



To: SAGE Subcommittee
From: Merri Baldwin and John Lund
Date: March 22, 2021
Re: SAGE Subcommittee Agenda Memo for the March 24, 2021 Meeting

Outline for Discussion

High Level Structure and Oversight

1. Consider these various options for the structure of the sandbox:
 - a. An independent body such as a 501(c)(3) charged by the Supreme Court with the responsibility to operate the sandbox.
 - b. An office of the Supreme Court and/or the Judicial Council.
 - c. An entity operated by the State Bar with direct report to the Supreme Court.
 - d. An entity operated by the State Bar reporting to the Bar's Board of Trustees.
 - e. Some other arrangement.
2. Pros and Cons to Consider – For the options listed above, please consider the pros and cons of the following aspects:
 - a. Consumer confidence in the entity and the services it regulates.
 - b. The effectiveness of the entity to fulfill its purpose.
 - c. Adequacy of Supreme Court control over the provision of legal services in California.
 - d. Constitutional and statutory considerations.
 - e. The level of legislative involvement.
 - f. The level of State Bar involvement.
 - g. The capacity for fund raising.
 - h. Other financial considerations.
 - i. The attitudes of the California lawyers.

- j. Other pros and cons

Details of Governing Board

1. Whichever structural option is adopted, what should the details be as to:
 - a. Member composition
 - b. Internal structure and governance
 - c. Functions of the board, such as policy making, public outreach, innovator outreach, approval of recommendations, enforcement, assessment of the sandbox project
 - d. Addressing consumer complaints
 - e. Fundraising?
 - f. Avoidance of conflicts and other basic governance issues

Meeting goals:

- Thoroughly discuss the options for the structure of the sandbox entity and determine what else must be learned in order to reach appropriate recommendations on that question.
- Achieve consensus where possible as to the details of the governing board but also identify any further investigation or analysis needed to reach a complete recommendation on the details of the governing board.
- Plan any follow-on study necessary to support recommendations.

March 17, 2021 Bridget Gramme and Dan Grunfeld to SAGE Subcommittee:

This document provides a starting point for the Committee's discussion at its next meeting as to the various options for the high-level structure and oversight of the sandbox, and a non-exhaustive list of the pros and cons for each option.

Overarching Principles

From the outset, we believe it is important for this group to discuss and clarify two principles:

- 1) The options below are focused only on the governance of the sandbox. It is not assumed that the governance structure of the sandbox will necessarily apply to what may emerge from the sandbox. However, the sandbox may provide an opportunity to gain information about how best to structure what may follow.
- 2) Whichever governance structure is eventually adopted for the sandbox, it is important that both conflicts of interest, and the appearance of conflicts of interest, be avoided and strictly monitored.

Possible Options (in no particular order)

A. **Independent Nonprofit Organization:** Under this model, the Court could either delegate entirely its authority to regulate the delivery of legal services to an independent 501(c)(3) or, as it does with the State Bar, retain the ultimate authority, but task the nonprofit organization with serving as the administrative arm of the Court with respect to entity regulation.

1. **Pros:**

- a. The leadership of the nonprofit will owe their fiduciary duties to that organization; therefore, the organization is likely to be, and to be perceived as, independent and a "fair broker."
- b. Setting up and applying to become a 501(c)(3) organization is relatively straightforward; the prospective 501(c)(3) organization could operate while its application is being considered by the Office of the Attorney General of California.
- c. The entity could seek funding from various philanthropic sources, including government bodies, without conflict concerns.
- d. Under the "Member Model" of a nonprofit organization, organizations such the Supreme Court, the State Bar, and others could appoint certain members.
- e. The organization could retain/utilize the services of individuals who are expert in the subject areas most important to the operation of the sandbox, including, for example, regulating the business of law, entrepreneurship, evaluation of results, etc.

2. Cons

- a. Additional expenses may be incurred in setting up and staffing a new organization.
- b. Nonprofits are required to comply with additional independent obligations, such as audits, filing Form 990s, adhering to their bylaws, etc.
- c. The nonprofit would not automatically cease to exist at the conclusion of the work of the sandbox and would therefore have to be dissolved.
- d. There may be some constitutional and other legal issues in establishing the nonprofit. For example, would the Supreme Court need to formally delegate authority in some way to this entity? How does the Supreme Court retain ultimate authority while maintaining the independence and authority of the nonprofit?
- e. As a non-governmental entity, transparency/rulemaking procedures and requirements to ensure public protection/oversight would need to be incorporated into the formation documents, and adhered to thereafter.

- B. Office of the Supreme Court and/or the Judicial Council:** Under this model, the regulator would be an office of the Court/Judicial Council, or another entity that is part of the Judicial Branch. This is the model that Utah is using for its sandbox.

