

**COMMENTS OF THE NEW YORK STATE BAR ASSOCIATION
COMMITTEE ON STANDARDS OF ATTORNEY CONDUCT**
on
**PROPOSED AMENDMENT OF THE RULES OF THE APPELLATE DIVISION
RELATING TO CONTINGENT FEE COMPUTATION IN PERSONAL INJURY AND
WRONGFUL DEATH ACTIONS**

In response to the Memorandum of the Unified Court System's Counsel dated March 18, 2013, the Committee on Standards of Attorney Conduct (COSAC) of the New York State Bar Association (NYSBA) hereby presents its comments on the proposal to amend the Appellate Division Rules that require, in a contingency fee case, that the expenses incurred in prosecuting the suit be deducted before calculation of the attorney's percentage recovery rather than after. These comments are those of COSAC alone. They have not been reviewed or approved by the NYSBA House of Delegates.

COSAC does not take a position on whether the proposed change in the rules should or should not be adopted. COSAC believes that that is a policy choice that would require broader input from within the NYSBA. Our comments here are directed toward the way in which the question is posed. In particular, we believe the question is a straight-up policy choice and not one that has been persuasively shown to be commanded by (1) the 2006 amendment to Judiciary Law § 488, (2) the long-standing rule set forth in Judiciary Law § 474, or (3) the statutory promulgation in Judiciary Law § 474-a of a net-calculation rule for certain malpractice actions and not for other contingency-fee actions. We also briefly address certain ethical arguments put forward by the proponents of the change.

Background

The Appellate Divisions each have identical rules setting forth the maximum permissible percentages (absent a court order) for contingency fee agreements in personal injury and wrongful death actions. 22 NYCRR §§ 603.7(e)(3), 691.20(e)(3), 806.13(c), 1022.31(c). Those rules also require that the percentage be applied to the net recovery, after deduction of the expenses incurred in prosecuting the successful suit. The Court of Appeals has upheld the Appellate Divisions' power to promulgate presumptively maximum contingency fees as a permissible exercise of the courts' inherent power to supervise attorney compensation and prevent excessive fees. *Gair v. Peck*, 6 N.Y.2d 97 (1959).¹ The proposal is to alter these rules so as to leave the current maximum percentages in place but to permit lawyers to provide in their

¹ Among the arguments made by proponents of a rule change is that, "[u]nlike the procedural rule at issue in *Gair*, the [Appellate Division's net-calculation 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" Exh. A to March 18, 2013 Request for Comments at 11 (emphasis in original). In fact, however, the rule at issue in *Gair* was the First Department's predecessor to the present Appellate Division rules and contained the same net-calculation provision. 6 N.Y.2d at 101 n.*.

retention agreements with clients that the contingent fee will be calculated on the gross recovery, before paying the fees and expenses from the client's share of the recovery.

The gross-calculation method that the proponents seek results in a higher attorney's fee than the net-calculation method. To illustrate the operation of the two options, we use a case that has resulted in a judgment of \$300,000 and in which the contingency fee is stated to be one-third, the maximum under the rules for recoveries of that size. Assume that there were expenses of \$30,000. The result under the current and proposed rules would be:

Current "Net-Calculation Rule"		Proposed "Gross-Calculation Rule"	
Judgment	\$300,000	Judgment	\$300,000
Expenses	30,000	Attorney's fee (1/3)	100,000
Net	\$270,000	Net	\$200,000
Attorney's fee (1/3)	90,000	Expenses	30,000
Client share	\$180,000	Client share	\$170,000

Arguments Advanced for Changing Net-Calculation Rule

N.Y. Judiciary Law § 488. The proponents of the change argue that the change is required by the Legislature's adoption in 2006 of amendments to N.Y. Judiciary Law § 488. Prior to 2006, that law provided that an attorney could not pay litigation expenses on a client's behalf. In Disciplinary Rule 5-103 the courts had allowed lawyers to advance expenses in contingent fee cases as long as the client remained ultimately liable for repayment, regardless of whether the matter was successful or not.² In 2006, the Legislature amended Section 488 to permit lawyers to advance costs and expenses, the repayment of which may be contingent on the outcome of the matter, and in contingency fee cases, to pay fees and expenses for the lawyer's

² This limitation did not apply if client was indigent and the representation was on a pro bono basis. Specifically, DR 5-103(B) provided:

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 court costs, expenses of investigation, expenses of medical examination, and costs of obtaining and presenting evidence, provided the client remains ultimately liable for such expenses.
2. Unless prohibited by law or rule of court, a lawyer representing an indigent client on a pro bono basis may pay court costs and reasonable expenses of litigation on behalf of the client.

own account, to be repaid out of the recovery. The new exceptions to the prohibition on paying litigation expenses on a client's behalf read as follows:

