

January 8, 2020

Justice Lee Edmon, Chair  
ATILS Task Force  
State Bar of California  
180 Howard Street  
San Francisco, CA 94105

Dear Justice Edmon:

This is a public comment on issues raised by Professor Mohr and Mr. Difuntorum's December 26, 2019 redraft of Alternative 1 for revision of Rule 5.4 and by Professor Mohr and Mr. Tuft's December 23, 2019 memorandum on Rule 5.7. I hope that these views can be transmitted to the members of the Task Force prior to its January 10 meeting. I regret that a prior commitment on the East Coast prevents me from delivering them in person.

These comments are submitted in my capacity as private citizen and lawyer-academic. Though I am the current Chair of the State Bar's Committee on Professional Rules and Conduct ("COPRAC"), this letter represents solely my own personal views, and not those of COPRAC or its staff. For COPRAC's views, many of which remain directly relevant to pending Rule 5.4 and 5.7 issues, I refer the Task Force to the letter from Chair Amy Bomse to Justice Edmon dated September 10, 2019.

This letter is driven by the concerns reflected in Professor Henderson's inspiring and path-breaking July 2018 Legal Landscape Market Report. Like that Report my focus is on whether and how the Professional Rules are serving consumers, not how they benefit lawyers or regulators. Henderson Report at 24. Moreover, like Professor Henderson, I believe that "[t]he law should not be regulated to protect the 10 percent of customers who can afford legal services while ignoring the 90 percent who lack the ability to pay." *Id.* at 28. Instead, the State Bar should take "an expansive view of protection that includes greater access to the legal system." *Id.* at 25.

### **Revised Alternative 1 of Rule 5.4—Non-Lawyer Investment**

As revised, Alternative Version 1 of Rule 5.4 raises many issues. I focus on non-lawyer investment.<sup>1</sup> Professor Henderson's report describes as "persuasive" the argument—advanced by scholars like Professor Gillian Hadfield, formerly of Berkeley and USC--that "outside sources of capital are most needed in the PeopleLaw sector to develop and finance innovative low-cost solutions to legal problems" that would improve access for the 90%. *Id.* at 24. He also cites with

---

<sup>1</sup> The COPRAC September 10 letter analyzes in detail a number of other important issues raised by Alternative 1. It is not clear to me whether or how revised Alternative 1 responds to any of that analysis.



evident approval Professor Hadfield's observation that current limitations on outside investment are "unnecessary and costly" and that "no one has, or could, demonstrate [that those Rules] improve the well-being of ordinary individuals whose alternative to standardized online legal help is no legal help at all." *Id.* Finally, he notes that the leading common law jurisdictions (U.K., Australia) that have studied the issue have ended the probation on non-lawyer investment. *Id.* at 28.

Unfortunately, there is no prospect that the ownership provisions in Alternative 1 will improve law firm access to outside capital, or to the kind of management or technical expertise that often accompanies it. That is because from the outset, that Alternative has limited non-lawyer's rights to participate in ownership to natural persons who are assisting the lawyers in the firm in providing legal services. To put it bluntly, law firm employees performing such roles are contributing "sweat equity." They will not bring with them the capital or business expertise required to drive disruptive, large scale innovation in the PeopleLaw sector. The revised version of Alternative 1 makes this situation worse, by piling on the regulatory requirements imposed on even these employee-owners.

Alternative 1 thus cuts off a promising avenue of reform, but without the careful analysis of consumer welfare that Professor Henderson recommends. Strikingly, the brief, sketchy pro and con discussion that accompanied the first version of Alternative 1 did not even mention that the Rule would bar all access to outside investor funding or the consequences of that bar for disruptive innovation. Nor does it address any of the arguments that such restrictions are "unnecessary and costly" or that they ignore the interests of the 90% of customers who cannot afford legal services. The only argument advanced against non-lawyer outside investment is that disclosure of privileged communications to such investors could result in waiver of the privilege. To the extent that this concern is genuine, existing doctrine could be modified to ensure that disclosure to such investors, if necessary, would not result in a privilege waiver. As presented, then, the argument in favor of Alternative 1 seems clearly to privilege the interests of the 10 percent who can afford services over the interests of the 90% of customers who can't.

