



The State Bar of California

Task Force on Access Through Innovation of Legal Services – Subcommittee on Alternative Business Structures / Multi-Disciplinary Practices

To: Subcommittee on Alternative Business Structures/Multi-Disciplinary Practices
From: Mark Tuft
Date: March 25, 2019
Re: B.2. Law Firm Discipline

Overview

Over the years, the concept of law firm discipline has been debated on a national level and has been considered by various jurisdictions, including California. Attached is a report, dated March 17, 2006, prepared for the first Rules Revision Commission (RRC-1) that describes the concept of law firm discipline, various approaches that have been considered and the pros and cons of possible sanctions. A few of the attachments to the report are also included.

In considering the concept of law firm discipline, RRC-1 recommended adoption of a managerial and supervisory rule based ABA Model Rules 5.1-5.3 and not a law firm discipline rule patterned on either the rule in New York or New Jersey. RRC-2 did not consider the issue of law firm discipline given time constraints.

Rules in New York and New Jersey

New York and New Jersey continue to be the only two jurisdictions that have rules intended to apply to law firms in addition to the individual lawyers that comprise the firms. Under these rules, law firms as entities are subject to discipline.

New York

New York's Rule 5.1 (Responsibilities of Law Firms, Partners Managers and Supervisory Lawyers) provides:

- (a) **A law firm shall make reasonable efforts** to ensure that all lawyers in the firm conform to these Rules.
- (b) (1) A lawyer with management responsibility in a law firm shall make reasonable efforts to ensure that other lawyers in the law firm conform to these Rules.
- (2) A lawyer with direct supervisory authority over another lawyer shall make reasonable efforts to ensure that the supervised lawyer conforms to these Rules.
- (c) **A law firm shall ensure** that the work of partners and associates is adequately supervised, as appropriate. A lawyer with direct supervisory authority over another lawyer shall adequately supervise the work of the other lawyer, as appropriate. In either case, the degree of supervision required is that which is reasonable under the circumstances, taking into account factors such as the experience of the person whose work is being supervised, the amount of work involved in a particular matter, and the likelihood that ethical problems might arise in the course of working on the matter.

(d) A lawyer shall be responsible for a violation of these Rules by another lawyer if:

(1) the lawyer orders or directs the specific conduct or, with knowledge of the specific conduct, ratifies it; or

(2) the lawyer is a partner in a law firm or is a lawyer who individually or together with other lawyers possesses comparable managerial responsibility in a law firm in which the other lawyer practices or is a lawyer who has supervisory authority over the other lawyer; and

(i) knows of such conduct at a time when it could be prevented or its consequences avoided or mitigated but fails to take reasonable remedial action; or

(ii) in the exercise of reasonable management or supervisory authority should have known of the conduct so that reasonable remedial action could have been taken at a time when the consequences of the conduct could have been avoided or mitigated. (Emphasis added)

New York rule 5.3 (Lawyer's Responsibilities for Conduct of Nonlawyers) provides:

(a) ***A law firm shall ensure*** that the work of nonlawyers who work for the firm is adequately supervised, as appropriate. A lawyer with direct supervisory authority over a nonlawyer shall adequately supervise the work of the nonlawyer, as appropriate. In either case, the degree of supervision required is that which is reasonable under the circumstances, taking into account factors such as the experience of the person whose work is being supervised, the amount of work involved in a particular matter and the likelihood that ethical problems might arise in the course of working on the matter.

(b) A lawyer shall be responsible for conduct of a nonlawyer employed or retained by or associated with the lawyer that would be a violation of these Rules if engaged in by a lawyer, if:

(1) the lawyer orders or directs the specific conduct or, with knowledge of the specific conduct, ratifies it; or

(2) the lawyer is a partner in a law firm or is a lawyer who individually or together with other lawyers possesses comparable managerial responsibility in a law firm in which the nonlawyer is employed or is a lawyer who has supervisory authority over the nonlawyer; and

(i) knows of such conduct at a time when it could be prevented or its consequences avoided or mitigated but fails to take reasonable remedial action; or

(ii) in the exercise of reasonable management or supervisory authority should have known of the conduct so that reasonable remedial action could have been taken at a time when the consequences of the conduct could have been avoided or mitigated. (Emphasis added)

New York's version of Rule 5.7 (Responsibilities Regarding Law-Related Services) is directed to lawyers and law firms.

New York also adopted Rule 5.8 on the Contractual Relationships Between Lawyers and Nonlegal Professionals, which provides:

(a) The practice of law has an essential tradition of complete independence and uncompromised loyalty to those it serves. Recognizing this tradition, clients of lawyers practicing in New York State are guaranteed “independent professional judgment and undivided loyalty uncompromised by conflicts of interest.” Indeed, these guarantees represent the very foundation of the profession and allow and foster its continued role as a protector of the system of law. Therefore, a lawyer must remain completely responsible for his or her own independent professional judgment, maintain the confidences and secrets of clients, preserve funds of clients and third parties in his or her control, and otherwise comply with the legal and ethical principles governing lawyers in New York State.

Multi-disciplinary practice between lawyers and nonlawyers is incompatible with the core values of the legal profession and therefore, a strict division between services provided by lawyers and those provided by nonlawyers is essential to protect those values. However, **a lawyer or law firm** may enter into and maintain a contractual relationship with a nonlegal professional or nonlegal professional service firm for the purpose of offering to the public, on a systematic and continuing basis, legal services performed by the lawyer or law firm as well as other nonlegal professional services, notwithstanding the provisions of Rule 1.7(a), provided that:

(1) the profession of the nonlegal professional or nonlegal professional service firm is included in a list jointly established and maintained by the Appellate Divisions pursuant to Section 1205.3 of the Joint Appellate Division Rules;

(2) the **lawyer or law firm** neither grants to the nonlegal professional or nonlegal professional service firm, nor permits such person or firm to obtain, hold or exercise, directly or indirectly, any ownership or investment interest in, or managerial or supervisory right, power or position in connection with the practice of law **by the lawyer or law firm**, nor, as provided in Rule 7.2(a)(1), shares legal fees with a nonlawyer or receives or gives any monetary or other tangible benefit for giving or receiving a referral; and

(3) the fact that the contractual relationship exists is disclosed **by the lawyer or law firm** to any client of the lawyer or law firm before the client is referred to the nonlegal professional service firm, or to any client of the nonlegal professional service firm before that client receives legal services from the lawyer or law firm; and the client has given informed written consent and has been provided with a copy of the “Statement of Client’s Rights In Cooperative Business Arrangements” pursuant to section 1205.4 of the Joint Appellate Divisions Rules.

