



# The State Bar of California

II.E. Rule 5.4 Proposed  
Amendments  
09-17-21 CTJG Meeting  
Open Session

**DATE:** September 10, 2021

**TO:** Closing the Justice Gap Working Group (CTJG)

**FROM:** Kevin Mohr and Patricia Squitiero

**SUBJECT:** Assignment re CTJG Consideration of Possible Amendments to **Rule 5.4** [Financial and Similar Arrangements with Nonlawyers]

## EXECUTIVE SUMMARY

The assignment addressed is whether there are possible amendments to rule 5.4 (Financial and Similar Arrangement with Nonlawyers) that should be considered – and possibly recommended – by the Closing the Justice Gap Working Group (“CTJG” or “Working Group”) outside of a regulatory sandbox environment. After consideration of several alternatives, including (i) Arizona’s abrogation of its version of rule 5.4 in combination with implementing a separate regulatory framework for alternative business structures, (ii) D.C. Rule 5.4, (iii) the New York City Bar Association proposals that would permit legal fee sharing with litigation funders, and (iv) two proposals considered by the ATILS task force, we recommend that CTJG not devote significant time to any of those proposals. Instead, anticipating that the principal reform arising from CTJG’s work will be a regulatory sandbox, we recommend that the Working Group focus on what is referred to in this memo as “Sandbox Rule 5.4,” which contemplates implementation of a sandbox and is intended to permit lawyers to engage in fee sharing with nonlawyers and provide legal services in an entity with nonlawyer ownership within the sandbox. See section C.1, below. Any rule revisions purported to promote innovation are better left to be tested within the confines of the sandbox. Nevertheless, in the event the Working Group does not recommend a regulatory sandbox, we recommend that the Working Group devote some time to evaluating the proposed revisions to rule 5.4 in ATILS Rule 5.4, ALT1. See section C.2(4)(a), below.

Working Group members are asked to:

1. Review this memo and the provided resources;
2. Be prepared to ask any questions about this rule revision task; and
3. Consider submitting comments on the options for change discussed in the memo and the advantages and disadvantages of implementing such a change.

## Introduction

This memorandum sets forth a report, as requested by the Chair at the April 9, 2021 CTJG plenary meeting, that addresses the following four questions:

- (1) Scope of assignment: What has the CTJG been asked to advise on?
- (2) What is the status quo (current rules and/or statutes and how they operate)?
- (3) What are possible options for change, and what are the recognized advantages/disadvantages?
- (4) What steps should we take (request presentations, conduct interviews, review studies, etc.) to reach a fully informed recommendation?

We address each of these questions in turn.

### A. SCOPE OF THE ASSIGNMENT: WHAT HAS THE CTJG BEEN ASKED TO ADVISE ON?

This assignment originates from the Task Force on Access Through Innovation of Legal Services ([ATILS](#)) [Final Report and Recommendations](#). ATILS Recommendation No. 1 stated:

Issue for public comment an 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 revisions to the rule.

ATILS proposed amended rule 5.4 was issued for public comment and the concept of ATILS's proposed amendment was ultimately approved by the Supreme Court effective March 22, 2021 (Supreme Court case no. S266066). (The full text of the rule as revised is provided as Attachment 1.) These amendments to rule 5.4 were modest, adding a new paragraph (a)(6) and associated rule comments that permit a lawyer to share non-court-awarded legal fees with a 501(c)(3) nonprofit that employed, retained, recommended, or facilitated the lawyer's employment with the client. In addition, ATILS Recommendation No. 1 also called for further consideration of possible amendments to rule 5.4 that might offer additional enhancements to promote access and innovation.

In establishing the CTJG, the State Bar Board of Trustees approved a [charter](#) which states, in part: "The working group will develop specific recommendations regarding the following . . . Amendments to rule 5.4 of the California Rules of Professional Conduct regarding attorney fee sharing with nonlawyers. The working group will specifically address the question of whether amendments to this rule are warranted independent of any temporary changes that might be evaluated in a sandbox."

It is important to recognize that the CTJG charter does not mandate that CTJG propose any amendments to rule 5.4; it simply directs the working group to "address" the question whether

such amendments “are *warranted* independent of any temporary changes” that would be subject to evaluation in a sandbox (emphasis added).

## **B. WHAT IS THE STATUS QUO (CURRENT RULES AND/OR STATUTES AND HOW THEY OPERATE)?**

The policy rule 5.4 is intended to advance is the protection of a lawyer’s exercise of independent professional judgment, one of the core duties of a lawyer. In support of this policy the rule prohibits lawyers from engaging in certain conduct that could compromise that independence: (i) sharing legal fees with persons or organizations that are not authorized to practice law (with recognized exceptions that would not interfere with independence of judgment) [Rule 5.4(a)]; (ii) forming a partnership or other organization with a nonlawyer where the organization’s activities consist of the practice of law [Rule 5.4(b)]; (iii) permitting another person who recommends, employs, or pays the lawyer to represent a client to regulate or direct the lawyer’s exercise of independent judgment on the client’s behalf or otherwise interfere with the lawyer-client relationship [Rule 5.4(c)]; (iv) practicing in a professional corporation or other organization authorized to practice law for a profit where (a) a nonlawyer owns any interest, (b) serves as a director, officer, or other similar position, or (c) has a right to direct or control a lawyer’s independent professional judgment [Rule 5.4(d)]; and (v) practicing with, or in the form of, a nonprofit legal aid, mutual benefit group, or advocacy group if the organization or group allows a third person to interfere with the lawyer’s independent professional judgment [Rule 5.4(f)].<sup>1</sup>

Recognized exceptions to fee-sharing with a nonlawyer include: (i) permitting a lawyer to share legal fees with a nonprofit organization that employed, retained, or recommended the lawyer’s employment [Rule 5.4(a)(5),(6)]; (ii) permitting a law firm’s to include nonlawyer employees in a firm compensation or retirement plan that involves a profit-sharing arrangement [Rule 5.4(a)(3)]; and (iii) permitting a lawyer to pay fees for participating in a State Bar certified lawyer referral service [Rule 5.4(a)(4)].<sup>2</sup>

As noted, the concept of the ATILS amendments that became effective March 22, 2021 added a new provision which expanded the prior limited exception for fee sharing arrangements with a nonprofit organization. Specifically, the new provision, paragraph (a)(6), adds an exception that permits sharing a legal fee that is not court-awarded (e.g., arises from a settlement), with a 501(c)(3) nonprofit organization, provided the lawyer complies with certain disclosure and written consent requirements intended to protect the client.

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<sup>1</sup> Rule 5.4(e) authorizes the State Bar Board of Trustees to “formulate and adopt Minimum Standards for Lawyer Referral Services.”