The Alternative 2 version of Rule 5.4 would have permitted outside investment in law firms. That Alternative was sweeping and not carefully worked out. Moreover, the pro and con discussion failed to analyze the regulatory risks created by outside investment or the question whether the existing regulation was sufficient to deal with those risks. But Alternative 2 moved in the right direction. The solution to its problems, one would think, would have been to revise Alternative 2, and/or do the required supporting analysis, not to abandon any possibility of meaningful equity financing for law firms.

On the current record, the Task Force has before it a strong endorsement of outside investment in law firms—coupled with the decision of the leading Commonwealth jurisdictions, reached after long study, to allow such investment. The Task Force does not appear to have done independent research or systematic analysis that would justify wholesale rejection of that approach. If there is not time to conduct an appropriate analysis of such financing, the solution is to acknowledge that the analysis has not been done and seek more time. If there is not enough experience with outside financing to permit a confident conclusion, then the Task Force should recommend the Utah approach and to allow controlled experimentation with such financing under the "regulatory sandbox model." On this record, it would be a serious mistake—and a heart-breaking missed opportunity to improve

access for the 90 percent--to abandon the possibility of outside funding for law firms without further study.

### **Rule 5.7 and Current California Law—the Mohr/Tuft Memorandum**

The Mohr/Tuft memorandum's suggestion that additional time is necessary to study ABA Model Rule 5.7 makes sense. A central premise of the Mohr/Tuft memorandum, however, is that when that further study occurs, it should be guided by the memorandum's conclusion that the Rule would have to be significantly modified to reflect settled California law and sound regulatory policy. With due respect, that conclusion is not correct and is not supported by the materials that are attached to the memorandum—the Mohr Memorandum on Rule 5.7, COPRAC Proposed Formal Opinion 16-0003, and the OCTC Memorandum concerning the COPRAC Opinion. Opinion.

What those materials show is that there is a legitimate dispute about whether California's common law of lawyering is consistent with Rule 5.7, but that the better view is that the two can be read as consistent. Moreover, even if California's common law of lawyering could somehow be read as inconsistent with Rule 5.7, common law rules can and should be changed where they would result in outcomes—or cast regulatory shadows—that are inconsistent with public protection goals, including access to justice. The disinterested access-sensitive policy analysis that shows the superiority of current California law to Model Rule 5.7 has not yet been done, and further study of the Rule should not proceed on the assumption that the outcome of that analysis will require modification of the Rule.

**How Rule 5.7 Works.** Rule 5.7 deals with the question of when the Rules of Professional Conduct should be applied to the conduct of a lawyer who is not practicing law.<sup>2</sup> It defines a class of services that, while not the practice of law, are “law related.” A lawyer whose conduct is not law-related is not subject to discipline under the Rules of Professional Conduct. A lawyer whose services are law-related is subject to the Rules of Professional Conduct unless those services are (1) distinct from the lawyer's legal practice and (2) the lawyer has taken “reasonable measures to assure that a person obtaining the law-related services knows that the services are not legal services and that the protections of the lawyer-client relationship do not exist.” Model Rule 5.7 (a) (1)-(2).

The rationale of Rule 5.7 is essentially consumer protection—that the lawyer's customer should receive the protections that the customer reasonably expects to receive. When the client cannot reasonably believe that the lawyer's conduct involves the practice of law or the formation of a lawyer-client relationship, however, there is no reason to apply rules specifically designed to regulate the practice of law to activities that are not the practice of law, are not understood by the relevant actors to be the practice of law, and that may be governed by rules different from or inconsistent with the professional rules.

**How Rule 5.7 Increases Access to Justice.** Rule 5.7 sounds technical, but it is a big deal. The rule is about regulating activities that are law-related but not the practice of law. If the Task Force persists in rejecting outside financing for law firms, this is the sector where outside capital will

---

<sup>2</sup> California lawyers are also subject to discipline for certain types of criminal conduct and conduct involving dishonesty whether or not that conduct occurs in the practice of law. Business & Professions Code §6106 and Rule 8.4 (b) and (c). Nothing in Rule 5.7 would change the availability of discipline under those provisions.

remain available and where the potential for disruptive innovation that can benefit the 90% can be realized. As the Henderson Report notes, the strategy will be to identify every activity or process in law firm delivery of legal services that is not the provision of legal advice and to establish separate businesses to conduct those law-related activities or processes. In those separate businesses, synergies between lawyer expertise, access to capital, technology and outside management expertise that are unavailable to law firms can generate lower-cost means of access. Henderson Report at 16-17. In that context, Rule 5.7 improves access to justice by allowing businesses that involve both lawyers and lay persons to obtain investment capital and to innovate in lowering costs for those services under rules designed to regulate the non-law conduct at issue—rules that may also involve lower compliance or insurance costs. Insofar as law related services better enable customers to obtain access to justice, the resulting lower costs should further that goal.

