How ABA Opinion Shifts Alternative Biz Structure Landscape

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Until recently, the American Bar Association and virtually every state aside from the District of Columbia balked at nonlawyer ownership of law firms, referred to as alternative business structures, or ABS. One of the practical effects of that resistance has been a series of hurdles for a law firm wishing to scale its practice.

On Sept. 8, the ABA's Standing Committee on Ethics and Professional Responsibility published Formal Opinion 499, loosening the reins and following a recent trend in Arizona and Utah.

The formal opinion, titled "Passive Investment in Alternative Business Structures,"[1] opines that a lawyer may passively invest in an ABS operating in a jurisdiction that permits ABS entities even if the lawyer is admitted to practice in a jurisdiction that prohibits nonlawyer ownership of law firms. Passive investment is defined as a scenario wherein "a lawyer contributes money to an ABS with the goal of receiving a monetary return on that investment."[2]

The opinion has wide-ranging implications for current prohibitions on sharing fees with nonlawyers, as well as access-to-justice initiatives.

Preserving Professional Independence: The Model Rule 5.4 Prohibition

ABA Model Rule of Professional Conduct 5.4(a) prohibits a lawyer or law firm from "shar[ing] legal fees with a nonlawyer" except in limited circumstances.[3]

The model rules also prohibit a lawyer from "form[ing] a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law," and practicing in a business structure in which a nonlawyer owns any interest in the business or serves as a corporate director or officer.[4]

The "traditional limitations on sharing fees" set forth in Model Rule 5.4 are intended to preserve a lawyer's "professional independence of judgment," and to express "limitations on permitting a third party to direct or regulate the lawyer's professional judgment in rendering legal services to another."[5]

One practical effect of Model Rule 5.4 is that it severely restricts a law firm's ability to scale.

Under the rule, a law firm that wishes to raise money to, for example, invest in technology that would allow it to automate parts of its practice, thereby reducing expenses and lowering fees, has two choices: It can borrow money from a bank, or it can pass the collection hat around to its partners.

Those two limited options impose an impediment for a firm that wishes to grow.

What Is an Alternative Business Structure, and Why Does It Matter?

An ABS is a legal entity that includes nonlawyer owners and/or managers. According to the Arizona Task Force on the Delivery of Legal Services, the purpose of allowing ABS is "rooted in the idea that entrepreneurial lawyers and nonlawyers would pilot a range of different business forms" that will ultimately improve access to justice and the delivery of legal services.[6]

By allowing nonlawyers to invest in — and help scale — legal practices, ABS arguably expand access to legal services.

The need for low-cost legal services cannot be overstated. The National Center for State Courts conducted a 2015 study sampling civil matters in 10 large urban counties and found that a jaw-dropping 76% of cases involved at least one unrepresented litigant.[7] And a task force formed by the Utah Supreme Court opined in 2019 that pro bono efforts do not solve the access-to-justice gap, adding that "we cannot volunteer or donate the problem away."[8]

Many of those pro se litigants are unrepresented in cases in which a low-cost, semiautomated representation could provide enormous relief.

For example, in the immigration context, many individuals need assistance finding and completing routine forms. Sometimes, those forms may require little, if any, bespoke assistance. Often, those forms are on court websites that a firm could in theory download, adapt to current practice, and offer with some element of automation.

Creating that type of semiautomation requires investment and capital that, under the current iteration of Model Rule 5.4, can only be procured from a bank loan or from other lawyers.

As to innovation, a July 2018 legal market landscape report by law professor William Henderson noted:

> The policy that underlies Rule 5.4 is lawyer independence. ... If knowledge is asymmetric, clients have little choice but to trust lawyers. Under this policy rationale, lawyers as a group must be completely independent. Yet this asymmetry does not exist in large corporations with legal departments comprised of former large law firm lawyers. In this context, Rule 5.4 is actually hindering the creation of solutions most needed by large organizational clients.[9]

In February 2020, the ABA issued Resolution 115, encouraging states to "consider innovative approaches to the access to justice crisis."[10] But, as Washington state's limited license legal technician, or LLLT, program showed us, innovation can be a fragile thing. The proliferation of program requirements, designed to reconcile the many — sometimes competing — interests of the Washington bar, ultimately proved too burdensome.

In June 2020, with fewer than 40 active technicians participating in the program, the Washington Supreme Court voted to sunset the LLLT program after only five years.[11] In a letter to the Washington State Bar Association, the court cited the "overall costs of sustaining the program and the small number of interested individuals" as justification for the decision to sunset the program.[12]

As a general matter, the model rules do not tell a lawyer what she can do with her own

money. A lawyer is free to invest in whatever enterprise she wishes.

