

# Judiciary Law § 495(5): Court of Appeals Limits Scope of Appellate Division's Review of Legal Services Plans

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## JUDICIARY LAW

*Judiciary Law § 495(5): Court of Appeals limits scope of appellate division's review of legal services plans.*

Section 495 of the Judiciary Law provides that no corporation or voluntary association may practice law.<sup>195</sup> There are, however, a number of exceptions to this general prohibition, including one which permits organizations with either benevolent or charitable purposes, or with the purpose of securing civil remedies for persons of limited financial resources, to be involved in the furnishing of legal services.<sup>196</sup> To avail themselves of this statutory exception, these organizations must obtain the prior approval of the appellate division.<sup>197</sup> Recently, in *Feinstein v. Attorney-General*,<sup>198</sup> decided with *New York County Lawyer's Association v. Appellate Division, First Department*, the Court of Appeals significantly limited the ambit of investigation which the appellate division may conduct when reviewing the propriety of a proposed prepaid legal services plan.<sup>199</sup> The *Feinstein* Court held that the appellate division cannot reject an applicant's request for an exemption where that rejection is based solely upon the determination that the proposed plan is in the nature of insurance.<sup>200</sup>

<sup>195</sup> N.Y. JUDICIARY LAW §§ 495(1)-(2) (McKinney 1968). This provision supersedes former N.Y. Penal Law § 280, ch. 483, § 1, [1909] N.Y. Laws 2. The primary justification for the enactment of this statute was the fear that corporation-employed attorneys might show greater loyalty to the corporation than to the confidential interests of their clients. *See, e.g.*, *People v. Peoples Trust Co.*, 180 App. Div. 494, 167 N.Y.S. 767 (2d Dep't 1917). *See also Kelly v. Greason*, 23 N.Y.2d 368, 375-76, 244 N.E.2d 456, 460, 296 N.Y.S.2d 937, 943-44 (1968).

<sup>196</sup> *See* N.Y. JUDICIARY LAW § 495(5) (McKinney 1968).

<sup>197</sup> *Id.* Applications of corporations or voluntary associations seeking to operate a law office are passed upon by the department of the appellate division having jurisdiction over the principal office of such organization. *Id.* After approval is granted, the organization remains under the scrutiny, disciplinary control, and regulation of the appellate division. *See* 22 N.Y.C.R.R. 608.7 (1975). *See also In re Pinkard*, 28 App. Div. 2d 34, 280 N.Y.S.2d 959 (4th Dep't 1967).

Although a legal assistance corporation need not be sponsored by lawyers, the day-to-day functions of the organization must be supervised by persons competent to practice law in the State. *See In re Community Action for Legal Servs. Inc.*, 26 App. Div. 2d 354, 361, 274 N.Y.S.2d 779, 787 (1st Dep't 1966). In addition, approved corporations must have relatively small directorates in order to promote their amenability to discipline and sanction by the court. *Id.* Present rules of the Appellate Division, First Department, limit the board of directors to 30 members, a majority of whom must be attorneys licensed to practice law in New York. 22 N.Y.C.R.R. 608.6 (1975). Although according to these rules approval is limited to a three-year period, an extension for an indefinite period is available. *Id.* 608.5.

<sup>198</sup> 36 N.Y.2d 199, 326 N.E.2d 288, 366 N.Y.S.2d 613 (1975) (Breitel, C.J.), *rev'g In re Feinstein*, 45 App. Div. 2d 440, 357 N.Y.S.2d 516 (1st Dep't 1974). The procedural rules governing § 495 applications and the first department's responsibilities in considering these applications are set forth in 22 N.Y.C.R.R. 608 (1975).

<sup>199</sup> 36 N.Y.2d at 204-05, 326 N.E.2d at 291, 366 N.Y.S.2d at 617-18.

<sup>200</sup> *Id.*

While the *Feinstein* application involved a legal services program for union members, to be financed through a welfare fund trust,<sup>201</sup> the *Lawyer's Association* application involved an attempt to establish an independent corporation to provide reimbursement of legal fees incurred by its subscribers.<sup>202</sup> The Appellate Division, First Department, finding no pertinent differences in the details of the two applications, considered them jointly and rejected both on the grounds that the court had neither the authority nor the resources to supervise what it considered to be insurance schemes.<sup>203</sup>

In an earlier opinion, *In re Application of Community Action for Legal Services, Inc.*,<sup>204</sup> the first department had defined its role in evaluating applications for proposed plans as a responsibility to assess authenticity, to assure freedom from improper professional conduct, to make certain that lawyer-client relationships are preserved, and to insure that the subject organization remains under the disciplinary control of the court.<sup>205</sup> In reversing *Feinstein*, the Court of Appeals stated that the appellate division had improperly failed to limit its concern to these guidelines.<sup>206</sup> The Court also stated that the appellate division is not to concern itself with the controversy over "open panel" and "closed panel" prepaid legal services plans.<sup>207</sup> Unless the plan, on its face, is clearly illegal

