral

Following the dictates of Rule 1.5(f) allows attorneys to divide a fee for legal services with lawyers outside their firms, something not generally permissible otherwise. But there is a price — the referring attorney is liable for the subsequent attorney's acts or omissions as if the first lawyer were a member of the second's firm.

The extent of vicarious liability to the referring attorney — Attorney A — is often overlooked. On the face of Rule 1.5, A is vicariously liable even though the client knows of and consents to referral of the case to the new attorney. As a practical matter, the client may actually consider the first attorney discharged and have little or no communication with him or her. Nonetheless, Attorney A, because of the fee agreement, remains on the hook for Attorney B's malpractice.

Effect of noncompliance with Rule 1.5

Failure to comply with the requirements governing fee referrals also subjects you to discipline by the Attorney Registration and Disciplinary Commission. The type of discipline undoubtedly would depend upon a number of factors, including

the nature of the rule infraction, whether it is an isolated instance, and whether it was wilful.

Failure to comply with Rule 1.5 can have financial consequences as well. If a fee referral agreement does not comply with the ethical rules, case law suggests that the agreement itself violates public policy and is unenforceable. Attorney A in that instance cannot enforce the fee agreement on a quantum meruit basis or otherwise, even if the first lawyer performed substantial work on the case before sending it to subsequent counsel.

This rule was discussed in *Leoris v Dicks*, 150 Ill App 3d 350, 501 NE2d 901 (1st D 1986). While it is unlikely as a practical matter that Attorney B will bite the hand that feeds him or her by failing to pay the first lawyer, theoretically, even if there's no disciplinary charge by the ARDC, the financial effect of failing to comply with the ethical rules governing fee agreements could be substantial.

"No Fee" Referrals

In general, Rule 1.5 does not apply where an attorney refers a case to subsequent counsel without a fee agreement. In addition, since no fee splitting has occurred, Attorney A is not vicariously liable for the acts of subsequent counsel.

The question of whether a fee agreement existed sometimes comes up in retrospect in attorney malpractice cases. It arises because arrangements between attorneys are often not spelled out despite the requirements of Rule 1.5. The failure to document the agreement often opens Attorney A up to a malpractice suit for negligent acts or omissions of the subsequent attorney.

Attorneys who receive a phone call or letter from someone they cannot assist often informally refer the potential client to another lawyer without further involvement. However, the chances of a claim against referring Attorney A after the subsequent lawyer mishandles the case diminish if Attorney A can demonstrate some evidence that he or she was not to obtain a fee from the referral *and* the client knew of and consented to retention of the subsequent lawyer. In such a case, even if an attorney-client relationship arose before the referral, the law considers Attorney A discharged from further responsibility for the referred matter.

The knowledge and consent issue is usually simple enough where the client was told to directly contact Attorney B and did so. But the fee issue is often more muddled and can come down to Attorney A's word against that of the subsequent lawyer (who may not have adequate insurance) or the disgruntled client preventing dismissal of Attorney A from the suit short of trial or settlement. See e.g. *Hotze v Daleiden*, slip op 1-89-3221 (1st D Feb 10, 1992) (summary judgment for attorney-defendant reversed based on conflicting testimony about whether defendant agreed to obtain subsequent counsel for the plaintiff).

Referral Pointers

A written acknowledgement from a client or would-be client that you have referred the case without a fee is ideal, though it may not be practical. In any event, here are some suggestions for handling referrals.

If you're getting a fee, comply with Rule 1.5. If you're not getting a fee, somehow document that fact, perhaps by obtaining a written acknowledgment from the client or sending him or her a courteous follow-up letter. Your letter need merely thank the person for the inquiry, express regret that you could not be of service and are not his or her lawyer, encourage the person to contact any one of several attorneys or a bar association referral service, and offer to help in the future.

Even if you are doing other legal work for the client after the referral, try to get a letter or some other acknowledgement of the referred matter to reflect the limited scope of your retention. Your desire not to alienate a client who is sending or might provide additional work should not prevent you from clearly defining the scope of your relationship or from confirming your discharge.

Second, develop some in-house method of keeping track of all cases you refer whether or not a fee is involved. This may require opening a file, though a general file for all "no fee" referrals may be enough.

By all means open a file when a fee is involved. Before accepting the fee for a referral, do a conflicts check to determine that the new client's interests do not conflict with any existing clients'. In addition, once you have referred the case, check any new cases that you accept against the names of all clients who have been referred out for fees. Just as you cannot accept a case which creates a conflict with an existing client, neither can you accept a fee for a referral if your relationship with the referred client creates a conflict with an existing client, nor can you later accept a case raising a conflict with the client you have referred for a fee. Failure to comply with conflict rules could result in disqualification or forfeiture of fees, including any referral fee, or both. Obtaining waivers from all concerned clients is sometimes an option, but without some means of including referred-for-fee clients into your conflicts system the chances of accepting a case where there is an unresolved conflict multiples.

Third, for all referrals, whether for a fee or not, consider the reputation and competence of the subsequent lawyer and the extent of his or her liability coverage. While you don't expect subsequent counsel to mishandle the referred matter, mistakes can happen. You are accepting far more risk referring a matter to a lawyer without adequate coverage since it increases the likelihood you will become the target of the subsequent malpractice suit regardless of whether you signed a written fee agreement.

