



Date: June 16, 2023

To: Members, Legal Services Trust Fund Commission

From: Raul Duran, Assistant General Counsel  
Brady Dewar, Assistant General Counsel

Subject: Proposed Rules Related to Fee Generating Cases

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### EXECUTIVE SUMMARY

This memo is part of the continuing work of the Legal Services Trust Fund Commission (LSTFC) to revise the State Bar Rules for the Legal Services Trust Fund Program (Rules). The overarching goal of these revisions is to ensure accuracy, clarity, transparency, and consistency in grants administration for applicants, grantees, the LSTFC, and State Bar staff.

This memo presents the staff's recommendation for the LSTFC regarding clarification of the rules governing fee generating cases.

Specifically, this memo addresses:

- How to interpret the definition of "fee generating case" based on the relevant statute.
- A proposal for clarifying, but not substantively altering, the rule defining fee generating cases to align with similar federal law.
- A proposal for requiring recipients to self-certify the applicability of fee generating case exemptions.
- A proposal for addressing concerns about the recovery of attorneys' fees in exempt cases by clarifying the applicable rule.
- General guidance on when fee generating case exemption documentation requirements apply.

Staff circulated its recommendations to the legal aid community via the Legal Aid Association of California (LAAC) on March 29, 2023. This memo describes staff's recommendations, after

considering the community's feedback and the discussion at the LSTFC Rules Committee meeting on April 27, 2023.

## **CODIFICATION PROCESS**

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

For the proposed rules regarding fee generating cases, staff developed preliminary recommendations, which were circulated to the legal aid community through LAAC to obtain feedback. Staff and the LSTFC Rules Committee then considered the proposed rule and community feedback before making this final recommendation to the LSTFC.

## **GOVERNING AUTHORITIES**

Applicants and grantees must comply with requirements in the IOLTA statute, State Bar Rules and Appendices, Eligibility Guidelines for Legal Services Projects and Support Centers, General Grant Provisions, and Standards for Financial Management Systems and Audits. In particular, the IOLTA statute and rules govern which applicants qualify for funding, on what work grantees may spend their IOLTA/EAF dollars, and how much funding they will receive.

By statute, IOLTA/EAF funds may not be used for the provision of legal advice in a "fee generating case," except in accordance with guidelines set by the State Bar.<sup>1</sup> The Business and Professions Code defines a fee generating case as "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."<sup>2</sup>

If a grantee determines that payment of a fee may reasonably be expected to result from the representation, there are several statutory exemptions that nonetheless permit the expenditure of IOLTA funds where adequate representation is unavailable.<sup>3</sup> Those exemptions are as follows:

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<sup>1</sup> See Business and Professions Code § 6223(a).

<sup>2</sup> Fee-shifting cases, such as cases brought under the Equal Access to Justice Act, are considered fee-generating cases unless otherwise exempt.

<sup>3</sup> See Business and Professions Code § 6213(e)(1-4); see also State Bar Rule 3.673(b).

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.

Under State Bar Rules, if an IOLTA recipient determines that a case falls within one of the above exemptions, it must document the records reflecting the facts that led to that conclusion and any action taken to confirm it.<sup>4</sup> However, there is no requirement to submit that documentation to the State Bar and, in practice, the State Bar does not ask to inspect such records.

Under Business and Professions Code section 6213(e), the State Bar has the authority to set out guidelines for when IOLTA/EAF funds may be used in fee generating cases. However, at present, the State Bar Rules do not set out any such guidelines other than the record keeping mandate regarding exemptions.

