

1 Honorable Christopher Staring, Chair
2 Arizona Supreme Court Ethics
3 Advisory Committee
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8 **IN THE SUPREME COURT**
9 **STATE OF ARIZONA**

10 In the Matter of:

Supreme Court No. R-22-

11 **PETITION TO AMEND RULE 42**
12 **(ER 1.5), ARIZ. R. SUP. CT.**

13 **EXPEDITED CONSIDERATION**
14 **REQUESTED**

15 Pursuant to Rules 28 and 42.1(b)(2) of the Arizona Supreme Court Rules, the
16 Petitioner, the Arizona Supreme Court Ethics Advisory Committee (the
17 “Committee”), petitions the Court to amend ER 1.5, Fees, to define a lawyer’s ethical
18 obligations when dividing a client’s fee with a person or entity outside of the
19 lawyer’s firm.

20 The Committee further requests, pursuant to Rule 28(h)(1) of the Arizona
21 Supreme Court Rules, the Court’s consideration of this petition at the August 2022
22 Rules Agenda. The Committee deals with matters of statewide importance to
23 members of the legal profession and consumers of legal services. Consideration of
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1 this petition during the August 2022 Rules Agenda would provide necessary
2 guidance to Arizona lawyers regarding their fee-sharing obligations under the
3 recently revised Arizona Rules of Professional Conduct. The emergence and
4 continued expansion of Alternative Business Structures further necessitates timely
5 guidance on fee sharing between lawyers and nonlawyers.
6

7 **I. Background.**

8 This rule-change petition addresses gaps and inconsistencies created by the
9 amendment and abrogation of several Arizona Rules of Professional Conduct
10 (“Rules” or “ERs”) by Arizona Supreme Court Orders R-20-0030 and R-20-0034.
11 Specifically, this proposed rule change clarifies a lawyer’s ethical obligations when
12 dividing a client’s legal fee with a person or entity outside of the lawyer’s firm.
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15 This petition arises from ethics opinion request EO-21-0001, filed with the
16 Committee on June 16, 2021. The requester sought guidance regarding a lawyer’s
17 ethical obligations when dividing a client’s fee with another lawyer who provides a
18 referral but otherwise is not involved in the client’s representation. The requester
19 noted that the amended Rules now permit lawyers: (1) to receive referral fees
20 without performing work or being jointly responsible for the client’s
21 representation; (2) to pay referral fees to anyone, lawyer or nonlawyer, and (3) to
22 share legal fees with nonlawyers, both within and outside of a lawyer’s firm.
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1 Moreover, the requester noted the absence of explicit guidance regarding client
2 notice and consent with regard to referral fees and fee sharing.

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4 The Committee evaluated this opinion request in light of the existing Rules,
5 case law, and ethics opinions. The Committee concluded that the absence of
6 guidance created by the abrogation of several ERs would be best addressed by a
7 rule-change petition rather than an ethics opinion. Therefore, the Committee now
8 files this petition to amend the Rules to require client notice and consent anytime a
9 lawyer divides the client's fee with a person or entity outside of the lawyer's firm.¹
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11 **II. Purpose of the Proposed Amendment.**

12 Prior to January 1, 2021, Arizona lawyers were not allowed to pay for
13 referrals.² The only exception was contemplated by ER 1.5(e). This provision
14 allowed lawyers to divide a client's fee with lawyers outside of their firms,
15 typically in situations where a lawyer referred a client to a trial specialist in
16 exchange for a percentage of the fee.³ However, the referring lawyer had to either
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20 ¹ This petition addresses only situations where a lawyer divides a client's fee with someone
21 outside of the lawyer's firm. The petition does not address a lawyer's ethical obligations when
22 paying referral fees in any other manner, such as a flat payment not tied to the amount of fees the
23 lawyer earns.

24 ² ER 7.2(b) prohibited lawyers from providing anything of value in exchange for a
25 recommendation of the lawyer's services. ARIZ. RULES OF PRO. CONDUCT ER 7.2(b), *abrogated*
by Ariz. Sup. Ct. Ord. R-20-0030.

³ ARIZ. RULES OF PRO. CONDUCT ER 1.5 cmt. 8 ("A division of fee facilitates association of more
than one lawyer in a matter in which neither alone could serve the client as well, and most often
is used when the fee is contingent and the division is between a referring lawyer and a trial
specialist."), *abrogated by* Ariz. Sup. Ct. Ord. R-20-0034.

