



The State Bar of California

OPEN SESSION AGENDA ITEM DECEMBER 2021 LEGAL SERVICES TRUST FUND COMMISSION ITEM VIII.A

DATE: December 13, 2021

TO: Members, Legal Services Trust Fund Commission

FROM: Members, Rules Committee, Legal Services Trust Fund Program

SUBJECT: Amendments to Rules of the State Bar Regarding Passthrough Expenditures

EXECUTIVE SUMMARY

The Rules Committee (Committee) of the Legal Services Trust Fund Commission (LSTFC) is working to gather, revise, and codify, as necessary and appropriate, all of the decision points and considerations related to the grants administration process. The purpose of this process is to ensure transparency, ease of administration, and clarity for grantee applicants, the LSTFC, and State Bar staff.

This memorandum presents analysis and recommendations from the Committee on the following issues regarding passthrough expenditures:

- How to define passthrough expenditures for purposes of administration of State Bar grants;
- How passthrough expenditures impact eligibility determinations and grant awards; and
- Whether to recommend revisions to State Bar Rules to codify practices regarding passthrough expenditures to ensure that the IOLTA program is administered in the spirit of the governing statutes.

This memorandum incorporates the advice of a working group selected to consider this matter in depth, as well as community input obtained through the Legal Aid Association of California

(LAAC). Further background was gathered through a survey of IOLTA grantees administered in January 2021, and analysis of IOLTA / EAF applications for 2019, 2020, and 2021.

The rules committee approved a resolution on November 22 to adopt the recommendations of the working group and recommend them to the LSTFC.

Any recommendations from the LSTFC will be subsequently considered for adoption by the State Bar's Board of Trustees.

BACKGROUND

CODIFICATION PROCESS

In 2019, following the recommendation of the Board of Trustees, State Bar staff and the LSTFC began a multi-phase process of revising and/or codifying all decision points employed in the grantmaking process for IOLTA and Equal Access Fund (EAF) grants. The intent was to provide more transparency about the process and to ensure consistency in administering the grants.

LSTFC members have formed working groups to investigate the questions raised in the Rules Committee's work plan and develop preliminary recommendations. The process then involves circulating those preliminary recommendations to the legal aid community to obtain feedback. The Rules Committee considers the feedback before making a final recommendation to the LSTFC, and in turn, the Board of Trustees.

GOVERNING AUTHORITIES

Statutory Framework

Approximately 100 nonprofit legal services organizations receive IOLTA and EAF grants each year in a program administered by the State Bar under Business and Professions Code sections 6210-6228 (IOLTA Statute), as implemented under State Bar Rules 3.660-3.692 (Rules).

State Bar staff and the Passthrough Funds working group reviewed the governing authorities for guidance regarding the administration of these transactions. Of particular relevance to the issues raised in this memorandum are:

- Business and Professions Code sections 6213(a) and (b), which respectively set the eligibility criteria for IOLTA grants for Qualified Legal Services Projects (QLSPs) and Support Centers (SCs);
- Business and Professions Code section 6216, which provides formulas for calculating grant allocations for QLSPs, at 6216(b)(1), and for SCs, at 6216(c); and
- State Bar Rule 3.671, which provides the formula for determining whether an applicant is presumed to meet the relevant criteria to be eligible to receive grant funds.

Determination and Use of Qualified Expenditures

The preamble to the IOLTA Statute states an intention to expand the availability and improve the quality of free legal services in civil matters to indigent persons, and to initiate new programs that will provide services to them.¹ Its legislative purpose is to allocate funding for legal services where the need is greatest, among eligible service providers proportionate to the amount of money they spend providing services. Approximately 100 nonprofit legal services organizations receive IOLTA and EAF grants each year as either Qualified Legal Services Projects (QLSPs) or Qualified Support Centers (SCs), under criteria set forth in the IOLTA Statute² as implemented by State Bar Rules. QLSPs have the primary purpose and function of providing free civil legal aid in California to indigent persons; SCs have the primary purpose and function of providing legal training, legal technical assistance, or advocacy support without charge to organizations that provide legal services to indigent persons.³

Applicants establish eligibility for IOLTA grants by demonstrating that their primary purpose and function meets the definition of a QLSP or an SC. This is determined by comparing their expenditures for the purposes stated in those definitions (“qualified expenditures”) to their total qualified corporate expenditures: an applicant is presumed to meet the eligibility criteria if at least 75 percent of its budget and expenditures from the previous year were qualified.⁴ Those with lower “QE ratios” receive individual review from the commission and may be required to attend an Eligibility Review Conference with a working group of the commission.

Grant award amounts are calculated under the IOLTA Statute using two different formulas for QLSPs and SCs. The formula for SCs allocates an equal share to each eligible SC applicant: every SC receives the same award regardless of its budget or expenditures.⁵

The remaining funding is distributed to QLSPs under a multistep process: it is first allocated among California’s 58 counties proportionate to their respective indigent populations; then it is allocated among the QLSPs serving each county proportionate to their qualified expenditures in that county.⁶ Under this formula, QLSPs with more qualified expenditures receive larger grant awards.

Excluding Passthroughs from an Applicant’s Budget and Expenditures

In calculating an applicant’s QE ratio under Rule 3.671, office practice interprets the terms “budget” and “expenditures” to refer to the portion of an organization’s funds that it allocates and spends to implement its programs and operations.⁷ This includes all expenditures to pay

¹ Business and Professions Code section 6210.

² Bus. & Prof. Code §§ 6210-6228.

³ Bus. & Prof. Code §§ 6213(a), (b)

⁴ State Bar Rules 3.671(A), (B)

⁵ Bus. & Prof. Code § 6216(c)

⁶ Bus. & Prof. Code § 6216(b)

⁷ “A **nonprofit operating budget** is a financial document that provides an overview of how a nonprofit organization is planning to spend its money. It also breaks down the nonprofit’s **operating expenses** and overall costs. The nonprofit operating budget is essentially the financial reflection of what the nonprofit business expects to achieve

staff and contractors, as well as non-personnel and administrative costs. However, office practice has not understood “budget” and “expenditures” to include non-cash items such as the value of donated services or write-offs of bad debt, nor “passthroughs” of funds from an outside source to a third-party recipient.

“Passthrough” is the term used in office practice to describe funds that were received for the sole purpose of disbursing them to a sub-recipient. Even though passthrough expenditures may appear on an applicant’s audited financial statements, they do not reflect expenditures for that organization’s program activities. Office practice therefore considers passthrough transactions to be corporate fiscal activities, not organizational expenditures, and excludes them from an applicant’s budget and expenditures when determining its primary purpose and when calculating QLSP grant awards.

CURRENT OFFICE PRACTICES

Calculating the Qualified Expenditure Ratio: Excluding Passthrough Expenditures; Deducting Non-Qualified Expenditures

A multi-step process determines an applicant’s QE ratio. First, the applicant reports its total corporate expenditures for its last fiscal year from its audited financial statements.⁸ It then categorizes these expenditures into budgetary line items for various categories of personnel, non-personnel, non-cash, and pass-through expenditures. Non-cash items and passthrough expenditures are immediately subtracted “off the top” and are not included as part of the applicant’s expenditures for eligibility purposes. The remainder is used as the basis for calculating the applicant’s QE ratio.

The applicant must then identify all of its expenditures for non-qualified activities and subtract that total. If the remaining expenditures comprise at least 75 percent of the applicant’s total expenditures for eligibility purposes, the applicant is presumed to meet the primary purpose criteria and be eligible for grants. All others receive individual consideration and, potentially, an eligibility review conference.

Identifying Passthrough Transactions

The IOLTA Statute and Rules are silent regarding passthrough transactions. It became apparent to staff over the course of administering the IOLTA program that, if counted as QEs, passthrough disbursements could significantly increase the applicant’s qualified expenditures for both eligibility and allocations purposes, without increasing the amount of services it provides. If passthroughs were treated as eligible expenditures, applicants with large passthroughs would qualify for eligibility more easily and might be allocated larger shares of available funding, resulting in smaller grants for neighboring QLSPs. On the other hand, if

over a 12-month period (annual budget).” From [A Guide to Nonprofit Budgeting](https://donorbox.org/nonprofit-blog/a-guide-to-non-profit-budget/), Donorbox Nonprofit Blog (https://donorbox.org/nonprofit-blog/a-guide-to-non-profit-budget/).

⁸ Applicants with gross corporate expenditures of \$500,000 or less may provide independently reviewed fiscal statements. Business and Professions Code section 6222; State Bar Rule section 3.680(E)(1).

passthroughs were deducted as non-qualified expenditures, they would lower an applicant's QE ratio even though it had not engaged in any non-qualified activities.

As an example, consider an applicant with total corporate expenditures of \$1 million. They report a \$300,000 passthrough and have an additional \$150,000 of non-qualifying expenditures.

In this scenario, with a passthrough exclusion, the applicant excludes \$300,000 off the top which leaves \$700,000 of organizational expenditures. The applicant then must deduct \$150,000 for non-qualifying activities, leaving qualified expenditures of \$550,000. This results in a QE ratio of 79 percent: this applicant would be presumed eligible for grants.

With no passthrough exclusion, this applicant's organizational expenditures would be \$1 million. If the \$300,000 payment was treated as non-qualified, this applicant would have to deduct those funds as well as its own \$150,000, leaving it with a QE ratio of 55 percent. Under such circumstances, a determination of eligibility would be unlikely. Alternatively, if this applicant counted the passthrough as a QE, it would only deduct \$150,000 against a total budget of \$1,000,000 – inflating its QE ratio to 85 percent and potentially entitling it to a larger share of available funding.

This issue has arisen primarily when applicants received funds provided by an external source, under terms or conditions that required those funds to be paid out to an external sub-recipient. While these transactions sometimes also were distinguished by other features, these expenses were seen as similarly inconsistent with the generally accepted definition of a non-profit organization's "budget" and "expenditures." Office procedures were adopted to neutralize the consequences of these expenditures, describing them as "passthroughs" and excluding them from an applicant's budget and expenditures for eligibility and allocation purposes.