(b) For purposes of paragraph (a):

(1) each profession on the list maintained pursuant to a Joint Rule of the Appellate Divisions shall have been designated sua sponte, or approved by the Appellate Divisions upon application of a member of a nonlegal profession or nonlegal

professional service firm, upon a determination that the profession is composed of individuals who, with respect to their profession:

(i) have been awarded a bachelor's degree or its equivalent from an accredited college or university, or have attained an equivalent combination of educational credit from such a college or university and work experience;

(ii) are licensed to practice the profession by an agency of the State of New York or the United States Government; and

(iii) are required under penalty of suspension or revocation of license to adhere to a code of ethical conduct that is reasonably comparable to that of the legal profession;

(2) the term "ownership or investment interest" shall mean any such interest in any form of debt or equity, and shall include any interest commonly considered to be an interest accruing to or enjoyed by an owner or investor.

(c) This Rule shall not apply to relationships consisting solely of non-exclusive reciprocal referral agreements or understandings between a **lawyer or law firm** and a nonlegal professional or nonlegal professional service firm. (Emphasis added)

Finally, **New York Rule 8.4 (Misconduct)**, applies to both lawyers and law firms:

A **lawyer or law firm** shall not:

(a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another;

(b) engage in illegal conduct that adversely reflects on the lawyer's honesty, trustworthiness or fitness as a lawyer;

(c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation;

(d) engage in conduct that is prejudicial to the administration of justice;

(e) state or imply an ability:

(1) to influence improperly or upon irrelevant grounds any tribunal, legislative body or public official; or

(2) to achieve results using means that violate these Rules or other law;

(f) knowingly assist a judge or judicial officer in conduct that is a violation of applicable rules of judicial conduct or other law;

(g) unlawfully discriminate in the practice of law, including in hiring, promoting or otherwise determining conditions of employment on the basis of age, race, creed, color, national origin, sex, disability, marital status or sexual orientation. Where there is a tribunal with jurisdiction to hear a complaint, if timely brought, other than a Departmental Disciplinary Committee, a complaint based on unlawful discrimination shall be brought

before such tribunal in the first instance. A certified copy of a determination by such a tribunal, which has become final and enforceable and as to which the right to judicial or appellate review has been exhausted, finding that the lawyer has engaged in an unlawful discriminatory practice shall constitute prima facie evidence of professional misconduct in a disciplinary proceeding; or

(h) engage in any other conduct that adversely reflects on the lawyer's fitness as a lawyer.

New Jersey

New Jersey Rule 5.1(a) (Responsibilities of Partners, Supervisory Lawyers and Law Firms) provides:

(a) **Every law firm**, government agency, and organization authorized by the Court Rules to practice law in this jurisdiction **shall make reasonable efforts** to ensure that member lawyers or lawyers otherwise participating in the organization's work undertake measures giving reasonable assurance that all lawyers conform to the rules of professional conduct. (Emphasis added).

New Jersey Rule 5.3(a) (Responsibilities Regarding Nonlawyer Assistants) provides:

With respect to a nonlawyer employed or retained by or associated with a lawyer:

(a) every lawyer, **law firm** or organization authorized by the Court Rules to practice law in this jurisdiction shall adopt and maintain reasonable efforts to ensure that the conduct of nonlawyers retained or employed by the lawyer, law firm, or organization is compatible with the professional obligations of the lawyer. (Emphasis added).

Entity Regulation in California

California currently has several rules of professional conduct that are directed at least in part to law firms as well as lawyers: **California Rules 1.15** (Safekeeping Funds and Property of Clients and Other Persons); **1.17** (Sale of a Law Practice); and **5.4** (Financial and Similar Arrangements with Nonlawyers). The definition of "law firm" for purposes of the rules of professional conduct includes an association authorized to practice law. California Rule 1.0.1((c)).

General Regulatory Approach.

Individuals. The State Bar's authority to formulate and enforce rules of professional conduct with approval of the Supreme Court is currently found in Business and Professions Code §§6076 and 6077. The rules are binding on all lawyers admitted or authorized to practice in California. California Rule 1.0(a) and see Business and Professions Code §6103 – authorizing disciplinary sanctions for violation of an attorney's oath or duties.

Organizations. However, under the Supreme Court's inherent power to regulate the practice of law and its partnership with the Legislature, regulations have been imposed on organizations authorized to practice law in California. For example, professional law corporations are bound by the rules of professional conduct and the State Bar Act. Business and Professions Code ¶16167 – in conducting business a law corporation is bound by statutes, rules and regulations "to the same extent as if specifically designated

therein as a member of the State Bar." *People ex rel. Herrera v. Stender* (2013) 212 Cal. App. 4th 614, 632-633. See also, Nonprofit Public Benefit Corporation Law (Corporation Code §5110 et. seq.; §12306(b)); *Frye v. Tenderloin Housing Clinic, Inc.* (2006) 38 Cal. 4th 23.

The Bar's regulatory authority for violating the rules or regulation requirements has generally been suspension or revocation of the law corporation's registration certificate. However, Business and Professions Code §§ 6167 – 6172 could provide a basis for imposing other forms of discipline against law corporations and other organizations authorized by the Supreme Court to practice law in California.