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.³

The proponents of the change argue that the Appellate Division's net-calculation rule is inconsistent with the "plain language" of the last sentence of Section 488(2)(d). We do not agree. The plain language of the last sentence says nothing about whether the contingent fee is calculated on a recovery that is the amount of the judgment or the amount of the judgment less expenses. Rather, the last sentence simply denominates as a "fee" any amount of costs and expenses that the lawyer has paid. The rationale for such drafting might have been to reinforce the tax rationale for subsection (d) (that is, that the repayment of costs and expenses is contingent and taxable as income when received) or to ensure that there was a statutory basis for the total fee, including costs and expenses, exceeding the percentages set forth in the court rules (and identical statutory fee limits on malpractice actions, Judiciary Law § 474-a(3)). *Simon's, supra*, at 415-16.

If the alternative reading of the last sentence of Section 488(2)(d) advanced by the proponents of the change is accepted, then the change to the Appellate Divisions' net-calculation rules would have to apply as well to the identical net-calculation language in Judiciary Law

³ Section 488(2)(c) and (d) differ slightly: subsection (c) permits a lawyer to "advance" the fees and expenses; subsection (d) permits a lawyer to "pay[] on the lawyer's own account." The difference between "advance" and "pay[] on the lawyer's own account" has tax significance: the lawyer paying on his or her own account can deduct the expenses in the year incurred; the lawyer advancing costs and expenses can only deduct them by establishing, at the end of the matter, that the client is excused from repaying the loan. Roy Simon, *Simon's New York Rules of Professional Conduct Annotated* 415 (2013) ("*Simon's*"). Supporters of the bill cited this rationale in explaining the provision. Memo from Joseph P. Awad, President, New York State Trial Lawyers Ass'n to the Governor (July 12, 2006), *reprinted in* New York Bill Jacket, 2006 Assembly Bill 11763 (avail. on Westlaw) (the bill "will also have a beneficial effect on the ability of small practitioners to cover the costs of litigation by allowing for the deduction of expenses in the year they are incurred"); Memo from Carol L. Ziegler, Adj. Prof. of Law, Columbia Law School (June 12, 2006), *reprinted in same* (subsection (d) "gives lawyers the flexibility to structure contingent fee agreements that may afford lawyers more favorable tax treatment of those expenses").

§ 474-a, the statute governing malpractice actions.⁴ Such an implied repeal is unlikely. The legislative history of the 2006 amendment contains no hint of a legislative intent to repeal any language in Section 474-a and makes no reference to the method of calculating contingency fees. Rather, the justification for the bill was simply to allow lawyers to advance costs to clients without having the client ultimately liable for the costs:

This bill provides the ability to attorneys to advance costs to clients who are not in a financial position to themselves afford some [of] the necessities of litigation. Further, in the same manner as a contingent arrangement, such fees need not be repaid by the client if the matter proves unsuccessful.

New York Assembly Memorandum in Support of Legislation, Bill Number A11763A, *reprinted in* New York Bill Jacket, 2006 Assembly Bill 11763.

We note as well that the change to Section 488 did not work a major change in practice. As the May 25, 2009 Memorandum in Support of Clarifying Amendment to Judiciary Law § 488 (circulated in the Unified Court System's request for comments) notes (p. 2), prior to 2006, lawyers would routinely advance costs and expenses and, if the action was unsuccessful, make no more than "*pro forma* efforts to recoup litigation costs from a client."⁵ The change to Section 488 formally approved this practice, allowing lawyers forthrightly to set forth in their retainer agreements that they would not seek to recover costs and expenses advanced by the lawyer if there was no recovery by the client. There is no reason to think that, in making this relatively minor adjustment, the Legislature intended to overturn the 50-year-old Appellate Division rules on fee calculation, rules that are also incorporated into the similar statutory limits in Section 474-a on contingency fees in malpractice actions.

The textual argument that proponents of changing the rules put forward is logically flawed. The argument starts from the proposition that the last sentence of Section 488(2)(d) envisions that the lawyer may recover the entire amount of the costs and expenses that he or she has advanced. That is true. But the argument then posits that if the costs and expenses are deducted from the amount of the judgment before the percentage is applied, the lawyer is in fact paying some portion of the costs and expenses. That assumes, however, that a percentage of the entire judgment (*e.g.*, 1/3) rightfully belongs to the lawyer. That is the logical fallacy: the argument assumes that the thing to be proved is true in order to prove it. The question to be answered is whether a percentage of the entire judgment is the lawyer's fee. If it is not – and

⁴ Section 474-a(3) requires that the percentages set forth in that section (applicable to malpractice actions) "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."

⁵ This was also mentioned by supporters of the bill. *E.g.*, Memo of Carol L. Ziegler, *supra* ("as a practical matter, many lawyers make no or only perfunctory efforts to recoup expenses in most instances where the litigation is unsuccessful").

under the Appellate Division rules, it is not – then the textual argument advanced by the proponents of the change does not work.