Practices Addressing Passthrough Transactions – Past and Present

Beginning in 2018, the IOLTA / EAF grant application provided the opportunity for applicants to "identify funds that are passed through from the applicant to another organization, for which the applicant has no involvement, oversight, or engagement in the execution of the funded work (e.g. program simply cuts a check to another organization but is not involved in decision-making and does not have oversight responsibilities, or involvement is limited to selecting a sub-grantee but program does not participate in decision-making or oversight beyond that)." Prior practice had identified passthrough transactions a little differently, considering passthroughs to be the funds received from an outside source, under restrictions requiring a subsequent disbursement of those funds to a specified sub-recipient in a specified amount.

2021 Applicant Survey and Review of IOLTA / EAF Applications

Current grantees completed a survey on passthrough transactions that requested information about funding source, recipients, and types of transaction. The survey indicated inconsistent understanding and reporting of passthrough funds. Staff then conducted a review of 2019, 2020, and 2021 IOLTA / EAF applications to gather additional information on how QLSPs and SCs reported funds provided from external sources that are designed to be directed to another

specified entity. Staff review indicated that SCs categorize subgrants as passthroughs three times more frequently than they reported contractor expenses. However, QLSPs report subgrants as contractor expenses two times more frequently than they report passthroughs. Reporting expenses as contractor expenses would have the effect of increasing an applicant's QEs whereas reporting a passthrough would exclude the expenses from organizational expenditures entirely. It appears that some QLSPs and SCs may be reporting similar expenses in different categories. During the three-year review period, SCs reported and excluded about \$32 million in passthrough expenditures, while QLSPs reported nearly the same amount in payments to other QLSPs as exchanged funds, which, per current office practice, are considered qualified expenditures for eligibility purposes but, if the transfer is to another QLSP, must be deducted by one of the QLSPs for award allocation calculations.⁹

DISCUSSION

PASSTHROUGH EXPENDITURES MUST BE EXCLUDED TO PRESERVE THE STATUTE'S INTENTIONS AND GOALS

The legislative record of the development and enactment of the IOLTA Statute does not indicate that its drafters considered the impact of passthrough transactions on organizational expenditures. Passthrough transactions are different from program or administrative expenditures: they reflect fiscal activity, not organizational services. These transactions can inflate an applicant's total expenditures by millions of dollars. If they were counted as qualified expenditures, both the eligibility formula and the funding formula would produce unintended results as applicants with large passthroughs would easily meet eligibility criteria and QLSPs would qualify for inflated grants. Conversely, if they were deducted as non-qualifying expenditures, some applicants may not be found eligible for grant funding. Those outcomes would be inconsistent with the Statute's goal of funding legal services programs in proportion to their qualified expenditures without excessive administrative infrastructure or cost. Informal office practices have precluded these unintended outcomes for many years, allowing applicants to exclude passthrough funds without deducting them as non-qualified.

Review of past and current office practices reveals that further clarification is needed to ensure that passthroughs are treated consistently by all applicants and to ensure the rules governing passthroughs are clear to QLSPs and SCs.

THE CURRENT DESCRIPTION OF PASSTHROUGH FUNDS OMITTS KEY CRITERIA AND ADDS NEW RESTRICTIONS

Currently, application instructions describe passthroughs as "funds that are passed through from the applicant to another organization, for which the applicant has no involvement, oversight, or engagement in the execution of the funded work." This description omits the

⁹ Exchanged funds have been addressed separately by the Rules Committee in parallel with passthrough transactions and are the subject of separate recommendations.

requirements that the funds be provided by an external source of funds or that funds are provided to the organization with restrictions requiring a subsequent disbursement of those funds. Under this definition, an applicant could donate its own funds to any recipient it selects and exclude it as a passthrough. Prior office practice would have considered that kind of payment to be a non-qualified charitable donation which would lower an applicant's QE ratio. Available documentation does not explain the analysis and intention in crafting the passthrough definition in this manner; the working group concluded that omission of these criteria was not consistent with the goals for handling of passthrough transactions.

The working group also noted that the current definition requires disbursement to organizations for "funded work," which would appear to exclude direct assistance to clients such as rental assistance payments. Requiring applicants to count direct assistance funds to clients as passthroughs will enable and encourage organizations to provide more holistic services to clients and communities, without penalizing them for disbursing these funds. They further noted that many fiscal sponsorship agreements require some measure of continuing control over the subrecipient's work. These kinds of transactions were considered to be passthroughs that were not contemplated by the current definition.

The working group also considered that some passthroughs pay for or non-qualified activities, and how that impacts the qualified or non-qualified nature of any associated administrative expenses. To encourage grantees to support their constituencies and partners by engaging in passthrough transactions, the working group revised its initial recommendations that all the administrative costs associated with passthroughs were non-qualified, to recommend instead that costs associated with a passthrough should be qualified expenditures where the underlying services being funded are qualified.

COMMUNITY FEEDBACK

Drafts of this memo were circulated to the legal services community on two occasions by the Legal Aid Association of California (LAAC), over the course of the committee's consideration of this issue. Feedback included:

- A request for a chart describing how to determine if a transaction is a passthrough
- Suggestions on wording to ensure against unintended exclusions
- Concern regarding transactions where an applicant has received funds for the purpose of selecting recipients and subgrant amounts on the funder's behalf, but without ongoing engagement in the funded activities
- Concern regarding passthroughs where the funder has imposed reporting requirements

In response to this feedback, a chart was developed illustrating different applications of each sub-section of the proposed rule's definition of a passthrough. This chart indicates that reporting requirements are not inconsistent with the nature of a passthrough transaction. Additionally, the language was revised for consistency, and a new subsection was added specific to subgrants made on behalf of an outside funder.

OPTIONS FOR DEFINING PASSTHROUGH TRANSACTIONS

The Committee agreed that, under the IOLTA Statute and State Bar Rules, passthrough transactions are not the type of expenditure that should be used to determine eligibility for funding and the amount of funding to be awarded. The Committee further agreed that practices addressing the impact of passthrough expenditures should be formalized through the codification process, and

considered various options:

OPTION 1 – REVISE THE RULES TO CODIFY THE CURRENT DEFINITION OF PASSTHROUGH EXPENDITURES AS SET FORTH IN THE IOLTA / EAF APPLICATION

Currently, application instructions require exclusion of passthrough expenditures for which the applicant had no authority or control over the recipient's use of the funds. This practice furthers the goals of the IOLTA Statute by helping to ensure that eligibility is based on an applicant's own budget and expenditures, as the Legislature intended; however, the description of passthrough transactions currently used does not appear to promote the greatest fairness or public policy outcomes. The failure to define passthrough funds as coming from an external source or to require that they must be redistributed pursuant to funder requirements may permit some expenditures to be classified as passthrough expenditures that should not properly qualify as such. Additionally, the current definition of passthrough fails to include transactions that are becoming increasingly common for legal aid organizations, like direct assistance grants, fiscal sponsorships, and grant making on behalf of a funder.

The current approach fails to fully and appropriately capture those transactions that should be excluded from all expenditures, and on those grounds the Committee does not recommend that the current description be codified.

OPTION 2 – REVISE THE RULES TO DEFINE PASSTHROUGH FUNDS TO ADDRESS THE CHALLENGES IDENTIFIED IN OPTION 1

A rule revision to codify the prior informal office practice which identified passthrough transactions as the receipt of funds from an outside source, received under restrictions requiring a subsequent disbursement of those funds, to a specified sub-recipient and in a specified amount, would help improve consistency as well as better define those transaction to be treated as passthroughs.

However, this definition would not adequately address the differences between different kinds of passthrough transaction. The Committee recommends a more detailed definition of passthroughs that recognizes the different types of these transactions, and has further refined this definition in response to working group and community feedback. To best support the goals of transparency, consistency, and adherence to the intended purpose of the IOLTA statute, the Committee recommends that State Bar Rule 3.671 be revised to include the following new subsection regarding which expenditures are part of an applicant's budget and expenditures for purposes of determining its primary purpose and function:

Passthrough expenditures are transactions that meet any of the following criteria:

1. Funds received from an outside source under terms or conditions that require those funds to be paid out to a specified external sub-recipient or sub-recipients and which allow the applicant no discretion over who receives the funds or control over their execution of the funded work. If the applicant organization is claiming the expenditure as a passthrough under this criteria, administrative expenses may be counted as qualified expenditures if the services provided are considered qualifying under Subpart (A) [or (B)] above.¹⁰ If the services provided are not qualifying activities, then the expenses related to the management and disbursement of these funds must be deducted as non-qualifying expenditures; or
2. Funds received from an outside source under terms or conditions that require the applicant to identify sub-recipients for those funds and the amount of the funds each will receive, but without responsibility for the subrecipients' execution of the funded work. If the applicant organization is claiming the expenditure as a passthrough under this criteria, administrative expenses may be counted as qualified expenditures if the services provided are considered qualifying under Subpart (A) [or (B)] above. If the services provided are not qualifying activities, then the expenses related to the management and disbursement of these funds must be deducted as non-qualifying expenditures; or
3. Funds received from an outside source pursuant to a fiscal sponsorship relationship where the applicant organization is providing funding to a sub-recipient that is an unincorporated entity unable to receive the funds directly. The applicant organization may or may not exercise oversight and control over the sub-recipient. If the applicant organization is claiming the expenditure as a passthrough under this criteria, administrative expenses may be counted as qualified expenditures if the services provided are considered qualifying under Subpart (A) [or (B)] above. If the services provided are not qualifying activities, then the expenses related to the management and disbursement of these funds must be deducted as non-qualifying expenditures; or
4. Funds received from an outside source under terms or conditions that require those funds to be paid out to assist individuals directly based on criteria set by the provider of the funds. The applicant may or may not exercise discretion or control over how the funds are distributed or how the individuals spend the funds. If the applicant organization is claiming the expenditure as a passthrough under this criteria, administrative expenses may be counted as qualified expenditures if the services provided are considered qualifying under Subpart (A) [or (B)] above. If the services provided are not qualifying activities, then the expenses related to the management and disbursement of these funds must be deducted as non-qualifying expenditures.

