

**COMMISSION PROVISIONAL REPORT AND RECOMMENDATION:
RULE 5.4 [1-320, 1-310, 1-600]**

Commission Drafting Team Information

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I. CURRENT CALIFORNIA RULE

Rule 1-320 Financial Arrangements With Non-Lawyers

- (A) Neither a member nor a law firm shall directly or indirectly share legal fees with a person who is not a lawyer, except that:
- (1) An agreement between a member and a law firm, partner, or associate may provide for the payment of money after the member's death to the member's estate or to one or more specified persons over a reasonable period of time; or
 - (2) A member or law firm undertaking to complete unfinished legal business of a deceased member may pay to the estate of the deceased member or other person legally entitled thereto that proportion of the total compensation which fairly represents the services rendered by the deceased member; or
 - (3) A member or law firm may include non-member employees in a compensation, profit-sharing, or retirement plan even though the plan is based in whole or in part on a profit-sharing arrangement, if such plan does not circumvent these rules or Business and Professions Code section 6000 et seq.; or
 - (4) A member may pay a prescribed registration, referral, or participation fee to a lawyer referral service established, sponsored, and operated in accordance with the State Bar of California's Minimum Standards for a Lawyer Referral Service in California.
- (B) A member shall not compensate, give, or promise anything of value to any person or entity for the purpose of recommending or securing employment of the member or the member's law firm by a client, or as a reward for having made a recommendation resulting in employment of the member or the member's law firm by a client. A member's offering of or giving a gift or gratuity to any person or entity having made a recommendation resulting in the employment of the member or the member's law firm shall not of itself violate this rule, provided that the gift or gratuity was not offered or given in consideration of any promise, agreement, or understanding that such a gift or gratuity would be forthcoming or that referrals would be made or encouraged in the future.

- (C) A member shall not compensate, give, or promise anything of value to any representative of the press, radio, television, or other communication medium in anticipation of or in return for publicity of the member, the law firm, or any other member as such in a news item, but the incidental provision of food or beverage shall not of itself violate this rule.

Discussion:

Rule 1-320(C) is not intended to preclude compensation to the communications media in exchange for advertising the member's or law firm's availability for professional employment.

Rule 1-310 Forming a Partnership With a Non-Lawyer

A member shall not form a partnership with a person who is not a lawyer if any of the activities of that partnership consist of the practice of law.

Discussion:

Rule 1-310 is not intended to govern members' activities which cannot be considered to constitute the practice of law. It is intended solely to preclude a member from being involved in the practice of law with a person who is not a lawyer.

Rule 1-600 Legal Service Programs

- (A) A member shall not participate in a nongovernmental program, activity, or organization furnishing, recommending, or paying for legal services, which allows any third person or organization to interfere with the member's independence of professional judgment, or with the client-lawyer relationship, or allows unlicensed persons to practice law, or allows any third person or organization to receive directly or indirectly any part of the consideration paid to the member except as permitted by these rules, or otherwise violates the State Bar Act or these rules.
- (B) The Board of Governors of the State Bar shall formulate and adopt Minimum Standards for Lawyer Referral Services, which, as from time to time amended, shall be binding on members.

Discussion:

The participation of a member in a lawyer referral service established, sponsored, supervised, and operated in conformity with the Minimum Standards for a Lawyer Referral Service in California is encouraged and is not, of itself, a violation of these rules.

Rule 1-600 is not intended to override any contractual agreement or relationship between insurers and insureds regarding the provision of legal services.

Rule 1-600 is not intended to apply to the activities of a public agency responsible for providing legal services to a government or to the public.

For purposes of paragraph (A), “a nongovernmental program, activity, or organization” includes, but is not limited to group, prepaid, and voluntary legal service programs, activities, or organizations.

II. FINAL VOTES BY THE COMMISSION AND THE BOARD

Commission:

Date of Vote: October 21 & 22, 2016

Action: Recommend Board Adoption of Proposed Rule 5.4 [1-320, 1-310, 1-600]

Vote: 15 (yes) – 0 (no) – 0 (abstain)

Board:

Date of Vote: November 17, 2016

Action: Board Adoption of Proposed Rule 5.4 [1-320, 1-310, 1-600]

Vote: 14 (yes) – 0 (no) – 0 (abstain)

III. COMMISSION’S PROPOSED RULE 5.4 (CLEAN)

Rules 5.4 [1-320, 1-310, 1-600] Financial and Similar Arrangements with Nonlawyers

- (a) A lawyer or law firm* shall not share legal fees directly or indirectly with a nonlawyer or with an organization that is not authorized to practice law, except that:
 - (1) an agreement by a lawyer with the lawyer's firm,* partner,* or associate may provide for the payment of money or other consideration over a reasonable* period of time after the lawyer's death, to the lawyer's estate or to one or more specified persons;
 - (2) a lawyer purchasing the practice of a deceased, disabled or disappeared lawyer may pay the agreed-upon purchase price, pursuant to Rule 1.17, to the lawyer's estate or other representative;
 - (3) a lawyer or law firm* may include nonlawyer employees in a compensation or retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement, provided the plan does not otherwise violate these Rules or the State Bar Act;
 - (4) a lawyer or law firm* may pay a prescribed registration, referral, or other fee to a lawyer referral service established, sponsored and operated in accordance with the State Bar of California's Minimum Standards for Lawyer Referral Services; or

