



The State Bar of California

Task Force on Access Through Innovation of Legal Services – Subcommittee on Rules and Ethics Opinions

To: Rules and Ethics Opinions Subcommittee
From: Kevin Mohr
Date: June 18, 2019
Re: C.2. Recommendation: Adoption of Proposed Rule 5.4 [Alternative 1]

Recommendation Not Yet Approved by the Task Force: Adoption of Proposed Rule 5.4 [Alternative 1]

During its June 3, 2019 subcommittee meeting, the Rules Subcommittee voted to recommend to the full Task Force amendments to California Rule of Professional Conduct (“CRPC” or “rule”) 5.4. One proposal is that the prohibition on fee sharing be loosened in some circumstances (Alternative 1). Another proposal is that the prohibition on fee sharing be removed in its entirety (Alternative 2). This memorandum provides a summary of the former proposal, i.e., the recommendation that the basic prohibitions in rule 5.4 against fee sharing and nonlawyer ownership or control of law firms be retained, but that the rule should be amended to permit limited fee sharing with, and ownership of law firms by, nonlawyers.

Proposed CRPC 5.4 is attached in both clean and redline versions, the latter compared to current CRPC 5.4. See Attachments 1 (clean version) and 2 (redline). In addition, a table with the proposed rule changes in the left column and the subcommittee comments in the right column is included as Attachment 3.

How the Recommendation Relates to the Charter: In reaching its decision to recommend the proposed comment, the Rules Subcommittee considered the Task Force’s Charter, which includes the direction to:

2) Evaluate existing rules, statutes and ethics opinions on lawyer advertising and solicitation, partnerships with non-lawyers, fee splitting (including compensation for client referrals) and other relevant rules in light of their longstanding public protection function with the goal of articulating a recommendation on whether and how changes in these laws might improve public protection while also fostering innovation in, and expansion of, the delivery of legal services and law related services especially in those areas of service where there is the greatest unmet need.

The subcommittee concluded that relatively modest changes to rule 5.4 should have a positive impact on both access to legal services and public protection.

I. Overview of the Proposed Revisions to CRPC 5.4

The proposed revisions to CRPC 5.4 described in this memorandum are intended to facilitate the ability of lawyers to enter into financial and professional relationships with nonlawyers who work in designing and implementing cutting-edge legal technology. Underlying the subcommittee efforts is the

understanding, from discussions with legal technologists on the Task Force and otherwise, that a primary impediment to such relationships is the inability of lawyers to share in the profits that accrue from the delivery of legal services. The subcommittee reasons that by expanding the kinds of situations under which nonlawyers can share in the profits and ownership of entities that deliver legal services, this deterrent to the adoption of technology will be removed and the concomitant practice efficiency enhancements will further access to legal services.

The proposed amendments are four in number. *First*, the subcommittee recommends that current paragraph (b)(5), which permits a lawyer or law firm to share with or give *court-awarded* fees to a nonprofit organization be expanded to permit such sharing or giving of legal fees to a nonprofit organization regardless of whether the fees have been awarded by a tribunal. *Second*, the subcommittee recommends the addition of a sixth exception to paragraph (a)'s fee sharing prohibition, new subparagraph (a)(6), which would permit fee sharing in a law firm in which nonlawyers hold a financial interest so long as the lawyer or law firm has complied with each of the requirements of paragraph (b). Paragraph (b), which replaces paragraph (b) of current CRPC 5.4, prohibits fee sharing in a law firm in which nonlawyers hold a financial interest unless each of the requirements set forth in subparagraphs (b)(1) through (b)(6) have been satisfied. *Third*, paragraph (d) is substantially revised to conform it with the changes made to paragraph (b). *Fourth*, new comment [4] has been added, and current comments [4] and [5] renumbered [5] and [6], respectively.

It is important to note that paragraph (b) is substantially more limiting than what was proposed as a "multidisciplinary practice" (MDP) by the ABA MDP Commission in 1999. Rather, it is based on the revisions to ABA Model Rule 5.4 as proposed by the ABA Ethics 20/20 Commission, dated 12/2/2011. Paragraph (b) only permits nonlawyer partners/owners of the firm to "assist" the firm's lawyers in the firm's sole purpose of providing legal services. Under an MDP, the nonlawyer owners could separately and independently provide services of a nonlegal nature, e.g., accounting or financial planning services, that are not necessarily related to the provision of legal services.

Each of the foregoing changes is discussed in detail in the next section.

II. Recommendation & Explanation of Proposed Changes to CRPC 5.4

A. Paragraph (a)

The introductory paragraph of paragraph (a) provides:

(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:

The basic prohibition on fee sharing is preserved. The concept is that lawyers should not share fees with nonlawyers. There is a concern that such fee sharing would result in nonlawyer marketing businesses that would direct clients to lawyers who pay the most for the referral, even if the lawyer is not qualified. Similarly, the absence of this provision would permit a business operated by a nonlawyer to employ lawyers to represent clients and permit interference with the lawyers' independent professional judgment or the lawyer-client relationship. However, there are six exceptions to this basic rule (five in

current rule, for which one of them the subcommittee has recommended amendments). A new exception, similar to one proposed by the ABA Ethics 20/20 Commission in 2011 (but never adopted), is provided in subparagraph (a)(6).

1. Subparagraphs (a)(1) through (a)(4).

No changes are recommended for subparagraphs (a)(1) through (a)(4).

Subparagraph (a)(1) is a long-standing exception that permits fee sharing with a deceased lawyer's survivors.¹

Subparagraph (a)(2) is another long-standing exception that conforms with the rule that permits sale of a deceased or disabled lawyer's practice to another lawyer (CRPC 1.17).²

Subparagraph (a)(3) recognizes that many businesses provide for employees to share in the businesses' profits. Without this exception, such profit sharing arrangements would not be permitted in a law firm.³ Comment [1] to the rule clarifies that the amount of bonus or profit share may not be based on a percentage or share of fees in specific cases or legal matters.

