

D.C. Bar Opinion

Opinion 307

Participation in Government Program Requiring Payment of Percentage of Fee

It is permissible for a lawyer to participate in a federal government referral service that negotiates contracts to provide legal services to federal agencies where that program requires the lawyer to submit one percent of the legal fees received through the service to the government office in order to fund the program.

Applicable Rules

- Rule 5.4 (Professional Independence of a Lawyer)
- Rule 7.1 (Communications Regarding a Lawyer's Services)

Inquiry

We have been asked to address the permissibility of a lawyer's participation in a General Services Administration (GSA) program designed to provide federal agencies with a schedule of pre-negotiated contracts for goods and services, including legal services for financial asset management. The program is funded by charging participating contractors a fee of one percent of the business they receive through the program, raising the question of whether, in the case of a lawyer's participation, this funding scheme would violate our rules prohibiting the sharing of legal fees with non-lawyers.

Our understanding of the background and working of the program is as follows: Federal law grants an office of GSA, the Federal Supply Service (FSS), authority to issue solicitations and award contracts for the provision of commercial products and services to federal agencies. The FSS carries out this task by negotiating contracts for space, goods and services with providers. It then places these contracts on a "schedule," from which customer agencies may select a contractor based on their determination of where they can obtain the best value. Agencies are not required to use the FSS-negotiated schedules; they may contract for services independently. The advantage of FSS schedules is that they often offer better deals to government agencies by offering lower prices gained through large volume contracts and sparing agencies the time and expense of independent procurement.

In 1994-95, Congress ceased funding FSS through the appropriations process and instead directed the agency to establish an "industrial funding" system through which customers would fund FSS's services. FSS accordingly established a system under which participating contractors are required to remit to FSS an "industrial funding fee" (IFF) of one percent of the contract amount. See 48 C.F.R. 552-238-77.¹

In January 2000, in response to requests from customer agencies, FSS added a line item for legal services to an already existing schedule for financial asset services. This schedule provides services to help agencies manage and dispose of financial assets such as loans and real and personal property—to provide, for example, the kind of short-term, concentrated financial and legal services the Small Business Administration might need in order to conduct an asset sale to dispose of ten thousand loans at one time. This introduction of legal services on a FSS schedule did not require government agencies to use legal services contracted for through FSS. Agencies remain free to negotiate independently for legal services, but can gain significant efficiency advantages by taking advantage of FSS schedule contracts.

Under the FSS's standard procedures, a law firm that bids to participate on a schedule contract to provide legal services to a government agency in connection with financial asset management would be obligated to pay the one percent IFF for all legal work thereby obtained. A law firm has asked whether participation in a FSS service contract would violate D.C. Rule of Professional Conduct 5.4(a), which prohibits lawyers from "sharing" legal fees with non-lawyers.

Discussion

The D.C. Rules of Professional Conduct allow lawyers to "participate in lawyer referral programs and pay the usual fees charged by such programs." Rule 7.1, Comment [6]. Rule 7.1(b)(5) further provides that a lawyer who uses an intermediary to obtain legal work must take reasonable steps "to ensure that the potential client is informed of (a) the consideration, if any, paid or to be paid by the lawyer to the intermediary, and (b) the effect, if any, of the payment to the intermediary on the total fee to be charged." It is thus clear that a lawyer can participate in a government-run schedule program for legal services, and pay "the usual fee" charged by this program, provided that the lawyer takes reasonable steps to inform government clients obtained through such a program of the existence of the fee and the effect, if any, of that fee on the government clients' legal fees.

D.C. Rule of Professional Conduct 5.4, however, prohibits lawyers from "sharing" fees with non-lawyers. Comment [1] to Rule 5.4 explains that the purpose of this prohibition is "to protect the lawyer's professional independence of judgment." In Opinion No. 286, this Committee examined the interaction between D.C. Rules 7.1 and 5.4. As we there explained, "[a] non-contingent payment for the referral of legal business, i.e., one that is paid regardless of the success or outcome of the representation, is not a division of legal fees." "On the other hand," we decided, "the payment of a contingent referral fee, tied to the amount of the lawyer's fees or recovery on behalf of the client, . . . is more akin to a commission, which directly reduces the fee income of the lawyer making the payment." Thus, we reasoned, the lawyer is, "in practical effect, paying some of the proceeds of a specific legal representation to another person," thus constituting impermissible "sharing" of fees with a non-

lawyer intermediary.

