

REVISED DRAFT REPORT

**REPORT
OF THE STATE BAR OF CALIFORNIA
TO THE SUPREME COURT OF CALIFORNIA
REGARDING NONPROFIT ENTITY LEGAL PRACTICE
IN RESPONSE TO THE SUPREME COURT'S REFERRAL
TO THE STATE BAR IN
FRYE v. TENDERLOIN HOUSING CLINIC, INC. (2006) 38 Cal.4th 23**



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**I.
SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS**

Nonprofit organizations address a critical role in the administration of justice providing access to justice for the economically disadvantaged and allowing the advancement of expressive and associational rights, all in furtherance of the public interest.

This report responds to the California Supreme Court's referral of this matter to the State Bar of California (State Bar), requesting the State Bar to conduct a study of law practice by nonprofit organizations in California and report back to the Court as to whether enhanced registration or regulatory standards in this area are warranted to protect the public interest.

Nonprofit organizations address a critical role in the administration of justice providing access to justice for the economically disadvantaged and allowing the advancement of expressive and associational rights all in furtherance of the public interest. Based upon its study, the State Bar concludes that there is no evidence that nonprofit corporations actually imperil client interests and, accordingly, there is no justification for changing at this time the exemption nonprofits enjoy from the public protection standards established for other practice contexts. The State Bar does not recommend that the Court implement any new regulations directed at the profit of law by nonprofit corporations. At most, the State Bar would recommend that nonprofit law corporations be required to register as such with the State Bar.

The State Bar defers to the Supreme Court as to whether the conclusions and recommendations in this report warrant further study.

**II.
PROCEDURAL BACKGROUND**

On March 9, 2006, the California Supreme Court issued its decision in *Frye v. Tenderloin Housing Clinic, Inc.* (2006) 38 Cal.4th 23, 40 Cal.Rptr.3d 221, holding that nonprofit public benefit corporations (including legal aid societies, public interest advocacy organizations and mutual benefit entities) providing legal services to the public are not bound by existing statutes and rules governing for-profit professional corporations and limited liability partnerships engaged in the practice of law in California.

In conjunction with this holding, the Supreme Court also recognized that, under its

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plenary authority to regulate the practice of law in California, it could impose registration, certification and other requirements upon nonprofit law practices if necessary to fulfill the Court's responsibility to regulate the practice of law in California. The Court indicated that it would consider enhanced regulation in this area only if the proposed regulatory standards addressed a demonstrated danger of injury to the public and appropriately balanced the First Amendment expressive and associational rights the Court found applicable to nonprofit law practices. [*Id.*, at pp. 50-54].

The Court referred the matter to the State Bar to conduct a study and report back to the Court as to whether enhanced regulation of nonprofit law practices is warranted. The Supreme Court's directive to the State Bar was as follows:

"In view of the State Bar's experience in regulating the practice of law, its knowledge of the practical problems presented by various forms of law practice, and its ability to seek information and recommendations from the legal community and other interested persons, we believe the matter should be referred to the State Bar for further study, followed by a report and specific recommendations to this court. After appropriate study and specific recommendations from the State Bar, we shall consider the implementation of carefully drawn regulations directed at the practice of law by nonprofit corporations, if such regulations meet a demonstrated danger of injury to clients without impairing First Amendment expressive and associational rights."

[*Id.*, at p. 50.]

The Court further stated:

"Our dominant concern when we adopted the general rule prohibiting corporations from employing attorneys to represent third parties was to protect clients from conflicts of interest that we viewed as inevitably flowing from the profit motive with which corporations are imbued. The profit motive being absent in the case of nonprofit corporations, it may be that additional regulation of groups such as THC is not needed. It is incumbent upon the State Bar to study whether groups such as THC *actually* imperil client interests despite the absence of a profit motive, and to consider how such a danger, if it exists, may be mitigated by regulations consistent with First Amendment principles. Specifically, such regulations must reasonably accommodate the expressive and associational interests of nonprofit organizations and their members."

[*Id.*, at pp. 50-51 (*italics in original*).] The Court charged the State Bar with evaluating the benefits and detriments of a regulatory structure for nonprofit entities, balanced against their First Amendment expressive and associational protections. [*Id.*, at p. 54.]

Following is the State Bar of California's study, report, conclusions and recommendations to the Supreme Court as approved by the State Bar's Board of Governors.

III.
HISTORICAL BACKGROUND ON THE REGISTRATION/CERTIFICATION
OF PROFESSIONAL LAW CORPORATIONS IN CALIFORNIA

A.
The Background of Registration/Certification of
For-Profit Professional Law Corporations

The State Bar's existing for-profit law corporation registration/certification program is essentially a "safe harbor" for registered corporations allowing them to practice in a form that would otherwise be prohibited by the corporate practice doctrine. Failure to register results in the loss of the protections of the "safe harbor," including the protections the corporate form provides.

The State Bar currently registers and certifies for-profit professional law corporations consistent with Corporations Code sections 13400 *et seq.*, Business and Professions Code sections 6160 *et seq.* and the State Bar's Law Corporation Rules. [Law Corporation Rules, Appendix 1-1]. Over time, the law corporation registration/certification program has become less of a regulatory program entitling the corporation to "practice law" and more of a "safe harbor" for those within registered entities to practice law. Registration allows those within registered law corporations and limited liability partnerships to practice in a form that would otherwise be prohibited by the corporate practice doctrine. Failure to comply with the registration/certification requirements results in the loss to those within the entity of the "safe harbor" rather than in an affirmative State Bar noncompliance action.

When originally confronted with the concept of corporations employing attorneys to render legal services to the public, courts developed the corporate practice doctrine holding that corporations could neither practice law nor employ lawyers to render legal services to the public. [*Frye v. Tenderloin Housing Clinic, Inc.*, *supra*, 38 Cal.4th at pp. 37-38; *People v. Merchants Protective Corp.* (1922) 189 Cal. 531, 537-38, 540, 209 P. 363; *Hildebrand v. State Bar* (1950) 36 Cal.2d 504, 509-510, 225 P.2d 508].

The corporate practice doctrine was based upon the nature of the attorney-client relationship, predicated as it is, upon the individualized duty of loyalty, confidentiality, and fidelity between lawyer and client. Incorporation was viewed as having a dilutive effect upon these duties by allowing law to be practiced through an intervening corporate entity that is itself a legal "person" unlicensed to practice law. [*People v. Merchants Protective Corp.*, *supra*, 189 Cal. at p. 539; *People v. California Protective Corp.* (1926) 76 Cal.App. 354, 360, 244 P. 1089; *Gafcon, Inc. v. Ponsor & Associates* (2002) 98 Cal.App.4th 1388, 1407-11, 120 Cal.Rptr.2d 392.

