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UNIFIED COURT SYSTEM
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A. GAIL PRUDENTI
Chief Administrative Judge

JOHN W. McCONNELL
Counsel

MEMORANDUM

March 18, 2013

TO: All Interested Persons

FROM: John W. McConnell

RE: Proposed amendment of the Rules of the Appellate Division relating to contingent fee computation in personal injury and wrongful death actions.

Attorneys practicing in the field of personal injury law have proposed an amendment of the Rules of the Appellate Division ("Rules") governing contingent fees in personal injury and wrongful death actions to permit an attorney's contingency fee to be calculated from the gross amount recovered in the action, before litigation expenses are deducted. The Rules currently mandate that an attorney's contingency fee be calculated from the net recovery, after litigation expenses are deducted.[1] In a memorandum in support of this proposal (Exh. A; "Memo"), the proponents have proffered the following arguments for consideration:

- The proposed method of calculation will provide greater incentives for attorneys to assume litigation costs, increase a lawyer's ability to effectively prosecute a claim on behalf of a client who is unable to underwrite essential costs, increase the likelihood that cases will be brought on behalf of indigent clients, and promote the lawyer's duty of loyalty to clients (Memo Exh. 1 ["Memorandum in Support of Clarifying Amendment to Judiciary Law § 488"], p. 3).

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[1] See 22 NYCRR § 603.7[e][3][1st Dept]; 22 NYCRR § 691.20[e][3][2d Dept]; 22 NYCRR § 806.13[c][3d Dept]; 22 NYCRR § 1022.31 [c][4th Dept]. The relevant language of the Appellate Division Rules is identical in all four Departments:

> [The attorney's contingency fee] percentage shall be computed on the net sum recovered after deducting from the amount recovered expenses and disbursements for expert testimony and investigative or other services properly chargeable to the enforcement of the claim or prosecution of the action.

- The current Rules are inconsistent with Judiciary Law § 488(2) (which permits a lawyer to advance or pay court costs and litigation expenses) because they effectively require an attorney to fund a portion of those litigation expenses (Memo, pp. 6-9).

- The Rules are inconsistent with Judiciary Law § 474, which provides that attorneys and clients are free to enter into fee agreements "not restrained by law . . . ." (Memo, pp. 9-10).

- The Rules "impermissibly create substantive law" (Memo, pp. 10-12).

- Inasmuch as Judiciary Law § 474-a(3) requires that contingent fees in medical, dental or podiatric malpractice be calculated on the "net sum recovered" after deducting expenses, but imposes no similar requirement in personal injury and wrongful death cases, the Rules are barred under the principle of inclusio unius est exclusio alterius (Memo, p. 2, n. 1).

- "Bar opinions and court decisions throughout the country [recognize] that basing a contingency calculation on gross recovery can be fair and ethical" (Memo, p. 12).

Persons wishing to comment on this proposal should e-mail their submissions to ADcontingfeerules@nycourts.gov or write to: John W. McConnell, Esq., Counsel, Office of Court Administration, 25 Beaver Street, 11th Fl., New York, New York 10004.

All public comments will be treated as available for disclosure under the Freedom of Information Law, and are subject to publication by the Office of Court Administration.

Comments must be received no later than May 22, 2013.

EXHIBIT A

ISSUE PRESENTED

Do the Appellate Division rules of all four Departments requiring that, in personal injury and wrongful death actions, an attorney's contingency fee be calculated from the *net* recovery after expenses are deducted violate the New York State Constitution because they are inconsistent with N.Y. Jud. Law §§ 474 and 488?

SHORT ANSWER

Yes. Because such rules reduce the portion of the recovery in which an attorney shares by the amount of the client's litigation expenses, and thus effectively require an attorney to fund a portion of those expenses, the rules are inconsistent with N.Y. Jud. Law §§ 474 and 488, which specifically permit attorneys to recover all such expenses and generally encourage freedom to contract between attorney and client. This inconsistency renders the rules unconstitutional. This inconsistency is particularly egregious because cases and ethics opinions in New York and other states have consistently found no impropriety in calculating the contingency fee based on the *gross* recovery.

ARGUMENT

I. BACKGROUND

Each of the four Appellate Divisions has adopted rules concerning the calculation of the contingency payment due to plaintiffs' attorneys in personal injury and wrongful death actions. These rules – which are identical in each of the four judicial departments – provide, in relevant part, that

> [The attorney's contingency fee] percentage shall be computed on the *net* sum recovered *after* deducting from the amount recovered expenses and disbursements for expert testimony and investigative or other services properly chargeable to the enforcement of the claim or prosecution of the action.

N.Y. COMP. CODES R. & REGS. tit. 22, §§ 603.7(e)(3); 691.20(e)(3); 806.13(c); 1022.31(c) (2009) (emphasis added). Hereinafter, these rules collectively shall be referred to as the Expense Rules.