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<sup>201</sup> The application submitted in *Feinstein* was proposed by a union of low-to-middle income municipal employees. The plan provided for a specified variety of legal services to be rendered by a law firm representing the union. In addition to a moderate initial charge, union members would be required to pay for services in excess of those available under the plan. As a "closed panel" plan, there would be no reimbursement of fees for lawyers the members retained on their own. *Id.* at 203-04, 326 N.E.2d at 290, 366 N.Y.S.2d at 616. "Closed panel" plan is defined in note 207 *infra*.

<sup>202</sup> The plan proposed by the New York County Lawyer's Association involved the use of a separate corporation set up to provide reimbursement for legal services rendered to middle-income persons paying a modest cost for membership. Since subscribers would be free to choose their lawyers from a panel of participants whose fees would be predetermined according to a schedule, the plan, to a limited extent, would be "open panel." *Id.* at 204, 326 N.E.2d at 290, 366 N.Y.S.2d at 616-17. "Open panel" plan is defined in note 207 *infra*.

<sup>203</sup> 45 App. Div. 2d at 441, 357 N.Y.S.2d at 517.

<sup>204</sup> 26 App. Div. 2d 354, 274 N.Y.S.2d 779 (1st Dep't 1966) (Breitel, J.).

<sup>205</sup> *Id.* at 359-62, 274 N.Y.S.2d at 786-88. The criteria enumerated in *Community Action* are not exclusive tests for evaluating the merits of a proposed plan. The court may consider any factor relevant to the protection of the public, which factor is the "paramount and final determinant." *Id.* at 364, 274 N.Y.S.2d at 790.

<sup>206</sup> 36 N.Y.2d at 202-05, 326 N.E.2d at 290-91, 366 N.Y.S.2d at 616-18.

<sup>207</sup> *Id.* at 205, 326 N.E.2d at 291, 366 N.Y.S.2d at 618.

An "open panel" plan theoretically permits subscribing clients to either freely choose private attorneys or select from those participating in a particular program. The plan then, in much the same way as a health insurance plan might work, reimburses the client for the attorneys' fees expended. A "closed panel" plan provides for a retained set of attorneys to whom member clients are assigned. Resembling the operation of a health clinic, it involves no free choice or selection. *See, e.g., N. SHAYNE, PREPAID LEGAL SERVICES 4-5 (AMA Man-*

or fraudulent,<sup>208</sup> it seems clear from *Feinstein* that the scope of the appellate division's inquiry may not extend to extraneous, *i.e.* non-*Community Action*, questions. Although it conceded that the proposed plans might be regulated by the Superintendent of Insurance,<sup>209</sup> the Court indicated that they were not within the "spirit and purpose of the existing provisions of the Insurance Law."<sup>210</sup> Even assuming that an evaluation of the Insurance Law implications should be made, the Court found that neither plan, at least on its face, involved insurance, and therefore the appellate division's inability to conduct a detailed analysis in terms of the Insurance Law was considered an inappropriate ground for rejecting the applications.<sup>211</sup>

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agement Briefing 1974); Wilson, *Justice Department and Other Views on Prepaid Legal Services Plans Get an Airing Before the Tunney Subcommittee*, 60 A.B.A.J. 791 (1974). See also Note, *Legal Service Plans — Coming of Age*, 49 ST. JOHN'S L. REV. 137, 156-61 (1974).

The proliferation of legal services plans, which plans are recognized as a legitimate exercise of constitutional freedoms, see *NAACP v. Button*, 371 U.S. 415 (1963), is a relatively recent phenomenon. In *Button*, the United States Supreme Court held that an organization may employ attorneys to advise and assist others in the enforcement of their legal rights. *Button* further held that such a program of legal representation is protected by the first amendment freedoms of expression and association. *Id.* at 437. More recently, the United States Supreme Court held that labor unions have a constitutionally protected right to establish and maintain a legal services plan which may enforce claims for its members. See *United Mine Workers of America v. Illinois Bar Ass'n*, 389 U.S. 217 (1967); *Brotherhood of R.R. Trainmen v. Virginia State Bar*, 377 U.S. 1 (1964). Accordingly, the American Bar Association, which had consistently opposed the concept of prepaid legal services plans, finally stated that it is ethically sound for an attorney to participate in such programs. See ABA CODE OF PROFESSIONAL RESPONSIBILITY DR 2-103(D), 2-104, 2-105(A)(3).