ABA Formal Opinion 499 recognizes that traditional freedom extends to passive investment in an ABS. It also eliminates at least one of the hurdles faced by an ABS entity — attracting lawyer investors from non-ABS jurisdictions.

Arizona and Utah

Every state aside from Utah, Arizona and the District of Columbia has an equivalent Model Rule 5.4 prohibiting business structures that allow nonlawyer ownership of law firms and the sharing of legal fees with nonlawyers.[13]

In 2020, the Utah Supreme Court launched a two-year pilot legal regulatory sandbox project whereby court-approved legal services entities could have nonlawyer owners.[14] And effective Jan. 1 of this year, Arizona jettisoned its Rule 5.4 altogether in lieu of a system whereby Arizona law firms that include nonlawyer owners or investors may be certified by the Arizona Supreme Court as ABS.[15]

The Utah Office of Legal Services Innovation reports that of the 29 authorized entities, 22% were considered to fall in the end-of-life planning service sector, 21% were considered to fall in the business service sector (e.g., intellectual property, contracts and warranties, and entity incorporation), and nearly 15% were considered to fall in the marriage or family service sector.[16]

In Arizona, several of the licensed ABS entities offer estate planning services.[17] The pool of ABS entities strikes a balance between traditional firms with nonlawyer ownership structures, financial service institutions — e.g., tax and accounting — that have adapted to offer relevant legal services, and virtual legal service providers that offer a gamut of services with accessibility and cost efficiency in mind.

Florida,[18] California[19] and Illinois[20] are all considering policy changes that would relax restrictions on nonlawyer ownership of organizations that provide legal services.

The District of Columbia's Rule 5.4 and a Shift 30 Years in the Making

Before 2020, the District of Columbia was the only jurisdiction to permit business structures that allowed nonlawyer ownership of law firms and the sharing of legal fees with nonlawyers. In 1991, the district amended its Rule 5.4 to permit a nonlawyer to have a financial interest in a law firm provided that "[t]he partnership or organization has as its sole purpose providing legal services to clients."[21]

The District of Columbia rules further require that any nonlawyer partner agree in writing to be bound by the rules and that the lawyer partners agree in writing to supervise the nonlawyer partner as otherwise required for nonlawyer employees.[22] Because under the district's rules, the nonlawyer partner must be "an individual ... who performs professional services" that assist a law firm in serving its clients, passive investment is prohibited.[23]

The ABA was quick to respond. Mere months after the District of Columbia changed its rule, the ABA's Standing Committee on Ethics and Professional Responsibility issued ABA Formal Opinion 91-360, clarifying that a lawyer admitted in the district who is also admitted in another jurisdiction could practice in a District of Columbia firm with a nonlawyer partner so long as the firm and the District of Columbia bar member confined their practice to the district.[24]

In other words, if the District of Columbia is going to allow nonlawyer partners, a lawyer who joins that practice cannot practice anywhere else.

It took more than 20 years for the ABA to reach a different point of view. In Formal Opinion 464 released in 2013, the ABA opined that lawyers in ABA model rule jurisdictions can share fees — i.e., work with — District of Columbia firms with nonlawyer partners.[25]

That opinion sparked vigorous debate, with one commentator stating, "In one simple, unsupported opinion, we've destroyed a principle we've fought so hard to protect ... a law firm won't be [independent] if it's splitting fees with a firm with nonlawyer owners."[26]

In Formal Opinion 499, the ABA has done a near 180 from its 1991 stance. Now, not only can a lawyer in a non-ABS jurisdiction share fees with a lawyer who is a member of an ABS, but that lawyer can be a passive investor in an ABS.

What's Next for the Aspiring Alternative Business Structure Investor?

For lawyers wishing to take advantage of the new ABA opinion, there are some things to keep in mind.

Navigate confidentiality.

Presumably, a passive investor in an ABS would like to know what, precisely, she is investing in. But how do you understand whether an ABS is financially successful absent revealing Rule 1.6 confidences?

One solution may be for ABS to provide aggregated, anonymized data allowing an investor to understand the business with sufficient specificity to make an informed choice, but without revealing confidential information.

Formal Opinion 499 recognizes that "[t]he issue of disclosure of confidential information by an ABS is a developing area of the law" and "beyond the scope" of the opinion, but cautioned that when investing in an ABS, a lawyer should be careful to avoid exposure to client confidences that suggest the investing lawyer is part of the ABS.[27]

If you wouldn't want your name publicly associated with the ABS, don't invest in it.

