



# The State Bar of California

## **Rules 5.4 Financial and Similar Arrangements with Nonlawyers (Rule Approved by the Supreme Court, Effective November 1, 2018)**

- (a) A lawyer or law firm\* shall not share legal fees directly or indirectly with a nonlawyer or with an organization that is not authorized to practice law, except that:
  - (1) an agreement by a lawyer with the lawyer's firm,\* partner,\* or associate may provide for the payment of money or other consideration over a reasonable\* period of time after the lawyer's death, to the lawyer's estate or to one or more specified persons;\*
  - (2) a lawyer purchasing the practice of a deceased, disabled or disappeared lawyer may pay the agreed-upon purchase price, pursuant to rule 1.17, to the lawyer's estate or other representative;
  - (3) a lawyer or law firm\* may include nonlawyer employees in a compensation or retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement, provided the plan does not otherwise violate these rules or the State Bar Act;
  - (4) a lawyer or law firm\* may pay a prescribed registration, referral, or other fee to a lawyer referral service established, sponsored and operated in accordance with the State Bar of California's Minimum Standards for Lawyer Referral Services; or
  - (5) a lawyer or law firm\* may share with or pay a court-awarded legal fee to a nonprofit organization that employed, retained or recommended employment of the lawyer or law firm\* in the matter.
- (b) A lawyer shall not form a partnership or other organization with a nonlawyer if any of the activities of the partnership or other organization consist of the practice of law.
- (c) A lawyer shall not permit a person\* who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's independent professional judgment or interfere with the lawyer-client relationship in rendering legal services.
- (d) A lawyer shall not practice with or in the form of a professional corporation or other organization authorized to practice law for a profit if:
  - (1) a nonlawyer owns any interest in it, except that a fiduciary representative of a lawyer's estate may hold the lawyer's stock or other interest for a reasonable\* time during administration;
  - (2) a nonlawyer is a director or officer of the corporation or occupies a position of similar responsibility in any other form of organization; or

- (3) a nonlawyer has the right or authority to direct or control the lawyer's independent professional judgment.
- (e) The Board of Trustees of the State Bar shall formulate and adopt Minimum Standards for Lawyer Referral Services, which, as from time to time amended, shall be binding on lawyers. A lawyer shall not accept a referral from, or otherwise participate in, a lawyer referral service unless it complies with such Minimum Standards for Lawyer Referral Services.
- (f) A lawyer shall not practice with or in the form of a nonprofit legal aid, mutual benefit or advocacy group if the nonprofit organization allows any third person\* to interfere with the lawyer's independent professional judgment, or with the lawyer-client relationship, or allows or aids any person\* to practice law in violation of these rules or the State Bar Act.

### **Comment**

[1] Paragraph (a) does not prohibit a lawyer or law firm\* from paying a bonus to or otherwise compensating a nonlawyer employee from general revenues received for legal services, provided the arrangement does not interfere with the independent professional judgment of the lawyer or lawyers in the firm\* and does not violate these rules or the State Bar Act. However, a nonlawyer employee's bonus or other form of compensation may not be based on a percentage or share of fees in specific cases or legal matters.

[2] Paragraph (a) also does not prohibit payment to a nonlawyer third-party for goods and services provided to a lawyer or law firm;\* however, the compensation to a nonlawyer third-party may not be determined as a percentage or share of the lawyer's or law firm's overall revenues or tied to fees in particular cases or legal matters. A lawyer may pay to a nonlawyer third-party, such as a collection agency, a percentage of past due or delinquent fees in concluded matters that the third-party collects on the lawyer's behalf.

[3] Paragraph (a)(5) permits a lawyer to share with or pay court-awarded legal fees to nonprofit legal aid, mutual benefit, and advocacy groups that are not engaged in the unauthorized practice of law. (See *Frye v. Tenderloin Housing Clinic, Inc.* (2006) 38 Cal.4th 23 [40 Cal.Rptr.3d 221]; see also rule 6.3.) Regarding a lawyer's contribution of legal fees to a legal services organization, see rule 1.0, Comment [5] on financial support for programs providing pro bono legal services.

[4] This rule is not intended to affect case law regarding the relationship between insurers and lawyers providing legal services to insureds. (See, e.g., *Gafcon, Inc. v. Ponsor Associates* (2002) 98 Cal.App.4th 1388 [120 Cal.Rptr.2d 392].)

[5] Paragraph (c) is not intended to alter or diminish a lawyer's obligations under rule 1.8.6 (Compensation from One Other Than Client).