Passthrough expenditures shall not be considered part of an applicant's budget or expenditures when determining its primary purpose and function, nor when calculating grant allocations under subdivision (b) of section 6216 of the Business and Professions Code.

¹⁰ "Subpart (A) [or (B)]" refers to subparts (A) and (B) of State Bar Rule 3.671, which reiterate the statutory definitions of a QLSP and an SC, respectively. This rule may be an appropriate place to add the new proposed definition and regulations regarding passthrough expenditures. The Office of General Counsel will determine the final formatting and structure of all approved rules.

COMMITTEE RECOMMENDATION

The Committee recommends a regulatory change to codify, clarify, and expand practices regarding passthrough expenditures as fully set forth at Option 2, above. If the LSTFC approves, this change will be presented to the Board of Trustees with a request that it be circulated for public comment. The proposed rule will be reconsidered and revised as necessary in light of any comments received. The revised text will be submitted for the Board's approval and adoption together with other recommendations arising through the codification process.

RECOMMENDATIONS

Should the Legal Services Trust Fund Commission concur in the proposed action, passage of the following resolution is recommended:

RESOLVED, that the Legal Services Trust Fund Commission approves the recommendations of the Rules Committee regarding the definition and treatment of passthrough expenditures as fully set forth at Option 2 above and will request that the State Bar Board of Trustees release this proposed rule for a 45-day public comment period.

ATTACHMENT(S) LIST

- A.** Governing Authorities:
 - a. Business and Professions Code sections 6210-6228
 - b. State Bar Rules 3.660-3.692
- B.** Proposed Revision to State Bar Rule 3.671
- C.** Summary of Survey Responses and Application Data Review
- D.** Application and Example Chart: Passthrough Expenditure Rule



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BUSINESS AND PROFESSIONS CODE - BPC

DIVISION 3. PROFESSIONS AND VOCATIONS GENERALLY [5000 - 9998.11] (*Heading of Division 3 added by Stats. 1939, Ch. 30.*)

CHAPTER 4. Attorneys [6000 - 6243] (*Chapter 4 added by Stats. 1939, Ch. 34.*)

ARTICLE 14. Funds for the Provision of Legal Services to Indigent Persons [6210 - 6228] (*Article 14 added by Stats. 1981, Ch. 789, Sec. 1.*)

6210. The Legislature finds that, due to insufficient funding, existing programs providing free legal services in civil matters to indigent persons, especially underserved client groups, such as the elderly, the disabled, juveniles, and non-English-speaking persons, do not adequately meet the needs of these persons. It is the purpose of this article to expand the availability and improve the quality of existing free legal services in civil matters to indigent persons, and to initiate new programs that will provide services to them. The Legislature finds that the use of funds collected by the State Bar pursuant to this article for these purposes is in the public interest, is a proper use of the funds, and is consistent with essential public and governmental purposes in the judicial branch of government. The Legislature further finds that the expansion, improvement, and initiation of legal services to indigent persons will aid in the advancement of the science of jurisprudence and the improvement of the administration of justice.
(*Added by Stats. 1981, Ch. 789, Sec. 1.*)

6211. (a) An attorney or law firm that, in the course of the practice of law, receives or disburses trust funds shall establish and maintain an IOLTA account in which the attorney or law firm shall deposit or invest all client deposits or funds that are nominal in amount or are on deposit or invested for a short period of time. All such client funds

may be deposited or invested in a single unsegregated account. The interest and dividends earned on all those accounts shall be paid to the State Bar of California to be used for the purposes set forth in this article.

(b) Nothing in this article shall be construed to prohibit an attorney or law firm from establishing one or more interest bearing bank trust deposit accounts or dividend-paying trust investment accounts as may be permitted by the Supreme Court, with the interest or dividends earned on the accounts payable to clients for trust funds not deposited or invested in accordance with subdivision (a).

(c) With the approval of the Supreme Court, the State Bar may formulate and enforce rules of professional conduct pertaining to the use by attorneys or law firms of an IOLTA account for unsegregated client funds pursuant to this article.

(d) Nothing in this article shall be construed as affecting or impairing the disciplinary powers and authority of the Supreme Court or of the State Bar or as modifying the statutes and rules governing the conduct of members of the State Bar.

(Amended by Stats. 2007, Ch. 422, Sec. 2. Effective January 1, 2008.)

6212. An attorney who, or a law firm that, establishes an IOLTA account pursuant to subdivision (a) of Section 6211 shall comply with all of the following provisions:

(a) The IOLTA account shall be established and maintained with an eligible institution offering or making available an IOLTA account that meets the requirements of this article. The IOLTA account shall be established and maintained consistent with the attorney's or law firm's duties of professional responsibility. An eligible financial institution shall have no responsibility for selecting the deposit or investment product chosen for the IOLTA account.

(b) Except as provided in subdivision (f), the rate of interest or dividends payable on any IOLTA account shall not be less than the interest rate or dividends generally paid by the eligible institution to nonattorney customers on accounts of the same type meeting the same minimum balance and other eligibility requirements as the IOLTA account. In determining the interest rate or dividend payable on any IOLTA account, an eligible institution may consider, in addition to the balance in the IOLTA account, risk or other factors customarily considered by the eligible institution when setting the interest rate or dividends for its non-IOLTA accounts, provided that the factors do not discriminate between IOLTA customers and non-IOLTA customers and that these factors do not include the fact that the account is an IOLTA account. The eligible institution shall calculate interest and dividends in accordance with its standard practice for non-IOLTA customers. Nothing in this article shall preclude an eligible

institution from paying a higher interest rate or dividend on an IOLTA account or from electing to waive any fees and service charges on an IOLTA account.

(c) Reasonable fees may be deducted from the interest or dividends remitted on an IOLTA account only at the rates and in accordance with the customary practices of the eligible institution for non-IOLTA customers. No other fees or service charges may be deducted from the interest or dividends earned on an IOLTA account. Unless and until the State Bar enacts regulations exempting from compliance with subdivision (a) of Section 6211 those accounts for which maintenance fees exceed the interest or dividends paid, an eligible institution may deduct the fees and service charges in excess of the interest or dividends paid on an IOLTA account from the aggregate interest and dividends remitted to the State Bar. Fees and service charges other than reasonable fees shall be the sole responsibility of, and may only be charged to, the attorney or law firm maintaining the IOLTA account. Fees and charges shall not be assessed against or deducted from the principal of any IOLTA account. It is the intent of the Legislature that the State Bar develop policies so that eligible institutions do not incur uncompensated administrative costs in adapting their systems to comply with the provisions of Chapter 422 of the Statutes of 2007 or in making investment products available to IOLTA members.

(d) The attorney or law firm shall report IOLTA account compliance and all other IOLTA account information required by the State Bar in the manner specified by the State Bar.

(e) The eligible institution shall be directed to do all of the following:

(1) To remit interest or dividends on the IOLTA account, less reasonable fees, to the State Bar, at least quarterly.

(2) To transmit to the State Bar with each remittance a statement showing the name of the attorney or law firm for which the remittance is sent, for each account the rate of interest applied or dividend paid, the amount and type of fees deducted, if any, and the average balance for each account for each month of the period for which the report is made.

(3) To transmit to the attorney or law firm customer at the same time a report showing the amount paid to the State Bar for that period, the rate of interest or dividend applied, the amount of fees and service charges deducted, if any, and the average daily account balance for each month of the period for which the report is made.

(f) An eligible institution has no affirmative duty to offer or make investment products available to IOLTA customers. However, if an eligible institution offers or makes investment products available to non-IOLTA customers, in order to remain an IOLTA-eligible institution, it shall make those products available to IOLTA customers or pay an interest rate on the IOLTA deposit account that is comparable to the rate of return or the dividends generally paid on that investment product for similar customers meeting the same minimum balance and other requirements applicable to the investment product. If the eligible institution elects to pay that higher interest

rate, the eligible institution may subject the IOLTA deposit account to equivalent fees and charges assessable against the investment product.

(Amended by Stats. 2009, Ch. 129, Sec. 1. Effective January 1, 2010.)

6213. As used in this article:

(a) "Qualified legal services project" means either of the following:

(1) A nonprofit project incorporated and operated exclusively in California that provides as its primary purpose and function legal services without charge to indigent persons and that has quality control procedures approved by the State Bar of California.

(2) A program operated exclusively in California by a nonprofit law school accredited by the State Bar of California that meets the requirements of subparagraphs (A) and (B).

(A) The program shall have operated for at least two years at a cost of at least twenty thousand dollars (\$20,000) per year as an identifiable law school unit with a primary purpose and function of providing legal services without charge to indigent persons.

(B) The program shall have quality control procedures approved by the State Bar of California.

(b) "Qualified support center" means an incorporated nonprofit legal services center that has as its primary purpose and function the provision of legal training, legal technical assistance, or advocacy support without charge and which actually provides through an office in California a significant level of legal training, legal technical assistance, or advocacy support without charge to qualified legal services projects on a statewide basis in California.

(c) "Recipient" means a qualified legal services project or support center receiving financial assistance under this article.

(d) "Indigent person" means a person whose income is (1) 125 percent or less of the current poverty threshold established by the United States Office of Management and Budget, or (2) who is eligible for Supplemental Security Income or free services under the Older Americans Act or Developmentally Disabled Assistance Act. With regard to a project that provides free services of attorneys in private practice without compensation, "indigent person" also means a person whose income is 75 percent or less of the maximum levels of income for lower income households as defined in Section 50079.5 of the Health and Safety Code. For the purpose of this subdivision, the income of a person who is disabled shall be determined after deducting the costs of medical and other disability-related special expenses.

(e) "Fee generating case" means a case or matter that, if undertaken on behalf of an indigent person by an attorney in private practice, reasonably may be expected to result in payment of a fee for legal services from an award to a client, from public funds, or from the opposing party. A case shall not be considered fee generating if adequate representation is unavailable and any of the following circumstances exist:

(1) The recipient has determined that free referral is not possible because of any of the following reasons:

(A) The case has been rejected by the local lawyer referral service, or if there is no such service, by two attorneys in private practice who have experience in the subject matter of the case.

