



The State Bar of California

ATILS Agenda Item B.1.
[Rule 5.4(a)(5)]
02-24-20 Meeting

Task Force on Access Through Innovation of Legal Services

To: ATILS Task Force
From: Kevin Mohr and Randall Difuntorum
Date: February 20, 2020
Re: B.1. Revised Rule 5.4(a)(5) (Financial and Similar Arrangements with Nonlawyers)

Short Statement of the Recommendation

The Task Force recommends that the Board adopt a proposed amended Rule of Professional Conduct 5.4 to expand the existing exception for fee sharing arrangements with a nonprofit organization, and continue to study other possible amendments to the rule.

Discussion

Rule 5.4 generally prohibits fee sharing with a nonlawyer. One exception, paragraph (a)(5), permits sharing a court awarded fee with a nonprofit organization. ATILS' proposed amended rule would expand the ability of a lawyer to share fees with a nonprofit organization by adding an exception which provides that where the legal fee is not court awarded but arises from a settlement or other resolution of the claim or matter, the lawyer may share or pay the legal fee to the nonprofit organization, provided that the nonprofit organization qualifies under Section 501(c)(3) of the Internal Revenue Code. The broad public policy concerning permissible fee sharing with a nonprofit organization is set forth in *Frye v. Tenderloin Housing Clinic, Inc.* (2006) 38 Cal.4th 23 [40 Cal.Rptr.3d 221]. A specific precedent for this proposed exception is found in the [District of Columbia's version of rule 5.4](#).¹ Regarding the comments to the proposed amended rule, revisions include additional public protection by including a cross-reference to the client communication duty (see proposed Comment [4]) with a statement that in some instances a fee sharing arrangement with a nonprofit organization might constitute a significant development that must be communicated to a client.

¹ D.C. Rule 5.4 includes Comment [11] which provides that:

[11] Subparagraph (a)(5) permits a lawyer to share legal fees with a nonprofit organization that employed, retained, or recommended employment of the lawyer in the matter. A lawyer may decide to contribute all or part of legal fees recovered from the opposing party to a nonprofit organization. Such a contribution may or may not involve fee-splitting, but when it does, the prospect that the organization will obtain all or part of the lawyer's fees does not inherently compromise the lawyer's professional independence, whether the lawyer is employed by the organization or was only retained or recommended by it. A lawyer who has agreed to share legal fees with such an organization remains obligated to exercise professional judgment solely in the client's best interests. Moreover, fee-splitting in these circumstances may promote the financial viability of such nonprofit organizations and facilitate their public interest mission. 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.

Following ATILS' February 4, 2020 meeting discussion of conforming changes to the rule 5.4 comments, the drafting team was assigned to reconsider the black letter revisions to paragraph (a)(5). Specifically, the drafting team was assigned to revise the language of the proposed expanded exception to make clear that the sharing of court awarded fees would continue the policy of the existing rule by allowing fee sharing with all of the types of organizations identified in existing Comment [3].² However, the expanded language allowing the sharing of fees with a nonprofit organization that are not court awarded fees (e.g., fees from a negotiated settlement of a claim) should be restricted to a nonprofit organization that qualifies under Section 501(c)(3) of the Internal Revenue Code. The drafting team was also asked to delete the proposed reference in paragraph (a)(5) to qualified legal services projects as that language was unnecessary. The drafting team has implemented all of the foregoing changes in a revised draft rule. In addition, the drafting team reviewed the conforming revisions to the comments and determined that no additional changes to the comments are required.

A redline/strikeout version of proposed amended rule 5.4 is provided as Attachment A. A clean version is provided as Attachment B. The drafting team welcomes feedback on this proposal and requests that any comments submitted prior to the meeting include suggested language for any changes to the proposed revisions to rule 5.4.

Although ATILS is recommending the above amendment to rule 5.4, ATILS also generally recommends an ongoing study of other amendments to the rule that would promote collaboration, innovation and investment in new delivery systems that lower costs and increase access to legal services. Specifically, ATILS observes that . . . [INSERT ATILS APPROVED STATEMENT ON FURTHER AMENDMENTS TO RULE 5.4 AFTER THAT STATEMENT IS APPROVED BY ATILS AT THE 2/24 MEETING]

ATILS Charter and Request for Public Comment

In part, ATILS' charter instructs the Task Force to:

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.