<sup>2</sup> The other two exceptions to fee sharing with nonlawyers relate to sharing fees with the estate of a deceased lawyer and the purchase of a deceased lawyer’s practice. [Rule 5.4(a)(1),(2)]

Other rules and statutes relate to the subject matter regulated by rule 5.4. These include the following:

- Rule 2.1 (lawyer as adviser, which imposes on a lawyer the duty to exercise independent professional judgment)
- Rule 1.8.1 (business transactions with clients and acquisition of adverse pecuniary interests)
- Rule 1.8.6 (compensation from a person other than the lawyer's client)
- Rule 1.13 (organization as client)
- Rule 5.1 (responsibilities of managerial and supervisory lawyers)
- Rule 5.3 (responsibilities regarding nonlawyer assistants)
- Rule 5.5 (aiding in the unauthorized practice of law)
- Rule 5.6 (restrictions on a lawyer's right to practice)
- Rule 7.2 (referral arrangements, gifts/gratuities given for employment recommendations)
- Business and Professions Code section 6125 et seq. (unauthorized practice of law)
- Business and Professions Code section 6151 et seq. (runners and cappers)

Caselaw also addresses the topic of a lawyer's independent professional judgment. As just one example, in *Emmons, Williams, Mires & Leech v. State Bar* (1970) 6 Cal.App.3d 565, 573, the propriety of lawyer participation in a county bar association lawyer referral service is discussed and the court identified some of the risks of harm that the predecessor rules to rule 5.4 sought to prevent:

Prohibited fee-splitting between lawyer and layman carries with it the danger of competitive solicitation (*Crawford v. State Bar*, 54 Cal.2d 659, 666, 7 Cal.Rptr. 746, 355 P.2d 490); poses the possibility of control by the lay person, interested in his own profit rather than the client's fate (*Utz v. State Bar*, 21 Cal.2d 100 at p. 108, 130 P.2d 377); facilitates the lay intermediary's tendency to select the most generous, not the most competent, attorney (*Linnick v. State Bar*, 62 Cal.2d 17, 21, 41 Cal.Rptr. 1, 396 P.2d 33; *Hildebrand v. State Bar*, 36 Cal.2d 504, 523, 225 P.2d 508, separate opinion of Traynor, J.). Rule 3's prohibition against lay intermediaries seeks to bar both solicitation and the presence of a party demanding allegiance the lawyer owes his client. (*People v. Merchants' Protective Corp.* (1922) 189 Cal. 531, 539, 209 P. 363.)

The foregoing quotation encapsulates the policy of independent professional judgment that underlies the structure and substance of rule 5.4. With the exception of Arizona, which only recently repealed its version of rule 5.4, every jurisdiction has some version of ABA Model Rule 5.4, most with only minor revisions.<sup>3</sup> In fact, prior to its elimination, Ariz. Rule 5.4 was identical to the Model Rule.

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<sup>3</sup> See Variations of the ABA Model Rules of Professional Conduct, Rule 5.4 (8/4/21), available at: [https://www.americanbar.org/content/dam/aba/administrative/professional\\_responsibility/mrpc-5-4.pdf](https://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/mrpc-5-4.pdf)

## C. WHAT ARE THE POSSIBLE OPTIONS FOR CHANGE, AND WHAT ARE THE RECOGNIZED ADVANTAGES AND DISADVANTAGES?

Following a review of materials from our independent research and also from materials provided by State Bar staff, we have identified several changes to rule 5.4 that are not “options,” i.e., they will be necessary to accommodate (i) the participation of lawyers in the regulatory sandbox; and (ii) the parallel development of a class of nonlawyer legal service providers by our sister committee, the Paraprofessional Working Group (“PPWG”).<sup>4</sup>

In addition to those “necessary” changes, there are other options that the Working Group might consider. However, given the anticipated implementation of the regulatory sandbox, a closely regulated environment where innovative legal services business models and technologies can be tested, we do not see an advantage in pursuing these changes at this time. Nevertheless, given our charge to consider such changes, we have laid out a discussion of both the changes necessary to an implementation of a sandbox, (Section C.1, immediately following) and the optional revisions to rule 5.4 that might be considered in the event the decision-makers reject a sandbox proposal, (Section C.2, below.)

### 1. “Necessary” Changes to Rule 5.4 to Accompany the Implementation of a Regulatory Sandbox

Because lawyers practicing in California are subject to rule 5.4 and all of its prohibitions against legal fee sharing and forms of practice in which the lawyers might provide legal services within the sandbox,<sup>5</sup> some minimal changes need to be made to rule 5.4 in order to permit lawyers to participate in innovative entity models or fee sharing without being in violation of the generally prohibited acts. In column 2 of the attached **Comparison Chart**, we propose several amendments to current rule 5.4 to provide lawyers with the necessary “regulatory cover” to be active sandbox participants. We will refer to this proposal as the “Sandbox Rule.”

The proposed Sandbox Rule is based in part on [Utah Rule 5.4](#), which made similar revisions to its version of Rule 5.4. Specifically, we have taken language from Utah Rule 5.4(c)(1) and 5.4(d).

First, to address **fee sharing** between a lawyer and nonlawyer in the sandbox, proposed paragraph (a)(7) provides:

(7) a lawyer or law firm\* may share a legal fee if: (i) the fee is not unconscionable as that term is defined in rule 1.5, (ii) the total fee charged the client is not increased solely by reason of the agreement to share fees, and (iii) the fee-sharing arrangement has been

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<sup>4</sup> We note that the name of the paraprofessional class of legal service providers that is being developed is still under consideration. We will refer to these providers as “paraprofessionals” in this memo.

<sup>5</sup> Both licensed California lawyers and lawyers not licensed in California but otherwise authorized to practice in California are subject to the California Rules of Professional Conduct, including rule 5.4. See rule 8.5.

authorized as required by \_\_\_\_\_ [add brief description of the enabling legislation/ rule of court regarding the Legal Services Sandbox];<sup>6</sup>

Paragraph (a)(7) is based in part on Utah Rule 5.4(c)(1). Language has also been borrowed from ATILS proposed rule 5.4, ALT2, set out in Column 4 of the Comparison Chart, to ensure that the fee being charged the client is not unconscionable or increased by reason of the sharing. Similar language is used to place limitations on legal fee division between lawyers who are not in the same law firm.

In addition to the addition of paragraph (a)(7), an additional change has been made to introductory paragraph (a) to permit fee sharing with a licensed paraprofessional, just as fee sharing is permitted among lawyers not in the same firm. See rule 1.5.1.<sup>7</sup> In other words,

Second, to address lawyers practicing in a **legal services entity with nonlawyer ownership**, which is otherwise prohibited by rule 5.4(b), we propose substituting new paragraph (b) for current paragraph (b):

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<sup>6</sup> An asterisk next to a word or phrase in the California Rules of Professional Conduct denotes that the term is defined in rule 1.0.1. Rule 1.0.1(c) defines what is meant by “law firm” or “firm”:

(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.

We note that Utah Rule 5.4 needed only to refer to “[Utah Supreme Court Standing Order No. 15](#),” the Supreme Court order that established the Utah Office of Legal Services Innovation to “establish and administer a pilot legal regulatory sandbox (Sandbox) through which individuals and entities may be approved to offer nontraditional legal services to the public through nontraditional providers or traditional providers using novel approaches and means, including options not permitted by the Rules of Professional Conduct and other applicable rules.” (footnote deleted). As we have discussed in Working Group meetings, because of California’s unique regulatory framework that allows for regulation of the practice of law by both the Supreme Court of California and the California Legislature, we cannot yet be certain what the precise sandbox-enabling authority will be.

