



ISBA Professional Conduct Advisory Opinion

Opinion No. 19-01
April 2019

Subject: Providing Additional Payment to Class Representative From Attorneys' Fees

Digest: Lawyers should carefully consider fee agreements under which they may be required to use part of their court-awarded fees in a class action case to compensate class representatives beyond the amount the court approves for that purpose. Such agreements create a substantial risk that the lawyer is operating under a conflict of interest that cannot be waived, because such a fee agreement places the interests of the lawyer's client, the class representative, at odds with the interests of absent class members, to whom the lawyer owes fiduciary obligations. In addition, such a fee agreement could, in some circumstances, violate the prohibition on sharing fees with non-lawyers.

References: Illinois Rules of Professional Conduct 1.7 and 5.4

Creative Montessori v. Ashford Gear, 662 F.3d 913 (7th Cir. 2011)

Rodriguez v. West Publ's Corp., 563 F.3d 948 (9th Cir. 2009)

O'Hara v. Ahlgren, Blumenfeld & Kempster, 127 Ill. 2d 333 (1989)

In re Gould Sec. Litig., 727 F. Supp. 1201 (N.D. Ill. 1989)

Vassalle v. Midland Funding LLC, 708 F.3d 747 (6th Cir. 2013)

In re Dry Max Pampers Litig., 724 F.3d 713, 722 (6th Cir. 2013)

TEX. COMM. ON PROF'L ETHICS, Op. 526, V. 61 TEX. B.J. 463 (1998)

D.C. ETHICS OP. 351 (2009)

ME. ETHICS OP. 198 (2009)

N.Y. STATE ETHICS OP. 819 (2007)

VA. ETHICS OP. 1783 (2003)

Kathryn Honecker, et al., *Class Actions 101: A Primer on Finding Plaintiffs for Your Class Action . . . Ethically*, 23 A. B. A.: CLASS ACTION AND DERIVATIVE SUITS, no. 4, Summer 2013

5 WILLIAM B. RUBENSTEIN, NEWBERG ON CLASS ACTIONS (Alba Conte & Herbert Newberg eds., 5th ed. 2015)

FACTS

The Committee received an inquiry regarding a proposed provision in an attorney retention agreement with a representative plaintiff in a putative class action lawsuit. In the inquiry, the author suggests that a plaintiff who serves as a class representative may recover less because he or she pursued the claim as a class action, compared to what the plaintiff may have recovered had he or she pursued the claim on an individual basis, and even though the plaintiff's service as a class representative will require the plaintiff to expend substantial financial and other resources in assisting the lawyers and the class in pursuit of the class claims. The author inquires about the following proposed fee agreement provision, which the author indicates is designed to address these concerns:

In that client [Class Representative] has agreed to advance new funds to assist in the pursuit of the class action on behalf of a substantial class, and client will be devoting substantial time and effort in assisting attorneys in pursuing the class action, and client has foregone any attempt to individually settle its claim so as to be able to serve as class representative, it is agreed that: if the attorneys achieve a recovery for the class, and if client's net recovery as a member of the class (including class representative's fee) is less than client's allowable damages as determined by the court and as measured at the time of recovery, then attorneys will pay the client one-half of the difference between client's net recovery and client's allowable damages.

The inquiry indicates that this provision, along with the full attorney retention agreement, would be disclosed to the court if and when the lawyer seeks the court's approval of an award of attorneys' fees following a successful class action.

QUESTION

Do the Illinois Rules of Professional Conduct permit the above fee agreement provision between a lawyer and a putative class representative?

OPINION

I. The fee agreement provision may give rise to a conflict of interest on the part of the lawyer under Rule 1.7.

The proposed fee agreement could be viewed as a lawyer's agreement to reduce the fee he or she charges the class representative, contingent on how much the class representative recovers in the litigation. The Rules of Professional Conduct do not comment on agreements to *reduce* fees charged by the lawyer at the end of a representation, and the Committee does not believe such agreements are *per se* impermissible.

