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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SUMMARY OF 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. Based on the study data, the issue raised is not whether substantially enhanced regulation in this area is necessary, but whether the exemption nonprofits enjoy from the public protection standards established for other practice contexts is warranted. The ultimate conclusion of this report is that such an exemption is not warranted. Nonprofit law practices can, and should, be brought into conformity with appropriate standards that can, and should, be modified to accommodate them. This practice area should no longer operate as a footnoted exception in discussions on professional standards but rather hold its own explicitly recognized place in the "safe harbor" recommended here, with harmonized standards and clear guidelines. Toward this end the following is recommended.

1. Seek amendments to Corporations Code section 13406(b) to allow those qualified entities that so choose, to become nonprofit public benefit professional law corporations under California law under the following circumstances:

    A. It is a qualified legal services project or support center under Business and Professions Code section 6213.

    B. It is otherwise qualified under California's nonprofit public benefit corporation law.

    C. Its "head of legal practice" registers with the State Bar of California as provided under Recommendation number 5.

2. Seek to further amend Corporations Code section 13406(b) to:

    A. Remove the requirement that all members, directors, officers and shareholders of the nonprofit public benefit professional corporation be licensed persons.

    B. Remove the requirement that seventy percent of the clientele of the nonprofit professional law corporation be of low income or otherwise without access to legal services.

C. Remove the prohibition on contingency fees.

3. Seek to further amend Corporations Code section 13406(b) to add the provision from Business and Professions Code section 6167 that provides:

> A law corporation [under this title] 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.

4. Seek to amend existing statutes governing nonprofit benefit corporations in California, possibly the provisions of the Nonprofit Integrity Act of 2004 [Amending Gov't Code §§12580 *et seq*.], to conform to the proposed amendments of section 13406(b), for those nonprofit corporations that practice law.

5. Adopt a Rule of Court or enhance existing Rule of Professional Conduct 1-600 to require the "heads of legal practice" in any nonprofit legal practice, including nonprofit public benefit professional corporations, nonprofit public benefit corporations, law school clinics and other nonprofit organizations that provide legal services to the public in California to register with the State Bar of California in the following manner:

   A. Qualified legal service providers under Business and Professions Code sections 6210 *et seq*. will be registered/certified by the State Bar through their initial and annual qualification as a qualified recipient. The application procedures to be a qualified recipient under sections 6210 *et seq*. will be enhanced to allow for this added certification requirement. The registration fee will be waived for these entities.

   B. Nonprofit corporations and other organizations engaged in the practice of law in California that are registered with California's Registry of Charitable Trusts [Gov't Code §12584] register with the State Bar through a certification provided by the designated "head of legal practice" for the entity. The registration fee will be waived for these entities.

   C. Law school clinics and other nonprofit organizations not covered by Business and Professions Code sections 6210 *et seq*. or the Registry of Charitable Trusts [Gov't Code §12584], register with the State Bar through a certification provided by the designated "head of legal practice" for the entity. A modest registration fee will apply to these entities.

   D. All nonprofit entities engaged in the practice of law in California,

regardless of their form of practice, (including those identified above), may enter a "safe harbor" provided through the governing rules by designating a "head of legal practice" who has responsibility for certifying to the State Bar on an annual basis that:

(1). The legal practice occurring in California is overseen by a qualified member of the State Bar of California.

(2). The nonprofit is subject to Business and Professions Code sections 6210 *et seq*. or is registered with California's Registry of Charitable Trusts, or is exempt from doing do explaining why. If exempt, further information may be sought through the State Bar's registration process.

(3). The attorney fee revenue generated by the nonprofit organization practicing law is dedicated to the reasonable operating expenses of the legal practice or to the programmatic public service activities of the legal practice.

(4). Those entities that are nonprofit corporations, maintain security for error and omissions claims against the legal practice at least in the same amount as required for for-profit law corporations in California.

(5). The law practice has in place policies and procedures to assist it operate in accordance with professional responsibility standards governing the legal profession in California.

6. Amend California Rules of Professional Conduct, rules 1-600 [Legal Service Programs] 1-320(A)(4) [Financial Arrangements with Non-Lawyers] and 1-310 [Forming a Partnership with a Non-Lawyer] and other rules as appropriate, using as models ABA Model Rule of Professional Conduct, rule 5.4, as interpreted by the ABA Committee on Ethics and Professional Responsibility, and Utah's and Washington D.C.'s versions of these rules to create a "safe harbor" for nonprofit legal practices in California allowing them to engage in the practice of law where nonattorney management or governance may exist, legal services may be mixed with other services to the public, and legal fees are charged. These amended rules will clarify that registered entities are within the "safe harbor" and not subject to the same standards that govern for-profit entities on the subjects of nonattorney governance, fee-sharing, and combining legal and nonlegal services, subject to the assurances that come with the registration requirements.

7. The penalty for noncompliance with registration requirements is the loss of the protections afforded by the "safe harbor," including the loss of the corporate "shield" for nonprofit corporations. Attorneys within the nonprofit organization will continue at all times to be fully subject to the requirements of their professional standards.

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

I. INTRODUCTION

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. The issue raised is not whether substantially enhanced regulation in this area is necessary, but whether the exemption nonprofits enjoy from the public protection standards established for other practice contexts is warranted. The ultimate conclusion of this report is that such an exemption is not warranted. Nonprofit law practices can, and should, be brought into conformity with appropriate standards that can, and should, be modified to accommodate them. This practice area should no longer operate as a footnoted exception in discussions on professional standards but rather hold its own explicitly recognized place in the "safe harbor" recommended here, with harmonized standards and clear guidelines.

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.

Having concluded this study, the State Bar reports that there is not a compelling need to significantly enhance the existing regulation of nonprofit corporations. However, the record also does not support the exception nonprofit law practice entities, whatever their form, now enjoy under *Frye* from the standards that protect the public interest when legal services are delivered through the corporate form of practice, when legal services may be mixed with other services, when nonattorneys manage or govern the practice entity in whole or in part, and when fees for legal services may be charged or obtained.

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 on the study data, the issue raised is not whether substantially enhanced regulation in this area is necessary, but whether the exemption nonprofits enjoy from the public protection standards established for other practice contexts is warranted. The ultimate conclusion of this report is that such an exemption is not warranted. Nonprofit law practices can, and should, be brought into conformity with appropriate standards that can, and should, be modified to accommodate them. This practice area should no longer operate as a footnoted exception in discussions on professional standards but rather hold its own explicitly recognized place in the "safe harbor" recommended here,

with harmonized standards and clear guidelines.

Although substantially enhanced State Bar regulation is not warranted, the State Bar finds value in seeking to bring harmony to the various statutes and rules that are in conflict in this area and in developing a "safe harbor" registration/certification program for nonprofit law practices. The proposed registration/certification program offers nonprofit entities a "safe harbor" to operate within, focuses upon the legal practice within the entity rather than the entity itself, addresses "gaps" in public protection that were identified in the study, is minimally burdensome and unintrusive and is described in the Conclusion and Recommendation sections of this report.

