

## May a Lawyer Split His Legal Fees with an Employee?

BY LAZAR EMANUEL

A paralegal who is employed by a personal injury practitioner receives a phone call from a friend. The friend describes a multi-vehicle accident in which several people are seriously injured. He reports that one of the victims has heard of the paralegal's employer and wants to consider retaining him.

The paralegal has been facing many financial problems, including the possible loss of his home. Life has not treated the practitioner any better, and the paralegal knows that. The paralegal makes an offer to his employer, the lawyer: "I'll introduce the victim to you if you agree to give me one-third of all the money you receive from the case." The lawyer agrees and receives a settlement offer of \$750,000, which the client accepts. The lawyer collects his share of the proceeds, \$250,000 - and the paralegal demands his 1/3 share, \$83,333.33. The lawyer objects, and the paralegal says, "You agreed, and this is all legal and proper. The rules say I can share in your profits."

Is the paralegal right? Instinctively, you say, "No, a lawyer may not split a fee with anyone except another lawyer." The problem you face is that your instinct is not exactly right. On the other hand, no other answer may be exactly right. We are in a twilight zone in which the New York courts have never tread and the Rules are not very clear.

### The *Marinis* case

If you think I'm overstating the problem, guess again. Consider the facts of *Marinis v. Goldblatt & Associates, P.C., et al.*, (Supreme Court, Queens County), 2010 NY Slip Op. 51085(U) (Charles J. Markey, J.).

Plaintiff Marinis, whom Judge Markey described as a "former ambitious paralegal", sued her former employer, a law firm headed by Kenneth B. Goldblatt, for additional compensation based upon a "profit sharing arrangement." Among other matters, she alleged that the compensation would be based upon her ability to bring "profitable personal injury matters to the firm," and would entitle her to receive "up to 33% of the total net compensation" generated from a matter.

Her complaint cited five matters referred by her to the law firm. In the Nadelman matter, the firm recovered a net of \$100,000 and the plaintiff was paid \$8,000. In the Rosenberg matter, the firm received a net of \$1.2 million and the plaintiff was paid \$17,500. In three other matters, the firm received unspecified amounts and the plaintiff apparently received nothing.

Defendant Rosenblatt argued that plaintiff had been paid a fixed salary and vacation, sick and personal time; that yearend bonuses were based on merit and profitability; that the terms of plaintiff's employment were the same as those of its other employees; that the plaintiff was told the firm did not have a profit-sharing plan; and that the compensation in the Nadelman matter was "in light of the plaintiff's extra efforts in assisting" in the matter.

In support of its motion for summary judgment, the defendant law firm submitted the affidavits of current and former employees which stated that at the time of plaintiff's employment, "there was no profit sharing plan in place, staff was given bonuses based on merit and profitability of the firm, and these bonuses were never guaranteed."

Judge Markey began his opinion in *Marinis* by describing the case as follows:

The case presents several causes of action...based on an alleged fee-splitting arrangement or what she (plaintiff) styles as breach of their 'profit sharing arrangement'. A lot of her causes of action, including for her termination, are predicated on the implied covenant of good faith and fair dealing.

He disposed expeditiously of several issues:

1. Plaintiff's claim of intentional infliction of emotional distress was barred by the one-year statute of limitations.
2. Plaintiff's claim for wrongful termination was without merit because "absent an agreement establishing a fixed duration, an employment relationship is presumed to be a hiring at will, terminable at any time by either party."
3. The affidavits submitted by defendant and its former employees established as a matter of fact that no profit sharing contract existed between the parties.

On the other hand, Judge Markey denied defendants' motion for summary judgment as to plaintiff's claims for breach of an implied-in-fact contract and for promissory estoppel:

1. Defendants argue that plaintiff's claim is barred by the Statute of Frauds. A claim which is based on an oral agreement capable of performance within one year – as is the plaintiff's claim for a proportionate share of funds received from successful matters brought in by her – is not barred by the Statute of Frauds.
2. Plaintiff has raised a triable issue of fact by stating in her affidavit that she relied to her detriment on defendants' promise that she would receive one-third of the net fees generated from matters referred to the firm by her; her reliance was reasonable; she had demonstrated her reliance "by going above and beyond" what was required of her; and her bonus was "vastly disproportionate" to the compensation she had been promised.

