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To: ABA Entities, Courts, Bar Associations (state, local, specialty and international), Law Schools, and Individuals

**From: Jamie S. Gorelick and Michael Traynor, Co-Chairs
ABA Commission on Ethics 20/20**

Re: For Comment: Discussion Paper on Alternative Law Practice Structures

Date: December 2, 2011

The ABA Commission on Ethics 20/20 has been asked to study how the Model Rules of Professional Conduct might need to be amended to respond to changes in technology and the increasingly global nature of law practice. The Commission's work in this area has been guided by three principles: protecting the public; preserving core professional values; and maintaining a strong, independent, and self-regulated profession.

We have conducted research to understand the questions presented by changing technologies and the increasingly borderless practice of law. We have also engaged in extensive outreach and received helpful input.

This process has shown that U.S. lawyers and law firms are increasingly doing business abroad or affiliating with non-U.S. firms that have different business structures than their own firms. Many countries -- prompted largely by consumer concerns about the accessibility of legal services -- have decided to permit alternative law practice structures, including those that allow nonlawyer ownership in law firms. The Commission decided to study whether U.S. lawyers and law firms should also be permitted to employ alternative law practice structures in which nonlawyers have an ownership interest and how U.S. lawyers should address the differences in rules applicable in different jurisdictions. The Commission's November 2009 Preliminary Issues Outline posed these questions and asked whether such practices could operate in a manner that is consistent with the American legal profession's core values.

The Commission has ruled out certain forms of nonlawyer ownership that currently exist in other countries. In particular, the Commission rejected: (a) publicly traded law firms, (b) passive, outside nonlawyer investment or ownership in law firms, and (c) multidisciplinary practices (i.e., law firms that offer both legal and non-legal services separately in a single entity). The Commission, however, continued to study other options and, on April 5, 2011, released for comment an Issues Paper that sought comment on those options:

http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/abs_issues_paper.authcheckdam.pdf.

Consistent with the Commission's promise to provide opportunities for input, we are publishing for comment the attached Discussion Draft relating to a form of nonlawyer ownership that is similar to the form of nonlawyer ownership that the District of Columbia has permitted for 21 years. In particular, the Working Group on this issue - led by George Jones and Ted Schneyer - recommended that the Commission propose a limited form of court-regulated, nonlawyer ownership that allows individual nonlawyers employed by a law firm in providing legal services to have a financial interest in the firm and to share in its profits.

The Working Group heard anecdotal evidence from lawyers who advise District of Columbia law firms on arrangements for admitting nonlawyers to their partnerships that law firms, and small law firms in particular, are increasingly interested in having nonlawyer partners. These firms believe that there is or will be client demand for the legal services that firms with nonlawyer partners are well-positioned to provide. Examples include law firms that focus their practice on land use planning with engineers and architects; law firms with intellectual property practices with scientists and engineers; family law firms with social workers and financial planners on the client service team; and personal injury law firms with nurses and investigators participating in the evaluation of cases and assisting in the evaluation of evidence and development of strategy.

The Working Group also heard anecdotal evidence that small firms believe that they can better recruit technology experts if they can offer them a partnership interest which would help them innovate by harnessing new technologies, thus responding to accelerating demand. Lawyers who believe that a law firm owned solely by lawyers is the best and most efficient structure for providing legal services would of course be free to continue providing legal services as they have in the past.

Following the District of Columbia model, the proposal is that the sole purpose of such a law firm must be the delivery of legal services and that the services provided by nonlawyers must be limited to assisting the lawyers in the delivery of those legal services. The lawyers would be responsible for assuring that the conduct of the nonlawyers is consistent with the lawyers' obligations under the Model Rules. Nonlawyer owners would not have their own clients or offer nonlegal services to clients independent of the legal services provided to clients of the firm. In short, alternative law practice structures are not multidisciplinary practice by another name.

Moreover, the proposal contains additional restrictions beyond those that the District of Columbia has imposed. First, the Working Group concluded that lawyers would have to maintain the controlling financial interest and voting rights in the law firm. Also, before a nonlawyer is permitted to have a financial interest in a law firm, the lawyer partners would have to investigate the nonlawyer's professional reputation for integrity. The investigation would be analogous to a character and fitness inquiry, and the firm would have to maintain a record of that investigation and its results.

Notwithstanding the limited nature of the Working Group proposal and the safeguards built into the proposal, we have heard expressions of concern about any form of nonlawyer ownership. One is that nonlawyer ownership, even in the limited form described above, could diminish the profession's current judicially-based system of regulation by expanding the scope of professional regulation beyond its traditional focus on lawyers, thus making external regulation more likely.

Another is whether there is demand from lawyers or clients for such changes. Although the District of Columbia model appears to have worked there without adverse effects, the Commission would like to hear whether there is a demand outside of that jurisdiction for firms with limited nonlawyer ownership of the sort the Working Group proposes.

We seek your views on these issues and any other aspect of the Working Group's proposal. Before deciding how to proceed, if at all, we want to hear your thoughts and to review any supporting materials you may wish to offer on these questions.

We encourage responses to these initial proposals by late January 2011, so that they can be discussed at the Commission's February 2 – 3, 2012 meeting. If you need additional time, please submit comments by **February 29, 2012**. Comments should be submitted to Senior Research Paralegal, Natalia Vera at natalia.vera@americanbar.org and may be posted to the Commission's website.

**ABA Commission on Ethics 20/20 Discussion Draft for Comment
Alternative Law Practice Structures
December 2, 2011**

The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing the policy of the American Bar Association.

REPORT

Introduction and Summary

The ABA Commission on Ethics 20/20 has been examining how globalization and advances in technology have affected the legal profession and transformed the delivery of legal services in the U.S. and abroad. The Commission’s work has been guided by the Association’s and the profession’s longstanding commitments to protecting the public; preserving core professional values; and maintaining a strong, independent and self-regulated profession.¹ The Commission has also been mindful of the need to increase access to justice and to identify opportunities that might permit lawyers to innovate in order to respond to unmet legal needs and enhance the delivery of legal services to their clients. In the course of its research and outreach, the Commission learned that many countries – prompted largely by consumer concerns about the accessibility of legal services – have decided to permit alternative law practice structures (ALPS) in which nonlawyers have an ownership interest. The Commission also learned that in countries that have permitted ALPS to date, the overwhelming majority of firms adopting an alternative structure have been small firms. Research also revealed that U.S. lawyers and law firms are increasingly engaging in practice abroad² or are affiliating with non-U.S. firms that have different business structures than they have.