The Expense Rules have no basis in New York statutes – indeed, they are inconsistent with them. Before being amended in 2006, the New York Judiciary Law did not address the calculation of expenses and disbursements in personal injury and wrongful death contingency actions.[1] As a result of the 2006 amendments, however, N.Y. Jud. Law § 488 ("Section 488") now permits lawyers to advance litigation expenses for their clients under certain circumstances and, more importantly for present purposes, to *recover* those expense payments, in full, as well. *See* N.Y. JUD. LAW § 488(2)(d) (2009) ("in [a contingency case], the fee paid to the attorney from the proceeds of the action *may include an amount equal to such costs and expenses*

[1] By contrast, the Legislature has adopted language identical to the Appellate Division rules concerning the calculation of contingency fees and expenses in medical, dental and podiatric malpractice actions. N.Y. JUD. LAW § 474-a(3) (2009).

incurred"). Neither Section 488 nor any other statute mandates the precise method by which an attorney's recovery is to be calculated from the total recovery in personal injury and wrongful death cases. In the absence of such legislative directive, the attorney's rights are governed by Section 474 of the Judiciary Law ("Section 474"), which provides that "[t]he compensation of an attorney or counsellor for his services is governed by agreement, express or implied, which is not restrained by law..." N.Y. JUD. LAW § 474 (2009). Crucially, the only method of calculating the contingent recovery that allows an attorney to fully recover her expenses without reducing the contingent payment – as Section 488 permits – is to allow the contingency to be calculated on the gross amount, and to deduct expenses thereafter.

Under the current regime, an attorney who wishes to structure such an arrangement with her client potentially faces judicial and disciplinary sanctions. Although New York statutory law permits this agreement, the Expense Rules provide that, in personal injury and wrongful death actions, attorneys' fees must be calculated from the *net* recovery (i.e., after expenses are deducted from the client's total recovery). The effect of the Expense Rules is that the attorney contributes to the payment of the client's expenses from her contingency fees, regardless of whether the attorney and client have agreed otherwise. Because the Expense Rules are inconsistent both with the attorney's general right to contract freely with the client on fees under Section 474 and with the right to recover expenses in full under Section 488, they constitute an unconstitutional exercise of power by the Appellate Divisions. Moreover, by creating a substantive limitation on the way contingency fees may be calculated in personal injury and wrongful death cases, the Expense Rules impermissibly encroach upon the province of the Legislature. Accordingly, they must be invalidated.

II. THE EXPENSE RULES CONFLICT WITH NEW YORK STATUTES AND THUS VIOLATE THE NEW YORK STATE CONSTITUTION

A. The Court's Authority To Promulgate Rules Under the Constitution

The New York State Constitution (the "Constitution") delineates the authority to promulgate rules and regulations concerning court procedures:

> The legislature shall have the same power to alter and regulate the jurisdiction and proceedings in law and in equity that it has heretofore exercised. The legislature may, on such terms as it shall provide and subject to subsequent modification, delegate, in whole or in part, to a court, including the appellate division of the supreme court, or to the chief administrator of the courts, any power possessed by the legislature to regulate practice and procedure in the courts.[2] The chief administrator of the courts shall exercise any such power delegated to him or her with the advice and consent of the administrative board of the courts. Nothing herein contained shall prevent the adoption of regulations by individual courts *consistent with the general practice and procedure as provided by statute or general rules.*

N.Y. CONST. art. VI, § 30 (emphasis added). The Court of Appeals has held that "the language of the Constitution leaves little room for doubt that the authority to regulate practice and procedure in the courts lies principally with the Legislature." *Cohn v. Borchard Affiliations*, 25 N.Y.2d 237, 247 & 249, 303 N.Y.S. 633, 694-696 (1969) (noting that paucity of cases "in which a procedural statute has been found to be an unconstitutional infringement upon judicial prerogatives"). Nor, as the italicized words above show, does that language leave room for doubt that, absent a specific delegation of authority, court rules must be consistent with existing statutes.

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[2] Section 85 of the Judiciary Law authorizes the Appellate Division to promulgate rules of practice: "The appellate division of each department...from time to time may provide rules as it may deem necessary generally to promote the efficient transaction of business and the orderly administration of justice therein." N.Y. JUD. LAW § 85 (2009).

