Keeping PE Out Of Law Is Job For Courts, Not Capitols

By **Felix Shipkevich** (June 8, 2026)

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The American legal market has undergone a significant structural shift, and state legislatures have taken notice.

Across the country, lawmakers are moving to bar private equity firms, hedge funds, and other nonattorney investors from owning or financing law firms. However well-intentioned, these efforts raise a serious separation of powers problem. By regulating the ownership and governance of law firms, legislatures risk intruding on authority that state constitutions and the inherent powers doctrine have traditionally assigned to the judiciary.

A handful of jurisdictions have led the way. Since the Arizona Supreme Court opened the door to alternative business structures in 2021, more than 150 nonattorney-owned entities have received approval to deliver legal services in that state, as of March.[1]

Utah's regulatory sandbox, which once counted approximately 39 participating entities, has been decreasing. The portion of the program open exclusively to alternative business structures was closed by the Utah Supreme Court on Dec. 31, 2024, and Phase 2 now focuses on moderate- and high-innovation models with a program sunset of Aug. 14, 2027.[2]

Puerto Rico also joined the movement in 2025 by adopting rules permitting nonattorney ownership of law firms capped at 49%.[3]

Beyond these formal programs, private equity firms and hedge funds have accelerated their use of management services organizations as workarounds in jurisdictions that still prohibit direct nonattorney ownership. The concern driving this legislative response is straightforward. When outside investors hold financial stakes in litigation outcomes, decisions about which cases to file and how to litigate them risk being shaped by return expectations rather than client interests.

That concern has now produced concrete legislative action in California, Colorado and Illinois.

The impulse is understandable, but these measures reveal a deeper constitutional difficulty.

By enacting detailed statutory prohibitions on ownership structures, financing arrangements and fee-sharing mechanisms that directly govern the internal operations of law firms, the legislatures are exercising authority that state constitutions and the inherent powers doctrine vest in the judicial branch.

The statutes do not merely supplement ethical rules adopted by state supreme courts. They redefine the boundaries of the practice of law through ordinary legislation. That redefinition exceeds what the separation of powers permits.

The traditional framework for regulating law firm structure has long rested with state supreme courts. Through the Rules of Professional Conduct, specifically the provisions equivalent to American Bar Association Model Rule 5.4, courts have prohibited nonlawyer ownership of law firms, fee sharing with nonlawyers, and any arrangement that allows nonlawyers to direct or influence professional judgment.[4]

California's Rule of Professional Conduct 5.4, for example, was adopted directly by the California Supreme Court.[5] It bars a lawyer from practicing in a professional corporation or other profit-seeking organization if a nonlawyer owns any interest in it, serves as a director or officer, or holds authority to control the lawyer's independent professional judgment. Colorado and Illinois follow the same judicially adopted model.[6]

This allocation is not accidental. State constitutions vest in supreme courts the authority to regulate the admission, discipline and practice of law.

In California, Article VI, Section 9, of the state Constitution, together with the court's inherent judicial powers, supplies the textual and doctrinal foundation for this primacy. In Colorado and Illinois, the supreme courts have similarly recognized their inherent and exclusive authority to regulate the practice of law, derived from their respective state constitutions and those courts' function as the sole admitting and disciplining authorities for the bar.[7]

The power to define who may engage in the practice of law, and under what structural conditions, belongs to the judiciary because it is inseparable from the administration of justice itself. Legislatures may regulate commercial aspects of legal services in appropriate cases, but they may not supplant that role.

The new statutes cross that line.

On April 6, the California Assembly passed A.B. 2305 by a unanimous bipartisan vote and the measure is pending before the Senate Judiciary Committee.[8] A.B. 2305 adds Article 7.5 to the California Business and Professions Code. As amended in the California Senate on June 1, the bill is now titled "Attorneys: corporate lenders" and reframes the prohibited conduct as the unauthorized practice of law by a corporate lender, while expressly preserving qualifying nonrecourse litigation finance.

The bill bars corporate lenders from exercising control over an attorney's professional judgment, including client selection, litigation strategy, settlement decisions and other substantive legal determinations, and provides for state bar discipline, statutory damages, and injunctive relief.

Colorado H.B. 26-1421, styled the Colorado Legal Practice Integrity and Fee-Sharing Prohibition Act and signed by Gov. Jared Polis on June 4, takes a similarly comprehensive approach.[9]

The **bill** broadly defines "legal services" to cover claims and legal matters with any Colorado nexus, giving the statute a wider reach than a purely venue-based trigger, and prohibits lawyers and law firms from sharing fees or revenues with nonlawyers or alternative business structures in any such representation. Flat-fee and hourly arrangements for management services organizations remain permissible, but percentage-based or success-based compensation structures are barred. A private right of action and disgorgement provisions reinforce the prohibitions.