The State Bar defers to the Supreme Court as to whether the conclusions and recommendations in this report warrant further development. With guidance from the Supreme Court, the State Bar is prepared to further serve the Court in developing proposed rules and standards in this area to the extent the Court finds beneficial.

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 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 directed the State Bar to determine whether there is evidence of actual client endangerment resulting from law practice in a nonprofit setting and whether any discovered harm to clients warrants regulation of the nonprofit entity itself, as opposed to the regulation of the individual attorneys, who remain always subject to State Bar and Supreme Court oversight as individual licensees. To this end, the Court instructed the State Bar to:

> Determine whether nonprofits actually imperil client interests *[Id.,* at p. 51.]; Determine whether, absent the usual profit motive, a nonprofit organization's ideological motivation may, nevertheless, pose a risk to client interests *[Id.,* at p. 51]; Determine if existing Rules of Professional Conduct applicable to individual attorneys already afford adequate safeguards to clients in the nonprofit setting *[Id.,* at pp. 51-52.]; Evaluate 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.
Registration/Certification of For-Profit Professional Law Corporations

The State Bar's existing 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. This is a self-effectuating, unintrusive program where entities are, or are not, registered, and as a result, are or are not, at risk of losing the benefits of the "safe harbor" provides. A similar registration "safe harbor" for nonprofit law practices is not intrusive nor burdensome.

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].

Initially, it is important to appreciate the nature of the State Bar's existing for-profit registration program as it serves as the point of reference for any similar program that may be extended to nonprofit organizations providing legal services to the public. Law corporation registration/certification under Business and Professions Code sections 6160 *et seq* and the State Bar's Law Corporation Rules has evolved over time through court analysis.

The significant observation to be made from this evolution is that 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. This is significant in assessing the burden of imposing similar "safe harbor" registration requirements upon nonprofit law practices.

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 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 misdemeanour 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 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 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].

This 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 *Cohen* 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].

Assuming that the corporate practice doctrine has evolved in the manner suggested in *Olson v. Cohen,* law corporation registration/certification is self-effectuating and enforcing as a "safe harbor." There are four primary aspects to the "safe harbor": 1) registration with the State Bar; 2) assurance that independent professional judgment is preserved, which is accomplished in the for-profit model by providing that only licensed attorneys occupy positions of ownership and leadership; 3) assurance that security for claims is maintained by the corporate entity; 4) assurance that the corporate form does not limit any professional responsibility or liability that runs between attorney and client. These same standards apply to limited liability law practice partnerships. [See, Corp. Code §§ 16101, 16953, 16956]

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]

From this perspective, the State Bar's existing for-profit law corporation and limited liability partnership registration/certification program is not inherently burdensome nor intrusive should aspects of it be extended to nonprofit law corporations. In order to do so, however, existing restrictions on nonlawyer governance in the nonprofit setting must be addressed. This is discussed below.

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 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].

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. In December 2006, public hearings were held in Los Angeles and San Francisco, following public announcements. [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 finalized following the public comment period and submitted to the Board of Governors in November 2007. Following the Board's approval, this report is filed with the Supreme Court this date in December 2007.

B.
Study Findings

1.
General Overview

The issue is not whether substantially enhanced regulation in this area is necessary, but whether an exemption for nonprofits from the standards established for law practices using the corporate form or potentially involving nonattorney governance, fee-sharing and mixed legal and nonlegal services is warranted. The conclusion is that an exemption is not warranted.

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, the survey responses indicate that the experience in the nonprofit law practice world is not materially different from law practice experience in general. [Appendix 2-2, Question 16]. 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 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 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.

However, the best, most conscientious, professionally committed practitioners are not those of concern to the State Bar's attorney discipline system. It is, rather the individuals and firms that operate on the margins of the profession that create the need for regulation. Just as with the general population of attorneys and for-profit law practices, the nonprofit world is not immune from marginal and misguided operators. Nor can it be said that nonprofit law practices, while endeavoring to do the best, never fall short.

2.
Do Nonprofits Imperil Client Interests?

There is no compelling evidence that nonprofits imperil client interests to any greater extent than do for-profit law practices. Nor is there compelling evidence that nonprofits imperil client interests to such a negligible extent that exemption from public protection safeguards is warranted, particularly where nonattorney governance is tolerated.

a.
Client Complaints and Claims

The everyday practice of law in the nonprofit setting is substantially similar to the practice of law in general. The complaints and claims faced by nonprofit entities practicing law are not materially different from those encountered in any law practice setting.

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;

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. 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]. 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.*]

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. From this we conclude that nonprofits imperil client interests to no greater extent than do for-profit law practices. This leads to the corollary conclusion that nonprofits practice law much the same way as does the general law practice population. From this, it follows that an exemption from public protection safeguards is unwarranted, particularly where nonattorney governance is tolerated.

b.
Entity Liability for Professional Responsibilities

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.

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 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. This perception, expanded upon below, may be incorrect and a misinterpretation of the laws governing incorporation. Nevertheless, it is an issue that was anticipated and directly addressed for for-profit law corporations, presenting the issue as to whether the exemption nonprofit corporations enjoy from the for-profit standard in this area is good public policy.

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. But the perception presented remains troubling.

To assure that it not even be suggested that the corporate form limits professional responsibilities in the for-profit sector, Business and Professions Code section 6167, and the related provisions discussed below at Section IV.B.2.b.iii, govern for-profit law

corporations and limited liability partnerships. Although materially enhanced regulation is not necessary to address this issue, extending to the clients of law practices within nonprofit corporations the same safeguards the clients of for-profit professional corporations receive in this area would enhance public protection.

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. The perception otherwise is troubling and can be addressed as noted below in Section IV.B.2.b.iii.

iii.
The For-Profit Model

In the for-profit model, professional law corporations are required not only to assure that the corporate form does not interfere with professional standards, but that the corporate form actually facilitates compliance with professional standards.

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 though a program of disruption of the judicial system, illegal activity or violation of applicable cannons of ethics."

[Rev. Proc. 92-59, 1992-29 I.R.B. 11 §3.03, Appendix 1-3]. This is insufficient lost, as it is, in the density of tax regulations. But the 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]. This perception is enhanced by the absence of a clearly articulated mandate that a nonprofit corporation engaged in law practice facilitate compliance with professional standards

Requiring nonprofit corporations, like for-profit corporations and limited liability partnerships to certify that the entity facilitates professional standards, as a condition of receiving the "safe harbor" treatment recommended here, enhances public protection without a material burden upon law practices operating through nonprofit corporations.

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.

A primary goal of 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.

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. But it is a voluntary "best practice" rather than a public protection mandate.

It is not only possible, but foreseeable, that a member of the public served by a nonprofit corporation law practice, could suffer an actionable error or omission, seek civil redress against the nonprofit corporation through a civil damage action, be denied full redress against corporate officers and employees due to the protections afforded by the corporate form and have no meaningful recourse against an undercapitalized nonprofit corporation lacking malpractice insurance. This has raised concerns among those who have examined this issue elsewhere as being a tangible risk to public protection. [See, *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.]