Accordingly, the Court of Appeals has held that court rules inconsistent with statutes are unconstitutional, particularly where such rules have substantive effect. For example, in *People v. Ramos,* 85 N.Y.2d 678, 681, 628 N.Y.S.2d 27, 29 (1995), the issue was whether the Appellate Division acted outside its rule-making authority by promulgating a rule requiring personal service of an appellate brief; in each of the three cases before the Court, the government's appeals had been dismissed for failure to personally serve the briefs pursuant to this rule. 85 N.Y.2d at 681-683, 628 N.Y.S.2d at 29-30. Noting that the Constitution permits only court rules "consistent with the general practice and procedure as provided by statute or general rules," the Court struck down the Appellate Division rule, holding that "a court may not significantly affect the legal relationship between litigating parties through the exercise of its rule-making authority." 85 N.Y.2d at 687, 628 N.Y.S.2d at 33 (citations omitted). *See also Gair v. Peck,* 6 N.Y.2d 97, 104, 188 N.Y.S.2d 491, 495-96 (1959) (if an Appellate Division rule "establishes substantive law applicable to but one segment of the State [*i.e.*, one group of lawyers handling a certain kind of case] ...it would be a fatal defect..."); *Corletta v. Oliveri,* 169 Misc.2d 1, 7, 641 N.Y.S.2d 498, 498 (Sup. Ct. Monroe Co. 1996) (holding that a court rule prohibiting an otherwise lawful agreement impaired an attorney's substantive right to contract in violation of the New York State Constitution); *Dorst v. Pataki,* 167 Misc.2d 329, 334, 633 N.Y.S.2d 730, 730 (Sup. Ct. Albany Co. 1995) (finding that an executive order containing "substantive content" and creating a different policy from that contained in the applicable legislation violated separation of powers).

Court rules in conflict with statutes are problematic for two principal reasons. *See Gair,* 6 N.Y.2d at 122, 188 N.Y.S.2d at 511 (Burke, J. dissenting). First, by "usurping power not

granted to it by the Legislature, the court has enacted legislation contrary to the method prescribed by the State Constitution." *Id. citing Chase Watch Corp. v. Heins,* 284 N.Y. 129, 134, 29 N.E.2d 646 (1940). Second, such a rule potentially "changes the substantive law of the State for one particular group of lawyers practicing in one particular area of the State." *Id.* Judge Burke noted that "[s]uch discrimination between citizens of the State with regard to their access to our courts is a violation of the due process and equal protection clauses of the State and Federal Constitutions." 6 N.Y.2d at 123, 188 N.Y.S.2d at 511.

B. The Expense Rules Impermissibly Conflict With Section 488

The Expense Rules conflict with Section 488 which, as noted earlier, explicitly permits lawyers both to advance expenses where their repayment is contingent on the outcome and to receive reimbursement in full of expenses paid in contingency cases.

Prior to 2006, New York law did not permit an attorney to pay litigation expenses on behalf of his client. Subdivision 2 of Section 488 prohibited an attorney from:

> By himself, or by or in the name of another person, either before or after action brought, promise or give, or procure to be promised or given, a valuable consideration to any person, as an inducement to placing, or in consideration of having placed, in his hands, or in the hands of another person, a demand of any kind, for the purpose of bringing an action thereon, or of representing the claimant in the pursuit of any civil remedy for the recovery thereof. But this subdivision does not apply to an agreement between attorneys and counselors, or either, to divide between themselves the compensation to be received.

Although the New York Code of Professional Responsibility permitted an attorney to advance litigation expenses, the client remained liable for repayment unless he was indigent and the representation was on a pro bono basis. *See* N.Y. Code of Professional Responsibility, DR 5-103. Therefore, apart from the limited exception, a client would remain liable for repayment of all expenses, regardless of the outcome of the matter.

Indeed, pre-2006 case law illustrates the presumption that *the client* shall bear responsibility for expenses and disbursements in contingency matters unless otherwise provided by agreement. *See, e.g., Hampton v. Rosenheim*, 92 Misc. 207, 209, 155 N.Y.S. 361, 361 (1st Dep't 1915) ("In the absence of agreement as to necessary disbursements in conducting the case it is presumed that they will be ultimately borne by the client.") *citing Spence v. Bode*, 57 Misc. 611, 612-13, 108 N.Y.S. 593, 594 (App. Term 1908) (fees agreed upon "for legal services" do not include reimbursement for expenses and disbursements). In *Manzo v. Dullea*, the Second Circuit rejected the client's argument that expenses should have been deducted from the attorney's contingency fee recovery. 96 F.2d 135, 137 (2d Cir. 1938). The court held that where a retainer agreement is silent as to whether expenses should be deducted, the attorney has a right to recovery of such expenses in addition to the contingency fee percentage: "the attorney's right to [expense reimbursement] follows as a matter of law from his making the advances for the benefit of the litigation he was employed to conduct." *Id.* at 138. The court further noted that the alternative (i.e., deducting expenses based on the amount recovered) would possibly violate the rules against champerty and maintenance. *Id.*

In 2006, the Legislature amended Section 2 of Judiciary Law § 488 in 2006 by creating two additional exceptions:

