**THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK**
**COMMITTEE ON PROFESSIONAL ETHICS**

# FORMAL OPINION 2020-1: ONGOING RELATIONSHIPS WITH ALTERNATIVE LEGAL BUSINESS ENTITIES

**TOPIC:** Obligations of a lawyer seeking to enter into an ongoing business relationship with a law firm in another jurisdiction with nonlawyer owners.

**DIGEST:** A New York lawyer may enter into an ongoing business relationship with a law firm with nonlawyer owners, located in a jurisdiction that permits nonlawyer ownership of law firms, whereby the lawyer and the law firm agree to regularly co-counsel matters and share fees related to those matters. Such an arrangement does not violate Rule 5.4 of the New York Rules of Professional Conduct (the "New York Rules"), nor does it interfere with a lawyer's independent professional judgment. However, any such arrangement must be non-exclusive, must be disclosed to the client, and must abide by the rules governing conflicts of interest, payment for referrals, and fee sharing with lawyers in separate firms.

**RULES:** 1.5, 1.7, 5.4, 7.2

**OPINION:**

## I. Introduction

As the legal profession continues to evolve, more and more lawyers and law firms are looking to enter into ongoing business relationships with law firms in other U.S. and foreign jurisdictions. In addition, a number of jurisdictions around the world have recognized the value of permitting "Alternative Business Structures" (ABS's), which allow limited nonlawyer ownership of legal service providers.

In this Opinion we will address the following scenario:

> A New York lawyer seeks to enter into a non-exclusive arrangement with an ABS whereby the New York lawyer and the ABS agree to regularly co-counsel matters and hold themselves out to the public as having an ongoing co-counsel relationship. In any case where the New York lawyer and the ABS are co-counsel, they will jointly invoice the client and share the legal fees. The New York lawyer and the ABS will only share fees on cases which they co-counsel and are otherwise separate entities that do not share resources.

In NYCBA Formal Op. 2015-8 (2015), we addressed whether a New York lawyer may ethically share fees with a law firm that, pursuant to the rules in that jurisdiction, has nonlawyer owners. We concluded that such an arrangement was permissible. Opinion 2015-8 did not address the possibility of a standing agreement between the New York

lawyer and the out-of-state law firm whereby the two firms hold themselves out as having an ongoing relationship. We address that issue here.

## II. The Rules Governing Fee-Sharing With Nonlawyers

The New York Rules generally prohibit lawyers from sharing legal fees with nonlawyers. Rule 5.4(a) states that a "lawyer or law firm shall not share legal fees with a nonlawyer," subject to certain exceptions that are not applicable here. Similarly, Rule 5.4(d) prohibits a lawyer from practicing "with or in the form of an entity authorized to practice law for profit" if the entity has nonlawyer owners. Rule 5.4 is substantially similar to ABA Model Rule 5.4, which prohibits fee sharing with nonlawyers.

The main purpose of Rule 5.4 is to "protect the lawyer's professional independence of judgment." Rule 5.4, cmt. [1]. Put another way, the Rule is premised on the notion that where a nonlawyer has a direct pecuniary interest in the success of a law firm, there is a risk that the lawyer's professional judgment on behalf of a client could be compromised. Although commentators generally agree with the purpose of Rule 5.4 – to protect the lawyer's professional independent judgment – many have criticized the current version of the rule as overbroad and ill-equipped to accomplish the Rule's stated purpose. *See, e.g.*, Anthony E. Davis, *Lawyer Regulation: Walking Backward Into the Future* (N.Y.L.J. May 5, 2014); *see also* Catherine Ho, *A Law Firm IPO? Not So Fast* (The Washington Post Feb. 16, 2015) (reporting on the debate over nonlawyer ownership and the restrictions on law firms trying to raise capital).[1]