It will be an economic burden to some nonprofit corporations to maintain security for claims. It may result in some nonprofits choosing not to incorporate or to cease operations. However, the study confirms that maintaining malpractice insurance is an industry "best practice." Not only must attorneys practicing through for-profit professional corporations maintain malpractice insurance, but accountants, chiropractors, dentists, optometrists, and osteopaths are all required to maintain malpractice insurance as a condition of benefiting from the corporate form of professional practice. In the absence of such coverage, the corporate representatives are returned to their natural state of being jointly and severally liable for claims against the entity. [2 Organizing Corporations in Cal., *supra,* Professional Corporations at §6.7, p. 726.]

A entity that seeks to benefit from incorporation but finds itself unable to afford such insurance is likely undercapitalized and poses the risk identified above.

d.
Independence of Attorney Judgment

The standards securing independence of professional judgment through prohibitions on mixed attorney and nonattorney boards and fee-splitting need to be harmonized so as to allow nonprofits more flexibility in these areas.

i.
Ideological and Financial Pressure

The issue is not whether financial and ideological pressures exist in the nonprofit environment. They do exist and they push toward the margins of professional conduct. The issue is whether these pressures are adequately managed within the nonprofit law practice setting and whether management of these forces can be effectively enhanced. We conclude that management of these forces can be enhanced.

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.]

Intrusions into attorney independence are not unique to the nonprofit setting. The attorney who is employed by a nonprofit legal aid society or a public interest entity faces the same issues as does the attorney employee of a corporate general counsel's office, an in-house insurance defense firm, or even a government entity. Attorneys and law firms commonly specialize in certain areas of practice, rejecting cases in other areas. In-house corporate law offices restrict the practice of salaried attorneys to those issues of significance to the corporate employer/client. Insurance defense counsel are routinely limited in their decision-making by the terms of the insurance policy to which the insured/client has subscribed. Budget limitations in all organizations require lawyers and organizations to make careful choices about how resources are expended, ultimately affecting the representation provided. Attorneys are free to limit the scope of their representation based on a wide range of self-imposed limitations, as long as appropriate disclosures are made to the client.

In-house lawyers all subject themselves to the standards of a particular employer, thus relinquishing their freedom to act with complete professional autonomy. They work subject to the " . . . bureaucratic matrix that limits . . . professional autonomy" and confront forces that, on occasion, push toward the ethical margins without regard to the profit motives of their employer. [See, 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. 2331, 2338 (citing Berger, *Legal Aid for the Poor: A Conceptual Analysis* (1982) 60 N.C.L. Rev. 281, 326); *Howard v. Babcock* (1993) 6 Cal.4th 409, 434, 25 Cal.Rptr.2d 80 (citing Rehnquist, *The Legal Profession Today* (1986) 62 Ind. L.J. 151, 154); See also, *Gafcon, Inc. v. Ponsor & Associates, supra,* 98 Cal.App.4th at pp. 1406-08.]

The harsh realities of law practice in today's business centric environment, were aptly observed by Justice Kennard in her dissenting opinion in *Howard v. Babcock*, *supra,* 6 Cal.4th at 434:

> "As [former] Chief Justice Rehnquist of the United State Supreme Court has observed, 'It is only natural, I suppose, that as the practice of law in large firms has become organized on more and more of a business basis, geared to the maximization of income, this practice should on occasion push toward the margins of ethical propriety. Ethical considerations, after all, are factors which counsel *against* maximization of income in the best Adam Smith tradition, and the stronger the pressure to maximize income the more difficult it is to avoid the ethical margins.' (Rehnquist, *The Legal Profession Today* (1986) 62 Ind. L.J. 151, 154, italics in original.) In my view, the increasing pressures to weaken the rules of professional ethics generated by the emphasis on maximizing income require more, not less, vigilance by this court to preserve the practice of law as a profession and to protect the public."

[*Ibid.*]

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].

Financial and ideological pressures may fairly be considered a "given" in this area. 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.)]

Even when economic pressures may be limited or absent, pressures to enhance visibility or political power, to address one constituency over another or advance the standing of the nonprofit in pursuit of its ideological mission can push toward the margins of 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. 824].

It has been accepted to date that 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. It is asserted that profit motives do not control in an entity specifically organized to serve public charitable purposes rather than self-serving private interests. It is asserted that organizations, dependent upon their charitable tax-exempt status, will be vigilant in prohibiting financial benefit from overtaking the "charitable" mission. [See *e.g.*, Brustin, *Legal Services Provision Through Multidisciplinary Practice -- Encouraging Holistic Advocacy While Protecting Ethical Interests, supra,* 73 U.Colo.L.Rev. 787 at p. 824 (relying upon the conclusion of the ABA's Ethics 2000 Commission, in its revision of the ABA's Model Rules of Professional Conduct, that the threat from these forces is checked in the nonprofit context. American Bar Ass'n Comm'n on Evaluation of the Rules of Prof'l Conduct, Report with Recommendations to the House of Delegates, at 221, 223 (Nov. 2000), http://abanet.org/cpr/ethics2k.html); see also, *Frye v. Tenderloin Housing Clinic, Inc., supra* 38 Cal.4th at pp. 39-43].

The issue, then, is not whether financial and ideological pressures exist in the nonprofit environment. They do exist and they push toward the margins of professional conduct. The issue is whether these pressures are adequately managed within the nonprofit law practice setting and whether the management of these forces can be effectively enhanced with additional tools.

In the for-profit model, the independent professional judgment of attorneys is secured by barring nonattorneys from management and board governance positions and prohibiting attorney fee revenues from being shared with nonattorneys in the practice form. Our conclusion that these management tools can be modified and enhanced to serve nonprofit law practices is discussed below

ii.
Board Interference

California's authorities should be amended to explicitly allow attorneys to represent client interests in nonprofit entities with nonattorney board members, subject to the registration/certification "safe harbor" recommended here.

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.]

Under current legal standards, the corporate practice doctrine runs counter to this and requires that, regardless of the form of professional service provided by a professional corporation, the corporation be controlled by the licensed professionals involved. [*Gafcon, Inc. v. Ponsor & Associates, supra,* 98 Cal.App.4th at pp.1407-1410.]

> "Several premises underlie the corporate practice doctrine. One is that the corporation will always exercise impermissible control over the employee-attorney's judgment and thus improperly interfere with his or her independence of judgment and loyalty to the client. Another is that the employee-attorney will necessarily be influenced by his or her employer and allow his or her judgment or independent decision making to be impaired [footnote omitted]. The concern is that an attorney-employee will not be able to abide by his or her duties to remain loyal to his client and avoid conflicts of interest, protect client confidences, and maintain independence of judgment. Such duties are of paramount importance to the practice of law."