However, the proposed fee agreement does implicate the prohibitions on concurrent conflicts of interest in Rule 1.7 and create a substantial risk that the lawyer is in violation of that rule. In general, Rule 1.7 prohibits lawyers from representing a client if “the representation involves a concurrent conflict of interest,” such as where “there is a significant risk that the representation of one or more clients will be materially limited by the lawyer’s responsibilities to another client.” ILL. R. PROF’L CONDUCT 1.7(a). Although “unnamed members of [a] class are ordinarily not considered to be clients of the lawyer” for purposes of evaluating whether the representation of one client is directly adverse to the representation of another client under Rule 1.7(a)(1), *see id.* at cmt. 25, a lawyer serving as class counsel has a fiduciary duty to the class as a whole, *e.g.*, *Creative Montessori v. Ashford Gear*, 662 F.3d 913, 917-18 (7th Cir. 2011) (discussing fiduciary obligations of class counsel); *Rodriguez v. West Publ’s Corp.*, 563 F.3d 948, 948 (9th Cir. 2009) (same and noting “[t]he responsibility of class counsel to absent class members whose control over their attorneys is limited does not permit even the appearance of divided loyalties of counsel”). Rule 1.7(a)(2) prohibits a lawyer from representing a client if, among other things, “there is a significant risk that the representation of one or more clients will be materially limited . . . by a personal interest of the lawyer.”

Here, the lawyer’s personal interest lies in her obligation to fulfill her fiduciary responsibilities to the class. The proposed fee agreement creates a disconnect between the interests of the class representative and the interests of the absent class members.

A hypothetical example is instructive. Assume that, following the successful outcome of a class action, a court will award the prevailing plaintiffs and/or their lawyers: (1) out-of-pocket expenses and costs; (2) an incentive award to the class representative; and (3) attorneys’ fees. The purpose of the incentive award is to compensate the class representative for any “time and effort” exerted in pursuing the class action. 5 WILLIAM B. RUBENSTEIN, NEWBERG ON CLASS ACTIONS 492 (Alba Conte & Herbert Newberg eds., 5th ed. 2015). What remains after expenses, attorneys’ fees, and the incentive award payment will be the damages award to be divided among the class members.

Assume a hypothetical case where a 100-member class has achieved a \$1 million judgment, which translates to \$10,000 per class member. The court approves a 30% fee award for the attorney, plus payment for \$10,000, with the \$10,000 payment covering both expenses and a \$1,000 incentive payment for the class representative. Deducting those amounts would leave \$690,000 to distribute to class members, or \$6,900 per class member. The class representative would receive that amount plus his incentive payment, or \$7,900. However, under the proposed

fee provision, “if client’s net recovery as a member of the class (including class representative’s fee) is less [than] client’s allowable damages . . . then attorneys will pay the client one-half of the difference between client’s net recovery and client’s allowable damages.” In this hypothetical, \$7,900 is the class representative’s “net recovery,” which is \$2,100 less than each class member’s \$10,000 allowable damages. Thus, the lawyer would pay the class representative one-half, or \$1,050, of this difference, on top of the \$1,000 incentive payment the court approved for that class representative’s services. That translates to the class representative receiving \$2,050 more than an absent class member (*i.e.*, a total of \$8,950 for the class representative, compared to \$6,900 for the class member), of which only \$1,000 was court-approved.

As this hypothetical demonstrates, the proposed fee agreement provision may disrupt the alignment between the class representative’s interests and the interests of absent class members because the class representative stands to gain more than absent class members. This appears to be especially true as the amount deducted from the class judgment to pay attorneys’ fees increases. For example, using the numbers above, but assuming a 35% rather than 30% fee award, the difference between what the class representative and a typical class member would receive increases to \$2,300 (*i.e.*, a total of \$8,700 for the class representative compared to \$6,400 for each class member).