**California’s Common Law Is Consistent with Model Rule 5.7.** California has no statute or rule similar to Model Rule 5.7. Instead, the California law on the subject is non-statutory and made on a case by case basis—part of the common law of lawyering. That common law is broadly consistent with Rule 5.7, though some of the issues resolved by that rule have not been the subject of any reported California opinion:

- California law recognizes a distinction between non-law activities that are related to or resemble the practice of law and those that are/do not. *See, e.g.*, Formal Opinion 1995-141, Mohr Memorandum at 7; Proposed Opinion at 4-5; OCTC Memorandum at p.1 fn.1. Though the precise language used in the California case law differs from that in the Model Rule, it has not been suggested that that difference would lead to any change in the outcome of decided cases.
- California law recognizes that the Rules of Professional Conduct can properly be applied to lawyers whose law-related activities are conducted in circumstances not distinct from the lawyer’s law practice, such as when the lawyer is playing a dual role in a transaction, *Layton v. State Bar*, 50 Cal. 3d 888, 904 (1990), Mohr Memorandum at 7, Proposed Opinion at 4, OCTC Memorandum at 9 and n. 15, or is personally providing both legal and non-legal services from the same office. *Libarian v. State Bar* (1944) 25 Cal. 2d 214, 317-18; Mohr Memorandum at 7-8; OCTC Memorandum at 7 and n. 12.
- California law also recognizes that a lawyer who conducts a law-related business that is distinct from the lawyer’s practice can still be subject to the Rules of Professional Conduct to the extent that the circumstances “could reasonably lead prospective clients to misperceive the nature of the services being offered.” Formal Opinion 1999-154; Mohr Memorandum at 8; Proposed Opinion at 4.
- California law expressly recognizes that an important rationale for applying the Rules of Professional Conduct to conduct that is not the practice of law is the protection of the client’s reasonable expectations. Formal Opinion 1999-154; Mohr Memorandum at 8; Proposed Opinion at 4-5.
- California case law also clearly recognizes that the client’s reasonable expectations are a function of the circumstances, including the client’s sophistication and the lawyer’s statements and conduct. Thus a client cannot rely on the client’s belief in the existence of an attorney-client relationship or a duty of confidentiality if that belief is not reasonable

in light of the lawyer's conduct and statements. See cases discussed in Mohr Memorandum at 10; Draft Opinion at 6-7.

Any controversy about how Rule 5.7 might change California law arises from two issues. First, the California courts have never decided a case raising the issue whether the Rules of Professional Conduct are applicable to law-related services that are not the practice of law, that are distinct from the lawyer's practice of law, and that the lawyer has clearly explained are not legal services and are not intended to give rise to an attorney-client relationship. Mohr Memorandum at 9-10; Proposed Opinion at 6; OCTC Memorandum at 16. As the Mohr Memorandum notes, there is non-binding ethics authority that in those circumstances the Rules of Professional Conduct do not apply. Formal Opinion 1999-154. But the issue has not arisen in any decided case. The Proposed Opinion concludes the courts would resolve the issue by reference to settled law holding that client expectations about the existence of an attorney client relationship are protected only when they are reasonable, so that the Rules of Professional Conduct would not apply. The OCTC memorandum contends otherwise, but it does not consider or discuss the cases on reasonable client expectations discussed above and the cases upon which it does rely involve unrelated questions. OCTC Memorandum at 14.

The second potential source of controversy stems from numerous discipline cases stating that "an attorney who accepts the responsibility of a fiduciary nature is held to the same high standards of the legal profession whether or not he acts in the capacity of an attorney." Often this rule is cited in cases involving intentional misconduct, dishonesty or deception where discipline is available without regard to whether a specific professional rule has been violated. See Proposed Opinion at 3 and n. 6. Rule 5.7 would have no impact on those cases.