Subparagraph (a)(4) is a long-standing exception that conforms the rule's application to the statutes and rules governing lawyer referral services in California.⁴

2. Subparagraph (a)(5) – Sharing legal fees with a nonprofit organization.

The following amendments to current CRPC 5.4(a)(5) are recommended:

(5) a lawyer or law firm* may share with or pay a legal fee, including but not limited to a fee awarded by a tribunal or received in settlement of a matter, to a nonprofit organization that (i) employed, retained, ~~or~~ recommended, or facilitated employment of the lawyer or law firm* in the matter and (ii) qualifies under Section 501(c)(3) of the Internal Revenue Code; or

¹ It provides an exception to the fee sharing prohibition for “(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 It provides an exception to the fee sharing prohibition for “(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 It provides that “(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 It provides “(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;”

At its June 3, 2019 meeting, the subcommittee voted to recommend adoption of a modified version of D.C. Rule 5.4(a)(5).⁵ The inclusion of the word “facilitate” is intended to capture the concept of a law practice incubator. See comment [4].

The phrase “including but not limited to” was substituted to expand the kinds of representations that can generate fee sharing beyond litigation.

The rationale for limiting the kinds of nonprofit organizations to those that qualify under Internal Revenue Code § 501(c)(3) is found in D.C. Rule 5.4, cmt. [8], which provides in relevant part:

“Unlike the corresponding provision of Model Rule 5.4(a)(5), this provision is not limited to sharing of fees awarded by a court because that restriction would significantly interfere with settlement of cases, without significantly advancing the purpose of the exception. To prevent abuse of this broader exception, it applies only if the nonprofit organization qualifies under Section 501(c)(3) of the Internal Revenue Code.”

Pros:

(1) By not limiting the (b)(5) exception to court-awarded fees, access to justice might be increased by providing an increased source of revenue to nonprofit legal service providers such as the ACLU.

(2) Concerns regarding potential abuse by a nonprofit specifically formed to share in legal fees are obviated by the limitation to those organizations that qualify under IR Code § 501(c)(3).

Cons:

(1) There is no evidence that expanding the exception beyond “court-awarded” fees will increase access to justice.

(2) The limitation to court-awarded legal fees ensures that “[n]ot only does this circumstance guarantee that the fee will be fairly determined and proportionate to the work performed, but it also recognizes that the litigation in which the fee was generated will have been determined to be of a kind that serves a useful public purpose.” ABA Formal Ethics Op. 93-374, at page 6.

(3) Further, limiting the exception to “court-awarded” legal fees “underscores the fact that economic considerations are of relative unimportance in the relationships between the lawyer, the sponsoring organization, and the client, and hence unlikely to be controlling of any litigation decisions.” *Id.*

3. *Subparagraph (b)(6) – Sharing legal fees with nonlawyers in a law firm that satisfies all requirements set forth in paragraph (b).*

Subparagraph (a)(6) provides an explicit exception to the general prohibition against sharing fees with nonlawyers so long as the lawyer or law firm complies with each of the conditions set out in paragraph

⁵ D.C. Rule 5.4(a)(5) provides: “(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). It is based on the revisions to ABA Model Rule 5.4 as proposed by the ABA Ethics 20/20 Commission, dated 12/2/2011.

Paragraph (a)(6) carves out the exception. Paragraph (b) sets out the six requirements or contingencies that the firm must satisfy to come within the scope of the exception. As explained in section I, above, the requirements in paragraph (b) make any firm that qualifies substantially more limited than what was proposed as a “multidisciplinary practice” (MDP) by the ABA MDP Commission in 1999.

The subcommittee has added the full statement of what is required so that there is no confusion as to what a law firm must do to qualify. The Ethics 20/20 version simply provided:

(x) a lawyer or law firm may do so pursuant to paragraph (b).

Although “do so” could be substituted, the subcommittee thought it important that the black letter text clarify that permission to “do so” mandates that “the lawyer or law firm complies with the requirements set forth in paragraph (b),” all of which requirements are mandatory.

The gist of paragraph (a)(6) is that lawyers and nonlawyers are permitted co-own a law firm, which is defined in the rules as follows:

(c) “Firm” or “law firm” means a law partnership; a professional law corporation; a lawyer acting as a sole proprietorship; an association authorized to practice law; or lawyers employed in a legal services organization or in the legal department, division or office of a corporation, of a government organization, or of another organization. CRPC 1.0.1(c).

Because sharing in the profits of such a firm requires that the legal fees, which would be the source of profit in such a firm, be shared, there must be an express exception to the paragraph (a) prohibition. Subparagraph (a)(6) provides an explicit exception that affords that opportunity.

The subcommittee concluded that no further changes need to be made to the definition of “law firm” because (i) the definition focuses on an organization that practices law and (ii) the kind of firm as envisioned in paragraph (a)(6) is one whose “sole purpose” is “providing legal services to clients.” See (b)(1). That would not have been true had the recommendation been to amend CRPC 5.4 to permit an MDP.

Rather than identify pros and cons for the exception in general, the subcommittee has identified pros and cons for each of the requirements in subparagraphs (b)(1) through (b)(6) that must be satisfied for a firm to qualify under the subparagraph (a)(6) exception.

B. Paragraph (b)

As noted, paragraph (b) is based on the amendments to Model Rule 5.4 proposed by the ABA Ethics 20/20 Commission in 2011. The ABA never adopted those proposed changes to the rule.

The introductory paragraph of (b) is substituted for current CRPC 5.4(b), which absolutely prohibits lawyers from forming a partnership or other organization with a nonlawyer if any of the activities of the organization involve practicing law.⁶ The proposed introduction would provide:

(b) A lawyer shall not practice law in a law firm in which individual nonlawyers in that firm hold a financial interest unless each of the following requirements is satisfied:

The preceding paragraph differs from the Ethics 20/20 proposal in two ways. *First*, the clause “each of the following requirements is satisfied” has been added to emphasize that each of the requirements is mandatory. *Second*, the introductory paragraph has been rewritten to be prohibitory (“shall not ... unless”) as is standard in the California Rules rather than permissive (“may ... but only if”) as in the ABA Ethics 20/20 proposed rule 5.4.

1. Subparagraph (b)(1).

Subparagraph (b)(1) is identical to the same paragraph in Model Rule 5.4 as proposed by the Ethics 20/20 Commission. It would provide:

(1) the firm’s sole purpose is providing legal services to clients;

Pros:

(1) Limiting the type of firm to one whose sole purpose is providing legal services enhances public protection because the lawyer partners, subject to codes and statutes imposing specific duties owed clients, will ultimately be responsible for decisions relating to those services.