Trade Names. A law firm's fictitious or trade name is also the subject of regulation. Business and Professions Code §§6132 (duty of any law firm, partnership, corporation or association to remove a disciplined attorney from its business name) 6133 (duty to supervise disciplined attorney's activities), Corporations Code §§16952 (name of a registered limited liability partnership) 17900(3) (fictitious law corporation name).

Court regulation of lawyers and law firms. State courts have statutory authority to impose sanctions against lawyers and law firms in non-disciplinary matters. See *California Practice Guide: Professional Responsibility* (Rutter Group 2018) ¶8:1098 for a listing of statutory and court rule sanction authority. Federal courts have both inherent and statutory and rule sanctions authority over lawyers and law firms. *Id* ¶8:8:11 ff. Federal agencies such as the SEC, IRS and USPTO also possess statute and regulatory sanctions authority over lawyers and law firms. Civil enforcement remedies against law firms also exist. See, e.g., Business and Professional Code §17200 et seq.

Alternative Business Structures and Entity regulation

ABA Ethics 2000 Commission's Rejection of an Entity Regulation Rule

The debate regarding law firm discipline did not center on the regulation of law-related services or alternative business structures. See generally Elizabeth Chambliss, *The Nirvana Fallacy in Law Firm Regulation Debates*, 33 Fordham Urb. L. J. 119 (Nov. 2005). After an extensive study of the concept of law firm discipline, The ABA Ethics 2000 Commission concluded that "[W]hile discipline of law firms may provide additional incentive to firms and may provide increased visibility of the disciplinary system to the public, law firm discipline is not necessary since all partners and those with managerial authority are responsible for making sure the firm has in effect reasonable measures to assure compliance with Rules 5.1(a) and 5.3(a)." *How Should We Regulate Large Law firms? Is a Large Law Firm Rule the Answer?*, 16 Geo. J. Legal Ethics 203, 209-10 (2002).

Considerations Regarding Regulation of ABSs by an Entity Regulation Rule

The reasons for concluding that a law firm disciplinary rule is not necessary do not apply equally to the regulation of ABSs. That is because the ethical identity of a traditional law firm is essentially the same as the individual attorneys who comprise the firm. Every lawyer in the firm has a professional obligation to see that the ethics rules are observed, not just by themselves but also by the other lawyers with whom they are associated in practice. See, e.g., Model Rules 5.1, 5.2 and 5.3; compare CRPC 5.1, 5.2 and 5.3. The argument that a law firm disciplinary rule would be redundant is not persuasive with respect to a firm comprised of both lawyer and nonlawyer service providers.

Respondeat superior. At the same time, an entity disciplinary rule that is based on principles of respondeat superior¹ would generate many of the same issues that drove the law firm discipline debate (e.g., unfairness and loss of reputation for those who had nothing to do with the conduct that caused the entity to be disciplined, due process concerns, financial instability, harm to other clients of the organization, and other collateral consequences). For example, would a service provider in jurisdiction A be denied the right to practice or suffer other adverse consequences by reason of discipline being imposed against the entity by regulators in jurisdiction B?

On the other hand, a vicarious liability standard would enable regulators to proceed directly against the entity without having to incur investigative difficulties and expense of having to identify the wrongdoers. Entity discipline would arguably also enhance internal supervision and conformity with the ethics rules. See, generally Ted Schneyer, *Professional Discipline for Law Firm?*, 77 Cornell L. Rev. 1 (1991); Ted Schneyer, *On Further Reflection: How "Professional Self-Regulation" Should Promote Compliance With Broad Ethical Duties of Law Firm Management*, Ariz L. Rev. 577 (Summer 2011).

Practical enforcement difficulties of regulating an ABS entity. Regulatory enforcement of an entity authorized to practice law that is comprised of service providers who are not themselves licensed to practice law would most likely include revoking the entity's registration or right to practice law. (Compare Bus. & Prof. C. § 6169 (allowing for suspension of revocation of law corporation's certificate of registration.) A fine, reprimand, admonition, disgorgement of fees, probation, and publicizing the name of the entity are also possible sanctions. Enforcement could also include restitution and supervision. The over-riding issue is whether disciplining the entity would provide adequate public protection. The service providers themselves could pull up stakes and start over under another entity unless suspended or otherwise prohibited from doing so by a finding that they were culpable in the conduct that warranted revoking the entity's license to practice. The concept of law firm discipline envisioned that individual lawyers would remain subject to discipline for their own violations. The effectiveness of regulating the entity would be diminished if the dissolved firm could reopen under a new name or new management.

In sum, sanctions against a nonlawyer or multidisciplinary entity may not be effective unless individual wrong doers and perhaps managers and direct supervisors were also subject to individual discipline. Alternatively, the entity could be required to have a registered compliance specialist who would be accountable for ensuring compliance with the rules and regulations governing the entity.

A California Version of ABA Model Rule 8.3? Entity regulation of ABSs in California may result in California revisiting Rule 8.3. Under ABA Model Rule 8.3, a lawyer is obligated to inform the appropriate professional authority if the lawyer knows that another lawyer has committed a violation of the rules of professional conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness unless the information is otherwise protected by Model Rule 1.6. Lawyers admitted or authorized to practice in California have self-reporting requirements under Business and Professions Code §6068(o), but do not have an affirmative obligation to report another lawyer's violation of the rules. One of the proposals during the law firm entity rule debate was that the entity would be subject to discipline unless the entity identifies and the individual wrong doers. Entity regulation could include reporting obligations to regulatory authorities of violations of rules and regulations by service providers in the organization.

¹ Respondeat superior is a legal doctrine under which a principal is responsible for the acts of the principal's agent. For example, in Tort law, so long as an employee is acting within the scope of his or her employment, the employer is held responsible for an employee's negligent acts.

Alternatively, the entity or a compliance officer may be required to periodically certify compliance with the rules and regulations governing the entity's operations.

