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Navigating California Rule 5.4

FEE SHARING, NONLAWYER ARRANGEMENTS, AND EVOLVING LEGAL ETHICS

California Rule of Professional Conduct 5.4 protects the independence, integrity, and public trust central to the legal profession. The rule restricts fee sharing with nonlawyers and prohibits certain business relationships that could undermine a lawyer's duty to act solely in the client's interest. These limits are not outdated; rather, they are well-designed protections to prevent improper influence, conflicts of interest, and commercial pressures from distorting legal judgment.

California attorneys must understand both the rule's clear prohibitions and its carefully framed exceptions. These exceptions often support nonprofit and public-interest work. They operate within strict boundaries intended to preserve independent professional judgment. This article discusses case law, enforcement decisions, and practical guidance for applying Rule 5.4 in contemporary practice. It also addresses recent developments regarding new laws on fee sharing and referral services.

The rule's specific provisions

(a) A lawyer or law firm* shall not share legal fees directly or indirectly with a nonlawyer or with an organization that is not authorized to practice law, except that:

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

(2) a lawyer purchasing the practice of a deceased, disabled or disappeared lawyer may pay the agreed-upon purchase price, pursuant to rule 1.17, to the lawyer's estate or other representative;

(3) a lawyer or law firm* may include nonlawyer employees in a

compensation or retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement, provided the plan does not otherwise violate these rules or the State Bar Act;

(4) a lawyer or law firm* may pay a prescribed registration, referral, or other fee to a lawyer referral service established, sponsored and operated in accordance with the State Bar of California's Minimum Standards for Lawyer Referral Services; or

(5) a lawyer or law firm* may share with or pay a court-awarded legal fee to a nonprofit organization that employed, retained, recommended, or facilitated employment of the lawyer or law firm* in the matter; or

(6) a lawyer or law firm* may share with or pay a legal fee that is not court-awarded but arises from a settlement or other resolution of the matter with a nonprofit organization that employed, retained, recommended, or facilitated employment of the lawyer or law firm* in the matter provided:

(i) the nonprofit organization qualifies under section 501(c)(3) of the Internal Revenue Code;

(ii) the lawyer or law firm* enters into a written* agreement to divide the fee with the nonprofit organization;

(iii) the lawyer or law firm* obtains the client's consent in writing,* either at the time the lawyer or law firm* enters into the agreement with the nonprofit organization to divide the fee or as soon thereafter as reasonably* practicable, after a full written* disclosure to the client of the fact that a division of fees will be made, the identity of the lawyer or law firm* and the nonprofit organization that are parties to the division, and the terms of the

division, including the restriction imposed under paragraph (a)(6)(iv); and

(iv) the total fee charged by the lawyer or law firm* is not increased solely by reason of the agreement to divide fees.

(b) A lawyer shall not form a partnership or other organization with a nonlawyer if any of the activities of the partnership or other organization consist of the practice of law.

(c) A lawyer shall not permit a person* who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's independent professional judgment or interfere with the lawyer-client relationship in rendering legal services.

(d) A lawyer shall not practice with or in the form of a professional corporation or other organization authorized to practice law for a profit if:

(1) a nonlawyer owns any interest in it, except that a fiduciary representative of a lawyer's estate may hold the lawyer's stock or other interest for a reasonable* time during administration;

(2) a nonlawyer is a director or officer of the corporation or occupies a position of similar responsibility in any other form of organization; or

(3) a nonlawyer has the right or authority to direct or control the lawyer's independent professional judgment.

(e) The Board of Trustees of the State Bar shall formulate and adopt Minimum Standards for Lawyer

Referral Services, which, as from time to time amended, shall be binding on lawyers. A lawyer shall not accept a referral from, or otherwise participate in, a lawyer referral service unless it complies with such Minimum Standards for Lawyer Referral Services.

(f) A lawyer shall not practice with or in the form of a nonprofit legal aid, mutual benefit or advocacy group if the nonprofit organization allows any third person* to interfere with the lawyer's independent professional judgment, or with the lawyer-client relationship, or allows or aids any person* to practice law in violation of these rules or the State Bar Act.

The rationale: Safeguarding public interest

Rule 5.4 reflects a core principle: Lawyers must offer undivided loyalty to clients, untainted by outside financial interests. The rule blocks marketers, investors, lead generators, or other nonlawyers from influencing decisions reserved to legal professionals. The State Bar views this rule as essential to client protection and the profession's integrity.