In view of these developments, the Commission has been studying whether to recommend permitting alternative law practice structures that would allow U.S. lawyers to innovate in order to provide more, better or less expensive legal services while operating in a manner consistent with the American legal profession’s core values. The Commission has also been examining how to address the differences that now exist

¹ In the United States, each jurisdiction’s highest court of appellate jurisdiction possesses the inherent or constitutional authority to regulate the legal profession. *See, e.g.,* Commission on Evaluation of Disciplinary Enforcement, Am. Bar Ass’n, *Lawyer Regulation for a New Century* (1992) at 2; *see also In re Shannon*, 876 P. 2d 49 (Ariz. 1994) (noting the state judiciary’s authority to regulate the practice of law is accepted in all fifty states). The American Bar Association has long supported primary state-based judicial regulation of the profession; that is what is meant in referring to “self-regulation” in the United States context.

² Of the sixty-seven U.S.-based law firms identified in the American Lawyer “Global 100” in 2010, which ranks the world’s top 100 law firms by gross revenue, only seven had offices exclusively in the United States. Two firms were structured as vereins and were therefore not identified as U.S.-based law firms for purposes of the American Lawyer survey. *See* Michael D. Goldhaber, “Empire Builders,” *The American Lawyer* (October 1, 2011), available at <http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202516509353>; *see also* “The 2011 Global 100”, *The American Lawyer* (October 1, 2011), available at <http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202516641977>.

**ABA Commission on Ethics 20/20 Discussion Draft for Comment
Alternative Law Practice Structures
December 2, 2011**

between the rules governing law practice structures in the jurisdictions in the global legal services marketplace in which many U.S. lawyers and law firms now compete.³

Guided by the three fundamental principles mentioned above, the Commission decided not to recommend to the ABA House of Delegates three of the forms of ALPS that currently exist in other countries: (a) publicly traded law firms; (b) passive, outside investment or ownership in law firms; and (c) multidisciplinary practices (i.e., law firms that offer both legal and non-legal services separately from within a single entity).

However, the Resolution accompanying this Report recommends amendments to ABA Model Rule of Professional Conduct 5.4 (Professional Independence of a Lawyer) that would permit limited nonlawyer ownership in law firms but with very stringent restrictions:

- such law firms would be restricted to providing legal services;
- nonlawyer owners would have to be active in the firm, providing services that support the delivery of legal services by the lawyers (i.e., the firm cannot be a multidisciplinary practice);
- nonlawyer ownership and voting interests would be restricted by a percentage cap sufficient to ensure that lawyers retain control of the firm;
- nonlawyer owners would be required to agree in writing to conduct themselves in a manner consistent with the Rules of Professional Conduct for lawyers;⁴ and
- lawyer owners would be responsible for both ensuring that the nonlawyer owners in their firm were of good character and supervising the nonlawyers in regard to compliance with the Rules of Professional Conduct.

The Resolution thus proposes a modest liberalization of the current Model Rule 5.4 prohibitions, but takes an approach that is more restrictive than even the limited form of nonlawyer ownership permitted under the version of Rule 5.4 the District of Columbia has had in place for over twenty years. The Commission's Alternative Law Practice Structures Working Group identified this stricter version of the District of Columbia rule as a potential option in its April 2011 Issues Paper Concerning Alternative Business Structures.⁵ The additional protections contained in the Resolution over and above those in the District of Columbia version of Rule 5.4 are designed to ensure the continued professional independence of lawyers in law firms, and to resolve any potential conflicts between the professional obligations of lawyers and any nonlawyer owners. For example,

³ See ABA Commission on Ethics 20/20, Preliminary Issues Outline at 6, *available at* http://www.americanbar.org/content/dam/aba/migrated/2011_build/ethics_2020/preliminary_issues_outline_authcheckdam.pdf.

⁴ This would ensure that if the professional obligations of a nonlawyer conflicted with those of lawyers, the lawyers' obligations would control and the nonlawyer would either be barred from working on pertinent matters or, if necessary, would preclude the nonlawyer from becoming a member of the law firm.

⁵ See ABA Commission on Ethics 20/20 Working Group on Alternative Business Structures, For Comment: Issues Paper Concerning Alternative Business Structures, April 5, 2011, *available at* http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/abs_issues_paper_authcheckdam.pdf ("April 2011 Issues Paper").

**ABA Commission on Ethics 20/20 Discussion Draft for Comment
Alternative Law Practice Structures
December 2, 2011**

the Resolution's character and fitness requirement for nonlawyer owners reinforces the primacy of public protection and the high standards of integrity expected of lawyers and law firms. At the same time, the proposed amendments to Model Rule 5.4 would permit lawyers and law firms that so desired to consider adopting alternative legal practice structures that might enable them to innovate in order to provide more, better, or less expensive legal services.

Lawyers who believe that a law firm owned solely by lawyers is the best and most efficient structure for providing legal services would, of course, be free to continue providing services as they always have. But in the absence of empirical evidence from the District of Columbia or elsewhere that lawyers cannot meet their professional obligations in any firm that has even a single nonlawyer owner, there is no clear justification for protecting lawyers in traditional law firms from having to compete with lawyers who believe that the kind of alternative law practice structures the Resolution would permit can improve client service, as long as the ethical values and protections at the heart of the U.S. legal profession's traditions are preserved.