**NEW RULE OF PROFESSIONAL CONDUCT 5.4  
(Former Rules 1-310; 1-320; 1-600)  
Financial and Similar Arrangements with Nonlawyers**

**EXECUTIVE SUMMARY**

The Commission for the Revision of the Rules of Professional Conduct (“Commission”) reviewed and evaluated current rules 1-310 (Forming a Partnership With a Non-lawyer), 1-320 (Financial Arrangements With Non-Lawyers), and 1-600 (Legal Service Programs) in accordance with the Commission Charter. In addition, the Commission considered the national standard of the ABA counterpart which contains many of the concepts included in these three California rules in a single rule, Model Rule 5.4 (Professional Independence Of A Lawyer). The Commission also reviewed relevant California statutes, rules, and case law relating to issues addressed by the proposed rule. The result of the Commission’s evaluation is proposed rule 5.4 (Financial and Similar Arrangements with Nonlawyers).

**Rule As Issued For 90-day Public Comment**

The main issue considered when evaluating these rules was whether to retain the existing rules separately, or to recommend adoption of a single rule organized similar to ABA Model Rule 5.4. The recommendation is for a rule patterned on ABA Model Rule 5.4. The proposed rule gathers together in a single rule concepts that are intended to promote the independence of a lawyer’s professional judgment, as opposed to continuing to spread these concepts across three separate rules. The proposed rule should improve public protection by providing broader prohibitions on a lawyer’s conduct and on relationships into which a lawyer might enter that could pose a threat to the lawyer’s exercise of independent professional judgment. In addition, the proposed rule provides greater public protection by expanding upon current rule 1-310<sup>1</sup> through not only prohibiting a lawyer from forming a partnership with a nonlawyer, but also any other organization with a nonlawyer if any of the activities of the organization consist of the practice of law. Finally, the proposed rule should ensure California’s existing laws permitting lawyers to participate with governmental entities, legal services programs and certain other organizations continue to be honored.

Paragraph (a) prohibits a lawyer or law firm from sharing legal fees with a nonlawyer or with an organization that is not authorized to practice law. Paragraph (a) contains five subparagraphs providing guidance on the exceptions to the prohibition permitted under the rule. Paragraph (a) contains the substance of current rule 1-320(A).

Paragraph (b) prohibits a lawyer from forming a partnership or other organization with a nonlawyer if any of the activities of the partnership or organization consist of the practice of law. Paragraph (b) contains the substance of current rule 1-310 but, as stated above, expands upon the current rule by prohibiting a lawyer from forming any other organization, in addition to a partnership, with a nonlawyer to conduct the practice of law.

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<sup>1</sup> Current rule 1-310 (Forming a Partnership With a Non-Lawyer) provides:

A member shall not form a partnership with a person who is not a lawyer if any of the activities of that partnership consist of the practice of law.

Paragraph (c) prohibits a lawyer from allowing a person who recommends, employs, or pays the lawyer to provide legal services for another to interfere with either the lawyer's independent professional judgment or with the lawyer-client relationship in rendering legal services.

Paragraph (d) prohibits a lawyer from practicing law with or in the form of a professional corporation or other organization authorized to practice law for a profit if: (1) a nonlawyer owns any interest in it;<sup>2</sup> (2) a nonlawyer is a director or officer of the corporation or holds a similar position of responsibility in any other form of organization; or (3) a nonlawyer has the right or authority to direct or control the lawyer's independent professional judgment.

Paragraph (e) requires the Board of Trustees of the State Bar of California to formulate and adopt Minimum Standards for Lawyer Referral Services which are binding on lawyers in California. This paragraph also prohibits a lawyer from accepting a referral from, or otherwise participating in, a lawyer referral service unless it complies with the Minimum Standards for Lawyer Referral Services as adopted by the Board. Paragraph (e) contains the substance of current rule 1-600(B).

Paragraph (f) prohibits a lawyer from practicing law with or in the form of a nonprofit legal aid, mutual benefit, or advocacy group if such organization allows any third person or organization to interfere with the lawyer's independent professional judgment, or with the lawyer-client relationship, or helps any person or organization to practice law in violation of the Rules of Professional Conduct or the State Bar Act. Paragraph (f) contains the substance of current rule 1-600(A).

There are four comments to the rule. Comment [1] states that paragraph (a) does not prohibit a lawyer or law firm from paying a bonus to a nonlawyer employee so long as the arrangement does not interfere with the lawyer's independent professional judgment; however, the nonlawyer's compensation may not be based on a percentage or share of fees in specific cases or legal matters. Comment [2] states that paragraph (a) also does not prohibit payment to a nonlawyer third party for goods and services provided to the lawyer so long as the compensation is not determined as a percentage or share of the lawyer's overall revenues, or tied to fees in specific cases or legal matters. Comment [3] clarifies that paragraph (a)(5) permits sharing with or paying court-awarded legal fees to nonprofit legal aid, mutual benefit, and advocacy groups that are not engaged in the unauthorized practice of law. Comment [4]

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<sup>2</sup> Proposed paragraph (d)(1) contains a limited exception which states: "except for allowing a fiduciary representative of a lawyer's estate to hold the lawyer's stock or interest for a reasonable time during administration." This is consistent with State Bar Rule 3.157(C) and Business and Professions Code section 6171(a).

