



The State Bar of California

Task Force on Access Through Innovation of Legal Services – Subcommittee on Alternative Business Structures / Multi-Disciplinary Practices

To: Subcommittee on Alternative Business Structures/Multi-Disciplinary Practices
From: Andrew Arruda and Joanna Mendoza
Date: June 18, 2019
Re: B.1. Recommendation: Entities can be composed of lawyers, non-lawyers or a combination of the two however, regulation would be required and may differ depending on the structure of the entity.

Recommendation approved by the Task Force: Entities can be composed of lawyers, non-lawyers or a combination of the two however, regulation would be required and may differ depending on the structure of the entity.

How the Recommendation Relates to the Charter: Paragraph 3 of the charter specifically states that the Task Force should prepare a recommendation addressing the extent to which, if any, the State Bar should consider increasing access to legal services by individual consumers by implementing some form of entity regulation or other options for permitting non-lawyer ownership or investment in businesses engaged in the practice of law. This recommendation reflects a balance of the dual goals of public protection and increased access to justice.

Pros: In the legal industry, there is no existing definitive structure that has demonstrated an ability to spark technology-based innovation in delivering legal services to consumers. Experimentation with all options seems important for a thorough assessment, and regulatory reform methods, such as a regulatory pilot programs, “sandbox (<http://www.legalexecutiveinstitute.com/wp-content/uploads/2019/03/Regulatory-Sandbox-for-the-Industry-of-Law.pdf>)” or another controlled environment, may be considered. Different strategies for balancing public protection and innovation should be tailored to different structures. While a tech entity comprised of a majority of lawyer owners might be conducive to modest reforms that are similar to the regulation of a registered professional law corporation, that should not be considered as a “one-size fits all” paradigm for all possible structures and combinations.

Cons: A multiplicity of structures for different new providers that each have their own rules and regulations may result in consumer confusion and stifle consumer adoption of any one of those new market participants. Robust education and outreach would be needed to help consumers, as well as lawyers, understand the new regulatory structures and the public protection consequences of a consumer using, or a lawyer participating in, one or more of the new legal services providers. Multiplicity of practice structures may also challenge the regulator and the participants in determining which regulations apply to their practice structure.

B.1. ATT1 Points Discussed by the Subcommittee re: What exactly will be regulated, including what are the important aspects of that regulation?

Hybrid Individual and Entity Regulatory Model: The subcommittee engaged in an in-depth discussion about the type of legal service providers that would be regulated under the proposal and came to agree on many aspects. Consensus was reached that the subcommittee is recommending a hybrid model that will allow individual licensing/registration/certification as appropriate (e.g., lawyers, LLLTs, paralegals, etc.) but will also allow for entity regulation. Entity regulation would encompass all forms of entities with regulation to be adjusted accordingly depending upon the scope of attorney involvement: a) attorney-only entities that include passive outside investment; b) entities owned/operated by a combination of attorneys and non-attorneys; and c) entities owned/operated by non-attorneys.

Points Discussed by the Subcommittee re: Aspects to require under new regulatory scheme: Much of the discussion was focused upon important aspects of regulating the entities and individuals under this regulatory scheme. Under the proposal, attorneys would continue under the existing regulatory scheme with rules changes as necessary to allow for implementation of the proposed structure.

Aspects applicable to all regulated entities and non-attorney individuals:

- 1) Create registration/certification structure/rules under the regulatory agency required in order to do business and be an exception to the UPL statute.
- 2) Incentivize specific types of legal services identified as most needed by the California Justice Gap Study. May include different fee structure for regulated entities and individuals, limiting registration/certification to those areas, and/or requiring a certain percentage of regulatory fees to be earmarked for legal services to help close the justice gap.
- 3) Require specific disclosures to consumers if services are not provided by licensed attorney (ensured informed consent).
- 4) Extend attorney/client confidentiality requirement to entities and other individuals delivering legal services (incl. prohibition against data sharing/selling).
- 5) Require data collection and reporting to regulatory agency (including specific data tracking impact on access to justice).
- 6) Require transparency (incl. providing credentials of service providers and pricing).
- 7) Require attorney sign-off/approval of law applied to service (e.g., ensuring that technology/AI apply law correctly).
- 8) Create a code of conduct and best practices applicable to regulated entities and non-attorney individuals.
- 9) Do not allow representation in court unless by attorney (current exceptions remain).
- 10) Each regulated entity and non-attorney individual would be given a number (like State Bar number) to allow consumers to know about validity of registration/certification.
- 11) Enforcement of regulations would be in form proposed by IAALS white paper.