Illinois H.B. 5487 and S.B. 3812 amend the Attorney Act. As originally introduced, both bills targeted private equity groups, hedge funds and the entities those investors control, including management services organizations.[10]

H.B. 5487, sent to Gov. JB Pritzker on May 31, was narrowed in the Illinois Senate to apply to law firms or attorneys operating in Illinois with less than $300 million in annual global legal services revenue, or firms that derive more than 50% of revenues from contingent-fee arrangements in each of the prior three calendar years.

As passed, the bill bars covered nonattorney-owned entities from revealing client records, hiring or firing attorneys or allied legal staff, interfering with professional judgment, or charging fees tied to firm revenues. It also prohibits noncompete and nondisparagement agreements, and imposes penalties of $10,000 per violation or treble damages. S.B. 3812, the companion measure, was re-referred to the Assignments Committee on March 27 and retains the original introduced framing.

The statutes themselves reveal the problem. By designating specific litigation decisions as matters requiring statutory protection from investor influence, the legislatures implicitly acknowledge they are regulating the practice of law itself, precisely the subject matter the constitution reserves to the judicial branch.

Recent judicial authority confirms the constitutional difficulty.

On May 9, in Anchor Law Firm PLLC v. State of New Jersey, the New Jersey Appellate Division struck down a legislative limitation on the attorney exemption in the Debt Adjustment and Credit Counseling Act.[11]

The "principally engaged" restriction, the court held, violated separation of powers because it attempted to define how much of an attorney's practice could consist of a particular type of legal work. That determination, the court explained, belongs exclusively to the Supreme Court under Article VI, Section 2, Paragraph 3, of the New Jersey Constitution, which vests the Supreme Court with plenary authority over the regulation of the legal profession.[12]

The Appellate Division also held, on an independent ground, that the provision was void for vagueness.

The New Jersey Supreme Court has since granted certification and is currently reviewing the Appellate Division's decision. The constitutional question, whether the Legislature may define the scope of permissible legal practice without encroaching on the judiciary's domain, is a significant separation of powers question. Absent earlier scheduling, merits argument would appear most likely during the 2026-2027 term.[13]

Courts examining similar challenges in California, Colorado and Illinois would face comparable analytical choices. If a legislature cannot condition an attorney exemption in ways that define the scope of permissible legal practice, it cannot define permissible law firm ownership structures by statute.

The structural problem is not cured by the protective intent of the legislation. Courts have long distinguished between commercial regulation that incidentally touches the legal profession and direct regulation of the profession's core functions. These bills fall into the latter category. They create parallel statutory causes of action, define professional judgment in legislative terms and impose remedies outside the judicial disciplinary process.

Counterarguments will be familiar. Proponents will emphasize that the statutes protect consumers and preserve the integrity of the justice system. They will note that legislatures have enacted professional corporation statutes and unauthorized practice of law prohibitions for decades without constitutional objection. That historical record does not carry the weight proponents assign it.

Professional corporation statutes were enabling measures that mirrored court-adopted ethics rules. They did not independently define "professional judgment," create private rights of action or impose statutory damages. The current bills do all three, substituting legislative command for judicial rulemaking at the profession's core. Legislative acquiescence in the former does not authorize the latter.

The strongest counterargument is not rooted in history but in framing. Defenders of the statutes will contend that the bills do not redefine the boundaries of legal practice at all. They will argue that the statutes merely supplement existing court-adopted ethics rules by adding commercial-law remedies, protect consumers through standard legislative channels and regulate the financing side of the attorney-client relationship rather than the professional conduct side.

Colorado's bill reinforces this framing with an explicit savings clause providing that the act does not limit or modify the Colorado Supreme Court's authority over the practice of law. If courts accept that characterization, the separation of powers concern dissolves.

The supplementation argument does not survive close examination. Statutes that define "professional judgment" in legislative text, void contracts that contravene those definitions, and create private rights of action enforced by disgorgement and treble damages are not reinforcing existing court rules. They are substituting a legislative framework for a judicial one. A savings clause cannot cure that substitution. It preserves the court's residual authority only where the legislature has not occupied the field. Here, the statute fills the center.

The access to justice and innovation concerns are serious, but the constitutional framework does not foreclose solutions. It redirects them to the appropriate branch. State supreme courts have the authority to address these concerns through rulemaking, including supervised alternative business structures. Legislatures may assist with funding or consumer protections, but they cannot substitute their judgment for the judiciary's on the structural governance of the profession.

The statutes now advancing in California, Colorado and Illinois present a clear opportunity for courts to reassert the constitutional baseline. A straightforward application of the separation of powers principles that animated the Appellate Division's analysis in the Anchor Law Firm decision would require either invalidation of the core provisions or narrow construction that preserves judicial primacy over professional judgment and firm structure. State bars and supreme courts, for their part, would do well to address the underlying policy questions through proactive rulemaking rather than allowing legislatures to fill the vacuum.