[Id. at pp. 1409-1410; see also, *Frye v. Tenderloin Housing Clinic, Inc., supra,* 38 Cal.4th at pp. 37-39].

The countervailing 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]. It is passionately argued by the nonprofit legal practice community that 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 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.

Intrusions into attorney independence come in many potential forms. Restrictions from funding sources like the Legal Services Corporation prohibit funds from being used to pursue certain claims in favor of others; nonprofit boards set priorities and allocate resources that effect the selection of cases and the availability of representation provided by employed attorneys; representation is conditioned upon clients agreeing to seek particular objectives and foregoing others; budget limitations and resource allocations inevitably affect the representation provided.

The expectation is that the individual lawyer will resist intrusions when they interfere with professional standards. This expectation is challenged when the attorney-employee is interested in retaining his/her job, receiving salary increases and other benefits of continued employment and enjoying professional advancement within the nonprofit entity. Nevertheless, 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, 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]. But 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.]

The mixed board issue needs to be explicitly addressed in California's governing authorities. Nonattorney participation in nonprofit governance is a "given." The existing statues and rules governing nonprofit law practice in California should be reformed so as to explicitly allow nonattorney participation on nonprofit boards engaged in the practice of law.

Pressures in the practice of law and in the nonprofit setting are increasing rather than diminishing. There are real challenges confronting lawyers practicing in this setting. [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 (discussing the conflicts between IRS standards governing nonprofit tax status and attorney professional responsibility standards)]. As a corollary to amending California's authorities to explicitly allow attorneys to represent client interests in a nonprofit organization governed by a board that includes nonattorneys, the registration "safe harbor" recommended here seeks to assist the attorneys within the nonprofit law practice more effectively manage the pressures that they inevitably encounter.

iii.
Fee Splitting: Fee Generation

California's authorities should be amended to explicitly allow nonprofits to seek fees limited by Internal Revenue Service restrictions and by the terms of the registration/certification "safe harbor" recommended here.

The extent to which attorneys fees are received and the manner in which they are treated by nonprofit entities is varied. [Appendix 2-2, Questions 14-15; see also Nazer, *Conflict and Solidarity: The Legacy of Evans v. Jeff D.* (2004) 17 Geo. J. Legal Ethics 499, 511 (discussing the challenges faced by public interest lawyers in addressing fee issues); Kuehn & Joy, *An Ethics Critique of Interference in Law School Clinics, supra,* 71 Fordham L. Rev. at n. 130-131 (discussing fee generating law school clinics).

Commenters in the study and others discussing the issue acknowledge that the terrain is evolving regarding attorney fees within nonprofit entities. Commenters reported that *Frye* has added uncertainty to this terrain. [Appendix 2-6, 78:3-8 (*Frye* created confusion as to how nonprofits should structure fee agreements)]. This uncertainty is enhanced by the fact that it was a contingent fee agreement that was at issue in *Frye*,

and that agreement was eviscerated in the course of that case. [See, *Frye v. Tenderloin Housing Clinic, Inc., supra,* 38 Cal.4th at p. 49].

Of concern, is the extent to which attorney fee revenue may be generated in an entity that is managed or governed by nonattorneys or that provides services in addition to the practice of law. The existing authorities on this subject are not in harmony.

"Splitting fees" between attorneys and nonattorneys is universally prohibited in all United States jurisdictions. California Rules of Professional Conduct, rule 1-320 states:

> "Neither a member nor a law firm shall directly or indirectly share legal fees with a person who is not a lawyer."

Similarly, ABA Model Rule of Professional Conduct, rule 5.4(a) states:

> " A lawyer or law firm may not share legal fees with a nonlawyer . . . "

Under both the ABA and California rules, exceptions are noted. Under ABA rule 5.4(A)(4), as recently amended in the ABA's Ethics 2000 rule revision process, an exception is made for the nonprofit legal practice sector:

> "(4) a lawyer may share ***court-awarded legal fees*** with a non profit organization that employed, retained or recommended employment of the lawyer in the matter."

[Emphasis added.]

California has a limited exception under rule 1-320(A)(4) for certified lawyer referral services. There is no explicit exception for nonprofit entities.

Rules of Professional Conduct, rule 1-600, repeats this prohibition by barring attorneys from participating in a program or organization that allows a third person or organization to share in legal fees. Rule 1-600(A) states:

> "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 receive directly or indirectly any part of the consideration paid to the member except as permitted by these rules . . . ."

The authorities that were at issue in *Frye* expressly limited nonprofit law corporations in their generation of fee revenues. [See *e.g*., State Bar Law Corp. Rules, rule IV.A.10.c; Corp. Code §16406(b); 75 Ops.Cal.Atty.Gen92, *supra*; see also, *Frye v. Tenderloin Housing Clinic, Inc., supra,* 38 Cal.4th at pp. 34-36, 44-45]. Nevertheless, as noted in *Frye*, actual practice in California regularly results in fees being awarded to nonprofit entities despite these limitations, creating a judicial exception to the authorities that otherwise ban or limit the practice. [*Id.* at p. 49, n. 10].

Fee-splitting concerns do not arise when fees are not obtained by the law practice entity. Many nonprofit entities adhere to this standard. [Appendix 2-2, Question 14 (nearly half of responding providers do not take fee-generating cases)]. However, this leaves many respondents that do obtain fees, in one form or another. [Appendix 2-2, Question 14)]. Traditionally limiting themselves to statutory court-ordered fee awards, some entities are now considering contingent and other fee arrangements that enhance the fee revenue potential for the nonprofit law practice. This is in part a response to the circumstances created by the holding in *Evans v. Jeff D*. (1986) 475 U.S. 717, 106 S.Ct. 1531, 89 L.Ed.2d 747 and its progeny. [Appendix 2-6, 17:1-8; 19:9-24; 18:17-19; 31:2-4, 22-25; 42: 14-17; 79:5-16; See also, Nazer, *Conflict and Solidarity: The Legacy of Evans v. Jeff D., supra,* 17 Geo. J. Legal Ethics at p. 511 (discussing the challenges faced by public interest lawyers in addressing fee issues); Kuehn & Joy, *An Ethics Critique of Interference in Law School Clinics, supra,* 71 Fordham L. Rev. at n. 130-131 (discussing fee generating law school clinics)].

Under *Evans v. Jeff D*., defendants, often in the public sector, negotiate away statutorily available attorney fee awards to plaintiffs' counsel in return for a favorable settlement to plaintiffs. This engenders one of the more challenging conflicts in the public interest law practice sector: *i.e*., serving the best interests of the client and relinquishing the statutory entitlement to attorney fees, or limiting the client's control over the case in favor of the economic needs of counsel or of the public interest entity representing the client.