<sup>7</sup> An alternative approach would be to add another exception to paragraph (a) and then include similar requirements as found in rule 1.5.1. Although our preference is to address this issue in the introductory paragraph (a), a “paraprofessional” exception might provide:

(8) A lawyer or law firm\* may share a fee with a licensed paraprofessional if each of the following are satisfied:

- (1) the lawyer and paraprofessional enter into a written\* agreement to share the fee;
- (2) the client has consented in writing,\* either at the time the lawyer and paraprofessional enter into the agreement to share the fee or as soon thereafter as reasonably\* practicable, after a full written\* disclosure to the client of: (i) the fact that a sharing of fees will be made; (ii) the identity of the lawyers or law firms\* and paraprofessional that are parties to the sharing; and (iii) the terms of the sharing; and
- (3) the total fee charged by all lawyers and paraprofessionals is not increased solely by reason of the agreement to share fees.

(b) A lawyer shall not practice law in a law firm\* or other organization in which individual nonlawyers in that firm\* or organization hold an ownership interest unless:

(i) each nonlawyer is a paraprofessional licensed by the State Bar of California, the combined ownership interest of all paraprofessionals in the firm is not a majority interest, and no paraprofessional exercises controlling managerial authority in the firm; or

(ii) the firm or other organization has been authorized as required by \_\_\_\_\_[add brief description of the enabling legislation/ rule of court regarding the Legal Services Sandbox] and provided the lawyer shall:

(A) before accepting a representation, provide written disclosure to the prospective client that one or more nonlawyers holds a financial interest in the firm\* or organization in which the lawyer practices [or that one or more nonlawyers exercises managerial authority over the lawyer]; and

(B) disclose in writing to the client the financial and managerial structure of the firm\* or organization in which the lawyer practices.

Paragraph (b)(i) addresses paraprofessionals who hold an ownership interest in the firm or other organization. It is our understanding that the PPWG contemplates that paraprofessionals will be permitted to have ownership interests in a law firm with lawyers so long as collectively paraprofessional owners do not have a majority share and no individual paraprofessional can exercise managerial authority within the firm.<sup>8</sup>

Similar to paragraph (a)(7), above, paragraph (b)(ii) is intended to permit a lawyer to provide legal services in a firm or other organization that has nonlawyer owners so long as the firm or organization is authorized by the sandbox regulatory agency and the lawyer has made specific written disclosures to any prospective client. See subparagraphs (b)(ii)(A) and (B).

Paragraph (b)(ii) is based on Utah Rule 5.4(d), with an important difference. The Utah rule requires that only notice be provided the client. Proposed paragraph (b)(ii)(A) and (B) require written disclosure. “Disclosure” in California requires more than mere notice, i.e., the lawyer is required to communicate and explain “(i) the relevant circumstances and (ii) the material risks,

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<sup>8</sup> See proposed Paraprofessional RPC 5.4(e), which provides:

- (e) A licensed paraprofessional shall not practice in a law firm\* with a lawyer if:
- (1) licensed paraprofessionals direct or regulate any lawyer's professional judgment in rendering legal services;
  - (2) licensed paraprofessionals have supervisory authority over any lawyer; or
  - (3) licensed paraprofessionals possess a *majority ownership interest* or exercise controlling managerial authority in the firm; (Emphasis added).

including any actual and reasonably\* foreseeable adverse consequences of the proposed course of conduct.” See rule 1.0(e), which describes the disclosure required to obtain a client’s informed consent.

One topic for further discussion is whether paragraph (b)(ii) should require not just that the lawyer provide written disclosure, but also whether the lawyer must obtain the client’s informed written consent.

Finally, to address the prohibitions in current rule 5.4(d) against practicing in an organization where a nonlawyer has an ownership interest, is a director or officer, or has authority to direct or control the lawyer’s independent professional judgment, we propose simply to preface the paragraph with the following clause: “Except as otherwise provided in paragraph (b).”

We recommend a similar prefatory clause in paragraph (f).

## **2. Other Possible Changes to Rule 5.4 Independent of a Regulatory Sandbox**

In the Rule 5.4 Assignment Memo prepared by State Bar staff, it was suggested that we consider several possible changes to rule 5.4, including the following:

- (1) the proposed rule drafted by ATILS members in a December 26, 2019 memorandum;
- (2) a rule modeled after District of Columbia’s Rule 5.4;
- (3) elimination of rule 5.4, as Arizona has done as part of a regulatory framework requiring Alternative Business Structures to be licensed;
- (4) other proposals for changes to rule 5.4, such as the two proposals put forth by the New York City Bar Association, permitting litigation funding of law firms; or
- (5) other changes not otherwise identified.

We have considered each of these proposed suggestions and have concluded that only one is suitable for extended consideration by the Working Group: the proposed rule drafted by ATILS which is set out in Column 3 of the Comparison Chart. It is our opinion, however, that even that proposal should only be considered as a possible fallback position in the event the decision-makers reject the contemplated regulatory sandbox. Regardless, we first discuss the other proposals outlined above, as well as a second rule draft debated in ATILS.

### **(1) *The Arizona Gambit to Eliminate Its Version of Rule 5.4***

As an initial matter, we recommend that CTJG eliminate from its docket any consideration of eliminating rule 5.4, as Arizona has done. As discussed above, we believe the policy underlying rule 5.4, the preservation of a lawyer’s independent professional judgment is a value that should be protected, for the benefit not just of lawyers but of their clients, whose effective and competent representation depends on their lawyers being able to exercise independent judgment on the clients’ behalf. More to the point, Arizona’s elimination of rule 5.4 did not



leave a vacuum in the legal regulation of legal service entities. As noted in the above list, the rule was eliminated as part of a larger regulatory scheme that require [alternative legal business structures to be licensed](#). It strikes us that there are more than sufficient regulatory thickets for this committee to hack through in designing a regulatory sandbox than to exacerbate the task by assigning the Working Group a separate task to design and develop an ABS regulatory framework. Any changes to legal business structures can and should be addressed on a case-by-case basis in the sandbox, studied and, if proven feasible, implemented more generally.

*(2) A Rule Modeled After D.C. Rule 5.4*

Until Arizona dispensed with its rule 5.4, [D.C. Rule 5.4](#) had long been recognized as the most permissive rule in the United States for lawyers practicing in a for-profit organization with nonlawyer ownership. D.C. Rule 5.4 for decades has permitted lawyers to practice in a firm with nonlawyer owners of the firm, most notably with nonlawyer lobbyists. We do not recommend a deep consideration of D.C. Rule 5.4 because the ATILS proposed rule that is the focus of this section of the memo is based on a rule debated in the ABA Ethics 20/20 Commission, which rule in turn used D.C. Rule 5.4 as its starting point. We believe that the ATILS proposed rule provides more security for clients by better ensuring that lawyers are free from adverse influences on their independent professional judgment. See discussion of ATILS proposed rule 5.4, ALT, at section C.2(4)(a), below.