(2) This limitation on the services provided should avoid the negative implications of a full-fledged MDP, which was soundly rejected by the ABA in 2000. See note **Error! Bookmark not defined..**

(3) This limitation on the services provided should also avoid the concerns stated in Sam Skolnik and Amanda Iacone, [Big Four May Gain Legal Market Foothold With State Rule Change, Bloomberg \(4/11/19\)](#), which likely would create pushback by the legal profession. This article suggests that some rules proposals that would open up the ability of lawyers to enter professional and financial relationships with nonlawyers will merely function as stalking horses and enable the Big Four accounting firms to expand their presence in providing legal services without a corresponding increase in access to justice.

(4) Although limited, this proposal should nevertheless provide nonlawyer technologists with a financial incentive to join forces with lawyers to fashion technological solutions to the justice access problem in concert with the lawyers’ provision of legal services.

Cons:

(1) There is little or no concrete evidence that even this modest proposal will increase access to justice. The only jurisdiction that has adopted a similar rule is D.C., and that rule appears primarily intended to

⁶ Current CRPC 5.4(b) provides: “(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.”

provide a means for nonlawyer lobbyists to share in a law firm's profits (and enhance the law firm's profits in that environment.)

(2) See Pro #3, above.

2. Subparagraph (b)(2).

Subparagraph (b)(2) is identical to the same paragraph in Model Rule 5.4 as proposed by Ethics 20/20. It would provide:

(2) the nonlawyers provide services that assist the lawyer or law firm in providing legal services to clients;

Pros:

(1) By limiting the role of nonlawyers to providing services “that assist” the provision of legal services, this provision addresses to some extent a concern expressed by members of ATILS regarding whether a tech solution can retain the protection of the privilege or work product in providing services. So long as the nonlawyers, whether through their own efforts or through apps they have designed, are assisting lawyers in providing services to the firm's clients, the protections of privilege and work product should be preserved.

For example, with respect to privilege, see Evid. Code 952, which provides:

As used in this article, “confidential communication between client and lawyer” means information transmitted between a client and his or her lawyer in the course of that relationship and in confidence by a means which, so far as the client is aware, discloses the information to no third persons other than those *who are present to further the interest of the client* in the consultation or *those to whom disclosure is reasonably necessary for the transmission of the information or the accomplishment of the purpose for which the lawyer is consulted*, and includes a legal opinion formed and the advice given by the lawyer in the course of that relationship. (Emphasis added)

Cons:

(1) This rule would not address the stated concern as to a nonlawyer's business that is engaged in providing legal services directly through technology, unless that business is majority owned or at least controlled by a lawyer or lawyers.

Possible Issue: Should nonlawyer ownership be limited to nonlawyers who “assist” the lawyers of the firm in providing legal services?

If not so limited, e.g., the firm is a true MDP (i.e., providing legal, accounting, etc., services independent of one another), which could open the door wider than intended. See Sam Skolnik and Amanda Iacone, [Big Four May Gain Legal Market Foothold With State Rule Change, Bloomberg \(4/11/19\)](#).

Compare the rule revision proposal of the ABA MDP Commission in their [Appendix A](#).

3. Subparagraph (b)(3).

Subparagraph (b)(3) is comprised of the first clause of paragraph (b)(5) of Model Rule 5.4 as proposed by Ethics 20/20. It would provide:

(3) the nonlawyers have no power to direct or control the professional judgment of a lawyer;

Subparagraph (b)(3) is comprised of the first clause of paragraph (b)(5) of Model Rule 5.4 proposed by Ethics 20/20. Paragraph (b)(5) provided:

(5) the nonlawyers have no power to direct or control the professional judgment of a lawyer, and the financial and voting interests in the firm of any nonlawyer are less than the financial and voting interest of the individual lawyer or lawyers holding the greatest financial and voting interests in the firm, the aggregate financial and voting interests of the nonlawyers does not exceed [25%] of the firm total, and the aggregate of the financial and voting interests of all lawyers in the firm is equal to or greater than the percentage of voting interests required to take any action or for any approval;

The subcommittee believes that the balance of subparagraph (b)(5) of the Ethics 20/20 version of the rule is confusing and unnecessary. There will likely be many different ways in which nonlawyer ownership of a law firm will be implemented. The key point is that the nonlawyers in the firm must not direct or control the lawyers' independent professional judgment. This provision will allow some flexibility in setting up a firm's management structure, so long as this cardinal principle is not violated.

Pros: (1) A simple declarative statement that nonlawyers in the firm have no power to direct or control the professional judgment of a lawyer should provide sufficient assurance that the lawyers' professional judgment will not be impinged by the nonlawyers in the firm.

(2) The statement should also provide sufficient guidance on how the various ownership and voting interests should be structured in a firm set up under subparagraph (b). For further clarification, a comment could be added. Consider, for example, a variant Comment [8] to Model Rule 5.4, as proposed by Ethics 20/20, which provided:

[8] For purposes of paragraph (b)(5), a financial interest in a law firm shall include, but not be limited to, an interest in the equity or profits of the firm. This provision provides that the nonlawyers cannot control the vote on or veto a specific matter by reserving to the nonlawyers the right to approve or disapprove a specific matter when all lawyers vote to approve the matter.

However, the subcommittee does not believe that such a comment is necessary to further explain subparagraph (b)(5), which explicitly prohibits nonlawyers from controlling or directing the lawyers' decisions.

Cons: (1) This black letter provision lacks specificity as to how the goal of preventing nonlawyer control of lawyers' professional judgment will be attained.

4. Subparagraph (b)(4).

Subparagraph (b)(4) is based on paragraph (b)(3) of Model Rule 5.4 as proposed by Ethics 20/20.⁷ It would provide:

(4) the nonlawyers state in writing that they have read and understand the Rules of Professional Conduct, the State Bar Act and other laws regulating lawyer conduct and agree in writing to undertake to conform their conduct to the Rules, the State Bar Act and other laws regulating lawyer conduct;

The additional language in subparagraph (b)(4) recognizes that in California, lawyer conduct is regulated not only by the Rules of Professional Conduct. Under subparagraph (b)(3), the nonlawyers must agree to undertake to conform their conduct to that of lawyers under the Rules of Professional Conduct, the State Bar Act, and the other laws that govern lawyer conduct (e.g., Evidence Code, Probate Code, Penal Code, etc.)