Thus, the fee agreement described above gives the lawyer an incentive to seek a higher attorneys’ fee award or class representative incentive payment than she otherwise might—to the detriment of the class as a whole—so that the lawyer will take less of an overall “hit” if and when she is required, under the fee agreement, to award the class representative an additional amount beyond her recovery as a class member. A lawyer considering a fee arrangement of the kind identified above would need to carefully consider whether the fee arrangement poses a “significant risk” that the lawyer will compromise her fiduciary obligations to the class as a whole in favor of the interests of her class representative client. *See* ILL. R. PROF’L CONDUCT 1.7(a). That would be a prohibited conflict of interest under Rule 1.7. The Committee believes that in many situations, such a conflict of interest would exist, and that this counsels against the use of the kind of fee agreements described above.

The Committee also believes this would be the kind of conflict of interest that could not be waived. Rule 1.7(b) provides that, notwithstanding a concurrent conflict of interest as set forth in Rule 1.7(a), “a lawyer may represent a client if,” among other things, “each affected client gives informed consent.” Here, however, the lawyer’s client is the class representative, and the class representative—who stands to gain from the fee arrangement—has an incentive to consent to the conflict of interest, even if the arrangement is to the detriment of the absent class members as to whom both the lawyer and the class representatives owe fiduciary obligations.

Moreover, the Committee does not believe that disclosing the fee agreement to the court and obtaining the court’s approval would resolve the likely Rule 1.7 problem. The inquiry indicates that the fee agreement would be disclosed only “if and when” the lawyer seeks approval of an attorneys’ fee award when the class action is successfully resolved. Although the Committee suspects there may be circumstances in which the fee agreement would have to be disclosed earlier, such as at the time class certification is sought, one significant problem is that disclosure and court approval would come too late—such steps would happen only at a time when the lawyer is already into the case, representing the class representative. More importantly, nothing in the Rules of

Professional Conduct suggests that a court can authorize what would otherwise be a lawyer's violation of the rules.

II. The fee agreement provision could implicate Rule 5.4(a)'s prohibitions on fee-sharing with a non-lawyer.

A lawyer considering the kind of fee arrangement described above also should consider whether the fee agreement implicates Rule 5.4(a), which prohibits a lawyer from sharing her fee with a non-lawyer: "A lawyer or law firm shall not share legal fees with a nonlawyer." ILL. R. PROF'L CONDUCT 5.4(a). In the usual situation, the negotiation of a fee agreement between a lawyer and his client does not implicate Rule 5.4(a), though other Rules of Professional Conduct are involved, such as Rule 1.5.

Rule 5.4(a)'s prohibition on fee sharing is a traditional limitation rooted in the idea of "protect[ing] the lawyer's professional independence of judgment." ILL. R. PROF'L CONDUCT 5.4(a) cmt. 1. Courts have long expressed concern that a lawyer may be less inclined—whether consciously or subconsciously—to devote the necessary time and attention to a case with a fee-sharing agreement because that case is less profitable than one where no such agreement exists. *See, e.g., O'Hara v. Ahlgren, Blumenfeld & Kempster*, 127 Ill. 2d 333, 343 (1989) ("Any reduction in the quality of legal services rendered by an attorney to a client creates a risk that the rights of the client may not be fully protected and results in prejudice to the client. Because of the harmful effects that fee-sharing agreements between attorneys and nonattorneys promote, such agreements are contrary to public policy.").

For purposes of this analysis, the Committee assumes that the additional payment to the class representative in the proposed fee agreement would be paid from a court-approved award of attorneys' fees. The Committee does not believe that this specific proposed fee agreement violates Rule 5.4, because the additional payment coming from the lawyer's fee would be made to the lawyer's own client—the class representative. As a general matter, Rule 5.4(a) does not prohibit lawyers from deciding to discount or rebate their fees to the benefit of their own clients. *See, e.g., D.C. ETHICS OP. 351* (2009) (advance agreement as to amount of lawyer's contingency fee, which had the effect of requiring the lawyer to pay the client an amount out of the attorney's court-approved fees awarded under fee-shifting statute, did not violate Rule 5.4(a)); *ME. ETHICS OP. 198* (2009) (noting "[a]n attorney is always free to discount his/her fee to a client" and concluding that a lawyer may refund a portion of his fee for the purpose of the client paying a non-lawyer advocate for assistance in initially representing the client in a Social Security case); *N.Y. STATE ETHICS OP. 819* (2007) (noting that the perils that can flow from sharing fees with non-lawyers "typically arise from the sharing of fees with non-client third parties" and concluding that divorce lawyer could agree to accept smaller fee from client than the court-approved award); *VA. ETHICS OP. 1783* (2003) ("The setting of an appropriate fee for particular work by an attorney with his client is not the sort of improper sharing of attorney's fees with a nonattorney addressed in Rule 5.4.").