*(3) New York City Bar Association Report and proposed changes to N.Y. Rule 5.4 that would permit litigation funding of law firms*

In early 2020, a working group of the New York City Bar Association issued a lengthy (97 pages) [Report on Litigation Funding](#) proposing two alternatives for changes to N.Y. Rule 5.4 that purportedly would facilitate litigation funding of law firms. We do not believe these proposals are suitable for extended consideration by the Working Group but include a brief summary of the provisions.

Alternative A would provide for a fourth exception to NY Rule 5.4(a) (prohibiting fee sharing with nonlawyers) and would provide:

[\(4\) a lawyer or law firm may share legal fees with an entity in exchange for the entity's providing financial assistance to the lawyer specifically for use with respect to a legal representation of one or more clients, provided that:](#)

[\(i\) the entity and its representatives do not participate, directly or indirectly, in the decision-making regarding the representation;](#)

[\(ii\) the lawyer or law firm maintains professional independence;](#)

[\(iii\) the client provides written informed consent to the financial arrangement; and](#)

[\(iv\) the lawyer or law firm complies with all other applicable Rules, including Rule 1.6 and Rule 1.7.](#)

Alternative B would similarly provide an exception to paragraph (a) and would provide:

(4) a lawyer or law firm may share legal fees with an entity in exchange for the entity's providing financing for the lawyer's or law firm's practice, provided that:

(i) the lawyer and law firm do not permit the entity to participate directly or indirectly in a matter except for the benefit of the client;

(ii) the lawyer and law firm do not disclose confidential client information except as Rule 1.6 may permit;

(iii) the lawyer and law firm comply with Rule 1.7; and

(iv) the lawyer or law firm informs the client in writing that they are sharing or may share fees with an entity in exchange for the entity's providing financing for the lawyer's or law firm's practice.

As can be seen, Alternative A would permit sharing of legal fees in exchange for financing "for use with respect to a legal representation of one or more clients," i.e., the focus of the funding would be on particular matters for which the lawyer or law firm had been retained by the client. Alternative B, on the other hand, would permit sharing of legal fees in return for "financing for the lawyer's or law firm's practice," i.e., it would not be tied to a particular matter or matters for which the law firm has been retained. The alternatives each have differently-phrased requirements to enable such funding but they have in common protection of the duties of confidentiality (rule 1.6) and loyalty (1.7), both require that the client either be informed of the funding arrangement (alternative B) or the client must provide informed written consent (alternative A), and both include a requirement designed to protect the professional independence of the lawyers.

The Report includes a helpful comparison of the two alternatives:

Condition	Proposal A	Proposal B
Use of Funding	Funding "specifically for use with respect to a legal representation."	Funding generally "for the lawyer's or law firm's practice."
Direct or Indirect Participation of Funding Entity	No participation by entity or representative "directly or indirectly, in the decision-making regarding the representation."	No participation by entity "directly or indirectly in a matter <u>except for the benefit of the client.</u> "
Client Notice	Written informed consent required: "the client provides written informed consent to the financial arrangement."	Written informed consent <u>not</u> required: "the lawyer or law firm informs the client in writing that they are sharing or may share fees with an entity in exchange for the entity's providing financing for the lawyer's or law firm's practice."

Condition	Proposal A	Proposal B
Incorporation of Other Rules	"[T]he lawyer or law firm complies with all other applicable Rules, including Rule 1.6 and Rule 1.7."	The lawyer and law firm comply with Rules 1.6 and 1.7: "the lawyer and law firm do not disclose confidential client information except as Rule 1.6 may permit" and "the lawyer and law firm comply with Rule 1.7."
Registration Requirement	Should New York adopt a registration or filing requirement, lawyers should borrow funds only from entities that comply with those requirements.	<u>Not</u> addressed at this time.

We see little benefit in pursuing the NYCBA's proposed alternatives regarding litigation funding. The focus of the NYCBA Report is not the closing of a justice gap but primarily the facilitation of a law firm's ability to obtain financing for its operations without running afoul of current prohibitions on fee-sharing. We do not see a benefit in the Working Group considering litigation funding beyond earmarking the topic as a potential item of study in the Sandbox where any direct or residual benefits to closing the justice gap can be studied in a controlled environment.<sup>9</sup>

*(4) ATILS Proposed Rule 5.4 Amendments Not Submitted for Adoption by the Board of Trustees and Approval by the California Supreme Court*

Although ATILS' modest revisions to rule 5.4 have been implemented, there remains the question of whether other similar amendments should be pursued apart from any sandbox experimentation. ATILS' recommendation contemplates consideration of amendments to rule 5.4 that could promote collaboration, innovation, and investment in new delivery systems that lower costs and increase access to legal services. The members of the ATILS Task Force identified revisions to rule 5.4 as being central to advancing innovation in the delivery of legal services. Further, rule 5.4 has been identified as an inhibitor of innovation that might be provided by nonlawyer entities, including individuals, organizations, and technologies.

Although the ATILS' Task Force only recommended a revision to rule 5.4 that allowed expanded fee sharing with nonprofit organizations, a substantial majority of the members agreed that additional revisions might be warranted, but that further study and data informing the specifics of those revisions would be needed. In addition to the fee sharing amendment, the ATILS Task Force drafted two alternative versions of an amended rule 5.4 that, although circulated for

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<sup>9</sup> The Working Group has engaged in several discussions about the possibility of grants from nonprofits that might be employed either to fund the regulatory work of the sandbox or the potential of such grants to legal service entities to enable them to provide lower cost legal services. The NYCBA Report makes only a single mention of nonprofit funding of litigation. See Report at p. 11 & note 58.

public comment, were never submitted for consideration by the Board of Trustees and the Supreme Court. Only the previously described modest revision to permit sharing with or payment to a nonprofit of legal fees that are not court-awarded wended its way to the Supreme Court and became new paragraph (a)(6), effective on March 22, 2021.

We first discuss ATILS rule 5.4, ALT1, which permits fee sharing with nonlawyers, as well as nonlawyer ownership of a law firm or other legal services organization so long as any such nonlawyer provides services that “assists” the lawyer or law firm in the practice of law. ATILS ALT1 is found in Column 3 of the Comparison Chart. ATILS also drafted rule 5.4, ALT2, in part in response to a request by some members of the Task Force, which would have permitted passive investment with client consent. ATILS ALT2 can be found in Column 4 of the Comparison Chart.

One final point is relevant when reviewing and considering the ATILS proposed rule changes. At the time these rule proposals were drafted, the concept of a regulatory sandbox to test these proposals was not at the forefront of ATILS consideration. See [7/11/19 ATILS Interim Report](#) to the Board of Trustees (making only passing reference to the concept of a regulatory sandbox. See Interim Report at p. 14.