State Bar Rule 3.157(C): "The shares of a deceased shareholder must be sold or transferred to the law corporation or its shareholders within six months and one day following the date of death."

Bus. & Prof. Code § 6171(a):

With the approval of the Supreme Court, the State Bar may formulate and enforce rules and regulations to carry out the purposes and objectives of this article, including rules and regulations requiring all of the following:

- (a) That the articles of incorporation or bylaws of a law corporation shall include a provision whereby the capital stock of the corporation owned by a disqualified person (as defined in the Professional Corporation Act) or a deceased person shall be sold to the corporation or to the remaining shareholders of the corporation within such time as the rules and regulations may provide.

states that the rule is not intended to affect case law regarding the relationship between insurers and lawyer providing legal services to insureds.

### **Post-Public Comment Revisions**

After consideration of comments received in response to the initial 90-day public comment period, the Commission made no changes to the proposed rule and voted to recommend that the Board adopt the proposed rule.

The Board adopted proposed rule 5.4 at its November 17, 2016 meeting.

### **Supreme Court Action (May 10, 2018)**

The Supreme Court approved the rule as modified by the Court to be effective November 1, 2018. In paragraph (f), the terms “or organization” and “organization or group” were deleted. A new Comment [5] was added to explain that: “Paragraph (c) is not intended to alter or diminish a lawyer’s obligations under rule 1.8.6 (Compensation from One Other Than Client).”

Other nonsubstantive changes were implemented, including changes to conform to the California Style Manual.

**Rule 1-320** Rules 5.4 Financial and Similar Arrangements With Non-Lawyers with Nonlawyers

(Redline Comparison to the California Rule Operative Until October 31, 2018)

- (a) A lawyer or law firm\* shall not share legal fees directly or indirectly with a nonlawyer or with an organization that is not authorized to practice law, except that:
- ~~(A) Neither a member nor a law firm shall directly or indirectly share legal fees with a person who is not a lawyer, except that:~~
- ~~(1) An~~ an ~~agreement between a member and a law~~ by a lawyer with the lawyer's ~~firm,\* partner,\* or associate may provide for the payment of money or other consideration over a reasonable\* period of time after the member's~~ lawyer's ~~death, to the member's~~ lawyer's ~~estate or to one or more specified persons~~ over a reasonable period of time; or\*
  - ~~(2) A member or law firm undertaking to complete unfinished legal business of a deceased member may pay to the estate of the deceased member or other person legally entitled thereto that proportion of the total compensation which fairly represents the services rendered by the deceased member; or~~
  - (2) a lawyer purchasing the practice of a deceased, disabled or disappeared lawyer may pay the agreed-upon purchase price, pursuant to rule 1.17, to the lawyer's estate or other representative;
  - ~~(3) A member~~ a lawyer or law firm\* may include ~~non-member~~ nonlawyer employees in a compensation, ~~profit-sharing,~~ or retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement, ~~if such~~ provided the plan does not ~~circumvent~~ otherwise violate these rules or ~~Business and Professions Code section 6000 et seq.~~ the State Bar Act; or
  - ~~(4) A member~~ a lawyer or law firm\* may pay a prescribed registration, referral, or ~~participation~~ other fee to a lawyer referral service established, sponsored, and operated in accordance with the State Bar of ~~California's~~ California's Minimum Standards for ~~a Lawyer Referral Service in California.~~ Services; or
  - (5) a lawyer or law firm\* may share with or pay a court-awarded legal fee to a nonprofit organization that employed, retained or recommended employment of the lawyer or law firm\* in the matter.
- ~~(B) A member shall not compensate, give, or promise anything of value to any person or entity for the purpose of recommending or securing employment of the member or the member's law firm by a client, or as a reward for having made a recommendation resulting in employment of the member or the member's law~~

~~firm by a client. A member's offering of or giving a gift or gratuity to any person or entity having made a recommendation resulting in the employment of the member or the member's law firm shall not of itself violate this rule, provided that the gift or gratuity was not offered or given in consideration of any promise, agreement, or understanding that such a gift or gratuity would be forthcoming or that referrals would be made or encouraged in the future.~~

~~(C) A member shall not compensate, give, or promise anything of value to any representative of the press, radio, television, or other communication medium in anticipation of or in return for publicity of the member, the law firm, or any other member as such in a news item, but the incidental provision of food or beverage shall not of itself violate this rule.~~

### ~~Rule 1-310 Forming a Partnership With a Non-Lawyer~~

~~(b) A member~~lawyer shall not form a partnership or other organization with a ~~person who is not a lawyer~~nonlawyer if any of the activities of ~~that~~the partnership or other organization consist of the practice of law.

