

New York State Bar Association

Committee on Professional Ethics

Opinion 679 - 1/10/96 (43-95)

Topic: Fee Sharing with Non-Lawyer; Class Actions

Digest: Lawyer may pay client out of the lawyer's own funds for researching information about a potential class action provided client remains ultimately liable to repay such expenses. Lawyer may not compensate client for investigatory services based on a percentage of court-awarded legal fees.

Code: DR 2-103(B); DR 2-106(A); DR 3-102(A); DR 5-103(B); DR 7-109(C); EC 3-3; EC 3-8.

QUESTIONS

A potential client approached the inquirer with information regarding a potential class action lawsuit. The individual has spent time investigating the matter, and is prepared to continue doing so if he can be compensated for such effort. He also seeks compensation for the work he has already performed.

1. May the inquirer compensate the individual out of the inquirer's own funds?
2. May the inquirer agree to seek compensation for the individual as part of the inquirer's fee request to the court where that compensation is based on a percentage of the legal fees requested?

OPINION

The Committee's jurisdiction is limited to matters of professional ethics. This opinion does not address any issue of substantive or procedural law that may be implicated by the inquiry.

Question 1

The first part of this inquiry concerns the lawyer's proposal to pay the putative class member for investigatory services out of the lawyer's own funds, without any obligation on the part of the client to reimburse the attorney in the event that the litigation fails to produce, from settlement or judgment, funds in sufficient amount to satisfy this expense of litigation. DR 5-103(B) of the Lawyer's Code of Professional Responsibility (the "Code") states:

While representing a client in connection with contemplated or pending litigation, a lawyer shall not advance or guarantee financial assistance to the client, except that:

1. A lawyer may advance or guarantee the expenses of litigation, including ... expenses of investigation, ... provided the client remains ultimately liable for such expenses.

By paying or agreeing to pay for investigation of facts about a class action suit, the inquirer is providing "financial assistance" to a potential client in connection with contemplated litigation within the meaning of the Disciplinary Rule. DR 5-103(B) permits a lawyer to provide financial assistance to a client, such as by advancing the expenses of investigation, only if "the client remains ultimately liable for such expenses." *Id.* Thus, the inquirer may pay his own client out of his own funds for investigatory services rendered in connection with the contemplated class action only if it is clearly understood that the client will be liable to reimburse such payments to the lawyer if the fruits of the litigation are inadequate to satisfy this expense.

Our conclusion assumes that the proposed compensation is for legitimate and valuable investigatory services performed by the client, and that the proposed payment represents the fair value of such services. If the payment is not bona fide compensation for services rendered or is intended to compensate the client for bringing the case to the inquirer, it would violate the prohibition in DR 2-103(B) against giving anything of value to a person for obtaining employment.

Question 2

The inquirer asks, alternatively, whether he can seek to compensate the individual through his eventual fee request to the court. Fees paid to attorneys in class action suits are subject to court approval. *See In re Presidential Life Secs.*, 857 F. Supp. 331 (S.D.N.Y. 1994); N.Y. CPLR § 909 (McKinney 1994). The inquirer proposes

to seek compensation for the individual in the fee request, and will not guarantee payment in violation of DR 5-103(B). If there is no fee award, the individual will receive nothing.

In issuing this opinion, the Committee does not intend to anticipate how a federal or New York state court will rule on any such fee request.

The Code provides that a lawyer "shall not share legal fees with a non-lawyer." DR 3-102(A). This broad, black-letter rule is intended to bar any financial arrangement in which a non-lawyer's profit or loss is directly related to the success of a lawyer's legal business. The purposes of the rule are to prevent the unauthorized practice of law, and to assure professional control over, and prevent any lay interference with, the representation of clients. EC 3-8.

This rule is specifically aimed at arrangements under which a non-lawyer is to receive a portion of a fee paid by a particular client or a stated portion of all fees paid. New York courts are generally strict when applying this rule. *See In re Friedman*, 196 A.D.2d 280, 609 N.Y.S.2d 578 (1st Dept.), *cert. denied*, ___ U.S. ___, 115 S.Ct. 81 (1994) (respondent engaged in fee sharing with a non-lawyer in violation of DR 3-102(A) by agreeing to pay a private investigator an hourly rate plus additional compensation contingent on success of litigation); *In re Shapiro*, 90 A.D.2d 22, 455 N.Y.S.2d 604 (1st Dep't 1982) (disciplinary proceeding against lawyer who was suspended by another state for various ethical violations, including paying a salary to a non-lawyer employee contingent on total fees earned); *Gorman v. Grodensky*, 130 Misc. 2d 837, 498 N.Y.S.2d 249 (Sup. Ct. N.Y. County 1985) (plaintiff, a non-lawyer, was hired by law firm engaged in debt collection work as office manager for a weekly salary plus one-third of the net profits; *held*, the compensation arrangement violated the fee sharing prohibition of DR 3-102 even though plaintiff's work was primarily of a business nature). The *Gorman* court stated: "It would appear, and this court holds, that the essence of 'fee splitting' is the sharing of profits on a percentage basis, rather than payment of a fixed compensation or salary." 130 Misc. 2d at 839, 498 N.Y.S.2d at 251.