- (5) a lawyer or law firm* may share with or pay a court-awarded legal fee to a nonprofit organization that employed, retained or recommended employment of the lawyer or law firm in the matter.
- (b) A lawyer shall not form a partnership or other organization with a nonlawyer if any of the activities of the partnership or other organization consist of the practice of law.
- (c) A lawyer shall not permit a person* who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's independent professional judgment or interfere with the lawyer-client relationship in rendering legal services.
- (d) A lawyer shall not practice with or in the form of a professional corporation or other organization authorized to practice law for a profit if:
 - (1) a nonlawyer owns any interest in it, except that a fiduciary representative of a lawyer's estate may hold the lawyer's stock or other interest for a reasonable* time during administration;
 - (2) a nonlawyer is a director or officer of the corporation or occupies a position of similar responsibility in any other form of organization; or
 - (3) a nonlawyer has the right or authority to direct or control the lawyer's independent professional judgment.
- (e) The Board of Trustees of the State Bar shall formulate and adopt Minimum Standards for Lawyer Referral Services, which, as from time to time amended, shall be binding on lawyers. A lawyer shall not accept a referral from, or otherwise participate in, a lawyer referral service unless it complies with such Minimum Standards for Lawyer Referral Services.
- (f) A lawyer shall not practice with or in the form of a nonprofit legal aid, mutual benefit or advocacy group if the nonprofit organization allows any third person* or organization to interfere with the lawyer's independent professional judgment, or with the lawyer-client relationship, or allows or aids any person,* organization or group to practice law in violation of these Rules or the State Bar Act.

Comment

[1] Paragraph (a) does not prohibit a lawyer or law firm* from paying a bonus to or otherwise compensating a nonlawyer employee from general revenues received for legal services, provided the arrangement does not interfere with the independent professional judgment of the lawyer or lawyers in the firm* and does not violate these Rules or the State Bar Act. However, a nonlawyer employee's bonus or other form of compensation may not be based on a percentage or share of fees in specific cases or legal matters.

[2] Paragraph (a) also does not prohibit payment to a nonlawyer third-party for goods and services provided to a lawyer or law firm;* however, the compensation to a nonlawyer third-party may not be determined as a percentage or share of the lawyer's or law firm's overall revenues or tied to fees in particular cases or legal matters. A lawyer may pay to a nonlawyer third-party, such as a collection agency, a percentage of past due or delinquent fees in concluded matters that the third-party collects on the lawyer's behalf.

[3] Paragraph (a)(5) permits a lawyer to share with or pay court-awarded legal fees to nonprofit legal aid, mutual benefit, and advocacy groups that are not engaged in the unauthorized practice of law. See *Frye v. Tenderloin Housing Clinic, Inc.* (2006) 38 Cal.4th 23 [40 Cal.Rptr.3d 221]. See also Rule 6.3. Regarding a lawyer's contribution of legal fees to a legal services organization, see Rule 1.0, Comment [5] on financial support for programs providing pro bono legal services.

[4] This Rule is not intended to affect case law regarding the relationship between insurers and lawyers providing legal services to insureds. See, e.g., *Gafcon, Inc. v. Ponsor Associates* (2002) 98 Cal.App.4th 1388 [120 Cal.Rptr.2d 392].

IV. COMMISSION'S PROPOSED RULE 5.4 (REDLINE TO CURRENT CALIFORNIA RULES 1-320, 1-310, 1-600)

Rule 5.4 [1-320] Financial and Similar Arrangements ~~With Non-Lawyers~~with Nonlawyers

~~(a)~~~~(A) Neither a member nor a~~A lawyer or law firm* shall ~~directly or indirectly~~not share legal fees ~~with a person who is not a lawyer~~directly or indirectly with a nonlawyer or with an organization that is not authorized to practice law, except that:

- (1) ~~An~~An agreement ~~between a member and a law~~by a lawyer with the lawyer's firm,* partner,* or associate may provide for the payment of money or other consideration over a reasonable* period of time after the ~~member's~~lawyer's death, to the ~~member's~~lawyer's estate or to one or more specified persons ~~over a reasonable period of time; or~~
- (2) a lawyer purchasing the practice of a deceased, disabled or disappeared lawyer may pay the agreed-upon purchase price, pursuant to Rule 1.17, to the lawyer's estate or other representative;
- ~~(2) A member or law firm undertaking to complete unfinished legal business of a deceased member may pay to the estate of the deceased member or other person legally entitled thereto that proportion of the total compensation which fairly represents the services rendered by the deceased member; or~~
- (3) ~~A member~~a lawyer or law firm* may include ~~non-member~~nonlawyer employees in a compensation, ~~profit-sharing~~, or retirement plan, even though the plan is based in whole or in part on a profit-sharing

arrangement, ~~if such~~provided the plan does not ~~circumvent these rules or Business and Professions Code section 6000 et seq.; or otherwise violate these Rules or the State Bar Act;~~

