

MEMORANDUM

To: Closing the Justice Gap Working Group

From: Bridget Gramme and Dan Grunfeld

Date: April 2, 2021

Re: Possible Options for Governance Structure of the Sandbox

At the SAGE committee's March 24, 2021 meeting, we considered a series of possible options for the high-level structure and oversight of the sandbox, and a non-exhaustive list of the pros and cons for each option. This document reflects the SAGE committee's discussion and further refinement of the possible options for the full Working Group to consider.

I. Overarching Principles

From the outset, we believe it is important for this group to discuss and clarify three 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.
- 3) Careful consideration will need to be given to the term of the sandbox. It should be long enough that applicants are able to develop a model, establish their businesses in the legal market, and provide the sandbox regulator a meaningful opportunity to assess results. Utah has recently extended the term of its sandbox. The choice of the options discussed below may have an impact on the ultimate term of the sandbox.

II. Possible Options

The Committee's preferred options (A.1 or A.2):

- A. **Entity under the supervision of the Supreme Court:** Under this model, the regulator would be an entity under the judiciary branch, reporting directly to the Supreme Court.

The Committee considered two different options under this category:

1. The regulator would be its own **governmental entity** with its own board, created by the Legislature, and serving as an arm of the Supreme Court with respect to the licensing and regulation of entities in the sandbox. Under this option the regulator

would be a “sister entity” to the State Bar, independent of the Bar, and reporting directly to the Supreme Court.

a. ***Pros:***

1. Operates directly under the auspices of the Court, with its inherent gravitas, competence, independence, and impartiality.
2. Communicates clearly to the public and lawyers that the sandbox is under the supervision of the Court.
3. The State Bar can serve as an existing model for establishing the entity such as formation and reporting infrastructure to the Court.
4. As a stand-alone entity, the regulator would be free to establish innovative regulatory models and less hindered by existing regulatory structures.

b. ***Cons/ Areas for Further Study:***

1. Is the Court interested in serving as the ultimate regulator of the business of law?
2. Presents complex legal and possibly constitutional issues with respect to entity formation that may require specialized legal expertise.
3. Imposes additional costs and oversight on the Court (although presumably less than option A.2 below).
4. May create potential conflicts around both funding from outside sources and potential liability resulting from sandbox operations (but more removed and therefore less so than option A.2 below).

2. The regulator would be an **office of the Court**/Judicial Council. This is the model Utah is using for its sandbox. Its [Office of Legal Services Innovation](#) is a division of the Utah Supreme Court, authorized to oversee the Sandbox. It accepts and reviews applicants to the Sandbox, and makes recommendations to the Supreme Court as to those applicants to be approved to offer legal services within the Sandbox.

a. ***Pros:***

1. Operates directly under the auspices of the Court, with its inherent gravitas, competence, independence, and impartiality.
2. Some operational infrastructure and expertise is already place, such as IT, HR, etc.
3. 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.
4. Communicates clearly to the public and lawyers that the sandbox is under the supervision of the Court.

b. ***Cons/Areas for Further Study:***

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

The committee believes the following two options (B. and C.), or elements thereof, should be, as necessary, further discussed and considered by the full Working Group:

B. Independent Nonprofit Organization: Under this model, the Supreme 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 (similar to option A.1 above, but not a governmental entity).

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/ Areas for Further Study***

- 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.

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.
- e. Possible disincentive to innovators who may view the Bar as stifling to new market entrants, and believe that it will act in attorneys' interests.

The committee considered the following two options (D. and E.), but ultimately concluded that they should not be pursued at this time as the cons appear to outweigh the pros.

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.
- f. Possible disincentive to innovators who may view the Bar as stifling to new market entrants, and believe that it will act in attorneys' interests.

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. Presents complex issues regarding constitutional authority, separation of powers, and jurisdiction over the delivery of legal services industry.
- b. Resolution of the issues described in "a" 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.

III. Recommendation to seek *pro bono* legal assistance

Establishing the sandbox may involve complex and/or cutting edge issues. The SAGE Committee recommends that, working with the State Bar's General Counsel's Office, we retain, on a *pro bono* basis, law firm(s) to assist with the analysis and establishment of the sandbox. Broadly speaking, the *pro bono* law firm(s) will have expertise in the intersection of California's laws and practices in corporate governance, state regulatory practice, administrative law, and constitutional issues.