(a) ATILS proposed rule 5.4, ALT1 (Nonlawyer Ownership of Law Firm with Participation in Provision of Legal Services)

ATILS ALT1 is based on a proposed rule drafted by the [ABA Ethics 20/20 Commission](#), convened in 2009 and charged with performing “a thorough review of the ABA Model Rules of Professional Conduct and the U.S. system of lawyer regulation in the context of advances in technology and global legal practice developments.” As already noted, the Ethics 20/20 rule in turn used as its starting point D.C. Rule 5.4.

To better understand the scope and intent of the amendments to ALT1, it is helpful to make several points about the proposed rule’s limitations and baked-in protections. First, ALT1 would not permit the development of a true multidisciplinary practice (MDP) firm or other organization. A true MDP firm comprised of lawyers and other nonlawyer professionals would perform a variety of professional services, e.g., legal, accounting, social work, etc. The ALT1 proposal is limited to nonlawyer ownership of a firm or other organization that has as its sole purpose the provision of legal services. See paragraph (b)(1).

Second, ALT1 would not permit passive investment by nonlawyers in the firm. Under paragraph (b)(2), the nonlawyer owners must “provide services that assist the lawyer or law firm in providing legal services to clients.” For example, an accountant could provide accounting or auditing services in relation to a case or other matter, e.g., a merger or acquisition, but would not be permitted to provide independent accounting services that are unrelated to a firm’s legal matters.<sup>10</sup>

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<sup>10</sup> ALT1 did provide in a comment that a nonlawyer owner could provide nonlegal services in the nonlawyer’s specialty so long as the services had a reasonably close nexus to the legal services provided to the firm client. See ALT1, proposed Comment [5].

Third, ALT1 includes a provision designed to explicitly protect the independent professional judgment of the lawyers in the firm. See paragraph (b)(3). Fourth, ALT1 includes several provisions that are intended to indirectly assure that nonlawyer owners do not interfere with the firm lawyers' independent professional judgment by requiring education in lawyer values and ethics. See paragraphs (b)(5) and (6). Finally, the lawyer partner/owners of the law firm are ultimately responsible for the conduct of the nonlawyers just as they are responsible for the conduct of any subordinate lawyer under rule 5.1.<sup>11</sup>

The ATILS submission to the Board of Trustees as part of its Interim Report in July 2019 seeking permission to circulate the proposal for public comment stated:

"The proposed revisions to rule 5.4 Alternative 1 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 Task Force 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 Task Force 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 increase access to legal services."

Ultimately, however, lacking data that might support the rule as an incentive for innovation and recognizing the need for further study, ATILS declined to further pursue the proposed revisions contained in paragraph (b) and associated comments of ALT1, choosing only to submit a request to expand sharing of legal fees with nonprofits.

We agree with the ATILS conclusion that ALT1 is deserving of further study. We disagree that such study should be undertaken outside the context of the sandbox. It is our opinion that the controlled setting of the regulatory sandbox is the appropriate environment in which to test ATILS's thesis that a rule similar in scope to ALT1 will generate innovation that could close the justice gap.

#### (b) ATILS proposed rule 5.4, ALT2 (Passive Investment with Client Consent)

ATILS's proposed rule 5.4, ALT2 would have permitted passive investment in law firms by eliminating the several prohibitory provisions against nonlawyer in rule 5.4 and retaining the fee-sharing prohibition with a single exception that would permit nonlawyer legal fee sharing so long as the lawyer or law firm entered into a written agreement with the nonlawyer and obtained the client's written consent after specific written disclosures. The client consent provision is largely borrowed from rule 1.5.1, which permits fee-sharing between lawyers.

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<sup>11</sup> It should be noted that rule 5.1 does not impose vicarious responsibility for the conduct of nonlawyer absent the managerial or supervising lawyer's knowledge of the subordinate lawyer's misconduct. See rule 5.1(c).

The ATILS submission to the Board of Trustees as part of the Interim Report in July 2019 seeking permission to circulate the proposal for public comment identified several pros and cons:

**Pros:**

1. The proposed Rule provides for highly skilled and trained individuals with unique skill sets not common to lawyers to be properly vested and incentivized by partnering with lawyers in a multitude of ways.
2. The proposed Rule would open up the market to both investment/funding and current/future technologies resulting in greater choices to be provided to the public.
3. The proposed Rule allows the California Supreme Court to consider delivering many of the services that could be implemented state-wide under a new interpretation.
4. The proposed Rule provides for informed consent and ultimately a much greater choice of services for the consumer. Recent surveys suggest consumers may not come to lawyers first for legal needs. Allowing new services to be created by partnering with community partners may result in consumers finding services early on in a dispute resulting in quicker resolutions with perhaps less court involvement.
5. The proposed rules allows for many, new types of partnership. The existing rules have often discussed the issue of fee sharing within the context of referral fees only. This proposed rule allows a wide breadth of new opportunity for innovating legal services which allows lawyers to collaborate w/ others to share both the burdens and rewards.
6. The proposed Rule provides for the inclusion of oversight by a licensed legal professional.

**Cons:**

1. There is no mechanism for regulating nonlawyers under this proposal because it does not provide the incentives as in rule 5.1 and 5.3 for lawyers to supervise the conduct of nonlawyers.
2. Little or no concrete evidence that this proposal would increase access to justice.

Given that this rule was proposed when a regulatory sandbox was not under serious consideration by the ATILS Task Force, and the purported pros remain largely untested, we do not believe ALT2 is a good candidate for serious consideration outside such a sandbox.

**D. WHAT STEPS SHOULD WE TAKE (REQUEST PRESENTATIONS, CONDUCT INTERVIEWS, REVIEW STUDIES, ETC.) TO REACH A FULLY INFORMED RECOMMENDATION?**

Our recommendation going forward is to focus on the proposed Sandbox Rule, above, which we believe is necessary to permit lawyers to participate in the Sandbox in an entity that permits nonlawyer ownership or the sharing of legal fees that otherwise would be in violation of an unamended rule 5.4. We also believe that the ATILS ALT1 proposal would be a reasonable rule revision to pursue in the event that a regulatory sandbox proposal is rejected by decision-makers. However, we do not countenance any revisions to rule 5.4 beyond those presented in the Sandbox Rule, above. Any rule revisions intended to promote innovation are better left to be tested within the confines of the sandbox.