1 accept joint responsibility for the representation or had to be paid in proportion to
2 the work performed.⁴ In other words, Arizona lawyers could not pay a referral fee
3 that would allow a referring lawyer to be paid solely for the referral, with no
4 additional work or responsibility to the client.
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6 On January 1, 2021, several changes took effect to the ERs. The Arizona
7 Supreme Court adopted these changes based on the report and recommendations
8 by the Court’s Task Force on the Delivery of Legal Services (“LSTF Report”).⁵
9 Changes to ER 1.5(e) eliminated the requirement that a lawyer dividing a fee with
10 another lawyer either take joint responsibility for the representation or be paid in
11 proportion to their work. Instead, the amended ER 1.5(e) now states:
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13 (e) Two or more firms jointly working on a matter may divide a fee
14 paid by a client if:
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- 16 (1) the firms disclose to the client in writing how the fee will be
17 divided and how the firms will divide responsibility for the
18 matter among themselves;
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23 ⁴ *Id.* ER 1.5(e), *abrogated by* Ariz. Sup. Ct. Ord. R-20-0034.

24 ⁵ Ariz. Sup. Ct. Task Force on the Delivery of Legal Servs., *Report and Recommendations* (Oct.
25 <https://www.azcourts.gov/Portals/74/LSTF/Report/LSTFReportRecommendationsRED10042019.pdf?ver=2019-10-07-084849-750> [hereinafter LSTF Report].

1 (2) the client consents to the division of fees in a writing signed by
2 the client:

3 (3) the total fee is reasonable: and

4 (4) the division of responsibility among firms is reasonable in light
5 of the client's need that the entire representation be completely
6 and diligently completed.
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9 Notably, the amended ER 1.5(e) now applies when two or more firms divide
10 fees when “jointly working on a matter.” Thus, the language of ER 1.5(e) appears
11 to expressly exclude situations where one firm merely refers a client to another
12 firm, with no further involvement or responsibility. Moreover, ER 1.5(e) applies
13 only to division of fees between “firms,” defined in ER 1.0(c) as “a lawyer or
14 lawyers in any affiliation, or any entity that provides legal services for which it
15 employs lawyers.”⁶ Therefore, ER 1.5(e) does not apply to division of fees
16 between a lawyer and a nonlawyer, or between a lawyer and an entity that does not
17 provide legal services.
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20 Concurrently with the amendment to ER 1.5(e), other changes to the Rules
21 created new possibilities for Arizona lawyers to pay referral fees to nonlawyers.
22 These changes included the elimination of ER 7.2(b)’s longstanding prohibition on
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⁶ ARIZ. RULES OF PRO. CONDUCT ER 1.0(c).

1 paying anything of value to a person who recommends a lawyer’s services and the
2 elimination of ER 5.4’s prohibition on sharing legal fees with nonlawyers. With
3 these eliminations, Arizona lawyers may now ethically pay nonlawyers for
4 referrals, and may do so by sharing legal fees.
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6 With the abrogation of ERs 5.4 and 7.2, the Rules do not expressly require
7 that a lawyer obtain a client’s informed consent to paying a referral fee, nor do the
8 Rules expressly require a lawyer to obtain a client’s informed consent before
9 sharing a client’s legal fee with a nonlawyer outside the lawyer’s firm, whether as
10 compensation for a referral or for another reason.⁷
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12 **III. Content and Rationale for the Proposed Amendment.**

13 The Committee recognizes that ER 1.5(e) was amended for a specific
14 purpose. As stated in the LSTF Report, ER 1.5(e) was amended to specify that its
15 fee-sharing requirements apply to two or more firms jointly working on a client’s
16 matter.⁸ Therefore, this petition does not seek to amend the current language of ER
17 1.5(e). Rather, this petition proposes a new subsection, ER 1.5(f), which states:
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22 ⁷ For example, Arizona Ethics Opinion 20-0003 held that a lawyer may ethically enter into a fee-
23 financing arrangement where a lender retains a portion of the client’s fee to cover the lender’s
24 collection management costs, as long as the lawyer obtains the client’s informed consent to the
25 arrangement. Ariz. Sup. Ct. Ethics Op. 20-0003 (Aug. 25, 2021),
<https://www.azcourts.gov/Portals/26/AEA%20Committee/Issued%20Opinions/EO-20-0003.pdf?ver=2021-08-30-113057-927>.