(B) Neither the referral service nor any attorney will consider the case without payment of a consultation fee.

(C) The case is of the type that attorneys in private practice in the area ordinarily do not accept, or do not accept without prepayment of a fee.

(D) Emergency circumstances compel immediate action before referral can be made, but the client is advised that, if appropriate and consistent with professional responsibility, referral will be attempted at a later time.

(2) Recovery of damages is not the principal object of the case and a request for damages is merely ancillary to an action for equitable or other nonpecuniary relief, or inclusion of a counterclaim requesting damages is necessary for effective defense or because of applicable rules governing joinder of counterclaims.

(3) A court has appointed a recipient or an employee of a recipient pursuant to a statute or a court rule or practice of equal applicability to all attorneys in the jurisdiction.

(4) The case involves the rights of a claimant under a publicly supported benefit program for which entitlement to benefit is based on need.

(f) "Legal Services Corporation" means the Legal Services Corporation established under the Legal Services Corporation Act of 1974 (P.L. 93-355; 42 U.S.C. Sec. 2996 et seq.).

(g) "Older Americans Act" means the Older Americans Act of 1965, as amended (P.L. 89-73; 42 U.S.C. Sec. 3001 et seq.).

(h) "Developmentally Disabled Assistance Act" means the Developmentally Disabled Assistance and Bill of Rights Act, as amended (P.L. 94-103; 42 U.S.C. Sec. 6001 et seq.).

(i) "Supplemental security income recipient" means an individual receiving or eligible to receive payments under Title XVI of the federal Social Security Act, or payments under Chapter 3 (commencing with Section 12000) of Part 3 of Division 9 of the Welfare and Institutions Code.

(j) "IOLTA account" means an account or investment product established and maintained pursuant to subdivision (a) of Section 6211 that is any of the following:

- (1) An interest-bearing checking account.
- (2) An investment sweep product that is a daily (overnight) financial institution repurchase agreement or an open-end money market fund.
- (3) An investment product authorized by California Supreme Court rule or order.

A daily financial institution repurchase agreement shall be fully collateralized by United States Government Securities or other comparably conservative debt securities, and may be established only with any eligible institution that is "well-capitalized" or "adequately capitalized" as those terms are defined by applicable federal statutes and regulations. An open-end money market fund shall be invested solely in United States Government Securities or repurchase agreements fully collateralized by United States Government Securities or other comparably conservative debt securities, shall hold itself out as a "money market fund" as that term is defined by federal statutes and regulations under the Investment Company Act of 1940 (15 U.S.C. Sec. 80a-1 et seq.), and, at the time of the investment, shall have total assets of at least two hundred fifty million dollars (\$250,000,000).

(k) "Eligible institution" means either of the following:

- (1) A bank, savings and loan, or other financial institution regulated by a federal or state agency that pays interest or dividends in the IOLTA account and carries deposit insurance from an agency of the federal government.
- (2) Any other type of financial institution authorized by the California Supreme Court.

(Amended by Stats. 2010, Ch. 328, Sec. 14. Effective January 1, 2011.)

6214. (a) Projects meeting the requirements of subdivision (a) of Section 6213 which are funded either in whole or part by the Legal Services Corporation or with Older American Act funds shall be presumed qualified legal services projects for the purpose of this article.

(b) Projects meeting the requirements of subdivision (a) of Section 6213 but not qualifying under the presumption specified in subdivision (a) shall qualify for funds under this article if they meet all of the following additional criteria:

- (1) They receive cash funds from other sources in the amount of at least twenty thousand dollars (\$20,000) per year to support free legal representation to indigent persons.
- (2) They have demonstrated community support for the operation of a viable ongoing program.

(3) They provide one or both of the following special services:

(A) The coordination of the recruitment of substantial numbers of attorneys in private practice to provide free legal representation to indigent persons or to qualified legal services projects in California.

(B) The provision of legal representation, training, or technical assistance on matters concerning special client groups, including the elderly, the disabled, juveniles, and non-English-speaking groups, or on matters of specialized substantive law important to the special client groups.

(Added by Stats. 1981, Ch. 789, Sec. 1.)

6214.5. A law school program that meets the definition of a "qualified legal services project" as defined in paragraph (2) of subdivision (a) of Section 6213, and that applied to the State Bar for funding under this article not later than February 17, 1984, shall be deemed eligible for all distributions of funds made under Section 6216.

(Added by Stats. 1984, Ch. 784, Sec. 2.)

6215. (a) Support centers satisfying the qualifications specified in subdivision (b) of Section 6213 which were operating an office and providing services in California on December 31, 1980, shall be presumed to be qualified support centers for the purposes of this article.

(b) Support centers not qualifying under the presumption specified in subdivision (a) may qualify as a support center by meeting both of the following additional criteria:

(1) Meeting quality control standards established by the State Bar.

(2) Being deemed to be of special need by a majority of the qualified legal services projects.

(Added by Stats. 1981, Ch. 789, Sec. 1.)

6216. The State Bar shall distribute all moneys received under the program established by this article for the provision of civil legal services to indigent persons. The funds first shall be distributed 18 months from the effective date of this article, or upon such a date, as shall be determined by the State Bar, that adequate funds are available to initiate the program. Thereafter, the funds shall be distributed on an annual basis. All distributions of funds shall be made in the following order and in the following manner:

(a) To pay the actual administrative costs of the program, including any costs incurred after the adoption of this article and a reasonable reserve therefor.

(b) Eighty-five percent of the funds remaining after payment of administrative costs allocated pursuant to this article shall be distributed to qualified legal services projects. Distribution shall be by a pro rata county-by-county formula based upon the number of persons whose income is 125 percent or less of the current poverty threshold per county. For the purposes of this section, the source of data identifying the number of persons per county shall be the latest available figures from the United States Department of Commerce, Bureau of the Census. Projects from more than one county may pool their funds to operate a joint, multicounty legal services project serving each of their respective counties.

(1) (A) In any county which is served by more than one qualified legal services project, the State Bar shall distribute funds for the county to those projects which apply on a pro rata basis, based upon the amount of their total budget expended in the prior year for legal services in that county as compared to the total expended in the prior year for legal services by all qualified legal services projects applying therefor in the county. In determining the amount of funds to be allocated to a qualified legal services project specified in paragraph (2) of subdivision (a) of Section 6213, the State Bar shall recognize only expenditures attributable to the representation of indigent persons as constituting the budget of the program.

(B) The State Bar shall reserve 10 percent of the funds allocated to the county for distribution to programs meeting the standards of subparagraph (A) of paragraph (3) and paragraphs (1) and (2) of subdivision (b) of Section 6214 and which perform the services described in subparagraph (A) of paragraph (3) of Section 6214 as their principal means of delivering legal services. The State Bar shall distribute the funds for that county to those programs which apply on a pro rata basis, based upon the amount of their total budget expended for free legal services in that county as compared to the total expended for free legal services by all programs meeting the standards of subparagraph (A) of paragraph (3) and paragraphs (1) and (2) of subdivision (b) of Section 6214 in that county. The State Bar shall distribute any funds for which no program has qualified pursuant hereto, in accordance with the provisions of subparagraph (A) of paragraph (1) of this subdivision.

(2) In any county in which there is no qualified legal services projects providing services, the State Bar shall reserve for the remainder of the fiscal year for distribution the pro rata share of funds as provided for by this article. Upon application of a qualified legal services project proposing to provide legal services to the indigent of the county, the State Bar shall distribute the funds to the project. Any funds not so distributed shall be added to the funds to be distributed the following year.

(c) Fifteen percent of the funds remaining after payment of administrative costs allocated for the purposes of this article shall be distributed equally by the State Bar to qualified support centers which apply for the funds. The funds provided to support centers shall be used only for the provision of legal services within California. Qualified support centers that receive funds to provide services to qualified legal services projects from sources other than this

article, shall submit and shall have approved by the State Bar a plan assuring that the services funded under this article are in addition to those already funded for qualified legal services projects by other sources.

(Amended by Stats. 1984, Ch. 784, Sec. 3.)

6217. With respect to the provision of legal assistance under this article, each recipient shall ensure all of the following:

- (a) The maintenance of quality service and professional standards.
- (b) The expenditure of funds received in accordance with the provisions of this article.
- (c) The preservation of the attorney-client privilege in any case, and the protection of the integrity of the adversary process from any impairment in furnishing legal assistance to indigent persons.
- (d) That no one shall interfere with any attorney funded in whole or in part by this article in carrying out his or her professional responsibility to his or her client as established by the rules of professional responsibility and this chapter.

(Added by Stats. 1981, Ch. 789, Sec. 1.)

6218. All legal services projects and support centers receiving funds pursuant to this article shall adopt financial eligibility guidelines for indigent persons.

(a) Qualified legal services programs shall ensure that funds appropriated pursuant to this article shall be used solely to defray the costs of providing legal services to indigent persons or for such other purposes as set forth in this article.

(b) Funds received pursuant to this article by support centers shall only be used to provide services to qualified legal services projects as defined in subdivision (a) of Section 6213 which are used pursuant to a plan as required by subdivision (c) of Section 6216, or as permitted by Section 6219.

(Added by Stats. 1981, Ch. 789, Sec. 1.)

6219. Qualified legal services projects and support centers may use funds provided under this article to provide work opportunities with pay, and where feasible, scholarships for disadvantaged law students to help defray their law school expenses.

(Added by Stats. 1981, Ch. 789, Sec. 1.)

6220. Attorneys in private practice who are providing legal services without charge to indigent persons shall not be disqualified from receiving the services of the qualified support centers.

(Added by Stats. 1981, Ch. 789, Sec. 1.)

6221. Qualified legal services projects shall make significant efforts to utilize 20 percent of the funds allocated under this article for increasing the availability of services to the elderly, the disabled, juveniles, or other indigent persons who are members of disadvantaged and underserved groups within their service area.

(Added by Stats. 1981, Ch. 789, Sec. 1.)