The question here, then, is whether the IFF, in being based on a percentage of “the fee income of the lawyer making the payment,” constitutes impermissible fee sharing.² We conclude that IFF does not constitute impermissible fee sharing, for a number of reasons. First, FSS is an established, organizational referral service rather than an individual third-party intermediary. Comment [6] to D.C. Rule 7.1 distinguishes between a “recognized or established agency or organization” offering a “lawyer referral program,” to which a lawyer may “pay the usual fees charged by such programs,” on the one hand, and “payments to intermediaries to recommend the lawyer’s services,” with respect to which “special considerations arise,” on the other. This comment suggests that the drafters of the D.C. Rules were not particularly concerned about the manner in which non-profit lawyer referral services structured their fee arrangements; their principal focus was on preventing non-lawyer intermediaries from using their power over lawyers who rely on them for business referrals to influence those lawyers’ “professional independence of judgment.” D.C. Rule 5.4, Comment [1]. Indeed, we see the development of referral schemes that do not compromise lawyers’ independence as a positive development, though we recognize that our Rules are less clear than they could be on this issue.

Lacking the benefit of complete clarity in our own rules, we turn for additional insight to the opinions of other jurisdictions. A great many opinions from other jurisdictions support the conclusion that lawyers’ payment of a fee linked to the legal bills generated through their participation in a non-profit, government-approved referral service is permissible, provided that the fee arrangement appears to be a reasonable means of funding the costs of running the referral service.

The ABA Committee on Professional Ethics and Grievances reached this conclusion as early as 1956, in response to a query from the ABA Standing Committee on Lawyer Referral Services as to whether a bar association could operate a lawyer referral service financed “either by a flat fee or a sliding scale charge based on the fees derived [by participating lawyers] from the cases referred to them.” In an opinion authored by Henry Drinker, the Committee held that such an arrangement would not violate Canon 34, the then-existing fee splitting prohibition, concluding that “[r]egistrants may be required to contribute to the expense of operating [the referral plan] . . . by a reasonable percentage of fees collected by them.” ABA Formal Op. 291 (1956). The ABA Committee on Ethics and Professional Responsibility reiterated this conclusion in 1968, when it gave approval to several proposed schemes for financing a lawyer referral service including remittance of “a reasonable percentage of the fees earned” through use of the service and assessment of “a forwarding fee, ranging from 10% to 25%, of the fee collected by the attorney.” See ABA Informal Op. 1076 (1968).

Following these ABA opinions, many state legal ethics committees reached similar conclusions. The Michigan State Bar Committee on Professional Ethics, for example, approved a lawyer’s participation in a not-for-profit referral service registered with the state bar that charged a percentage of the fee collected by the lawyer, reasoning that, so long as participating lawyers in a bar association referral service are not subject to “undue influence, the professional judgment of the lawyer is not interfered with and the rule against fee-splitting with nonlawyers is not violated.” Michigan State Bar Comm. on Prof. and Judicial Ethics, Op. RI-75 (1991).³

Another comprehensive opinion is Pennsylvania Bar Ass’n Ethics Op. 93-162 (1993), which collects many other ethics committee opinions approving bar associations’ use of referral fees based on a percentage of lawyers’ fees obtained through the service. The Pennsylvania opinion also examines statistics from the ABA Standing Committee on Lawyer Referral and Information Services, which indicate that, in 1989, twenty-two states and localities used “earned fee” financing to support bar association referral services. The Committee reasoned that such widespread implementation of earned fee financing shows that this funding mechanism falls within the “acceptable usual charges of a not-for-profit lawyer referral service” under Pennsylvania Rule of Professional Conduct 7.2(c). It further reasoned that this specific quoted language took precedence over the more general fee splitting prohibition of Pa. Rule of Professional Conduct 5.4(a). A similar interpretation of the language of D.C. Rules 7.1 and 5.4 can be made here, as already noted above. See D.C. Rule 7.1, Comment [6].

Both the Michigan and Pennsylvania Committees found persuasive on public policy grounds *Emmons v. State Bar of California*, 6 Cal. App. 3d 565, 86 Cal. Rptr. 367 (Ct. App. 3d Dist., 1970), in which the court concluded that the evils created by lawyer fee splitting with non-lawyers are not present in the case of lawyer referral services. As the *Emmons* court explained:

There are wide differences—in motivation, technique and social impact—between the lawyer reference service of the bar association and the discreditable fee-splitting features in the disciplinary decisions. Prohibited fee-splitting between lawyer and layman carries with it the danger of competitive solicitation; poses the possibility of control by the lay person, interested in his own profit rather than the client’s fate; facilitates the lay intermediary’s tendency to select the most generous, not the most competent, attorney.

6 Cal. App. 3d at 573-74; 86 Cal. Rptr. at 372 (internal citations omitted). The court held that none of these dangers is present where a referral service

seeks not individual profit but the fulfillment of public and professional objectives. It has a legitimate, nonprofit interest in making legal services more readily available to the public. When conducted within the framework conceived for such facilities, its reference service presents no risks of collision with the objectives on the canons of fee splitting and lay interposition.