⁸ LSTF Report, *supra* note 5, at 17.

1 (f) A firm may divide a client’s legal fee with another firm, person, or
2 entity outside of the firm under circumstances other than those
3 governed by 1.5(e) if:

4 (1) the firm discloses to the client in writing how the fee will be
5 divided with the other firm, person, or entity;

6 (2) the client consents to the division of fees in a writing signed by
7 the client before or within a reasonable time after commencing
8 the representation; and
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10 (3) the total fee is reasonable.
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12 The proposed ER 1.5(f) would not diminish an Arizona lawyer’s ability to
13 pursue innovative business opportunities as contemplated by the LSTF Report.⁹

14 Arizona lawyers may still divide client fees with individual referral sources,
15 commercial lawyer referral services, lead generators, fee-financing lenders, and the
16 like. However, no matter how innovative, the practice of law in Arizona remains a
17 profession and not a “mere money getting trade.”¹⁰ Arizona lawyers must still
18 place a client’s interests before their own business interests.
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24 ⁹ *Id.* at 10 (identifying former ER 5.4’s prohibition on sharing fees with nonlawyers as “a barrier
25 to innovation in the delivery of legal services”).

¹⁰ *In re Swartz*, 141 Ariz. 266, 273 (1984).

1 Dividing a client's fee with someone outside of the firm creates a risk to
2 clients. A lawyer may increase overall billings as a means of compensating for the
3 fee-sharing arrangement. In a contingent fee representation, a lawyer may be
4 influenced by the fee-sharing arrangement in counseling a client to accept or reject
5 offers of settlement. These risks are further enhanced by a client's lack of
6 specialized legal knowledge and inability to monitor the lawyer's actions.¹¹

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9 Transparency mitigates this risk. A client who knows that her legal fee will
10 be divided with someone outside the firm will be better equipped to evaluate
11 settlement offers and the overall reasonableness of the lawyer's fees. Requiring
12 client notice and consent strikes an appropriate balance between the client's
13 interests and the lawyer's. The requirements of ER 1.5(f) impose a minimal burden
14 on Arizona lawyers, who can obtain client consent as part of their written fee
15 agreement with the client.¹²

17 Furthermore, the proposed ER 1.5(f) comports with national ethical norms.
18 Every U.S. jurisdiction permits fee sharing to some degree. Many jurisdictions
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22 ¹¹ In economics, this is known as the principal-agent problem. The agent may act in the agent's
23 best interest rather than the principal's; this problem is exacerbated when the agent has more
24 information than the principal. The problem may be mitigated in several ways, such as by
25 decreasing asymmetry of information and allowing the principal opportunities to monitor the
agent. *E.g.*, Bengt Holmstrom, *Moral Hazard and Observability*, 10 BELL J. ECONOMICS 74-91
(Spring 1979), <https://www.gwern.net/docs/economics/1979-holmstrom.pdf>.

¹² ARIZ. RULES OF PRO. CONDUCT ER 1.5(b) (requiring written fee agreements).

1 have adopted verbatim American Bar Association Model Rule 1.5(e), which
2 permits fee sharing among lawyers not in the same firm only when the lawyers
3 divide the fee in proportion to work performed or share joint responsibility for the
4 representation.¹³ Others, such as California, Kansas, and Michigan, permit fee
5 sharing among lawyers *without* a concurrent requirement of proportional work or
6 joint responsibility, thereby allowing lawyers to pay each other solely for
7 referrals.¹⁴ Nonetheless, all jurisdictions require the lawyer to obtain the client’s
8 agreement to the fee-sharing arrangement.¹⁵

11 Lastly, informing the client of the fee-sharing arrangement ensures the
12 client’s right to legal representation of her choice. Even in fee-sharing
13 arrangements where the total fee is reasonable, the client may end up paying a
14 higher fee than she would have to a lawyer who was not dividing her fee with
15 someone else.¹⁶ As noted in the Restatement (Third) of the Law Governing
16 Lawyers, “[t]he remedy of the client . . . lies in rejecting the arrangement and
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20 ¹³ MODEL RULES OF PRO. CONDUCT r. 1.5(e) (Am. Bar Ass’n 2021).

21 ¹⁴ See Am. Bar Ass’n Ctr. for Pro. Resp. Pol’y Implementation Comm., *Variations of the ABA*
22 *Model Rules of Professional Conduct, Rule 1.5: Fees* 7, 18, 27 (current as of August 2021),
https://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/mrpc-1-5.pdf.