The corporation, as a form of professional practice, is different from other forms of practice in that it is a distinct entity under the law, apart from those who operate through it. [1 Organizing Corporations in Cal. (Cont.Ed.Bar 3d ed. 2001) Alter Ego and Adequate Capitalization § 1A.1, p. 162.] A key benefit of incorporation, distinct from the partnership, association or sole proprietorship as a form of practice, is that the corporation's employees, officers, shareholders and directors are not personally liable

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for the obligations and liabilities of each other or of the corporation. [*ibid.*] This also is a distinguishing characteristic of the relatively new limited liability partnership (LLP) as a form of practice. The defining characteristic of the LLP is the elimination of vicarious liability of partners for partnership debts. [1 Organizing Corporations in Cal., *supra*, Considerations Before Incorporation at § 1.91, p. 73; (a limited liability partnership is “shielded” from error and omission claims related to the practice of law when registered and certified by the State Bar.)].

The individual lawyer representing client interests is always subject to the regulation of the State Bar. When practicing as a sole proprietor, in an association or partnership, the individual lawyer’s responsibilities and liabilities flow directly to and from the client. However, incorporation creates a separate legal entity between lawyer and client that is intended to “shield” corporate employees from corporate liabilities, tax requirements, and other business obligations. [2 Organizing Corporations in Cal. (Cont.Ed. Bar 3d ed. 2001) Professional Corporations § 6.5 pp. 723-24]. As law practice in the corporate form became accepted, the need arose to assure that the corporate “shield” against liabilities did not also limit the professional responsibilities attorneys had to the public and to clients regardless of their form of practice.

This was accomplished through the development of what has evolved into “safe harbor” requirements. To reach the “safe harbor,” the corporation must assure that 1) the corporate entity is bound by all the duties and responsibilities of the individual attorneys practicing through it [Bus. & Prof. Code § 6167; Corp. Code § 13410; State Bar Law Corp. Rules, rule IV.A.8]; the corporate entity maintains errors and omissions (malpractice) insurance so that liability for professional errors and omissions is not eliminated or limited by incorporation [Bus. & Prof. Code § 6171; State Bar Law Corp. Rules, rule IV.A.7]; independence of professional judgment is not eroded by nonattorney control of the corporate entity [Rules Prof.Conduct, rule 1-600; Bus. & Prof. Code § 6165; Corp. Code § 13405; State Bar Law Corp. Rules, rule IV.A.2.]

The original articulation of the corporate practice doctrine required law corporations to register and be certified *to practice law*, separate and distinct from the attorneys within it. [Bus. & Prof. Code § 6160 (once registered, a law corporation is “entitled to practice law.”)] This led to the assumption that a professional law corporation that failed to properly register not only lost the protections of the “safe harbor,” but also was engaged in the unauthorized practice of law, an unlawful act under Business and Professions Code sections 6125 *et seq.*, subject to prosecution.

This perspective was advanced by parties in disputes with lawyers and professional law corporations. In *Cappiello, Hoffman & Katz v. Boyle* (2001) __ Cal.App.4th __; 105 Cal.Rptr.2d 147, a case ordered decertified from publication by the Supreme Court July 11, 2001 [see, Cal. Rules Court, rule 8.1115], the Court of Appeal held that, absent registration with the State Bar, a professional law corporation providing legal services to the public is engaged in the unauthorized practice of law, a misdemeanor under Business and Professions Code section 6126.

The depublication of *Cappiello* rendered it uncitable as legal precedent. *Cappiello* was followed two years later by *Olson v. Cohen* (2003) 106 Cal.App.4th 1209, 131

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Cal.Rptr.2d 620. As observed in *Olson*, the decision to incorporate as a professional corporation is made to obtain certain business benefits for the professionals operating through the corporation, such as tax advantages and limits on personal liability for corporate debts. Incorporation is not undertaken for the protection or benefit of clients or the public. Failure to perfect the corporate structure through registration results in the loss of the protections afforded by the corporate form. It does not render acts of properly licensed professionals through the corporation unlawful, voidable, uncompensable or otherwise flawed. It simply removes from those within the corporation the business benefits sought by incorporation. [*Id.*, at p. 1215].

This *Olson* case was followed by *Frye v. Tenderloin Housing Clinic, Inc.* in 2004. In *Frye*, the Court of Appeal viewed law corporation registration more from perspective of *Cappiello* than of *Olson*, and was reversed by the Supreme Court. [*Frye v. Tenderloin Housing Clinic, Inc.*, *supra*, 38 Cal.4th 23].

The Court of Appeals decision in *Frye* was followed by *Garber & Associates v. Eskandarian* (2007) 150 Cal.4th 813, 59 Cal.Rptr.3d.1. The Court of Appeal in *Garber* relied upon *Olson* and found, in relevant part:

“As the court explained in *Olson v. Cohen*, *supra*, 106 Cal.App.4th at pages 1215-1216, incorporation as a professional corporation is not undertaken for the protection of clients [footnote and citation to *Cohen* omitted], nor does the fact a law firm is not registered as a professional corporation amount to the unauthorized practice of law. Contrary to appellants’ claim that the holding of *Olson* is ‘limited to the facts of the case,’ *Olson* took into consideration broad questions of policy [footnote omitted] and concluded that the failure to register as a professional corporation should not have, and does not have, an impact on attorney fees. Given the purposes of registration as a professional corporation, we think that this conclusion is eminently sound.”

[*Id.*, at 820; Italics in original].

Consistent with the “safe harbor” concept, the State Bar does not affirmatively seek to identify uncertified corporations for prosecution or penalty. Nor, under current legal trends, does the lack of certification constitute the unauthorized practice of law, invalidate contracts, nor bar collection of attorney fees. In return for compliance with registration requirements, registrants enter the “safe harbor” that allows them to practice in their chosen form, otherwise barred by the corporate practice doctrine. The registration requirements address inconsistencies between incorporation and professional standards. The consequence of failing to register is the loss of the “safe harbor,” including the benefits offered by the corporate form of practice. [See, *Olson v. Cohen*, *supra*, 106 Cal.App.4th at p. 1215]

B.
**The Development of Nonprofit
Professional Law Corporations**

The Professional Corporations Act [Corp. Code §§ 13400 *et seq.*], focused upon private, for-profit, law firms practicing in the corporate form and did not address nonprofit entities practicing law for the public interest. These nonprofit organizations consist of legal aid societies, public interest advocacy organizations (*e.g.*, the American Civil Liberties Union, National Association for the Advancement of Colored People, Pacific Legal Foundation) and mutual benefit associations (*e.g.*, trade unions) that have provided legal services to the public through a variety of business forms for decades, and continued to do so without change after the enactment of the Professional Corporations Act.

In 1972, the California Attorney General was called upon to opine as to whether these nonprofit entities could continue to engage in law practice without complying with State Bar registration requirements. The Attorney General recognized three exceptions that allowed nonprofit entities to engage in the practice of law without the formalities of entity registration where the mission of the entity was the public interest, rather than profit advancement. The three excepted entities were: 1) public interest entities established for the purpose of preserving and defending the legal rights and interests of the indigent or oppressed; 2) associations that represented their members in matters of common interest; and 3) legal aid societies that provided free legal services to those unable to afford counsel. [See, 55 Ops.Cal.Atty.Gen. 39 (1972)]

In 1993-94, the Oakland Community Law Center (OCLC), an unincorporated legal service entity that charged fees on a sliding scale, sought an opinion from the Attorney General to allow it to incorporate as a nonprofit public benefit corporation and still remain within the legal aid society exception to State Bar registration. The Attorney General found that by charging fees, OCLC failed to fit within the legal aid society standard, and did not fit the other exceptions recognized by the Attorney General. [See, 75 Ops.Cal.Atty.Gen. 92 (1992).]