> . . . c. a lawyer advancing court costs and expenses of litigation, *the repayment of which may be contingent on the outcome of the matter*; or
>
> d. a lawyer, in an action in which an attorney's fee is payable in whole or in part as a percentage of the recovery in the action, paying on the lawyer's own account court costs and expenses of litigation. **In such case, the fee paid to the attorney from the proceeds of the action may include an amount equal to such costs and expenses incurred.** (Emphasis added)

These exceptions now expressly allow a lawyer both to pay and to advance expenses on behalf of his client in certain circumstances.[3] Subsection (c) expressly permits an attorney to advance expenses to his client, and, as the italicized language shows, permits the attorney to fully recover his expenses if the litigation outcome permits. Subsection (d) addresses contingency fee arrangements, noting in the bold language that the fee paid to the attorney may include all costs and expenses advanced by the attorney. Notably, both exceptions retain the premise that the attorney will be reimbursed for expenses, unless the outcome is unfavorable.[4]

The Expense Rules are inconsistent with the amended Section 488(2). The Legislature made clear its intention that attorneys should be able to advance – and to recover in full – litigation expenses: "the fee paid to the attorney from the proceeds of the action may include an amount equal to such costs and expenses incurred." N.Y. JUD. LAW § 488(2)(d). Yet the effect of the Expense Rules, which require the litigation expenses to be deducted from the total recovery before the attorney's fee percentage is calculated, is that the attorney ultimately pays for a portion of the litigation expenses out of her fee.

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[3] New York's shift toward permitting attorneys to advance litigation expenses is hardly an extreme position. Other jurisdictions allow attorneys to finance not only litigation expenses, but also medical and living expenses and other financial assistance to their clients. *See, e.g.*, Rules of Prof. Conduct, Rule 1.8, AL ST RPC Rule 1.8 (Ala.); State Bar Articles of Incorporation, Art. 16, Rules of Prof. Conduct, Rule 1.8, LSA-R.S. foll. 37:222 (La.); Rules of Prof. Conduct, Rule 1.8, MS R RPC Rule 1.8 (Miss.).

[4] DR 5-103 of the New York Code of Professional Responsibility (the "Code") was amended to conform to amended Section 488(2). The Code was replaced by the Rules of Professional Conduct, effective April 1; 2009, but Rule 1.8(e) reflects the Code's amended language, as well as the amended language in Section 488(2). Indeed, subdivisions (1) and (3) of Rule 1.8(e) are identical to Section 488(2)(c) and (d), respectively. N.Y. COMP. CODES R. & REGS. tit. 22, § 1200.0 (2009).

The calculation *required* by the Expense Rules is inconsistent with Sections 488(c) and (d).[5] Subsection (c) permits *advancement* of expenses where the repayment is contingent upon the outcome. Full repayment will *never* occur in contingency matters under the Expense Rules because where expenses are deducted first, the attorney is never fully reimbursed for the advanced expenses. Similarly, Subsection (d) permits *payment* of expenses in contingency matters and also permits an attorney to recover as part of his fees "an amount equal to such costs and expenses incurred." The Expense Rules foreclose the possibility of recovering an amount *equal to* expenses incurred. Therefore, these Rules are inconsistent with Section 488(c) and (d), and thus violate the New York State Constitution.

C. The Expense Rules Impermissibly Conflict With Section 474

The Expense Rules unequivocally prescribe a precise method of calculating contingency fees, without regard to the parties' fee agreement, and thus conflict with Section 474, which

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[5] The State may contend that, rather than being inconsistent with Section 488, the Expense Rules merely clarify how expenses are to be calculated. In *Levenson v. Lippman*, the Court of Appeals held that a rule promulgated by the Chief Administrative Judge was not inconsistent with the relevant compensation-setting statute, but merely filled in a "gap" in the administrative process by providing a mechanism for review of excess compensation awards. 4 N.Y.3d 280, 291, 794 N.Y.S.2d 276, 281 (2005). The State may argue that because the Legislature did not set forth a mechanism for calculating expenses in personal injury contingency cases, the Appellate Division was entitled to do so.

This argument is wrong for two reasons. First, the Legislature did specify that the contingency fee in medical, dental and podiatric cases malpractice had to be calculated in a manner identical to the Expense Rules [N.Y. Jud. Law § 474-a], so under the maxim *expressio unius est exclusio alterius*, the Legislature's silence with respect to personal injury and wrongful death cases demonstrates its intent to not apply that formula to those cases. Second, and perhaps more importantly, unlike the rule at issue in *Levenson*, the Expense Rules are not merely administrative rules, but rather reflect a substantive determination inconsistent with that already made by the Legislature.

provides that the "the compensation of an attorney or counsellor for his services is governed by agreement, express or implied, which is not restrained by law." N.Y. JUD. LAW § 474 (2009). As noted in *Corletta v. Oliveri*, New York common law and Section 474 of the Judiciary Law establish the contract rights of an attorney and client and to the extent that a court rule impinges upon this right, it is an unconstitutional transgression upon "the providence of the Legislature..." 169 Misc.2d at 6, 641 N.Y.S.2d at 498 (holding that a court rule requiring written retainer agreements unconstitutionally violated substantive right to create implied agreements for compensation under Section 474). By dictating how expenses are to be calculated, the Expense Rules undermine agreements between attorneys and clients that provide otherwise, and thus contravene the legislative intent set forth in Section 474.