Without these safeguards, the legal marketplace could shift toward commercial incentives in ways that place client welfare at risk. Past incidents involving nonlawyer client solicitors, often referred to as “runners and cappers,” illustrate how quickly consumer protection breaks down when nonlawyers influence client selection or strategy.

Rule 5.4 reinforces obligations rooted in confidentiality, loyalty, and independent judgment, and it is closely aligned with related rules that prohibit unauthorized practice and improper referrals.

The rule and its recent amendments

Rule 5.4(a) prohibits lawyers and law firms from sharing legal fees with nonlawyers or unauthorized entities. The rule contains six exceptions that permit fee sharing only under narrow and strictly regulated circumstances. The most significant amendments, adopted in March 2021, expanded the nonprofit fee-sharing provisions

while maintaining strong protections for clients and the profession.

Summary of exceptions to Rule 5.4(a) and practical applications

Payments to a deceased lawyer's estate

An agreement by a lawyer with the lawyer's firm may provide for payment of money or other consideration over a reasonable period of time after the lawyer's death, to the lawyer's estate or to one or more specified persons.

Example: A partner in a three-lawyer firm passes away. Under a previously executed firm agreement, the surviving partners continue payments to the deceased lawyer's spouse for a two-year period. Because the arrangement is time-limited and established in advance, it complies with Rule 5.4(a)(1).

Purchase of a law practice

A lawyer who purchases the practice of a deceased, disabled, or disappeared lawyer may pay the agreed-upon price to the estate or representative in accordance with Rule 1.17 (Sale of a Law Practice), and clients must receive written notice of the transfer.

Example: A retiring lawyer sells his practice. The purchasing lawyer pays installments to the retiree's estate in accordance with the sale agreement. Clients receive written notice and may choose other counsel.

Nonlawyer employee compensation and retirement plans

Lawyers may include nonlawyer employees in compensation or retirement plans, even when those plans are based partly on overall firm profits. However, compensation may not be tied to the fees of specific cases.

Example: A mid-sized firm awards annual profit-based bonuses to paralegals. Because the bonuses are derived from overall firm performance rather than fees generated by specific cases, they comply with the rule.

Certified lawyer referral service fees

Lawyers may pay required fees to State Bar-certified lawyer referral services, provided the service complies with the Minimum Standards

for Lawyer Referral Services and the lawyer complies with Rules 5.4, 7.2 (Advertising), and 7.3 (Solicitation of Clients).

Example: A solo practitioner participates in a certified lawyer referral service and pays the applicable referral fee for each new matter. The arrangement complies with Rule 5.4 and related advertising and referral rules.

Court-awarded fees to qualified nonprofits

Lawyers may share court-awarded fees with a nonprofit organization that employed, retained, recommended, or facilitated the lawyer's representation. The lawyer is obligated to exercise independent professional judgment in the client's best interest.

Example: A lawyer may share with or pay court-awarded legal fees to nonprofit legal aid, mutual benefit, and advocacy groups that are not engaged in the unauthorized practice of law. This includes the concept of a nonprofit organization facilitating the employment of a lawyer to provide legal services.

Settlement-derived fees to qualified nonprofits

Added in 2021, this exception allows fee sharing from settlements when the nonprofit (1) qualifies under Section 501(c)(3) of the Internal Revenue Code, (2) the parties have a written division-of-fee agreement, (3) the client gives informed written consent, and (4) the total fee charged is not increased solely by reason of the agreement to divide fees.

Example: A nonprofit advocacy group collaborates with pro bono counsel. The parties execute a written agreement permitting the nonprofit to receive a portion of a settlement-based fee. After reviewing a detailed written disclosure, the client gives informed written consent.

A State Bar investigator's perspective

With respect to Rule 5.4, as a former investigator with the State Bar of California in the Office of Chief Trial Counsel, I investigated hundreds of cases involving loan modification scams, student loan fraud scams, personal injury “capping cases,” and

other types of fraudulent conduct resulting in attorney disciplinary actions up to and including disbarment.