However, there may be instances where a class representative fee agreement similar to the above would cross the line and violate Rule 5.4(a), but the specific circumstances in which that may be the case are beyond the scope of this opinion. *See NEWBERG ON CLASS ACTIONS* 518, § 17:5 ("[I]f counsel give a portion of their fees to their clients, the payment would likely violate the ethical prohibition on a lawyer sharing a fee with a non-lawyer, as well as the prohibition on a

lawyer going into business with her client. It would also create bad policy.”) (collecting cases); Kathryn Honecker, et al., *Class Actions 101: A Primer on Finding Plaintiffs for Your Class Action . . . Ethically*, 23 A. B. A.: CLASS ACTION AND DERIVATIVE SUITS, no. 4, Summer 2013 (“[D]o not take it upon yourself to reward the class representatives for serving as named plaintiffs. Never promise or give them anything of value, including a percentage of your fees in the case, in exchange for being named plaintiffs in the case. In addition to violating Model Rule 5.4(a)’s prohibition against sharing legal fees with a nonlawyer, your reward may be seen as an illegal kickback and land you in jail.”)¹; TEX. COMM. ON PROF’L ETHICS, Op. 526, V. 61 TEX. B.J. 463 (1998) (in finding that a law firm may not distribute to non-lawyer class member clients a portion of court-awarded legal fees, the Committee noted that if “the law firm’s [class member] clients deserved special compensation . . . that was a matter for the court to determine”).

Relatedly, although also outside the scope of this opinion, a fee agreement with a proposed class representative like that described above could be viewed as an improper incentive payment to the class representative under the rules and legal principles governing class actions. *See, e.g.*, NEWBERG ON CLASS ACTIONS § 17:17 (“One . . . disfavored practice[] is an *ex ante* agreement between putative class counsel and putative class representatives containing certain assurances with regard to incentive awards.”); *Rodriguez v. West Publishing Corp.*, 563 F.3d 948, 959 (9th Cir. 2009) (finding incentive agreements violated the California Rules of Professional Conduct prohibiting fee-sharing with clients and among lawyers). Courts are already wary that incentive payments can misalign the interests of the class representative from the interests of the rest of the class because they “may lead named plaintiffs to expect a bounty for bringing suit or to compromise the interest of the class for personal gain.” *In re Dry Max Pampers Litig.*, 724 F.3d 713, 722 (6th Cir. 2013); *accord Vassalle v. Midland Funding LLC*, 708 F.3d 747, 755 (6th Cir. 2013) (rejecting class settlement in part because named plaintiffs received preferential treatment under its terms); *In re Gould Sec. Litig.*, 727 F. Supp. 1201 (N.D. Ill. 1989) (denying incentive fees for class representatives because they lost the right to preferred treatment when they joined the class).

CONCLUSION

The fee agreement at issue creates a substantial risk that the lawyer would be operating under a conflict of interest under Illinois Rule of Professional Conduct 1.7 that cannot be waived, because it sets up a conflict between the lawyer’s obligations to his or her client, a class representative, and the lawyer’s own fiduciary obligations to absent class members. In addition, lawyers considering fee agreements similar to the proposed fee agreement should consider whether the agreement violates Rule 5.4(a)’s prohibition on fee-sharing with a non-lawyer, although the Committee does not believe the proposed fee agreement at issue here violates that rule.

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¹ <http://apps.americanbar.org/litigation/committees/classactions/articles/summer2013-0913-primer-on-finding-plaintiffs-for-your-class-action-ethically.html>.

not binding on the courts or disciplinary agencies, but they are often considered by them in assessing lawyer conduct.

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