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

FORMAL OPINION 2024-4: LAWYERS ASSOCIATING WITH ALTERNATIVE LEGAL BUSINESS ENTITIES

TOPIC: A New York lawyer holding a financial interest in an Alternative Legal Business Entity.

DIGEST: A New York lawyer may hold a financial interest in an Alternative Business Structure (ABS) that is lawfully operating in a jurisdiction that permits ABS entities to provide legal services. A New York lawyer is not permitted to practice law as part of an ABS if the predominant effect of the New York lawyer's conduct will be felt in New York, but the New York Rules do not prohibit a lawyer or law firm from entering into ongoing business arrangements with an ABS provided the ABS and the New York firm are operating as legally separate entities.

RULES: **5.4; 8.5**

QUESTION: May a New York lawyer hold a financial interest in an ABS that is lawfully operating in a jurisdiction that permits such entities to provide legal services? May a New York lawyer enter into business arrangements beyond a financial interest with an ABS that is lawfully operating in a jurisdiction outside of New York?

OPINION: A New York lawyer may hold a financial interest in an ABS provided the lawyer is not practicing law through the ABS and is merely a financial investor. A lawyer must also be mindful of the bounds of NY Rule 8.5 and NY Rule 5.4, which set the parameters for a lawyer's ability to associate and do business with an ABS while the lawyer is admitted in New York.

Introduction

Although the New York Rules of Professional Conduct (the "New York Rules") as well as the ethics rules of almost all other U.S. jurisdictions prohibit nonlawyer ownership of law firms, some jurisdictions have adopted rules and regulatory programs that permit Alternative Legal Business Structures (ABS) to provide legal services. In broad terms, an ABS is an entity that is authorized to practice law but that has at least one nonlawyer who shares in the proceeds of the firm.[1]

The District of Columbia Rules of Professional Conduct have permitted ABS entities since 1991, subject to certain limitations. *See* D.C. R. Prof. Cond. 5.4. Arizona took steps in 2021 to eliminate its version of Rule 5.4 altogether and to create a regulatory scheme to allow ABS entities, subject to certification and regulation by the Supreme Court of Arizona. Also in 2021, the Utah Supreme Court established a "regulatory sandbox" program to allow for ABS entities under certain

[1] We assume for purposes of this Opinion that the ABS is lawfully organized in a jurisdiction that permits such entities to provide legal services, and that the laws of the ABS jurisdiction would permit a New York lawyer to hold a financial interest in the ABS.

conditions. The United Kingdom has permitted ABS law firms since at least 2007. *See* Legal Services Act, 2007 c. 29, § 71 et seq. (U.K.).

The purpose of this opinion is twofold. *First*, this opinion will identify common themes running through the various ABS-related ethics opinions issued by the American Bar Association ("ABA") and New York ethics committees. *Second*, this opinion will address why we believe the New York Rules permit a New York lawyer to hold a financial interest in an ABS that is legal in the jurisdiction where it is operating.

I. Relevant Rules and Ethics Opinions Related to ABS Ownership

As earlier ethics opinions have observed, some other U.S. jurisdictions permit ABS law firms, and a New York lawyer may wish to practice with an ABS lawfully operating in one of those jurisdictions. There are two New York Rules that must be considered in determining whether a New York lawyer may have an ownership interest in an ABS.

Rule 5.4

Rule 5.4 of the New York Rules addresses nonlawyer ownership of law firms. NY Rule 5.4(a) states that a "lawyer or law firm shall not share legal fees with a nonlawyer." NY 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." In the same vein, NY Rule 5.4(c) prohibits a nonlawyer owner from "directing or regulating the lawyer's professional judgment in rendering legal services," while NY Rule 5.4(d) says that a lawyer may not form "a professional corporation or association" if a nonlawyer owns any interest in it, or is a "corporate officer or director thereof", or has the right to direct or control its operations.[2] Accordingly, it is well settled that the New York Rules prohibit a lawyer from practicing law in New York through an ABS (*e.g.*, as the resident New York partner in an ABS based in Arizona).

NY Rule 5.4, however, does not end our analysis. Whether a lawyer admitted in New York may have an ownership interest in an ABS may turn on which ethics rules apply to the lawyer's conduct.

Rule 8.5

NY Rule 8.5(a) provides that:

> A lawyer admitted to practice in this state is subject to the disciplinary authority of this state, regardless of where the lawyer's conduct occurs. A lawyer may be subject to the disciplinary authority of both this state and another jurisdiction where the lawyer is admitted for the same conduct.