OCLC then sought legislation to allow it to incorporate as a nonprofit entity, charge fees, and practice law, subject to registration. Section 13406(b) was then added to the Corporations Code, permitting an organization to incorporate as nonprofit public benefit *professional* corporations and practice law, subject to various restrictions, *e.g.*, that it be a qualified legal services project or support center as defined by statute; that all of its members and directors be licensed attorneys; that seventy percent of its clients be of limited means; and that it refrain from entering into contingency fee agreements.

C.
Frye v. Tenderloin Housing Clinic, Inc.

These issues were at the center of *Frye v. Tenderloin Housing Clinic, Inc.* The underlying litigation in *Frye* began as a landlord-tenant dispute. Frye and several other tenants of a residential hotel retained Tenderloin Housing Clinic, Inc. (THC). THC is a nonprofit public benefit corporation that provides, among other things, legal services to

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low and moderate-income tenants in San Francisco, California. It did not register as such with the State Bar, nor did it conform to the requirements of Corporations Code section 13406(b).

Frye claimed that THC was not entitled to attorneys fees because it had not complied with Corporations Code section 13406(b) and had not registered with the State Bar to practice law as a nonprofit professional law corporation. The trial court found that there was no requirement that THC register with the State Bar in order to render legal services. The Court of Appeal reversed, holding that all nonprofit public benefit corporations must register with the State Bar and conform to Corporations Code section 13406(b) in order to practice law in California.

The Supreme Court ultimately determined that incorporation as a nonprofit public benefit professional law corporation under section 13406(b) is permissive rather than mandatory. The Supreme Court noted that section 13406(b) is not the exclusive body of law under which nonprofit organizations are authorized to operate and provide legal services in California and that, in enacting section 13406(b), the Legislature intended to expand the provision of legal services in California, not restrict nonprofit providers. The Court reasoned that to hold otherwise could raise First Amendment issues, since such organizations have a First Amendment right of association and expression to organize for political and advocacy purposes, and nonprofit law practices engage these protections.

Despite so holding, the Supreme Court requested the State Bar to study the nonprofit law practice sector in California and report back to the Supreme Court as noted above.

IV. THE STATE BAR STUDY

A. Study Methodology

Following the Supreme Court's March 9, 2006 opinion, the State Bar undertook the work requested by the Court. In March 2006, a staff working group was created. Between March and June, 2006, the working group developed and presented to the State Bar Board of Governors, Committee on Regulation, Admissions and Discipline (RAD) a proposed action plan for conducting the study and analysis that the Supreme Court requested. Staff recommended that the RAD Committee oversee the process. The RAD Committee approved the plan and referred the matter to the Board. In August 2006, the Board of Governors ratified RAD's proposed action plan.

In October 2006, study outreach began. Requests for public comment were posted on the State Bar's website with a January 31, 2007 deadline. An electronic survey tool using three surveys: one for providers of legal services, one for consumers and one for general commenters, was developed and distributed. [Appendix 2-1]. Requests for public comment were announced in select newspapers. The State Bar announced the study in its Cal Bar Journal and in on-line communications to members. [Appendix 3-1].

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Over 2000 targeted mailings were sent to legislators, judges, law schools and clinics, nonprofit legal services providers, local bar associations, law enforcement agencies, consumer groups and numerous other entities and individuals seeking input. Following public announcements, the State Bar conducted public hearings in December 2006 in Los Angeles and San Francisco. [Appendix 3-2].

During this same period, the State Bar consulted with the State Bar's Commission on the Revision of the Rules of Professional Conduct regarding its review of California's Rules of Professional Conduct and rule 1-600 [Legal Services Programs], in particular. The commission is undertaking a complete "cover-to-cover" review of the Rules of Professional Conduct and will ultimately make recommendations to the Supreme Court on proposed amendments. Rule 1-600 addresses the professional responsibilities of lawyers who provide legal services through nonprofit entities.

The State Bar also surveyed the State Bar's Office of Chief Trial Counsel (OCTC) for available data on public protection issues within OCTC files that pertained to legal services provided by nonprofit entities. The State Bar consulted with the State Bar's Legal Services Trust Fund Program for data on qualified legal service projects funded by the Legal Services Trust Fund under Business and Professions Code sections 6210 *et seq.* The State Bar also reviewed existing state and federal regulations governing nonprofit law practices including those enforced by the United States Internal Revenue Service, the Charitable Trust Division of the California Attorney General's Office, the California Secretary of State and the California Department of Corporations.

On January 31, 2007, the public comment period ended. A status report was provided to the Board of Governors and to the Supreme Court in March 2007.

Through August 2007, study responses were reviewed and analyzed. Follow-up research was conducted in response to the data received and this report was developed. This report was presented to RAD in August 2007 and approved for circulation for public comment.

Public comment was sought on the report between September and mid-October 2007. [Appendix 2-7]. The report was drafted following the public comment period and re-submitted to the Regulation, Admission and Discipline Committee of the Board of Governors in December 2007. The final report was submitted to the Board of Governors in March 2008 and is now being submitted to the Supreme Court.

**B.
Study Findings**

**1.
General Overview**

The State Bar's Study did not reveal any evidence that nonprofits actually imperil client interests.

Three separate surveys were conducted: of nonprofit consumers; of nonprofit providers and of general commenters not falling into either of the other two categories. [Appendix 2-1]. The most robust survey response was from providers, they having the greatest interest in the study. [Appendix 2-2]. Not only did nonprofit providers respond to the survey, but representatives from a variety of public interest, legal aid, and other nonprofit legal service organizations appeared at the public hearings conducted on this subject and provided a wealth of valuable information. [Appendix 2-5, 2-6].

The least responsive sector to the study was the consumers of nonprofit legal services. [Appendix 2-3]. Those served by nonprofits often are near the fringe of society, difficult to reach and not likely to respond to official inquiries of this nature. The greatest value of the comment received from this sector is that it generally paralleled the data received elsewhere.

The general commenters provided a range of observations from a wide spectrum of perspectives. Representatives from law schools, the courts, libraries, bar associations, social service agencies, law enforcement, the Legislative, and others responded to the survey providing valuable data. [Appendix 2-4].

Although not statistically valid to establish verified trends, the survey data provides an independent and sound "snapshot" of real world experience in the nonprofit legal services sector.

In general, complaints that were reported by consumers of nonprofit services parallel complaints from consumers of legal services in any context. The primary complaint is that cases are not resolved to the satisfaction of clients regardless of the value of the outcome achieved. Complaints are directed at the conduct of individual attorneys acting through the nonprofit entity, rather than at the conduct of the nonprofit entity itself. [Appendix 2-3, Questions 11-12; Appendix 2-4, Question 3].