Some courts have suggested that failing to exercise due care in selecting new counsel can itself provide the basis for a suit. The concept of "negligent referral" has found its way into the law of other jurisdictions, although not yet in Illinois. Even assuming the client knows of and consents to a "no fee" referral and considers Attorney A discharged from further responsibility, there is non-Illinois precedent for allowing the client to sue the first lawyer under the negligent referral theory. One New Jersey court emphasized that the initial lawyer must exercise ordinary care and skill in selecting new counsel. *Tormo v Yormark*, 398 F Supp 1159 (D NJ 1975). When no fee is involved Attorney A should avoid selecting a particular lawyer if possible and

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space as a single room could constitute the principal place of business for each of the business activities carried on there.

So much for the good news. The bad news came when the court required the statutory tests to be applied to each separate business activity. It stated that if one business activity did not satisfy all of the tests, the taxpayer did not meet the "exclusive use" requirement of the section. Consequently, he or she could not get the deduction for any of the trades or businesses operating out of the home office. The court specifically disallowed allocating expenses between qualifying and nonqualifying use — the deduction is an all or nothing proposition.

Hamacher's business use of his home to perform school duties ran afoul of § 280A. As noted in *Mathes*, employees trying to claim the home office deduction have to demonstrate that the home office is for the convenience of the employee's employer. The school provided him with an office where he could perform all of his administrative duties. Hamacher's use of his home office for school activities served his own personal purposes and was not for the "convenience of the employer," as that term has been interpreted.

As the court said, "[m]any people engaged in businesses and professions may find it helpful to take work home with them, but that does not automatically establish that the home office is maintained for the convenience of their employers." Since the home office was not for the convenience of the school (Hamacher's employer), the use attributable to Hamacher's business of being an employee did not satisfy the statutory requirements. The office was not *exclusively* used in activities permitted by the statute. The non-qualifying use, even though business-related, was considered personal use and thus tainted the qualifying business use of the office relating to Hamacher's acting career. The entire deduction was disallowed.

Conclusion

Although the current *Soliman* approach offers new opportunities for the "home-office deduction," *Mathes* and *Hamacher* teach the stark reality of limitation. The tax court will continue to read the statute as written and strictly apply the tests provided. While it is not news that employees have a tougher row to hoe to qualify for the § 280A deduction, it is now clear that employee status can easily taint otherwise qualifying deductible use of a home office.

Qualifying business use must meet a stricter standard for employees than it does for self-employed persons. But the statute does not offer any significant guidance on how to satisfy its test. The tax court seems to be interpreting the language to mean that the employee must either maintain the office as a condition of employment (see, *Green v Comm.*, 78 TC 428, 430 (1982), rev'd on other grounds, 707 F2d 404 (9th Cir 1983)), or show that the home office is in some way necessary to the performance of his or her duties or the functioning of the employer's business (see *Frankel v Comm.*, 82 TC 318,325-326 (1984)). The failure to establish either of the above would seem to make the home office for the personal convenience, comfort, or economy of the employee, and the expenses from it nondeductible.

Notwithstanding the favorable ruling in *Soliman*, or perhaps because of it, effective tax year 1991 home office deductions can expect to receive closer scrutiny. The IRS has introduced a new form (Form 8829) which must be filed for all taxpayers claiming a home office deduction. Therefore, employees may be best served by keeping their moonlighting activities unrelated to their full-time employment in their offices, and taking their employers' work home to bed. In any event, watch the advance sheets for further developments from the Supreme Court.

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PRACTICE TIPS *(Continued from page 243)*

instead refer the would-be client, in writing, to any one of several lawyers or to a local bar association.

One final note: At presstime, the Illinois Supreme Court was still reconsidering its decision in *Collins v Reynard*, No 70325 (1991) which would limit lawyer malpractice negligence actions by plaintiffs seeking only "economic damages." Since Rule 1.5 of the Illinois Rules of Professional Conduct creates exposure as a matter of law in fee referral cases as if the first lawyer were a member of the second's firm, *Collins* should have little impact on the principles discussed above regardless of the final ruling. Just as a partner is liable for a copartner's negligence, a partner is also liable for any breaches by a copartner of the attorney-client agreement, since retention of one member of a firm is generally considered retention of all firm partners.

Conclusion

Attorneys often overlook the disciplinary rules governing referrals. Many lawyers enter into fee agreements informally and simply ignore Rule 1.5. Since you could assume vicarious liability for the acts of subsequent counsel in referring cases, depending in general on whether a fee is involved and whether the client knows of and consents to the referral, be cautious in referring cases, clearly identify the nature of the referral, and make sure all parties understand and consent to the arrangement.

While Rule 1.5 does not apply where no fee is involved, caution dictates that you document in some way the nature of the relationship even if a fee is not expected. With proper compliance with Rule 1.5, organized file maintenance and record keeping, conflicts checks, and caution in selecting new counsel, the risk of vicarious liability for subsequent counsel's malpractice can be dramatically diminished.

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