[2] Although we do not opine on issues relating to the unauthorized practice of law, we note that New York's Judiciary Law also prohibits corporations or other similar entities from practicing law. *See, e.g.,* N.Y. Jud. Law § 495 (which says, in pertinent part, that "no corporation shall be permitted to render any services which cannot lawfully be rendered by a person not admitted to practice law in this state nor to solicit directly or indirectly professional employment for a lawyer").

NY Rule 8.5(a) is meaningfully different, however, from Rule 8.5(a) of the ABA Model Rules of Professional Conduct (the "Model Rules"). Specifically, Model Rule 8.5(a) contains the following additional language: "A lawyer not admitted in this jurisdiction is also subject to the disciplinary authority of this jurisdiction if the lawyer *provides or offers to provide* any legal services in this jurisdiction." (Emphasis added.) NY Rule 8.5(a) does not include this language. In other words, unlike the jurisdictions that have adopted Model Rule 8.5(a), NY Rule 8.5(a) applies the New York Rules only to a lawyer who is actually "admitted to practice" in New York, not to a non-New York lawyer who merely "provides or offers to provide" legal services in New York.[3]

In the case of a lawyer licensed in multiple jurisdictions, NY Rule 8.5(b)(2)(ii) provides that:

> the rules to be applied shall be the rules of the admitting jurisdiction in which the lawyer principally practices; provided, however, that if particular conduct clearly has its *predominant effect* in another jurisdiction in which the lawyer is licensed to practice, the rules of that jurisdiction shall be applied to that conduct.

(Emphasis added.)

New York and ABA Ethics Opinions

The ABA and ethics committees in New York have issued several ethics opinions regarding lawyers working for and owning interests in ABS entities. We briefly summarize some of the key opinions below.

A seminal opinion is New York State Opinion 889 (2011), which permitted a lawyer admitted in both New York and the District of Columbia (which permits certain types of ABS entities) to become part of an ABS law firm in the District of Columbia provided that the predominant effect of the lawyer's practice was in the District of Columbia. New York State Opinion 889 further stated that this conclusion would not change if the lawyer conducted "occasional New York litigation" so long as "the lawyer and the law firm, now and in the foreseeable future, have their principal place of business in the District of Columbia and … the bulk of their revenue is derived from matters unrelated to the State of New York."

One year later, New York State Opinion 911 (2012) concluded that a New York lawyer was not permitted to practice law principally in New York as an employee of an ABS firm based in the U.K. (which generally permits ABS entities). Both New York State Opinions 889 and 911 were based on the New York State Bar Association Committee's analysis of NY Rule 8.5. New York State Opinion 889 analyzed NY Rule 8.5(b) to determine the "predominant effect" of the conduct of lawyers admitted in *both* New York and the District of Columbia, while New York

[3] To be clear, a lawyer may be "admitted to practice" in New York in ways other than a plenary bar admission. *See, e.g.*, 22 NYCRR § 520.11 (admission *pro hac vice*); 22 NYCRR § 522 (authorized in-house counsel program); 22 NYCRR § 523 (temporary practice).

State Opinion 911 analyzed NY Rule 8.5(a) and concluded that because the inquiring lawyers were admitted *only* in New York, the New York Rules clearly applied.[4]

New York State Opinion 1038 (2014) similarly concluded that a New York lawyer who practiced primarily in New York could not join a D.C. law 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."

In New York City Opinion 2015-8, this Committee addressed whether a New York lawyer may ethically share fees with a law firm in another jurisdiction that is permitted to have (and has) nonlawyer owners. We concluded that such an arrangement was permissible. *Accord* ABA Formal Op. 464 (2013) (approving fee-sharing between a law firm located in a Model Rules jurisdiction and an ABS firm located in a jurisdiction that permits ABS entities). Similarly in New York City Opinion 2020-1, we concluded that the New York Rules did not prohibit a New York law firm from entering into an ongoing business relationship with an ABS entity where the two firms regularly act as co-counsel on matters together and share fees pursuant to a standing agreement, but the two firms remain separate legal entities.

Further, in addressing a question similar to the one we address here, ABA Formal Op. 499 (2021) concluded that a lawyer admitted in a Model Rules jurisdiction could become a "passive investor" in an ABS firm. (We use the term "Model Rules Jurisdiction" to mean a jurisdiction that has adopted Model Rule 5.4, which prohibits non-lawyer ownership of for-profit law firms and prohibits fee sharing between lawyers and nonlawyers.) ABA Formal Op. 499 defined a "passive" investment as one where the lawyer "contributes money to an ABS with the goal of receiving a monetary return on that investment." ABA Formal Op. 499 added that "[p]assive 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." In other words, ABA Formal Op. 499 reasoned, simply making a monetary investment in an ABS entity would not subject the lawyer to regulatory scrutiny in a Model Rules jurisdiction under Model Rule 8.5(b), but actively participating in the day-to-day operations of an ABS entity might subject the investing lawyer to regulatory scrutiny.