Pros:

(1) This provision, when read in conjunction with subparagraph (b)(5), which imposes on the firm's lawyer partners the duty to ensure the firm's nonlawyers' compliance with the Rules, etc., provides assurance that the services provided by the firm will be in compliance with the Rules.

(2) Requiring certification would not increase public protection. The key element in ensuring legal services are being provided in compliance with the Rules, etc., will be the continued monitoring of nonlawyer conduct by the lawyer partners in the firm.

Cons:

(1) The provision does not provide sufficient public protection, even when read in concert with subparagraph (b)(5). The public would be better protected by requiring that each nonlawyer partner be certified by an appropriate authority. See "Issue2," below.

Although the subcommittee concluded that the provision as drafted should provide sufficient protection when read in conjunction with subparagraph (b)(5), it did identify two further issues that the Task Force as a whole might want to address:

Issue1: The provision requires nonlawyers agree to "undertake to conform their conduct." Should the provision provide that the nonlawyers agree "to conform their conduct." In other words, we're not asking you to attempt to conform your conduct but telling you that you must agree to do so.

Issue2: In addition to the foregoing issues presented for the May 13-14, 2019 meeting, during the May 14 subcommittee meeting, there was a discussion whether this provision provides sufficient protection or whether each nonlawyer should be certified by some process implemented by the State Bar. The subcommittee concluded that this provision was sufficient. On reflection, perhaps a slightly revised provision that specifies that *each* nonlawyer must agree in a *signed* writing that the

⁷ Ethics 20/20 proposed rule 5.4(b)(3) provided:

(3) the nonlawyers state in writing that they have read and understand the Rules of Professional Conduct and agree in writing to undertake to conform their conduct to the Rules;

nonlawyer will conform his or her conduct would be an acceptable compromise. For example, subparagraph (b)(4) could be revised as follows:

(4) ~~the each~~ nonlawyer~~s~~ states in a writing signed by the nonlawyer that ~~they have the nonlawyer has~~ read and understands the Rules of Professional Conduct, the State Bar Act and other laws regulating lawyer conduct and agrees in that writing to undertake to conform ~~their his or her~~ conduct to the Rules, the State Bar Act and other laws regulating lawyer conduct;

See also note 8.

5. Subparagraph (b)(5).

Subparagraph (b)(5) is identical to paragraph (b)(4) of Model Rule 5.4 proposed by Ethics 20/20. It would provide:

(5) the lawyer partners in the law firm are responsible for these nonlawyers to the same extent as if the nonlawyers were lawyers under rule 5.1;

Pros: (1) Subparagraph (b)(4) clarifies that managerial and supervisory lawyers are still responsible for the nonlawyers, even though they might be co-owners in the firm. There could be circumstances where a particular nonlawyer might have a larger ownership share in the firm. Nevertheless, the lawyer would still ultimately be responsible for that nonlawyer as if the nonlawyer were a nonmanagerial partner/shareholder or a subordinate lawyer.

(2) This provision would fill a gap in the current rules that would arise should the subcommittee's proposed amendments to CRPC 5.4 be adopted. Under current CRPC 5.1, managerial and supervisory lawyers are responsible for subordinate or non-managerial lawyers. Under current rule 5.3, lawyers in a firm are responsible for nonlawyer assistants (or in ABA Model Rule 5.3, nonlawyer "assistance.") This provision clarifies that the lawyers in the firm remain responsible for the nonlawyers even if they are co-owners in the law firm. See also note 8.

Cons:

(1) None identified.

6. Subparagraph (b)(6).⁸

Subparagraph (b)(6) is identical to paragraph (b)(7) of Model Rule 5.4 as proposed by Ethics 20/20. It would provide:

(6) compliance with the foregoing conditions is set forth in writing.

Subparagraph (b)(6) simply requires that the firm keep a written record, including the writings required under subparagraph (b)(4), to demonstrate that it has complied with all the requirements of paragraph (b).

Pros:

(1) This provision should have a similar effect as a lawyer failing to keep adequate trust account records, i.e., failure to keep adequate records is a violation in itself and even if records are kept, but are inadequate, that would also be a violation. Further, the lack of sufficient writings would constitute evidence of the violation.

Cons:

None identified.

C. Paragraphs (c), (e) and (f)

The subcommittee does not recommend any changes to paragraphs (c), (e) or (f) of current CRPC 5.4.

Paragraph (c) prohibits a lawyer from permitting a person who recommends, employs, or pays the lawyer to render legal services for another to direct the lawyer's independent professional judgment or interfere in the lawyer-client relationship.

Paragraph (e) requires that the Board of Trustees formulate and adopt Minimum Standards for Lawyer Referral Services, and prohibits lawyers from participating in any such service that is not in compliance with the Minimum Standards.

Paragraph (f) prohibits a lawyer from practicing in a nonprofit legal aid, mutual benefit or advocacy group if the nonprofit organization allows any third person to interfere with the lawyer's independent professional judgment or the lawyer-client relationship.

⁸ In addition to the six subparagraphs proposed by the subcommittee, Ethics 20/20 also proposed a seventh, subparagraph (b)(6), which provided:

(6) the lawyer partners in the firm make reasonable efforts to establish that each nonlawyer with a financial interest in the firm is of good character, supported by evidence of the nonlawyer's integrity and professionalism in the practice of his or her profession, trade or occupation, and maintain records of such inquiry and its results;

At its May 14 meeting, the subcommittee concluded that this provision was not necessary in light of subparagraph (b)(5) regarding the lawyers' duty to be responsible for the nonlawyers as if the nonlawyers were lawyers under rule 5.1.

D. Paragraph (d)

The subcommittee proposes that current CRPC 5.4(d) be amended as follows:

(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~~ Notwithstanding paragraph (a), a fiduciary representative of a lawyer's estate may hold the lawyer's stock or other interest in a law corporation or other organization authorized to practice law for a reasonable* time during administration; ~~or~~

~~(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.~~

The proposed changes to paragraph (d) parallel those recommended by Ethics 20/20. These changes are necessary because the prohibitions in former paragraphs (b) and (d) have been subsumed in new paragraph (b). Thus, former paragraph (d) is deleted except for current subparagraph (d)(1) regarding the fiduciary of a lawyer's estate, which is not affected by the changes to paragraph (b).

E. Comments

Current CRPC 5.4 includes five comments. The subcommittee does not recommend any changes to these existing comments as they each address a provision in the current rule that the subcommittee does not recommend amending.