- (4) ~~A member~~a lawyer or law firm* may pay a prescribed registration, referral, or ~~participation~~other fee to a lawyer referral service established, sponsored, and operated in accordance with the State Bar of California's Minimum Standards for ~~a Lawyer Referral Service in California.~~Services; or
- (5) a lawyer or law firm* may share with or pay a court-awarded legal fee to a nonprofit organization that employed, retained or recommended employment of the lawyer or law firm* in the matter.
- ~~(B) A member shall not compensate, give, or promise anything of value to any person or entity for the purpose of recommending or securing employment of the member or the member's law firm by a client, or as a reward for having made a recommendation resulting in employment of the member or the member's law firm by a client. A member's offering of or giving a gift or gratuity to any person or entity having made a recommendation resulting in the employment of the member or the member's law firm shall not of itself violate this rule, provided that the gift or gratuity was not offered or given in consideration of any promise, agreement, or understanding that such a gift or gratuity would be forthcoming or that referrals would be made or encouraged in the future.~~
- ~~(C) A member shall not compensate, give, or promise anything of value to any representative of the press, radio, television, or other communication medium in anticipation of or in return for publicity of the member, the law firm, or any other member as such in a news item, but the incidental provision of food or beverage shall not of itself violate this rule.~~

Rule 1-310 Forming a Partnership With a Non-Lawyer

- (b) A member~~lawyer~~ shall not form a partnership or other organization with a ~~person who is not a lawyer~~nonlawyer if any of the activities of ~~that~~the partnership or other organization consist of the practice of law.
- (c) A lawyer shall not permit a person* who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's independent professional judgment or interfere with the lawyer-client relationship in rendering legal services.
- (d) A lawyer shall not practice with or in the form of a professional corporation or other organization authorized to practice law for a profit if:
- (1) a nonlawyer owns any interest in it, except that a fiduciary representative of a lawyer's estate may hold the lawyer's stock or other interest for a reasonable* time during administration;

- (2) a nonlawyer is a director or officer of the corporation or occupies a position of similar responsibility in any other form of organization; or
- (3) a nonlawyer has the right or authority to direct or control the lawyer's independent professional judgment.
- (e) The Board of Trustees of the State Bar shall formulate and adopt Minimum Standards for Lawyer Referral Services, which, as from time to time amended, shall be binding on lawyers. A lawyer shall not accept a referral from, or otherwise participate in, a lawyer referral service unless it complies with such Minimum Standards for Lawyer Referral Services.

Rule 1-600 Legal Service Programs

- ~~(A) A member shall not participate in a nongovernmental program, activity, or organization furnishing, recommending, or paying for legal services, which allows any third person or organization to interfere with the member's independence of professional judgment, or with the client-lawyer relationship, or allows unlicensed persons to practice law, or allows any third person or organization to receive directly or indirectly any part of the consideration paid to the member except as permitted by these rules, or otherwise violates the State Bar Act or these rules.\~~
- (e) The Board of Trustees of the State Bar shall formulate and adopt Minimum Standards for Lawyer Referral Services, which, as from time to time amended, shall be binding on lawyers. A lawyer shall not accept a referral from, or otherwise participate in, a lawyer referral service unless it complies with such Minimum Standards for Lawyer Referral Services.
- ~~(B) The Board of Governors of the State Bar shall formulate and adopt Minimum Standards for Lawyer Referral Services, which, as from time to time amended, shall be binding on members.~~
- (f) A lawyer shall not practice with or in the form of a nonprofit legal aid, mutual benefit or advocacy group if the nonprofit organization allows any third person* or organization to interfere with the lawyer's independent professional judgment, or with the lawyer-client relationship, or allows or aids any person,* organization or group to practice law in violation of these Rules or the State Bar Act.

Discussion: COMMENT

[Discussion paragraph for Rule 1-320]

~~Rule 1-320(C) is not intended to preclude compensation to the communications media in exchange for advertising the member's or law firm's availability for professional employment.~~

[1] Paragraph (a) does not prohibit a lawyer or law firm* from paying a bonus to or otherwise compensating a nonlawyer employee from general revenues received for

legal services, provided the arrangement does not interfere with the independent professional judgment of the lawyer or lawyers in the firm* and does not violate these Rules or the State Bar Act. However, a nonlawyer employee's bonus or other form of compensation may not be based on a percentage or share of fees in specific cases or legal matters.

[2] Paragraph (a) also does not prohibit payment to a nonlawyer third-party for goods and services provided to a lawyer or law firm;* however, the compensation to a nonlawyer third-party may not be determined as a percentage or share of the lawyer's or law firm's overall revenues or tied to fees in particular cases or legal matters. A lawyer may pay to a nonlawyer third-party, such as a collection agency, a percentage of past due or delinquent fees in concluded matters that the third-party collects on the lawyer's behalf.