Nonprofit providers responding to the survey confirmed that complaints are periodically received from clients and are addressed through a variety of client grievance procedures. [Appendix 2-2, Questions 5-7]. Lawsuits against nonprofit entities are not common, but do occur. When they arise, they are based on the same claims that are seen in the for-profit population. [Appendix 2-2, Question 8]. Providers reported that they maintain varying degrees of internal controls for risk management purposes. [Appendix 2-2, Question 9]. Providers responding to the study also confirmed that, although not required to do so, they consider it a "best practice" to maintain errors and

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omissions insurance to protect clients. [Appendix 2-5, 8:2-5, 8:12; 49:17-20; Appendix 2-6 23:1-4; 45:9-10, 23; 52:16-18; 55:3-5; 74:16-21].

A concern expressed throughout the survey responses is that nonattorneys in the nonprofit legal service sector engage in the unauthorized practice of law. [Appendix 2-3, Question 4; Appendix 2-4, Questions 5, 8].

Calls for more regulation of nonprofits from consumers were based on perceptions that nonprofit entities were not regulated to the extent that many, particularly nonprofit corporations, actually are, and on concerns that attorneys working for nonprofits not escape their individual professional responsibilities and liabilities simply due to the form through which they practice. [Appendix 2-3, Question 14].

While providers overwhelmingly stated that enhanced regulation was not warranted, those few who chose to discuss the subject suggested that any enhancements be as unintrusive and unburdensome as possible, conform to the standards applicable to the for-profit model, focus on the attorneys rather than upon the nonprofit entity, and not duplicate existing federal and state regulation of nonprofit entities. [Appendix 2-2, Questions 17, 19-22].

The majority of general commenters found existing standards for nonprofits administered by the United States Internal Revenue Service and the California Attorney General's Office, Secretary of State and Department of Corporations along with the regulation of individual attorneys by the State Bar to be adequate. Those favoring greater regulation identified the independence of professional judgment, fee-sharing and the unauthorized practice of law as primary concerns. [Appendix 2-4, Questions 5-9.]

A general observation drawn from the comments received from the nonprofit law practices that participated in the survey is that Californians are richly served by the entities that provided data on the nature of their operations and the manner in which they seek to provide quality services to those most in need. It can fairly be stated that, just as Californians are well served by the best lawyers and law firms California has to offer, those in need are well served by the best legal aid, public interest and other nonprofit entities California has to offer.

2.

Do Nonprofits Imperil Client Interests?

There is no compelling evidence that nonprofits actually imperil client interests or that there is a demonstrated danger which should be remedied by additional regulations over nonprofit law corporations.

a.

Client Complaints and Claims

The types of complaints and claims faced by nonprofit entities practicing law are not materially different from those encountered in any law practice setting, but the State Bar receives a minimal number of complaints about nonprofits, as compared to the general law practice population.

Survey responses indicate that the experience in the nonprofit law practice world is not dramatically different from the experience in the general law practice population. [Appendix 2-2, Question 16]. Complaints reported by consumers of nonprofit services parallel complaints from consumers of legal services in any context. Complaints relate primarily to the conduct of individual attorneys rather than of the nonprofit entities. [Appendix 2-3, Questions 11-12; Appendix 2-4, Question 3].

The State Bar's Office of the Chief Trial Counsel reported that, to the extent data could be drawn from its complaint files and records, complaints from consumers against nonprofit law practices were minimal compared to the general law practice population. The complaints that have been received, involved the conduct and performance of individual attorneys (e.g., competence, communication, conflicts of interest, fee disputes) rather than the conduct of the nonprofit entity.

Two thirds of general commenters had no knowledge of client complaints against nonprofit entities. The complaints that were known pertained mostly to the harsh reality within the sector nonprofits serve: i.e., too few services available; too few resources; overwhelming unmet needs for service in this area. [Appendix 2-4, Question 3].

Among the nonprofit providers responding to the survey question on client complaints, half reported that they have received no client complaints in 2003 through 2006. [Appendix 2-2, Question 7]. The majority of client complaints that were received related to the consumer's ineligibility for services or the lack of available resources. The remainder related to failures in individual attorney-client relationships including failure to communicate effectively, rudeness or dissatisfaction with the result obtained. [Appendix 2-2, Question 7; Appendix 2-6, 6:20-7:12; Appendix 2-7, 35:15-20; 35:21-24; 62:23-25; 63:2-5].

Eight-five percent of the nonprofits responding to the survey have never been sued by a client. Fifteen percent of the respondents have been sued. Claims vary, but generally consist of typical negligence, malpractice and related tort claims. In most of the cases reported, the dispute ended in a resolution in favor of the nonprofit provider. [Appendix 2-2, Question 8; Appendix 2-5, 6:20-7:23; 7:3-6; 8:2-5; 8:8-12; 9:6-7; 23:14-16, 18-19;

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27:2-9; 37:11-25; 53:8-9.]

Sixty percent of nonprofit providers reported using some form of regular client questionnaire or other means to measure client satisfaction. Indeed, one major funder of nonprofit legal services in California, the federal Legal Services Corporation (LSC), mandates that recipients of LSC funds provide clients with a grievance procedure. [Appendix 2-5, 7:3-6; Appendix 2-6 23:10-14; 45 C.F.R. §§ 1621 *et seq.*] Those providers that do not have a formalized client questionnaire use some alternative measure of client satisfaction such as a client grievance procedure, exit interviews when services are completed, periodic audits, input from courts, opposing counsel, and other third parties. [Appendix 2-2, Question 5].

Survey responses from providers on internal risk management controls varied, although nearly all respondents confirmed their use of case management policies and procedures, staff supervision and training, conflict of interest compliance systems, standardized forms and procedures, periodic case reviews and file audits, calendaring and tickler systems. [Appendix 2-2, Questions 5, 6, 9, 10].

Based on data from the American Bar Association's *Lawyer Statistical Report, The U.S. Legal Population in 2000*, and its *Profile of Legal Malpractice Claims for 2000-2003*, the claims experience of nonprofit entities practicing law in California is not out of line with that encountered in the general law practice environment.

b.

Entity Liability for Professional Responsibilities

There is no evidence that the exception Frye created for nonprofit corporate law practices creates the possibility that nonprofit corporations could be used to limit or avoid the professional responsibilities of lawyers providing legal services through the nonprofit entity. The perceptions expressed by some commentators were based upon a misapprehension of the law, or there were no facts supporting their conclusions.

A commenter at the public hearing cited as an example of potential harm to clients from nonprofit law practice, the limited liability nonprofit entities have for noncompliance with the professional standards governing the attorneys rendering services through the nonprofit entity. It was *suggested* that a victimized client had no meaningful recourse against a nonprofit entity for harm caused the client by noncompliance with professional standards. [Appendix 2-6, 94:16-24 (only remedy for nonprofit client is to sue entity, no State Bar process available)].

We address the issue of professional standards, giving rise to professional discipline here, separately from civil liability for professional errors and omissions, discussed below in Section IV.B.2.c.