1. Pros:

- a. Operates directly under the auspices of the Court, with its inherent gravitas, competence, independence, and impartiality.
- b. Some operational infrastructure and expertise is already in place, such as IT, HR, etc.
- c. May render it easier to establish consistent policies with respect to overlapping issues, particularly if attorneys (licensed by the Bar) are also applicants of the sandbox.
- d. Communicates clearly to the public and lawyers that the sandbox is under the supervision of the Court.

2. Cons:

- a. Imposes additional costs and oversight on the Court.
- b. The Court's operations systems are already under strain, and the Court may lack capacity or interest in doing this work.
- c. Would create potential conflicts around both funding from outside sources and potential liability resulting from sandbox operations.
- d. Is the Court really best equipped to serve as a regulator of the business of law?

C. Entity operated by the State Bar, with separate leadership, reporting directly to the Supreme Court:

1. Pros:

- a. Should create efficiencies because State Bar operations/staff expertise already in place.
- b. May render it easier to establish consistent policies with respect to overlapping issues, particularly if attorneys (licensed by the Bar) are also applicants of the sandbox.
- c. Direct reporting to the Court would alleviate actual/impression of undue influence of practicing attorneys over operations of the sandbox.
- d. Transparency/rulemaking procedures are already in place.

2. Cons:

- a. Actual/perceived issues with Bar's ability to take on additional enforcement responsibilities.
- b. Operations/staff traditionally focused on prosecutorial model of discipline/discipline of individuals vs. risk-based regulation of entities.
- c. Potential antitrust concerns will need to be addressed.
- d. The funding model is uncertain.

D. Entity operated by the State Bar, with separate leadership, reporting to the Bar's Board of Trustees:

1. Pros:

- a. Should create efficiencies because State Bar operations/staff already in place.
- b. May render it easier to establish consistent policies with respect to overlapping issues, particularly if attorneys (licensed by the Bar) are also applicants of the sandbox.
- c. Transparency/rulemaking procedures are already in place.

2. Cons:

- a. Actual/perceived issues with Bar's ability to take on additional enforcement responsibilities.
- b. Actual/perceived issues of undue influence of practicing attorneys over regulation of the sandbox.
- c. Potential antitrust concerns will need to be addressed.
- d. Operations/staff traditionally focused on prosecutorial model of discipline/discipline of individuals vs. risk-based regulation of entities.
- e. The funding model is uncertain.

- E. Agency of the Executive Branch:** Under this option, an entity would be established under the “innovation” wing of the newly-reorganized Department of Financial Protection and Innovation, or the Department of Consumer Affairs, which houses most other occupational licensing boards.

1. Pros:

- a. Staff/infrastructure with expertise in consumer protection/occupational licensing and regulation.
- b. Subject to transparency/rulemaking procedures.
- c. A partial funding structure may be available.

2. Cons:

- a. There may be issues regarding constitutional authority, separation of powers, and jurisdiction over the delivery of legal services industry.
- b. Resolution of the issues described in i., above, would be time-consuming and potentially subject to litigation.
- c. There is a threat of possible inconsistencies between regulation of individuals by the Bar/Judicial Branch and regulation of entities by the Executive Branch.

F. Other options:

Open to discussion.

February 19, 2021 Jim Sandman to SAGE Subcommittee:

Here are my thoughts on structure and oversight of the sandbox and the parameters for the governing board.

1. The sandbox should be administered by a state government entity, not by an independent 501(c)(3). Regulation is a government function. The regulatory entity should qualify for state actor immunity under federal antitrust law.
2. I prefer the Utah model -- the Utah Office of Legal Services Innovation is a division of the Utah Supreme Court. I do not think the regulatory entity should be operated by the State Bar. I believe the State Bar would not be perceived as objective in assessing proposals and operations involving non-lawyers in the delivery of legal services. I believe consumers would have more confidence in a regulatory body separate from the State Bar. I do not believe "the attitudes of the California lawyers" should be a factor in selecting the structure of the sandbox.
3. I recommend that the members of the regulatory body be appointed by the Supreme Court with a majority of non-lawyer members.
4. I think it is unlikely that the regulatory body will be successful in raising funds from private philanthropy. I think private funders will regard the regulatory function as a government

responsibility, particularly in a state the size of California. Utah had special advantages in private fundraising by virtue of being a first mover and a smaller state, and in any event I doubt their private funding is sustainable in the long term.



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: 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.

* * * * *

Points Discussed by the Subcommittee: 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: 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 considered with respect 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 considered with respect 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.

Points Discussed by the Subcommittee: 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)

* * * * *

Option 1: State Bar to Regulate

- 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.

Points Discussed by the Subcommittee: 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: 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: 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: 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.

[Arguments in favor...] 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.

[Potential concerns associated...] 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.