While your role as an ABS investor may be confidential, you should operate as though it is not. By way of analogy, defendants in litigation funding cases sometimes pursue discovery of the litigation funding agreement. Operate as though your name as an ABS investor will be discoverable, and don't make an ABS investment that you would not feel comfortable being publicly disclosed.

Check your firm's insurance policy before you invest in an ABS.

Some firms' insurance carriers may require that the firm complete a questionnaire that asks, among other things, whether any of the firm's lawyers are officers or directors of a firm client. Others may ask about lawyers' personal investments.

Consider whether your investment in an ABS could change your firm's answer to the questionnaire. If it could, err on the side of caution and refrain from investing in an ABS.

You must remain a passive investor.

The ABA opinion is clear: "Passive investment does not include scenarios in which the investing lawyer practices law through the ABS, manages or holds a position of corporate or managerial authority in the ABS, or is otherwise involved in the daily operations of the ABS."[28]

As the opinion stresses, a lawyer investing in an ABS must take care to ensure that the ABS "does not identify the Model Rule Lawyer as a lawyer or hold out the Model Rule Lawyer as a lawyer associated with the ABS."[29]

Add your alternative business structure investments to your conflicts database.

According to the formal opinion, the "mere fact of a passive investment by a Model Rules Lawyer in an ABS does not require imputation of conflicts."[30] But what if a law firm lawyer passively invests in an ABS that is adverse to one of the law firm's clients?

As the opinion states, a conflict of interest could arise if the investing lawyer "were to act as an advocate against a client of the ABS or represent a business in a transactional matter requiring negotiation with a client of the ABS" because the lawyer's efforts on behalf of her client could be limited by her interest in the ABS's financial success.[31]

Lawyers who choose to take advantage of the new ABA opinion may wish to add the ABS into their firm's conflicts database to identify and address any potential adversity.

Consider which ABS are least likely to create a conflict of interest in your practice.

For example, if you routinely practice intellectual property law, consider whether you should avoid investing in an intellectual property law-focused ABS, and whether your investment will create a conflict of interest that limits your ability to take on prospective clients.

In general, it is best to avoid using particularized knowledge gained during your practice to invest in an ABS. So, if you routinely defend companies in intellectual property disputes, carefully consider the optics of investing in an intellectual property law-focused ABS and consider avoiding the investment altogether.

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[1] ABA Comm. on Ethics & Pro. Resp., Formal Op. 499 (2021).

[2] Id. at 2.

[3] Note that the traditional prohibition on fee-splitting with nonlawyers does not impose an impediment to the typical litigation financing arrangement in which passive investors

finance a contingent fee case based on an agreement for a share of any monetary recovery because it creates an agreement between the financer and the client, not between the financer and the lawyer.

[4] See Model Rules of Pro. Conduct r. 5.4(b), (d) (Am. Bar Ass'n 2021).

[5] Model Rules of Pro. Conduct r. 5.4 cmt. 1–2 (Am. Bar Ass'n 2021).

[6] Arizona Task Force on the Delivery of Legal Services: Report and Recommendations 12 (Oct. 4, 2019), https://www.azcourts.gov/Portals/74/LSTF/Report/LSTFReportRecommendationsRED10042019.pdf?ver=2019-10-07-084849-750.

[7] William D. Henderson, Legal Market Landscape Report 19–20 (July 2018) (citing Paula Hannaford-Agor, Scott Graves & Shelley Spacek Miller, The Landscape of Civil Litigation in State Courts (National Center for State Courts 2015)), https://board.calbar.ca.gov/docs/agendaItem/Public/agendaitem1000022382.pdf ("Henderson Report").

[8] Narrowing the Access-to-Justice Gap by Reimagining Regulation: Report and Recommendations from the Utah Work Group on Regulatory Reform 4 (Aug. 2019), https://www.utahbar.org/wp-content/uploads/2019/08/FINAL-Task-Force-Report.pdf.

[9] Henderson Report at 26.

[10] ABA Center for Innovation, Resolution 115—Encouraging Regulatory Innovation (Feb. 2020), https://www.americanbar.org/groups/centers_commissions/center-for-innovation/Resolution115/.

[11] See Lyle Moran, Washington Supreme Court sunsets limited license program for nonlawyers, ABAJournal (June 8, 2020), https://www.abajournal.com/news/article/washington-supreme-court-decides-to-sunset-pioneering-limited-license-program.