1. New Comment [4].

The subcommittee proposes the addition of new Comment [4], which would clarify the application of subparagraph (a)(5) by explaining the addition of the word "facilitate" in that subsection. New Comment [4] would provide:

[4] A nonprofit organization that provides logistical or operational support, such as physical facilities or clerical assistance, to a lawyer facilitates the employment of the lawyer as provided in paragraph (a)(5).

At its 6/3/19 meeting, the Subcommittee voted to include Comment [4] to clarify that subparagraph (a)(5) is intended to also apply to law practice incubators in addition to legal services organizations.

Conclusion

The subcommittee recommends that the Task Force include in its Report a recommendation that the proposed changes to CRPC 5.4 outlined in this memo be adopted by the Board of Trustees and approved by the Supreme Court.

Rule 5.4 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;

(5) a lawyer or law firm* may share with or pay a legal fee, including but not limited to a fee awarded by a tribunal or received in settlement of a matter, to a nonprofit organization that (i) employed, retained, recommended, or facilitated employment of the lawyer or law firm* in the matter and (ii) qualifies under Section 501(c)(3) of the Internal Revenue Code; or

(6) a lawyer or law firm may share legal fees with a nonlawyer if the lawyer or law firm complies with the requirements set forth in paragraph (b).

(b) A lawyer shall not practice law in a law firm in which individual nonlawyers in that firm hold a financial interest unless each of the following requirements is satisfied:

(1) the firm's sole purpose is providing legal services to clients;

(2) the nonlawyers provide services that assist the lawyer or law firm in providing legal services to clients;

(3) the nonlawyers have no power to direct or control the professional judgment of a lawyer;

(4) the nonlawyers state in writing that they have read and understand the Rules of Professional Conduct, the State Bar Act and other laws regulating lawyer conduct and agree in writing to undertake to conform their conduct to the Rules, the State Bar Act and other laws regulating lawyer conduct;

(5) the lawyer partners in the law firm are responsible for these nonlawyers to the same extent as if the nonlawyers were lawyers under rule 5.1;

(6) compliance with the foregoing conditions is 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 independent professional judgment or interfere with the lawyer-client relationship in rendering legal services.

(d) Notwithstanding paragraph (a), a fiduciary representative of a lawyer's estate may hold the lawyer's stock or other interest in a law corporation or other organization authorized to practice law for a reasonable* time during administration.

(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* to interfere with the lawyer's independent professional judgment, or with the lawyer-client relationship, or allows or aids any person* 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] A nonprofit organization that provides logistical or operational support, such as physical facilities or clerical assistance, to a lawyer facilitates the employment of the lawyer as provided in paragraph (a)(5).

[5] 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].)

[6] Paragraph (c) is not intended to alter or diminish a lawyer's obligations under rule 1.8.6 (Compensation from One Other Than Client).

<p>Underlines represent additions to, and strikethroughs deletions from, current California Rule 5.4.</p>
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Rule 5.4 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 legal fee, including but not limited to a fee awarded by a tribunal or received in settlement of a matter, to a nonprofit organization that (i) employed, retained, ~~or~~ recommended, or facilitated employment of the lawyer or law firm* in the matter and (ii) qualifies under Section 501(c)(3) of the Internal Revenue Code; or

(6) a lawyer or law firm may share legal fees with a nonlawyer if the lawyer or law firm complies with the requirements set forth in paragraph (b).

~~(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. A~~ lawyer shall not practice law in a law firm in which individual nonlawyers in that firm hold a financial interest unless each of the following requirements is satisfied:

(1) the firm's sole purpose is providing legal services to clients;

(2) the nonlawyers provide services that assist the lawyer or law firm in providing legal services to clients;

(3) the nonlawyers have no power to direct or control the professional judgment of a lawyer;

(4) the nonlawyers state in writing that they have read and understand the Rules of Professional Conduct, the State Bar Act and other laws regulating lawyer conduct and

agree in writing to undertake to conform their conduct to the Rules, the State Bar Act and other laws regulating lawyer conduct;

(5) the lawyer partners in the law firm are responsible for these nonlawyers to the same extent as if the nonlawyers were lawyers under rule 5.1;

(6) compliance with the foregoing conditions is 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 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~~ Notwithstanding paragraph (a), a fiduciary representative of a lawyer's estate may hold the lawyer's stock or other interest in a law corporation or other organization authorized to practice law 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* to interfere with the lawyer's independent professional judgment, or with the lawyer-client relationship, or allows or aids any person* 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] A nonprofit organization that provides logistical or operational support, such as physical facilities or clerical assistance, to a lawyer facilitates the employment of the lawyer as provided in paragraph (a)(5).

[45] 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].)

[56] Paragraph (c) is not intended to alter or diminish a lawyer's obligations under rule 1.8.6 (Compensation from One Other Than Client).

Rule 5.4 Financial and Similar Arrangements with Nonlawyers	Subcommittee Comments
(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:	The basic prohibition on fee sharing is preserved. The concept is that lawyers should not share with nonlawyers. There is a concern that such fee sharing would result in nonlawyer marketing businesses that would direct clients to lawyers who pay the most for the referral, even if the lawyer is not qualified. Similarly, the absence of this provision would permit a business operated by a nonlawyer to employ lawyers to represent clients and permit interference with the lawyers' independent professional judgment. However, there are six exceptions (five in current rule; one proposed) to this basic rule. A new exception, as proposed by the Ethics 20/20 Commission, is stated in subparagraph (a)(6), which refers to the paragraph (b) requirements.
(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;*	No change. This is a long-standing exception that permits fee sharing with a deceased lawyer's survivors.
(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;	No change. Another long-standing exception to conform with the rule that permits sale of a deceased or disabled lawyer's practice to another lawyer.
(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;	No change. Many businesses provide for employees to share in the businesses' profits. Without this exception, such profit sharing arrangements would not be permitted in a law firm. Comment [1] clarifies that the amount of bonus or profit share may not be based on a percentage or share of fees in specific cases or legal matters.
(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	No change. This is a long-standing exception that conforms the rules application to the statutes and rules governing lawyer referral services in California.
(5) a lawyer or law firm* may share with or pay a legal fee, <u>including but not limited to a fee awarded by a tribunal or received in settlement of a matter,</u> to a nonprofit organization that (i) employed, retained, or recommended, <u>or facilitated</u> employment of the lawyer or law firm* in the matter <u>and (ii) qualifies under Section 501(c)(3) of the Internal Revenue Code; or</u>	At its 5/14/19 meeting, the Subcommittee voted to revise subparagraph (b)(5) to extend the exception for sharing legal fees with a nonprofit beyond just court-awarded fees. At its 6/3/19 meeting, the Subcommittee voted to adopt a modified version of D.C. Rule 5.4(a)(5). The inclusion of the word "facilitate" is intended to capture the concept of a law practice incubator. See Cmt. [4]. The phrase "including but not limited to" was substituted to expand the kinds of representations that can generate fee sharing beyond litigation. Pros: (1) By not limiting the (b)(5) exception to court-awarded fees, access to justice might be increased by providing an increased source of revenue to nonprofit legal service providers such as the ACLU. Cons: (1) There is no evidence that expanding the exception beyond "court-