The *Marinis* case is very curious and mystifying. Why did no one – plaintiff, defendant, or Judge Markey – recognize, plead or address any of the ethical issues raised by the facts? It's as though our rules and our laws had never existed. Why is there no discussion about the proprieties of fee-splitting between lawyer and non-lawyer employee; about the Code of Professional Responsibility and the Rules of Professional Conduct; about Judiciary Law § 491; about profit-sharing plans and their limits?

At one point in his decision, Judge Markey said, distinguishing *Marinis* from *Wieder v. Skala*, 80 NY2d 628 (1992):

The case at bar has far different facts and does not involve or implicate any set or code of professional ethical norms....At any rate, the umbrella given to plaintiffs in *Wieder*, under certain narrow circumstances, cannot be stretched beyond all recognition in trying to protect the paralegal who simply wanted ‘a bigger share of the pie’ with regard to the cases she helped bring to her former employer.

### **Impact of Judiciary Law § 491**

One thing is clear – by soliciting and demanding a share of the fees resulting from the cases she had referred to the firm, the paralegal in *Marinis* had committed a misdemeanor. Judiciary Law § 491 provides.

§ 491. Sharing of compensation by attorneys prohibited.

1. It shall be unlawful for any person, partnership, corporation, or association to divide with or receive from, or to agree to divide with or receive from, any attorney-at law or group of attorneys-at-law, whether practicing in this state or elsewhere, either before or after action brought, any portion of any fee or compensation, charged or received by such attorney-at-law or any valuable consideration or reward, as an inducement for placing, or in consideration of having placed, in the hands of such attorney at-law, or in the hands of another person, a claim or demand of any kind for the purpose of collecting such claim, or bringing an action thereon, or of representing claimant in the pursuit of any civil remedy for the recovery thereof. But this section does not apply to an agreement between attorneys and counselors-at law to divide between themselves the compensation to be received.
2. Any person violating any of the provisions of this section is guilty of a misdemeanor.

We may well ask: Why is § 491 headed “sharing of compensation by attorneys” instead of “sharing of compensation with attorneys” or “sharing of compensation by non-attorneys”? Why is § 491 directed only at the person who solicits part of a fee and not the lawyer who agrees to share it? But a question more relevant to our present discussion would be: “Does this help us to determine unequivocally whether and when an employee who is not himself a lawyer may share in his employer’s legal fees?” The answer is “No,” so we are forced to look elsewhere for our answer.

**[Author’s note:** COSAC recognized the dilemma posed by Judiciary Law § 491. In its Commentary to the changes from the Code to the new Rules, the Committee said:

COSAC notes that the sharing of fees as contemplated by this provision (Rule 5.4(a)) would appear to violate section 491 of the Judiciary Law, and, therefore, would not be permitted under the ‘except’ clause. COSAC nevertheless urges the adoption of this provision and recommends an appropriate amendment of the Judiciary Law, which would permit the limited fee sharing described here [to] be considered.

Since April 1, 2009, when the Rules of Professional Conduct were adopted, Judiciary Law § 491 has not been amended.]

### **History of DR 3-102(A)(3)**

Prior to adoption of the new Rules of Professional Conduct on April 1, 2009, DR 3-102(A)(3) of the Code of Professional Responsibility provided as follows:

#### **DR 3-102 [1200.17] Dividing Legal Fees with a Non-Lawyer.**

A. A lawyer or law firm shall not share legal fees with a non-lawyer, except that:

1. An agreement by a lawyer with his or her firm, partner, or associate may provide for the payment of money, over a reasonable period of time after the lawyer's death, to the lawyer's estate or to one or more
  1. specified persons.
2. A lawyer who undertakes to complete unfinished legal business of a deceased lawyer may pay to the estate of the deceased lawyer that proportion of the total compensation which fairly represents the services rendered by the deceased lawyer.
3. A lawyer or law firm may compensate a non-lawyer employee, or include a non-lawyer employee in a
4. retirement plan, based in whole or in part on a profit sharing arrangement.