Discussion and Options Considered

In order to examine these issues in depth, the Commission formed a Working Group composed of a cross-section of Commission members and participants from other ABA and outside entities who could provide particular insight into the potential impact of any proposed changes. The Working Group included representatives from the ABA General Practice, Solo and Small Firm Division; the ABA Standing Committee on Ethics and Professional Responsibility; the ABA Standing Committee on Professional Discipline; the Coordinating Council of the ABA Center for Professional Responsibility; and the National Organization of Bar Counsel.⁶

Recognizing that the legal profession has a vital role to play in remedying the growing problem of unmet legal needs,⁷ the Working Group studied domestic and international developments in law practice with a view to finding ways to increase access to justice. In that regard, the Working Group considered whether lawyers and law firms should be allowed to structure their practices differently than the Model Rules of Professional

⁶ The members of the Working Group are George W. Jones (Co-Chair and Commissioner), Professor Theodore J. Schneyer (Co-Chair and Commissioner), Jeffrey B. Golden (Commissioner), Roberta Cooper Ramo (Commissioner), Professor Carole Silver (Commissioner), Chief Justice Gerald W. VandeWalle (Commissioner), Donald B. Hilliker (ABA Center for Professional Responsibility), Kathleen J. Hopkins (ABA General Practice, Solo and Small Firm Division), George Ripplinger (ABA Standing Committee on Ethics and Professional Responsibility), Wallace E. "Gene" Shipp, Jr. (National Organization of Bar Counsel) and Robert D. Welden (ABA Standing Committee on Professional Discipline). Professor Paul D. Paton serves as Reporter. Elyn S. Rosen, Commission Counsel, and Arthur Garwin, Deputy Director of the ABA Center for Professional Responsibility, provided counsel to the Working Group.

⁷ See William D. Henderson and Rachel M. Zahorsky, "Law Job Stagnation May Have Started Before the Recession – And It May Be A Sign of Lasting Change," *ABA Journal*, July 2011 (comments of Commissioner Fred Ury, former President of the Connecticut Bar Association, stating that "[t]he biggest problem... is that ordinary citizens cannot afford to hire a lawyer" and predicting that the problem of unmet legal needs, if not solved by lawyers, "will be solved by technology").

**ABA Commission on Ethics 20/20 Discussion Draft for Comment
Alternative Law Practice Structures
December 2, 2011**

Conduct have permitted to date. In particular, the Working Group analyzed whether the traditional ban on sharing legal fees with nonlawyers or practicing law in a firm in which one or more nonlawyers are principals unduly limits innovation, discourages U.S. lawyers from optimally leveraging new technologies to offer new services, or slows progress in delivering traditional services more efficiently and effectively.

The District of Columbia's ethics rules have permitted a limited form of nonlawyer ownership or management of law firms for over twenty years with no evidence of adverse consequences. Taking account of the District of Columbia model and others now in effect abroad, the Working Group considered what, if any, features from these models could be implemented within our existing regulatory framework in a manner consonant with the principles guiding the Commission's work.

Consumer demand for inexpensive and Internet-accessible solutions to legal problems has grown rapidly. But simply downloading legal forms without the benefit of personalized legal advice can be unhelpful or, worse, misleading. Encouraging law firms to innovate, especially by harnessing new technologies, can respond to the accelerating demand while affording clients the benefit of fully qualified – and regulated – lawyers. The Working Group received anecdotal evidence that small firms in the District of Columbia find that being able to hold out the possibility of partnership to technology experts enables them to recruit and retain the nonlawyer experts they want, without compromising the independence of the firm or lawyer control.

The Working Group released an Issues Paper in April 2011 describing in considerable detail current domestic and foreign approaches to ALPS.⁸ The Working Group identified five possible approaches:

- A. Limited Lawyer/Nonlawyer Partnerships with a Cap on Nonlawyer Ownership;
- B. Lawyer/Nonlawyer Partnerships with No Cap on Nonlawyer Ownership (The District of Columbia Approach);
- C. Multidisciplinary Practices that Offer Both Legal and Non-Legal Services;
- D. Limited Outside Investment in Law Firms; and
- E. The Australian Model Permitting Public Trading of Shares in Law Firms.

Before releasing the Working Group's Issues Paper, the Commission in February 2011 ruled out Options D and E – passive outside investment in law firms and the public trading of shares in law firms. Both have recently been adopted abroad but so far have little track record, would depart sharply from U.S. traditions, and raised significant ethical concerns among Commission members and certain commentators.

However, the Commission authorized the Working Group to continue considering the other options. To that end, the Working Group and Commission representatives have undertaken extensive efforts to reach out to state and local bar associations and ABA entities for their views about whether and how amendments to the Rules of Professional

⁸ April 2011 Issues Paper, *supra* note 5.

**ABA Commission on Ethics 20/20 Discussion Draft for Comment
Alternative Law Practice Structures
December 2, 2011**

Conduct might enhance access to legal services and encourage innovations that would enable law firms to better serve clients while preserving the profession's core values.⁹ Because ALPS in the District of Columbia and abroad have so far been established primarily by lawyers in small firms,¹⁰ the Commission, in addition to its broad general outreach, has also engaged in more focused discussions with the ABA General Practice, Solo and Small Firm Division and the ABA Young Lawyers' Division.

In June 2011, the Commission eliminated further consideration of the third approach set out in the Issues Paper – Option C: multidisciplinary practices (MDPs) in which lawyers offer legal services and nonlawyers offer other professional services to clients who may or may not also be using the firm's legal services. Like the other two options eliminated from consideration, MDPs are permitted in a number of countries in which U.S. lawyers and law firms engage in the practice of law. The ABA considered whether to permit MDPs in 1999-2000 and strongly rejected the idea.¹¹

A Narrowed Focus

As a result of the Commission's directions in February and June 2011, the Working Group narrowed further consideration of ALPS to the first two options identified in the Issues Paper:

- i) **Option B:** the approach taken by the District of Columbia, which permits lawyers to share legal fees with nonlawyers where the lawyers practice law in a partnership or other form of organization in which a financial interest is held or managerial authority is exercised by one or more nonlawyers who provide services that assist the firm in providing legal services to clients, under certain conditions, but without a cap on nonlawyer ownership¹²; and
- ii) **Option A:** a narrower version of the District of Columbia approach, which would permit lawyers to become partners with (and share fees with) nonlawyers, such as economists, social workers, architects, engineers, consultants and financial advisors, under narrowly defined circumstances. In its Issues Paper, the Working Group called this the "most modest

⁹ However, the Working Group's efforts to solicit written submissions addressing these matters yielded only six submissions. These are available at http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20110627_abs_issues_paper_comments_for_posting_authcheckdam.pdf.

¹⁰ See the discussion below of implementation in the District of Columbia, and the statistics available from English authorities about firms registered as Legal Disciplinary Practices in England since 2009.