[3] Paragraph (a)(5) permits a lawyer to share with or pay court-awarded legal fees to nonprofit legal aid, mutual benefit, and advocacy groups that are not engaged in the unauthorized practice of law. See *Frye v. Tenderloin Housing Clinic, Inc.* (2006) 38 Cal.4th 23 [40 Cal.Rptr.3d 221]. See also Rule 6.3. Regarding a lawyer's contribution of legal fees to a legal services organization, see Rule 1.0, Comment [5] on financial support for programs providing pro bono legal services.

~~*[Discussion paragraph for Rule 1-310]*~~

~~Rule 1-310 is not intended to govern members' activities which cannot be considered to constitute the practice of law. It is intended solely to preclude a member from being involved in the practice of law with a person who is not a lawyer.~~

~~*[Discussion paragraph for Rule 1-600]*~~

~~The participation of a member in a lawyer referral service established, sponsored, supervised, and operated in conformity with the Minimum Standards for a Lawyer Referral Service in California is encouraged and is not, of itself, a violation of these rules.~~

~~Rule 1-600 is not intended to override any contractual agreement or relationship between insurers and insureds regarding the provision of legal services.~~

~~Rule 1-600 is not intended to apply to the activities of a public agency responsible for providing legal services to a government or to the public.~~

~~For purposes of paragraph (A), "a nongovernmental program, activity, or organization" includes, but is not limited to group, prepaid, and voluntary legal service programs, activities, or organizations.~~

[4] This Rule is not intended to affect case law regarding the relationship between insurers and lawyers providing legal services to insureds. See, e.g., *Gafcon, Inc. v. Ponsor Associates* (2002) 98 Cal.App.4th 1388 [120 Cal.Rptr.2d 392].

V. RULE HISTORY

A. Introduction

The three rules being considered together under the rubric of a new proposed rule 5.4 that would be patterned after Model Rule 5.4 all deal to some extent with a lawyer's duty of exercising independent professional judgment in representing a client. Specifically, each rule incorporates prohibitions on lawyer conduct that are intended to *avoid interference* by nonlawyers with a lawyer's exercise of independent judgment in providing legal services to a client.

B. History of Current Rule 1-310

The predecessor to current Rule 1-310, former Rule 3-103, became operative on January 1, 1975, under the current title, "Forming a Partnership With a Non-Lawyer." That rule contained the substance of Disciplinary Rule (DR) 3-103 of the ABA Model Code of Professional Responsibility".¹

In 1992, the proposed amendments to the rule and to the Discussion section, in conjunction with the proposed amendment to rule 1-100(B)(3), intended to correct an ambiguity in the then-operative rules. At that time, rule 1-100(B)(3) defined "lawyer" as a person licensed to practice law somewhere in the United States. Then-operative rule 1-310 was titled "Forming a Partnership With a Non-Lawyer" and prohibited the formation of a partnership "with a person not licensed to practice law" if any of the activities of that partnership consisted of the practice of law. However, lawyers from other countries may be licensed to practice law, but did not fit within the then-operative definition of "lawyer." Thus, an ambiguity existed between the title and the text of rule 1-310 (and the Discussion section) regarding foreign-licensed attorneys.

The amendments to rule 1-310 and to the Discussion section conformed the title of the rule to the text and the Discussion section and conformed the rule to the definition of "lawyer" proposed in rule 1-100(B)(3). These amendments clarified that formation of partnerships (to engage in the practice of law) with foreign-licensed attorneys were not prohibited under rule 1-310.

C. History of Current Rule 1-320

In 1972, the Special Committee to Study the ABA Code of Professional Responsibility recommended the adoption of proposed rule 3-102, which was derived from ABA Code, DR 3-102 (Dividing Legal Fees with a Nonlawyer). The DR was modified to carry forward California Rule 3 (1928), which prohibited *direct or indirect* fee division except with a person licensed to practice law.

¹ DR 3-103 provided:

DR 3-103 Forming a Partnership with a Non-Lawyer.

(A) A lawyer shall not form a partnership with a non-lawyer if any of the activities of the partnership consist of the practice of law.

The rule that was adopted, effective 1975, was identical to the rule with one slight revision.²

Amendments were made effective April 1979 to render the rule gender neutral, and also add new paragraphs (B) and (C), concerning payments for referrals or recommendations of the lawyer's services.³ Further amendments were made effective October 1979 to add a sentence to paragraph (B).⁴

In 1989, several amendments were made. The rule number was changed to 1-320 as part of the comprehensive revision of the Rules. Paragraph (A) continued the prohibition and exceptions found in current rule 3-102(A) regarding sharing legal fees with persons not licensed to practice law. Subparagraph (A)(4) was added to clarify that payments to a State Bar Certified Lawyer Referral Service does not violate the rule. Finally, paragraph (B) was amended to make it consistent with proposed rule 2-200(B).