In the Commentary prepared by COSAC to guide the Appellate Divisions in their formulation of the transition from the Code to the new Rules of Professional Conduct, COSAC recommended that subsection A.1. be retained as written, and that subsection A.2 be modified by replacing "deceased lawyer" with "deceased, disabled or disappeared lawyer", and "proportion of total compensation" with "portion of total compensation".

With respect to subsection A.3., the COSAC Commentary stated:

¶ (a)(3) is identical to DR 3-102(A) (3); unlike Model Rule 5.4(a)(3), it allows compensation of a single employee without an all-employee plan.

Though the Code and the new Rule are not exactly identical (two commas in DR 3-102(A)(3)) were eliminated), this difference between the DR and the new Rule on the one hand, and the Model Rule on the other hand, is important. DR 3-102(A) was amended in 1999 to read exactly as it read in 2009, when Rule 5.4(a) replaced it. Before 1999, it was limited to profit sharing arrangements which were incorporated in retirement plans, and did not address the right of a lawyer's employees to share in fees based on similar profit-sharing arrangements.

The history of the 1999 Code amendment was recorded in the American Legal Ethics Library maintained by Cornell Law School's Legal Information Institute, [www.law.cornell.edu/ethics/](http://www.law.cornell.edu/ethics/) :

**(Prior to 1999)**

NY DR 3-102(A) states: "A lawyer or law firm shall not share legal fees with a non-lawyer, except that: ... (3) A lawyer or law firm may include nonlawyer employees in a retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement."

Subparagraph (A)(3) allows fee-sharing for purposes of a law firm's retirement plan. This exception is compelled by the tax laws which disallow 'top heavy' plans that confer benefits on managers but not workers, and by ERISA (Employment Retirement Income Security Act of 1974) which mandates roughly equal retirement plan treatment for all employees in an enterprise. Note that New York rejects the language of Model Rule 5.4(a)(3) and the ABA Model Code version which allow firms to include non-lawyer employees not only in a retirement plan, but also in a compensation plan.

**Ethics Opinion 733 (2000)**

Following adoption of the 1999 amendment to DR 3-102(A) (3), which extended the concept of profit-sharing to employee compensation, the NY SBA Committee on Professional Ethics issued Ethics Opinion 733 (10/5/00). The Opinion asks the following Question: "Does the 1999 amendment...allow a lawyer to pay a non-lawyer employee a percentage of fees attributable to matters referred by the employee?"

In partial response to the Question, the Committee quoted its own Special Committee to Review the Code of Professional Responsibility, which had prepared the 1999 amendment:

[The amendment] incorporates the substance of Model Rule 5.4(a)(3) in allowing non-lawyer employees of a lawyer or law firm to participate in a profit-sharing plan with respect to their salaries and bonuses and otherwise to be compensated, in whole or in part, based on the profitability of the lawyer or law firm...

The Opinion continued:

The Committee has been asked whether DR 3-102 as amended to permit "profit-sharing compensation" would now allow payment to a non-lawyer employee of a percentage of fees attributable to matters referred by the employee as compensation for the referral. Although the Disciplinary Rule as amended provides greater latitude with respect to compensation arrangements for non-lawyer employees that have profit sharing as a component, the particular compensation arrangement suggested continues to be unethical...

While non-lawyers may be paid based on a lawyer or law firm's profitability or business performance, a non-lawyer may not be paid a percentage of fees attributable to matters referred by the employee. Indeed, a contrary construction of the new amendment to DR 3-102 would conflict directly with Section 491 of the Judiciary Law...

Where does that leave us? If Rule 5.4(a)(3) and DR 3-102(A)(3) are deemed identical and Judiciary Law § 491 is not repealed or substantially amended, how can law firm employees share in any profit sharing plan, whether under individual agreements with the firm, or as a group under a defined employee plan? Why have a Rule which conflicts with the intent of a statute?