6 Cal. App. 3d at 574; 86 Cal. Rptr. at 372-73.

We are likewise persuaded by this reasoning. FSS is a nonprofit service aimed at achieving important public policy objectives, including holding down the cost to taxpayers of legal services provided to government agencies. It presents no risks of interfering with participating lawyers' independent professional judgment. To be sure, all the opinions we have cited deal with referral plans operated by bar associations, rather than by a government agency. Nevertheless, we find their underlying rationale equally compelling here.⁴ The IFF, established under congressional direction, is a reasonable means of funding a non-profit service to assist government agencies in obtaining lower cost legal services, just as the bar associations' referral services provide less costly legal services to the general public. Given the nonprofit, public interest motivation underlying both arrangements, we see no more potential for the kinds of abuses at which D.C. Rule 5.4 is aimed in one context than in the other.

The reasonableness of the one percent IFF charge further supports our conclusion. This percentage appears small when compared to the percentages found reasonable in other legal ethics committee opinions we examined.⁵ The fact that government agencies can choose whether or not to use the FSS schedule in contracting for legal services provides still further indication that the IFF is reasonable. If the agency can negotiate a lower fee for legal services by approaching a law firm that is not on the FSS schedule, the agency is free to do so. It thus seems safe to assume that to the extent that agencies opt to use FSS schedules to obtain legal services, FSS offers a reasonable, cost-effective means for government agencies to contract for legal services.⁶

Of course, as we noted at the outset, under Rule 7.1(b)(5) lawyers participating in a referral service, including the FSS scheme we are examining here, must comply with the requirement to take reasonable steps "to ensure that the client is informed of (a) the consideration, if any, paid by the lawyer to the intermediary, and (b) the effect, if any, of the payment to the intermediary on the total fee to be charged." Thus, under Rule 7.1(b)(5), lawyers must disclose to their government agency client their payment of the one percent IFF and the effect of doing so, if any, on their legal fee.

Inquiry No. 01-1-1

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1. 48 C.F.R. 552-238-77(a) states that "The IFF reimburses the GSA Federal Supply Service for the costs of operating the Federal Supply Schedules Program and recoups its operating costs from ordering activities."
2. We assume for purposes of this opinion that attorneys participating in the FSS program meet all other qualifications and conditions for providing legal services to the clients at issue and we consider the FSS program only with regard to the IFF funding mechanism, as described above, and not with regard to any other of its requirements.
3. See also California State Bar Ethics Op. 1983-70 (1983) (attorney may pay approved lawyer referral service a fee based on percentage of fees collected but may not raise fee charged to client to cover referral charge); Chicago Bar Ass'n Prof. Resp. Comm., Op. 87-1 (1987) (lawyer may pay a percentage of the fee collected to bar association-sponsored lawyer referral service in order to cover the expense of operating the service, provided fee is limited to one that is reasonable) Arkansas Bar Association Op. 95-01 (1995) (bar association referral service may require participating attorney to pay a percentage of fees produced by clients where increase in revenue produced for bar association will help maintain this public service).
4. *Contra* Ohio Sup. Ct. Bd. Of Comm'rs on Grievances and Discipl., Op. 95-6 (1995) (disapproving payment of fee based on a percentage of legal fee earned from client referred by a non-profit service that was *not* affiliated with a bar association). This opinion is distinguishable, however, because Ohio Rule Code of Professional Responsibility DR 2-103 differs from D.C. Rule 7.1 in specifically prohibiting lawyers from paying *any* type of fee to a referral service other than a bar association.
5. See, e.g., *Emmons v. State Bar of California*, 6 Cal. App. 3d at 568, 86 Cal. Rptr. at 368 (referral fee of one third of fee received); Vermont Advisory Ethics Op. 87-12 (1987) (lawyer expected to pay 10% of any fee received); Calif. St. Bar Ethics Op. 1983-70 (1983) (10% of all fees collected over a \$300 minimum); ABA Informal Op. 1076 (10% to 25% of the fee collected by the attorney).
6. We thus need not reach the issue of whether lawyers may "pass through" a referral service fee to clients in the form of increased charges for legal services. Many bar associations have been adamant in disallowing this practice. See, e.g., California Opinion 1983-70, *supra*; Michigan Op. RI-75, *supra*; Pa. Ethics Op. 93-162, *supra*. In light of the voluntary and competitive nature of the FSS contracting scheme, there appears to be little danger that the IFF fee results in higher legal bills to government clients. Indeed, the very purpose of FSS is to provide agencies with contract options through which they may be able to obtain *lower* prices for legal services. Lawyers must, of course, take into account their obligation to pay the IFF in negotiating a rate for legal services with FSS, but will have incentives not to pass through this cost in their billing rate in order to present a competitive proposal.

We also note, relatedly, that this case, in which lawyers are responsible for submitting referral service fees, differs from the situation presented in our recent Opinion 302, where we decided that Rule 5.4 was not implicated where a client *directly* pays a fee to use a legal services bidding system. Where it is the lawyer's responsibility to submit a referral service fee based on a percentage of the legal fees earned, D.C. Rules 5.4 and 7.1 apply. The lawyer cannot claim to be merely remitting the fee on behalf of the client.