In response, both the ABA and several states have committed to exploring the issue of nonlawyer ownership of legal service providers. *See, e.g.*, ABA Resolution 115 (Feb. 2020) (urging states to consider regulatory innovations to provide more cost-effective legal services); State Bar of California, Task Force on Access Through Innovation of Legal Services, Report and Recommendations, available at http://www.calbar.ca.gov/Portals/0/documents/publicComment/ATILS-Final-Report.pdf (March 6, 2020) (proposing, *inter alia*, certain changes to Cal. R. Prof. Cond. 5.4 to permit fee sharing with non-lawyers under certain circumstances; the report was approved by the State Bar of California Board of Trustees in May 2020); Supreme Court of Utah, Implementation Task Force on Regulatory Reform, available at https://sandbox.utcourts.gov/ (Feb. 18, 2020) (encouraging experimentation in a "Legal Services Sandbox" to test alternative legal services models). In addition, one state has already amended its rules to permit nonlawyer ownership of legal businesses. *See* Supreme Court of Arizona, Order Amending The Arizona Rules of the Supreme Court and the Arizona Rules of Evidence, No. R-20-0034 (Aug. 27, 2020).

[1] We also note that, in addition to Rule 5.4, there are other Rules that already serve to protect the lawyer's independent professional judgment on a case-by-case basis. *See* Rule 1.7(a)(2) (prohibiting representation of a client where the lawyer's personal, professional, or pecuniary interests would alter her judgment on behalf of a client); Rule 1.8(f) (permitting payment of fees by a third party only under certain circumstances).

At present, the District of Columbia and Arizona are the only U.S. jurisdictions that permit nonlawyer ownership of law firms. D.C. Rule of Professional Conduct 5.4(b)[2] states:

> 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 organization undertake to be responsible for the nonlawyer participants to the same extent as if nonlawyer participants were lawyers under [D.C.] Rule 5.1;
>
> (4) The foregoing conditions are set forth in writing.

In addition, several other countries permit ABS's and have developed a nuanced regulatory scheme that attempts to balance a lawyer's duties to her clients, on one hand, while also permitting certain nonlawyer ownership to allow law firms to compete in a twenty-first century market, on the other hand. *See, e.g.*, Legal Services Act, 2007 c. 29, § 71 *et seq.* (U.K.).

The conflicting rules between New York and jurisdictions that permit ABS entities create a great deal of uncertainty for lawyers engaged in multijurisdictional practice. As detailed below, the text and history of Rule 5.4, as well as the ethics opinions interpreting the rule, support the conclusion that a New York lawyer may enter into an ongoing co-counsel agreement with an ABS, provided the New York lawyer is not employed by or otherwise part of the ABS. Moreover, any agreement between the lawyer and the ABS must comply with other Rules of Professional Conduct including the rules governing conflicts of interest, prohibitions on payment for referrals, and fee sharing with lawyers in different firms.

*a. Does the Proposed Arrangement Constitute Improper Fee Sharing Under Rule 5.4(a)?*

As noted, Rule 5.4 generally prohibits New York lawyers from sharing fees with nonlawyers and also prohibits New York lawyers from forming a partnership or other entity authorized to practice law with a nonlawyer. In 2013 the ABA Standing Committee on Ethics and Professional Responsibility issued Formal Opinion 464, which

[2] In contrast to the District of Columbia, Arizona eliminated its version of Rule 5.4 entirely in favor of other court rules specifically designed to regulate ABS's.

concluded that "a division of a legal fee by a lawyer or law firm in a Model Rules jurisdiction with a lawyer or law firm in another jurisdiction that permits the sharing of legal fees with nonlawyers does not violate Model Rule 5.4(a) simply because a nonlawyer could ultimately receive some portion of the fee under the applicable law of the other jurisdiction." ABA Formal Op. 464 (Aug. 19, 2013). Citing Comment [1] to Model Rule 5.4 (which is the same as Comment [1] to NY Rule 5.4), Opinion 464 stated that "there is no reason to believe that the nonlawyer in the District of Columbia might actually influence the independent professional judgment of the lawyer in the Model Rules jurisdiction, who practices in a different firm, in a different jurisdiction." *See also* Philadelphia Bar Assn. Prof'l Guidance Comm., Advisory Op. 2010-7 (2010) (cited by ABA Op. 464 and concluding that a lawyer may divide a legal fee with a D.C. law firm that has nonlawyer partners without running afoul of Pennsylvania's version of Rule 5.4.).[3]