Of course, notwithstanding Section 474, New York courts are permitted to promulgate rules that regulate the manner in which fee agreements are executed, *see* N.Y. COMP. CODES R. & REGS. tit. 22, § 1200.0, R. 1.5(b) (2009) (requiring contingency agreements to be in writing), or that prohibit inherently improper fee agreements, *see id.*, R. 1.5(a) (prohibiting "excessive" fees). As the next section makes clear, however, the courts' authority in this area does not extend to barring agreements that are *permitted by* legislative enactments — and indeed by other court rules as well.

D. The Expense Rules Impermissibly Create Substantive Law

Furthermore, the Expense Rules create an impermissible substantive rule of law with respect to attorney-client agreements. The Court of Appeals has held that "the Appellate Divisions cannot make substantive law by rules . . ." *Gair*, 6 N.Y.2d at 104, 188 N.Y.S.2d at 496. At issue in *Gair* was Rule 4, an Appellate Division rule establishing a fee schedule for

compensation for legal services. The Court of Appeals analyzed whether the rule conflicted with the (identical) predecessor to Section 474. It concluded that Rule 4 merely established fees that were prima facie reasonable, leaving fees in excess subject to court supervision or discipline that might otherwise be required under Canon 13, the excessive fee provision of the old Canons of Professional Conduct. 6 N.Y.2d at 108-09, 188 N.Y.S.2d at 498-99. Because Rule 4's effect had only presumptive effect in light of the court's inherent power to supervise compensation, it did not create a change in the parties' substantive relationship. 6 N.Y.2d at 114, 188 N.Y.S.2d at 504. The court held that "it lay within the competence of the First Department....to adopt rule 4 as a procedural aid in rendering effectual its disciplinary power over attorneys in the case of unlawful contingent fees." *Id.* The Court of Appeals explained, "...what is of the utmost importance, these [fee] schedules are *merely presumptive* of what constitutes an exorbitant contingent fee in a particular case" – a fee in excess of the amount still might be permissible with court approval. 6 N.Y.2d at 113, 188 N.Y.S.2d at 503 (emphasis added).

Unlike the procedural rule at issue in *Gair*, the Expense Rules create substantive law by establishing a bright-line rule that *any* attorney-client agreement under which expenses and disbursements are deducted *after* computing contingency fees is impermissible, regardless of whether the client is sophisticated or the terms are fair and reasonable. Such a significant encroachment upon the statutory rights to contract between attorney and client and to recover expenses in full involves a careful policy determination that must be made by the Legislature.

This is particularly so because, unlike the excessive fees that the Appellate Division wanted to guard against in *Gair,* there is nothing inherently unethical about gross recovery under contingency fee arrangements. Indeed, the New York State Bar Association Ethics Committee

concluded that in contingency fee cases outside the ambit of the Appellate Division rules, "a lawyer may compute the attorney's fee *prior to* deducting litigation expenses, provided the fee is otherwise legal and reasonable in light of all the circumstances, and the attorney has provided a prompt written statement to the client stating how the fee is to be calculated, including whether expenses are to be deducted before or after the fee is calculated." New York State Bar Ass'n Committee on Professional Ethics, Opinion No. 669, June 14, 1994. Perhaps even more importantly, N.Y. Rule 1.5(c) permits calculating a fee based on gross recovery as long as this is stated in the retainer agreement and is not otherwise prohibited.[6] All of this is consistent with Bar opinions and court decisions throughout the country, which make clear that basing a contingency calculation on gross recovery can be fair and ethical.[7]

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[6] The New York Rules of Professional Conduct state that a contingency fee agreement must state "whether such expenses are to be deducted before or, if not prohibited by statute or court rule, after the contingent fee is calculated . . . ." N.Y. COMP. CODES R. & REGS. tit. 22, § 1200.0, R. 1.5(c) (2009). The majority of other states simply provide that the agreement must state whether expense are to be deducted before or after the contingent fee is calculated, without reference to any statutes or court rules to the contrary. *See, e.g.*, State Bar Articles of Incorporation, Art. 16, Rules of Prof.Conduct, Rule 1.5, LSA-R.S. foll. 37:222 (La.); Rules of Prof. Conduct, Rule 1.5, MS R RPC Rule 1.5 (Miss.); Sup. Ct. Rules, Rule 8, RPC 1.5, TN R S CT Rule 8, RPC 1.5; Rules of Prof. Conduct 1.5 (Tenn.), AK Rules of Prof. Conduct, Rule 1.5 (Alaska); Rules of Prof. Conduct 1.5, CT R RPC Rule 1.5 (Conn.); Rules of Prof. Conduct 1.5, DE R RPC Rule 1.5 (Del.); Rules of Prof. Conduct 1.5, DC R RPC Rule 1.5 (D.C.).