Perhaps the answers to our questions lie in comparing the ABA Model Rules to the New York Rules. What's the real difference between Model Rule 5.4(a)(3) and New York's corresponding rules as expressed both in the Code and the new Rule 5.4(a)(3)? It's all in the language.

**ABA Rule:** A lawyer or law firm may include non-lawyer employees in a compensation or retirement plan, even though the plan is based in whole or in part on a profit sharing arrangement.

**ABA Comment [1]:** The provisions of this Rule express traditional limitations on sharing fees. These limitations are to protect the lawyer's professional independence of judgment....

**NY Rule:** A lawyer or law firm may compensate a nonlawyer employee or include a nonlawyer employee in a retirement plan based in whole or in part on a profit-sharing arrangement.

**NY Comment [1]:** [Identical to ABA Comment 1]

**NY Comment [1B]:** Paragraph (a)(3) permits fee sharing with a non-lawyer employee, where the employee's compensation or retirement plan is based in whole or in part on a profit sharing arrangement. Such sharing of profits with a nonlawyer employee must be based on the total profitability of the law firm or a department within a law firm and must not be based on the fee resulting from a single case.

(Comments with a number and a capital letter were written expressly for the New York Rules of Professional Conduct and have no ABA equivalent.)

Because the *Marinis* case (*supra*) would be governed by the Code of Professional Responsibility (all relevant events in *Marinis* took place between 1999 and 2009, when the Code was in effect), we quote EC 3-8 to the Code:

EC 3-8 Since a lawyer should not aid or encourage a nonlawyer to practice law, the lawyer should not practice law in association with a non-lawyer or otherwise share legal fees with a non-lawyer. This does not mean, however, that the pecuniary value of the interest of a deceased lawyer in a firm or practice may not be paid to the lawyer's estate or specified persons such as the lawyer's spouse or heirs. In like manner, profit-sharing compensation or retirement plans of a lawyer or law firm which include non-lawyer office employees are not improper. These limited exceptions to the rule against sharing legal fees with non-lawyers are permissible since they do not aid or encourage non-lawyers to practice law.

Because the ABA Model Rule anticipates a profit-sharing plan in which all employees share whereas former NY DR 3-102(A)(3) and current NY Rule 5.4(a)(3) both anticipate the possibility of a profit-sharing agreement with an individual employee (in which not all employees share), I am led to wonder why COSAC recommended, and the Courts adopted, Rule 5.4(a)(3) without switching to the Model Rule and its recognition of the problems inherent in a lawyer's negotiation of profit-sharing with an individual employee.

Frequently – perhaps inevitably – the negotiations between a lawyer and an individual employee regarding a “profit sharing” bonus would focus on particular matters and particular fees, especially if the

employee was himself involved in working on the matter (a paralegal, for example) and believed either that he had been instrumental in referring the matter or that his work had contributed to the “value” of the matter. Obviously, negotiations with individual employees are much more likely to lead to discussions of fee-splitting. Also, Rule 5.4(a)(3) applies only to lawyers and not to laymen, who are ignorant of the laws and the Rules affecting lawyers, and who may consequently believe they are entitled to bargain for and receive a share of a lawyer’s fees, especially because Rule 5.4(a)(3) employs the excessively simple term “profit-sharing.”

### **Roy Simon’s Commentary**

My friend Roy Simon foresaw this very problem. In the 2008 Edition of his New York Code of Professional Responsibility Annotated, Thomson/West, Roy wrote:

“In either case [compensation to a non-lawyer employee or inclusion of a non-lawyer employee in a retirement plan] the money given to the non-lawyer employee may be based wholly or partly on a ‘profit-sharing arrangement.’ This creates an ambiguity, because the phrase ‘profit-sharing arrangement’ is not defined in the Code of Professional Responsibility [author’s note: or in the Rules of Professional Conduct] and has no fixed or rigid meaning outside the Code. Therefore, it could be read to permit a lawyer to make an “arrangement” to share the “profit” from a particular case with a non-lawyer.