Those nonprofit providers responding to the study who accept fees, reported that their fee-generating activities are restricted by the regulations of the Legal Services Corporation [45 C.F.R. §1607.3(c) & (d)]; the State Bar's Legal Services Trust Fund standards [Bus. & Prof. Code §§ 6210 *et seq*]; their status under Internal Revenue Code section 501(c)(3) and I.R.S. Revenue Procedures; [Appendix 1-4]; their reporting requirements as nonprofit corporations [Corp. Code §§5130, 5120, 6210]; among other standards. [Appendix 2-2, Questions 14-15; Appendix 2-6, 77:6-22].

Fees received are allocated in a number of ways within the nonprofit entity. Usually, but not always, they are dedicated to the legal services program generating the fee. [Appendix 2-2, Question 14, 15; Appendix 2-6, 44:2-18; 51:2-4 (fees from law practice is separated from other revenues); 45:3-4; 71:4-10; 30:12-23 (legal fees remain in the legal program); but see Appendix 2-6, 34:20-24 (no reason for fees not to be used to fund other aspects of the organization)].

While fee potential may influence case selection criteria from a policy perspective, once a specific case is undertaken, fee potential is not supposed to alter the manner in which the case is handled by the assigned attorneys. [Appendix 2-6, 18:15-17; 19:10-13, 17-21].

Historically, public interest and legal aid lawyers have limited themselves to no-fee services or court-awarded statutory fees. This derives from the view that charging fees is inconsistent with a public interest mission. Commenters in the study observed that the "windfall" aspect of contingency fees undercuts the spirit upon which a public interest nonprofit practice is predicated. [Appendix 2-6, 79:5-16; 8:2-25; 79:17-25].

Others argued that contingency and other fee arrangements should not be beyond the reach of nonprofit entities, particularly in response to *Evans v. Jeff D.* [Appendix 2-6 106:4-10; 31:2-4; 12-25; 32:1-5; 42:14-17; 42:1-4; 79:5-16; 80:1-6].

The historical reluctance to maximize fee revenues in the nonprofit setting has been bolstered by IRS regulations limiting the ability of a nonprofit "charity" to generate significant fee revenues. I.R.S. Revenue Procedure 92-59, allows a nonprofit to collect fee revenues awarded by the court or paid by the opponent. Client-paid fees cannot exceed half of the annual operating expenses of the organization's legal functions. [Appendix 1-4; see also, 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 at p. 446.]

The view that fees are inconsistent with the public mission of nonprofits and the IRS's restrictions on revenue generation within nonprofit entities has created a "culture" resistant to fee structures other than court-awarded statutory fees. [Nazer, *Conflict and Solidarity: The Legacy of Evans v. Jeff D., supra,* 17 Geo. J. Legal Ethics at p. 513]. However, this "culture" is eroding. [Appendix 2-6, 17:1-8 19:9-24, 18:17-19, 31:2-4, 12-25; 32:1-5 (favoring contingent fees); 29:18-30:7 (favoring fee generation); see also Nazer, *Conflict and Solidarity: The Legacy of Evans v. Jeff D., supra,* 17 Geo. J. Legal Ethics at p. 51; Kuehn & Joy, *An Ethics Critique of Interference in Law School Clinics, supra,* 71 Fordham L. Rev. at n. 130-131 (discussing fee generating law school clinics)].

Currently, ABA Model Rule of Professional Conduct, rule 5.4(a)(4) is the mainstream exception allowing attorneys to practice law without fee-sharing concerns in a nonprofit managed or governed in part by nonattorneys. It is expressly limited to court-awarded fees. The ABA Standing Committee on Ethics and Professional Responsibility has opined that court oversight provides the appropriate "check" to assure that the fees are consistent with the public purpose served by the legal representation and are calculated based on actual work performed. [ABA Comm. on Ethics and Professional Responsibility, Formal Op. 374 (1993) cited in Brustin, *Legal Services Provision Through Multidisciplinary Practice -- Encouraging Holistic Advocacy While Protecting Ethical Interests, supra,* 73 U.Colo.L.Rev. at n. 50-54; see also *Frye v. Tenderloin Housing Clinic, Inc., supra,* 38 Cal.4th at pp. 48-49.]

Currently, California's Rules of Professional Conduct, rule 1-320, unlike its ABA counterpart, does not explicitly except nonprofit legal practices from its fee-sharing prohibitions. The opportunity is ripe to amend California's Rules of Professional Conduct in this regard. At the very least, California's rules should conform to the mainstream reflected in ABA rule 5.4(a)(4) providing that attorneys may render legal services and obtain court-award fees in a nonprofit governed or managed by nonattorneys. This reflects practice reality in California. [See, *Frye v. Tenderloin Housing Clinic, Inc., supra,* 38 Cal.4th at p. 49, n. 10; see also, *Gafcon, Inc. v. Ponsor & Associates, supra,* 98 Cal.App.4th at p. 1419.]

The time is also ripe to move California further on this subject by allowing nonprofits to seek fees of any sort, limited by Internal Revenue Service restrictions and by the terms of the registration/certification "safe harbor" recommended here.

The registration requirements contemplated need to address the legitimate concern expressed by Justice Chin in his concurring and dissenting opinion in *PLCM Group, Inc. v. Drexler* (2000) 22 Cal.4th 1084, 1106, 95 Cal.Rptr.2d 198. Justice Chin aptly observed that while a corporation is entitled to compensation for the value of the legal work performed by its in-house legal counsel, no entity but a pure law practice should be allowed to create a profit center out of that work. Unauthorized practice of law and fee-splitting concerns arise when those, other than lawyers and clients, stand to benefit from legal fee revenues. As Justice Chin notes, to avoid this, " . . . courts have required either use of a cost-plus approach [to fee calculations] or a showing that all of the fee award will be put back into the legal operations, rather than general corporate coffers. [Citations omitted]." [*Id.* at 1106-07; See also, *Gafcon, Inc. v. Ponsor & Associates, supra* 98 Cal.App.4th at p. 1419].

Consistent with this, California's rule 1-320(A)(4) recognizes a fee-sharing exception for lawyer referral services, and does so subject to the limitation Justice Chin identifies. In order to fit the exception, a LRS must be certified by the State Bar and, particularly relevant here, the fees received by the certified LRS, are restricted in their use by the LRS's sponsoring entity, usually a nonprofit bar association. The Rules and Regulations Pertaining to Lawyer Referral Services, Including Minimum Standards, rule 17.2 [Fees Charged by a Lawyer Referral Service] states:

> "The income generated by a nonprofit Lawyer Referral Service shall be used only to pay reasonable operating expenses of the Service and/or to fund programmatic public service activities of the Service or its sponsoring entity, including the delivery of pro bono legal services."

[*Id*., Appendix 1-4.]

Allowing nonprofits to charge fees for legal services is appropriate if the nonprofit enters the "safe harbor" recommended here, fees are subject to I.R.S. restrictions, fees are dedicated to the actual costs and activities of the legal services provided, and the nonprofit otherwise accepts the "safe harbor" standards recommended here.

3.
Is It Necessary to Further Regulate the Day-to-Day Practice of Law Within a Nonprofit Law Practice?

There are identifiable risks to the public interest that are unaddressed by existing regulation and which can be addressed by an unburdensome certification/registration "safe harbor" directed at the attorneys within the entity as opposed to the entity itself.