¹¹ See Report to the House of Delegates 109 (August 1999) at C9-10, available at http://www.americanbar.org/groups/professional_responsibility/commission_multidisciplinary_practice/mdpfinalreport.html; see also the April 2011 Issues Paper, *supra* note 5, at pp. 5-7 for a detailed history.

¹² District of Columbia Bar, DC Rules of Professional Conduct, Rule 5.4 (Professional Independence of a Lawyer), available at http://www.dcb.org/for_lawyers/ethics/legal_ethics/rules_of_professional_conduct/amended_rules/rule_five/rule05_04.cfm.

**ABA Commission on Ethics 20/20 Discussion Draft for Comment
Alternative Law Practice Structures
December 2, 2011**

approach.” It would require that: i) the firm engages only in the practice of law; 2) the nonlawyers own no more than a certain percentage (e.g. 25%) of the firm, and 3) the nonlawyers pass a “fit to own” test.¹³

The Working Group and the Commission evaluated these two options carefully, taking into account both domestic and international developments. The Commission also took note of legislation to permit up to 49% nonlawyer equity ownership of incorporated law firms introduced in North Carolina in March 2011.¹⁴

It is sometimes claimed as an overarching and general objection that permitting law firms to have nonlawyer partners will interfere with the lawyers’ exercise of independent professional judgment on behalf of clients, while offering few, if any, benefits for those clients. But the relevant policy issue concerns the specific risks and benefits associated with the highly restricted form of ALPS that the accompanying Resolution would permit. Both the District of Columbia, and more recently, England have had experience with ALPS that are closely analogous to the ALPS that would be permitted under this proposed amended version of Model Rule 5.4. The experience in those two jurisdictions provides some insight into the risks and potential benefits associated with their particular ALPS structures.

Domestic Experience: The District of Columbia Approach

As noted above, the District of Columbia has permitted a form of nonlawyer ownership or management of law firms for over twenty years. Because Washington, D.C. law firms that have nonlawyer partners are not required to register as such with the District of Columbia Bar Association, information about the number of those firms operating today and their nonlawyer complement is unavailable. Such firms clearly exist, however, and the Commission was advised that there have been no disciplinary cases involving interference with lawyers’ professional judgment by nonlawyers with an ownership interest since that was first permitted. There is simply no evidence that the perceived risk of interference has materialized.

At the same time, there was anecdotal evidence from lawyers who advise District of Columbia law firms on arrangements for admitting nonlawyers to their partnerships that law firms, and small law firms in particular, are increasingly interested in having nonlawyer partners. These firms believe that there is or will be client demand for the legal services that firms with nonlawyer partners are well-positioned to provide. Examples include law firms that focus their practice on land use planning with engineers and architects; law firms with intellectual property practices with scientists and engineers; family law firms with social workers and financial planners on the client service team; and personal injury law firms with nurses and investigators participating in the evaluation of cases and assisting in the evaluation of evidence and development of strategy.

¹³ April 2011 Issues Paper, *supra* note 5 at 17-18.

¹⁴ See An Act to Allow Nonattorney Ownership of Professional Corporation Law Firms, Subject to Certain Requirements, available at <http://www.ncleg.net/Sessions/2011/Bills/Senate/HTML/S254v0.html>.

**ABA Commission on Ethics 20/20 Discussion Draft for Comment
Alternative Law Practice Structures
December 2, 2011**

Commission outreach and research yielded the following additional information:

- Many of the firms with nonlawyer partners under the District of Columbia Rule have been small firms;
- Small firms that have nonlawyer partners found the opportunity to hold out the prospect of partnership helpful in recruiting and retaining nonlawyers;
- While large law firms can often recruit and retain key nonlawyers as employees rather than as partners by providing salaries and bonuses comparable to the total compensation received by law partners, providing guaranteed compensation of that magnitude to nonlawyer partners or owners was not feasible for many smaller firms;
- Some plaintiff personal injury firms working on a contingent fee basis view fee-sharing with nonlawyer partners as a more equitable distribution of firm income given the value of the support nonlawyer partners provide in developing their firm's cases;
- Some firms reported that taking on nonlawyer partners has allowed for greater innovation and efficiency than segregating nonlawyers in a related ancillary business of the sort permitted under Rule 5.7 of the Model Rules of Professional Conduct. This applied even for firms that focus on lobbying; and
- Transaction costs borne by clients to deploy law firms and other professional service providers to work together on projects can be eliminated by firms that have nonlawyer partners.

In addition, in the course of discussing the District of Columbia experience with lawyers who assist firms in structuring in compliance with the District's version of Rule 5.4, the Commission learned that many law firms in the District of Columbia are multijurisdictional firms, an appreciable number of which would like to add nonlawyer partners in their District of Columbia offices but for the continuing prohibition on nonlawyer partners in other U.S. jurisdictions.

Analogous International Experience: Legal Disciplinary Partnerships in England

The Working Group also studied ALPS models adopted abroad, because U.S. lawyers and law firms are increasingly operating in markets where such models are permitted. As of August 2011, there were 1,017 U.S. qualified partners in firms regulated by the English Solicitors Regulatory Authority (SRA), and 119 U.S. qualified partners working in what the SRA would recognize as "English" law firms.¹⁵ England provides what the

¹⁵ Letter from Samantha Barrass, Executive Director – Standards, Risk & Supervision, Solicitors Regulation Authority, to Ellyn S. Rosen, ABA Regulation Counsel, November 8, 2011. The letter notes that the 1,017 U.S. qualified partners may include U.S. partners in branches of U.S. firms in different parts of the world which are required to register with the SRA "because they have one or more solicitor partners, or because they are part of the same partnership as the London office."