23 ¹⁵ *Id.* For example, California requires client consent; Kansas requires that the client “not object
24 to the division,” and Michigan requires the client “not object to the participation of all the
25 lawyers involved.” *Id.*


¹⁶ RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 47, *Fee-Splitting Between*
Lawyers Not in the Same Firm, cmt. f (Am. L. Inst. 2000) (noting that “there will usually be a
range of total fees satisfying the reasonableness requirement . . .”).

1 retaining a single lawyer at a lower fee.”¹⁷ This remedy is available only when
2 clients are informed that the lawyer intends to divide their fee with someone
3 outside the firm.
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5 **IV. Conclusion.**

6 The Petitioner respectfully requests that the Court adopt the proposed rule as
7 set forth in Appendix A. In the alternative, Petitioner requests that the Court refer
8 the matter back to the Committee with directions. Opinion Request EO 21-0001 is
9 attached.
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11 RESPECTFULLY SUBMITTED this 31 day of January, 2022.
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13 
14 /s/ _____
15 Judge Christopher Staring
16
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18 Electronic copy filed with the
19 Clerk of the Supreme Court of Arizona
20 this 31 day of January, 2022.

21 by: E. Ashleigh Hansen
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25 _____
¹⁷ *Id.*

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APPENDIX A

Rule 42, Arizona Rules of Supreme Court Ethical Rule 1.5

(Proposed addition is underlined)

ER 1.5 Fees

(a) through (e) [no changes.]

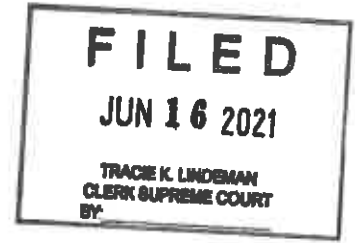
(f) A firm may divide a client's legal fee with another firm, person, or entity outside of the firm under circumstances other than those governed by 1.5(e)

if:

- (1) the firm discloses to the client in writing how the fee will be divided with the other firm, person, or entity;
- (2) the client consents to the division of fees in a writing signed by the client before or within a reasonable time after commencing the representation; and
- (3) the total fee is reasonable.

Comment [2021 Amendment]

Comments [1] through [8] [no changes.]



June 16, 2021

Arizona Attorney Ethics Advisory Committee
c/o Supreme Court of Arizona
Court Clerk's Office
1501 West Washington, Suite #402
Phoenix, AZ 85007-3231

Re: Ethics Opinion Request – Rule 1.5(e)

Dear Chair McMurdie and Members:

Pursuant to Arizona Supreme Court Rule 42.1 I respectfully request guidance from the Attorney Ethics Advisory Committee regarding an interpretation of amended Arizona Rule of Professional Conduct, Ariz.R.S.Ct. 42 (“ERs”) 1.5(e) as it may or may not apply to an Arizona lawyer who wants to pay another Arizona lawyer a percentage of legal fees simply for the referral of a case.

As you know, effective on January 1, 2021, among other changes, the Arizona Supreme Court eliminated ER 7.2(b)(giving anything of value for recommending a lawyer) and ER 5.4(sharing legal fees with nonlawyers). One of the consequences of these changes is that Arizona lawyers now may pay for referrals of cases. This change was an intentional update of the Rules to afford lawyers more flexibility in disseminating information about the availability of legal services. Moreover, there was no discipline data suggesting that there is a significant problem with lawyers taking cases they should not (either for competence or diligence reasons) just because they pay a referral fee to someone.

Under the 2021 amendments to the Ethical Rules, Arizona lawyers are not required to disclose to clients when they pay a referral fee to a *nonlawyer*. There is no requirement to make such a disclosure. Rule 7.2(b)'s antiquated prohibition against giving “anything of value” was eliminated, in part, because, as the *Petition to Amend Rules 7.1 to 7.5, R-20-0030*, at p. 3-4 explained:

Anecdotally, it has been observed that this provision is violated daily because, taken literally, this provision prohibits taking an existing client golfing to say thank you for a referral or giving a firm paralegal a gift card or sending flowers for referring a family member to the firm. Similarly, there are many ethics opinions issued both in Arizona² and around the United States that provide convoluted attempts to distinguish between what is permissible “group advertising” versus what is an impermissible “referral service.” Not only do these technical interpretations serve no productive regulatory purpose,

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AEAC Request on ER 1.5(e)

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but the unnecessary complexity in the regulations stifles lawyers' ability to embrace more efficient online marketing platforms for fear the website or service may be deemed a for-profit referral service.

