



The State Bar *of California*

CLOSING

II.D. Scope of Sandbox
10-18-21 CTJG Meeting
Open Session

WORKING GROUP

DATE: October 12, 2021

TO: Closing the Justice Gap Working Group

FROM: Scope Subcommittee Co-Chairs

SUBJECT: II.D Discussion and Possible Action on a Subcommittee Recommendation for the Scope of a Regulatory Sandbox, including a Sandbox Mission Statement and the Kinds of Innovations to Encourage

At the October Scope meeting, the subcommittee considered the attached memorandum that presents a series of proposals for specific entry and eligibility concepts. Nine individual concepts are presented and each one is intended to balance the twin goals of encouraging innovation and assuring public protection. The subcommittee has conducted an initial discussion of all of these proposals and now seeks input from the full working group to further inform the subcommittee's anticipated action on the proposals at its upcoming November 5, 2021 meeting.



The State Bar of California

CLOSING

II.B. Scope of Sandbox
10-08-21 Scope Meeting
Open Session

WORKING GROUP

DATE: October 4, 2021

TO: Scope Subcommittee, Closing the Justice Gap Working Group

FROM: David Engstrom, Tom Greene, Kevin Mohr, & Toby Rothschild

SUBJECT: A Specific Discussion Proposal for Delimiting the Scope of the Sandbox

INTRODUCTION

A key issue we must address as a group as we move toward a comprehensive sandbox recommendation is the scoping question we've debated on and off, both within the Scope subcommittee and as a full working group: whether to limit the providers who may enter the sandbox and, if yes, how to do so.

We believe the ultimate question for the group will be: How might we design a sandbox structure that provides information to policymakers on the performance of innovative legal services providers? Such information includes:

- the scope of services provided to low- and moderate-income Californians
- investment in, use, and effectiveness of legal technologies
- use and effectiveness of the deployment of non-lawyer paraprofessionals or staff
- assessments of the quality of the legal services provided by the sandbox entity

The sandbox should be designed to generate useable, policy-relevant information across the widest breadth of legal services innovation that might better serve consumers while ensuring that the public is protected.

Toward those ends, the following proposal sets forth for consideration of the working group a set of specific entry and eligibility rules designed to steer between the views articulated by some working group members that the sandbox be as open as possible to new and innovative legal services providers and the views articulated by other members that we should place judicious limits on entry in order to focus the sandbox on those populations identified as most in need and legal areas featuring the most acute unmet civil justice needs. This proposal also aims to borrow the best aspects of the Utah and Arizona approaches. Specifically, it aims to borrow from Utah the openness to a variety of models and the attention to data-collection that

could inform policymaking, and from Arizona the safeguard of ethics rules like confidentiality and conflicts as applied to alternative business structures, even if not controlled by lawyers.

PROPOSAL

We propose for consideration the following principles for delimiting the scope of the Sandbox:

1. The sandbox is open to entities offering legal practice services through “nontraditional” business or service models. Nontraditional means business or service models that are:
 - not permitted by California Rule of Professional Conduct [5.4](#) (*i.e.*, entities using business models in which nonlawyers hold an economic interest or managerial role or through which lawyers otherwise share revenue with nonlawyers);
 - not permitted by California Bus. & Prof. Code Section [6125 et seq.](#) (*i.e.*, entities using service models potentially violating the proscription on practice of law by unlicensed nonlawyers, whether software or human); or
 - otherwise not permitted by the California Rules of Professional Conduct.
2. Applicants who credibly demonstrate that their proposed legal services model will predominantly serve low- and moderate-income Californians will be prioritized for expedited assessment and authorization over those entities which do not. The sandbox process will not be “first in, first out.”
3. Applicants who credibly demonstrate that their proposed legal services model will predominantly serve low- and moderate-income Californians do not pay application fees. All others will pay application fees in the amount of [X].
 - **[NOTE:** Should we have application fees at all? If so, should they be tiered—and thus based on revenue projection (for instance, \$250 for each projected \$100k increment of revenue), for-profit/non-profit status, or something else?]
4. Once admitted to the sandbox, sandbox participants will pay semi-annual user fees, with the fee amount to be based on a tiered schedule keyed to an entity’s revenue during the previous 6 months.
 - **[NOTE:** In Utah, an entity with \$0-\$100k in revenue must pay an annual licensing fee of \$250. Each \$100k increase in revenue results in an additional \$250 in fee. For example, an entity with \$500,001 to \$600,000 in revenue pays a fee of \$1,500 annually.]
5. No sandbox application will be considered where a lawyer who has been disbarred, suspended, resigned with charges pending or involuntarily inactive from the State Bar of California, or the attorney licensing agency of another state or US territory, or otherwise declared ineligible to practice law by the regulatory authority in a foreign country is either a provider of legal services, a manager of legal service provision, or an equity owner.