No amendments have been made to rule 1-320 since 1989.

D. History of Current Rule 1-600

Rule 1-600 was originally adopted and approved as rule 2-102, effective April 1, 1979, in substantially the same form as the current rule. The State Bar explained the rationale for the rule:

² The change was as follows:

(2) A member of the State Bar who undertakes to complete unfinished legal business of a deceased member of the State Bar may pay to the estate of the deceased member of the State Bar or other person legally entitled thereto that proportion of the total compensation which fairly represents the services rendered by the deceased member of the State Bar.

³ New paragraphs (B) and (C) provided:

(B) A member of the State Bar shall not compensate or give or promise anything of value to any person or entity for the purpose of recommending or securing employment of the member or the member's firm by a client, or as a reward for having made a recommendation resulting in employment of the member or the member's firm by a client.

(C) A member of the State Bar shall not compensate or give or promise anything of value to any representative of the press, radio, television or other communication medium in anticipation of or in return for publicity of the member, the member's firm, or any other attorney as such in a news item, but the incidental provision of food or beverages shall not of itself violate this subdivision.

⁴ The sentence provided:

A member's offering of or giving a gift or gratuity to any person or entity, which has made a recommendation resulting in the employment of the member or the member's firms, shall not of itself violate this rule, provided that the gift or gratuity was not offered in consideration of any promise, agreement or understanding that such a gift or gratuity would be forthcoming or that referrals would be made or encouraged in the future.

It has long been recognized that “[t]here are situations . . . when an attorney’s association with a lay organization fulfills a legitimate interest of the organization or its members, and presents no risk of conflicting interests or other abuses.”³³

In a series of four landmark decisions, the United States Supreme Court clearly established that “collective activity undertaken to obtain meaningful access to the courts is a fundamental right within the protection of the First Amendment.” (United Transportation Union v. State Bar of Michigan (1971) 401 U.S. 576, 585, 91 S.Ct. 1076, 1082; United Mine Workers of America v. Illinois State Bar Association (1967) 389 U.S. 217, 88 S.Ct. 353 [hereinafter “United Mine Workers”]; Brotherhood of Railroad Trainmen v. Virginia (1964) 377 U.S. 1, 84 S.Ct. 1113 [hereinafter “Railroad Trainmen”]; National Association of the Advancement of Colored People v. Button (1963) 371 U.S. 415, 83 S.Ct. 328 [hereinafter “NAACP”].) The Court recently reaffirmed this position in In re Primus (1978) ___ U.S. ___, 98 S.Ct. 1893.

In doing so, however, the Court did not invalidate the fundamental prohibition against attorneys soliciting professional employment for their own purposes. Instead, the Court recognized a distinction between solicitation and the activities involved in the cases, and held that the prohibition against solicitation could not be applied so as to prohibit legitimate collective activity undertaken to obtain meaningful access to the courts. (See, e.g., United Mine Workers, 389 U.S. at pp. 222-223, 88 S.Ct., at pp. 356-357; Railroad Trainmen, 377 U.S., at pp. 6-7, 84 S.Ct., at pp. 1116-1117; NAACP, 371 U.S., at pp. 439-444, 83 S.Ct., at pp. 341-343; In re Primus, ___ U.S. ___, at pp. ___, 98 S.Ct., at p. 1893, 1906.)

Thus, constitutionally protected activity constitutes an exception to the prohibition against solicitation; the exception coexists with the prohibition.

Subdivision (A) is intended to continue and to expand the current exception for attorney participation in legal aid and similar programs for the furnishing of services to indigents (present rule 2-101 (F)), in plans or programs of nonprofit organizations furnishing legal services to persons in respect of their civic, political or constitutional rights (present rule 2-104(F)), and in group and prepaid legal service arrangements (present rule 2-104(D) and (E)).

Proposed rule 2-102(A) also changes the previous rule approach to group and prepaid legal service arrangements by focusing on attorney’s conduct rather than on the structure of the arrangement itself.

Given the relatively recent history of group and prepaid legal service programs, we believe that the public interest is best served by permitting flexibility and experimentation, coupled with an on-going study by the Legal Services Section of the need for regulation.

The proposed rule thus eliminates all current distinctions between “group” and “prepaid” programs, open and closed panel programs, and all requirements for reporting to the State Bar the fact of an attorney’s participation in a plan contained in present rule 2-104(D) and (E).

In this respect it should be noted that this proposal contemplates the repeal of sections (D) and (E) of existing rule 2-104, relating to open and closed panel programs.

Present rule 2-104(E) sets out certain requirements for open panel programs. Your Committee believes that this provision has not served to foster the growth of legal services programs, and, in light of the change in the advertising rules, it no longer seems viable. Existing requirements in present rule 2-104 for registration with the State Bar by an attorney participating in a group legal service program are also repealed.

Subdivision (B) of proposed rule 2-102 continues the exception for attorneys who participate in lawyer referral services contained in present rule 2-104(C). The extent to which lawyer referral services are constitutionally permitted to solicit cases in-person is unclear. (See appendix F.) Your Committee recommends that you refer this issue to the appropriate committee for further research and study.