Shortly after the ABA issued ABA Formal Op. 499, New York State Opinion 1234 (2021) concluded that a New York lawyer may not merge practices with an out-of-state law firm owned directly or indirectly by nonlawyers, even if such ownership is permissible under the rules applicable in the out-of-state law firm's home jurisdiction (the ABS jurisdiction), unless (a) the New York lawyer is also admitted in that jurisdiction; (b) the New York lawyer principally practices in that jurisdiction; and (c) the predominant effect of the work is in the ABS jurisdiction.

New York State Opinion 1234 also noted, in passing, that "New York is not among the jurisdictions that allow nonlawyer [ownership of law firms]" and that "New York Rule 5.4(d) prohibits a New York lawyer from practicing in an entity authorized to practice law for profit if a nonlawyer owns *any* interest." *See* New York State Opinion 1234, ¶ 13 (citing New York City

[4] New York State Opinion 911 noted, in the alternative, that "[e]ven if the lawyers in question are also licensed in the UK, the predominant effect of their conduct, in practicing law from a New York office on behalf of New York clients, would be in New York."

Opinion 2020-1). In our view, New York State Opinion 1234 is consistent with the opinions cited above. New York State Opinion 1234 merely reinforces the conclusion that a New York lawyer cannot *actively* participate in the activities of an ABS firm – whether by becoming a partner in an ABS firm or by "merging" with an ABS firm – unless the New York lawyer's conduct has a predominant effect in another jurisdiction that permits fee sharing with nonlawyers *and* the New York lawyer is also admitted in that jurisdiction.

The above rules and ethics opinions lead to several important conclusions.

First, a New York lawyer is not permitted to practice with an ABS entity if the predominant effect of the New York lawyer's practice is clearly felt in New York. *See, e.g.*, New York State Opinion 911; New York State Opinion 1234. These opinions are based on the conclusion that under NY Rule 8.5(b), if the "predominant effect" of the lawyer's conduct is clearly felt in New York, then the New York rules will govern the lawyer's conduct regardless of where the ABS entity is located.[5]

Second, Model Rule 8.5 does not prohibit a lawyer from investing in a lawful ABS entity when the investment is a passive one. *See* ABA Formal Op. 499.

Third, a New York lawyer is permitted to enter into an arm's-length fee-sharing agreement with an ABS firm provided the New York law firm and the ABS are operating as legally separate entities. *See* ABA Formal Op. 464; New York City Opinion 2015-8; New York City Opinion 2020-1. Such a fee-sharing arrangement may be ongoing – it does not need to be reinvented on a case-by-case basis. *See* New York City Opinion 2020-1.

II. May a New York Lawyer Ethically Invest in an ABS?

New York ethics committees have not yet answered whether a lawyer admitted in New York (a non-ABS jurisdiction) may passively invest in an ABS firm in a jurisdiction that permits out-of-state lawyers to invest in an ABS. The conclusion in ABA Formal Op. 499 is based largely on a reading of Model Rule 8.5(b)(2), which states that where a lawyer's conduct is not related to a matter pending before a tribunal, the applicable ethics rules are "the rules of the jurisdiction in which the lawyer's *conduct occurred or*, if the *predominant effect* of the conduct is in a different jurisdiction, the rules of that jurisdiction shall be applied to the conduct." (Emphasis added.) ABA Formal Op. 499 therefore concluded:

> [U]nder Rule 8.5(b)(2), the predominant effect of a Model Rule Lawyer's passive investment in an ABS would be in the jurisdiction(s) where the ABS would be permitted. That conclusion follows from the fact that the investment is passive and is made in order to fund the activities of an ABS in a jurisdiction that permits such entities. Assuming the Model Rule Lawyer's investment is genuinely passive, the lawyer cannot be deemed to be practicing law in the ABS-permissive jurisdiction, just as a lawyer who is an investor in a mutual fund that includes widget company

[5] NY Rule 8.5(b)(2)(ii) applies where the lawyer is admitted in New York *and* another jurisdiction (*e.g.*, a jurisdiction that permits ABS entities to offer legal services). If the lawyer is admitted *only* in New York, then under NY Rule 8.5(b)(2)(i) the New York Rules would apply and the New York lawyer would similarly be prohibited from representing clients in New York on New York legal matters through an ABS entity.