Several years later, this Committee issued Formal Opinion 2015-8 (2015), which fully endorsed ABA Op. 464. Opinion 2015-8 concluded that a New York lawyer may share fees with lawyers who practice in law firms with nonlawyer owners, provided those law firms are based in jurisdictions that permit such arrangements with nonlawyers. Opinion 2015-8 reasoned that such an arrangement "presents little risk that a nonlawyer would impair a New York lawyer's independent professional judgment." *See also* NYSBA Ethics Op. 889 (2011) (endorsing Phila. Op. 2010-7, which follows the same reasoning as ABA Op. 464, and suggesting that a New York lawyer should be permitted to share fees with a D.C. lawyer who is duly authorized under the D.C. rules to share fees with nonlawyers); *New York State Bar Association: Report of the Task Force on Nonlawyer Ownership*, 76 Alb. L. Rev. 865, 930-31 (2013) (endorsing inter-firm fee sharing based on the same reasoning as ABA Op. 464).

In line with these opinions, we see little difference between a New York lawyer sharing fees with an ABS on a case-by-case basis and a lawyer who enters into a strategic business relationship with an ABS to co-counsel cases on an ongoing basis. We believe there is little risk that the New York lawyer's relationship with an ABS would impair her independent professional judgment simply because a portion of the legal fee the two firms intend to share will make its way into the hands of nonlawyer owners. Ultimately, the New York lawyer (or her firm) and the ABS are two separately operating entities with different management structures. If the agreed-upon fee split between the New York

[3] The history behind ABA Op. 464 is also relevant. In 2012, the ABA Ethics 20/20 Commission proposed revisions to the Model Rules to permit some degree of fee sharing with nonlawyers. *See* ABA Comm'n on Ethics 20/20: Draft for Comment, Fee Division Between Lawyers in Different Firms (Sept. 18, 2012). These revisions included adding a new comment to Model Rule 1.5 explaining that the Rules should not be read to allow a lawyer in a jurisdiction that does not permit fee-sharing with nonlawyers, to "divide a fee with a lawyer from another firm in a jurisdiction that permits a firm to share legal fees with nonlawyers or to have nonlawyer owners, unless the lawyer who is governed by the Rules of Professional Conduct in [the jurisdiction prohibiting nonlawyer ownership] knows that the other firm's relationship with nonlawyers violates the rules of the jurisdiction that apply to the relationship." *Id.* Although the ABA Commission ultimately abandoned this effort, the ABA Ethics Committee issued ABA Op. 464 the following year, essentially adopting the same reasoning.

lawyer and the ABS risked compromising the lawyer's independent professional judgment, we believe it is more likely that the reasons for such a conflict would have to do with the fee itself and not the fact that it was being shared with a law firm where nonlawyers share in the overall revenues. *See* Rule 1.5(a); Rule 1.7(a)(2). If anything, the joint client of the two firms could actually *benefit* from the strategic relationship between the New York lawyer and the ABS. If the New York lawyer were forced to find new co-counsel for each out-of-state matter, it may result in the client being forced to hire two sets of lawyers who are not accustomed to working together and may not be able to handle the matter as efficiently as possible.[4]

*b. Is the Proposed Arrangement An Improper Partnership With a Nonlawyer?*

The second question is whether the Rules allow the New York Lawyer to enter into an ongoing relationship with the ABS. Rule 5.4(b) states that a lawyer "shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law." Similarly, Rule 5.4(d) states that a lawyer "shall not practice with or in the form of an entity authorized to practice law for profit" if a nonlawyer owns an interest in the entity.

Because the New York lawyer in this situation will not be a "partner" or otherwise hold an ownership interest in the ABS, we do not believe that Rule 5.4(b) prohibits the proposed arrangement here.