6222. A recipient of funds allocated pursuant to this article annually shall submit a financial statement to the State Bar, including an audit of the funds by a certified public accountant or a fiscal review approved by the State Bar, a report demonstrating the programs on which they were expended, a report on the recipient's compliance with the requirements of Section 6217, and progress in meeting the service expansion requirements of Section 6221.

The Board of Trustees of the State Bar shall include a report of receipts of funds under this article, expenditures for administrative costs, and disbursements of the funds, on a county-by-county basis, in the annual report of State Bar receipts and expenditures required pursuant to Section 6145.

(Amended by Stats. 2011, Ch. 417, Sec. 60. Effective January 1, 2012.)

6223. No funds allocated by the State Bar pursuant to this article shall be used for any of the following purposes:

- (a) The provision of legal assistance with respect to any fee generating case, except in accordance with guidelines which shall be promulgated by the State Bar.
- (b) The provision of legal assistance with respect to any criminal proceeding.
- (c) The provision of legal assistance, except to indigent persons or except to provide support services to qualified legal services projects as defined by this article.

(Added by Stats. 1981, Ch. 789, Sec. 1.)

6224. The State Bar shall have the power to determine that an applicant for funding is not qualified to receive funding, to deny future funding, or to terminate existing funding because the recipient is not operating in compliance with the requirements or restrictions of this article.

A denial of an application for funding or for future funding or an action by the State Bar to terminate an existing grant of funds under this article shall not become final until the applicant or recipient has been afforded reasonable notice and an opportunity for a timely and fair hearing. Pending final determination of any hearing held with reference to termination of funding, financial assistance shall be continued at its existing level on a month-to-month basis. Hearings for denial shall be conducted by an impartial hearing officer whose decision shall be final. The hearing officer shall render a decision no later than 30 days after the conclusion of the hearing. Specific procedures governing the conduct of the hearings of this section shall be determined by the State Bar pursuant to Section 6225.

(Added by Stats. 1981, Ch. 789, Sec. 1.)

6225. The Board of Trustees of the State Bar shall adopt the regulations and procedures necessary to implement this article and to ensure that the funds allocated herein are utilized to provide civil legal services to indigent persons, especially underserved client groups such as but not limited to the elderly, the disabled, juveniles, and non-English-speaking persons.

In adopting the regulations the Board of Trustees shall comply with the following procedures:

(a) The board shall publish a preliminary draft of the regulations and procedures, which shall be distributed, together with notice of the hearings required by subdivision (b), to commercial banking institutions, to members of the State Bar, and to potential recipients of funds.

(b) The board shall hold at least two public hearings, one in southern California and one in northern California where affected and interested parties shall be afforded an opportunity to present oral and written testimony regarding the proposed regulations and procedures.

(Amended by Stats. 2011, Ch. 417, Sec. 61. Effective January 1, 2012.)

6226. The program authorized by this article shall become operative only upon the adoption of a resolution by the Board of Trustees of the State Bar stating that regulations have been adopted pursuant to Section 6225 which conform the program to all applicable tax and banking statutes, regulations, and rulings.

(Amended by Stats. 2011, Ch. 417, Sec. 62. Effective January 1, 2012.)

6227. Nothing in this article shall create an obligation or pledge of the credit of the State of California or of the State Bar of California. Claims arising by reason of acts done pursuant to this article shall be limited to the moneys generated hereunder.

(Added by Stats. 1981, Ch. 789, Sec. 1.)

6228. If any provision of this article or the application thereof to any group or circumstances is held invalid, such invalidity shall not affect the other provisions or applications of this article which can be given effect without the invalid provision or application, and to this end the provisions of this article are severable.

(Added by Stats. 1981, Ch. 789, Sec. 1.)

TITLE 3. PROGRAMS AND SERVICES

Adopted July 2007

DIVISION 5. PROVIDERS OF PROGRAMS AND SERVICES

Chapter 2. Legal Services Trust Fund Program

Article 1. Administration of the Legal Services Trust Fund Program

Rule 3.660 Legal Services Trust Fund Commission

The Board of Trustees of the State Bar of California has established a Legal Services Trust Fund Commission ("Commission") to administer, in accordance with legal requirements and these rules ("Trust Fund Requirements"), revenue from IOLTA (Interest on Lawyers' Trust Accounts) and other funds remitted to the Legal Services Trust Fund Program of the State Bar.

Rule 3.660 adopted effective March 6, 2009; amended effective January 1, 2012.

Rule 3.661 Duties of the Legal Services Trust Fund Commission

- (A) The Commission must determine an applicant's eligibility for grants and notify each grant applicant that its application has been approved or denied. If the Commission tentatively approves an application, it issues a notice of the grant award, including the tentative allocation. If the notice requires submission of additional information, the Commission considers the application incomplete pending receipt of the information.
- (B) The Commission must monitor and evaluate a recipient's compliance with Trust Fund Requirements and grant terms. The evaluation may be based on
 - (1) application information, grant reports, and additional information reasonably necessary to determine compliance with Trust Fund Requirements;
 - (2) reasonable site visits scheduled upon adequate notice;
 - (3) an evaluation of a recipient by an impartial third party designated and funded by the Commission; or
 - (4) information from other sources, such as an evaluation provided by the Legal Services Corporation or other funding entity.
- (C) The Standards for the Provision of Civil Legal Aid adopted by the American Bar Association's House of Delegates on August 7, 2006, as limited by the general introduction to the standards, are the guidelines used by the Commission in

approving the quality control procedures and reviewing and evaluating the maintenance of quality service and professional standards of applicant and recipient programs. With due notice, the Commission may also rely on other standards that are consistent with law and generally accepted access to justice principles in the legal aid community.

- (D) The Commission may terminate a grant for noncompliance or take other action in accordance with Article 4 of this chapter.

Rule 3.661 adopted effective March 6, 2009.

Rule 3.662 Legal Services Trust Fund Commission membership and terms

The Commission consists of twenty-one voting members and three nonvoting judicial advisors. At least two members must be or have been within five years of appointment indigent persons as defined by statute.¹ No employee or independent contractor acting as a consultant to a potential recipient of Trust Fund grants may be appointed to the Commission.

- (A) The Board of Trustees appoints fourteen voting members, ten of whom must be licensees of the State Bar and four of whom must be public members who have never been admitted to the practice of law in any United States jurisdiction. Each member serves at the pleasure of the Board for a term of three years that begins and ends at the State Bar annual meeting. Upon completion of an initial term, the Board may reappoint a member for a second three-year term. The Board may extend an initial or second term by one or two years to allow a member to serve as chair or vice-chair.
- (B) The chair of the Judicial Council appoints seven voting members, five of whom must be licensees of the State Bar and two of whom must be public members, as well as three nonvoting judges, one of whom must be an appellate justice. Each member serves at the pleasure of the chair of the Judicial Council for a term of three years.
- (C) The Board of Trustees appoints voting members as chair and vice-chair.

Rule 3.662 adopted effective March 6, 2009; amended effective January 1, 2012; amended effective September 14, 2014; amended effective January 25, 2019.

Article 2. Construction of certain statutory provisions

Rule 3.670 Operation in California by qualified entities

- (A) A qualified legal services project is required by statute to be a nonprofit corporation operating exclusively in California or a program operated exclusively

¹ Business & Professions Code § 6213(d).

in California by a nonprofit law school accredited by the State Bar.² A qualified legal services project that is a California nonprofit corporation with operations outside California may be considered as meeting the statutory requirement if it otherwise meets Trust Fund Requirements and expends Trust Fund Program grant funds only in California.

- (B) A qualified support center is required by statute to be an incorporated nonprofit legal services center that provides through an office in California a significant level of legal support services to qualified legal services projects on a statewide basis.³

Rule 3.670 adopted effective March 6, 2009.

Rule 3.671 Primary purpose and function

- (A) A qualified legal services project is required by statute to have as its primary purpose and function providing legal services without charge to indigent persons.⁴ A qualified legal services project applying for Trust Fund Program funds is presumed to have such a purpose and function if 75% or more of the budget for the fiscal year for which it is seeking funds is designated to provide free legal services to indigents, and 75% or more of its expenditures for the most recent reporting year were incurred for such services. The calculation of 75% of expenditures may include a reasonable share of administrative and overhead expenses.
- (B) A qualified support center is required by statute to have as its primary purpose and function the provision of legal training, legal technical assistance, or advocacy support without charge.⁵ A qualified support center applying for funds is presumed to have such a primary purpose and function if 75% or more of its budget for the fiscal year for which it is seeking funds is designated to provide such support services, and 75% or more of its expenditures for the most recent reporting year were incurred for such services.
- (C) A qualified legal services project or qualified support center that does not meet the 75% test may nevertheless apply, provided that the applicant can satisfactorily demonstrate that it meets the primary purpose and function requirement by other means.

Rule 3.671 adopted effective March 6, 2009.

² Business & Professions Code § 6213(a).

³ Business & Professions Code § 6213(b).

⁴ Business & Professions Code § 6213(a)(1).

⁵ Business & Professions Code § 6213(b).

Rule 3.672 Delivery of legal services

- (A) “Legal services” include all professional services provided by a licensee of the State Bar and similar or complementary services of a law student or paralegal under the supervision and control of a licensee of the State Bar in accordance with law.⁶
- (B) “Legal support services” required by statute to be provided by a qualified support center include but are not limited to
 - (1) professional services to qualified legal services projects; and
 - (2) the direct provision of legal services to an indigent client of a qualified legal services project, provided the services are provided directly to the client
 - (a) as co-counsel with an attorney employed or recruited by a qualified legal services project; or
 - (b) at the request of an attorney employed or recruited by a qualified legal services project that is unable to assist the client.⁷

Rule 3.672 adopted effective March 6, 2009; amended effective January 25, 2019.