Attorneys in any form of practice have professional responsibility for their individual conduct. The Rules of Professional Conduct address individual "member" conduct through the discipline of individuals rather than of entities. [Cal. Rules. Prof. Conduct, rule 1-100(A)]. Incorporation does not diminish the professional discipline liability of the

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individual. Nor is the corporation or other practice entity subject to discipline for the professional misconduct of the individual attorneys practicing through it. This is to be distinguished from civil liability for negligent errors and omissions, which may be imputed and shared vicariously. [Vapnek, et al., Cal. Practice Guide: Professional Responsibility (The Rutter Group 2006) ¶ 2:72, p. 2-18.2].

The suggestion in the study comment that a nonprofit corporation could facilitate noncompliance with professional standards is troubling, but it is only that: a suggestion. This perception, expanded upon below, may be incorrect and a misinterpretation of the laws governing incorporation.

i. Trust Account Maintenance

An example offered by commenters at the public hearings in this area was the belief that nonprofits providing legal services do not need to maintain attorney trust accounts, despite their receipt of client funds. [Appendix 2-6, 86:24-88:23 (client funds held by nonprofit not subject to State Bar regulation)].

Rules of Professional Conduct, rule 4-100 [Preserving Identify of Funds and Property of a Client] is the source of an attorney's duty regarding the maintenance of client trust funds and property. The duty runs to the individual attorney, not to the entity through which the attorney provides legal services. Rule 4-100 repeatedly identifies the "member" of the State Bar as being responsible for the maintenance of client trust funds. The failure to maintain or properly administer a trust account is addressed through the professional discipline of the individual attorney rather than in a compliance action against the entity through which the attorney practices law. [Cal. Rules Prof. Conduct, rules 1-100(A), 4-100; Vapnek, et al., Cal. Practice Guide: Professional Responsibility, *supra*, at ¶ 2:72, p. 2-18.2.]

Business and Professions Code sections 6210, *et seq.*, which establish the duties of attorneys regarding the Legal Services Trust Fund Program, funded by interest on lawyers trust accounts (IOLTA), similarly imposes the duties there defined upon individual attorneys.

The State Bar's analysis of this issue confirms that the survey comments derive from a misunderstanding of the governing authorities. Because there is no evidence to support this misunderstanding, the State Bar sees no need to implement additional regulations over nonprofits in this area.

ii. Mandatory Fee Arbitration

Another example offered by commenters at the public hearing as a potential harm to clients from nonprofit law practice was the belief that the fee arbitration procedures of Business and Professions Code sections 6200 *et seq.*, and other professional standards governing fees do not apply to nonprofit entities providing legal services. [Appendix 2-6, 95:11-20; 95:21-96:13; 92:12-25 (fees not subject to State Bar regulation when paid to

nonprofit rather than to individual attorneys].

The State Bar's Mandatory Fee Arbitration Program reports that it accepts fee arbitration requests from clients regardless of the form of practice through which the client receives legal services. The program requires that there be a client, an attorney and a fee dispute. An individual attorney must be named in the dispute as the process and its enforcement mechanism are directed at the individual attorney and not the attorney's form of practice. [See, e.g., Bus. & Prof. Code §6203(d)]. But if an attorney is identified, the dispute is arbitrable.

California Rules of Professional Conduct, rule 4-200 [Fees for Legal Services], consistent with the discussion above pertaining to trust funds, binds the individual "member" of the State Bar. Any perception that illegal or unconscionable fees and fee disputes arising from the provision of legal services in the nonprofit corporation are outside the coverage of Business and Professions Code sections 6200, *et seq.*, or rule 4-200 is incorrect. There is no need to implement additional regulations to address this misperception regarding the mandatory fee arbitration program and nonprofit corporations.

iii.

The For-Profit Model

The State Bar's for-profit Law Corporation Rules require that certified law corporations "attest that the applicant's affairs will be conducted in compliance with the law and the rules and regulations of the State Bar." [State Bar Law Corp. Rules, rule IV.A.8]. In this same vein, Business and Professions Code section 6167 provides:

"A law corporation shall not do or fail to do any act the doing of which or the failure to do which would constitute a cause for discipline of a member of the State Bar, under any statute, rule or regulation now or hereafter in effect. In the conduct of its business, it shall observe and be bound by such statutes, rules and regulations to the same extent as if specifically designated therein as a member of the State Bar."

This is also a condition imposed upon limited liability partnerships in California. [See, Corp. Code §16953(h); Limited Liability Partnership Rules & Regs., rule 3.5; Appendix 1-2] Under *Frye*, nonprofit corporations are free from the requirements of Corporations Code section 16953(h), Business and Professions Code section 6167 and the parallel Law Corporation Rules.

An Internal Revenue Service Revenue Procedure governing nonprofit entities includes at Guideline 3.03 a requirement that, in order to receive favorable tax status:

"The organization does not attempt to achieve its objectives through a program of disruption of the judicial system, illegal activity or violation of applicable canons of ethics."

[Rev. Proc. 92-59, 1992-29 I.R.B. 11 §3.03, Appendix 1-3]. This concept is valid. Just

as favorable tax treatment affirmatively facilitates compliance with professional standards, so too should favorable treatment sought by nonprofit incorporation.

The comments on this subject indicate that there is at least a perception that those within a nonprofit corporation can use the exemption from these requirements to justify noncompliance with professional responsibilities. [Appendix 2-6, 92:12-25; 95:21-96:13; 86:24-88:23]. There is no evidence, however, that any nonprofit law corporation has used the exemption from these requirements to justify noncompliance with professional responsibilities.

C.
Entity Liability for Professional
Errors and Omissions

Nonprofit corporations practicing law are not required to maintain errors and omissions insurance, although many do voluntarily. An exemption from maintaining errors and omissions insurance when services are offered through the nonprofit corporate form is a “gap” in public protection that exists within the nonprofit law practice sector, but does not justify the passage of any requirements or regulations to address this perceived “gap” at this time.

A primary goal of for-profit incorporation is to protect those operating through the corporation from corporate liabilities, particularly vicarious liability for the errors and omissions of others with whom one practices. [1 Organizing Corporations in Cal., *supra*, Alter Ego and Adequate Capitalization at §1A.1, p. 162; 2 Organizing Corporations in Cal., *supra*, Professional Corporations at §6.6, p. 725; Vapnek, et al. Cal. Practice Guide: Professional Responsibility, *supra*, at §§6:276-277.5, pp. 6-55-56.] Although there is no requirement in California that individual attorneys be insured for malpractice, there is a requirement that professional law corporations maintain security for claims as a prerequisite to obtaining the protections the corporate form provides. [State Bar Law Corp. Rules, rule IV.A.7]. This is likewise required for limited liability partnerships in California. [Corp. Code §16956; State Bar Limited Liability Partnership Rules & Regs., rules 5.0 et seq., Appendix 1-2] This requirement derives directly from the goal of incorporation, *i.e.*, to limit the civil liability of those acting through the corporate form.