Rule 5.4(d) does not define what it means to practice "with or in the form of" an entity, but the plain terms of the Rule suggest that it was intended to prohibit a lawyer from becoming an owner of or entering into some form of an employment relationship with a nonlawyer-owned entity practicing law for profit. *See* Roy D. Simon, *Simon's New York Rules of Professional Conduct Annotated*, 1441 (2019 ed.) ("[A] lawyer cannot join an entity practicing law for profit if nonlawyers [own an interest in the entity]."). Thus, the New York lawyer would be prohibited from affiliating with the ABS as an employee, partner, shareholder or another similar role. However, the New York lawyer and the ABS may advertise their strategic relationship so long as the two firms do not give the impression that the New York lawyer is employed by or otherwise part of the ABS and that any statement about the New York lawyer's relationship with the ABS is not misleading.

Prior ethics opinions have concluded that the New York Rules do not permit a lawyer to maintain an employment or ownership relationship with an ABS. For instance, in NYSBA Ethics Op. 911 (2012) the state bar ethics committee concluded that Rule 5.4 prohibited a group of New York lawyers from establishing a New York office of a firm based in the United Kingdom and that had nonlawyer shareholders. In the proposed arrangement, the New York lawyers "would be employees of the UK entity and would hold stock options and, in some cases, vested shares in the UK entity." NYSBA Ethics Op. 911. The Opinion concluded that the

[4] This Opinion does not address the obligations of the New York lawyer's obligations under Rule 5.5, which prohibits a lawyer from engaging in the unauthorized practice of law or assisting another in engaging in the unauthorized practice of law. We assume that if the New York lawyer intends to co-counsel with an out-of-state law firm, both firms will comply with the rules governing multijurisdictional practice.

proposed arrangement clearly violated Rule 5.4(a) because it constituted fee-sharing with nonlawyers and also violated Rule 5.4(d) because the proposed arrangement would involve a lawyer "practicing law for profit with an entity that includes a nonlawyer owner or member." *Id.* Similarly, NYSBA Ethics Op. 1038 concluded that a New York lawyer who practiced primarily in New York could not join a D.C. firm (with nonlawyer members) "as a partner" or by "forming a 'wholly owned subsidiary law firm' in New York to be 'independently managed/operated' by the New York lawyer." NYSBA Ethics Op. 1038.[5]

The above opinions, however, involved lawyers seeking to enter into formal employment relationships with the ABS firms. *See* NYSBA Ethics Op. 1038 (concluding that Rule 5.4(d) would still prohibit the relationship if the inquiring lawyer "were only an employee of either entity"). The proposed arrangement here would not involve the New York lawyer becoming an employee of the ABS. Instead, as noted, the New York lawyer and the ABS would be two entirely separate businesses with separate ownership and management structures. In other words, the New York lawyer will not have any involvement in the ABS's day-to-day affairs and will not be compensated by the ABS, other than perhaps through the agreed-upon fees split on a case-by-case basis. As a result, if the New York lawyer and the ABS hold out to the public that they have a strategic relationship in which they regularly co-counsel matters together, we do not believe that by doing so, the lawyer – who otherwise has no involvement in the operation of the ABS – would violate Rule 5.4(d). However, in an abundance of caution, the New York lawyer should make clear that she is not employed by the ABS, has no interest in the ABS, and that the only relationship between her and the ABS is a recurring co-counsel relationship.

## III. Other Ethical Considerations

Although we conclude that the proposed arrangement between the New York lawyer and the ABS does not violate Rule 5.4, that does not end the inquiry. Before entering into any ongoing relationship, the lawyer must also be mindful of the other ethical issues which accompany the proposed relationship, including potential conflicts of interest, improper payments for referrals, and fee sharing with lawyers in different firms.