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 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 benefits of having a central registry of nonprofit law practices was viewed positively by general commenters. [Appendix 2-4, Question 7]. Concerns about the potential for nonattorney intrusion into and control of legal services was raised as a structural problem in nonprofit entities that are governed by boards composed of nonattorneys. [Appendix 2-4, Question 5]. Fee-sharing between attorneys and their nonprofit employers was an area of concern and confusion among nonprofits. [Appendix 2-6, 78:3-8].

Also surfacing in the comments was the sentiment that while for-profit and nonprofit corporations may serve differing goals and operate under differing assumptions, the core reason that nonprofit and for-profit corporations seek the benefits of incorporation are the same. Therefore, the certification and registration requirements pertaining to each should be similar, if not the same, particularly when these requirements address real issues of public protection. [Appendix 2-4, Question 5].

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. The realities of practice within nonprofits lead us to conclude that this traditional approach will not be adequate to safeguard professional standards and public protection in the future.

The practice of law has historically been regulated by professional standards enforced though 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 betting 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.

To date, 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. But it cannot be said that this approach is universally successful in securing public protection and there is no assurance that it can withstand the pressures nonprofits inevitably face in the future.

First and foremost is the fact that a lawyer working in the corporate setting limits his/her liability for negligence by working in that setting. Incorporation, like any choice of business form through which professionals practice, is sought, whether for-profit or nonprofit purposes, to serve the strategic business interests of those who operate through the entity, rather than to serve client or public interests. [*Olson v. Cohen, supra,* 106 Cal.App.4th at 1215]. Limiting liability, particularly vicarious liability for errors and omissions is a primary goal of incorporation. [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. 726; Vapnek, et al. Cal. Practice Guide: Professional Responsibility, *supra,* at §§6:276-277.5, pp. 6-55-56].

In the for-profit corporate model, this is addressed by the requirement that the corporation certify that it maintains security for claims. [State Bar Law Corp. Rules, rule IV.B; see also State Bar Limited Liability Partnership Rules & Regs. rules 5.0-5.2.4]. In the nonprofit corporation this is unaddressed.

Flowing from this is a second concern: the perception and possibility that the nonprofit corporation can be used to limit or avoid professional responsibilities, beyond civil liability, exemplified by the trust account and fee regulation examples noted above. [See Section IV.B.2.b, *supra*].

As a condition of forming a for-profit law corporation in California, the corporation is subjected to Business and Professions Code Section 6167. [*Supra*, section IV.B.2.b.iii]. This assures not only that the corporate entity will never interfere with the duties of the attorneys acting through the entity, but even more significant, it engages the corporation in facilitating compliance with professional standards. This is likewise true for limited liability partnerships in California. [See, Corp. Code §16953(h); Limited Liability Partnership Rules & Regs. rule 3.5. See also, Vapnek, et al., Cal. Practice Guide: Professional Responsibility, *supra,* at ¶ 6:277, p. 6-55]. This is unaddressed in nonprofit corporations.

A third concern is that Rules of Professional Conduct, rule 1-600 seeks to address compliance with professional standards in the law practice within a nonprofit corporation or other organization by placing the burden for assuring compliance entirely upon the individual attorney. Where nonattorneys are involved in governing or managing the practice and any revenues generated by legal services, the individual attorney employee is not fairly expected to do this entirely alone. [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, at pp. 448-460.]

For this reason, the for-profit corporation is required, as a condition of receiving the protections of the corporate form, to certify through registration that it: (1) assures independence of attorney judgment; (2) maintains security for error and omissions claims; 3) and assures that the corporate entity facilitates compliance with standards of professional responsibility, among other things. In return, the corporation is allowed to engage in activities otherwise prohibited by the corporate practice doctrine. A similar program customized for the needs of nonprofit corporations and other nonprofit organizations, simple in its administration and focused not upon the entity but upon the lawyers within the entity, would serve to enhance compliance with professional standards as discussed below.

c.
Is Existing Regulation of Nonprofit Entities Sufficient?

Existing oversight can be enhanced in unintrusive and unburdensome ways that assure that gaps existing from the current exemption for nonprofits under Frye are addressed and that public protection is fully effectuated in the legal profession.

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, s*upra*, § 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.]

This was confirmed 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]. This data 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 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 a strong support for not duplicating this oversight in a State Bar registration program. However, there is an equally strong basis for supplementing this ovesight in unintrusive and unburdensome ways to address professional standards. The agencies that have ovesight responsibilities for nonprofit organziations do not have professional standards as their point of focus. The "safe harbor" registration program recommended here will assure that gaps existing from the current exemption for nonprofits under *Frye* are addressed and that public protection is fully effectuated in the legal profession.

d.
Registration/Certification
"Safe Harbor"

A registration/certification "safe harbor" for nonprofit entities that harmonizes the conflicting authorities that now exist, addresses public protection "gaps" and does so through the certification of the designated "head of legal practice" rather than through the entity itself, is not intrusive nor burdensome to the entity, maximizes public protection and does not materially limit the constitutional freedoms these entities enjoy.

A registration program requiring nonprofit corporations, as entities, to register with the State Bar is duplicative of the existing Charitable Trust Registry maintained by the Attorney General's Office. Further, the corporate entity's registration would not serve the State Bar's interests in public protection, particularly where the nonprofit is dedicated to a broader mission than the practice of law. It is not the entity's conduct with which the State Bar is concerned, but maintenance of professional standards for the law practice within the entity when the entity is managed or governed by nonattorneys, may charge or collect attorney fees and may provide services to the public in addition to legal services.

The registration/certification requirement proposed here is directed at the "head of legal practice" within the entity, keeping the focus upon attorney professional standards, whether the entity be a nonprofit corporation or other nonprofit organization. The designated "head of legal practice" in a nonprofit law practice will register with the State Bar and certify that the law practice 1) maintains security for claims*, if it is a corporation*; 2) is bound by all professional standards; 3) has policies and procedures in place to assure compliance with professional standards; and 4) dedicates legal fees obtained by the entity to the legal practice.

Registration provides a "safe harbor" for the nonprofits. Failure to register alone is not a disciplinary offense either for the "head of practice" or for the entity. Failure to register merely eliminates the protections the corporate "shield" provides in the corporate setting and removes from nonprofit corporations and other organizations the "safe harbor" allowances on nonattorney governance, fee-sharing and mixing legal services with other services.

The "head of legal practice" registration elevates the profile of the attorney in the nonprofit legal practice where nonattorneys and nonlegal services may dominate. Registration gives the attorney a heightened ability to resist interference with professional standards. Nonattorney board members and managers in a nonprofit will come to appreciate that noncompliance with the registration/certification requirements has institutional costs. This will enhance compliance with public protection and professional standards.