CTJG – [5.4] – COMPARISON CHART – Possible Amendments & ATILS Recommendations  
Revised (09-06-21)

1. Current Rule 5.4 (Amended, 3/22/21)	2. Proposed Rule 5.4 (CTJG) [To accommodate Sandbox & Proposed Paraprofessional Rule 5.4]	3. Proposed Rule 5.4 (ATILS-ALT1) [Permitting Ownership of Firm by Nonlawyer Professionals]	4. Proposed Rule 5.4 (ATILS-ALT2) [Permitting Passive Ownership of Firm w/ Client Consent]
<b>Rule 5.4 Financial and Similar Arrangements with Nonlawyers</b>	<b>Rule 5.4 Financial and Similar Arrangements with Nonlawyers<sup>1</sup></b>	<b>Rule 5.4 Financial and Similar Arrangements with Nonlawyers<sup>2</sup></b>	<b>Rule 5.4 Financial and Similar Arrangements with Nonlawyers<sup>3</sup></b>
(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:	(a) A lawyer or law firm* shall not share legal fees directly or indirectly with a <del>nonlawyer person* who is not a lawyer or</del> <u>a licensed paraprofessional<sup>4</sup></u> or with an organization that is not authorized to practice law, except that:	(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:	<del>(a) A lawyer or law firm* shall not share a</del> legal fees <del>directly or indirectly</del> with a <del>nonlawyer person</del> or <del>with an</del> organization <del>that is</del> not authorized to practice law, <del>except that unless:</del>  <u>(a) The lawyer or law firm enters into a written* agreement to share the fee with the person or organization not authorized to practice law;</u>  <u>(b) the client has consented in writing,* either at the time of the agreement to share fees or as soon thereafter as reasonably* practicable, after a full written* disclosure to the client of: (i) the fact that the fee will be</u>

<sup>1</sup> This proposed rule is based in part on Utah RPC 5.4 and also in part on proposed California Paraprofessional Rule 5.4, which would permit paraprofessionals to take an ownership interest up to 49% in a law firm in which the paraprofessional provides legal services. The amendments are intended to accommodate lawyers who might participate in the regulatory sandbox and the Paraprofessional Rules currently being considered and proposed by the Paraprofessional Working Group. Otherwise, the rule should apply to lawyers as it has in the past.

<sup>2</sup> ATILS proposed rule 5.4, ALT1, was based on a rule drafted by the ABA Ethics 20/20 Commission, but which was never submitted for consideration and adoption by the ABA House of Delegates. The ABA 20/20 Commission, convened in 2009, was charged with performing a thorough review of the ABA Model Rules of Professional Conduct and the U.S. system of lawyer regulation in the context of advances in technology and global legal practice developments. The ABA 20/20 rule in turn is based in large part on D.C. Rule 5.4, which permits lawyers and nonlawyer lobbyists to practice in the same firm. Rule 5.4, ALT1, was circulated for public comment as part of ATILS Interim Report released in July 2019 but was not made part of the ATILS Final Report submitted to the Board of Trustees in March 2020.

<sup>3</sup> ATILS proposed rule 5.4, ALT2, was drafted in response to a request by members of the Task Force for an alternative to ALT1 that would permit, at least to some extent, passive investment by nonlawyers in law firms. It was circulated for public comment but, similar to ATILS rule 5.4, ALT1, it was not made part of the ATILS Final Report.

<sup>4</sup> The phrase “person\* who is not a lawyer or a licensed paraprofessional” is substituted for the term “nonlawyer” in anticipation that there will be one group of nonlawyers with whom lawyers will be permitted to share fees, so the exceptions in subparagraphs (a)(1) – (a)(6) would not apply.



CTJG – [5.4] – COMPARISON CHART – Possible Amendments & ATILS Recommendations  
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			<u>shared with a person* or organization not authorized to practice law; (ii) the identity of the person* or organization; and (iii) the terms of the fee sharing;</u>  <u>(c) there is no interference with the lawyer's independent professional judgment. or with the lawyer-client relationship; and</u>  <u>(d) the total fee charged is not unconscionable as that term is defined in rule 1.5 and is not increased solely by reason of the agreement to share the fee.</u>
(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;*	(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;*	(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;*	<del>(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;*</del>
(2) a lawyer purchasing the practice of a deceased, disabled or disappeared lawyer may pay the agreed-upon purchase price, pursuant to rule 1.17, to the lawyer's estate or other representative;	(2) a lawyer purchasing the practice of a deceased, disabled or disappeared lawyer may pay the agreed-upon purchase price, pursuant to rule 1.17, to the lawyer's estate or other representative;	(2) a 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;	<del>(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;</del>

**CTJG – [5.4] – COMPARISON CHART – Possible Amendments & ATILS Recommendations**  
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(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;	(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;	(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;	<del>(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;</del>
(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;	(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;	(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; <del>or</del>	<del>(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</del>
(5) a lawyer or law firm* may share with or pay a court-awarded legal fee to a nonprofit organization that employed, retained or recommended employment of the lawyer or law firm* in the matter; or	(5) a lawyer or law firm* may share with or pay a court-awarded legal fee to a nonprofit organization that employed, retained or recommended employment of the lawyer or law firm* in the matter; or	(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, <del>or</del> 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>	<del>(5) a lawyer or law firm* may share with or pay a court-awarded legal fee to a nonprofit organization that employed, retained or recommended employment of the lawyer or law firm* in the matter; or</del>
(6) a lawyer or law firm* may share with or pay a legal fee that is not court-awarded but arises from a settlement or	(6) a lawyer or law firm* may share with or pay a legal fee that is not court-awarded but arises from a settlement or	<u>(6)<sup>5</sup> a lawyer or law firm may share legal fees with a nonlawyer if the lawyer or law firm complies with the</u>	<del>(6) a lawyer or law firm* may share with or pay a legal fee that is not court-awarded but arises from a settlement or other</del>

<sup>5</sup> At the time ATILS drafted ALT1, paragraph (a)(6) of current rule 5.4 did not exist. Instead, ATILS suggested an amendment to paragraph (a)(5) to capture the concept stated in current paragraph (a)(6), i.e., sharing of non-court-awarded legal fees with a nonprofit organization. ATILS further revised paragraph (a)(5), which was then studied by the State Bar's Committee on Professional Responsibility and Conduct (COPRAC). COPRAC further revised paragraph (a) to create two separate provisions related to the sharing of legal fees, current paragraphs (a)(5) and (a)(6), which eventually were approved by the Supreme Court, effective 3/22/21.

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<p>other resolution of the matter with a nonprofit organization that employed, retained, recommended, or facilitated employment of the lawyer or law firm* in the matter provided:</p> <p>(i) the nonprofit organization qualifies under section 501(c)(3) of the Internal Revenue Code;</p> <p>(ii) the lawyer or law firm* enters into a written* agreement to divide the fee with the nonprofit organization;</p> <p>(iii) the lawyer or law firm* obtains the client's consent in writing,* either at the time the lawyer or law firm* enters into the agreement with the nonprofit organization to divide the fee or as soon thereafter as reasonably * practicable, after a full written* disclosure to the client of the fact that a division of fees will be made, the identity of the lawyer or law firm* and the nonprofit organization that are parties to the division, and the terms of the division, including the restriction imposed under paragraph (a)(6)(iv); and</p>	<p>other resolution of the matter with a nonprofit organization that employed, retained, recommended, or facilitated employment of the lawyer or law firm* in the matter provided:</p> <p>(i) the nonprofit organization qualifies under section 501(c)(3) of the Internal Revenue Code;</p> <p>(ii) the lawyer or law firm* enters into a written* agreement to divide the fee with the nonprofit organization;</p> <p>(iii) the lawyer or law firm* obtains the client's consent in writing,* either at the time the lawyer or law firm* enters into the agreement with the nonprofit organization to divide the fee or as soon thereafter as reasonably * practicable, after a full written* disclosure to the client of the fact that a division of fees will be made, the identity of the lawyer or law firm* and the nonprofit organization that are parties to the division, and the terms of the division, including the restriction imposed under paragraph (a)(6)(iv); and</p>	<p><u>requirements set forth in paragraph (b) [and written notice of the nonlawyers' responsibilities within the law firm is provided to the State Bar].<sup>6</sup></u></p>	<p><del>resolution of the matter with a nonprofit organization that employed, retained, recommended, or facilitated employment of the lawyer or law firm* in the matter provided:</del></p> <p><del>(i) the nonprofit organization qualifies under section 501(c)(3) of the Internal Revenue Code;</del></p> <p><del>(ii) the lawyer or law firm* enters into a written* agreement to divide the fee with the nonprofit organization;</del></p> <p><del>(iii) the lawyer or law firm* obtains the client's consent in writing,* either at the time the lawyer or law firm* enters into the agreement with the nonprofit organization to divide the fee or as soon thereafter as reasonably * practicable, after a full written* disclosure to the client of the fact that a division of fees will be made, the identity of the lawyer or law firm* and the nonprofit organization that are parties to the division, and the terms of the division, including the restriction imposed under paragraph (a)(6)(iv); and</del></p> <p><del>(iv) the total fee charged by the lawyer or law firm* is not increased solely by reason of the agreement to divide fees.</del></p>