It provides for filing of minimum standards for such services with the Court and approval thereof by the Court. This is the same procedure proposed with respect to advertising standards promulgated under proposed rule 2-101(D).

There is no intent, by these changes, to lessen the responsibility of the attorney who participates in such programs to adhere to the requirements of the State Bar Act or of the Rules of Professional Conduct, including, for example, the prohibitions on aiding the unauthorized practice of law (Bluestein v. State Bar (1974) 13 Cal.3d 162; People v. California Protection Corp. (1926) 76 Cal.App. 354; rule 3-101); allowing a third party to receive part of the consideration paid to a member of the State Bar, (including kickbacks or other fees paid in consideration for a union or group representative’s having referred legal business to an attorney) (rules 4-101, 5-101, 5-102 and 5-103); and false, deceptive or misleading advertising placed by or on behalf of the member (proposed rule 2-101). In other words, the attorney must not permit a group or its agents to interfere with or control his or her performance of duties owed a client, the courts or the administration of justice.

[1978 Final Report, Pages 37-41]

In 1989 non-substantive amendments were made to the rule for brevity and clarity. In addition, the Discussion to the rule was expanded to include the content in the current rule Discussion.

Since 1989, no further amendments have been made to the rule.

E. The First Commission's Proposed Rule 5.4

The first Commission's proposed Rule 5.4 gathered together, in a single rule, concepts that were intended to promote the independence of a lawyer's professional judgment, but which are currently found in three separate California Rules of Professional Conduct: rules 1-310, 1-320, and 1-600. The history of these three rules has been outlined above, in sections A to D.

Differences From Model Rule 5.4. The proposed rule's structure closely followed that of Model Rule 5.4. However, the first Commission recommended revisions and additions to both the black letter and model rule commentary that was intended to afford greater client protection by providing (i) broader prohibitions on a lawyer's conduct and on relationships into which the lawyer might enter that could pose a threat to the lawyer's exercise of independent professional judgment, and (ii) better guidance on the exceptions to these prohibitions that would have been permitted under the Rule (many of which exceptions may be found in current rule 1-320). The revisions of the Model Rule included: (1) a prohibition on sharing legal fees either "directly or indirectly" with a nonlawyer;⁵ (2) extending that prohibition to sharing legal fees with an organization not authorized to practice law;⁶ (3) extending the prohibition on practicing law with nonlawyers in a "partnership" to practicing law with nonlawyers in any kind of "organization;"⁷ (4) cautioning that a lawyer must avoid interference not only with the lawyer's independent judgment but also with the lawyer-client relationship;⁸ (5) carrying forward the concept in current rule 1-320(A)(4) that permits a lawyer to accept referrals from a lawyer referral service so long as that service complies with the Board of

⁵ RRC1 explained the proposed amendment:

The inclusion of the adverbs "directly or indirectly" was originally included in rule 1-320 to preclude lawyers from avoiding application of this client-protective rule by creatively structuring relationships with nonlawyers who send them clients. Proposed Comments [1A] and [1B] elaborate on the application of that term to lawyer's payment of nonlawyer employees and contractors.

⁶ RRC1 explained the proposed amendment:

The prohibition against sharing legal fees with an organization not authorized to practice law was added because the same prohibition is found in current California rule 1-600, which regulates legal services programs. See also State Bar of California Minimum Standards for Lawyer Referral Services.

⁷ RRC1 explained the proposed amendment:

The phrase "or other organization" has been added so a lawyer cannot avoid application of the Rule by entering into a non-partnership arrangement with a person who is not a lawyer. The phrase "person who is not a lawyer" has been substituted for "nonlawyer."

⁸ RRC1 explained the proposed amendment:

The Model Rule provision has been revised to clarify that it is generally interference with a lawyer's decisions concerning the legal services that are being provided that interfere with the lawyer's professional judgment. In addition, to enhance client protection, a prohibition on permitting interference with the lawyer-client relationship has been added.

Trustees' Minimum Standards on lawyer referral services;⁹ and (6) adding an express provision that clarifies the concerns the Supreme Court expressed in *Frye v. Tenderloin Housing Clinic, Inc.* (2006) 38 Cal.4th 23, about lawyers practicing with nonprofit organizations that might permit third parties to interfere with a lawyer's independence of judgment.¹⁰

Title. In addition to the foregoing changes, the first Commission recommended that the title of the Model Rule be amended to more accurately describe the content of the proposed Rule. Initially, the Commission voted to recommend the following title: "Duty to *Avoid* Interference with a Lawyer's Professional Independence."¹¹ (Emphasis added.)¹² Ultimately, however, the Commission voted to recommend the following title: "Financial and Similar Arrangements With Nonlawyers".