Summary

Only two jurisdictions have adopted entity regulation of law firms: New York and New Jersey. The ABA Ethics 2000 Commission rejected law firm discipline during the last major overhaul of the Model Rules in 2001. The ABA concluded that given the accountability of individual lawyers within a law firm, entity regulation of the “firm” would be redundant. Although California provides for regulation of law corporations, its disciplinary system remains focused on the conduct of individual lawyers. California recently implement a set of rules that include the supervision rules, CRPC 5.1 to 5.3, which are closely modeled on the ABA Model Rule counterparts. There are significant issues related to the implementation of entity regulation for nonlawyer or multidisciplinary firms, including unfairness and loss of reputation for those who had nothing to do with the conduct that resulted in entity discipline, due process concerns, financial instability, harm to other clients of the organization, and concerns whether disciplining the entity would actually provide adequate public protection if the individual constituents of the entity could simply leave and provide the services under a different name.

MEMORANDUM

TO: Rules Revision Commission
FROM: Mark L. Tuft
DATE: March 17, 2006
RE: The Concept of Law Firm Discipline

Overview

The controversial topic of law firm discipline involves consideration of three primary issues: what is the standard of discipline that should be imposed against a law firm, what types of violations should result in law firm discipline, and what are the appropriate sanctions that should be imposed. There are also policy considerations whether law firm discipline is effective to deter institutional misconduct, whether the State Bar has sufficient resources to impose discipline against law firms fairly and to monitor compliance and whether jurisdictional and due process issues make enforcement less feasible.

Concepts of Law Firm Discipline

The idea of law firm discipline is to ensure that the environment in which lawyers practice is conducive to proper ethical conduct. The objective is to insure that a culture of ethical behavior is encouraged and practiced by all members of the firm from senior partners to new associates.

A number of different standards of law firm discipline have been proposed over the years. Professor Ted Schneyer proposes, for example, that the tort theory of respondeat superior should be applied to law firms and law firms should be liable for the ethical violations of its

lawyers. Schneyer, *Professional Discipline for Law Firms?*, 77 Cornell L.Rev. 1 (1991).

Schneyer argues that attorneys who commit ethical violations while working for large firms know that if they are clever, they can bury their misconduct within the firm, making it impossible to pin the violation(s) on any particular individual. Professional discipline of law firms should be viewed in the same manner as corporate criminal liability; that is, ethical problems in law firms can be inherently structural and, thus, similar to corporate malfeasance. The respondeat superior standard has not gain much acceptance.

Another approach is to impose a collective sanction against a responsible group within the firm (e.g., the firm's labor and employment group) instead of the entire firm. This would diminish the feeling of unjust punishment by members of the firm that have no connection with the misconduct and would lead to an increase in group policing at a more focused level. Proponents argue that this approach would better achieve the goal of law firm discipline since lawyers in large firms tend to interact primarily with other attorneys in their practice group. See, *Collective Sanctions and Large Law Firm Discipline*, 111 Harv. L.Rev. 2336 (2005).

Another approach would require all law firms to designate at least one partner as a compliance specialist for the firm. Since law firm culture is viewed as having a significant impact in shaping conduct within the firm, law firm discipline should mirror the way the legal profession regulates itself through the use of a designated compliance officer. Chamliiss & Wilkens, *A New Framework For Law Firm Discipline*, 16 Geo.J.Legal Ethics 335 (2003). However, proponents of this approach are unable to articulate a formal plan, concluding instead

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that each firm must be able to police itself and determine the best means of enforcement on its own.

A more practical approach from this writer's perspective, and one that was initially proposed by Ethics 2000, is to extend responsibility under Rules 5.1(a) and 5.3(a) to the law firm itself as well as to partners and other lawyers in the firm who possess comparable managerial authority. Attached as part of these materials are copies of public discussion draft no. 3 of proposed revised rule 5.1 and the discussion draft of rule 5.3, dated September 2, 2000. Ethics 2000 decided not to include law firms in the proposed revisions to these rules primarily as a result of comments received from NOBC and ALAS. Copies of the Reporter's notes on the comments received from NOBC and a statement filed on behalf of ALAS opposing extending these rules to law firms are also attached.

New York and New Jersey

Currently, New York and New Jersey are the only two jurisdictions that have included law firm discipline in their rules. New York has its own rule, DR 1-104, while New Jersey adopted rules 5.1 and 5.3 with the addition of "law firm" as a responsible party. Copies of both rules are included in the materials. New York also has DR 5-105(E), which requires law firms to maintain a conflict checking system.

The New York approach "encourages law firms to put institutional measures in place in order to avoid lapses in ethics or competence." See the attached comments of NYBA,

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Committee on Ethics 2000. Although New York has so far meted out a few private reprimands to law firms under DR 1-104, the NYBA reports that law firms have put prophylactic measures in place to maintain an ethical environment. *Id.*

There are a few reported cases in New Jersey dealing with law firm discipline:

Matter of Jacoby & Meyers, 147 N.J., 374 (1977) – law firm reprimanded for failure to process matters through a New Jersey Trust Account in one of the approved financial institutions of the New Jersey State Bar. However a fine of \$10,000 was not enforced because of uncertainty regarding the authority of the court to impose such a fine.

Matter of Ravich, Koster, Tobin, Oleckna, Reitman & Greenstein, 155 N.J. 357, (1998) – law firm reprimanded and ordered to pay cost of proceedings for soliciting clients immediately following a gas leak disaster which lead to the destruction of several homes in New Jersey. Attorneys and the firm were disciplined for arriving at a Red Cross shelter and offering legal advice, soliciting clients and placing an RV outside of the Red Cross shelter as a mobile law office. However, the case does not discuss NJRC 5.1 but focuses instead on improper solicitation. Thus, the reasoning behind disciplining the law firm remains unclear.

California

A proposed policy that either the name of the law firm or office where a disciplined attorney was affiliated at the time of the discipline violation be published was circulated for public comment in 1997 but was not adopted by the State Bar Board of Governors. A second

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proposal that the Bar consider publishing the size and type of the law firm or office where a disciplined attorney was affiliated at the time the disciplinary violation was published was ultimately referred to RAD.

