



THE STATE BAR OF CALIFORNIA

180 HOWARD STREET, SAN FRANCISCO, CALIFORNIA 94105

TELEPHONE (415) 538-2000

MEMORANDUM

DATE: October 28, 2009 **MIRS Item III.B**

TO: Board Committee on Member Involvement, Relations and Services

FROM: Starr Babcock, Senior Executive for Member Services
Dina DiLoreto, Director of Administration, Member Services

**SUBJECT: PROPOSED LAW CORPORATIONS RULES:
REQUEST TO RELEASE FOR PUBLIC COMMENT**

Executive Summary

State Bar rules for law corporations have been revised as part of an ongoing effort to clarify the organization and language of State Bar rules. Although the revised rules for law corporations are not intended to substantially modify current requirements, they exclude nonprofit public benefit corporations for reasons explained below, require law corporations to provide and maintain a current e-mail address, and propose the following three changes that conform to administrative practice:

- Proposed rule 3.153 provides applicants a simpler approach to fixing problems with applications than does current rule III.
- Rule 3.154(D) includes attorneys who have resigned with charges pending among those who may not practice law for a law corporation.
- Rule 3.155 (B) involuntarily terminates certification of a law corporation that has not remedied a suspension after more than a year.

This memorandum requests that the committee approve circulation of the proposed new rules for law corporations for a sixty day public comment period. If the Board of Governors subsequently adopts the proposed rules, they would become part of Title 3 of the Rules of the State Bar, which deals with Programs and Services.

Question

Whether the Board of Governors should circulate for public comment the proposed State Bar rules for law corporations, which if adopted would replace the current Law Corporations Rules of The State Bar of California.

Background

In 2006 the State Bar undertook a rules revision project to integrate the organization's more than two dozen sets of rules into a comprehensive structure of seven titles and to make the rules simpler, clearer, and more uniform. Of the seven titles, the board has adopted four.

Title 1: Global Provisions

Title 2: Member Rights and Responsibilities

Title 4: Admissions and Educational Standards

Title 7: Miscellaneous (Judicial Nominees Evaluation)

The board has adopted two titles in part.

Title 3: Programs and Services

Title 6: Governance

In the first half of 2010, staff anticipates forwarding proposals to complete Title 6 and substantially complete Title 3. Revision of Title 5, Discipline, is expected to begin in 2010.

The Law Corporations Rules of The State Bar of California were originally adopted by the Board of Governors in 1968 and have since been amended on occasion, most recently in 1994. The rules for law corporations proposed here, which were drafted by State Bar rules revision staff working closely with staff for law corporations, would be in the Attorney Members Division of Title 3, Programs and Services.

Copies of the current and the proposed rules are attached. To enable readers to compare current and proposed rules, the proposed rules reference current rules in italicized footnotes. Such footnotes are drafting devices that would be deleted in a board-adopted version. Footnotes in Roman type are citations or cross-references to other rules; such footnotes would be retained.

With exceptions noted, changes to the proposed rules are intended to be organizational and stylistic rather than substantive.

Provisional exclusion of nonprofit public benefit corporations

Current rules permit but do not require nonprofit public benefit corporations to register with the State Bar. Rule IV.A provides for certification of an applicant incorporated as nonprofit public

benefit corporation under the Non-profit Public Benefit Corporation Law under specified conditions; current IV.B.4 deals with security for such corporations; and VI.D deals with their reporting obligations. The proposed rules make no reference to nonprofit public benefit corporations.

In *Frye v. Tenderloin Housing Clinic, Inc.*, (2006) 38 Cal.4th 23, 40 Cal.Rptr.3d 221, the California Supreme Court noted that established case law permits legal aid, mutual benefit, and advocacy groups to practice law in corporate form without registering with the State Bar or complying with Corporations Code § 13406(b), which specifies the circumstances under which a professional law corporation may be incorporated as a nonprofit public benefit corporation under the Nonprofit Public Benefit Corporation Law. Registration with the State Bar has been discretionary and ultimately a business decision for these groups.

A nonprofit public benefit corporation continues to have an option to apply to the State Bar for certification as a law corporation as a common law exception pursuant to *Frye*. Pending action on recommendations submitted by the State Bar in an August 2007 report to the court, this option has not been delineated in the proposed rules. It will, however, be explained on the State Bar Web site page that deals with law corporations.

Clarification of requirements

The rules revision project has streamlined rules by eliminating procedural steps that relate to internal operations; using forms to specify steps required for compliance; and using a schedule to specify fees and due dates. The proposed rules for law corporations offer three examples of this approach. Current rule III uses about 200 words to explain the application process. Proposed rule 3.152(A) is approximately three-fourths shorter by focusing on the applicant's obligations; deleting language dealing with internal processing of the application; and using the Schedule of Charges and Deadlines to specify the calendar date for filing an application and the amount of the application fee. Similarly, rather than specify a due date of March 31 for the annual report as does current rule VI.A, proposed rule 3.156(A) states that "A law corporation must annually renew its authorization to practice law by submitting an Annual Renewal with the fee set forth in the Schedule of Charges and Deadlines." The schedule provides the board an annual opportunity to specify the fee and compliance deadline. Perhaps the most conspicuous example of streamlining is proposed rule 3.158(A), which references the schedule for the minimum amounts of security required for errors and omissions. This use of the schedule reduces proposed 3.158(A) to about half the length of IV.B, the current rule on the topic. The schedule provides an opportunity to revisit these amounts, which have in fact not been updated in more than forty years.