[7] Apart from the Expense Rules and Judiciary Law § 474-a, there is nothing unlawful about deducting expenses from the net recovery in New York and in other jurisdictions, which have approved, either implicitly or explicitly, attorney-client agreements in which the contingency fee is calculated based upon the gross recovery. *See Hibdon v. Sedalia Anesthesia Consultants, Inc.*, No. 01-CV-213735, 2003 WL 24141306 (Mo. Cir. Aug. 22, 2003) (approving a contingency fee arrangement in a wrongful death case providing for a percentage of the gross recovery plus expenses); *Ramirez v. Sturdevant*, 26 Cal. Rptr. 2d 554, 558 (Ct. App. 1994) ("Although it appears that other attorneys...routinely calculate a contingency fee after deducting costs form any gross settlement, we cannot say that to do [so] otherwise shocks the conscience."); *Cappa v. F & K Rock & Sand, Inc.*, 249 Cal. Rptr. 718 (Ct. App. 1988) (implicitly upholding an agreement providing for attorneys' fee based on gross recovery by prioritizing lien

Finally, it bears noting that the Court of Appeals rendered its decision in *Gair* before the Legislature had enacted laws concerning the appropriate amount of contingency fees and the calculation thereof. The court rules at issue in *Gair* were thus necessary to provide guidance in this legislative vacuum. Since the *Gair* decision, however, the Legislature has enacted Section 474-a, which outlined a contingency fee schedule as well as the method of calculation for such fees in medical, dental and podiatric malpractice cases. The Legislature also amended Section 488, allowing the advancement and *recovery in full* of litigation expenses in contingent fee arrangements where recovery was contingent upon the outcome of the suit. The Expense Rules governing the calculation of fees in contingency cases, even if they could be construed as procedural, are inconsistent with these legislative pronouncements, and therefore unconstitutional.

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for fees and disbursements); *In re Cooper*, 344 S.E.2d 27 (N.C. Ct. App. 1986) (holding that contingency fee arrangements in equitable distribution proceedings were not void against public policy, implicitly countenancing the agreement at issue which provided for a percentage fee of the gross recovery plus expenses); *Kramer v. Fallert*, 628 S.W.2d 671 (Mo. Ct. App. 1981) (awarding contingency fee based on percentage of gross recovery before deducting expenses in a suit for, *inter alia*, fraudulent misrepresentation and replevin).

Memo Exhibit 1

May 25, 2009

Memorandum in Support of Clarifying Amendment to Judiciary Law §488

This memo provides insight into the recent substantial modifications to subdivision 2 of Judiciary Law §488,[1] which permit lawyers to assume the responsibility for the payment of litigation expenses and court costs ("litigation costs") incurred in connection with the prosecution of a client's claim, and the pre-existing law and rules governing matters litigated on a contingent basis.

This relationship is significant because New York's traditional posture of imposing limits on contingent fee percentages and requiring that the contingent fee be calculated after deducting litigation costs has significantly different implications under a regimen in which lawyers are specifically permitted to "own" litigation costs than it did under a regimen in which clients were required to remain liable for these costs.

This memorandum first explains the current law and rules governing contingent fees. Second, it addresses the rules that prevailed with regard to payment of litigation costs before §488 was amended and third, the changes effected by the 2006 modifications to §488. Finally, the memo addresses the inconsistency between the court rules governing contingent fees and the changes effected by the recent modifications to §488 and sets forth the method to resolve the inconsistency to effectuate the legislature's intent.

I. Current Law and Rules

Under §474 of the Judiciary Law, lawyers and their clients are free to agree to fee arrangements, and these agreements either express or implied, will govern the payment of fees, " if not restrained by law."[2] In other than medical malpractice cases, limitations on contingent fees and

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[1] Effective April 1, 2009, The Rules of Professional Conduct (the "Rules" or "RPC") replaced the New York Code of Professional Responsibility (the "Code"). The Code had been amended by the courts to conform with the amendments to Judiciary Law §488 and the RPC mirrors the amended language of the Code:

RPC 1.8 Current Clients: Specific Conflict of Interest Rules

(e) 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 court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter;

(2) A lawyer representing an indigent or pro bono client may pay court costs and expenses of litigation on behalf of a client; and

(3) A lawyer in an action in which an attorney's fee is payable in whole or in part as a percentage of the recovery in the action, may pay on the lawyer's own account court costs and expenses of litigation. In such case, the fee paid to the attorney from the proceeds of the action may include an amount equal to such costs and expenses incurred.