Courts in California have on occasion imposed sanctions on law firms based on a climate of wrongdoing. A good example (thanks to Bob Kehr) is *Moser v. Bret Hart Union High School District*, 366 F. Supp 2d 944 (E.D. 2005). In *Moser*, a District Court in the Eastern District sanctioned a school district, its attorney and the law firm under Rule 11 and other authority based on frivolous objections, mischaracterizations of facts and misstatements of the law. The court relied on Model Rule 3.3, CRPC 5-200 and section 6068(d) in support of the court's authority under its local rules.

Appropriate Sanctions and Consequences

Whether law firm discipline will actually deter institutional misconduct depends in large part on the sanctions that should be administered and the consequences to the firm of having discipline imposed. Attached is a report from the ABA Standing Committee on Professional Discipline and Competence recommending amendments to the ABA Model Rules for lawyer disciplinary enforcement to provide for the discipline of law firms with possible sanctions, including reprimand, admonition, disgorgement of fees and fines.

Some proponents believe that the imposition of fines and disgorgement of fees will cause law firms to behave more ethically. Proponents argue that firms do not want to lose profits and

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finances will hurt the bottom line and will hit partners where it hurts the most. Others believe that a private or public reprimand will get a firm's attention and will encourage compliance as no firm wants a disciplinary record or to have unethical conduct by its lawyers that occurs during the ordinary course of the firm's business made known to the public.

Opponents argue that it will be hard to discipline a law firm in a fashion that will effectively deter ethical misconduct. Imposition of a fine, for example, will either cause the law firm to break up, particularly if the fine is more than the firm can bear, or it will be factored in by large law firms as the cost of doing business. Some believe that a private reprimand will not materially change the behavior of the firm since the reprimand will be unknown to the legal community and the public. At the same time, a public reprimand may go too far in damaging the reputation of innocent attorneys associated with the firm, particularly where the ethical violation is limited to one practice group or to one office in a multi-office law firm. A public reprimand or other sanction could also result in harm to clients of the firm if the firm goes out of business.

Opponents further argue that the current disciplinary system is inadequate to fairly sanction law firm misconduct. If the goal is to ensure that law firms behave ethically, there must be some sort of policing or monitoring system to prevent the law firm from resuming impermissible conduct when the initial scrutiny has ended. The State Bar may not have sufficient resources or personnel to monitor law firm conduct or to discipline large law firms. There are also jurisdictional and due process concerns. For example, should a law firm be disciplined if the attorneys who conducted the unethical behavior have left the firm? See,

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generally, *How Should We Regulate Large Law Firms? Is a Law Firm Disciplinary Rule the Answer?* 16 Geo.J.Legal Ethics 203 (2002).

ABA Ethics 2000 Commission
Rule 5.1
Comments received in Response to Final Draft
for review by the Commission in Charleston, March 16-17, 2001

1. Should the Commission eliminate the duty of a "law firm" to make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that all lawyers in the firm conform to the Rules of Professional Conduct?

The Commission has heard numerous concerns about its proposal. I will not rehash all the arguments pro and con, but do want to call the Commission's attention to some concerns that may not have been considered. Recently, the National Organization of Bar Counsel indicated that, although no formal vote was taken, its members, without dissent, voiced serious concern about the Commission's proposal. In addition to questioning the Commission's assumption that law firm discipline would provide an additional incentive to partners to comply with Rule 5.1(a), NOBC also voiced concern about some practical problems associated with law firm discipline:

Firm discipline poses practical problems, which include determining the aggravating effect and malpractice insurance implications of law firm discipline on firm lawyers with varying levels of culpability. Also, the nature and effectiveness of disciplinary sanctions against a firm must be considered. In practice, the sanction of choice will almost certainly be fines. Expanding the use of this sanction has the potential to lead to the prospect of firms or lawyers internalizing the cost of breaking the rules as a cost of doing business, or of offering firm-paid fines to avoid individual discipline. Also, ironically, law firm discipline has the potential to let culpable lawyers off the hook while at the same time stigmatizing innocent ones with a disciplinary history.

Also, in "Revisiting Law Firm Discipline - Does it Really Work?," *New York Professional Responsibility Report*, (February 2001), Sarah McShea raises another set of concerns about the personal and professional effect of a law firm's discipline for the lawyers associated with the firm:

Are the partners and associates obliged to report on *pro hac vice* applications and malpractice policy renewal applications that they have been disciplined? Are they obliged to report that their law firm has been disciplined? If a multi-jurisdictional firm is disciplined in New York for misconduct occurring in New York, have the lawyers in the firm's Los Angeles or Dallas office also been disciplined? Must the Los Angeles members of the firm report the New York discipline to California? Will California then impose reciprocal discipline on the law firm's members in California? Will a lateral partner joining the firm after it has been disciplined inherit the taint? Will departing partners carry it with them? If individual lawyers are not required to report the firm's discipline, what is to prevent the firm from disbanding and re-forming as a new entity?

While acknowledging the criticism and concern, the Reporter would also remind the Commission of the prior endorsement of law firm discipline by the Association of the Bar of the City of New York and the ABA Standing Committee on Professional Discipline. Stephen Krane, the President-Elect of the New York State Bar Association has also communicated his strong support for the Commission's proposal. The Reporter also thinks that it is always possible for people to do silly things as they go about implementing a sensible idea. The Reporter thinks it is quite sensible to hold a law firm responsible for violations of Rule 5.1(a) because it is the one rule that specifically relates the "ethical environment" of the firm as an entity.