### The Federal Analogue

The Federal Legal Services Corporation Act of 1974 (“LSCA”) created the Legal Services Corporation (“LSC”) to provide funding to civil legal aid services to the indigent. The LSCA

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<sup>4</sup> See State Bar Rules 3.673(b).

includes a similar prohibition on the use LSC funds “to provide legal assistance (except in accordance with guidelines promulgated by the [LSC]) with respect to any fee-generating case.”<sup>5</sup> LSC has implemented regulations governing fee generating cases and has stated that the purpose of the prohibition is “to ensure recipients do not use scarce legal services resources when private attorneys are available to provide effective representation.”<sup>6</sup>

The LSC rules include exemptions to the definition of fee generating cases that are nearly identical to those in the Business and Professions Code.<sup>7</sup>

In 1996, LSC amended its rules to clarify that the definition of fee generating cases “excluded situations where recipients undertake representation under a contract with a government agency or other entity and the agency or entity pays the recipient because a contract payment does not constitute fees that come from an award to a client or attorneys’ fees that come from the losing party in a case, or from public funds.”<sup>8</sup> To the extent the LSC imposes restrictions on the use of non-LSC funds, those restrictions address concerns that the LSC would indirectly subsidize prohibited categories of activities such as lobbying, prisoner litigation, and abortion.<sup>9</sup>

In 2017, LSC adopted a further revision to the definition of fee generating case. At the time, the definition was identical to the definition the State Bar presently uses. The 2017 revision was adopted to address the concern that “[a] reader could interpret ‘award’ as modifying only ‘to a client’ and not include an ‘award . . . from public funds or [an award] from the opposing party.’” The definition was therefore modified to read as follows: “Fee-generating case means any case or matter which, if undertaken on behalf of an eligible client by an attorney in private practice, reasonably may be expected to result in a fee for legal services from an award to a client.”<sup>10</sup>

The LSC also clarified the exemption where the recovery of damages is not the principal object of the case. It eliminated reference to “ancillary relief” and “counter claims” as needlessly complicated and revised the exemption to read as follows: “Recovery of damages is not the principal object of the recipient’s client’s case and substantial statutory attorneys’ fees are not likely to be available.” Along with this change, LSC included commentary that this exemption was meant to cover situations where the available fees are not sufficient to attract private counsel.<sup>11</sup>

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<sup>5</sup> See 42 U.S.C. 2996f(b)(1).

<sup>6</sup> See 45 CFR 1609.

<sup>7</sup> See 45 CFR 1609.3.

<sup>8</sup> 45 CFR 1609.2(b).

<sup>9</sup> 42 U.S.C. 2996i(c).

<sup>10</sup> 45 CFR 1609.2(a).

<sup>11</sup> 45 CFR 1609.3.

The LSC's regulations also govern how fund recipients must handle any recovered attorneys' fee. It mandates that any recovered attorneys' fees be proportionately allocated to the fund that supported the matter.<sup>12</sup>

## DISCUSSION

### Is it Fee Generating?

In a typical IOLTA/EAF fund application, it is relatively clear whether a case is fee generating. In practice, cases involving a contingency agreement or where the client is themselves paying for legal services are treated as falling within the definition of a Fee Generating Case.

However, over the years there have been select instances where questions have arisen about whether a case was in fact fee generating or if the case fell within an exemption. For example, awards to programs that have arrangements with public entity-third parties to pay for legal services (e.g., partnerships courts/judicial entities) have raised concerns whether such awards should be disallowed on the basis that the programs are receiving a fee from public funds. With the present opportunity to refine and/or clarify the rules, a question remains about whether such cases should be excluded moving forward.

#### 1. Grantee Example 1

Grantee Example 1 ("GE1") is a nonprofit family defense organization that provides free legal services to indigent parents, and some children, in a local juvenile dependency system. In connection with the representation it provides, GE1 receives partial funding through a contract with a judicial entity. In 2019, GE1's application was discussed during an LSTFC Eligibility & Budget Review Committee meeting for IOLTA and EAF funds for 2020. The committee discussed GE1's application and recommended IOLTA/EAF funds not be budgeted for representation in cases where GE1 had an existing contract. Ultimately, the committee never voted on the issue because GE1 withdrew its request and attributed the funds to a more clearly qualifying purpose before the committee's next meeting.

This example and the recommendation LSTFC adopted illustrate the ambiguity under the statute and current rules of whether this and other similar government funding partnerships run afoul of the prohibition of public fund expenditure in fee generating cases. However, a fair reading of the current definition of fee generating case would exclude the GE1 situation, at least if the LSC's clarifying approach, expressly adopted through its 2017 rule revision, is followed in interpreting the concept of fee generating case: The source of public funds in this case is not from **an award** of public funds.<sup>13</sup> Furthermore, as written, the definition of a fee

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<sup>12</sup> See 45 CFR 1609.4.