[2] The applicable provision of the Rules, RPC 1.5(c), permits lawyers and clients to enter into fee agreements including whether litigation costs are to be deducted before or after the contingent fee is calculated "if not prohibited

the requirement that contingent fees be calculated *after* deduction of litigation costs are found in the rules of the Appellate Division of the Supreme Court for the four judicial departments, not in statute. The major Court rules governing contingent fees are found in 22 N.Y.C.R.R. §603.7(e) (First Department); 22 N.Y.C.R.R. §691.20 (e) (Second Department); 22 N.Y.C.R.R. §803.13 (b) (Third Department); and 22 N.Y.C.R.R. §1022.31 (b) (Fourth Department). Each sets the same schedules for maximum contingent fees in various types of matters and each provides that the percentage "shall be computed on the net sum recovered *after* deducting from the amount recovered expenses and disbursements..." (Emphasis added).

II. Pre-§488 Rules Regarding Treatment of Litigation Costs

Until the recent modifications to §488, the Code and then the RPC, New York was one of a tiny minority of American jurisdictions that retained the requirement that clients remain liable for litigation expenses.[3] The New York Lawyer's Code of Professional Responsibility permitted lawyers to advance litigation costs but, except where the lawyer represented an indigent client on a pro bono basis, required that the client remain liable for the repayment of those costs and expenses, regardless of the outcome of the litigation. Accordingly, under the previous regimen, a lawyer did not, and indeed could not, assume the ownership of these expenses, which remained the responsibility of the client. Theoretically, at least, this regimen assumed that clients would repay any advances by lawyers for litigation costs.

Just as New York did not follow the vast majority of jurisdictions that permitted repayment of advances for litigation costs to be "contingent on the outcome of the matter", New York's rule requiring that litigation costs be deducted *before* the contingent fee is calculated does not reflect national practice.

III. 2006 Modifications to Judiciary Law §488

The 2006 modifications to subdivision 2 of §488 of the Judiciary Law sought to modernize the way in which lawyers may handle the payment of litigation costs on behalf of a client. This statutory change and the subsequent change in the applicable disciplinary rule mark a significant departure from the way in which client expenses have historically been treated in New York. Under this new regimen, lawyer and client are free to decide who will "own" these expenses.

These modifications reflected discontent with the negative public policy implications of the previous rule. First, the modifications brought the law into conformity with the widespread practice of lawyers who resisted making any but *pro forma* efforts to recoup litigation costs from

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by law or court rule." It goes on to require a lawyer who has been employed in a contingent fee matter provides to "promptly" provide the client "with a writing stating the method by which the fee is to be determined, including the percentage or percentages that shall accrue to the lawyer in the event of settlement, trial or appeal; litigation and other expenses to be deducted from the recovery; and whether such expenses are to be deducted before or, if not prohibited by statute or court rule, after the contingent fee is calculated.

[3] Before §488 was amended, the four states that retained some version of the old rule were New York, Oregon, Virginia and Washington. The Oregon rule makes the client liable only "to the extent of the client's ability to pay." *Or. RPC 1.8 (e) (2004)* The Washington rule contains an exception for class actions where repayment "may be contingent on the outcome of the matter." *Wash., RPC 1.8 (e)(2)* (2003).

a client in an unsuccessful matter. Suing one's client to recoup litigation costs places a lawyer in an uncomfortable adversarial posture towards a client who has already suffered from the injury underlying the litigation, and to whom the lawyer rightfully feels a duty of loyalty.

Second, if clients were responsible for litigation costs win or lose, lawyers would be constrained to incur discovery, investigative and other litigation expenses only in the amount the client can afford, whether or not that amount is sufficient to effectively prosecute the client's claim.

Thus, Judiciary Law §488 permits lawyers to "own" the responsibility for litigation costs and shifts the risk to the lawyer and away from the client is seen as a way not only to promote the lawyer's duty of loyalty to clients, but as importantly is a way to insure that a lawyer's ability to effectively prosecute a claim on behalf of a client.

Judiciary Law §488 consists of three provisions which permit a lawyer to:

1. Pay the costs and expenses of litigation when representing an indigent or pro bono client;
2. Advance costs and expenses, the repayment of which may be contingent on the outcome of the matter;
3. Use his or her own account to pay litigation costs and expenses when the attorney's fee is based on a percentage of recovery.