The Reporter's review of two N.J. cases throws little light on the subject. In the Matter of Jacoby & Meyers, 147 N.J. 374 (1977), all the report of the case reveals is that the firm consented to a reprimand for failing to process funds received in connection with New Jersey legal matters through an attorney trust account maintained in an approved New Jersey financial institution. There is no indication that any partner was personally disciplined. Nor do the facts clearly indicate whether the firm simply had no trust account in N.J., or, on the other hand, that it had one but did not use it. Nor is it clear whether the discipline was based on a single incident or a series of incidents. On the other hand, in In the Matter of Ravich, Coster, Tobin, Oleckna, Reitman and Greenstein, 155 N.J. 357 (1998), a six-partner law firm and one of the partners were disciplined for improper solicitation when the partner arranged to have an RV (with advertisements in the windows) parked at the site of a gas explosion. The disciplined partner was in charge of venture, but the opinion does not reveal the extent to which the other partners were involved in the decision-making. One would at least assume some of them knew what was going on. There is no specific discussion of why the court chose to discipline the firm as well as the one obviously culpable partner.

2. Should Comment [2] be modified to more clearly indicate that the law firm's responsibility is intended to be in addition to the personal responsibility of the partners or managing attorneys and that a law firm should only be held to violate Rule 5.1(a) if it can be established that at least one of its partners or managing attorney has also violated the Rule?

If law firm responsibility for violations of Rule 5.1(a) is to be retained, NOBC has asked that Comment [2] be revised to more forcefully make the point that each partner and person with comparable managerial authority in a firm retain full personal responsibility for compliance with Rule 5.1(a). NOBC also objects to the suggestion in Comment [2] and the Reporter's Explanation of Changes that a firm could be in violation of the rule without an individual or group of individuals also being in violation. The Reporter concurs with this recommendation and proposes the following changes to Comment [2]:

[2] Paragraph (a) also applies to the law firm as an entity. See Rule 1.0(c) for the definition of a firm. For example, if through the acts or omission of one or more of its partners or managing attorneys, a law firm that has no system for identifying conflicts of interest, the firm may itself be disciplined for a violation of paragraph (a). Although a law firm may be disciplined, the responsibility for the firm's compliance with paragraph (a), however, still resides with each partner or managing other lawyer in the firm with comparable authority.

3. Should Paragraph (a)(1) be modified to specifically refer to “partners and shareholders in a law firm?”

NOBC has so suggested. The applicability of Rule 5.1(a) to shareholders is noted in Comment [1, which also provides a cross reference to the definition of a partner in Rule 1.0(g) that includes shareholder within the meaning of partner. To add shareholder to the rule text would be redundant. This comment, however, has called the Reporter’s attention to the fact that definition of partner is under-inclusive because it makes no reference to lawyers who are members of a professional limited liability companies. There also are some places where the rules refer to a “partnership” - e.g. Rule 5.6(a) - and there is no definition of a partnership in the Rules. Is this something we ought to fix? If this can be cleaned up without undue difficulty. I recommend we do so.

Hon. E. Norman Veasey
Chief Justice
Delaware Supreme Court
Floor 11
820 N. French Street
Wilmington DE 19801

March 8, 2001

Dear Chief Justice Veasey:

The ABA Standing Committee on Professional Discipline supports the report of the Commission on Evaluation of the Rules of Professional Conduct (Ethics 2000). As you know, the Discipline Committee requested the amendment of the ABA Model Rules of Professional Conduct to incorporate the discipline of law firms.

I understand that Ethics 2000 has received objections to this proposal. I am writing on behalf of the Discipline Committee to reiterate the Committee's recommendation that Rule 5.1 should be amended to subject law firms that do not have in place appropriate systems to appropriate disciplinary sanctions, such as reprimand, admonition, disgorgement of fee, fine or supervision.

In a February 1999 report to the ABA House of Delegates, the Standing Committee on Professional Discipline proposed amendments to Rules 6, 7, 9, 10 and 13 of the ABA Model Rules for Lawyer Disciplinary Enforcement ("MRLDE") to provide for the discipline of law firms with possible sanctions of reprimand, admonition, disgorgement of fee, fine or supervision. I have attached the relevant portion of that report.

In addition to New York's adoption of law firm discipline mentioned in the report, I would also note that New Jersey incorporated law firm discipline in its Rules from the time of their adoption in 1984 as follows (relevant portions underlined):

5.1 RESPONSIBILITIES OF A PARTNER OR SUPERVISORY LAWYER

(a) Every law firm and organization authorized by the Court Rules to practice law in this jurisdiction shall make reasonable efforts to ensure that member lawyers or lawyers otherwise participating in the organization's work undertake measures giving reasonable assurances that all lawyers conform to the Rules of Professional conduct.

(b) A lawyer having direct supervisory authority over another lawyer shall make reasonable efforts to ensure that the other lawyer conforms to the Rules of Professional Conduct

(c) A lawyer shall be responsible for another lawyer's violation of the Rules of Professional Conduct if:

- (1) the lawyer orders or ratifies the conduct involved; or
- (2) the lawyer having direct supervisory authority over the other lawyer knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action.

Comment to RPC 5.1

The Court has adopted the Debevoise Committee recommendation, with one revision to paragraph (a) so as to make clear its applicability to all lawyers and entities engaged in the practice of law. This version further differs somewhat from the ABA-adopted rule in that it does not impute responsibility upon a partner in a law firm for the ethical transgressions of law partners unless the attorney had direct supervisory authority over them. See also RPC 8.4(a).

5.3 RESPONSIBILITIES REGARDING NONLAWYER ASSISTANTS

With respect to a nonlawyer employed or retained by or associated with a lawyer:

(a) every lawyer or organization authorized by the Court Rules to practice law in this jurisdiction shall adopt and maintain reasonable efforts to ensure that the conduct of nonlawyers retained or employed by the lawyer, law firm or organization is compatible with the professional obligations of the lawyer.
[Sections (b) and (c) omitted].

Comment to RPC 5.3

The Court ... revised paragraph (a) consistent with the recommendations of the NJSBA so as to make the rule applicable to all entities engaged in the practice of law.