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	<p>awarded” fees will increase access to justice.</p> <p>(2) The limitation to court-awarded legal fees ensures that “[n]ot only does this circumstance guarantee that the fee will be fairly determined and proportionate to the work performed, but it also recognizes that the litigation in which the fee was generated will have been determined to be of a kind that serves a useful public purpose.” ABA Formal Ethics Op. 93-374, at page 6.</p> <p>(3) Further, limiting the exception to “court-awarded” legal fees “underscores the fact that economic considerations are of relative unimportance in the relationships between the lawyer, the sponsoring organization, and the client, and hence unlikely to be controlling of any litigation decisions.” <i>Id.</i></p>
<p>(6) a lawyer or law firm may share legal fees with a nonlawyer if the lawyer or law firm complies with the requirements set forth in paragraph (b).</p>	<p>Subparagraph (a)(6) provides an explicit exception to the general prohibition against sharing fees with nonlawyers so long as the lawyer or law firm complies with each of the conditions set out in paragraph (b). It is based on the revisions to ABA Model Rule 5.4 as proposed by the ABA Ethics 20/20 Commission, dated 12/2/2011.</p> <p>Note: Paragraph (b) is substantially more limiting than what was proposed as a “multidisciplinary practice” (MDP) by the ABA MDP Commission in 1999. It only permits nonlawyer partners/owners of the firm to “assist” the firm’s lawyers in the firm’s sole purpose of providing legal services. Under an MDP, the nonlawyers could separately and independently provide services of a nonlegal nature, e.g., accounting or financial planning services, that are not necessarily related to the provision of legal services.</p> <p>Paragraph (a)(6) carves out the exception. Paragraph (b) sets out the six requirements or contingencies that the firm must satisfy to come within the scope of the exception.</p> <p>The subcommittee has added the full statement of what is permitted so that there is no confusion as to what is being permitted. The Ethics 20/20 version simply provided:</p> <p style="padding-left: 40px;">(x) a lawyer or law firm may <u>do so pursuant to paragraph (b).</u></p> <p>Although “do so” could be substituted, the subcommittee thought it important that the black letter text clarify that permission to “do so” mandates that “the lawyer or law firm complies with the requirements set forth in paragraph (b),” all of which requirements are mandatory.</p> <p>The gist of paragraph (a)(6) is that lawyers and nonlawyers are permitted co-own a law firm, which is defined in the rules as follows:</p> <p style="padding-left: 40px;">(c) “Firm” or “law firm” means a law partnership; a professional law</p>

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	<p>corporation; a lawyer acting as a sole proprietorship; an association authorized to practice law; or lawyers employed in a legal services organization or in the legal department, division or office of a corporation, of a government organization, or of another organization. CRPC 1.0.1(c).</p> <p>Because sharing in the profits of such a firm requires that the legal fees, which would be the source of profit in such a firm, be shared, there has to be an express exception to the paragraph (a) prohibition as stated in subparagraph (a)(6).</p> <p>The subcommittee concluded that no further changes need to be made to the definition of “law firm” because (i) the definition focuses on an organization that practices law and (ii) the kind of firm as envisioned in paragraph (a)(6) is one whose “sole purpose” is “providing legal services to clients.” See (b)(1).</p>
<p>(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. A lawyer shall not practice law in a law firm in which individual nonlawyers in that firm hold a financial interest unless each of the following requirements is satisfied:</p>	<p>Similar to subparagraph (a)(6), the italicized phrase has been added to the Ethics 20/20 language:</p> <p>(b) A lawyer shall not practice law in a law firm in which individual nonlawyers in that firm hold a financial interest unless <i>each of the following requirements is satisfied</i>:</p> <p><u>Two points:</u> <i>First</i>, this language is intended to emphasize that each of the requirements is mandatory. <i>Second</i>, the introductory paragraph has been rewritten to be prohibitory (“shall not ... unless”) as is standard in the California Rules rather than permissive (“may ... but only if”) as in the ABA Ethics 20/20 proposed rule 5.4.</p>
<p><u>(1) the firm’s sole purpose is providing legal services to clients;</u></p>	<p>Subparagraph (b)(1) is identical to the same paragraph in Model Rule 5.4 proposed by Ethics 20/20.</p> <p><u>Pros:</u> (1) Limiting the type of firm to one whose sole purpose is providing legal services enhances public protection because the lawyer partners, subject to codes and statutes imposing specific duties owed clients, will be ultimately responsible for decisions relating to those services.</p> <p>(2) This limitation on the services provided should avoid the negative implications of a full-fledged MDP, which was soundly rejected by the ABA in 2000. See note Error! Bookmark not defined.</p> <p>(3) This limitation on the services provided should also avoid the concerns stated in Sam Skolnik and Amanda Iacone, Big Four May Gain Legal Market Foothold With State Rule Change, Bloomberg (4/11/19), which likely would create pushback by the legal profession. This article suggests that some rules</p>