[12] Letter from Debra L. Stephens, Chief Justice of the Washington State Supreme Court, to Stephen R. Crossland, Rajeev Majumdar & Terra Nevitt (June 5, 2020), https://www.abajournal.com/files/Stephens_LLLT_letter.pdf.

[13] California has created a task force expected to deliver a final recommendation around the creation of a paraprofessional licensure program by September 30, 2021. See Aebra Coe, Where 5 States Stand on Nonlawyer Practice of Law Regs, Law360 Pulse (Feb. 5, 2021), https://www.law360.com/pulse/articles/1352126/where-5-states-stand-on-nonlawyer-practice-of-law-regs; Toby J. Rothschild, Whatever Happened to the Task Force on Access and Innovation?, Cal. Laws. Ass'n (May 28, 2020), https://calawyers.org/california-lawyers-association/whatever-happened-to-the-task-force-on-access-and-innovation/.

[14] To Tackle the Unmet Legal Needs Crisis, Utah Supreme Court Unanimously Endorses a Pilot Program to Assess Changes to the Governance of the Practice of Law, Utah Courts Recent Press Notifications (Aug. 13, 2020), https://www.utcourts.gov/utc/news/2020/08/13/to-tackle-the-unmet-legal-needs-crisis-utah-supreme-court-unanimously-endorses-a-pilot-program-to-assess-changes-to-

the-governance-of-the-practice-of-law/.

[15] Arizona Supreme Court Makes Generational Advance in Access to Justice, Azcourts.gov (Aug. 27, 2020), https://www.azcourts.gov/Portals/201/Press%20Releases/2020Releases/082720RulesAgenda.pdf

[16] Utah Supreme Court Office of Legal Services Innovation, Innovation Office Activity Report Executive Summary 4 (June 2021), https://utahinnovationoffice.org/wp-content/uploads/2021/07/Innovation-Office-Public-Report-June-2021.pdf.

[17] See Alternate Business Structures Program, Azcourts.gov (Aug. 31, 2021), https://www.azcourts.gov/LinkClick.aspx?fileticket=SBWa8Oj0rFM%3d&portalid=0; see also Andy Blye, Arizona Approves First Licenses for Nonlawyer-Owned Firms Providing Legal Services, Phx. Bus. J. (Mar. 18, 2021), https://www.bizjournals.com/phoenix/news/2021/03/18/arizona-supreme-court-approves-first.html (descriptions of two of the eight ABS entities licensed); Committee on Alternative Business Structures—Meeting Agenda, Azcourts.gov (Aug. 6, 2021), https://www.azcourts.gov/Portals/0/ABS/Public.pdf?ver=2021-08-04-114559-113 (August Meeting agenda of the Arizona ABS Committee, which provides descriptions of five licensed ABS entities).

[18] See Justin Wise, CORRECTED: Florida Special Committee Recommends Regulatory "Sandbox," Law360 (June 29, 2021), https://www.law360.com/articles/1398652/corrected-florida-special-committee-recommends-regulatory-sandbox.

[19] See Lauren Berg, Calif. Bar Oks Exploring "Sandbox" to Boost Legal Access, Law360 (May 14, 2020), https://www.law360.com/articles/1273812/calif-bar-oks-exploring-sandbox-to-boost-legal-access.

[20] See Aebra Coe, Where 5 States Stand On Nonlawyer Practice Of Law Regs, Law360 (Feb. 5, 2021), https://www.law360.com/articles/1352126/where-5-states-stand-on-nonlawyer-practice-of-law-regs.

[21] D.C. Rules of Pro. Conduct r. 5.4(b)(1).

[22] D.C. Rules of Pro. Conduct r. 5.4(b)(2)–(4).

[23] D.C. Rules of Pro. Conduct r. 5.4(b).

[24] ABA Comm. on Ethics & Pro. Resp., Formal Op. 91-360 (1991).

[25] ABA Comm. on Ethics & Pro. Resp., Formal Op. 464 (2013).

[26] James Podgers, ABA Ethics Opinion Sparks Renewed Debate over Nonlawyer Ownership of Law Firms, ABAJournal (Dec. 1, 2013), https://www.abajournal.com/magazine/article/aba_ethics_opinion_sparks_renewed_debate_over_nonlawyer_ownership_of_law_fi.

[27] ABA Comm. on Ethics & Pro. Resp., Formal Op. 499 at 5 (2021).

[28] Id. at 2.

[29] Id. at 4.

[30] Id.

[31] Id.