By contrast, the primary purpose of incorporation for nonprofits is to allow them to obtain tax-exempt status so that they may solicit contributions. [See 46 U.S.C. § 501(c)(3), California Revenue and Taxation Code § 23701d. See also Appendix 2-7, 9:4, 10:4-5]. This purpose is substantially different from the purpose for which for-profit law firms incorporate.

The nonprofit entities participating in the study reported that they maintain errors and omissions insurance. [Appendix 2-5, 8:2-5, 8:12; 49:17-20; Appendix 2-6, 23:1-4; 45:9-10, 23; 52:16-18; 55:3-5; 74:16-21]. They also reported that legal aid providers in California maintain such insurance. [Appendix 2-5, 8:2-5; 8:8-12; Appendix 2-6, 66:2-16; 67:1-5]. This is a commendable “best practice” within the industry. Given that nonprofit entities already take steps to protect the public interest, the mere possibility

that a member of the public served by a nonprofit corporation law practice could suffer an actionable error or omission and be denied full redress against corporate officers and employees due to the protections afforded by the corporate form does not justify additional regulations governing nonprofit law corporations at this time. [Cf., e.g., *In Re Education Law Center, Inc.* (1981) 86 N.J. 124, 138; 429 A.2d 1051 [staff attorneys must remain fully responsible to the client and the corporation must provide for damages arising from attorney malpractice.] There is no evidence that such a risk has actually imperiled client interests in the nonprofit sector. Therefore the State Bar does not perceive the need for additional regulation governing the maintenance of security for claims by nonprofit law corporations.

d.

Independence of Attorney Judgment

There is no evidence that attorneys in nonprofits are having their independence of professional judgment compromised through mixed attorney and nonattorney boards.

i.

Ideological and Financial Pressure

Even if financial and ideological pressures exist in the nonprofit environment, there is insufficient evidence that these pressures push attorneys toward the margins of professional conduct to justify further regulation.

Sixty percent of general commenters reported no knowledge of ideological or profit motives causing unethical or unprofessional behavior in the nonprofit law practice world. The remaining forty percent of these respondents expressed the concern that ideological and profit motives inevitably push toward the margins of ethical behavior in any context. [Appendix 2-4, Question 6 (nonprofits solicit clients to pursue their ideological agendas; ideological and political interests create conflicts of interest; pressures exist to demonstrate results to funders; strongly held beliefs push as hard as profit motives; clients are pressured to surrender claims they would otherwise pursue; money always matters.)]

These perceptions were based upon assumptions more than facts. [Appendix 2-6, 90:17-23 (positions taken do not “seem” to be in the client’s best interest); Appendix 2-6, 103:18-104:3; 104:9-12; 104:13-19 (decisions by counsel “make us wonder” whether they are in the client’s best interest); Appendix 2-6, 88:89-15 (this “could” cause a client to surrender legal rights)]. Nevertheless, these perceptions and assumptions are not isolated. [See, e.g., *Frye v. Tenderloin Housing Clinic, Inc.*, *supra*, 38 Cal.4th at pp. 50-51; *Gafcon, Inc. v. Ponsor & Associates*, *supra*, 98 Cal.App.4th at pp. 1407-1412; *In Re Education Law Center*, *supra*, 86 N.J. at pp. 137-140; Kuehn & Joy, *An Ethics Critique of Interference in Law School Clinics* (2003) 71 Fordham L. Rev. 1971; Levine, *Legal Services Lawyers and the Influence of Third Parties on the Lawyer-Client Relationship: Some Thoughts from Scholars, Practitioners, and Courts* (1999) 67 Fordham L. Rev. 2319.]

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Among the nonprofit service providers who responded to the survey, ninety percent stated that ideological and fiscal pressures exist but were adequately checked by the existing regulatory structures that govern individual attorneys and nonprofit entities. [Appendix 2-2, Question 18; Appendix 2-5, 14:2-14; 2-6; Appendix 2-6, 22:4-12; 25:11-18; 41:5-6; 450:8-13; 59:9-17]. The remaining ten percent of responders in this category expressed concerns that competition for funding can affect decision-making and “twist” the nonprofit mission away from service and toward funding preservation and maximization. [Appendix 2-2, Question 18]. None of these respondents cited any evidence that such “twisting” of the nonprofit’s mission away from services toward funding preservation and maximization had actually occurred.

Incentives exist to raise funds, maintain or increase revenues, maintain staff, increase staff salaries, maintain visibility and expand services. [See generally, Brustin, *Legal Services Provision Through Multidisciplinary Practice -- Encouraging Holistic Advocacy While Protecting Ethical Interests*, *supra*, 73 U.Colo.L.Rev. at p. 824; Kuehn & Joy, *An Ethics Critique of Interference in Law School Clinics*, *supra*, 71 Fordham L. Rev. at pp. 1999, n. 130, 131 (citing various articles on law school clinics moving toward fee revenue models.)] Apart from the assumptions of certain respondents, which were not based upon any facts, there was no evidence of a circumstance where ideological pressures actually pushed a nonprofit toward the margins of professional standards. [Cf. generally, Brustin, *Legal Services Provision Through Multidisciplinary Practice -- Encouraging Holistic Advocacy While Protecting Ethical Interests*, *supra*, 73 U.Colo.L.Rev. at p. 824].

To date, existing practices, traditions and standards governing nonprofit entities have effectively “checked” the push to generate revenues through litigation and representation, to improperly pressure attorneys to act contrary to client interests, or otherwise compromise professional standards. Profit motives do not control in an entity specifically organized to serve public charitable purposes rather than self-serving private interests. The respondents from nonprofits stated that their organizations, which are dependent upon their charitable tax-exempt status and reporting to grantors, will be vigilant in prohibiting financial benefit from overtaking the “charitable” mission. The State Bar’s study did not uncover any evidence to the contrary.

ii.

Board Interference

There is no need to change the law that nonattorneys may serve on governing boards of nonprofit entities providing legal services.

A primary concern in *Frye* was that funding sources or policy considerations mandate that nonattorneys serve on governing boards of nonprofit entities providing legal representation to the public. [*Frye v. Tenderloin Housing Clinic, Inc.*, *supra*, 38 Cal.4th at pp. 41-42]. Confirming this, providers responding to the survey reported that most have nonattorney participation on governing boards either for policy reasons or as required by funding sources. [Appendix 2-2, Question 11; see also 45 C.F.R. §1607.3(c) & (d) (2005) (Legal Services Corporation requires nonattorney

representatives on LSC funded legal service entities.]

The policy basis for mixed boards in the nonprofit law practice is one of the strongest arguments for exempting nonprofits from the application of the corporate practice doctrine. [*Frye v. Tenderloin Housing Clinic, Inc.*, *supra*, 38 Cal.4th at pp. 42-43]. Banning nonattorneys from the governing boards of these entities is most at odds with the mission of, constitutional protections afforded, and funding requirements for these entities. [Appendix 2-2, Question 13, 17, 22; Appendix 2-5, 31:22-32:6; 32:8-14; Appendix 2-6, 82:16-5; 83:6-20; 39:16-24, 69:10-17].