6. No sandbox application will be considered where attorneys who are not authorized to practice law by the State Bar of California are providing legal services or managing legal service provision.
7. Unless a specific rule has been waived in whole or in part in the entity's scope of sandbox authorization, any lawyer practicing law within a sandbox entity, whether as an employee, contractor, partner, shareholder or otherwise, must comply with the California Rules of Professional Conduct and statutes governing lawyer conduct at all times, including the lawyer's duty to supervise subordinate lawyers and nonlawyers under rules [5.1](#) and [5.3](#), and the duty to comply, pursuant to rule [5.2](#), with the rules and statutes notwithstanding that the lawyer acts at the direction of another.
8. Nonlawyer sandbox participants are subject to specific duties of care and fiduciary obligations as set forth in the California Rules of Professional Conduct and statutes governing lawyer conduct only to the extent those rules have been specifically applied to them under the sandbox rules.¹ For instance, per the full working group vote at our 9/17 meeting, all sandbox participants must comply with duties of confidentiality and competence. Note that a sandbox participant's obligations will *also* include whatever duties of care and fiduciary obligations, reporting requirements and other requirements relating to regulatory oversight that the full working group decides, upon the recommendation of the SAGE subcommittee, will also apply to sandbox participants. This will also likely include a system for adjudicating alleged violations and meting out sanctions. In addition, to the extent a sandbox participant employs a lawyer, that lawyer will be subject to rules [5.1](#) and [5.3](#). See Principle #7.
9. All sandbox participants must maintain a statutory agent in California.

NOTES AND DISCUSSION ITEMS

First, note that the above rules govern entry and eligibility but also shade into the SAGE subcommittee's work. Ultimately, the sandbox's front-end entry and eligibility rules and its mid-stream and back-end regulatory and oversight provisions should be considered together and rationalized as a common set of design features.

Second, an important decision to be made is how to define the set of sandbox entrants who gain the benefits of expedited processing and lower entrance fees. In our view, the best approach is two-fold: a "credibly demonstrate" standard at the application stage, and then a simple revenue-based approach to calculating fees thereafter. The "credibly demonstrate" standard strikes us as the right one at the application stage because many applicants will only have a business plan containing *projections* as to reachable markets, rather than hard data

¹ We note that what is at issue here is not just **duties** to which the legal service providers would be subject, but also just as important, the **protections** that are afforded to the clients of the nonlawyer legal service provider, e.g., the attorney-client privilege and, where applicable, the work product doctrine. For example, unless the legal service provider maintains the confidentiality of client communications, the privilege can be lost.

about actual populations or legal areas served. In our view, a more informationally demanding approach would not be appropriate for a sandbox system designed to attract new and innovative approaches, some untested and untried, to closing the justice gap. A more stringent filter would also likely serve to delay the entry of precisely those providers who plan to serve needy populations, draining the benefit of expedited processing.