**ABA Commission on Ethics 20/20 Discussion Draft for Comment
Alternative Law Practice Structures
December 2, 2011**

Working Group found to be the most pertinent foreign model for the Working Group's purposes – the Legal Disciplinary Partnership (or LDP). The LDP is a form of ALPS that permits up to 25% of a law firm's partners to be nonlawyers.¹⁶ In 2010, a New York-based litigation firm converted its office in London, England to operate as an LDP. By August 2011, three U.S. firms were registered with the SRA as LDPs.¹⁷

The structure of LDPs is much like that of the law firms that would be permitted to have nonlawyer partners under the amendments to Model Rule 5.4 proposed in the Resolution accompanying this Report. An LDP must only provide legal services. It may have principals who are different types of lawyers (e.g., barristers and solicitors). Much more importantly, an LDP may have up to 25% nonlawyer principals.¹⁸ External or "passive" owners are forbidden.¹⁹ Nonlawyer principals in an LDP are subject to a "fitness-to-own" review and approval by the SRA.²⁰ The SRA imposes an approval fee of £250 plus the cost of the criminal background check for each nonlawyer principal.²¹ The SRA can later withdraw approval of a nonlawyer principal for good cause. The SRA may direct an LDP to appoint a designated lawyer to ensure compliance with the LDP's obligations and duties under the applicable laws, codes of conduct and other rules and regulations. Finally, LDPs are required to maintain professional liability insurance.²²

LDPs have been permitted in England and Wales since March 31, 2009. In the remarkably short period between then and October 2011, the SRA had approved a total of 490 LDPs. The growth in the number of firms seeking approval is remarkable, as is the fact that the LDPs with nonlawyer principals are -- like the Washington, D.C. law firms that have nonlawyer partners -- primarily small firms. At the Commission's August 2010 meeting, the Chief Executive of the Law Society of England and Wales reported that, as of June 2010, there were 254 registered LDPs; 184 of them (over 70%) were firms of 10 or fewer partners. The types of nonlawyer partners in these firms included teachers, financial planners and accountants, among others. By March 2011, the SRA had

¹⁶ Claire Ruckin, *New York trial specialist firm converts City arm to LDP status*, LegalWeek.com (9 June 2010), available at <http://www.legalweek.com/legal-week/news/1653625/new-york-trial-specialist-firm-converts-city-arm-ldp-status>; see also James Dean, *US lawyers consult on ABS reforms*, Law Society Gazette (14 April 2011), available at <http://www.lawgazette.co.uk/news/us-lawyers-consult-abs-reforms>. Firm promotional materials reference "a diverse team of financial analysts to work alongside our lawyers in all financial products matters" but do not identify whether the financial analysts are employees or partners of the firm under the LDP rules. See http://www.kobrekim.com/kobre_kim_solutions.html.

¹⁷ Registration as an LDP does not necessarily mean that the firm has nonlawyer partners, but the registration permits it.

¹⁸ See *Legal Services Act: Legal disciplinary practices – practical issues* at <http://www.sra.org.uk/sra/legal-services-act/faqs/abs-faqs.page> and Solicitors' Code of Conduct 2007, the Management and control requirement, para. 10-21, available at <http://www.sra.org.uk/solicitors/code-of-conduct/rule14.page>.

¹⁹ *Id.*

²⁰ See SRA Recognised Bodies Regulations 2009 at 3.3, available at <http://www.sra.org.uk/solicitors/change-tracker/code-of-conduct/recognised-bodies-regulations.page#r3>.

²⁰ <http://www.sra.org.uk/sra/legal-services-act/faqs/abs-faqs.page>.

²¹ *Id.*

²² See *Legal Services Act, 2007*, c. 29 (U.K.), available at <http://www.legislation.gov.uk/ukpga/2007/29/contents>; see also The Law Society, *Legal disciplinary practice – 6 April 2011*, available at <http://www.lawsociety.org.uk/productsandservices/practicenotes/ldp/4946.article#ldp7>.

**ABA Commission on Ethics 20/20 Discussion Draft for Comment
Alternative Law Practice Structures
December 2, 2011**

approved registration for 377 LDPs.²³ As of April 2011, 56% of the 389 registered LDPs included nonlawyer partners; around one-third of the 218 partnerships with nonlawyers included four partners or fewer; the weighted average size of all partnerships with nonlawyers was seven partners; and the largest of the partnerships with nonlawyers had more than 300 partners in total.²⁴ The 490 LDPs approved by October 2011, then, was nearly double the number from less than 18 months before.²⁵ To date, no disciplinary problems with LDPs have been reported.²⁶

Choosing Option A: Law Firms with Caps on Nonlawyer Ownership, and Fitness to Own Requirements for Nonlawyer Partners

The Working Group's Options A and B present similar models for a restricted approach to law firm partnership between lawyers and nonlawyers. Both require that the firm engage only in the practice of law.

The Resolution accompanying this Report proposes the more restrictive Option A, which in addition would require that:

1. the nonlawyers own no more than a certain percentage of the firm, and
2. the nonlawyers pass a "fit to own" test

Option B, the District of Columbia model in place for over twenty years, has neither a cap on nonlawyer ownership nor a "fit to own" test for nonlawyers. While recognizing that the District of Columbia model has operated without generating disciplinary complaints, the Working Group determined that Option A would provide comparable opportunities for innovation and increased access to justice while offering stronger protections consonant with the core professional values of the broader U.S. legal community.

²³ *First report on UK legal reforms cautiously optimistic*, New Legal Review (6 July 2011), available at http://www.cpaglobal.com/newlegalreview/4914/first_report_on_uk_legal_reform. See also Legal Services Consumer Panel, "Consumer Impact Report 2011," at p. 13, available at http://www.legalservicesconsumerpanel.org.uk/publications/research_and_reports/documents/ConsumerPanel_ConsumerImpactReport_2011.pdf.

²⁴ Solicitors Regulation Authority, *Legal Disciplinary Practice As At April 2011* [copy on file with the Commission].

²⁵ Solicitors Regulation Authority, *Regulated Community Statistics* (last updated: 3 November, 2011), available at <http://www.sra.org.uk/sra/how-we-work/reports/statistics/regulated-community-statistics.page>.

²⁶ With the introduction of Alternative Business Structures (ABS) from 2011, LDPs will have to transition to become ABS if they want to maintain nonlawyer owners in the firm: "When ABSs are permitted, all LDPs which have non-lawyer managers will need to become ABSs and will need to comply with the rules governing them. ... Firms will be able to passport across from October 2011 and must do so by October 2012 if they wish to retain their non-lawyer managers. Firms which have non-solicitor lawyer managers will not have to become ABS." See The Law Society, *Legal disciplinary practice – 6 April 2011*, *supra* note 22.