<sup>13</sup> See 45 CFR 1609.2(b).

generating case does not depend solely on the fee in fact being paid from “an award to a client, from public funds, or from the opposing party” but whether “at attorney in private practice” would reasonably expect to secure a fee from such sources. Although the GE1 situation involves compensation from “public funds” by virtue of its contract with the judicial entity, such funding source is not one a private attorney would reasonably expect to secure.

### Is it Exempt?

Business and Professions Code section 6213(e)(1) exempts fee generating cases where a free referral is not possible for various reasons. However, it is ambiguous how robust an assessment is required to claim the exemption and the justifications allowed by statute are somewhat subjective. For example, how would a fund recipient document that a case is one “that attorneys in private practice in the area ordinarily do not accept”<sup>14</sup> or that “[r]ecovery of damages is not the principal object of the case”?<sup>15</sup>

In practice, the State Bar has allowed recipients to self-determine and self-report the applicability of an exemption. The State Bar has not provided guidance on how a recipient should document that determination. A couple recent examples of how the State Bar handled the question of whether a case is fee generating and/or exempt are discussed below.

#### 1. Grantee Example 2

At a monitoring visit in 2022, the State Bar learned that about half of Grantee Example 2’s (“GE2”) revenue is derived from attorneys’ fees awarded in due process appeals in special education-related cases.

Under the Individuals with Disabilities in Education Act (“IDEA”), a parent of a child with a disability, who prevails on appeal to a state agency that a public school system has denied the child an appropriate education, can recover attorneys’ fees.<sup>16</sup> GE2’s staff have indicated that generating revenue through the recovery of attorneys’ fees is a significant focus in these cases. Indeed, the likelihood of recovering attorneys’ fees factors heavily in GE2’s decision about assuming representation of a client.

Given the organization’s years as a grantee, a decision was made to defer addressing any eligibility concerns until after the current codification process. When GE2’s eligibility is revisited, it should be evaluated in light of whether the available attorneys’ fees would be sufficient to attract private counsel. It may also be important to consider that the Section 6213

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<sup>14</sup> Business and Professions Code § 6213(e)(1)(C).

<sup>15</sup> Business and Professions Code § 6213(e)(2).

<sup>16</sup> See 20 U.S.C. § 1415(i)(3)(B)(i).

exemptions are alternatives. If GE2's cases are not exempt under section 6213(e)(2), that would not preclude that they would be exempt under the section 6213(e)(1-4) exemptions.

## 2. Grantee Example 3

In 2022, Grantee Example 3 ("GE3") contacted the State Bar with concerns about running afoul of the fee generating case rule. GE3 provides legal representation to indigent clients on issues concerning elder abuse. Under Welfare and Institutions Code section 15657.5, a plaintiff who prevails under a claim of elder abuse "shall" be awarded attorneys' fees. GE3's concern was that, in successful cases, their clients would automatically be entitled to attorneys' fees. However, the State Bar's determination was that this type of case was exempt as the fee generating aspect of the case was not the main objective of the representation<sup>17</sup> and because GE3 reported that attorneys in private practice would not typically assume this type of representation.<sup>18</sup>

### Reasonably Likely to Result in Payment of a Fees versus Exempt

An assessment of the applicability of the Business and Professions Code § 6213(e)(1-4) exemptions is only required if a grantee has first determined that a case "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."

After the April 27, 2023 Committee meeting, Staff circulated a questionnaire to the LAAC organizations about the factors they use to determine the threshold question of whether a case is reasonably likely to result in payment of a fee. The responses we received reflected that there may be some confusion about the appropriate fee generating case analysis. Certain responses mentioned factors appropriate to the applicability of an exemption rather than a determination of the threshold question of the probability of a fee. This distinction is significant because the documentation requirements of State Bar Rules 3.673(b) apply to the determination of exemptions.

Factors that should **not** be considered for the threshold question as they do not concern the probability of a fee:

- Whether the case involves a low anticipated recovery;
- Whether the cases is one in which a private for-profit attorney could not anticipate a fee substantial enough to compensate for time and costs;

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<sup>17</sup> See Bus. & Prof. Code § 6213(e)(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. . .")