Third, consistent with our discussion at the last meeting about being reluctant to impose too many up-front limits on entrants and models, we are inclined not to follow either of the twin requirements proposed by Florida's "Special Committee to Improve the Delivery of Legal Services" that non-lawyers may only have non-controlling equity interests (*i.e.*, not more than 49%) in firms or that nonlawyers "actively support the work of the law firm." Imposing these requirements would mean shutting the sandbox door to some of the models whose intended audience is underserved consumers. For example, Rocket Lawyer is in the Utah sandbox, and Legal Zoom has applied for an ABS license in Arizona. Both are successfully operating in the UK. These are organizations with national reach who know more about serving underserved markets of both individuals and very small businesses (think plumbers, restaurant owners, landscapers) than anyone who might enter the sandbox. It would therefore be odd to rule them out up front, not to mention the fact that—judging from what they're doing elsewhere—their model is likely to mean creating new jobs for California lawyers by opening currently unserved segments of the market.

Fourth, we have not addressed whether the sandbox rules should include an insurance or bonding requirement as a condition of entry. We note that California lawyers are not required to carry liability insurance but must disclose that they are not insured if that is the case.

Finally, embedded in Principles #7 and #8 are a trio of key and unresolved issues that, in our view, merit discussion. These include:

- Can lawyers have supervisory duties as to nonlawyers where the latter, per Principle #8, do not owe conventional legal-ethical duties except where expressly specified? Rules [5.1](#) and [5.3](#) impose upon California lawyers a duty to supervise lawyers and nonlawyers, respectively. Principle #7 makes clear that rule [5.1](#) would apply in full to lawyers supervising lawyers in sandbox participants. Simply put, lawyers do not shed legal-ethical duties upon entry to the sandbox. Less clear is whether rule [5.3](#) can or should extend to lawyer supervision of *nonlawyers* within the sandbox, at least where legal services are being delivered, for example, through technological means by an entity that does not include lawyers. As a concrete illustration, a nonlawyer paraprofessional provider or a technologist who designs and administers an automated system arguably would not, per Principle #8, owe the full panoply of duties and obligations set forth in the CRPC and statutes. A concern we have identified here is that demanding supervision under rule [5.3](#) could create perverse incentives for sandbox participants to choose business models and organizational designs that exclude lawyers, in order to avoid the additional regulatory constraints that they would bring. In our view, we should encourage, not discourage, entities that are pursuing innovative legal services delivery models to include lawyers, who add a salutary ethical sense and domain expertise, in their business models and organizational designs. One possible way out of

this puzzle—and the preferred resolution of some of us—would be to note that a lawyer’s duty to supervise nonlawyers within the sandbox extends only to the avoidance of consumer harm, as defined elsewhere in the sandbox rules (and currently within the jurisdiction of the SAGE subcommittee). Others of us are of the opinion that lawyer supervision of nonlawyers to ensure that their conduct is compatible with the lawyer’s obligation should either be a prerequisite to sandbox participation or, at a minimum, be one of the criteria in assessing risk in determining whether to permit participation in the Sandbox, at least with respect to those obligations that are fiduciary in nature (*e.g.*, confidentiality, loyalty, safekeeping client funds and property, etc.).

- Related to the first question is whether a sandbox entrant can have no lawyers at all. The Arizona ABS structure does not appear to permit lawyerless entities. Rather, the ABS structure is geared toward permitting the involvement of nonlawyers with entities that otherwise largely take the form of traditional law firms. Our view is that mandating lawyer involvement as a condition of sandbox entry is unwise. It is also inconsistent with the aim, noted above, of generating useable information for policymakers about the full scope of innovation that could be expected were court and legislature to make permanent changes to current regulation of legal services delivery in California. A further, related question is: Should sandbox entrants be required to have at least a “compliance lawyer,” as in Arizona, who is responsible for making sure that ethics rules are followed? Here, too, we have reservations. Such a requirement could have undesirable distributive implications among different firm sizes and types. In particular, the requirement might discourage smaller entities from applying, particularly if the compliance lawyer must be in-house, as opposed to an outside, part-time contractor.
- A third question, which may be premature depending on how the first two questions are resolved, is whether it might be necessary to redefine “firm” or “law firm” in rule [1.0.1\(c\)](#) to include non-traditional legal service providers.