**ABA Commission on Ethics 20/20 Discussion Draft for Comment
Alternative Law Practice Structures
December 2, 2011**

I. Requirements for Participation and Limits on Nonlawyer Ownership

The Commission determined that, in order to protect and preserve the independence of the lawyers in a law firm, any revision to Model Rule 5.4 should require that nonlawyer owners be actively engaged in supporting the firm's provision of legal services, and that a cap be placed on the financial and voting participation of nonlawyers in the firm. Each of these requirements is addressed in turn.

A. Active Participation by Nonlawyers

Although the U.S. Chamber Institute for Legal Reform (ILR)'s written submission to the Commission in response to the Issues Paper's call for comments opposed any change to Model Rule 5.4, ILR added that if the Commission nevertheless proceeded with a recommendation for change, it must "require that the non-lawyers *actively* and *materially* assist the lawyers in providing legal services to clients *by bringing some valuable non-legal professional service to the table*, not merely by raising capital or assessing the likely profitability of any case for the partnership. Such direct professional involvement is critical to ensure that non-lawyer partners do not simply become involved in the law firm as a conduit for a passive equity investment."²⁷ [emphasis in original]

The draft Resolution is responsive to this recommendation. In addition, the Resolution expressly requires that the firm's sole purpose be the provision of legal services to clients. Accordingly, it precludes passive equity investment and does *not* permit multidisciplinary practice. Nonlawyer owners would not have their own clients or offer nonlegal services to clients independent of the legal services provided to clients of the firm.

B. Caps on Nonlawyer Ownership

The Working Group and Commission also agreed that lawyers must retain controlling authority in order to protect the independent exercise of lawyer judgment and control of the firm. In its May 25, 2011 letter responding to the Issues Paper, the ABA Standing Committee on Client Protection, while taking no position on whether the ABA should adopt a policy for ALPS, recommended that "[a]ny proposal promulgated by the Commission should include a limitation on the percentage of nonlawyer owner/managers. Lawyer managers should retain the majority interest."²⁸ The ILR had similarly recommended that a change to Model Rule 5.4 "should also cap the interest that nonlawyer(s) may have in an alternative business structure in order to prevent the

²⁷ Letter from John H. Beisner to Natalia Vera, Senior Research Paralegal, Commission on Ethics 20/20, Comments of the U.S. Chamber Institute for Legal Reform on the Issues Paper Concerning Alternative Business Structures, June 1, 2011, at p. 5 ["ILR letter"].

²⁸ Letter from Justice Daniel J. Crothers, Chair, ABA Standing Committee on Client Protection to ABA Commission on Ethics 20/20 Re: Issues Paper Concerning Alternative Business Structures, May 25, 2011 [hereafter "Client Protection Letter"].

**ABA Commission on Ethics 20/20 Discussion Draft for Comment
Alternative Law Practice Structures
December 2, 2011**

nonlawyer(s) from having inordinate influence over the practice of law and strategic decision making.’’²⁹

The Commission invited comment on whether limiting the percentage of nonlawyer ownership would adequately protect clients, and, if so, what the limit should be. The Commission considered two possible options: a minority (49%) level (as in the proposed North Carolina legislation) and a 25% level (as in the LDP regime in England). A third option would be to leave a bracketed reference in the Model Rule so that individual jurisdictions could decide what they thought most appropriate for their jurisdiction.³⁰

The Commission favored a 25% limit as more consonant than a 49% limit with the aim of protecting core professional values, but recognized that the states may have different preferences. Accordingly, the Resolution contains a bracketed 25% limit. It is important to note, however, that this 25% limit is not calculated simply on the basis of a per capita headcount.

The Commission also discussed further modifications to address concerns about the ability of lawyers to maintain control of the law firm. In particular, the Commission sought to ensure that as a practical matter, nonlawyers would not be able to affect decisions except in matters where supermajorities prevailed. If a nonlawyer partner has a vote at all, the nonlawyer may have the power to break ties among the lawyers or to form voting coalitions with groups of lawyer partners to achieve supermajorities that may be necessary for certain actions. But the lawyer partners still retain control of the firm, even if, in some limited circumstances, they may want or need the votes of nonlawyer partners. While the Commission has sought to limit the extent to which nonlawyer voting rights could affect decision-making within a law firm it recognizes that lawyers should be free to tailor the detailed arrangements within their own partnership agreements, subject to overall restrictions.

The Resolution thus contains the following requirement in proposed Rule 5.4(b)(5):

the financial and voting interests in the firm of any nonlawyer are less than the financial and voting interest of the individual lawyer or lawyers respectively holding the greatest financial and voting interests in the firm, the aggregate financial and voting interests of the nonlawyers does not exceed [25%] of the firm total, and the aggregate of the financial and voting interests of all lawyers in the firm is equal to or greater than the percentage of voting interests required to take any action or for any approval.

²⁹ ILR letter, *supra* note 27, at p. 8.

³⁰ Such an approach is not without precedent, as in Rule 2.11 of the Model Code of Judicial Conduct.

**ABA Commission on Ethics 20/20 Discussion Draft for Comment
Alternative Law Practice Structures
December 2, 2011**

II. “Fit to Own”/Character Assessment and Lawyer Responsibility for Nonlawyer Partner Conduct

Recognizing the importance of fitness of character for ensuring the integrity of those admitted to practice law, the Commission concluded that a character and fitness assessment should also be required for nonlawyers who would become partners in law firms under the proposed revisions to Model Rule 5.4. The Resolution recommends two requirements:

5.4(b)(4): the lawyers who have a financial interest in the firm are responsible for these nonlawyers to the same extent as if the nonlawyers were lawyers under Rule 5.1; and

5.4(b)(6): lawyers with a financial interest in the firm make reasonable efforts to establish that each nonlawyer with a financial interest in the firm is of good character, supported by evidence of the nonlawyer’s integrity and professionalism in the practice of his or her profession, trade or occupation, and maintain records of such inquiry and its results.