Effective date of certification

Both the current and proposed rules make certification of a law corporation effective on the date the State Bar receives a complete application, and they give the State Bar discretion to grant a later effective date. Current rule III.B.2 also gives the State Bar discretion to make certification effective earlier than the date on which it receives a

complete application “if the interests of justice require and good cause appears therefor.” The proposed rule eliminates the alternative for an earlier date. In practice, the State Bar has not issued certifications for such earlier dates and could not legally certify for a date earlier than the one on which the Secretary of State certified the articles of incorporation.

Incomplete or abandoned applications

Current rule III.B provides that “A request for further information or a request that the application be amended may be deemed by the applicant to be a refusal to approve the application.” The remainder of the rule explains how the applicant may request that a board committee review a refusal. Proposed rule 3.153 would streamline this process considerably. An applicant would have sixty days to cure an incomplete or defective application upon notice by the State Bar, and failure to cure would cancel the application. Proposed 3.153, which covers the topic in about fifty words as opposed to nearly 500 in current rule III, conforms to administrative practice and eliminates a review function the board has never exercised.

Involuntary termination following suspension

The most common compliance problem for law corporations is failure to submit an annual report. Although current rule VI.A allows the State Bar to suspend or revoke the certification of a law corporation that fails to do so, the rule does not spell out consequences of such a failure. Proposed rule 3.156(B) addresses the problem by providing that “A law corporation that fails to submit a complete Annual Renewal and fee is suspended and is not entitled to practice law. It may be reinstated upon submission within one year of the renewal, fee, and any penalty. If the suspension lasts more than one year, the registration of the law corporation is involuntarily terminated.”

Evidence of security

Business & Professions Code § 6171 requires “That a law corporation, as a condition of obtaining a certificate pursuant to the Professional Corporation Act and this article, shall provide and maintain security by insurance or otherwise for claims against it by its clients for errors and omissions arising out of the rendering of professional services.”

Current rule IV.B spells out two alternatives for meeting the statutory requirement, depending on whether the State Bar certified a law corporation before or after October 27, 1971. The rule provides three options for a law corporation certified before October 27, 1971: 1) insurance in specific minimum amounts; 2) a written agreement whereby the shareholders agree to cover the deductible portion of the required minimum amount of insurance; and 3) a written guarantee whereby the shareholders agree to cover the minimums that would otherwise be required for insurance. The rule limits law corporations certified after October 27, 1971 to the third means available to earlier certified law corporations, namely “a written guarantee whereby the shareholders agree to cover the minimums that would otherwise be required for insurance.”

Proposed rule 3.158(A) requires the written guarantee of every law corporation and allows the shareholders to back up the guarantee in whatever manner they choose, “by insurance or otherwise.” The approximately sixty active law corporations certified prior to October 27, 1971 would still be permitted to provide a certificate of insurance rather than a written agreement, as noted in a footnote to the rule: “Law corporations incorporated before October 27, 1971 that have elected to provide security by insurance must provide as a guarantee a certificate of insurance issued by the insurer.” Use of the footnote allows the rule to focus on the vast majority of law corporations rather than a few dozen exceptions.

Duties

Proposed rule 3.154 reiterates in one place duties that current rules impose on law corporations but with two additions, one in subpart (C) and another in (D). Rule 3.154 (C) states that “A law corporation must observe all rules and law that apply to a member of the State Bar and must not do or fail to do anything that would constitute a cause for discipline of a member.” Although current rules do not state this duty, it is mandated by Business & Professions Code § 6167. Reiterating the obligation here highlights the broad disciplinary implications of noncompliance with rules or law. Rule 3.154(D) conforms to Business & Professions Code sections 6132 and 6133 regarding the removal of names (from firm names) and the supervision of disciplined attorneys.

E-mail address required

If the board adopts the proposed rules, the application for certification will be revised to require an e-mail address. To ensure that a law corporation maintains a current e-mail address, proposed rule 3.155 includes the e-mail address as information required for a special report.

Public Information

The proposed rules incorporate the current law corporation public records policy and will be consistent with the current and proposed LLP rules.

Length of public comment period

The sixty day comment period would run from November 16, 2009 through January 15, 2010. If comments do not require substantive changes necessitating another comment period, the board will be asked to adopt the proposals at its May 2010 meeting for an effective date of July 1, 2010.

Effective date of proposal

If the board adopts new rules for law corporations at its May 2010 meeting, staff proposes an effective date of July 1, 2010.

Fiscal impact

Adoption of the proposed rules would require no new resources.

Board Book impact

None.

Proposed Board Committee action

Staff recommends that the Committee on Member Involvement, Relations and Services authorize the circulation of the proposed law corporations rules for a sixty day public comment period. If the committee agrees, adoption of the following resolution would be appropriate.

RESOLVED, that the Board Committee on Member Involvement, Relations and Services authorizes for publication, in the form attached, for a sixty day comment period from November 16, 2009 through January 15, 2010 the proposed rules for law corporations that would replace the current Law Corporation Rules of The State Bar of California.

FURTHER RESOLVED, that this authorization to release for public comment is not, and is not to be construed as, an approval of the proposed rules.

Attachments

A: Proposed Law Corporations Rules

B: Current Law Corporation Rules of The State Bar of California