### *a. Conflicts of Interest*

Rule 1.7(a)(2) prohibits a lawyer from representing a client where there is a significant risk that the lawyer's "professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests." If, notwithstanding this risk, the lawyer reasonably believes that she will be able to competently represent the client, she can obtain a written conflict waiver from the client with informed consent. *See* Rule 1.7(b)(4). Here, the relationship between the New York lawyer and the ABS may be so great that the lawyer is tempted to balance her interest in preserving her ongoing relationship with the ABS against her judgment on behalf of the client about whether to engage the ABS as co-

[5] NYSBA Ethics Op. 889 (2011) also addressed a lawyer's relationship with an ABS. However, in Opinion 889, the lawyer was licensed in both the District of Columbia, which permits ABS firms, and New York. The Opinion therefore analyzed which jurisdiction's rules would apply under Rule 8.5. Because we assume the lawyer in this scenario is only licensed in New York, the New York Rules will apply to her conduct.

counsel. Although this may not create a conflict of interest in every circumstance, it would be prudent for the lawyer, at the outset of the representation, to disclose her relationship with the ABS to the client and obtain a written waiver from the client of any potential conflict of interest.

In addition, Rule 1.7(a)(1) would prohibit the lawyer from acting as co-counsel with the ABS on any matter that would involve the lawyer representing clients with "differing interests" unless the conflict may be properly waived and the lawyer obtains a written conflict waiver from each affected client. *See* Rule 1.7(a)(1); Rule 1.7(b). Any conflict waiver under these circumstances should also include a disclosure concerning the lawyer's relationship with the ABS.

*b. Payments for Referrals*

Rule 7.2(a) prohibits a lawyer from compensating or giving "anything of value to a person or organization to recommend or obtain employment by a client, or as a reward for having made a recommendation resulting in employment by a client . . . except that (2) a lawyer may pay . . . referral fees to another lawyer as permitted by Rule 1.5(g)." Although Rule 7.2 does not prohibit a reciprocal referral arrangement between two law firms, the comments to Rule 7.2 warn that "[s]uch reciprocal referral arrangements must not interfere with the lawyer's professional judgment as to making referrals or as to providing substantive legal services." Rule 7.2, cmt. [4] (citing Rules 2.1, 5.4(c)). Comment [4] also states that any reciprocal referral arrangement may not be "exclusive" and the client must be informed of the referral agreement. Thus, the proposed arrangement between the New York lawyer and the ABS must not be exclusive and must be disclosed to the client.

*c. Fee-Sharing With Lawyers in Other Firms*

As noted, one exception to Rule 7.2's prohibition on the payment of for referrals is "[a] referral fee[] [paid] to another lawyer as permitted by Rule 1.5(g)." Rule 7.2(a)(2). Rule 1.5(g), in turn, states that

> A lawyer shall not divide a fee for legal services with another lawyer who is not associated in the same law firm unless:
>
> (1) the division is in proportion to the services performed by each lawyer or, by a writing given to the client, each lawyer assumes joint responsibility for the representation;
>
> (2) the client agrees to employment of the other lawyer after a full disclosure that a division of fees will be made, including the share each lawyer will receive, and the client's agreement is confirmed in writing; and
>
> (3) the total fee is not excessive

In other words, the only way the New York Rules permit two lawyers from different firms to divide a legal fee for a matter is in accordance with Rule 1.5(g). Thus, if the New York lawyer intends to divide legal fees with the ABS – which we have already opined is permissible under the New York Rules – the New York lawyer and the ABS must do so in accordance with

Rule 1.5(g), including dividing the fee proportionally or assuming joint responsibility and disclosing the details of the fee division to the client.[6]

**CONCLUSION:**

A New York lawyer may enter into an ongoing relationship with an alternative business structure law firm (ABS) with nonlawyer owners, whereby the New York lawyer and the ABS agree to regularly co-counsel cases and hold themselves out as having an ongoing relationship, provided that the New York lawyer is not employed by, or otherwise participates in the day-to-day operations of the ABS. Any such arrangement must be non-exclusive and must be disclosed to the client at the outset of the representation, so that the client can provide written informed consent. The agreement must also comply with the rules governing conflicts of interest, payment for referrals, and fee-sharing with lawyers in different firms.

[6] Rule 1.5(g) would only apply if the lawyer and the ABS intend to divide the fee after receipt from the client. If, however, the New York lawyer and the ABS charged the client separately and the client paid each firm separately, no such division would exist and neither Rule 5.4 nor Rule 1.5(g) would apply.