Aspects applicable to regulated entities in particular:

- 1) Outside shareholders/owners allowed (including passive investment) but consumer interest shall remain paramount.
- 2) Attorney owners can be disciplined individually for violations of entity regulations and any applicable rules violations.
- 3) Corporate entities and LLCs must be a California entity or registered foreign entity in CA with annual statement of information identifying officers and directors and registered agent for service of process. Partnerships would need to identify all partners with the regulatory agency and identify a registered agent for service.

B.1. ATT2 Organization which will be responsible for regulating these individuals or entities

Points Discussed by the Subcommittee re: What organization(s) will regulate these individuals or entities? Two options were discussed: the State Bar (Option 1); and the State Bar and an Independent 3rd Party Agency (Option 2)

How these Discussion Points Relate to the ATILS Charter: Paragraph 3 of the charter provides that the Task Force should prepare a recommendation addressing the extent to which, if any, the State Bar should consider increasing access to legal services by individual consumers by implementing some form of entity regulation or other options for permitting non-lawyer ownership or investment in businesses engaged in the practice of law. Inherent in this section is the question whether such regulation should be performed by the State Bar or by another entity. This recommendation provides those options to be considered by the Task Force.

Option 1: State Bar to Regulate (Mendoza)

- a) Scope of regulation would broaden to include all entities/individuals providing legal services. This could include a name change for the agency allowing consumers to more easily identify it as a regulatory agency for anything falling under the umbrella of legal services.
- b) Regulation would continue to fall under the Judicial Branch with oversight by the California Supreme Court.
- c) The regulatory Board would have one or more commissions/committees under its oversight (similar to Committee of Bar Examiners and Board of Legal Specialization) which would propose policies and regulation for the different forms of legal services (e.g., entities, LLLTs, paralegals, document preparers, etc.).
- d) The regulatory fees charged for registration/certification of each form of legal service provider would cover the cost of regulation and discipline.

Pros: Existing structure is in place that can be most easily expanded to cover new areas of regulation in the legal services space. This avoids a significant amount of the implementation cost and duplication that would be associated with a parallel regulatory agency set up just for entity regulation. For example, the State Bar already has processes in place for regulating those not licensed under California law to practice law, such as registered in-house counsel, registered legal service providers and registered military spouses. Given the State Bar's history and long expertise handling these registrations, the agency is most qualified to continue and expand upon this regulation to entities or individuals that would be encompassed within the new regulatory scheme.

Furthermore, by keeping regulation of all legal services under one umbrella it will allow the regulation of attorneys, entities and other legal service providers to be overseen by a single board with a singular mission. This will allow for coordination and complementing legal services to better serve the public, improve access to justice as well as improving the administration of justice in California. This will avoid competing or conflicting missions and duplication of efforts.

This will also avoid issues associated with attorneys being owners or operators of a newly regulated entity and yet falling under the regulation of two separate agencies. When an attorney is involved in any way it will come under the State Bar regulation, so this will ensure no different treatment. The existing enforcement system will help ensure consistent treatment for both attorneys and non-attorneys, as appropriate.

Cons: Expanding the umbrella of the existing State Bar could bring with it challenges associated with changing how regulation is performed. Starting from zero and building a new regulatory agency from the ground up could make it easier to create a risk-based regulatory system rather than trying to change how the State Bar has operated all these years (role based regulatory system).

Could perhaps have more flexibility if not within the current agency structure, as more specifically referenced in the Option 2 discussion.

Unless the name changes, the State Bar is believed by many (attorneys and the public) to be a trade association that exists for the benefit of lawyers rather than the regulatory agency that it is. Creating an entirely new agency would avoid the stigma, preconceived ideas and misunderstanding associated with an organization that sounds like it exists to provide benefits and cover to lawyers.

**Option 2: Existing State Bar and an independent 3rd party agency
which would regulate individuals and entities.**

(Input provided by Crispin Passmore, Passmore Consulting, UK)

Points Discussed by the Subcommittee re: Regulatory Approach

Before addressing the structure of this particular option, it is important to consider the regulatory approach. Based on the UK's experience with entity regulation, this type of regulation is most successful when the regulator is given a certain degree of flexibility. To this end, an [anticipatory regulation](#) approach that has been successfully adopted in the UK, in which the regulator is given a set of objectives and functions (as set forth below) so that it can utilize these regulatory principles and adjust to the market as it evolves and new risks emerge. Having an overly-prescriptive regulatory approach can stifle the expansion of the market and the regulator's ability to efficiently and effectively do its job.