<sup>18</sup> See Bus. & Prof. Code § 6213(e)(1)(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.")

Factors that can be considered when assessing the probability of a fee:

- The ability of a party to pay fees;
- Whether there is a statutory basis for fees;
- The type of relief sought;
- Whether a fee-shifting statute requires the plaintiff to meet a substantive standard to be eligible for fees;
- Whether, on the merits, fees are likely;
- Asking the prospective client or client their goals and assessing the facts of the case.
- Whether it is the type of case that a private attorney would take on a contingency basis.

## RECOMMENDATIONS

### 1. Clarifying the Definition of Fee Generating

To reduce the ambiguity of the definition of “fee generating case,” the State Bar should enact a rule consistent with the current statute to align the definition with the federal analogue in the LSCA. The language of a proposed revision to the rule is included in **Attachment A**.

Part of the feedback we received from LAAC involved concerns that the fee generating case definition would include fee-shifting cases such as those brought under the Equal Access to Justice Act and cases involving employment law and housing law claims. Such cases are indeed fee generating cases for purposes of the statute. In a fee-shifting case, where a plaintiff prevails, the defendant must pay the plaintiff’s attorneys’ fees and/or costs. Accordingly—under the plain meaning of both the original and proposed revision to the definition—fee-shifting cases are cases that “may reasonably result in the payment of fee from an award to a client, from public funds, or from the opposing party.”<sup>19</sup>

### 2. Requiring Self-Certification of Exemptions With State Bar Monitoring

The current version of Rule 3.673(b) requires only that recipients document their determinations that a case is an exempt fee generating case and to maintain records of all such fees. Given the lack of visibility into to how recipients are invoking these exemptions in practice, we initially considered recommending a revision to Rule 3.673(b) that would require recipients to submit their Rule 3.673(b) records along with their annual IOLTA/EDF application. However, the feedback we received from LAAC was that requiring recipients to document and assemble such records for every case would be administratively burdensome. Based on such concerns, State Bar staff considered and determined that recipient self-certification of compliance together with a focus during monitoring visits on how such exemptions are invoked would provide sufficient protection against improper exemption determinations. Accordingly,

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<sup>19</sup> Business and Professions Code § 6213.



we recommend instead that (1) recipients self-certify that any fee generating case receiving IOLTA/EAF funds is exempt, and (2) that the State Bar devote additional attention to how recipients invoke fee generating case exemptions during monitoring visits. Staff believes this approach will ensure compliance with the statute and avoid imposing undue administrative burden on grant recipients. For the proposed revision, see **Attachment A**.

As for determining the applicability of the Section 6123(e)(2) exemption, staff should consider evaluating whether the availability of attorneys' fees in a case would be sufficient to attract private counsel.

### 3. Clarifying the Appropriate Use of Recovered Attorneys' Fees

Both recent instances discussed above where there were concerns about the applicability of an exemption for fee generating cases involved those where the types of claims involved in the representation provided for the recovery of attorneys' fees.

At present, the State Bar rule governing the recovery attorneys' fees in exempt cases is unclear. Rule 3.673(b) states "[i]f attorney fees are generated in cases funded by Trust Fund Program grants, the fees must be used only for purposes permitted by statute." To clarify that such funds must only be used for the provision of legal services for the indigent, we propose revising Rule 3.673(b) to make such restriction explicit. For the proposed revision, see **Attachment A**.

### **FISCAL/PERSONNEL IMPACT**

None.

### **ATTACHMENTS**

Attachment A.

## Attachment A

### 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. 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, 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 permitted by statute~~ civil legal services to the indigent in California. Recipients must maintain complete records of all such fees. Recipients must certify, with their annual IOLTA/EAF application, that any fee generating case which received IOLTA/EAF funds is exempt.
- (c) Except as described in Business and Professions Code section 6213(e)(1)-(4), a fee-generating case means any case or matter which, if undertaken on behalf of an eligible client by an attorney in private practice, reasonably may be expected to result in a fee for legal services from an award to a client.