In short, we see nothing in the amendments to Section 488 that requires the Appellate Divisions to rewrite their existing rules on calculation of contingency fees. The rule requiring deduction of expenses prior to application of the permitted percentages is part and parcel of the rule prescribing the percentages. Both components of the rules are a permissible exercise of the courts' power to regulate attorney compensation. Logically, if the net-calculation is to be changed, the courts should consider whether the permissible percentages are still the correct percentages, because changing the method of calculation will be in effect to raise the permissible percentages.

N.Y. Judiciary Law § 474. The proponents of the rule change also argue that the net-calculation sentence in the Appellate Divisions' rules is inconsistent with N.Y. Judiciary Law § 474, which provides that “the compensation of an attorney or counsellor for his services is governed by agreement, express or implied, which is not restrained by law.”⁶ This argument depends on the view that Section 488(d) now requires that a lawyer be permitted to recover a fee that is a percentage of the full judgment, not the judgment less expenses. If that is not so, as we conclude above, then the Appellate Division net-calculation sentence is just part of the courts' regulation of excessive fees, which the proponents concede is permitted.

N.Y. Judiciary Law § 474-a. We also are not persuaded by the proponents' argument that the Appellate Divisions' net-calculation rule is inconsistent with the fact that the Legislature chose to impose such a rule in medical, dental and podiatric malpractice cases and did not extend the limitation to personal injury and wrongful death claims. Judiciary Law §474-a(3). As the Court of Appeals has explained, the limitations in Judiciary Law § 474-a were aimed at reducing the percentage fees available in malpractice actions “as part of a comprehensive State legislative initiative to reduce the spiraling medical malpractice premium rates fueled by enormous plaintiffs' verdicts and the high costs of litigation.” *Yalango v. Popp*, 84 N.Y.2d 601, 606 (1994). Originally enacted in 1976 to reduce the previously permitted 50% contingency fee, the statute was amended in 1985 to “eliminate[] the one-third recovery as an option and relegated medical malpractice attorneys to the percentages contained in the fee schedule.” *Id.* at 607. The change thus was focused on reducing the percentage of awards that went to fees because of the effect high fees had on medical malpractice insurance premiums. This is a rational response to a perceived evil in a particular industry segment. There is no more basis to conclude from the existence of that statute that all other contingency-fee lawyers are entitled to a gross-calculation method than there would be to conclude that all other contingency-fee lawyers should be allowed to charge the original 50% contingency fee.

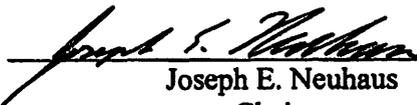
⁶ The term “which is not restrained by law” should be read, in modern English, “that is not restrained by law” – that is, that the statute permits agreements on fees that are not restrained by law. *See Gair*, 6 N.Y.2d at 106 (so reading the statute).

Ethical Points. The proponents also note that the proposed change would be permissible as an ethical matter.⁷ It is true that there is no current New York disciplinary rule that requires any particular method of calculating contingency fees. Rule 1.5(a) prohibits lawyers from charging an “excessive” fee. As long as the overall fee is not excessive, the current rules would not be violated by application of the percentage before or after deduction of expenses. At the same time, the Appellate Divisions, in the exercise of their inherent power to supervise the attorneys who appear before them, are free to determine that a particular method of calculation results in an excessive fee within the meaning of the rules promulgated by the Appellate Divisions themselves.

Conclusion

There may be policy reasons to increase compensation for contingency-fee lawyers who have advanced costs and expenses in the prosecution of successful personal injury and wrongful death cases. We have not analyzed the policy questions. But the question should be addressed as a policy matter rather than on the ground that the change is required to comply with recent legislative action.

May 16, 2013



Joseph E. Neuhaus
Chair
Committee on Standards of Attorney Conduct
of the New York State Bar Association

⁷ The proponents of the change also state that other States do not have New York’s net-calculation rule. We have not surveyed other State law to verify the accuracy of this claim.

ADcontingfeerules - Please register my strong support!!

From: Lenore Kramer <lenore@kramerdunleavy.com>
To: "ADcontingfeerules@nycourts.gov" <ADcontingfeerules@nycourts.gov>
Date: 3/20/2013 10:40 AM
Subject: Please register my strong support!!

Thank you!

Lenore Kramer, Esq.