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	<p>proposals that would open up the ability of lawyers to enter professional and financial relationships with nonlawyers will merely function as stalking horses and enable the Big Four accounting firms to expand their presence in providing legal services without a corresponding increase in access to justice.</p> <p>(4) Although limited, this proposal should nevertheless provide nonlawyer technologists with a financial incentive to join forces with lawyers to fashion technological solutions to the justice access problem in concert with the lawyers' provision of legal services.</p> <p><u>Cons:</u> (1) There is little or no concrete evidence that even this modest proposal will increase access to justice. The only jurisdiction that has adopted a similar rule is D.C., and that rule appears primarily intended to provide a means for nonlawyer lobbyists to share in a law firm's profits (and enhance the law firm's profits in that environment.)</p>
<p><u>(2) the nonlawyers provide services that assist the lawyer or law firm in providing legal services to clients;</u></p>	<p>Subparagraph (b)(2) is identical to the same paragraph in Model Rule 5.4 proposed by Ethics 20/20.</p> <p>Pros: (1) By limiting the role of nonlawyers to providing services “that assist” the provision of legal services, this provision addresses to some extent a concern expressed by members of ATILS regarding whether a tech solution can retain the protection of the privilege or work product in providing services. So long as the nonlawyers, whether through their own efforts or through apps they have designed, are assisting lawyers in providing services to the firm's clients, the protections of privilege and work product should be preserved.</p> <p>For example, with respect to privilege, see Evid. Code 952, which provides:</p> <p style="padding-left: 40px;">As used in this article, “confidential communication between client and lawyer” means information transmitted between a client and his or her lawyer in the course of that relationship and in confidence by a means which, so far as the client is aware, discloses the information to no third persons other than those <i>who are present to further the interest of the client</i> in the consultation or <i>those to whom disclosure is reasonably necessary</i> for the transmission of the information or <i>the accomplishment of the purpose for which the lawyer is consulted</i>, and includes a legal opinion formed and the advice given by the lawyer in the course of that relationship. (Emphasis added)</p> <p><u>Cons:</u> (1) This rule would not address the stated concern as to a nonlawyer's business that is engaged in providing legal services directly through technology, unless that business is majority owned or at least controlled by a lawyer or lawyers.</p>

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	<p>Issue: Should nonlawyer ownership be limited to nonlawyers who “assist” the lawyers of the firm in providing legal services?</p> <p>If not so limited, e.g., the firm is a true MDP (i.e., providing legal, accounting, etc., services independent of one another), which could open the door wider than intended. See Sam Skolnik and Amanda Iacone, Big Four May Gain Legal Market Foothold With State Rule Change, Bloomberg (4/11/19).</p> <p>Compare the rule revision proposal of the ABA MDP Commission in their Appendix A.</p>
<p>(3) the nonlawyers have no power to direct or control the professional judgment of a lawyer;</p>	<p>Subparagraph (b)(3) is comprised of the first clause of paragraph (b)(5) of Model Rule 5.4 proposed by Ethics 20/20. Subparagraph (b)(3) is comprised of the first clause of paragraph (b)(5) of Model Rule 5.4 proposed by Ethics 20/20. Paragraph (b)(5) provided:</p> <p style="padding-left: 40px;">(5) the nonlawyers have no power to direct or control the professional judgment of a lawyer, and the financial and voting interests in the firm of any nonlawyer are less than the financial and voting interest of the individual lawyer or lawyers holding the greatest financial and voting interests in the firm, the aggregate financial and voting interests of the nonlawyers does not exceed [25%] of the firm total, and the aggregate of the financial and voting interests of all lawyers in the firm is equal to or greater than the percentage of voting interests required to take any action or for any approval;</p> <p>The subcommittee believes that subparagraph (b)(5) of the Ethics 20/20 version of the rule is confusing and unnecessary. There will likely be many different ways in which nonlawyer ownership of a law firm will be implemented. The key point is that the nonlawyers in the firm must not direct or control the lawyers’ independent professional judgment. This provision will allow some flexibility in setting up a firm’s management structure, so long as this cardinal principle is not violated.</p> <p><u>Pros:</u> (1) A simple declarative statement that nonlawyers in the firm have no power to direct or control the professional judgment of a lawyer should provide sufficient assurance that the lawyers’ professional judgment will not be impinged by the nonlawyers in the firm.</p> <p>(2) The statement should also provide sufficient guidance on how the various ownership and voting interests should be structured in a firm set up under subparagraph (b). For further clarification, a comment could be added. Consider, for example, a variant Comment [8] to Model Rule 5.4, as proposed by Ethics 20/20, which provided:</p>

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	<p>[8] For purposes of paragraph (b)(5), a financial interest in a law firm shall include, but not be limited to, an interest in the equity or profits of the firm. This provision provides that the nonlawyers cannot control the vote on or veto a specific matter by reserving to the nonlawyers the right to approve or disapprove a specific matter when all lawyers vote to approve the matter.</p> <p>However, the subcommittee does not believe that such a comment is necessary to further explain subparagraph (b)(5), which explicitly prohibits nonlawyers from controlling or directing the lawyers' decisions.</p> <p><u>Cons:</u> (1) This black letter provision lacks specificity as to how the goal of preventing nonlawyer control of lawyers' professional judgment will be attained.</p>
<p>(4) the nonlawyers state in writing that they have read and understand the Rules of Professional Conduct, the State Bar Act and other laws regulating lawyer conduct and agree in writing to undertake to conform their conduct to the Rules, the State Bar Act and other laws regulating lawyer conduct;</p>	<p>Subparagraph (b)(4) is based on paragraph (b)(3) of Model Rule 5.4 proposed by Ethics 20/20, which provided:</p> <p>(3) the nonlawyers state in writing that they have read and understand the Rules of Professional Conduct and agree in writing to undertake to conform their conduct to the Rules;</p> <p>The additional language in subparagraph (b)(4) recognizes that in California, lawyer conduct is regulated not only by the Rules of Professional Conduct. Under subparagraph (b)(3), the nonlawyers must agree to undertake to conform their conduct to that of lawyers under the Rules of Professional Conduct, the State Bar Act, and the other laws that govern lawyer conduct (e.g., Evidence Code, Probate Code, Penal Code, etc.)</p> <p><u>Pros:</u> (1) This provision, when read in conjunction with subparagraph (b)(5), which imposes on the firm's lawyer partners the duty to ensure the firm's nonlawyers' compliance with the Rules, etc., provides assurance that the services provided by the firm will be in compliance with the Rules.</p> <p>(2) Requiring certification would not increase public protection. The key element in ensuring legal services are being provided in compliance with the Rules, etc., will be the continued monitoring of nonlawyer conduct by the lawyer partners in the firm.</p> <p><u>Cons:</u> (1) The provision does not provide sufficient public protection, even when read in concert with subparagraph (b)(5). The public would be better protected by requiring that each nonlawyer partner be certified by an</p>