Rule 3.673 Permissible uses of funds

- (A) A qualified legal services project or qualified support center must use funds received under Business and Professions Code Section 6216 to provide legal assistance to indigent persons or qualified legal services projects as defined by statute.⁸ Reasonable administrative expenditures and overhead required to deliver such services meet the statutory requirement.
- (B) No recipient may use an allocation made under Business and Professions Code Section 6216 to provide services in a fee-generating case, except as described in Business and Professions Code Section 6213(e)(1)-(4). If a recipient determines that a case is not fee generating because it qualifies for a statutory exemption,⁹ the recipient must maintain records reflecting the facts that led to that conclusion and any action taken to confirm it. Client reimbursements of nominal costs or expenses are not considered fees. If attorney fees are generated in cases funded by Trust Fund Program grants, the fees must be used only for purposes

⁶ Business & Professions Code § 6213(a).

⁷ Business & Professions Code § 6213(b).

⁸ Business & Professions Code §§ 6216 and 6223.

⁹ Business & Professions Code § 6213(e)(1).

permitted by statute.¹⁰ Recipients must maintain complete records of all such fees.

Rule 3.673 adopted effective March 6, 2009.

Article 3. Applications and distributions

Rule 3.680 Application for Trust Fund Program grants

To be considered for a Trust Fund Program grant, a qualified legal services project or qualified support center seeking a Trust Fund Program grant must submit a timely and complete application for funding in the manner prescribed by the Commission. The applicant must agree to use any grant in accordance with grant terms and legal requirements.

- (A) A qualified legal services project must meet statutory criteria.
- (B) A qualified support center must agree to offer support services in two or more of the following ways: consultation, representation, information services, and training. The board of directors of the support center must establish priorities for providing such services after consulting with legal services attorneys and other relevant stakeholders.
- (C) A support center not in existence prior to December 31, 1980 must demonstrate that it is deemed to be of special need by a majority of qualified legal services projects in accordance with Trust Fund Program procedures. Upon request, the Commission must make available to the applicant a list of all the names and addresses of qualified legal services projects.
- (D) A nonprofit corporation that believes it meets the criteria for a qualified legal services project and qualified support center may submit two applications, one as a project and one as a support center, indicating in each application whether it is to be considered the primary or secondary application. The Commission will consider the secondary application only if the primary application is not approved. No applicant may receive a grant as a qualified legal services project and as a qualified support center.
- (E) An application must include
 - (1) an audited financial statement by an independent certified public accountant for the fiscal year that concluded during the prior calendar year. A financial review in lieu of an audited financial statement may be submitted by an applicant whose gross corporate expenditures were less than the amount specified in the Schedule of Charges and Deadlines;

¹⁰ Business & Professions Code § 6223.

- (2) information about the maintenance of quality service and professional standards and how the applicant maintains standards, such as internal quality control and review procedures; experience and educational requirements of attorneys and paralegals; supervisory structure, procedures, and responsibilities; job descriptions and current salaries for all filled and unfilled professional and management positions; and fiscal controls and procedures.
- (3) a budget and budget narrative, which must be submitted within thirty days of receipt of a notice of tentative allocation, explaining how funds will be used to provide civil legal services to indigent persons, especially underserved client groups such as, the elderly, the disabled, juveniles, and non-English-speaking persons within the applicant's service area; and
- (4) information about program activities, such as substantive practice areas, extent and complexity of services, a summary of litigation, and populations served.

Rule 3.680 adopted effective March 6, 2009; amended effective January 25, 2019.

Rule 3.681 Duties of Trust Fund Program grant recipient

The recipient of a Trust Fund Program grant must

- (A) use the grant in accordance with the terms of the grant agreement and Trust Fund Requirements;
- (B) maintain complete financial records, including budgets, to account for the receipt and expenditure of all grant funds and all income earned by a grant recipient from grant-supported activities, such as income from fees for services (including attorney fee awards and reimbursed costs), training, sales and rentals of real or personal property, and interest earned on grant amounts;
- (C) maintain records for five years after completion of services to a client regarding the eligibility of the client and promptly provide such records to the Commission for inspection upon demand;
- (D) annually submit information that describes, in the manner required by the Commission, the grant recipient's maintenance of quality service and professional standards and compliance with program requirements and, as requested by the Commission,
 - (1) information for evaluative purposes about program activities in the prior grant year; and
 - (2) information to enhance the delivery system of legal services;

- (E) cooperate regarding any reasonable site visit;
- (F) submit timely quarterly financial reports and any other information reasonably required by the Commission; and
- (G) pay any noncompliance fees set forth in the Schedule of Charges and Deadlines for processing documents that are substantially noncompliant with Trust Fund Requirements or that are late without permission.

Rule 3.681 adopted effective March 6, 2009.

Rule 3.682 No abrogation of legal or professional responsibilities

Nothing in these rules may limit or impair in any way the professional responsibility of an attorney to provide a client with legal services appropriate to the client's needs. Trust Fund Program applicants and recipients and their staffs; volunteers; consultants; and clients and prospective clients are entitled to all rights and privileges under the law. Nothing in these rules may be interpreted to require a grant applicant or recipient to violate the law.¹¹

Rule 3.682 adopted effective March 6, 2009.

Article 4. Requests for review and complaint process

Rule 3.690 Receipt of document

For purposes of this article, receipt of a document mailed by staff or the Commission is deemed to be the earlier of either five days after the date of mailing or is the actual time of receipt when staff or the Commission delivers a document physically by courier or otherwise.

Rule 3.690 adopted effective March 6, 2009.

Rule 3.691 Denial or termination of funding

- (A) The Commission has the authority to deny an application for initial funding or for renewal of funding, or to terminate existing funding in accordance with law and these rules.¹² The applicant or grant recipient is entitled to written notice of the denial or termination.
- (B) The applicant or grant recipient may request reconsideration by the Commission.

¹¹ Business & Professions Code § 6217(d).

¹² Business & Professions Code § 6224.

- (1) The request must be provided to the Commission in writing within thirty days of receipt of the notice of denial or termination of funding. The request may include additional information.
 - (2) The Commission may affirm its decision, modify its decision, or schedule an informal conference to be held within ninety days of receipt of the request. The applicant or recipient is entitled to written notice of the date, time and place of the conference, and must have an opportunity to present information at the conference.
 - (3) Unless all parties agree otherwise, the Commission must mail or otherwise deliver a written decision within sixty days of the conference.
- (C) Within thirty days of receipt of written notice of the Commission decision on the request for reconsideration, the applicant or grant recipient may file a request for review by the State Bar Court. The request must be submitted to the State Bar Court in accordance with the Rules of Procedure of the State Bar on Legal Services Trust Fund Proceedings. Pending a final decision by the State Bar Court, a current grant recipient must continue to receive funding.
- (D) The decision of the Commission on the request for reconsideration is final if the applicant or grant recipient fails to file a timely request for review by the State Bar Court.

Rule 3.691 adopted effective March 6, 2009.

Rule 3.692 Complaints

- (A) Any person or entity may file a formal written complaint that a grant recipient fails to meet Trust Fund Requirements.
- (B) Staff must provide a copy of a formal written complaint to the grant recipient whom it concerns and attempt to resolve the complaint. If the complaint is not resolved within ninety days after staff receives the complaint, staff must provide the Commission, complainant, and recipient with a written report of its efforts to resolve the complaint and recommendation of what action, if any, is appropriate.
- (C) Within thirty days of receipt of the staff report, the complainant and grant recipient may provide the Commission with a written response that may include additional information and may request review by the Commission.
- (D) Within a reasonable time, the Commission or a committee of its members appointed by the Commission must consider the staff report and any response. The Commission or committee must then dismiss the complaint or schedule an informal conference. The complainant and grant recipient are entitled to written notice of a dismissal or the date, time, and place of the conference.

- (E) At the informal conference, the staff member who conducted the investigation must be present barring extenuating circumstances. The complainant and grant recipient must have an opportunity to present information. The Commission must issue a written notice dismissing the complaint; requiring corrective action; or terminating funds. The complainant and recipient are entitled to written notice of the decision.
- (F) If the Commission or committee decides to dismiss the complaint, the decision is final.
- (G) If the Commission or committee decides to terminate funding, within thirty days of receipt of written notice of the decision the grant recipient may file a request for review by the State Bar Court. The request must be submitted to the State Bar Court in accordance with the Rules of Procedure of the State Bar on Legal Services Trust Fund Proceedings. Pending a final decision by the State Bar Court, a current grant recipient must continue to receive funding.
- (H) The decision of the Commission to terminate funding is final if the grant recipient fails to file a timely request for review by the State Bar Court.

Rule 3.692 adopted effective March 6, 2009.

ATTACHMENT B

Proposed Rule 3.671 Primary purpose and function

(A) A qualified legal services project is required by statute to have as its primary purpose and function providing legal services without charge to indigent persons.⁴ A qualified legal services project applying for Trust Fund Program funds is presumed to have such a purpose and function if 75% or more of the budget for the fiscal year for which it is seeking funds is designated to provide free legal services to indigents, and 75% or more of its expenditures for the most recent reporting year were incurred for such services. The calculation of 75% of expenditures may include a reasonable share of administrative and overhead expenses.

(B) A qualified support center is required by statute to have as its primary purpose and function the provision of legal training, legal technical assistance, or advocacy support without charge.⁵ A qualified support center applying for funds is presumed to have such a primary purpose and function if 75% or more of its budget for the fiscal year for which it is seeking funds is designated to provide such support services, and 75% or more of its expenditures for the most recent reporting year were incurred for such services.

(C) A qualified legal services project or qualified support center that does not meet the 75% test may nevertheless apply, provided that the applicant can satisfactorily demonstrate that it meets the primary purpose and function requirement by other means.