Non-lawyer ownership of law practice. The first Commission did *not* recommend that the rule be amended to permit non-lawyer ownership interests in a partnership or other organization that practices law, similar to such practice models as are currently permitted in Australia and the United Kingdom. At present, only one jurisdiction in the United States, the District of Columbia, permits non-lawyer ownership of a partnership or other organization that practices law.¹³

⁹ See RRC1 Proposed Rule 5.4(e), attached.

¹⁰ RRC1 explained this proposed addition (proposed Rule 5.4(f)):

[The provision] has been added to address the concerns raised by the California Supreme Court in *Frye v. Tenderloin Housing Clinic, Inc.* (2006) 38 Cal.4th 23 [40 Cal.Rptr.3d 221].

In addition to paragraph (f), RRC1 also recommended the addition of two comments, proposed comments [8] and [9], "to clarify that this rule is intended to work in concert with the regulatory standards expressed by the Supreme Court in *Frye v. Tenderloin Housing Clinic, Inc.* (2006) 38 Cal.4th 23 [40 Cal.Rptr.3d 221]."

¹¹ Similar to Model Rule 5.4, Model Rule 1.8(f) (payments by third persons) also requires lawyers to avoid interference with independent judgment. Compare current rule 3-310(F).

¹² The duty to exercise independent judgment is found in Model Rule 2.1 (Advisor), which provides:

Rule 2.1 Advisor

In representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client's situation.

¹³ D.C. Rule 5.4 provides:

D.C. Rule 5.4--Professional Independence of a Lawyer

(a) A lawyer or law firm shall not share legal fees with a nonlawyer, except that:

VI. OCTC / STATE BAR COURT COMMENTS

- **Gregory Dresser, Office of Chief Trial Counsel, 9/27/2016**
(In response to 90-day public comment circulation):

1. OCTC supports this rule and its Comments.

- **State Bar Court:** No comments were received from State Bar Court.

[Footnote continued...]

(1) An agreement by a lawyer with the lawyer's 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 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. A lawyer who purchases the practice of a deceased, disabled, or disappeared lawyer may, pursuant to the provisions of Rule 1.17, pay to the estate or other representative of that lawyer the agreed-upon purchase price.

(3) A lawyer or law firm may include nonlawyer employees in a compensation or retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement;

(4) Sharing of fees is permitted in a partnership or other form of organization which meets the requirements of paragraph (b); and

(5) A lawyer may share legal fees, whether awarded by a tribunal or received in settlement of a matter, with a nonprofit organization that employed, retained, or recommended employment of the lawyer in the matter and that qualifies under Section 501(c)(3) of the Internal Revenue Code.

(b) A lawyer may practice law in a partnership or other form of organization in which a financial interest is held or managerial authority is exercised by an individual nonlawyer who performs professional services which assist the organization in providing legal services to clients, but only if:

- (1) The partnership or organization has as its sole purpose providing legal services to clients;

- (2) All persons having such managerial authority or holding a financial interest undertake to abide by these Rules of Professional Conduct;

- (3) The lawyers who have a financial interest or managerial authority in the partnership or organization undertake to be responsible for the nonlawyer participants to the same extent as if nonlawyer participants were lawyers under Rule 5.1;

- (4) The foregoing conditions are set forth in writing.

(c) A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.

VII. PUBLIC COMMENTS & PUBLIC HEARING TESTIMONY

Four comments, including the above comment from OCTC were received. One agreed with the proposed rule, one disagreed, and two agreed only if modified. A public comment synopsis table, with the Commission's responses to each comment, is provided at the end of this report.

VIII. RELATED CALIFORNIA LAW AND ABA MODEL RULE ADOPTIONS

Illinois Rule 5.4 Professional Independence of a Lawyer

(a) A lawyer or law firm shall not share legal fees with a nonlawyer, except that:

(1) an agreement by a lawyer with the lawyer's 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 specified persons;

(2) a lawyer who purchases the practice of a deceased, disabled, or disappeared lawyer may, pursuant to the provisions of Rule 1.17, pay to the estate or other representative of that lawyer the agreed-upon purchase price;

(3) a lawyer or law firm may include nonlawyer employees in a compensation or retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement; and

(4) a lawyer may share court-awarded legal fees with a nonprofit organization that employed, retained or recommended employment of the lawyer in the matter.

(b) A lawyer shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law.

(c) A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.

(d) A lawyer shall not practice with or in the form of a professional corporation or association authorized to practice law for a profit, if:

(1) a nonlawyer owns any interest therein, except that a fiduciary representative of the estate of a lawyer may hold the stock or interest of the lawyer for a reasonable time during administration;

(2) a nonlawyer is a corporate director or officer thereof or occupies the position of similar responsibility in any form of association other than a corporation; or

(3) a nonlawyer has the right to direct or control the professional judgment of a lawyer.