In July 1998, the New Jersey Supreme Court amended its Rules of Disciplinary Jurisdiction to provide that "Every attorney and business entity authorized to practice law in the State of New Jersey ... shall be subject to the disciplinary jurisdiction of the Supreme Court..." It also provided for the imposition of monetary sanctions in exceptional circumstances. Disciplinary counsel had argued that these amendments were unnecessary in that the Court had already reprimanded two firms under the New Jersey Rules of Professional Conduct. See *Jacoby & Myers*, 147 N.J. 374 (1997) and *Ravitch, Koster et al.*, 155 N.J. 357 (1998). In its December 1997 report, the New Jersey Professional Responsibility Rules Committee recommended that the Court amend its Rules to clarify the ability to impose disciplinary sanctions on law firms and to expand the sanctions that can be imposed to include fines. It also concurred in much that was raised in the 1993 report of the New York Committee on Professional Responsibility. See *The Record of the Association of the Bar of the City of New York*, Volume 48, No. 3. That report argued that extension of the disciplinary rules to law firms would:

1. Improve the "practice environment" by creating an atmosphere that will discourage ethical violations in law firms.
2. Further the model of self-policing by making compliance with the disciplinary rules a "collective effort within a firm."
3. Impose joint responsibility and supervision on lawyers who practice in firms, which would reflect the practicalities of modern practice.
4. Require firms to clarify responsibility for the actions of non-attorney employees of a law firm when a specific attorney with supervisory responsibility for those actions cannot be identified.
5. Promote policies that will clarify ethical responsibility in law firms that use a "team" approach to tasks such as document production.
6. Close a gap in enforcement by sanctioning law firms when partners who do not have supervisory authority over certain associates implicitly encourage unethical behavior by those associates to further the firm's interests.
7. Address organizational and procedural problems when they are the source of the problem, not the conduct of individual lawyers.

Credit should also be given to Professor Ted Schneyer who propounded the idea in his article, *Professional Discipline for Law Firms?*, 77 Cornell Law Review 1 (1991). In that article, Schneyer noted the growth of law firms and the infrequency of

disciplinary proceedings against large firm lawyers due to the nature of group practice. This, he said, results in:

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1. Proof problems in assigning blame to individual lawyers, each of whom tries to shift blame onto others.
2. Reluctance to scapegoat lawyers for others in the firm who would have taken the same actions.
3. The structures of large firms are as responsible as the individual lawyers.

Professor Schneyer summarized his argument for law firm discipline as follows:

Law firms, like individual lawyers, can be directly regulated through malpractice litigation, disqualification, civil sanctions, peer review, and oversight by the administrative agencies before which they sometimes practice. But just as the availability of these alternative controls has not obviated the need for individual lawyer discipline, so these techniques, even in tandem, are either too little used or too limited in reach to make law firm discipline a superfluous reform. As they presently operate, these techniques are, at best, complements to state-supreme-court administered discipline for law firms, not substitutes for it.

To these arguments for law firm discipline, I would add two points. One is that solo and small firm practitioners, especially minority group lawyers in these types of practice, feel unfairly singled out for discipline. This may be due to a variety of factors, including the lack of support systems provided by large firms. But when a firm engages in misconduct due to a lack of support systems and no individual lawyer is responsible for the misconduct, the firm should be sanctioned.

Also, it should be noted that the Discipline Committee embraced the concept of law firm discipline at the time when multidisciplinary practice and the possibility of equity ownership of law firms by nonlawyers were on the horizon. Law firm discipline offered the possibility of regulating the conduct of nonlawyers in such entities.

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I would also emphasize that law firm discipline can only be employed for conduct that does not involve scienter.

I hope that Ethics 2000 will retain its proposed amendment of 5.1, and I would like to offer the assistance of Discipline Committee members in the House of Delegates.

Very Truly Yours,

Paula J. Frederick
Chair

cc: Charlotte Stretch

From the February 1999 ABA Standing Committee on Professional Discipline Report to the House of Delegates:

The ABA MODEL RULES OF PROFESSIONAL CONDUCT ("MRPC"), ... form the substantive standards which are enforced by the MRLDE. The Rules which the MRPC establish are so expressed as to apply only to individual lawyers who are members of the bar, and not to the entities formed by these lawyers for the practice of law or which employ these lawyers, such as law firms, the legal departments of corporations, or other entities. Hence, any professional discipline for violation of the MRPC must be imposed only on individual lawyers.

This has the effect of both limiting the options available to disciplinary authorities and, often unfairly to members of the bar, exposing individual lawyers to discipline for activities conducted or authorized either by other lawyers in their firm or by a decision of the firm's or legal department's hierarchy. This discipline may be imposed even where the respondent lawyer may have objected to, or even been unaware of, the offending conduct.

The primary Model Rule imposing this vicarious disciplinary liability is MRPC 5.1, which provides as follows:

RULE 5.1 RESPONSIBILITIES OF A PARTNER OR SUPERVISORY LAWYER

- (a) A partner in a law firm shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that all lawyers in the firm conform to the Rules of Professional Conduct.
- (b) A lawyer having direct supervisory authority over another lawyer shall make reasonable efforts to ensure that the other lawyer conforms to the Rules of Professional Conduct.
- (c) A lawyer shall be responsible for another lawyer's violation of the Rules of Professional Conduct if:
 - (1) the lawyer orders or, with knowledge of the specific conduct, ratifies the conduct involved; or
 - (2) the lawyer is a partner in the law firm in which the other lawyer practices, or has direct supervisory authority over the other lawyer, and knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action.

Rule 5.1(c) imposes disciplinary liability on a lawyer for *another* lawyer's violation under certain prescribed circumstances. Rule 5.1(b) imposes personal disciplinary liability on a lawyer having "direct supervisory authority" over another for the former's own failure to "make reasonable efforts" having an effect on the supervised lawyer. Both of these rules require, as a predicate to discipline, either involvement (supervision, ordering or ratification) or scienter and failure to act, as in Rule 5.1(c)(2).