<sup>6</sup> The bracketed clause is added at the suggestion of Staff. It is modeled on a similar notice provision in CRPC 5.3.1(d) and is intended to provide added assurance that the nonlawyers' conduct conforms to the requirements of the rule.

CTJG – [5.4] – COMPARISON CHART – Possible Amendments & ATILS Recommendations  
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(iv) the total fee charged by the lawyer or law firm* is not increased solely by reason of the agreement to divide fees.	(iv) the total fee charged by the lawyer or law firm* is not increased solely by reason of the agreement to divide fees.		
	<u>(7) a lawyer or law firm* may share a legal fee if: (i) the fee is not unconscionable as that term is defined in rule 1.5, (ii) the total fee charged the client is not increased solely by reason of the agreement to share fees, and (iii) the fee-sharing arrangement has been authorized as required by _____ [add brief description of the enabling legislation/ rule of court regarding the Legal Services Sandbox];<sup>7</sup></u>		
(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.	<del>(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</del> <u>A lawyer shall not practice law in a law firm* or other organization in which individual nonlawyers in that firm or organization hold an ownership interest unless:</u>  <u>(i)<sup>8</sup> each nonlawyer is a paraprofessional licensed by the State</u>	<del>(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</del> <u>A lawyer shall not practice law in a law firm in which individual nonlawyers in that firm hold an ownership interest in the firm unless each of the following requirements is satisfied:</u>  <u>(1) the firm’s sole purpose is providing legal services to clients;</u>	<del>(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.</del>

<sup>7</sup> Paragraph (a)(7) is based in part on Utah RPC 5.4(c)(1). Language has also been borrowed from ATILS proposed 5.4, ALT2, set out in Column 4.

<sup>8</sup> Subparagraph (i) recognizes that the proposed Paraprofessional RPC contemplate that paraprofessional may possess an ownership interest in a law firm in which lawyers are practicing so long as licensed paraprofessionals in the organization do not possess a majority ownership interest. See proposed Paraprofessional RPC 5.4(e)(3).

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	<p><u>Bar of California, the combined ownership interest of all paraprofessionals in the firm is not a majority interest, and no paraprofessional exercises controlling managerial authority in the firm; or</u></p> <p><u>(ii)<sup>9</sup>the firm or other organization has been authorized as required by _____ [add brief description of the enabling legislation/ rule of court regarding the Legal Services Sandbox] and provided the lawyer shall:</u></p> <p><u>(A) before accepting a representation, provide written disclosure to the prospective client</u></p>	<p><u>(2) the nonlawyers provide services that assist the lawyer or law firm in providing legal services to clients;</u></p> <p><u>(3) the nonlawyers have no power to direct or control the professional judgment of a lawyer;<sup>10</sup></u></p> <p><u>(4) the nonlawyers have each satisfactorily demonstrated that they are of good moral character as determined by the State Bar.<sup>11</sup></u></p> <p><u>(5) the nonlawyers (i) satisfactorily complete a class of legal education approved by the State Bar or offered by a State Bar-approved provider on</u></p>	

<sup>9</sup> Subparagraph (ii) is based on Utah RPC 5.4(d) and is intended to accommodate lawyers who participate in the Sandbox. Without this provision or something similar to it, lawyers could not participate in a Sandbox entity in which nonlawyers possess an ownership interest.

<sup>10</sup> An earlier version of this rule added the following language at the end of subparagraph (b)(3):

“and the ownership 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 ownership 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 ownership 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.”

This language had been taken nearly verbatim from the ABA Ethics 20/20 Commission’s proposed amended rule 5.4, the only change being to substitute “ownership interest” for “financial interest.” This language engendered substantial debate in the ATILS Rules Subcommittee and was eventually deleted. The rationale was that regardless of ownership interest of the nonlawyers, they should never be able to direct or control the professional judgment of the lawyers in the firm.

<sup>11</sup> This language was added at the suggestion of Prof. Stephen Gillers.

**Pro:** It is appropriate that a nonlawyer owner of a law firm that has as its sole purpose the provision of legal services must demonstrate good moral character as is required for any lawyer owners of the firm.

**Con:** None determined.

Although Prof. Gillers also suggested that the cost of the moral character review should be assumed by the nonlawyer, that requirement should be left to a State Bar rule.

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	<p><u>that one or more nonlawyers holds a financial interest in the firm* or organization in which the lawyer practices [or that one or more nonlawyers exercises managerial authority over the lawyer]; and</u></p> <p><u>(B) disclose in writing to the client the financial and managerial structure of the firm* or organization in which the lawyer practices.</u></p>	<p><u>the Rules of Professional Conduct, the State Bar Act and other laws regulating lawyer conduct, (ii) state in writing that they understand the Rules of Professional Conduct, the State Bar Act and other laws regulating lawyer conduct; and (iii) agree in writing to undertake to conform their conduct to the Rules, the State Bar Act and other laws regulating lawyer conduct;<sup>12</sup></u></p> <p><u>(6) The nonlawyers annually complete at least [X] hours of legal education approved by the State Bar or offered by a State Bar-approved provider on the Rules of Professional Conduct, the State Bar Act and other laws regulating lawyer conduct. Each nonlawyer must report his or her compliance to the State Bar under rules adopted by the Board of Trustees of the State Bar;<sup>13</sup></u></p> <p><u>(7) the lawyer partners in the law firm are responsible for these nonlawyers to the same extent as if the</u></p>	

<sup>12</sup> The language regarding completion of legal education classes was added at the suggestion of Prof. Gillers, to ensure that the nonlawyers are familiar with the duties owed by lawyers to their clients and to the justice system. Prof. Gillers did not believe that a simple written statement that the nonlawyers had read the Rules and State Bar Act would provide the necessary assurance that the nonlawyers were familiar with the duties lawyers owe.  
This provision would be supplemented by a requirement that the nonlawyers fulfill continuing legal education requirements just as lawyers are required. See proposed subparagraph (b)(6).