Currently, a nonprofit corporation must have a certified public accountant or an authorized corporate officer, certify the accuracy of the nonprofit's annual financial

report. [Corp. Code §§ 6321(b), 8321(b); 2 Advising California Nonprofit Corporations, *supra,* Tax Filing, Record Keeping and Reporting at § 11.27, pp. 648-49)]. The nonprofit entities that are governed by the Nonprofit Integrity Act of 2004 [Gov't. Code §§ 12585, *et seq.*], must prepare an annual financial statement audited by a certified public accountant and file it with the Attorney General's Office. [Amending Gov't. Code. §12580(e); 2 Advising California Nonprofit Corporations, *supra,* Tax Filing, Record Keeping and Reporting, at §11.32A, p. 653.] Having a requirement that the "head of legal practice" certify the legal practice, just as the financial officer certifies the finances of the nonprofit entity, gives heightened assurance that the legal practice conforms to appropriate professional standards.

Registration is not a foreign concept to State Bar processes. For-profit corporations and limited liability partnerships register with the State Bar. [Bus. & Prof. Code §6160]. Law students register with the State Bar upon their commencement of law school study. [Rules Regulating Admission to Practice Law, rule V, §2.] Law students in practical training register with the State Bar. [Cal. Rules Court, rule 9.42]. Foreign legal consultants register with the State Bar. [Cal. Rule Court, rule 9.44]. In-house corporate counsel not admitted to practice in California who serve an in-house client in California register with the State Bar. [Cal. Rule Court, rule 9.46]. Legal services attorneys not admitted in California who serve a qualified legal service provider in California register with the State Bar. [Cal. Rule Court, rule 9.45].

Nor is the designation of a "head of legal practice" as a responsible person foreign to State Bar processes. Rules of Professional Conduct, rule 2-400, imposes a duty upon management agents in law practice settings not to "knowingly permit" "illegal" discrimination in the "management or operation of a law practice." This includes "law corporations, corporate and governmental legal departments and other entities which employ members to practice law."

Rules of Professional Conduct, rule 3-110 requires, as part of the duty of competence, that attorneys supervise the work of subordinate attorneys and nonattorney employees or agents. This is consistent with ABA Model Rule of Professional Conduct, rule 5.1 [Responsibilities of Partners, Managers and Supervisory Lawyers] which is even more explicit on the subject than California's rule 3-110. It states:

> "A partner in a law firm, and a lawyer who individually or together with other lawyers posses comparable managerial authority in a law firm, shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that all lawyers in the firm conform to the Rules of Professional Conduct."

Comment [1] to ABA Model Rule of Professional Conduct, rule 5.1 states that the rule applies to:

> ". . . members of a partnership, the shareholders in a law firm organized as a professional corporation, and members of other associations authorized to practice law; ***lawyers having comparable managerial authority in a legal services organization*** or a law department of an

enterprise or governmental agency."

[Id, Emphasis added.]

ABA Model Rule of Professional Conduct, rule 5.3 [Responsibilities Regarding Non-lawyer Assistants] extends the duty to supervise to subordinate nonlawyers with whom the lawyer works in providing legal services.

England, with whom we share a common law heritage, is moving in a direction that is worthy of note in this regard. The Secretary of State for Constitutional Affairs in the United Kingdom, Lord Falconer, has published a "White Paper" entitled "The Future of Legal Services: Putting Consumers First." The "White Paper" sets out the U.K. government's proposals for reforming the legal profession in England and Wales following up on the report and recommendations of Sir David Clementi along the same lines, issued in December 2004.

One element of the far-reaching proposal is to allow "Alternative Business Structures" (ABSs) for delivering legal services in the U.K. The ABS model allows attorneys and nonattorneys to work together in providing integrated legal and nonlegal services to the public and also allows private nonattorney investment in law practices. While this concept may not be ripe for consideration here, the proposed regulatory structure for this integrated environment is of relevance.

Under the U.K. proposal, in order to be allowed to provide legal services, the ABS must designate a "head of legal practice" and a "head of finance and administration." The "head of legal practice" must be a lawyer in good standing and is responsible for ensuring that the legal services provided by the ABS meet all standards governing the practice of law. The "head of legal practice" for the ABS must certify periodically to the regulating agency that the legal services provided by the ABS are provided in conformity with the legal profession's governing standards. Nonprofit legal service providers are expressly *included* in this process. [Appendix 1-5].

This proposal is moving toward implementation in Great Britain and Canada. [See reports and materials available at www.lawsociety.org.uk; www.lawsociety.org.bc].

This concept was also a point of discussion among responders to the survey. [Appendix 2-4, Question 8 (registration should identify a "responsible managing officer" for the delivery of legal services; an attorney should be assigned to oversee the nonprofit).]

V.
Conclusions

1. 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.

2. Based on the study data, the issue raised is not whether substantially enhanced regulation in this area is necessary, but whether the exemption nonprofits enjoy from the public protection standards established for law practice through the corporate form or involving nonattorney governance, fee-sharing and mixed legal/nonlegal services is warranted. The ultimate conclusion of this report is that such an exemption is not warranted.

3. Nonprofit law practices can, and should, be brought into conformity with appropriate standards that can, and should, be modified to accommodate them. This practice area should no longer operate as a footnoted exception in discussions on professional standards but rather hold its own explicitly recognized place in the “safe harbor” recommended here, with harmonized standards and clear guidelines.

4. The everyday practice of law in the nonprofit setting is substantially similar to the practice of law in general. The complaints and claims faced by nonprofit entities practicing law are not materially different than those encountered in any law practice setting.

5. There is no compelling evidence that nonprofits imperil client interests to any greater extent than encountered in the general practice of law.

6. Nor is there compelling evidence that nonprofits imperil client interests to such a negligible extent that an exemption from requirements governing for-profit practice is warranted, particularly where nonattorney governance is tolerated.

7. A nonprofit law practice entity need not be a corporation nor a professional corporation. Thus, compliance with Corporations Code section 13406(b) need not be mandatory.

8. Nonprofits that choose to incorporate and practice law do not generally incorporate as professional corporations. As a result, they are not required to maintain errors and omissions insurance, although most do so voluntarily. This is a significant departure from for-profit law corporations and limited liability partnerships. It is a condition of their existence that they maintain errors and omissions insurance due to the protections from liability that they obtain through incorporation. Incorporation in the nonprofit setting is sought for the same benefits as in the for-profit setting, including limitations on liability. The exemption from maintaining errors and omissions insurance is a “gap” in public

protection that currently exists for nonprofits that incorporate and practice law.

9. For-profit professional corporations and limited liability partnerships are required, as a condition of formation, to assure that:

> "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."

The exception under *Frye* for nonprofit corporations practicing law exempts these nonprofits from this assurance and creates the possibility that the nonprofit corporate entity could be used to limit or avoid the professional responsibilities of lawyers through the nonprofit corporation. This is a "gap" in public protection that currently exists within the nonprofit corporation law practice sector

10. The issue is not whether financial and ideological pressures exist in the nonprofit environment. They do exist and they push toward the margins defined by professional standards. The issue is whether these pressures are adequately managed within the nonprofit law practice setting and whether the management of these forces can be effectively enhanced with additional tools. The recommendations here seek to enhance management of these forces.