> stock in its portfolio is not deemed to be making widgets. Accordingly, when the Model Rule Lawyer is passively investing, the only relevant "conduct" and the only meaningful "effect" of that conduct occurs in the ABS-permissive jurisdiction.

ABA Formal Op. 499 at 3; *see also* ABA Formal Op. 504 (2023) (concluding that a lawyer lawfully practicing as part of an ABS firm may practice *pro hac vice* in a non-ABS jurisdiction because the "predominant effect" under Model Rule 8.5(b) of the lawyer's conduct as it relates to ownership of the ABS firm would be the jurisdiction where the law firm structure was established and that permitted such conduct).[6]

We agree with the conclusion in ABA Formal Op. 499, albeit for slightly different reasons. Because the language of Model Rule 8.5(b) differs from the language of NY Rule 8.5(b)(2), the New York version requires a narrower application. As noted, Model Rule 8.5(b)(2) applies to "*any other conduct*" outside of the lawyer's home jurisdiction that is not related to a matter pending before a tribunal. (Emphasis added.) NY Rule 8.5(b)(2)(i)-(ii), by contrast, provides that for any multijurisdictional conduct: (i) if the lawyer is licensed to practice *only* in New York then the New York Rules will apply regardless of where the predominant effect will occur, but (ii) if the lawyer is licensed to practice in *both* New York *and* another jurisdiction, then the "predominant effect" test comes into play.

We do not believe that NY Rule 8.5(b) requires that the New York Rules apply to a lawyer's passive investment in an ABS if the lawyer is admitted only in New York. Were the New York Rule read to require such a result, then that same conduct – making a passive investment in an ABS operating in another jurisdiction – would be governed by different ethics rules depending on whether the New York lawyer was admitted only in New York or also admitted in the jurisdiction where the ABS operated. We cannot discern any legitimate basis for such a distinction. Further, such a distinction is inconsistent with the purpose of NY Rule 8.5(b). *See* NY Rule 8.5 Cmt. [3] (the purpose of NY Rule 8.5(b) is "to resolve … potential conflicts" between the rules of multiple jurisdictions, and the premise of Rule 8.5(b) is that "minimizing conflicts between rules, as well as uncertainty about which rules are applicable, is in the best interest of clients and the profession (as well as the bodies having authority to regulate the profession).").

We therefore reach a similar conclusion to ABA Formal Op. 499. As a threshold matter, because the lawyer's proposed investment in the ABS is not, by itself, the practice of law, we do not believe that an application of NY Rule 8.5 is necessary in the first instance. As ABA Formal Op. 499 reasoned: "Assuming the Model Rule Lawyer's investment is genuinely passive, the lawyer cannot be deemed to be practicing law in the ABS-permissive jurisdiction, just as a lawyer who is an investor in a mutual fund that includes widget company stock in its portfolio is not deemed to be making widgets." We agree with this reasoning. Put simply, an otherwise lawful passive investment in a company is not the practice of law subject to regulation under the ethics rules. Although NY Rule 8.5 is not limited to conduct involving the practice of law – for example,

[6] ABA Formal Op. 504's application to the issue addressed in this Opinion is limited. ABA Formal Op. 504 is based on a reading of Model Rule 8.5 that, as detailed below, is materially different from NY Rule 8.5. In addition, ABA Formal Op. 504's discussion of ABS ownership was about whether a lawyer who practiced in an ABS firm may appear in a non-ABS jurisdiction. Here, we address the inverse scenario: whether a lawyer admitted in a non-ABS jurisdiction (New York) may invest in an ABS firm practicing in another jurisdiction.

it may require the application of NY Rule 8.4(c) to dishonest, deceitful or illegal conduct of a New York lawyer outside of the practice law and committed outside New York – the underlying conduct must also implicate a specific Rule of Professional Conduct. As detailed below, that is not the case here because NY Rule 5.4 is meant to address conduct involving the practice of law.

In our opinion, NY Rule 5.4 does not apply to a lawyer's passive investment in an ABS. As detailed above, NY Rule 5.4 provides that a New York lawyer shall not: (i) share legal fees with a nonlawyer (NY Rule 5.4(a)); (ii) "form a *partnership* with a nonlawyer if any of the activities of the partnership constitute the practice of law" (NY Rule 5.4(b)) (emphasis added); and (iii) "*practice with* or in the form of an entity authorized to practice law for profit" if a nonlawyer holds an interest in the entity (NY Rule 5.4(d)) (emphasis added). A financial investment in an out-of-state ABS does not fit any of these criteria.