² See State Bar of Ariz. Ops.05-08 (2005), 06-06 (2006); 10-01 (2010), and 11-02 (2011).

A client really does not care who receives a portion of a legal fee, or that a lawyer paid for a referral – as long as the overall fee charged to the client for the actual legal services is “reasonable” under the factors set forth in ER 1.5(a).

However, even though lawyers do not need to disclose to clients the sharing of a legal fee with a *nonlawyer*, it is unclear whether Arizona lawyers nevertheless must comply with ER 1.5(e) when sharing a fee for a referral with another *lawyer*.

The most common situation is that Lawyer “A” speaks with a potential client about a legal matter that Lawyer A does not handle. Lawyer A informs prospective client that Lawyer “B” – at another firm – does handle the type of legal matter for which client needs representation. Lawyer A merely refers potential client to Lawyer B and for that referral Lawyer A now (post-January, 2021) wants to receive a portion of the legal fees Lawyer B earns on the case.

Historically, because of the prohibition in ER 7.2(b) against giving “anything of value” to someone for recommending a lawyer, lawyers in Arizona could only pay for a referral if Lawyer A was willing to be “jointly responsible” for the case with Lawyer B. See *Ariz. Op. 04-02* (Arizona lawyers may not pay straight referral fees – they must follow ER 1.5(e)).

As of January, 2021 ER 7.2(b) is gone and ER 1.5(e), as amended, provides:

(e) Two or more firms jointly working on a matter may divide a fee paid by a client if:

(1) the firms disclose to the client in writing how the fee will be divided and how the firms will divide responsibility for the matter among themselves;

(2) the client consents to the division of fees in a writing signed by the client;

(3) the total fee is reasonable; and

(4) the division of responsibility among firms is reasonable in light of the client's need that the entire representation be completely and diligently completed.

ER 1.5(e) clearly contemplates that two firms are “jointly working on a matter.” This is *not*, however, what is contemplated when Lawyer A refers a case to Lawyer B and Lawyer A just wants to receive a portion of Lawyer B’s fees, simply for the referral. In other circumstances where lawyers are not “jointly” responsible for a case, the Rule does not apply. For instance, when lawyers change firms (and their prior firm wants a portion of the fees ultimately earned) and clients terminate one firm to retain another firm, ER 1.5(e) does not apply. See, e.g., *ABA Op. 487* (2019) (“The successor counsel is not bound by the requirements of Rule 1.5(e), either at the time of engagement or upon a recovery, because Rule 1.5(e) addresses situations where two lawyers are working on a case together, not situations where one lawyer is replacing another.”).

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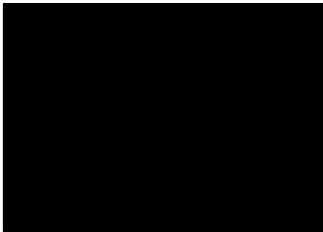
Similarly, if Lawyer B did not give Lawyer A any portion of the legal fees earned on the matter, but instead Lawyer B paid Lawyer A just a flat amount that was not tied to the amount of fees earned on the referral, ER 1.5(e) would not be implicated at all.¹

Accordingly, there are at least two arguments to find that ER 1.5(e) should not apply to the situation when one Arizona lawyer wants to be paid for referring a case to another lawyer: 1) the referring lawyer will *not* be jointly responsible for the matter; and 2) lawyers do not need to disclose to clients if the lawyer pays a referral fee to a *nonlawyer*. Why then should a lawyer be required to disclose if they are paying a referral fee to another lawyer? As long as the overall fee is reasonable for the work performed, the client is protected.

Nevertheless, I inquire of the Committee whether Arizona lawyers still need to comply with ER 1.5(e) when simply paying a portion of the fees earned on a matter to another lawyer, in a different firm, just for referring the case.

The Committee's guidance on this issue would be useful for the Arizona legal community. If you have any questions about this issue, I would be happy to discuss them with the Committee.

Best regards,



¹ Inquiries regarding the interpretation of these Rule changes indicate that Arizona lawyers are not willing to just pay a flat amount for a referral, but instead would like the option of offering a percentage of earned fees to the referring lawyer. Hence the need for this opinion request.