As noted above, the rationale for the rule against fee sharing is to prevent non-lawyers, who are not subject to the same ethical and judicial constraints as lawyers, from having an incentive to influence the lawyer's professional judgment. *See* EC 3-3; *In re Friedman*, 196 A.D.2d at 292, 609 N.Y.S.2d at 584 (fee arrangement with private investigator contingent on outcome of case "created an incentive for [the investigator] to make that outcome eventually beneficial to him and created the incentive to influence the testimony of a witness"). Where a particular fee sharing arrangement does not create a risk of or incentive for lay interference, ethics committees have approved such arrangements notwithstanding DR 3-102(A). *See, e.g.*, N.Y. State 651 (1993) (attorney may pay to lawyer referral service a portion of fees received to cover organization's expenses); ABA 93-374 (1993) (attorney may pay to pro bono referral organization a portion of fees received to cover organization's expenses); ABA Inf. 1440 (1979) (law firm's compensation arrangement with its office administrator, including payment of a percentage of the net profits of the law firm, did not involve improper fee splitting "because the compensation relates to the net profits and business performance of the firm and not to the receipt of particular fees").

This rationale provides a means for distinguishing between situations that would and would not constitute improper fee sharing: Where the non-lawyer is engaging in tasks that provide the opportunity to influence a lawyer's professional judgment, the non-lawyer's compensation arrangement should not provide a motive to the non-lawyer to exercise such influence. If, however, neither the opportunity nor motive are present, the rule may not be implicated.

In the present inquiry, the individual, acting as an investigator, is in a position to influence the lawyer's professional judgment. In researching the facts relating to the basis of the class action suit, the individual will have the opportunity to be selective about which facts are disclosed and may be the first to contact potential witnesses. The individual, as a potential class member, has a strong motive to influence the case. Compensation based in any way on a percentage of the legal fees awarded would only add to this incentive and, therefore, is prohibited as an improper fee sharing arrangement.

The rule against fee sharing does not, of course, prevent a lawyer from paying employees or independent contractors for services rendered with funds derived from client fees. In N.Y. State 668 (1994), this Committee ruled that an attorney may pay an individual an hourly rate to conduct pre-trial fact-finding so long as (i) the client consents after full disclosure, (ii) the individual is not being compensated for his testimony at trial in violation of DR 7-109(C),¹ and (iii) the aggregate fee paid by the client to the individual and the attorney does not constitute an excessive fee in violation of DR 2-106(A). The inquirer could, accordingly, pay the non-lawyer investigator (and putative class member) a reasonable hourly rate or fixed amount for investigatory services out of fees awarded to the attorney.

We reiterate our earlier admonition that the compensation, particularly as it relates to research conducted prior to contact with the inquirer, must, in fact, be a *bona fide* payment for research and not payment by the inquirer to obtain the case or referrals of other class members. See DR 2-103(B) (“[a] lawyer shall not compensate or give anything of value to a person...to recommend or obtain employment by a client”).

CONCLUSION

¹ DR 7-109(C) states:

- C. A lawyer shall not pay, offer to pay, or acquiesce in the payment of compensation to a witness contingent upon the content of his or her testimony or the outcome of the case. But a lawyer may advance ...:
1. Expenses reasonably incurred by a witness in attending or testifying.
 2. Reasonable compensation to a witness for the loss of time in attending or testifying.
 3. A reasonable fee for the professional services of an expert witness.

A lawyer may not compensate a non-lawyer who is a potential client out of the attorney's own funds for researching a potential class action lawsuit unless the client remains liable to reimburse the lawyer for such compensation if the litigation proves unsuccessful. The lawyer may not compensate the non-lawyer based on a percentage of legal fees awarded. However, the non-lawyer/potential client may be compensated out of fees awarded by the court if such compensation is based on a reasonable hourly or fixed rate.