The ABA Standing Committee on Client Protection recommended to the Commission that “[a]ll owners should be required to satisfy standards of character and fitness.” The Standing Committee also noted that “[t]raditionally lawyer discipline is individual and is not applied to the entity or firm. However, according to Rule 5.3... lawyer supervisors may be disciplined for failure to ensure that non-lawyer subordinates adhere to professional standards, including a violation of the Rules of Professional Conduct.” The Standing Committee recommended that Model Rule 5.3 be amended to include nonlawyer owners, so that lawyer supervisors would be disciplined for any violations by either nonlawyer owners or by nonlawyer assistants.³¹

The Commission concurred with the spirit of the Standing Committee’s recommendations. However, the Commission noted that Model Rule 5.1 makes supervising lawyers responsible for having policies and procedures in place to ensure compliance by other lawyers in the firm. The proposed revision to Model Rule 5.4(b)(4) makes lawyers responsible for the fitness and conduct of their nonlawyer partners in language parallel to the approach taken in Rule 5.1.

The Resolution thus requires lawyer partners to make reasonable efforts to ensure that their nonlawyer partners are of good character. It also makes lawyer partners responsible for documenting evidence to support such a conclusion. Further, these obligations apply both when an initial assessment is done at the time the nonlawyer partner is admitted to the law firm partnership, and on an ongoing basis.

The ABA Standing Committee on Client Protection had recommended that registration for ABS/ALPS firms be made mandatory: “Firms should have to register with the highest

³¹ Client Protection Letter, *supra* note 28, at 1.

**ABA Commission on Ethics 20/20 Discussion Draft for Comment
Alternative Law Practice Structures
December 2, 2011**

court of appellate authority and with the jurisdiction's secretary of state, if required. Registration should include a list of all lawyer and nonlawyer owners. Accordingly, both lawyer and nonlawyer owners should be subject to the authority of that jurisdiction's highest Court."³² Elsewhere, the suitability of nonlawyer partners has been assessed within a system of entity regulation.³³

The approach adopted in the Recommendation instead relies on court supervision of the responsible lawyer partners, who themselves have a vested interest in ensuring the character and fitness of their nonlawyer partners. The Commission was concerned that adopting the approach recommended by the Standing Committee on Client Protection could result in a new and potentially costly system. However, the proposed amendments to the Comments to Rule 5.4 note that individual states may impose additional firm registration and nonlawyer character assessment requirements.

³² *Id.* at 2.

³³ Solicitors Regulatory Authority, *SRA Suitability Test 2011*, available at <http://www.sra.org.uk/solicitors/handbook/suitabilitytest/content.page?ref=search>. The SRA Suitability Test forms part of edition 1 of the SRA Handbook, published on 16 September 2011. The regulatory material contained in the Suitability Test was scheduled to go into effect on 6 October 2011, and is part of the SRA move to "outcomes-focused" regulation, including entity regulation. See SRA Handbook, available at <http://www.sra.org.uk/documents/solicitors/handbook/sra-handbook.pdf>; for more on outcomes-focused regulation, see <http://www.sra.org.uk/solicitors/freedom-in-practice/OFR/ofr-quick-guide.page>. See also the discussion of entity regulation in Australia in the April 2011 Issues Paper, *supra* note 5 at pp. 9-10, though Australia has not adopted a fit-to-own test for nonlawyer partners.

1 The views expressed herein have not been approved by the House of Delegates or the Board of
2 Governors of the American Bar Association and, accordingly, should not be construed as
3 representing the policy of the American Bar Association.

4
5 **AMERICAN BAR ASSOCIATION**
6 **COMMISSION ON ETHICS 20/20**
7 **DRAFT RESOLUTION**
8

9 RESOLVED: That the American Bar Association adopts the proposed amendments to
10 Rule 5.4 of the ABA Model Rules of Professional Conduct as follows (insertions
11 underlined; deletions ~~struck through~~):

12
13 **Rule 5.4 Professional Independence of a Lawyer**

14
15 (a) A lawyer or law firm shall not share legal fees with a nonlawyer, except that:

16
17 (1) an agreement by a lawyer with the lawyer's firm, partner, or associate may
18 provide for the payment of money, over a reasonable period of time after the lawyer's
19 death, to the lawyer's estate or to one or more specified persons;

20
21 (2) a lawyer who purchases the practice of a deceased, disabled, or disappeared
22 lawyer may, pursuant to the provisions of Rule 1.17, pay to the estate or other
23 representative of that lawyer the agreed-upon purchase price;

24
25 (3) a lawyer or law firm may include nonlawyer employees in a compensation or
26 retirement plan, even though the plan is based in whole or in part on a profit-sharing
27 arrangement; ~~and~~

28
29 (4) a lawyer or law firm may do so pursuant to paragraph (b); and

30
31 (5) a lawyer may share court-awarded legal fees with a nonprofit organization that
32 employed, retained or recommended employment of the lawyer in the matter.

33
34 ~~(b) A lawyer shall not form a partnership with a nonlawyer if any of the activities of~~
35 ~~the partnership consist of the practice of law~~ A lawyer may practice law in a law firm in
36 which individual nonlawyers in that firm hold a financial interest, but only if:

37
38 (1) the firm's sole purpose is providing legal services to clients;

39
40 (2) the nonlawyers provide services that assist the lawyer or law firm in
41 providing legal services to clients;

42
43 (3) the nonlawyers state in writing that they have read and understand the Rules of
44 Professional Conduct and agree in writing to undertake to conform their conduct to
45 the Rules;

ABA Commission on Ethics 20/20 Discussion Draft for Comment
Alternative Law Practice Structures
December 2, 2011

46 (4) the lawyer partners in the law firm are responsible for these nonlawyers to the
47 same extent as if the nonlawyers were lawyers under Rule 5.1;
48

49 (5) the nonlawyers have no power to direct or control the professional judgment
50 of a lawyer, and the financial and voting interests in the firm of any nonlawyer are
51 less than the financial and voting interest of the individual lawyer or lawyers holding
52 the greatest financial and voting interests in the firm, the aggregate financial and
53 voting interests of the nonlawyers does not exceed [25%] of the firm total, and the
54 aggregate of the financial and voting interests of all lawyers in the firm is equal to or
55 greater than the percentage of voting interests required to take any action or for any
56 approval;
57

58 (6) the lawyer partners in the firm make reasonable efforts to establish that each
59 nonlawyer with a financial interest in the firm is of good character, supported by
60 evidence of the nonlawyer's integrity and professionalism in the practice of his or her
61 profession, trade or occupation, and maintain records of such inquiry and its results;
62 and
63