This recommendation responds to the charter by proposing a rule change that is intended to directly impact the ability of a nonprofit legal services organization to expand its activities through sharing in legal fees that are achieved through a settlement. This revision also adds the term "facilitate" to the language of the exception and this is intended to address incubator programs and other similar relationships with lawyers who are working through a nonprofit legal services organization administering an incubator or similar program.

This proposal was included in ATILS' request for public comment on various options for regulatory reform, in particular as a part of one of two possible alternate revisions to rule 5.4. It was issued as an aspect of recommendation 3.1. However, recommendation 3.1 included the concept of nonlawyer

² Under existing Comment [3], court-awarded legal fees may be shared with nonprofit legal aid, mutual benefit, and advocacy groups that are not engaged in the unauthorized practice of law.

ownership of a law practice and that is a significant material difference from the instant proposal. Accordingly, most of the public comment on recommendation 3.1 addresses nonlawyer ownership and is not responsive to the proposal for limited expansion of the existing exception for fee sharing with a nonprofit legal services organization. There were only a few comments that specifically addressed the proposal to expand the existing nonprofit exception. One example is the Northern and Southern Chapters of the American Academy of Matrimonial Lawyers comment letter dated September 20, 2019 that in part states:

We fully support the first suggested change to Rule of Professional Conduct 5.4 to authorize non-profits to share fees with attorneys who recommend them or otherwise facilitate their employment. Currently, these non-profits can only share court awarded fees. To tackle the justice gap head on, greatly expanding the reach of Public Law Center, Legal Aid, and Neighborhood Legal Services, so that these non-profits and others like them can provide legal services to underserved communities is the answer.

Conclusion and Possible Next Steps

ATILS believes that the proposed expanded fee sharing exception described above will enhance access to legal services rendered by nonprofit legal services organizations. Some of these consumers are persons with the most critical need for legal assistance as they have few other alternatives for help. Should the Board agree with this proposal, it is anticipated that the proposed amendment to rule 5.4 would be considered for a 60-day public comment period and following consideration of that public comment presented to the Board for adoption. (A redline version of the proposed amended rule is provided as Attachment A.)

ATTACHMENT A

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) where a nonprofit organization employs, retains , recommends, or facilitates employment of a lawyer in a matter, (i) the lawyer or law firm* may share with or pay a court-awarded legal fee to that nonprofit organization, and (ii) where the legal fee in the matter is not court awarded but arises from a settlement or other resolution of the matter, the lawyer or law firm may share or pay the legal fee to the nonprofit organization, provided that the nonprofit organization qualifies under Section 501(c)(3) of the Internal Revenue Code.
- (b) A lawyer shall not form a partnership or other organization with a nonlawyer if any of the activities of the partnership or other organization consist of the practice of law.
- (c) A lawyer shall not permit a person* who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's independent professional judgment or interfere with the lawyer-client relationship in rendering legal services.
- (d) A lawyer shall not practice with or in the form of a professional corporation or other organization authorized to practice law for a profit if:
 - (1) a nonlawyer owns any interest in it, except that a fiduciary representative of a lawyer's estate may hold the lawyer's stock or other interest for a reasonable* time during administration;
 - (2) a nonlawyer is a director or officer of the corporation or occupies a position of similar responsibility in any other form of organization; or
 - (3) a nonlawyer has the right or authority to direct or control the lawyer's independent professional judgment.
- (e) The Board of Trustees of the State Bar shall formulate and adopt Minimum Standards for Lawyer Referral Services, which, as from time to time amended, shall be binding on lawyers. A lawyer

shall not accept a referral from, or otherwise participate in, a lawyer referral service unless it complies with such Minimum Standards for Lawyer Referral Services.

- (f) A lawyer shall not practice with or in the form of a nonprofit legal aid, mutual benefit or advocacy group if the nonprofit organization allows any third person* 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), as just one example, 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] Depending on the specific facts and circumstances, a lawyer's sharing of fees as permitted by paragraph (a)(5) might constitute a "significant development" that must be communicated to a client under rule 1.4 and Business and Professions Code section 6068(m).

[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).