() When determining whether an applicant has demonstrated the necessary primary purpose and function, or when determining the budget and expenditures of the program under section 6216(b) of the Business and Professions Code, the following expenditures will be excluded or deducted as specified:

() Passthrough expenditures are transactions that meet any of the following criteria:

- 1) Funds received from an outside source under terms or conditions that require those funds to be paid out to a specified external sub-recipient or sub-recipients and which allow the applicant no discretion over who receives the funds or control over their execution of the funded work. If the applicant organization is claiming the expenditure as a passthrough under this criteria, administrative expenses may be counted as qualified expenditures if the services provided are considered qualifying under Subpart (A) [or (B)] above. If the services provided are not qualifying activities, then the expenses related to the management and disbursement of these funds must be deducted as non-qualifying expenditures; or
- 2) Funds received from an outside source under terms or conditions that require the applicant to identify sub-recipients for those funds and the amount of the funds each will receive, but without responsibility for the subrecipients' execution of the funded work. If the applicant organization is claiming the expenditure as a passthrough under this criteria, administrative expenses may be counted as qualified expenditures if the services provided are considered qualifying under Subpart (A) [or (B)] above. If the services provided are not qualifying

activities, then the expenses related to the management and disbursement of these funds must be deducted as non-qualifying expenditures; or

- 3) Funds received from an outside source pursuant to a fiscal sponsorship relationship where the applicant organization is providing funding to a sub-recipient that is an unincorporated entity unable to receive the funds directly. The applicant organization may or may not exercise oversight and control over the sub-recipient. If the applicant organization is claiming the expenditure as a passthrough under this criteria, administrative expenses may be counted as qualified expenditures if the services provided are considered qualifying under Subpart (A) [or (B)] above. If the services provided are not qualifying activities, then the expenses related to the management and disbursement of these funds must be deducted as non-qualifying expenditures; or
- 4) Funds received from an outside source under terms or conditions that require those funds to be paid out to assist individuals directly based on criteria set by the provider of the funds. The applicant may or may not exercise discretion or control over how the funds are distributed or how the individuals spend the funds. If the applicant organization is claiming the expenditure as a passthrough under this criteria, administrative expenses may be counted as qualified expenditures if the services provided are considered qualifying under Subpart (A) [or (B)] above. If the services provided are not qualifying activities, then the expenses related to the management and disbursement of these funds must be deducted as non-qualifying expenditures.

Passthrough expenditures shall not be considered part of an applicant's budget or expenditures when determining its primary purpose and function, nor when calculating grant allocations under subdivision (b) of section 6216 of the Business and Professions Code.

SUMMARY OF GRANTEE SURVEY ON PASSTHROUGH EXPENDITURES AND REVIEW OF 2019-2021 IOLTA / EAF APPLICATION DATA ON PASSTHROUGH EXPENDITURES AND SIMILAR DISBURSEMENTS

To gain better a better understanding of the impact of passthrough transactions and other similar disbursements, the State Bar conducted a survey of its grantees in January 2021 and analyzed data from three years of IOLTA / EAF applications. Survey results indicate that around 20 percent of qualified legal services providers (QLSPs), and around 40 percent of support centers (SCs) reported passthrough transactions. Application data indicates that QLSPs report proportionately fewer passthrough transactions than SCs but report higher expenditures for other similar disbursements, which are treated differently for eligibility and allocation purposes.

GRANTEE SURVEY ON PASSTHROUGH TRANSACTIONS

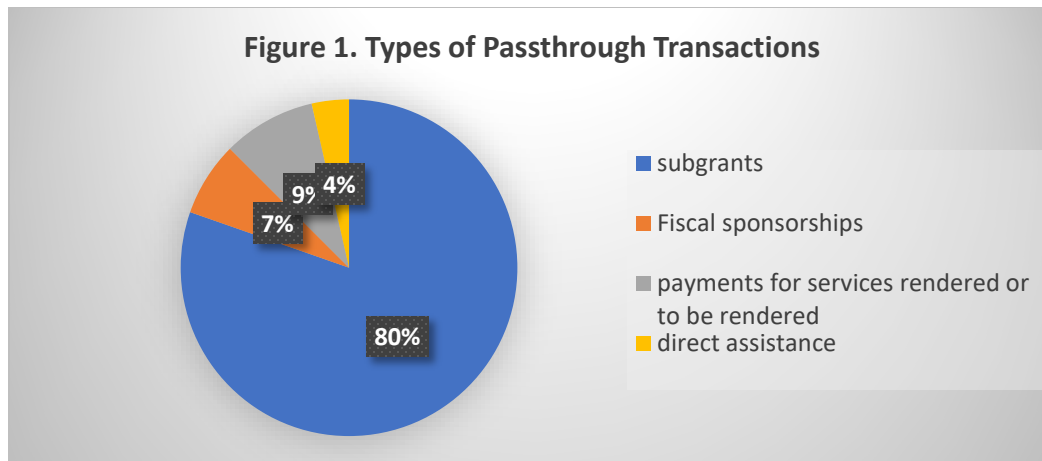
Grantees were asked to identify the total number and dollar value of all passthroughs, or transactions they considered similarly to a passthrough, appearing on their financial statements for their most recently completed fiscal year. For their five largest passthroughs, respondents were asked to identify the source of the funds, the subrecipient(s), and the type of transaction (such as subgrant or fiscal sponsorship, for example).

For this survey, “passthroughs” were defined as:

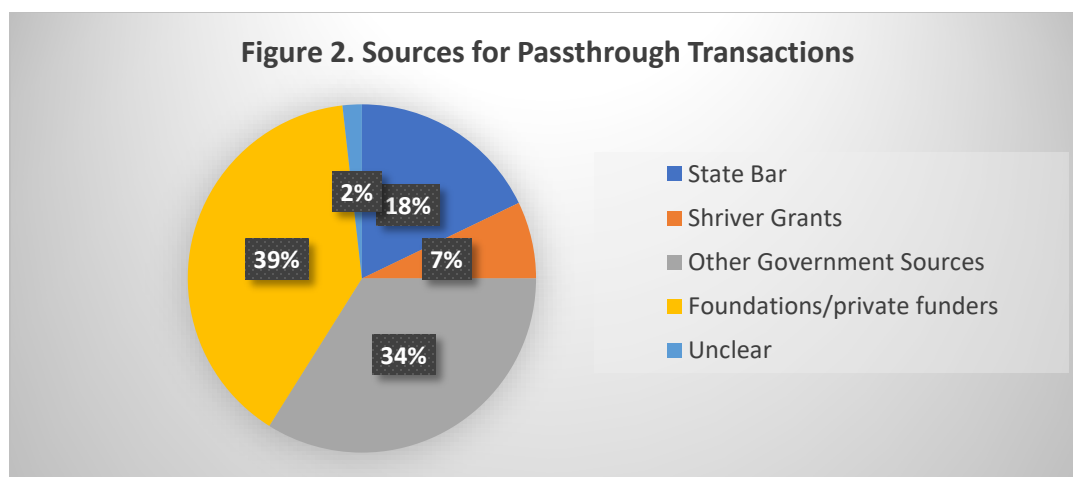
disbursements of funds that were provided by an unrelated external entity or entities, under restrictions that 1) required disbursement of the funds to a specified external Sub-Recipient or Sub-Recipients, 2) in a specified amount or pursuant to specified criteria, and 3) did not impose any duty on the Recipient, or allow the Recipient any control, regarding administration of or use of the funds after disbursement to the Sub-Recipient or Sub-Recipients.

Fifty-two organizations responded to the survey, with thirty-two reporting no passthroughs. The 20 respondents that reported at least one passthrough included 15 QLSPs, four SCs, and one organization that did not identify its type. They reported a total of 179 passthroughs and provided details for 54.

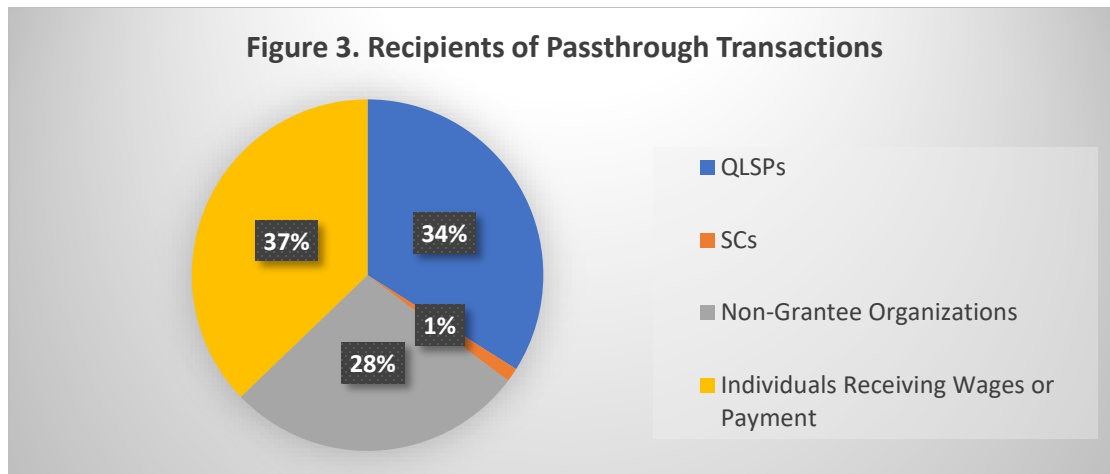
Passthrough transactions were predominantly described as subgrants (45 disbursements), followed by fiscal sponsorships (4) and direct client assistance grants (2). Additional transactions related to fellowships or payment for services (5).



Passthrough funding predominantly came from government sources: State Bar (10), Shriver Grants (4), or other local, state, or federal sources (19). Foundations and private sources provided funding for 22 passthroughs; one transaction's source of funding was unclear.