64 (7) compliance with the foregoing conditions is set forth in writing.
65

66 (c) A lawyer shall not permit a person who recommends, employs, or pays the lawyer
67 to render legal services for another to direct or regulate the lawyer's professional
68 judgment in rendering such legal services.
69

70 ~~(d) A lawyer shall not practice with or in the form of a professional corporation or~~
71 ~~association authorized to practice law for a profit, if: A fiduciary representative of~~
72 ~~the estate of a lawyer may hold the stock or interest of the lawyer in a firm for a~~
73 ~~reasonable time during administration.~~
74

75 ~~(1) a nonlawyer owns any interest therein,~~
76 ~~except that a fiduciary representative of the estate of a lawyer may hold the stock~~
77 ~~or interest of the lawyer for a reasonable time during administration;~~
78

79 ~~(2) a nonlawyer is a corporate director or officer thereof or occupies the position~~
80 ~~of similar responsibility in any form of association other than a corporation ; or~~
81

82 ~~(3) a nonlawyer has the right to direct or control the professional judgment of a~~
83 ~~lawyer.~~
84

84 **Comment**

85
86 [1] This Rule ~~traditional~~ limits sharing of legal fees with nonlawyers. Lawyers
87 sharing legal fees with other lawyers not in the same firm is addressed by Rule 1.5(e).
88 These limitations are to protect the lawyer's professional independence of judgment.
89 Where someone other than the client pays the lawyer's fee or salary, or recommends
90 employment of the lawyer, that arrangement does not modify the lawyer's obligation to
91 the client. As stated in paragraph (c), such arrangements should not interfere with the

ABA Commission on Ethics 20/20 Discussion Draft for Comment
Alternative Law Practice Structures
December 2, 2011

92 lawyer's professional judgment.

93 [2] Paragraph (b) rejects an absolute prohibition against lawyers and nonlawyers
94 sharing legal fees, but continues to impose traditional ethical requirements with respect to
95 such fee sharing. Thus, a lawyer may practice law in a firm where nonlawyers hold a
96 financial interest, but only if the requirements set forth in paragraphs (b)(1) - (7) are
97 satisfied. The requirement of a writing helps ensure that the other conditions are not
98 overlooked in establishing the organizational structure of entities in which nonlawyers
99 have a financial interest.

100 [3] Paragraph (b) does not permit an individual or entity to acquire all or any part of
101 an interest in a law firm for investment or other purposes. Such an investor would not be
102 an individual nonlawyer in the firm who performs services that assist the law firm in
103 providing legal services under paragraph (b)(2). It thus does not permit a corporation, an
104 investment banking firm, an investor, or any other person or entity to entitle itself to all or
105 any portion of the profits of a law firm.

106 [4] The term "individual" in paragraph (b) does not preclude the participation in a law
107 firm by an individual professional corporation.

108 [5] Paragraph (b) does not preclude a lawyer from providing "law-related services",
109 as defined in Rule 5.7, whether through a law firm or other organization. A lawyer shall
110 remain subject to the Rules of Professional Conduct with respect to his or her provision
111 of law-related services pursuant to Rule 5.7 whether or not the entity through which the
112 lawyer provides such services is a partnership or other form of organization in which a
113 financial interest is held by nonlawyers pursuant to this Rule.

114 [6] Paragraph (b)(3) requires that all nonlawyers having a financial interest in a law
115 firm state in writing that they have read and understand the Rules of Professional
116 Conduct and agree to conform their conduct to the Rules. This accords with the
117 requirement that a partner or lawyer with comparable managerial authority in a law firm
118 shall make reasonable efforts to ensure that the firm has measures in effect giving
119 reasonable assurance that all lawyers in the firm conform to the Rules. See Rule 5.1.
120 Further, the requirement in paragraph (b)(6) that each lawyer having a financial interest
121 in the firm shall make reasonable efforts to ensure that each individual nonlawyer having
122 a financial interest in the firm is of good character is an ongoing obligation that does not
123 terminate with the admission of the nonlawyer to the partnership or other organization
124 through which the lawyer delivers legal services to clients. The ethical atmosphere of a
125 firm can influence the conduct of all its members, and the lawyer partners may not
126 assume that all those associated with the firm will inevitably conform to the Rules. See
127 Rule 5.1 Comment 3. Due care must therefore be exercised by the lawyers having a
128 financial interest or exercising managerial authority with respect to the admission to the
129 firm of a nonlawyer whose character and fitness may reflect on the integrity of the firm
130 and thereby on the legal profession. Whether a lawyer may be liable civilly or criminally
131 for the conduct of a nonlawyer partner or member of the firm is a question of law beyond
132 the scope of these Rules.

133 [7] To avoid possible conflicts between a lawyer's duties and those of a nonlawyer
134 under the ethical rules or law applicable to their conduct, the law firm should not permit a
135 nonlawyer to participate or continue to participate in a matter if the lawyer knows or
136 reasonably should know that the legal or ethical duties of the nonlawyer are inconsistent
137 with the duties of the lawyer or lawyers in the matter.

ABA Commission on Ethics 20/20 Discussion Draft for Comment

Alternative Law Practice Structures

December 2, 2011

138 [8] For purposes of paragraph (b)(5), a financial interest in a law firm shall include,
139 but not be limited to, an interest in the equity or profits of the firm. This provision
140 provides that the nonlawyers cannot control the vote on or veto a specific matter by
141 reserving to the nonlawyers the right to approve or disapprove a specific matter when all
142 lawyers vote to approve the matter.

143 [9] Some sharing of fees is likely to occur in the kinds of organizations permitted by
144 paragraph (b). Subparagraph (a)(4) makes it clear that such fee sharing is not prohibited.

145 [10] If a lawyer practices law in a partnership or other form of organization in which
146 a financial interest is held by nonlawyers pursuant to this Rule, the lawyer, all such
147 nonlawyers and the entity may be subject to registration or other requirements as may be
148 determined by this jurisdiction.

149 [211]This Rule also expresses traditional limitations on permitting a third party to
150 direct or regulate the lawyer's professional judgment in rendering legal services to
151 another. See also Rule 1.8(f) (lawyer may accept compensation from a third party as long
152 as there is no interference with the lawyer's independent professional judgment and the
153 client gives informed consent).