<sup>208</sup> 36 N.Y.2d at 205, 207, 326 N.E.2d at 291-92, 366 N.Y.S.2d at 617-18, 619. Where the plan is clearly illegal or fraudulent, approval must be denied by the appellate division. *Id.*

<sup>209</sup> *Id.* at 206-07, 326 N.E.2d at 292, 366 N.Y.S.2d at 619. The Superintendent of the Insurance Department has extensive statutory authority to ensure compliance with all provisions of the Insurance Law. See N.Y. INS. LAW § 35 (McKinney 1966). Desiring not to invade the province of the Insurance Department, the appellate division determined that it was precluded from considering an application having the characteristics of insurance. 45 App. Div. 2d at 441, 357 N.Y.S.2d at 517.

<sup>210</sup> 36 N.Y.2d at 209, 326 N.E.2d at 294, 366 N.Y.S.2d at 621. See also *id.* at 208, 326 N.E.2d at 293, 366 N.Y.S.2d at 620.

<sup>211</sup> *Id.* at 204, 207, 326 N.E.2d at 291, 292, 366 N.Y.S.2d at 617, 619. In considering whether "on their face" these plans were insurance schemes, the Court directed its attention to N.Y. INS. LAW § 41(1) (McKinney 1966) which defines an "insurance contract" as

any agreement or other transaction whereby one party . . . is obligated to confer benefit of pecuniary value upon another party . . . dependent upon the happening of a fortuitous event in which the insured or beneficiary has, or is expected to have at the time of such happening, a material interest which will be adversely affected by the happening of such event. A fortuitous event is any occurrence or failure to occur which is, or is assumed by the parties to be, to a substantial extent beyond the control of either party.

Construing this section in a literal sense, the Court in *Feinstein* stated:

The proposed prepaid legal service plans are not insurance businesses or insurance contracts . . . .

Viewed as a provider of professional services, sought as a matter of choice, at flat fees rather than as reimbursement for material losses or expenses precipitated

It is submitted that the Court of Appeals' decision recognizes that legal services plans are coming of age and that such plans must serve middle-income as well as indigent persons.<sup>212</sup> Despite, as noted by the Court, the absence of adequate legislative provisions with respect to review and control of such plans,<sup>213</sup> *Feinstein* appears to have created an environment more favorable to their development and growth.<sup>214</sup> It is not, however, the Court's first step in this direction. In *In re Thom*,<sup>215</sup> for example, section 495's "benevolent purpose" language was liberally viewed as intended to extend to more than just the assistance of indigents.<sup>216</sup>

Both *Feinstein* and *Thom* manifest a sympathetic view towards applicants seeking section 495(5) approval. While *Feinstein* indicates a willingness to limit the scope of the appellate division's review pursuant to section 495(5), *Thom* encourages liberal statutory construction with regard to areas found to be within the bounds of that review. This is not to suggest that the appellate division's role is either meaningless or insignificant. Under existing law, it is faced with the difficult tasks of preventing commercialization of the legal profession, maintaining ethical standards, and

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by fortuitous events, the proposed plans do not pose the dangers that the Insurance Law was designed to obviate.

36 N.Y.2d at 208, 326 N.E.2d at 293, 366 N.Y.S.2d at 620-21.

The Court further indicated that prepaid legal services are not insurance schemes since the need for a number of the legal services provided by the plan is not precipitated by a fortuitous event beyond the control of the parties. The drafting of a will and the purchase of a house were cited as examples. *Id.*

<sup>212</sup> The Court noted that current literature is

largely unanimous that new paths must be staked out to make legal services available to persons between those served by poverty-level schemes and those rich enough to purchase legal services without assistance or extraordinary measures . . . .

36 N.Y.2d at 206, 326 N.E.2d at 292, 366 N.Y.S.2d at 619 (citations omitted).

<sup>213</sup> *Id.* at 209-10, 326 N.E.2d at 293-94, 366 N.Y.S.2d at 621-22.

<sup>214</sup> Notably, the Court, instead of affirming the appellate division decision and leaving the matter to legislative resolution, chose to limit judicially the scope of review permissible under § 495, thus facilitating, in the absence of legislative action, the approval of legal services plans.

<sup>215</sup> 33 N.Y.2d 609, 301 N.E.2d 542, 347 N.Y.S.2d 571 (1973) (per curiam), *rev'g* 40 App. Div. 2d 787, 337 N.Y.S.2d 588 (1st Dep't 1972).