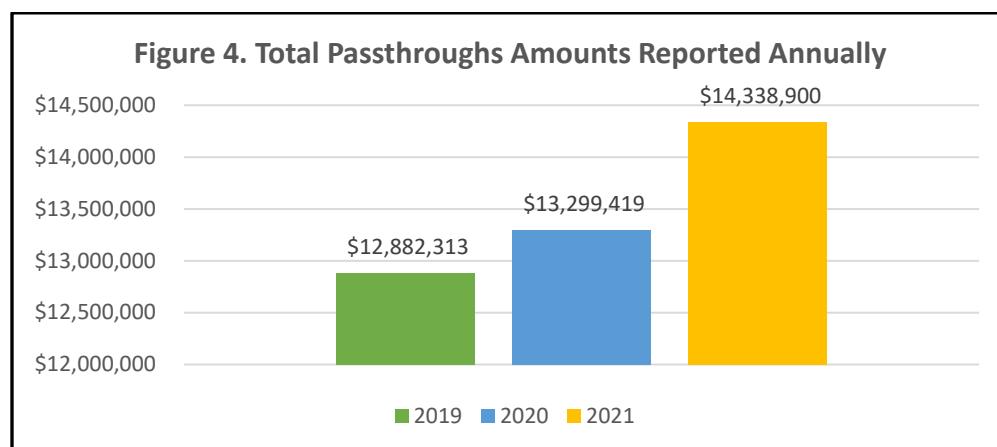
Many, but far from all, recipients of passthrough funding were IOLTA grantees: counting each transaction separately, recipients included QLSPs (53), SCs (2), non-grantee organizations (more than 43), and individuals who received funds as wages or payment (58), as well as an unspecified number of individuals who received direct cash assistance. The total exceeds the number of reported passthroughs received because some were disbursed to multiple sources. Note that Figure 3 below does not include direct assistance grants; two grantees reported disbursing direct assistance funds to clients, but survey responses did not include the number of individuals receiving these funds.



REVIEW OF 2019-2021 APPLICATION DATA

In 2018, the IOLTA / EAF application was revised to incorporate an exclusion for passthrough funds. Data from the first three years of applications submitted with this feature was analyzed for the amounts reported as passthroughs, as funds exchanged between two QLSPs; and payments to subcontractors itemized or identifiable as subgrants. Payments to subcontractors may be considered to be qualified expenditures for purposes of determining eligibility, but passthrough payments are excluded.

A total of 26 unduplicated organizations reported passthroughs on their applications. Most reported passthroughs in multiple years; new grantees and support centers were represented at higher rates than QLSPs. A total of \$40,520,632 was reported and excluded as passthrough expenditures over the review period, averaging around \$13.5 million annually.



Passthrough expenditures were reported by 17 QLSPs and 9 SCs, which is equal to about 22 percent of QLSPs and about 41 percent of SCs. Eight programs reported less than \$100,000 in

total passthrough payments over the three-year period; twelve reported between \$100,000 and \$500,000; five reported between \$1 million and \$3 million in passthroughs, and one reported nearly \$30,000,000.

Figure 5. Total Passthrough Amounts Reported by QLSPs and SCs, 2019-2021

Total Amount of Passthroughs Reported	Total Reporting	QLSPs	SCs
Less than \$50,000	3	2	1
\$50,000 to \$99,000	5	4	1
\$100,000 to \$199,999	4	3	1
\$200,000 to \$500,000	8	4	4
\$1 million to \$2 million	4	3	1
\$2 million to \$3 million	1	1	0
\$25 million to \$30 million	1	0	1
Totals	26	17	9

Over the three-year review period, QLSPs deducted almost the same amount as exchanged funds that SCs excluded as passthrough expenditures: \$31,727,285 and \$32,356,587, respectively - an approximately \$64 million variance.

Figure 6. Reported Passthroughs, Subgrant Contracts, and Exchanged Funds Amounts

	Passthroughs		Sub-Grant Sub-Contracts with QLSPs		Sub-Grant Sub-Contracts with Non-QLSPs		Exchanged Funds Deducted	
	Transactions	Total Value	Transactions	Total Value	Transactions	Total Value	Transactions	Total Value
SCs	18	\$32,356,587	0	\$ -	6	\$1,534,889		
QLSPs	35	\$8,164,045	25	\$18,319,060	40	\$11,461,842	62	\$31,727,285

Noteworthy

- SCs reported three times more passthroughs than subgrant subcontracts (18 passthroughs to 6 subgrant subcontracts); QLSPs reported about twice more subgrant subcontracts than passthroughs (65 subgrant subcontracts to 35 passthroughs).
- When two QLSPs have an exchanged funds transaction, one must deduct the expenditure for allocation purposes. Subcontract payments by a QLSP to a non-QLSP count both towards eligibility and for grant allocations.

AAPPLICATIONS AND EXAMPLES CHART, PASSTHROUGH EXPENDITURE RULE

Categorization of passthroughs depends on each transaction's unique facts and circumstances. The following examples illustrate some transactions that would meet the definition of the proposed passthrough rule.

Passthrough expenditures are transactions that meet any of the following criteria:

1) Funds received from an outside source under terms or conditions that require those funds to be paid out to a specified external sub-recipient or sub-recipients and which allow the applicant no discretion over who receives the funds or control over their execution of the funded work. If the applicant organization is claiming the expenditure as a passthrough under this criteria, administrative expenses may be counted as qualified expenditures if the services provided are considered qualifying under Subpart (A) [or (B)] above. If the services provided are not qualifying activities, then the expenses related to the management and disbursement of these funds must be deducted as non-qualifying expenditures; or	A funder issues a grant to the applicant for a medical-legal partnership that includes a specific amount to be paid to the medical partner organization. The applicant has no further control over the funds after paying its medical partner. This is a passthrough.
	The applicant has submitted a proposal with five other agencies to provide health care-related legal services statewide. The funding agreement specifies an allocation for each agency and directs the applicant to receive all the funding and disburse each agency's allocation. The applicant must also coordinate reporting to the funder from all the agencies, including information on how each one spent its allocation. This is a passthrough.
	A non-profit organization asks the applicant to provide it with fiscal support services for a fee, rather than hiring staff to manage those matters in-house. In this capacity as a fiscal agent, the applicant receives funds on the organization's behalf and pays funds on its instructions. This is a passthrough.
	A foundation funds the applicant's immigration-related services without restriction on how the funds are spent. The applicant decides to hire another organization to help it provide these services and pays them with a portion of these funds. This is an organizational expenditure, not a passthrough: the applicant was not required by the terms of the funding to hire a subcontractor.
2) Funds received from an outside source under terms or conditions that require the applicant to identify sub-recipients for those funds and the amount of the funds each will receive, but without responsibility for the subrecipients' execution of the funded work. If the applicant organization is claiming the expenditure as a passthrough under this criteria, administrative expenses may be counted as qualified expenditures if the services provided are considered qualifying under Subpart (A) [or (B)] above. If the services provided are not qualifying activities, then the expenses related to the management and disbursement of these funds must be deducted as non-qualifying expenditures; or	A foundation issues a grant to an applicant to support workplace safety advocacy, which includes funds set aside for subrecipients that conduct related work. The foundation requires the applicant to select the subrecipients and determine the amounts each will receive, but the applicant will have no further control over those funds after the subrecipients have been paid. This is a passthrough.
	A philanthropist asks the applicant, as an expert in the philanthropist's field of interest, to help provide specific funds to other organizations so they can be used in the selected field to the greatest effect. The applicant has no control over the funds after facilitating their disbursement to the recipient. This is a passthrough.
	An applicant allocates a portion of its assets to make grants to other organizations. This is an organizational expenditure, not a passthrough: the source of funds is internal. The organization's expenses incurred in the administration of these grants are non-qualified organizational expenditures.

3) Funds received from an outside source pursuant to a fiscal sponsorship relationship where the applicant organization is providing funding to a sub-recipient that is an unincorporated entity unable to receive the funds directly. The applicant organization may or may not exercise oversight and control over the sub-recipient. If the applicant organization is claiming the expenditure as a passthrough under this criteria, administrative expenses may be counted as qualified expenditures if the services provided are considered qualifying under Subpart (A) [or (B)] above. If the services provided are not qualifying activities, then the expenses related to the management and disbursement of these funds must be deducted as non-qualifying expenditures; or	<p>The applicant has been working with a community partner organization that has not yet formally incorporated. A foundation offers that organization a grant if the applicant serves as its fiscal sponsor. The applicant will not participate in the organization's execution of the funded work but accepts the funds on the organization's behalf and agrees to retain ultimate responsibility for them. This is a passthrough. If the partner organization is providing eligible services, the applicant's associated administrative costs are qualified expenditures.</p>
	<p>The applicant has a community development project and helps its clients organize into an independent advocacy group. The applicant applies for and receives a grant on behalf of the advocacy group and disburses the funds as directed by that group for its expenses on this project. The applicant provides technical and strategic advice to the advocacy group and must report on the use of the funds, but does not direct or control the funded activities. This is a passthrough.</p>
	<p>The applicant contributes a sum of its own funds toward the launch of a new organization that will continue work that the applicant had previously performed. This is not a passthrough.</p>
4) Funds received from an outside source under terms or conditions that require those funds to be paid out to assist individuals directly based on criteria set by the provider of the funds. The applicant may or may not exercise discretion or control over how the funds are distributed or how the individuals spend the funds. If the applicant organization is claiming the expenditure as a passthrough under this criteria, administrative expenses may be counted as qualified expenditures if the services provided are considered qualifying under Subpart (A) [or (B)] above. If the services provided are not qualifying activities, then the expenses related to the management and disbursement of these funds must be deducted as non-qualifying expenditures.	<p>An applicant contracts with the county to issue rental assistance payments to individuals at risk of homelessness. The county specifies eligibility criteria for these funds, and a maximum amount to be paid. Checks are issued directly to landlords. This is a passthrough.</p>
	<p>An applicant receives foundation support to help survivors of domestic violence who are experiencing homelessness with pre-loaded debit cards to pay for necessities of daily life. The foundation does not require the cards to be issued to the applicant's legal clients; the applicant sometimes gives cards to individuals for whom no other services can be provided. Legal clients must demonstrate that they used these funds for a purpose authorized by the funder; other recipients are exempt from this requirement. This is a passthrough regardless of whether the recipient was subject to reporting requirements.</p>
	<p>An applicant receives cy pres funds that are specified for health care uses, and spends the funds to purchase durable medical equipment for clients who cannot afford the equipment themselves. These are organizational expenditures: the applicant is spending its own funds as it chooses within a specified subject-matter area.</p>

Passthrough expenditures shall not be considered part of an applicant's budget or expenditures when determining its primary purpose and function, nor when calculating grant allocations under subdivision (b) of section 6216 of the Business and Professions Code.