A. ABA Model Rule Adoptions

The ABA State Adoption Chart for Model Rule 5.4, whose paragraph (b) is the counterpart to rule 1-310, is posted at:

- http://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/mrpc_5_4.pdf
- 9 states have adopted 5.4 verbatim (Arizona, Arkansas, Delaware, Illinois, Montana, Nebraska, New Hampshire, Vermont, Wisconsin); 38 jurisdictions have adopted something substantially similar to model rule 5.4 (Alabama, Alaska, Colorado, Florida, Hawaii, Iowa, Idaho, Indiana, Kansas, Kentucky, Louisiana, Massachusetts, Maryland, Maine, Michigan, Minnesota, Montana, Mississippi, North Carolina, North Dakota, New Jersey, New Mexico, Nevada, New York, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, Wyoming); and 4 jurisdictions have adopted something substantially different to model rule 5.4 (California, Connecticut, District of Columbia, and Georgia). The District of Columbia authorizes certain business combinations between lawyers and non-lawyers. Some legal commentators have critically examined the issue of lawyer / non-lawyer combinations with regard to expanding access to legal services for middle and lower income individuals.¹⁴

IX. CONCEPTS ACCEPTED/REJECTED; CHANGES IN DUTIES; NON-SUBSTANTIVE CHANGES; ALTERNATIVES CONSIDERED

A. Concepts Accepted (Pros and Cons):

1. Recommend adoption of a single rule, derived from ABA Model Rule 5.4, that contains concepts intended to promote the independence of a lawyer's professional judgment.
 - Pros: Proposed Rule 5.4 gathers together, in a single rule, concepts that are intended to promote the independence of a lawyer's professional judgment, but which are currently found in three separate California Rules of Professional Conduct: rules 1-310, 1-320, and 1-600.

Improves public protection by providing broader prohibitions on a lawyer's conduct and on relationships into which the lawyer might enter that could pose a threat to the lawyer's exercise of independent professional judgment.

A lawyer in a partnership or other organization that engages in law practice with a nonlawyer commits UPL whether the form of the business is a partnership, as stated in the current rule, or any other form of business

¹⁴ See *Protecting the Profession or the Public? Rethinking Unauthorized-Practice Enforcement* (2014) 82 Fordham L. Rev. 2587.

association. Compromised legal judgment and impairment of the protections against revelation of confidential information could result.

Provides guidance on the exceptions to the prohibitions permitted under the Rule (many of which may be found in current rule 1-320) in an effort to articulate a clear and enforceable articulation of disciplinary standards.

Ensures California's existing laws permitting lawyers to participate with governmental entities, legal services programs and certain other organizations continues to be honored.

Responds to the Supreme Court's concern about possible conflicts between rules and comments.

- Cons: None identified.

B. Concepts Rejected (Pros and Cons):

1. Retain the existing separate rules 1-310, 1-320, 1-600 language with no changes.

- Pros: Comports with and simply states CA's longstanding policy of preventing non-lawyers from practicing law with lawyers.

Extensive body of California law interpreting the existing Rules.

- Cons: Rule 1-320 does not expressly state the rationale that underlies the rule's prohibition on sharing legal fees with a non-lawyer, i.e., avoid interference with the lawyer's exercise of independent professional judgment.

Rule 1-320 does not expressly except from its prohibition the payment by a lawyer of court-awarded legal fees to a non-profit organization that employed, retained or recommended the lawyer. These fees are an important source of income for such non-profit organizations.

Rules 1-320 and 1-600 do not address the concerns the Supreme Court expressed in *Frye v. Tenderloin Housing Clinic, Inc.* (2006) 38 Cal.4th 23, about lawyers practicing with nonprofit organizations that might permit third parties to interfere with a lawyer's independence of judgment.

Arguably does not list all types of other organizations contained in the prohibition against lawyers practicing law with non-lawyers.

C. Changes in Duties/Substantive Changes to the Current Rule:

None.

D. Non-Substantive Changes to the Current Rule:

1. The proposed rule language is conformed to § 4.3A of the Guidelines for Drafting and Editing Court Rules.

E. Alternatives Considered:

1. Keep current rule without any changes.
2. Incorporate language allowing some form of organization in which a financial interest is held or managerial authority is exercised by an individual non-lawyer who performs professional services or provides a multidisciplinary practice combination.
3. The question of third-party case or matter funding was discussed but it was determined that the issue should be deferred. Lawyers routinely work with vendors and others. Participation with vendors and outsourcing has been the subject of much discussion.² There would need to be significantly more study with specific data before determining if there is a need for modifications of the rule with regard to this topic, and whether any such change would be consistent with the statutory prohibition on the unauthorized practice of law.

X. RECOMMENDATION AND PROPOSED BOARD RESOLUTION

Recommendation:

That the Commission recommends adoption of proposed Rule 5.4 [1-320, 1-310, 1-600] in the form attached to this report and recommendation.

Proposed Resolution:

RESOLVED: That the Board of Trustees adopt proposed Rule 5.4 [1-320, 1-310, 1-600] in the form attached to this Report and Recommendation.

² See ABA Formal Opinion. No. 08-451; California State Bar Formal Opinion No. 2010-179; California State Bar Formal Opinion No. 1971-25; Los Angeles County Bar Assn. Formal Opinion No. 374 (1978)).