Most of the cases involved an attorney who had little to no oversight of the law firm and who allowed nonlawyers to oversee the law firm. For example, in the loan-modification scams, the law firms targeted homeowners, and the scams involved false promises such as guaranteed modification. The attorneys collected up-front fees before any work was completed, provided legal advice from a non-lawyer, including directives to stop paying the mortgage without action or authority. In a word, they failed to provide any competent legal services and the homeowner ended up in foreclosure.

Other cases involving student loan debt scams had a similar modus operandi. The attorney allowed nonlawyers to run the practice, sales representatives used high-pressure tactics and charged borrowers illegal upfront fees for services that were freely available (i.e., federal forgiveness/repayment plans), and didn't provide any services to the client.

"Cappers" are non-lawyers who solicit individuals who are involved in personal injury matters (i.e., car accidents), who monitor EMS frequencies and loiter in emergency departments, and are paid by attorneys and law firms for the right to represent the client. There were turf wars and violent crime associated with these scoundrels. Many times, the criminal enterprise involved not only law firms and nonlawyers, but also the medical providers who had contact with the victim. They received kickbacks that violate Business & Professions Code section 650. It was all part of a criminal enterprise.

Other cases involve immigration "notario" consultant partnerships in which nonlawyer "immigration consultants" or notaries, advertise heavily in immigrant communities, often in non-English languages. An attorney may be brought in superficially such as having the attorney's name on the letterhead while the notario operates the enterprise, collecting fees and giving legal advice.

Moreover, many of these scams operated not only in California but targeted victims nationally, resulting in millions of dollars of losses to the victims. These are just a few of the many scams that involved attorneys and law firms which resulted in violations of Rule 5.4 and other Rules of Professional Conduct, Business and Professions Code, and the State Bar Act.

Noteworthy case law

***Frye v. Tenderloin Housing Clinic, Inc.* (2006) 38 Cal.4th 23**

Frye v. Tenderloin Housing Clinic, Inc. (2006) 38 Cal.4th 23, held that Corporations Code section 13406 subdivision (b) does not provide the exclusive authority for nonprofit corporations to practice law. The Supreme Court reaffirmed longstanding judicial exceptions that allow nonprofit legal aid, mutual benefit, and advocacy organizations to employ lawyers and practice law without registering as professional law corporations. The decision also rejected disgorgement of statutory fees, concluding the plaintiff suffered no injury.

Frye is relevant to Rule 5.4 because the rule's nonprofit fee-sharing exceptions apply only to nonprofits that are lawfully authorized to practice law. *Frye* clarifies which nonprofit entities fall into that category, ensuring that fee sharing under Rule 5.4(a)(5) and (a)(6) occurs only with nonprofits that are not engaged in the unauthorized practice of law.

***In the Matter of Huang* (Review Dept. 2014) 5 Cal. State Bar Ct. Rptr. 296**

In the Matter of Huang (Review Dept. 2014) 5 Cal. State Bar Ct. Rptr. 296, highlights the dangers of allowing nonlawyers to control a high-volume legal practice. Huang delegated nearly all loan-modification functions to nonlawyer staff who negotiated with lenders, advised clients, collected legal fees, and managed hundreds of matters with little or no attorney oversight. The Review Department found that Huang aided and abetted in the unauthorized practice of law, collected illegal advance fees, and

failed to competently supervise his employees. The case underscores the foundational purposes of Rule 5.4, which prohibit fee sharing, nonlawyer partnerships, and nonlawyer interference with a lawyer's independent professional judgment and conduct that resulted in widespread client harm in Huang's practice.

***In the Matter of DeClue* (Review Dept. 2016) __ Cal. State Bar Ct. Rptr. __**

In the Matter of DeClue (Review Dept. 2016) __ Cal. State Bar Ct. Rptr. __, illustrates the risks Rule 5.4 is intended to guard against. DeClue expanded his loan-modification practice by delegating nearly all legal and managerial responsibilities to nonlawyer staff who controlled client intake, negotiated agreements, collected fees, and provided legal advice. The Review Department found that DeClue illegally collected advance fees, failed to supervise his staff, and aided in the unauthorized practice of law. The decision emphasizes that nonlawyer-involvement prohibitions that permit nonlawyers to control core elements of a law practice compromise independent professional judgment and harm clients, and that these concerns are central to Rule 5.4's restrictions on fee sharing, nonlawyer partnerships, and nonlawyer interference with legal representation.