The focus on risks is crucial – a good regulator should be aiming to make the market work well for everyone – grow the legal market to its maximum size rather than most profitable for lawyers, to encourage innovation and new services, and to ensure that all needs of potential consumers are met wherever possible. The goal is for individuals, the poor, those living in rural communities, and small businesses can benefit from the legal services market in addition to large corporations and individuals who are able to afford high legal fees.

Points Discussed by the Subcommittee re: Structure of the Organization

Under this option, the legislature would statutorily create a new regulatory entity, which, for purposes of this memo, we will call the Legal Services Regulatory Board ("LSRB"). The LSRB will regulate individuals as

well as entities authorized to deliver “legal services.” The definition and scope of “legal services” would be determined through the public rulemaking process, incorporating public comment.

Composition: The enabling act would set forth the composition of the Legal Services Regulatory Board. Ideally, it would have a public member majority, and its members would be appointed by the Supreme Court, the Governor, and both houses of the Legislature. The legislation could even specify demographics and areas of expertise for certain members of the Board (for example, consumer organizations, economists, etc.) The Chair could also be an appointed position, possibly requiring Senate confirmation. The Board would then be tasked with appointing its own CEO.

Transparency: The Legal Services Regulatory Board would hold all of its meetings in public and be subject to the Bagley-Keene Open Meeting Act and the California Public Records Act.

Points Discussed by the Subcommittee re: Regulatory Objectives: The enabling legislation would impose a set of regulatory objectives for the Legal Services Regulatory Board. (See attached article from Laurel Terry describing regulatory objectives from a variety of jurisdictions). These objectives might include:

- Public protection
- Meaningful access to justice and information about the law, legal issues, and the civil and criminal justice systems.
- Advancement of the administration of justice and the rule of law.
- Transparency regarding the nature and scope of legal services to be provided, the credentials of those who provide them, and the availability of regulatory protections.
- Delivery of affordable and accessible legal services.
- Efficient, competent, and ethical delivery of legal services.
- Protection of privileged and confidential information.
- Independence of professional judgment.
- Accessible civil remedies for negligence and breach of other duties owed, and disciplinary sanctions for misconduct
- Promoting an efficient and competitive market for legal services

In exercising any of its functions the Legal Services Regulatory Board should seek to deliver the regulatory objectives. This is not a standalone set of objectives – so they are not designed to force the regulator to do anything that anyone can think of that might help them, it is a constraint on how it exercises its functions. So when it sets standards for lawyers to enter the market, or when it sets some kind of threshold for a non-lawyer owner of a legal business, it must do so in a way that is compatible with the regulatory objectives. In other words, adhering to these objectives places competition and economic growth at the core rather than protectionism/lawyers interests.

Points Discussed by the Subcommittee re: Accountability/Governance: In order to protect the rule of law, it is important that this Board be an independent agency. This could happen in a number of ways:

- One option would be that the Board would exist under the jurisdiction of the Supreme Court, but be separate and apart from the State Bar’s regulation of individual attorneys.

- Another option would be to place the Legal Services Regulatory Board under the umbrella of the Department of Consumers Affairs in the Executive Branch, along with all of the other professional regulatory boards such as the Medical Board, Accountancy Board, etc.
- Under either approach, to ensure independence, the Board could be subject to “sunset review,” by the legislature (most likely a joint session of the judiciary committees) on a regular basis, and the legislature would have the opportunity to assess the Board’s performance adhering to the legislatively-set regulatory objectives. The Chair of the Legal Services Regulatory Board and CEO should be required to attend and answer questions on performance against the regulatory objectives etc.
- The legislation might also require the Regulatory Board to publish an annual report containing finance information/accounts, performance on increasing access to justice, and other reporting that is high level/proportionate/sensible. That should be laid before your elected representatives of the California Senate ahead of the annual hearing.

Pros: An independent body can ensure that consumer needs – and not attorney self-interests—are at the heart of the regulatory scheme. It may also be more innovative and creative in its regulatory approach as opposed to being limited by the existing framework.

Cons: It might be challenging (and potentially confusing to consumers) to have one entity—the State Bar—regulating individual lawyers, and a wholly separate entity regulating entities.