With respect to NY Rule 5.4(a), we do not believe that a lawyer would be "sharing legal fees" with a nonlawyer simply by collecting a return on the lawyer's investment from the ABS. NY Rule 5.4(a) addresses the obligations of the lawyers who are sharing the fees, not the activities of the non-lawyers receiving a share of the fees. The New York lawyer's role in the ABS as a passive investor is identical to that of the nonlawyer passive investors. As noted, the lawyer is not practicing law through the ABS or providing legal services to the ABS's clients. Model Rule 5.4(a) in ABS jurisdictions, like New York's version of the rule, addresses the actions of the lawyers who are practicing in the ABS, but unlike New York's rule permits the lawyers to share fees with the nonlawyer investors. Those fees paid to the ABS were not for services rendered by the New York lawyer or over which the New York lawyer had any direction or control and so NY Rule 5.4(a) is not implicated. Conversely, if the lawyer was involved in providing or directing the legal services, Rule 5.4(a) would be implicated and NY Rule 8.5(a) would require the application of NY Rule 5.4(a).[7]

With respect to NY Rules 5.4(b) and 5.4(d), we believe they are similarly inapplicable to a passive financial investment in a permissible out-of-state ABS. A financial investment in an ABS does not constitute a "partnership" with a nonlawyer for the purposes of practicing law. NY Rule 1.0(m) defines a "partner" as a "member of a partnership, a shareholder in a law firm organized as a professional legal corporation or a member of an association authorized to practice law." *See also* Roy D. Simon, *Simon's New York Rules of Professional Conduct Annotated* § 1.0:41 (Thomson Reuters 2022) ("The related term 'partnership' is not defined in Rule 1.0, but it should likewise be read to encompass every form of association included in the definition of 'partner.'"). An outside investor in an ABS is none of these. Although the lawyer may nominally be termed a "shareholder," the lawyer would not be practicing law through the ABS firm, would not have any involvement in the ABS firm's representation of clients, and would not otherwise hold himself or herself out as practicing law through the ABS firm. In other words, so long as the lawyer is not practicing law through the ABS, there is no meaningful difference between a lawyer's investment in an ABS entity and an investment in any other number of companies.[8] Similarly, a lawyer who

[7] By contrast, if the lawyer wanted to provide legal services through the ABS firm then the lawyer's conduct would be analyzed under the opinions discussed in Section I above.

[8] Of course, a lawyer investing in an ABS must take steps to ensure that the ABS entity's activities are lawful and that the ABS entity is not engaged in misconduct, which includes that the ABS is compliant with the applicable rules

is a mere investor is not "practicing" in the form of an entity authorized to practice law and therefore is not subject to NY Rule 5.4(d). As detailed above, a passive investment does not constitute the practice of law. It is merely an economic investment in a business venture. Accordingly, NY Rule 5.4(d) is not applicable.

The purpose of NY Rule 5.4 is to protect the lawyer's "professional independence of judgment." *See* NY Rule 5.4, Cmt. [1]. Where the lawyer is not practicing law through the ABS, we do not see any attribute of a New York lawyer's financial investment in an ABS entity that would risk compromising the lawyer's professional independence. Any legal practice that the lawyer maintains would be entirely separate from the lawyer's investment. It would therefore be impossible for any nonlawyer affiliated with the ABS entity to attempt to influence the lawyer's decision making on behalf of clients of the lawyer's New York law practice.

Under these circumstances, we are of the opinion that the New York Rules do not apply to a New York lawyer's holding a passive financial interest in a legal ABS entity operating in another jurisdiction because NY Rule 5.4 does not address such an investment.

Conclusion

A lawyer admitted in New York is permitted to hold a financial interest in an ABS entity that is lawfully operating in another jurisdiction (*i.e.*, a jurisdiction that permits ABS entities to practice law) provided the New York lawyer-investor is not practicing law through the ABS entity. A New York lawyer is not permitted to practice as part of an ABS firm if the predominant effect of the New York lawyer's conduct is in New York. Finally, a New York lawyer or law firm is permitted to enter into ongoing business arrangements with an ABS firm to work on client matters together provided the ABS firm and the New York firm are operating as legally separate entities.

of professional conduct in the jurisdictions where it operates. By the same token, however, a lawyer would also be prohibited from investing in a company that the lawyer knows is engaged in illegal activity.