ABA Model Rules of Professional Conduct, rule 5.4(d), like similar rules in virtually all United States jurisdictions, prohibits nonlawyer oversight of the practice of law. However, through ethics opinions or rule amendments, the ABA and most states have, in one way or another, interpreted the strictures of rule 5.4 so as not to apply to the nonprofit law practice. [See, Brustin, *Legal Services Provision Through Multidisciplinary Practice -- Encouraging Holistic Advocacy While Protecting Ethical Interests*, *supra*, 73 U.Colo.L.Rev. at pp. 805-08 (discussing the ABA and state application of ABA rule 5.4 to nonprofit organizations); see also, Levine, *Legal Services Lawyers and the Influence of Third Parties on the Lawyer-Client Relationship: Some Thoughts from Scholars, Practitioners, and Courts*, *supra*, 67 Fordham L. Rev. 2319].

Utah's Rules of Professional Conduct, rule 5.4(e) is an example of a rule that directly addresses the issue. It provides that:

“[a] lawyer may practice in a nonprofit corporation which is established to serve the public interest provided that the nonlawyer directors and officers of such corporation do not interfere with the independent judgment of the lawyer.”

[Cited in Brustin, *Legal Services Provision Through Multidisciplinary Practice -- Encouraging Holistic Advocacy While Protecting Ethical Interests*, *supra*, 73 U.Colo.L.Rev. at n. 54].

Washington D.C. has moved furthest in this regard, explicitly authorizing lawyers to “partner” with nonlawyers in a multidisciplinary practice environment. Its version of rule 5.4 states:

“(4) sharing of fees is permitted in a partnership or other form of organization which meets the requirements of paragraph (b).

(b) a lawyer may practice law in a partnership or other form of organization in which a financial interest is held or managerial authority is exercised by an individual nonlawyer who performs professional services which assist the organization in providing legal services to clients, but only if:

(1) the partnership or organization has as its sole purpose providing legal services to clients;

(2) all persons having such managerial authority or holding a financial interest undertake to abide by these rules of professional

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conduct;

(3) the lawyers who have a financial interest or managerial authority in the partnership or other organization undertake to be responsible for the non-lawyer participants to the same extent as if nonlawyer participants were lawyers under rule 5.1;

(4) the foregoing conditions are set forth in writing.

[Cited in Brustin, *Legal Services Provision Through Multidisciplinary Practice -- Encouraging Holistic Advocacy While Protecting Ethical Interests*, *supra*, 73 U.Colo.L.Rev. at pp. 807-08.]

Rules of Professional Conduct, rules 1-310 [Forming a Partnership with a Nonlawyer] and 1-600 [Legal Service Programs] address this issue in California. Rule 1-310 prohibits attorneys from “partnering” with nonattorneys when any aspect of the activity constitutes the practice of law. Rule 1-600 provides that the attorney working in a “nongovernmental program” providing legal services to the public, is responsible for assuring that “third person[s] or organization[s]” do not interfere with the attorney’s independence of professional judgment or with the attorney-client relationship, and that unauthorized practice of law and illegal fee-splitting is not countenanced.

The expectation is that the individual lawyer will resist intrusions when they interfere with professional standards. This is the predicate assumption that has prevailed for the past 30 years in striking the delicate balance between nonprofit governance and law practice professional standards. [See generally, Brustin, *Legal Services Provision Through Multidisciplinary Practice -- Encouraging Holistic Advocacy While Protecting Ethical Interests*, *supra*, 73 U.Colo.L.Rev. at p. 825; Kuehn & Joy, *An Ethics Critique of Interference in Law School Clinics*, *supra*, 71 Fordham L. Rev. at pp. 2011-17; Levine, *Legal Services Lawyers and the Influence of Third Parties on the Lawyer-Client Relationship: Some Thoughts from Scholars, Practitioners, and Courts*, *supra*, 67 Fordham L. Rev. at pp. 2328-2335; but see, Chapin, *Regulation of Public Interest Law Firms by the IRS and the Bar: Making it Hard to Serve the Public Good* (1993) 7 Geo. J. Legal Ethics 437 (discussing the failures of existing assumptions)].

Nonprofit providers outlined in their responses to the survey the procedures they use to limit the role of board and or association members in the representation of client interests. Providers rely on the integrity of individual attorneys under rule 1-600 along with guidelines, procedures and more regimented policies within the nonprofit that seek to assure that the attorney-client relationship, once formed, is beyond the reach or influence of board and association members.

Although boards set the mission and strategic direction of the nonprofit, policies seek to isolate boards from linking the overall direction of the nonprofit mission to the outcome or administration of specific pending cases. Boards are tasked with the entity’s strategic planning; policy development; program prioritization; client complaint procedures; finance, grant and fundraising administration and directing the nonprofit’s mission. Litigation is reviewed through periodic reports. Policy input is provided on allocating resources toward or away from general areas of interest. But board input is not supposed to be provided on individual cases once they are undertaken. [Appendix 2-2,

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Questions 10-13.]

Once a client is accepted, the attorney is to represent the client without regard to potential countervailing policy concerns within the entity. [Appendix 2-2, Questions 10, 13; Appendix 2-5, 13:19-25; 14:3-4; 42: 6-12; 53:14-19; Appendix 2-6, 59:9-17; 81:1-7.] Individual clients are to be selected and represented without interference from the board and the interests of the individual clients should prevail. [Appendix 2-2, Questions 10, 13; Appendix 2-5, 10:23-11:5; 11:11-16; 12:25-13:7; 50:7-21; Appendix 2-6, 13:14-24; 22:4-12; 25:11-18; 41:5-6; 50:8-13; 55: 13-15; 82:16-25; 83: 6-20; 84:3-11].

These standards conform to the “best practices” accepted as the “norm” in the nonprofit practice community. [See, Kuehn & Joy, *An Ethics Critique of Interference in Law School Clinics*, *supra*, 71 Fordham L. Rev. at pp. 2011-18; *Legal Services Lawyers and the Influence of Third Parties on the Lawyer-Client Relationship: Some Thoughts from Scholars, Practitioners, and Courts*, *supra*, 67 Fordham L. Rev. at p. 2319]. Although suspicion remains that within the confines of the nonprofit law practice, compromises are made on professional standards that are not open to public view, [see generally, Chapin, *Regulation of Public Interest Law Firms by the IRS and the Bar: Making it Hard to Serve the Public Good*, *supra*, 7 Geo. J. Legal Ethics 437], these suspicions were not borne out by the facts developed in the State Bar study and no changes are warranted at this time in the service of nonattorneys on the boards of nonprofit corporations.

3.

Is It Necessary to Further Regulate the Day-to-Day Practice of Law Within a Nonprofit Law Practice?

No identifiable risks to the public interest were found that could be addressed through regulations without possibly interfering with the First Amendment rights of nonprofit corporations and the clients they serve. The State Bar would recommend, at most, a registration requirement.

a.

Overview

The study reveals that consumers of nonprofit legal services favor nonprofit regulation, *but they offer little factual support for further regulating the nonprofit entity*. Their focus is upon the individual attorneys practicing through the entity. [Appendix 2-3, Question 14].