“However, I do not think the courts will read subparagraph (A)(3) that broadly. I do not think that a law firm could base its retirement contributions on a share of fees from a particular matter or group of matters (*e.g.*, 20% of the fees from the *Magillicuddy* class action, or 10% of all billings to IBM). This problem does not arise as a practical matter with respect to retirement plans because ERISA does not allow such hit-or-miss schemes for retirement contributions, but it could arise in crafting a bonus plan or other “profit-sharing arrangement” for non-lawyer employees.

“In my view, the rule of thumb should be that a profit-sharing bonus or salary must be based on an entire firm’s net profits, or at least all of a particular lawyer’s profits, not just on fees from a selected matter or matters. This is consistent with the historical policy justification for prohibiting fee sharing with non-lawyers, and is faithful to the Krane Committee’s intention to allow non-lawyer employees to ‘participate in a profit-sharing plan with respect to their salaries and bonuses and otherwise be compensated ... based on the profitability of the lawyer or law firm.’ (Emphasis added.) The ‘profitability of the lawyer or law firm’ depends on all of the firm’s cases, not just the profits generated by a discrete department or practice group. In Nassau Bar Ethics Op. 02-3 (2002), the Committee agreed, stating:

[T]he history, background, and commentaries reflect that a ‘profit-sharing arrangement’ still does not encompass a share in the revenue or profit from a particular segment of the practice of a lawyer or law firm. Rather, the profit-sharing salary or bonus is to be based on the entire annual revenue or profitability of the lawyer or law firm....

“However, in N.Y. State Bar Op. 733 (2000), which concluded that a lawyer could not compensate a non-lawyer with a percentage of the fees from a matter referred to the law firm by a non-lawyer, the Committee left the broader question open, saying: ‘Whether and under what circumstances a lawyer may

now compensate a non-lawyer employee based on the profitability of a particular client's matter where the payment is not compensation for a referral is beyond the scope of this opinion.' Thus, the question of bonuses or profit-sharing plans based on fees from particular cases will remain open until courts or ethics committees provide a clear answer."

### **Recommended Changes in § 491 and Rule 5.4(a)(3)**

There is a simple solution for all this confusion:

1. Rewrite Judiciary Law 491 to read as follows:

§ 491. Sharing of a lawyer's fees or compensation with a nonlawyer

1. It shall be unlawful for any lawyer, or any person employed by the lawyer, to agree, or to enter into an arrangement or agreement, to share in or to divide a fee or other compensation earned by or paid to the lawyer by any client of the lawyer, or as the result of any one matter or group of matters in which the lawyer participates or renders any services. But this section does not apply: (a) to a written profit-sharing plan in which all employees of the lawyer participate and which provides for bonuses or other compensation based on the employees' merit and/or a percentage of the profits of a lawyer from all matters and clients in a prescribed period of time; or (b) an agreement between attorneys and counselors-at-law to divide between themselves the compensation to be received from one matter or a group of matters.
2. Any lawyer or other person violating any of the provisions of this section is guilty of a misdemeanor.

2. Rewrite Rule 5.4(a)(3) of the Rules of Professional Conduct to read:

A lawyer or law firm may:

- (i) include nonlawyer employees in a retirement plan based in whole or in part on a profit-sharing arrangement, and/or
- (ii) adopt a written profit-sharing plan in which all employees of the lawyer participate and which provides for bonuses or other compensation based on merit and/or a percentage of the profits of a lawyer from all matters and clients in a prescribed period of time, but not on an agreement between the lawyer and any employee to share in or divide a fee or other compensation earned by or paid to the lawyer by any client of the lawyer, or as the result of any one matter or group of matters in which the lawyer participates or renders any services. We may, in making these changes, edge closer to, and even expand on, Model Rule 5.4(a)(3), but what's wrong with that?

One last comment: to avoid litigation by a disgruntled employee, a lawyer would be well advised to record the salary of each employee, the other basic terms of compensation (vacation, sick leaves, holidays), and the basis for any bonus or other compensation in excess of the employee's salary and basic compensation, including, if based on a profit-sharing arrangement, the steps by which such excess was computed.

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*Lazar Emanuel is the Publisher of NYPRR.*

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