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	<p>appropriate authority. See “Issue2,” below.</p> <p>Although the subcommittee concluded that the provision as drafted should provide sufficient protection when read in conjunction with subparagraph (b)(5), it did identify two further issues that the Task Force as a whole might want to address:</p> <p>Issue1: The provision requires nonlawyers agree to “undertake to conform their conduct.” Should the provision provide that the nonlawyers agree “to conform their conduct.” In other words, we’re not asking you to attempt to conform your conduct but telling you that you must agree to do so.</p> <p>Issue2: In addition to the foregoing issues presented for the May 13-14, 2019 meeting, during the May 14 subcommittee meeting, there was a discussion whether this provision provides sufficient protection or whether each nonlawyer should be certified by some process implemented by the State Bar. The subcommittee concluded that this provision was sufficient. On reflection, perhaps a slightly revised provision that specifies that <i>each</i> nonlawyer must agree in a <i>signed</i> writing that the nonlawyer will conform his or her conduct would be an acceptable compromise. For example, subparagraph (b)(4) could be revised as follows:</p> <p style="padding-left: 40px;">(4) the each nonlawyers states in a writing <u>signed by the nonlawyer</u> that they have the nonlawyer has read and understands the Rules of Professional Conduct, the State Bar Act and other laws regulating lawyer conduct and agrees in <u>that</u> writing to undertake to conform their his or her conduct to the Rules, the State Bar Act and other laws regulating lawyer conduct;</p> <p>See also note 1.</p>
<p><u>(5) the lawyer partners in the law firm are responsible for these nonlawyers to the same extent as if the nonlawyers were lawyers under rule 5.1;</u></p>	<p>Subparagraph (b)(5) is identical to paragraph (b)(4) of Model Rule 5.4 proposed by Ethics 20/20.</p> <p>Pros: (1) Subparagraph (b)(4) clarifies that managerial and supervisory lawyers are still responsible for the nonlawyers, even though they might be co-owners in the firm. There could be circumstances where a particular nonlawyer might have a larger ownership share in the firm. Nevertheless, the lawyer would still ultimately be responsible for that nonlawyer as if the nonlawyer were a nonmanagerial partner/shareholder or a subordinate lawyer.</p> <p>(2) This provision would fill a gap in the current rules that would arise should the subcommittee’s proposed amendments to CRPC 5.4 be adopted. Under current CRPC 5.1, managerial and supervisory lawyers are responsible for subordinate or non-managerial lawyers. Under current rule 5.3, lawyers in a</p>

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	<p>firm are responsible for nonlawyer assistants (or in ABA Model Rule 5.3, nonlawyer “assistance.”) This provision clarifies that the lawyers in the firm remain responsible for the nonlawyers even if they are co-owners in the law firm. See also note 1.</p> <p><u>Cons:</u> (1) None identified.</p>
<p>(6) compliance with the foregoing conditions is set forth in writing.¹</p>	<p>Subparagraph (b)(6) is identical to paragraph (b)(7) of Model Rule 5.4 as proposed by Ethics 20/20. Subparagraph (b)(6) simply requires that the firm keep a written record, including the writings required under subparagraph (b)(4), to demonstrate that it has complied with all the requirements of paragraph (b).</p> <p><u>Pros:</u> (1) This provision should have a similar effect as a lawyer failing to keep adequate trust account records, i.e., failure to keep adequate records is a violation in itself and even if records are kept, but are inadequate, that would also be a violation. Further, the lack of sufficient writings would constitute evidence of the violation.</p> <p><u>Cons:</u> None identified.</p>
<p>(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.</p>	<p>No change.</p>
<p>(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:</p> <p>(1) a nonlawyer owns any interest in it, except that a Notwithstanding paragraph (a), a fiduciary representative of a lawyer’s estate may hold the lawyer’s stock or other interest in a law corporation or other organization authorized to practice law for a reasonable* time during administration;</p> <p>(2) a nonlawyer is a director or officer of the corporation or occupies a</p>	<p>Because the prohibitions in former paragraphs (b) and (d) have been subsumed in new paragraph (b), former paragraph (d) is deleted except for current subparagraph (d)(1) regarding the fiduciary of a lawyer’s estate, which is not affected by the changes to paragraph (b).</p>

¹ In addition to the six subparagraphs proposed by the subcommittee, Ethics 20/20 also proposed a seventh, subparagraph (b)(6), which provided:

(6) the lawyer partners in the firm make reasonable efforts to establish that each nonlawyer with a financial interest in the firm is of good character, supported by evidence of the nonlawyer’s integrity and professionalism in the practice of his or her profession, trade or occupation, and maintain records of such inquiry and its results;

At its May 14 meeting, the subcommittee concluded that this provision was not necessary in light of subparagraph (b)(5) regarding the lawyers’ duty to be responsible for the nonlawyers as if the nonlawyers were lawyers under rule 5.1.

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<p>position of similar responsibility in any other form of organization; or</p> <p>(3) a nonlawyer has the right or authority to direct or control the lawyer's independent professional judgment.</p>	
<p>(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.</p>	No change.
<p>(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* to interfere with the lawyer's independent professional judgment, or with the lawyer-client relationship, or allows or aids any person* to practice law in violation of these rules or the State Bar Act.</p>	No change.
<p>Comment</p>	
<p>[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.</p>	No change.
<p>[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.</p>	No change.
<p>[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 <i>Frye v. Tenderloin Housing Clinic, Inc.</i> (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,</p>	No change.

Rule 5.4 Financial and Similar Arrangements with Nonlawyers	Subcommittee Comments
see rule 1.0, Comment [5] on financial support for programs providing pro bono legal services.	
[4] A nonprofit organization that provides logistical or operational support, such as physical facilities or clerical assistance, to a lawyer facilitates the employment of the lawyer as provided in paragraph (a)(5).	At its 6/3/19 meeting, the Subcommittee voted to include Comment [4] to clarify that paragraph (a)(5) is intended to also apply to law practice incubators in addition to legal services 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., <i>Gafcon, Inc. v. Ponsor Associates</i> (2002) 98 Cal.App.4th 1388 [120 Cal.Rptr.2d 392].)	No change.
[5] Paragraph (c) is not intended to alter or diminish a lawyer's obligations under rule 1.8.6 (Compensation from One Other Than Client).	No change.