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Committee on Professional Ethics

Opinion 601 - 10/2/89 (6-89)

Topic: Adverse effect on professional judgment of lawyer; interests of lawyer; conflict of interest; opposing party; payment of fees by; fee for legal services.

Digest: Improper for lawyer who represents group of tenants in dispute with landlord to accept payment from landlord of "bonus" in connection with settlement of the dispute.

Code: EC 2-20, 2-23, 2-24, 2-25, 5-1;
DR 2-106, (B), (C);
5-101(A); 5-105(B), (C); 5-107(A), (B).

QUESTION

May a lawyer who represents a group of tenants in a dispute with their landlord arising from a cooperative or condominium conversion plan accept payment from the landlord of legal fees and expenses, including a "premium" or "bonus," in connection with a settlement of the dispute?

OPINION

The Code of Professional Responsibility does not bar counsel from receiving payment of a reasonable fee from an adverse party, but it does place significant restrictions on such a practice. For the reasons discussed below, we conclude that receipt of a "bonus" or "premium" from an adverse party in the context of a settlement of a dispute, where such sum exceeds the fee counsel could reasonably expect to obtain from the client in a noncon-

tingency fee matter, creates differing interests between client and counsel and is prohibited by the Code.

At the outset, we note that there are numerous circumstances in which a lawyer's fees may properly be paid by persons other than the client if the important restrictions of DR 5-107(A) are satisfied. Statutory provisions, including the Equal Access to Justice Act, 42 U.S.C. § 1988, may permit or mandate so-called fee shifting in certain circumstances. Even where statutory provisions do not apply, private contracts often provide for fee shifting. Thus, borrowers often agree to pay the lender's lawyer's fees in both negotiated agreements and future litigations. *See, e.g.,* N.Y. State 438 (1976). Similarly, one participant in a transaction may agree to pay the fees of the other side's counsel both in the context of initial negotiations and in the event of future litigation, and corporations often pay legal fees for their directors or employees even when such persons have separate representation precisely because of a potential or actual conflict of interest with the corporation. Insurance companies may pay counsel fees for their insureds, even when their interests conflict. *See, e.g.,* N.Y. State 73 (1968).

It is also not uncommon for agreements settling litigation in ordinary commercial disputes to include fee shifting arrangements, even in the absence of statute or prior contractual agreements. Indeed, even where a settlement agreement does not explicitly provide for fee shifting, the sums paid will often reflect the lawyer's fees incurred, as, for instance, when the sum paid in settlement of a tort claim is intended to compensate the plaintiff net of the plaintiff's lawyer's contingency fee.

The Code does not condemn such arrangements. Rather, statutory or private fee shifting often allows persons to obtain adequate legal representation where their financial resources would otherwise not be sufficient; fee shifting agreements are often useful aids to the resolution of disputes. *See* EC 2-24, 2-25.

Fee shifting arrangements, like other fee arrangements, can give rise to potential conflict, however, between the lawyer's duty to represent the client zealously with undivided loyalty and the lawyer's pecuniary interest. The Code is clear that a lawyer's ethical obligation is to represent the client regardless of the source of the lawyer's fee. *See* EC 5-1; DR 5-101(A). Thus, DR 5-107(B) specifically mandates that a lawyer may "not permit a person who recommends, employs or pays him to render legal services for another to direct or regulate his professional judgment"

Furthermore, as in any instance where a lawyer receives compensation from a person other than the client, fee shifting arrangements require the knowledge and consent of the client after full disclosure. DR 5-107(A) sets forth the rule:

Except with the consent of his client after full disclosure, a lawyer shall not:

1. Accept compensation for his legal services from one other than his client.
2. Accept from one other than his client anything of value related to his representation of or his employment by his client.

See EC 2-21.

The question posed here departs from the circumstances described above because it involves payment by an adverse party of a fee beyond what may be a reasonable amount and in circumstances in which it may not be obvious that payment of the fee by the adverse party has not affected counsel's ability to represent the client. DR 5-107(B). At issue here is payment of a "bonus" or "premium" by an adverse party in the context of a settlement of the claims of the lawyer's client, where the amount so paid exceeds the fee the lawyer could reasonably have expected to obtain from the client for whom the work was performed. In circumstances, as appears to be the case here, in which counsel is retained by a client (or group of clients) with an understanding that the client is responsible to pay the fees incurred,* acceptance from the adverse party in the context of a settlement of a larger fee than the amount that would be paid by the client creates two significant problems. First, it may give rise to an excessive fee. See DR 2-106; N.Y. State 576 (1986) ("If the fee is one the lender would not agree to pay in the same transaction were the lender not passing the fee on to the borrower, the fee will be viewed with great suspicion as exceeding a reasonable fee"); N.Y.

* This opinion does not address circumstances in which counsel agrees to represent a client on the understanding that the client will not be responsible for fees, but instead counsel will be compensated only in the event the adverse party pays the fee, by virtue of judicial award or otherwise.

The conduct at issue in this Opinion also differs from payment of a contingent fee (which in certain circumstances is approved by the Code, EC 2-20, DR 2-106(C)) in the critical respects that the amount of a contingent fee is set in advance by agreement with the client, and is ultimately to be paid out of the proceeds of a judgment or settlement without need for approval of the adverse party. It bears noting that an engagement agreement with the client in a non-contingency case may provide for an adjustment in the fee to be paid by the client depending on the value of the results achieved for the client. See DR 2-106 ("reasonableness of a fee" determined in part by "the results obtained").

State 461 (1977) (“While the Code thus makes clear that a lawyer may accept compensation related to his client’s affairs from persons other than his client, its evident intention is not to augment what would otherwise be an appropriate fee for services rendered, but merely to provide alternative sources for his just compensation.”)

Second, payment of a “bonus” by the adverse party conditioned on a settlement of the dispute gives rise to an incentive on the lawyer’s part to settle his client’s claims independent of their merits or the client’s interest. DR 5-105(B); EC 5-1. Since it is not obvious that counsel can, in the face of the proffered “bonus,” exercise independent professional judgment and adequately represent the client, consent by the client to the bonus, even if full disclosure is made of the possible effects of the payment on counsel’s representation, cannot rectify the conflict. DR 5-105(B), (C); N.Y. State 584 (1987) (“obvious” test of DR 5-105(C) cannot be satisfied where lawyer simultaneously represents party to a transaction and intermediary whose compensation depends on consummation of the transaction); N.Y. State 208 (1971) (lawyer may not act as lawyer and broker for client in same transaction); Tenn. Op. 80-F-1 (1981), indexed in ABA/BNA Lawyer’s Man. Prof. Conduct 801:8101 (structured settlement that permits participation by opposing party in determination of legal fees prohibited because of potential of “divided loyalties”); N.Y. City 206 (1931) (where defendant paid “commission” to counsel in connection with settlement, counsel could not have dealt “at arm’s length” with defendant or sought “to get maximum for his client”).

Accordingly, we conclude that counsel representing tenants in a dispute with their landlord may not accept a “bonus” or “premium” from the landlord in connection with settlement of their dispute.