There are many cases, however, where the rule has been invoked to justify discipline under a Rule of Professional Conduct. There are two ways that the fiduciary cases could create tension with Rule 5.7. First, fiduciaries come in many varieties: trustees, conservators, guardians, brokers, agents of all kinds, escrow holders, corporate directors, controlling shareholders, partners, executors, investment advisors, liquidators and trustees, even spouses. It is conceivable that some of these roles may not be law related. In practice, however, the decided cases all seem to involve conduct that was clearly law related. See OCTC Memorandum at 16. Accordingly, Rule 5.7's definition of law-related services would not change the outcome of those cases.

Second, the fiduciary rule could be read as demanding that the Rules of Professional Conduct apply even to fiduciary roles that are wholly distinct from a lawyer's practice and even though the lawyer has taken measures to make clear to the person receiving that service that no legal services are being provided or attorney client relationship being created. That is the OCTC's reading of the law. Normatively, that would be a difficult result to justify—it would amount to saying that a very wide range of ordinary business activity is subject to the Rules of Professional Conduct, even though no one thinks that the activity is the practice of law or involves the formation of a lawyer-client relationship and even though those Rules would conflict with the other legal rules that might apply, simply because a lawyer is involved in conducting that business. Importantly, however, no decided case endorses that outcome, and the facts of the decided cases in which the Rules of Professional Conduct have been applied to law-related services all involve situations where the services were not distinct from the lawyer's practice and where the lawyer did not take any measures to clarify that the

services were non-legal and that the protections of the attorney client privilege would not apply. Proposed Opinion at 9 & nn. 13-14.<sup>3</sup> All those cases would be decided the same way under Rule 5.7.

The bottom line: adoption of Rule 5.7 is consistent with the principles announced in California cases and with the results of those cases. Its adoption would not change the outcome of any decided case. Rule 5.7 would also resolve the undecided and important issue of whether such lawyer involvement in law-related services, whether or not they qualify as fiduciary in nature, can ever occur in a manner which does not trigger the application of specific Rules of Professional Conduct, such as rules that could limit the ability of law-related businesses to accept outside equity investment from non-lawyers. Accordingly, existing law provides no basis for rejecting or modifying Rule 5.7.

Even if California law were inconsistent with Rule 5.7, however, it is common law that could be changed by disciplinary rule. Accordingly, the choice between Rule 5.7 and any California common law rule that is found to be inconsistent with it should rest on analysis of which rule represents a better policy outcome under the relevant tests of fairness and public protection. The Task Force has not conducted that analysis. When that analysis is finally conducted, by the Task Force or its successor, in analyzing the issue of public protection, care should be taken to give appropriate weight to access to justice issues. Without wanting to prejudge the outcome of that analysis, I respectfully submit that it is not easy to see how a California version of Rule 5.7 that limits cost-reducing innovations or increases regulatory costs for providing law-related services that all relevant actors understand are not the practice of law would be consistent with treating access to justice as part of public protection.

Thank you for your consideration of these comments.

Very truly yours,

s/Stephen Bundy

Stephen McG. Bundy  
Professor of Law, Emeritus

---

<sup>3</sup> It is not possible here to discuss every case cited by OCTC. But the core California cases which OCTC argues are inconsistent with a Rule 5.7 approach in fact would all be decided the same way under Rule 5.7. All involve the application of one or more Rules of Professional Conduct to law-related activity by the lawyer that grew out or was closely connected to the lawyer's practice of law, was not in any way distinct from the lawyer's practice, and did not involve even a hint that legal services were not being provided or that an attorney client relationship was not being formed. *In the Matter of Gordon*, 2018 WL 5801485 (loan modification services provided directly from the lawyer's office); *Crawford v. State Bar* (1960) 54 Cal.2d 659 (law-related services performed in the attorney's office for firm clients); *Schneider v. State Bar* (1987) (lawyer client business transaction rule applied to lawyer's dealings with client funds as trustee of a trust that he drafted for the clients); *Guzetta v. State Bar* (1987) 44 Cal.3d 962, 969 (trust accounting rules applied to a lawyer whose role as escrow agent grew directly out of his representation of a client and involved holding funds belonging to the client's wife in the lawyer's trust account). None involve law-related activities distinct from the lawyer's practice or where the client was advised of the nature of those activities and the fact that no attorney-client relationship was being formed.