When legislatures enact statutes that define the boundaries of professional independence and law firm governance, they do more than regulate commerce. They reallocate constitutional authority. The recent wave of statutory restrictions on nonattorney investment makes that reallocation visible, and the constitutional error, once recognized, is not difficult to correct. The remedy lies in returning these structural questions to the branch

the constitutions have always entrusted with them. The practice of law belongs to the judicial branch.

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[1] Ariz. Supreme Court Admin. Order No. 2020-96 (eff. Jan. 1, 2021); Ariz. Code of Judicial Admin. sec. 7-209. As of March 2026, 150 ABS entities are currently licensed in Arizona. See IAALS, ABS Evaluation Blueprint (2026); "Arizona Model Allowing Non-Lawyers to Own Law Firms Shakes Legal Profession," Wash. Times (Apr. 27, 2026).

[2] Utah Office of Legal Services Innovation, Regulatory Sandbox Program (est. 2020). The Utah Supreme Court closed the ABS-only portion of the sandbox on December 31, 2024. Phase 2 now focuses on moderate- and high-innovation models and is set to sunset on August 14, 2027.

[3] Puerto Rico Supreme Court (Tribunal General de Justicia), Rules of Professional Conduct, Rule 5.4(b) (adopted June 17, 2025) (permitting non-lawyer ownership up to 49 percent of law firm shares, subject to conditions including: non-lawyers may not interfere with professional judgment; client representation information must be protected; non-lawyer ownership must be disclosed to clients; and an annual affidavit must be filed with the Supreme Court). The Court will evaluate the rule's effectiveness within three years of its effective date.

[4] ABA Model Rules of Prof'l Conduct r. 5.4 (2023).

[5] Cal. Rules of Prof'l Conduct r. 5.4 (as adopted by the California Supreme Court, eff. Nov. 1, 2018, amended eff. Mar. 22, 2021).

[6] Colo. Rules of Prof'l Conduct r. 5.4 (adopted by the Colorado Supreme Court); Ill. Rules of Prof'l Conduct r. 5.4 (adopted by the Illinois Supreme Court).

[7] The Colorado Supreme Court has "long held that as part of its inherent powers, it has exclusive authority to regulate and supervise the practice of law in Colorado." People v. Office of Attorney Regulation Counsel, No. 19SA118 (Colo. 2019); see also Colo. Const. art. VI; Colo. Att'y Regulation Counsel, Overview, https://www.coloradolegalregulation.com. For Illinois, the Supreme Court has recognized its "inherent and exclusive power to regulate the practice of law in this State." In re: Mitan, 119 Ill. 2d 229, 246, 518 N.E.2d 1000, 1008 (1987); see also In re: Mitan, 75 Ill. 2d 118, 123, 387 N.E.2d 278, 280 (1979); Ill. Const. art. VI, sec. 16.

[8] Cal. Assembly Bill 2305 (2025-2026 Reg. Sess.), as amended Mar. 16, 2026, and as further amended in Senate June 1, 2026.

[9] Colo. H.B. 26-1421, 75th Gen. Assemb., 2d Reg. Sess. (2026) (creating the "Colorado Legal Practice Integrity and Fee-sharing Prohibition Act"). Introduced Apr. 21, 2026. The bill

passed the full Colorado House on Third Reading on May 1, 2026, by a vote of 51 to 10. The Senate passed an amended version on Third Reading on May 11, 2026 (33-2), and the House concurred in the Senate amendments on May 12, 2026 (59-5). The bill was transmitted to Governor Jared Polis on June 3, 2026.

[10] Ill. H.B. 5487, 104th Gen. Assemb. (2025-2026). Ill. S.B. 3812, 104th Gen. Assemb. (2025-2026). Both were introduced Feb. 6, 2026. HB 5487 passed the House on April 9, 2026, by a vote of 70 to 36 to 1.

[11] Anchor Law Firm, PLLC v. State of N.J., No. A-0052-23, 2025 N.J. Super. LEXIS 37 (App. Div. May 9, 2025) (approved for publication).

[12] N.J. Const. art. VI, sec. 2, para. 3 (granting the New Jersey Supreme Court authority over the admission and discipline of attorneys and providing that its rule-making power in those domains is not subject to legislative override). See Winberry v. Salisbury, 5 N.J. 240, 247-55 (1950).

[13] The New Jersey Supreme Court's 2025-2026 argument calendar runs through July 9, 2026, with remaining sessions reserved for rules hearings and disciplinary matters, making the 2026-2027 term the earliest practicable window for merits argument. See N.J. Courts, Supreme Court Argument Schedule 2025-
2026, https://www.njcourts.gov/courts/supreme/arguments.