### ~~Rule 1-600 Legal Service Programs~~

~~(A) A member shall not participate in a nongovernmental program, activity, or organization furnishing, recommending, or paying for legal services, which allows any third person or organization to interfere with the member's independence of professional judgment, or with the client-lawyer relationship, or allows unlicensed persons to practice law, or allows any third person or organization to receive directly or indirectly any part of the consideration paid to the member except as permitted by these rules, or otherwise violates the State Bar Act or these rules.~~

~~(c) A lawyer shall not permit a person\* who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's independent professional judgment or interfere with the lawyer-client relationship in rendering legal services.~~

~~(d) A lawyer shall not practice with or in the form of a professional corporation or other organization authorized to practice law for a profit if:~~

~~(1) a nonlawyer owns any interest in it, except that a fiduciary representative of a lawyer's estate may hold the lawyer's stock or other interest for a reasonable\* time during administration;~~

~~(2) a nonlawyer is a director or officer of the corporation or occupies a position of similar responsibility in any other form of organization; or~~

~~(3) a nonlawyer has the right or authority to direct or control the lawyer's independent professional judgment.~~

~~(B)~~(e) The Board of ~~Governors~~Trustees of the State Bar shall formulate and adopt Minimum Standards for Lawyer Referral Services, which, as from time to time amended, shall be binding on ~~members~~lawyers. A lawyer shall not accept a referral from, or otherwise participate in, a lawyer referral service unless it complies with such Minimum Standards for Lawyer Referral Services.

(f) A lawyer shall not practice with or in the form of a nonprofit legal aid, mutual benefit or advocacy group if the nonprofit organization allows any third person\* to interfere with the lawyer's independent professional judgment, or with the lawyer-client relationship, or allows or aids any person\* to practice law in violation of these rules or the State Bar Act.

### **Discussion**Comment

[1] Paragraph (a) does not prohibit a lawyer or law firm\* from paying a bonus to or otherwise compensating a nonlawyer employee from general revenues received for legal services, provided the arrangement does not interfere with the independent professional judgment of the lawyer or lawyers in the firm\* and does not violate these rules or the State Bar Act. However, a nonlawyer employee's bonus or other form of compensation may not be based on a percentage or share of fees in specific cases or legal matters.

[2] Paragraph (a) also does not prohibit payment to a nonlawyer third-party for goods and services provided to a lawyer or law firm;\* however, the compensation to a nonlawyer third-party may not be determined as a percentage or share of the lawyer's or law firm's overall revenues or tied to fees in particular cases or legal matters. A lawyer may pay to a nonlawyer third-party, such as a collection agency, a percentage of past due or delinquent fees in concluded matters that the third-party collects on the lawyer's behalf.

[3] Paragraph (a)(5) permits a lawyer to share with or pay court-awarded legal fees to nonprofit legal aid, mutual benefit, and advocacy groups that are not engaged in the unauthorized practice of law. (See *Frye v. Tenderloin Housing Clinic, Inc.* (2006) 38 Cal.4th 23 [40 Cal.Rptr.3d 221]; see also rule 6.3.) Regarding a lawyer's contribution of legal fees to a legal services organization, see rule 1.0, Comment [5] on financial support for programs providing pro bono legal services.

[4] This rule is not intended to affect case law regarding the relationship between insurers and lawyers providing legal services to insureds. (See, e.g., *Gafcon, Inc. v. Ponsor Associates* (2002) 98 Cal.App.4th 1388 [120 Cal.Rptr.2d 392].)

[5] Paragraph (c) is not intended to alter or diminish a lawyer's obligations under rule 1.8.6 (Compensation from One Other Than Client).



~~*[Discussion paragraph for Rule 1-320]*~~

~~Rule 1-320(C) is not intended to preclude compensation to the communications media in exchange for advertising the member's or law firm's availability for professional employment.~~

~~*[Discussion paragraph for Rule 1-310]*~~

~~Rule 1-310 is not intended to govern members' activities which cannot be considered to constitute the practice of law. It is intended solely to preclude a member from being involved in the practice of law with a person who is not a lawyer.~~

~~*[Discussion paragraph for Rule 1-600]*~~

~~The participation of a member in a lawyer referral service established, sponsored, supervised, and operated in conformity with the Minimum Standards for a Lawyer Referral Service in California is encouraged and is not, of itself, a violation of these rules.~~

~~Rule 1-600 is not intended to override any contractual agreement or relationship between insurers and insureds regarding the provision of legal services.~~

~~Rule 1-600 is not intended to apply to the activities of a public agency responsible for providing legal services to a government or to the public.~~

~~For purposes of paragraph (A), "a nongovernmental program, activity, or organization" includes, but is not limited to group, prepaid, and voluntary legal service programs, activities, or organizations.~~