Moreover, the final sentence of the three new provisions of subdivision 2 provides:

> "In such case, the fee paid to the attorney from the proceeds of the action may include an amount equal to such costs and expenses incurred."

A plain reading of this final sentence indicates that where a lawyer and client agree that the lawyer will pay litigation costs and there is a successful outcome of the matter, the lawyer may recover these costs as part of the lawyer's fee. In other words, the lawyer may obtain as his or her fee the percentage of the recovery permitted by the court rules or statute, *plus* the litigation costs incurred in obtaining the recovery for the client.

IV. Clarifying Judiciary Law §488 to Insure that the Legislative Purpose of the 2006 Modifications Is Not Undermined

The 2006 modifications to §488 providing that "the fee paid to the attorney from the proceeds of the action may include an amount equal to the costs and expenses incurred" are inconsistent with the court rules requiring that litigation costs be deducted before calculating the lawyer's contingent fee. (*See* attachment 6, 7, 8, and 9; *see also* 22 N.Y.C.R.R. §603.7(e) (First Department); 22 N.Y.C.R.R. §691.20 (e) (Second Department); 22 N.Y.C.R.R. §803.13 (b) (Third Department); and 22 N.Y.C.R.R. §1022.31 (b) (Fourth Department). In the event of an inconsistency or conflict between a statute and a court rule, it is clear that the statute controls. As former Chief Judge Kaye wrote; "[u]nless a statute in some ways contravenes the state or federal constitution, we are obliged to follow it--and of course we do. *State Courts at the Dawn*

of a New Century: Common Law Courts Reading Statutes and Constitutions, 70 N.Y.U. L. Rev. 1, 19-20 (1995).

It is a basic tenet of administrative law that administrative agencies can only make rules in accordance with authority granted by the legislature, and that the rules must conform to statutory law. "The cornerstone of administrative law is derived from the principle that the Legislature may declare its will, and after fixing a primary standard, endow administrative agencies with the power to fill in the interstices in the legislative product by prescribing rules and regulations consistent with the enabling legislation." *Matter of Nicholas v. Kahn,* 47 N.Y.2d 24, 31, 416 N.Y.S.2d 565(1979). The same principles apply to the courts in the promulgation of their own rules. *Gair v. Peck,* 6 N.Y.2d 97, 188 N.Y.S.2d 491(1959), remittitur and, 6 N.Y.2d 983, (1959), 191 N.Y.S.2d 951, cert den and app dismd, 361 US 374, 80 S Ct 401, 4 L Ed 2d 380 (1960).

The application of this principle to court rules has also been acknowledged in the context of the amendment to New York's Constitution, effective January 1, 1978, which specifically authorizes the Chief Judge to administer the court system and to promulgate rules to facilitate court administration. The amendment granted the courts the power to promulgate rules that are consistent with statute. *Levenson v. Lippman* 772 N.Y.S.2d 286 (1st Dept 2004). The amendment does not affect the legislature's ability to regulate attorneys' fees and other matters relating to the judicial system, and the courts' obligation to comply with statutory law. *Kindlon v. County of Rensselaer,* 158 App Div 2d 178, 558 N.Y.S.2d 286 (3d Dept 1990).

The Court of Appeals has explicitly held that the authority to regulate practice and procedure in the courts lies principally with the Legislature. *Cohn v. Borchard Affiliations,* 25 N.Y.2d 237, 303 N.Y.S.2d 633 (1969). Particularly relevant to the question at hand, is a lower court decision that declared a court rule requiring written retainer agreements in matrimonial cases to be unconstitutional. The court also held that the rule illegally contravened Judiciary Law §474, which specifically recognizes implied contracts. *Corletta v. Oliveri,* 169 Misc. 2d 1, 641 N.Y.S.2d 498 (1996).

Therefore, it is necessary to **amend** the rules of the respective Appellate Divisions or **clarify and amend §488**. Clearly, it is undesirable as a matter of public policy for the governing law to be uncertain, and notwithstanding the 2006 legislative change, lawyers have been loath to act in a way that is inconsistent with the court rules.

To eliminate this uncertainty and to insure that the legislature's purpose in enacting the 2006 modifications to subdivision 2 of §488 of the Judiciary Law is realized, administrative clarification or legislative action is called for. The key features are as follows:

1. **Amend the rules of the First, Second, Third, and Fourth Departments** (*see* 22 N.Y.C.R.R. §603.7(e) (First Department); 22 N.Y.C.R.R. §691.20 (e) (Second Department); 22 N.Y.C.R.R. §803.13 (b) (Third Department); and 22 N.Y.C.R.R. §1022.31 (b) (Fourth Department) *see also* attachments 6, 7, 8 and 9); or
2. **Amend Judiciary law §488 paragraph (2)(d) clarifying the method of computation.**