<sup>13</sup> Subparagraph (b)(6)’s language is based roughly on Cal. Rule of Court 9.31(c), which sets forth continuing legal education requirements.



**CTJG – [5.4] – COMPARISON CHART – Possible Amendments & ATILS Recommendations**  
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		<p><u>nonlawyers were lawyers under rule 5.1;<sup>14</sup></u></p> <p><u>(8) compliance with the foregoing conditions is set forth in writing.<sup>15</sup></u></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.	(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.	(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.	<del>(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.</del>
<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 fiduciary representative of a lawyer's estate may hold the lawyer's stock or other interest for a reasonable* time during administration;</p> <p>(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</p>	<p>(d) <u>Except as otherwise provided in paragraph (b).</u> 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 fiduciary representative of a lawyer's estate may hold the lawyer's stock or other interest for a reasonable* time during administration;</p> <p>(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</p>	<p>(d)<sup>16</sup> <del>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:</del></p> <p><del>(1) a nonlawyer owns any interest in it, except that</del> <u>Notwithstanding paragraph (a),</u> a fiduciary representative of a lawyer's estate may hold the lawyer's stock or other interest <u>in a law corporation or other organization authorized to practice law</u> for a reasonable* time during administration.;</p> <p><del>(2) a nonlawyer is a director or officer of the corporation or occupies a position of</del></p>	<p><del>(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:</del></p> <p><del>(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;</del></p> <p><del>(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</del></p>

<sup>14</sup> This provision is taken nearly verbatim from the ABA Ethics 20/20 proposed rule. Rule 5.1 sets out duties of managerial and supervisory lawyers to make reasonable efforts to ensure the firm has policies assuring that all lawyers in the firm comply with the rules and statutes that set forth lawyers' duties.

<sup>15</sup> This provision is taken verbatim from the ABA Ethics 20/20 proposed rule.

<sup>16</sup> Paragraph (d) was revised in recognition that the prohibitions in current rule 5.4(d)(2)-(3) are already addressed in paragraph (b).

**CTJG – [5.4] – COMPARISON CHART – Possible Amendments & ATILS Recommendations**  
**Revised (09-06-21)**

1. Current Rule 5.4 (Amended, 3/22/21)	2. Proposed Rule 5.4 (CTJG) [To accommodate Sandbox & Proposed Paraprofessional Rule 5.4]	3. Proposed Rule 5.4 (ATILS-ALT1) [Permitting Ownership of Firm by Nonlawyer Professionals]	4. Proposed Rule 5.4 (ATILS-ALT2) [Permitting Passive Ownership of Firm w/ Client Consent]
(3) a nonlawyer has the right or authority to direct or control the lawyer's independent professional judgment.	(3) a nonlawyer has the right or authority to direct or control the lawyer's independent professional judgment.	<del>similar responsibility in any other form of organization; or</del> <del>(3) a nonlawyer has the right or authority to direct or control the lawyer's independent professional judgment.</del>	<del>(3) a nonlawyer has the right or authority to direct or control the lawyer's independent professional judgment.</del>
(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.	(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.	(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.	<del>(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.</del>
(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.	(f) <u>Except as otherwise provided in paragraph (b),</u> <del>A</del> 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.	(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.	<del>(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.</del>



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Comment	Comment <sup>17</sup>	Comment	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.		[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.	

<sup>17</sup> No amendments to the Comment to CRPC 5.4 are proposed at this time. Such amendments can be considered after discussion of the proposed changes to the blackletter rule has advanced.

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[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.		[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 <i>Frye v. Tenderloin Housing Clinic, Inc.</i> (2006) 38 Cal.4th 23 [40 Cal.Rptr.3d 221]; see also rule 6.3.) Under the specified circumstances, paragraph (a)(6) permits a lawyer to share with or pay legal fees arising from a settlement or other resolution of the matter to 501(c)(3) organizations, such as nonprofit legal aid and charitable groups that are not engaged in the unauthorized practice of law. Paragraphs (a)(5) and (a)(6) include the concept of a nonprofit organization facilitating the employment of a lawyer to provide legal services. One example of		[3] Paragraph (a)(5), <a href="#">as just one example</a> , 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, see rule 1.0, Comment [5] on financial support for programs providing pro bono legal services.	

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such facilitation is a nonprofit organization's operation of a law practice incubator program.			
[4] A lawyer or law firm* who has agreed to share with or pay legal fees to a qualifying organization under paragraphs (a)(5) or (a)(6) remains obligated to exercise independent professional judgment in the client's best interest. See rules 1.7 and 2.1. 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.		<a href="#">[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).</a>	
[5] Nothing in paragraphs (a)(5) or (a)(6) is intended to alter the regulation of lawyer referral activity set forth in Business and Professions Code section 6155. In addition, a lawyer must comply with rules 5.4(a)(4) and 7.2(b).		<a href="#">[5] Notwithstanding paragraph (b)(1), a nonlawyer may provide law-related services to a client for whom the firm has provided legal services. For example, subject to rules 1.7 and 1.8.1, a nonlawyer financial advisor could provide investment advice to a firm client who has received a judgment in a personal injury action.<sup>18</sup> [See also rule 5.7]<sup>19</sup></a>	

<sup>18</sup> Prof. Gillers also recommended that nonlawyers should be able to provide law-related services to firm clients. The intent of his recommendation was that services should have a nexus to the legal representation as the example indicates.

<sup>19</sup> The reference to rule 5.7 is bracketed pending a recommendation that a California rule counterpart to ABA Model Rule 5.7 should be adopted.

Note that the following comment was included in the Ethics 20/20 Commission's proposed draft of MR 5.5:

[5] Paragraph (b) does not preclude a lawyer from providing "law-related services", as defined in Rule 5.7, whether through a law firm or other organization. A lawyer shall remain subject to the Rules of Professional Conduct with respect to his or her provision of law-related services pursuant to Rule 5.7 whether or not the entity through which the lawyer provides such services is a partnership or other form of organization in which a financial interest is held by nonlawyers pursuant to this Rule.

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[6] 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].)		[46] 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].)	
[7] Paragraph (c) is not intended to alter or diminish a lawyer’s obligations under rule 1.8.6 (Compensation from One Other Than Client). [Amended effective March 22, 2021]		57] Paragraph (c) is not intended to alter or diminish a lawyer’s obligations under rule 1.8.6 (Compensation from One Other than Client).	
	[	<u>[8] This rule is not intended to abrogate the law governing lawyer referral services, or the law prohibiting running and capping. See Business and Professions Code sections 6151-6155. A runner or capper would not be deemed to “assist” a lawyer or law firm in providing legal services to a client within the meaning of paragraph (b)(2). Similarly, a lawyer referral service would not be deemed to “assist” a lawyer or law firm in providing legal services to a client under that paragraph.</u> <sup>20</sup>	

<sup>20</sup> This comment was added to address concerns raised in the ATILS public comment that this rule could provide a means to avoid the application of the lawyer referral service and runner/capper restrictions.