Past President

New York State Trial Lawyers Association

Women's Bar Association of the State of New York

Kramer & Dunleavy LLP

350 Broadway

New York , New York 10013

lk@kramerdunleavy.com

212-226-6662

1-877- WOMANLAW

ADcontingfeerules - PI Contingency Fees

From: Jason Kaufer <jkaufer@jmkaufferlaw.com>
To: <ADcontingfeerules@nycourts.gov>
Date: 3/19/2013 7:55 PM
Subject: PI Contingency Fees

I support a change of PI contingency fees to being based upon the gross settlement amount as opposed to the net after expenses are deducted.

Jason M. Kaufer
923 Saw Mill River Road
Suite 146
Ardsley, New York 10502
917-690-9159

ADcontingfeerules - Contingent Fee rule change

From: <sweeneylawfirm@optonline.net>
To: <ADcontingfeerules@nycourts.gov>
Date: 3/19/2013 4:44 PM
Subject: Contingent Fee rule change

Dear Mr. McConnell, I fully support this rule change for the reasons expressed in the memo.
Terry Sweeney

Law Offices of Terence J. Sweeney, Esq.
44 Fairmount Avenue 225 Broadway
Suite 1 Suite 2500
Chatham, New Jersey 07928 N. Y., N.Y. 10007
(973) 665-0400 (212) 727-0721
Facsimile (973) 665-0401
www.TSweeneyLawfirm.com

ADcontingfeerules - Proposed Rule Change

From: STEPHEN FRANKEL <tortesq1@yahoo.com>
To: <ADcontingfeerules@nycourts.gov>
Date: 3/19/2013 3:46 PM
Subject: Proposed Rule Change

I am strongly in favor of revising this rule. Change is long overdue.

Sincerely,

Stephen H. Frankel, Esq.
Law Office of Stephen H. Frankel
368 Willis Avenue
Mineola, New York 11501
T(516)742-0400
F(516)742-0499
Email: tortesq1@yahoo.com

ADcontingfeerules - Comment on proposed rule

From: Joshua Stein <jstein1202@gmail.com>
To: <ADcontingfeerules@nycourts.gov>
Date: 3/19/2013 3:27 PM
Subject: Comment on proposed rule

I am in favor of the changing of this rule. As it is it makes the attorney financially responsible for 1/3 of the expenses. I don't believe this to be the intent of the Court when they made the rule. The attorney should be able to front the expenses, but ultimately they should be the client's responsibility as they are in every other facet of the attorney/client relationship. Thank you,

Joshua N. Stein
Greenberg & Stein, P.C.
360 Lexington Avenue -Suite 1501
New York, NY 10017

(212)681-2535
(516) 320-8044 - Fax

ADcontingfeerules - Changing the computation of contingent fees

From: Paul Hanly <phanly@hanlyconroy.com>
To: "ADcontingfeerules@nycourts.gov" <ADcontingfeerules@nycourts.gov>
Date: 3/19/2013 12:57 PM
Subject: Changing the computation of contingent fees

Our firm is in favor of the proposed change, which would bring NY in line with most, if not all, other states' rules. It seems quite unfair, and frankly inconsistent with the principle that costs and expenses are the responsibility of the party, not counsel, to have a rule whereby counsel is paying 1/3 of the client's expenses.

Paul J. Hanly, Jr.

Hanly Conroy Bierstein Sheridan

Fisher & Hayes LLP

112 Madison Avenue

New York, NY 10016-7416

[REDACTED]
212.784.6400 (Main)

[REDACTED]
phanly@hanlyconroy.com

www.hanlyconroy.com

[REDACTED]

ADcontingfeerules - NY State Courts Requests for Public Comment on Proposed Amendments

From: Mitchell Breit <mbreit@hanlyconroy.com>
To: "ADcontingfeerules@nycourts.gov" <ADcontingfeerules@nycourts.gov>
Date: 3/19/2013 12:53 PM
Subject: NY State Courts Requests for Public Comment on Proposed Amendments

I am in favor of the proposed amendment of Appellate Division Rules relating to contingent fee computation in personal injury and wrongful death actions.

Mitchell M. Breit
Hanly Conroy Bierstein Sheridan Fisher & Hayes LLP
112 Madison Avenue
New York, New York 10016-7416
Main (212) 784-6400


Fax (212) 213-5949
mbreit@hanlyconroy.com

ADcontingfeerules - Comments on Rule Change

From: Thomas Sheridan <tsheridan@hanlyconroy.com>
To: "ADcontingfeerules@nycourts.gov" <ADcontingfeerules@nycourts.gov>
Date: 3/19/2013 11:42 AM
Subject: Comments on Rule Change

I am in favor of the proposed amendment of Appellate Division Rules relating to contingent fee computation in personal injury and wrongful death actions.

Thomas I. Sheridan, III
Hanly Conroy Bierstein Sheridan Fisher & Hayes LLP
112 Madison Avenue
New York, NY 10016
(212) 784-6404
(212) 213-5949 (fax)
tsheridan@hanlyconroy.com
www.hanlyconroy.com

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