Seventy percent of general commenters either had no opinion on whether enhanced regulation was warranted or thought existing regulatory systems were sufficient. The remaining thirty percent of these responders favored some form of enhanced regulation. [Appendix 2-4, Question 5].

Consumers and general commenters identified the unauthorized practice of law as a significant concern. [Appendix 2-3, Question 14; Appendix 2-4, Questions 5, 6, 8.] Concerns were also expressed that non-California nonprofits warranted closer scrutiny

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than California nonprofit entities. [Appendix 2-2, Question 19.] Qualified legal service providers under Business and Professions Code sections 6210 *et seq.* asserted that they are already adequately regulated by State Bar standards. [Appendix 2-2, Question 19.]

The State Bar did not identify any actual harm to consumers that could be addressed by regulations without possibility intruding on nonprofits' First Amendment rights and the rights of the clients they serve. The State Bar would recommend, at most, a requirement that nonprofit law corporations register as such with the State Bar.

b.

Do Existing Rules of Professional Conduct Governing Individual Attorneys Suffice?

Existing Rules of Professional Conduct and other professional standards that govern individual attorney conduct have historically been relied upon to assure the integrity of professional standards in nonprofit legal practices and remain sufficient to check the professional conduct of attorneys practicing in nonprofits.

The practice of law has historically been regulated by professional standards enforced through the discipline of individual attorneys and by civil malpractice liability shared vicariously by those who practice together. The Rules of Professional Conduct address individual "member" conduct through the discipline of individuals rather than of firms or entities. Law firms, partnerships, sole proprietorships, office-sharing associations, are not "regulated" as entities for professional discipline purposes. [Cal. Rules Prof. Conduct, rule 1-100(A); Vapnek, et al., Cal. Practice Guide: Professional Responsibility, *supra*, at ¶ 2:72, p. 2-18.2].

For the individual attorney, practicing law through a corporation, whether for-profit or nonprofit, in no way alters the attorney's duty to fulfill his/her professional responsibilities. Standards on advertising and solicitation [rule 1-400], the unauthorized practice of law [rule 1-300]; aiding and abetting others in rule violations [rule 1-120]; interference with professional judgment [rule 1-600]; fees [rule 1-320, 4-200]; confidentiality [rule 3-100]; competence [rule 3-110]; self-dealing [rule 3-300]; conflicts of interest [rule 3-310]; trust fund maintenance [rule 4-100] bind individual attorneys regardless of the business form through which they practice.

The individual lawyer in the nonprofit setting has been expected to assure compliance with professional standards despite the pressures that arise when a nonprofit is managed or governed in part by nonattorneys and may mix the law practice with other activities. This approach is reported to have been largely successful by those responding to the survey. The State Bar sees no need to modify the current approach.

C.
**Is Existing Regulation of Nonprofit Entities
Sufficient?**

Existing oversight of nonprofit corporations need not be enhanced.

As observed in *Frye*, nonprofit corporations currently receive more oversight than for-profit corporations in order to obtain and maintain their nonprofit and favorable tax status.

. . . [T]he Attorney General is vested with authority to bring actions to challenge a nonprofit public benefit corporation's failure to comply with its charitable mission or corporate charter. ([Corp. Code,] §§ 5250, 6216; see also §§ 5141, 5142). Nonprofit public benefit corporations are required to register with the Secretary of State and register annually with the Attorney General. ([Corp. Code,] § 6210; Gov. Code, §§ 12585-12587.) Annual reports must include certain financial transactions, nonprogram expenditures, use of professional fundraisers, receipt of government funds, and certain IRS reporting requirements. (2 Advising California Nonprofit Corporations (Cont.Ed.Bar 2d ed. 1998) § 1140, pp. 611-612). 'Public benefit corporations are subject to examination by the Attorney General at all times to ascertain the extent to which they may have departed from the purposes for which they were formed or have failed to comply with [the requirements of the] charitable trusts they have assumed. The Attorney General may institute any proceedings necessary to correct such a departure or noncompliance,' including proceedings to compel compliance with statutes governing nonprofit corporations. (1 Advising California Nonprofit Corporations, *supra*, § 8.115, pp. 397-398). In addition, public interest law firms seeking to maintain nonprofit status for the purpose of compliance with 26 U.S.C. § 501(c) are subject to oversight by the Internal Revenue Service, both with respect to their public purpose and the circumstances under which they may accept fees from clients or through judicial awards. (Rev.Proc. 92-95, 1992-2 C.B. 411.]"

[*Frye v. Tenderloin Housing Clinic, Inc.*, *supra*, 38 Cal.4th at p. 53.]

The State Bar study confirmed this finding in the data received from those nonprofit providers responding to the study. [Appendix 2-2, Questions 20, 21; Appendix 2-6, 49:22-25; 57:3-10; 58: 5-9; 70:7-19; 73:1-21; 74:5-9 76:6-18]. The State Bar study also confirmed that many nonprofit entities are also subject to enhanced oversight through the recently enacted Nonprofit Integrity Act of 2004 [Amending Gov't Code §§ 12580 *et seq.*]

Complaints about nonprofit charities are reviewed by the Attorney General's Charitable Trusts audit staff. If improper actions result in a loss of charitable assets, the Attorney

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General may sue the directors to recover from them the missing funds. The funds recovered by the Attorney General are returned to the charity. The Attorney General has limited staff and financial resources to carry out charitable investigations. Although disclosure procedures prohibit the Attorney General from discussing pending investigations or indicating whether or not any specific action has or will be taken with respect to a particular organization, the Attorney General seeks to administer the Charitable Trust laws equitably and efficiently. [See, <http://ag.ca.gov/charities/faq.php>].

There is no need to duplicate this oversight in a State Bar registration or oversight program.

V. Conclusions

Nonprofit organizations address a critical role in the administration of justice providing access to justice for the economically disadvantaged and allowing the advancement of expressive and associational rights all in furtherance of the public interest. There is no evidence that nonprofit corporations actually imperil client interests. Based on the study data, the State Bar concludes that there is no justification for changing the exemption nonprofits enjoy from the public protection standards established for other practice contexts. The State Bar would recommend, at most, a requirement that nonprofit law corporations register as such with the State Bar.

**VI.
Appendices**

Appendix 1-1:	Law Corporation Rules of the State Bar of California
Appendix 1-2:	Limited Liability Partnership Rules & Regulations of the State Bar of California
Appendix 1-3:	Internal Revenue Service Revenue Procedure 92-59
Appendix 1-4:	Rules & Regulations Pertaining to Lawyer Referral Services in California Including Minimum Standards
Appendix 2-1:	Survey Tools
Appendix 2-2:	Survey Responses from Providers
Appendix 2-3:	Survey Responses from Consumers
Appendix 2-4:	Survey Responses from General Commenters
Appendix 2-5:	Transcript Los Angeles Public Hearing
Appendix 2-6:	Transcript San Francisco Public Hearing
Appendix 2-7:	Public Comment on Report
Appendix 3-1:	Survey Announcements
Appendix 3-2:	Public Hearing Announcements