Rule 5.1(a), by contrast, imposes personal disciplinary liability on a lawyer *regardless* of the absence of any antecedent Rule violation by anyone in the firm. Liability is imposed on a partner for failure to "make reasonable efforts to ensure that the *firm* has in effect measures giving reasonable assurance that all lawyers in the firm conform to the Rules of Professional Conduct." (emphasis supplied). This potential liability is imposed even if the decision on such matters is reposed by firm governance procedures, corporate policies, or partnership agreements in others (such as management committees or a managing partner), and even if the partner-respondent had long, but unsuccessfully, sought to put such measures into effect.

Many lawyers have perceived a measure of unfairness in the Rule's requirement that discipline be imposed on an individual partner in such situations. Disciplinary authorities, on the other hand, have felt that their hands were tied because the Rules provide only for disciplining individual lawyers.

Two years ago, as part of its ongoing review, the Standing Committee on Professional Discipline undertook a study of whether the ABA MODEL RULES FOR LAWYER DISCIPLINARY ENFORCEMENT should be amended to provide for the discipline of law firms. It found that, in May 1996, the four Appellate Divisions of the State of New York adopted a joint order amending the underlying Disciplinary Rules of the New York State Code of Professional Responsibility to provide for discipline of law firms.¹ This action followed the endorsement of the concept of law firm discipline "in even broader form than that ultimately enacted - by the Association of the Bar of the City of New York in 1993."²

The ABA Standing Committee on Professional Discipline examined the New York Disciplinary Rules and other relevant materials and recommends the adoption of rules embracing the concept of law firm discipline for misconduct as defined in the MODEL RULES OF PROFESSIONAL CONDUCT. Specifically, it recommends that the ABA Standing Committee on Ethics and Professional Responsibility consider an amendment of Rule of Professional Conduct 5.1(a) and any other relevant Rules of Professional

¹ See N.Y. DR 1-102(A) [providing that a lawyer or law firm "shall not violate a disciplinary rule, engage in illegal conduct, etc.]; DR 1-104(A) ["A law firm shall make reasonable efforts to ensure that all lawyers in the firm conform to the disciplinary rules."] See also *New York Adopts New Rules Subjecting Firms to Discipline* 12 ABA/BNA LAWYERS' MANUAL ON PROFESSIONAL CONDUCT CURRENT REPORTS 191-7 (June 12, 1996); 13 ABA/BNA LAWYERS' MANUAL ON PROFESSIONAL CONDUCT CURRENT REPORTS 157-8 (June 11, 1997).

² See *The Discipline of Law Firms*, The Record of the Association of the Bar of the City of New York Vol. 48 no. 5 page 628 (June 1993).

Conduct to include "law firms" (as currently defined in the Comment to Rule 1.10³). The subject of that subsection of Rule 5.1, dealing as it does with *firm* practices, procedures and protocols, is the part of the Rule particularly appropriate to be applied to firms as objects of potential disciplinary action.

While such an amendment would permit disciplinary authorities in the limited circumstances of Rule 5.1(a) to pursue firms rather than singling out individual partners, it in no way expands the area of liability for respondent lawyers. That area remains the same: discipline for the *firm's* failure to have "in effect measures giving reasonable assurance that all lawyers in the firm conform to the Rules of Professional Conduct" (emphasis supplied). This presumably would include inadequate systems for checking conflicts of interest before taking on matters or the lack of a means for updating conflicts of interest data when changes in client identity or control (e.g., by merger, acquisition or other means) create conflicts in the middle of a representation that might not have existed at its inception; inadequate procedures for quality control of product created by new associates in the firm before that product is sent to the client or others outside the firm to the potential detriment of the client; and adequate systems for ensuring proper and appropriate billing of clients and proper handling of clients' funds and other funds over which the firm exercises fiduciary responsibility.

The Standing Committee on Professional Discipline also proposes amending various provisions of the MRLDE in light of the proposed change in Rule 5.1. The proposed amendment of MRLDE 6(D) makes law firms subject to discipline under the inherent authority of the judicial branch to regulate and define the practice of law. The definition of "law firm" in the Commentary to MRLDE Rule 6 goes beyond the definition in the Comment to Rule of Professional Conduct 1.10. It also includes: the legal departments of partnerships, limited liability companies or other organizations rendering or offering to render legal services in the jurisdiction "whether to that entity or to third parties."⁴ The proposed amendment of MRLDE 7 requires law firms to register with the disciplinary authority. The proposed amendment of MRLDE 13 provides for

³ ABA MODEL RULE OF PROFESSIONAL CONDUCT 1.10, Comment 1. *Definition of "Firm"*:

For purposes of the Rules of Professional Conduct, the term "firm" includes lawyers in a private firm, and lawyers in the legal department of a corporation or other organization, or in a legal services organization. Whether two or more lawyers constitute a firm within this definition can depend on the specific facts. For example, two practitioners who share office space and occasionally consult or assist each other ordinarily would not be regarded as constituting a firm. However, if they present themselves to the public in a way suggesting that they are a firm or conduct themselves as a firm, they should be regarded as a firm for the purposes of the Rules. The terms of any formal agreement between associated lawyers are relevant in determining whether they are a firm, as is the fact that they have mutual access to information concerning the clients they serve. Furthermore, it is relevant in doubtful cases to consider the underlying purpose of the Rule that is involved. A group of lawyers could be regarded as a firm for purposes of the rule that the same lawyer should not represent opposing parties in litigation, while it might not be so regarded for purposes of the rule that information acquired by one lawyer is attributed to the other.

⁴ This definition would subject entities that have nonlawyer affiliates to the agency's jurisdiction if the jurisdiction allows such an affiliation.

any proposed notice of disciplinary charges by personal service or by mail to the address designated under proposed amended Rule 7. Rule 10 of the proposed amendments to the MRLDE provides for sanctions for law firms that are found to have violated the applicable Rules of Professional Conduct. The sanctions available for law firms are: (1) public reprimand; (2) private admonition; (3) restitution of persons or entities financially injured and disgorgement of all or part of the fee, as well as reimbursement to the client protection fund; and (4) fines and supervision. The sanction of fines applies only to law firms while the sanctions of disbarment, suspension and probation apply only to individual lawyers.