<sup>216</sup> In *Thom*, the Appellate Division, First Department, had denied approval of a legal defense fund created to ensure the rights of homosexuals. Since the applicant would not have limited its services to indigents, the court found that the organization could be deemed neither benevolent nor charitable. 40 App. Div. 2d at 787, 337 N.Y.S.2d at 589. The Court of Appeals reversed and remanded. In a lengthy concurring opinion, Judge Burke construed the "benevolent purpose" language of § 495(5) and stated that approval should be granted to any corporation whose application satisfied the requirements of part 608, *see* note 198 *supra*, and *Community Action* regardless of the financial situation of the individuals included in the class proposed to be served. 33 N.Y.2d at 613-16, 301 N.E.2d at 544-46, 347 N.Y.S.2d at 574-76 (Burke, J., concurring). *See also* *Green v. Javits*, 7 Misc. 2d 312, 314-15, 166 N.Y.S.2d 198, 201 (Sup. Ct. N.Y. County), *aff'd sub nom.* *Green v. Lefkowitz*, 4 App. Div. 2d 869, 167 N.Y.S.2d 431 (1st Dep't 1957) (mem.).

assuring that groundless or frivolous legal actions are not solicited by applicant organizations.<sup>217</sup> At the same time, its obligation not to create unnecessary obstacles to the approval of properly conceived organizations appears evident.

The increasing number of proposed prepaid legal services plans intended to serve middle-income persons,<sup>218</sup> and, as demonstrated by *Feinstein*, the difficulties which our courts are having in determining the requirements for such programs indicate that the legislature should make the needed changes in the Judiciary Law as soon as is practicable. Limited by the inadequacies of the present statutory framework, the Court of Appeals has been virtually compelled to invite a two-stage approval process pursuant to which the appellate division will review plans from one view point while the Insurance Department will not be precluded from making an independent, and possibly contrary, evaluation from another. Further, both authorities will retain continuing supervisory and regulatory functions.<sup>219</sup> A unified system of approval and supervision encompassing both professional and fiscal integrity is obviously needed.

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<sup>217</sup> See 22 N.Y.C.R.R. 608 (1975), which sets forth procedural guidelines for organizations seeking to qualify as § 495(5) benevolent corporations. Specifically, these rules deal with the responsibility of sponsors, methods of financing, scope of proposed activities, and other matters which may affect the public interest. *In re Thom*, 33 N.Y.2d 609, 611, 301 N.E.2d 542, 543, 347 N.Y.S.2d 571, 572 (1973) (per curiam). The appellate division, in enforcing these rules, is faced with the additional burden of balancing the historical purpose of § 495, see note 195 *supra*, with the flexible approach recently taken by the Court of Appeals. This balancing process becomes particularly difficult where a proposed plan is in the nature of insurance and conceivably not within the province of the appellate division. See N.Y. Ins. Law § 35 (McKinney 1966). It is interesting to note, however, that the *Feinstein* Court stated that even the Insurance Law may not actually encompass prepaid legal services plans. See note 210 and accompanying text *supra*.

<sup>218</sup> See proposals discussed in Note, *Legal Service Plans — Coming of Age*, 49 ST. JOHN'S L. REV. 137 (1975). The Federal Retirement Security Act of 1974, 29 U.S.C.A. § 1001 *et seq.* (Supp. 1975), precludes states from regulating union welfare plans. Hence, as noted by the *Feinstein* Court, the number of such programs is almost certain to rise. 36 N.Y.2d at 209, 326 N.E.2d at 294, 366 N.Y.S.2d at 621. In addition, subsequent to *Feinstein*, a bill proposing that insurance companies be permitted to issue group policies to provide legal care services was approved by the New York State Senate. N.Y.S. 1001, 198th Sess. (1975). A similar bill is now pending in the New York Assembly. N.Y.A. 941, 198th Sess. (1975). If passed, New York will have legislatively approved legal services insurance pursuant to which persons insured would hold contracts with private corporations. Depending upon the nature of the contracts, subscribers would be free either to choose their own lawyer and be reimbursed for fees expended or be guaranteed representation by a lawyer retained by the corporation. Thus, both "open" and "closed panel" plans would be permitted. See also N.Y.S. 4887, 197th Sess. (1974); N.Y.A. 8916, 197th Sess. (1974), cited in *Feinstein v. Attorney-General*, 36 N.Y.2d 199, 209, 326 N.E.2d 288, 294, 366 N.Y.S.2d 613, 621 (1975).

<sup>219</sup> Compare 22 N.Y.C.R.R. 608.7 (1975) with N.Y. Ins. Law § 35 (McKinney 1966). Although both the appellate division and the Insurance Department perform essential functions in relation to prepaid legal insurance services, it would appear that a consolidation of their roles under a more definitive rule would avoid needless duplication of effort, yet ensure that no significant area be overlooked.