Enforcement and disciplinary trends

Recent State Bar enforcement actions demonstrate increasing scrutiny of improper fee sharing and nonlawyer involvement. Violations often lead to significant consequences, including suspension and, in severe cases, disbarment. Lawyers may also be required to pay restitution, participate in ethics training, and implement compliance measures. In almost every instance, the lawyer will be required to inform their clients.

Policy considerations and current developments

Assembly Bill 931: State Bar Act: Consumer Legal Funding

AB 931 was recently approved on October 10, 2025. It provides new

prohibitions on fee sharing. Some of the highlights of the bill are:

- It prohibits an attorney from promising or giving anything of value to a person for the purpose of recommending or securing the attorney's or the attorney's law firm's services, subject to specified exceptions (such as certain permitted gifts or bar-operated referral services).
- The fee-sharing prohibition applies only to contracts entered into on or after January 1, 2026, through January 1, 2030.
- The statute provides a \$10,000 fine per violation, or three times the actual damages incurred by the consumer, as well as injunctive relief and reimbursement of attorneys' fees.

Section 6156 was added to the Business and Professions Code. Section 6156 (a) states: No attorney licensed or otherwise authorized to practice in this state shall share legal fees directly or indirectly with an out-of-state alternative business structure unless all of the following apply:

1. The attorney is also licensed in the state in which the Alternative Business Structure (ABS) is approved.
2. The fees are compensation for the provision of legal services in that state.
3. The law of that state is controlling pursuant to Rule 8.5 (Disciplinary Authority, Choice of Law), or any successor rule.

Section 6156(b) states: A violation of this section shall constitute cause for the imposition of discipline by the State Bar of California and shall subject the attorney to the following penalties:

1. Statutory damages of \$10,000 per violation or three times the actual damages incurred by the consumer, whichever is greater.
2. Attorney's costs and fees.
3. Injunctive or declaratory relief.

Senate Bill 37: Attorneys: Unlawful solicitations and advertisements

SB 37 was recently approved on October 11, 2025, and amends Business and Professions Code sections 6153, 6157, 6157.2, and 6158.4 and adds section 6156.5. Some key elements of SB 37 that involve fee sharing include:

- Existing laws already make it unlawful for any person or entity to act as a runner or capper. SB 37 strengthens enforcement by creating a private right of action for consumers harmed by unlawful solicitation or illegal referral services.
- SB 37 tightens standards for lawyer-referral services, including ownership and operation limits (for example, barring referral services from being owned or operated by lawyers who receive more than a set percentage of referrals), and ties enforcement to the State Bar's registration and certification system.
- SB 37 adds section 6156.5, giving consumers a private cause of action to enforce existing prohibitions on unlawful solicitation, illegal referral services, and certain advertising violations, with (1) statutory damages ranging from \$5,000 to \$100,000 per violation or three times actual damages or whichever is greater, (2) attorney's fees, (3) injunctive and declaratory relief, and (4) any other relief the court deems proper.

Conclusion

Rule 5.4 is an essential safeguard, protecting clients and upholding public confidence in institution of public justice. By understanding its structure, exceptions, and enforcement trends, lawyers can navigate modern practice challenges while maintaining the highest ethical standards.

Viewed alongside Rule 5.4, SB 37 and AB 931, they operate as legislative "belt and suspenders" for the public's protection. If money is the root of all evil, Rule 5.4 is the core ethical rule that ameliorates its influence. Together,

these authorities create an integrated framework that reinforces ethical compliance and strengthens public trust in the legal profession. 

Lita Abella, JD, founder of Lita Abella Coaching, Consulting & Mediation Services, specializes in trauma-informed coaching, conflict resolution, and mediation. Her approach centers on empathy, neutrality, and practical strategies to support clients and organizations in navigating trauma and other issues with resilience. With a legal background and experience as a law clerk for prosecutorial agencies, she brings deep insight into legal complexities and ethical challenges. Lita served more than a decade at the State Bar of California in investigative and leadership roles, focusing on attorney misconduct and workers' advocacy. She also draws on her law-enforcement experience understanding the emotional toll of high-stress careers, including PTSD and compassion fatigue. Lita is a seasoned public speaker and has delivered over 400 presentations on substance use disorders, mental health issues, and work-life balance. She is a business law professor committed to educating future legal and business professionals.