11. California's standards securing independence of professional judgment through prohibitions on mixed attorney and nonattorney boards, fee-splitting and mixing legal services with nonlegal services need to be harmonized so as to allow nonprofits more flexibility in these areas.

12. California's standards should be amended to explicitly allow attorneys to represent client interests in a nonprofit corporation or other organization governed by nonattorney board members and where nonlegal services are also provided, subject to the registration/certification "safe harbor" recommended here.

13. California's standards should be amended to explicitly allow nonprofit organizations to seek attorney fees, limited by Internal Revenue Service restrictions, subject to the registration/certification "safe harbor" recommended here.

14. 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. The realities of corporate practice and the pressures nonprofit organizations face lead to the conclusion that this traditional approach will not be adequate to safeguard

professional standards and public protection in the future.

15. The State Bar's existing law corporation registration/certification program is essentially a "safe harbor" for registered corporations allowing those within them to practice in a form that would otherwise not be available. Failure to register results in the loss of the protections of the "safe harbor," including the protections the corporate form provides to incorporated entities. This is a self-effectuating, unintrusive program where entities are, or are not, registered, and as a result, are or are not, at risk of losing the benefits the "safe harbor" provides. A similar registration "safe harbor" for nonprofit law corporations and other nonprofit organizations is not intrusive nor burdensome.

16. There are identifiable risks to the public interest that are unaddressed by existing regulation and which can be addressed by an unburdensome certification/registration program directed at the "head of the legal practice" within any entity that provides legal services where there is the potential for nonattorney governance, fee-splitting and mixed legal and nonlegal services.

17. A registration/certification program for nonprofit entities that harmonizes the conflicting authorities that now exist, that addresses those public protection "gaps" identified here (errors and omissions insurance in the corporate setting, entity liability, fee-splitting, independence of professional judgment, mixed legal/nonlegal services) and does so through the certification of the designated "head of legal practice" rather than through the entity itself, is not intrusive nor burdensome to the entity, maximizes public protection and does not materially limit the constitutional freedoms these entities enjoy.

VI.
Recommendations

1. Seek amendments to Corporations Code section 13406(b) to allow those qualified entities that so choose, to become nonprofit public benefit professional law corporations under California law under the following circumstances:

   A. It is a qualified legal services project or support center under Business and Professions Code section 6213.

   B. It is otherwise qualified under California's nonprofit public benefit corporation law.

   C. Its "head of legal practice" registers with the State Bar of California as provided under Recommendation number five.

2. Seek to further amend Corporations Code section 13406(b) to:

   A. Remove the requirement that all members, directors, officers and shareholders of the nonprofit public benefit professional corporation be licensed persons.

B. Remove the requirement that seventy percent of the clientele of the nonprofit professional law corporation be of low income or otherwise without access to legal services.

C. Remove the prohibition on contingency fees.

3. Seek to further amend Corporations Code section 13406(b) to add the provision from Business and Professions Code section 6167 that provides:

> A law corporation [under this title] 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.

4. Seek to amend existing statutes governing nonprofit benefit corporations in California, possibly the provisions of the Nonprofit Integrity Act of 2004 [Amending Gov't Code §§ 12585 *et seq*.], to conform to the proposed amendments of section 13406(b), for those nonprofit corporations that practice law.

5. Adopt a Rule of Court or enhance existing Rule of Professional Conduct 1-600 to require the "heads of legal practice" in any nonprofit legal practice, including nonprofit public benefit professional corporations, nonprofit public benefit corporations, law school clinics and other nonprofit organizations that provide legal services to the public in California to register with the State Bar of California in the following manner:

A. Qualified legal service providers under Business and Professions Code sections 6210 *et seq.* will be registered/certified by the State Bar through their initial and annual qualification as a qualified recipient. The application procedures to be a qualified recipient under sections 6210 *et seq.* will be enhanced to allow for this added certification requirement. The registration fee will be waived for these entities.

B. Nonprofit corporations and other organizations engaged in the practice of law in California that are registered with California's Registry of Charitable Trusts [Gov't Code § 12584] register with the State Bar through a certification provided by the designated "head of legal practice" for the entity. The registration fee will be waived for these entities.

C. Law school clinics and other nonprofit organizations not covered by Business and Professions Code sections 6210 *et seq.* or the Registry of Charitable Trusts [Gov't Code § 12584] register with the State Bar through a certification provided by the designated "head of legal practice" for the entity. A modest registration fee will apply to these entities.

D. All nonprofit entities engaged in the practice of law in California regardless of their form of practice, (including those identified above), may enter a "safe harbor" provided through the governing rules by designating a "head of legal practice" who has responsibility for certifying to the State Bar on an annual basis that:

(1). The legal practice occurring in California is overseen by a qualified member of the State Bar of California.

(2). The nonprofit is subject to Business and Professions Code sections 6210 *et seq.* or is registered with California's Registry of Charitable Trusts, or is exempt from doing do explaining why. If exempt, further information may be sought through the State Bar's registration process.

(3). The attorney fee revenue generated by the nonprofit organization practicing law is dedicated to the reasonable operating expenses of the legal practice or to the programmatic public service activities of the legal practice.

(4). Those entities that are nonprofit corporations, maintain security for error and omissions claims against the legal practice at least in the same amount as required for for-profit law corporations in California.

(5). The law practice has in place policies and procedures to assist it operate in accordance with professional responsibility standards governing the legal profession in California.

6. Amend California Rules of Professional Conduct, rules 1-600 [Legal Service Programs] 1-320(A)(4) [Financial Arrangements with Non-Lawyers] and 1-310 [Forming a Partnership with a Non-Lawyer] and other rules as appropriate, using as models ABA Model Rule of Professional Conduct, rule 5.4, as interpreted by the ABA Committee on Ethics and Professional Responsibility, and Utah's and Washington D.C.'s versions of these rules to create a "safe harbor" for nonprofit legal practices in California allowing them to engage in the practice of law where nonattorney management or governance may exist, legal services may be mixed with other services to the public, and legal fees are charged. These amended rules will clarify that registered entities are within the "safe harbor" and not subject to the same standards that govern for-profit entities on the subjects of nonattorney governance, fee-sharing, and combining legal and non-legal services, subject to the assurances that come with the registration requirements.

7. The penalty for noncompliance with registration requirements is the loss of the protections afforded by the "safe harbor," including the loss of the corporate "shield" for nonprofit corporations. Attorneys within the nonprofit organization will continue at all times to be fully subject to the requirements of their professional standards.

VII.
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 1-5	Falconer, *The Future of Legal Services: Putting Consumers First*, Chapter 6: Confidence and Choice -- New Ways of Delivering for Consumers, Secretary of State for Constitutional Affairs, United Kingdom (October 2005)
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