



The State Bar of California

CLOSING

II.B. Proactive Regulation
11-03-21 SAGE Meeting
Open Session

WORKING GROUP

DATE: November 2, 2021

TO: SAGE Subcommittee, Closing the Justice Gap Working Group

FROM: Bridget Gramme, Deputy Chief of Programs

SUBJECT: II.B. Recommendations for Proactive Regulation and Monitoring of Sandbox Providers

INTRODUCTION

CTJG's recommendations for proactive regulation are intended to serve as the pillars of a robust regulatory system that ensures public protection by actively monitoring sandbox providers as they test new models of legal services delivery.

At the October 18, 2021 meeting, the SAGE subcommittee presented the full working group with recommendations for methods the regulator should utilize to monitor sandbox providers under the risk-based regulatory approach. Specifically, SAGE presented: 1) a Risk Assessment Process, which establishes criteria for the sandbox regulator to measure potential risk to consumers posed by each sandbox applicant, and a mechanism for assigning a level of risk, and 2) a list of tools and interventions which the sandbox regulator, informed by the assigned risk level, may utilize to protect the public.

These items were presented to the full working group not for action, but for input for the subcommittee's consideration as it refines the proposals.

PROACTIVE REGULATION TOOLS INCLUDING REPORTING, MONITORING, AND AUDITING

Traditional regulation uses primarily reactive tools to regulate licensees: the regulator receives a complaint about potential harm, investigates the complaint, and then after a hearing process imposes some form of discipline on the licensee.

The tools used for proactive regulation are different. In a sandbox environment where the legal services might be provided under modified rules or by an entity that is not a law firm, proactive tools are implemented according to the level of risk to maximize consumer protection. These methods are designed to prevent harm from occurring in the first instance. While the regulator will still receive and investigate consumer complaints, and discipline or other corrective action will be imposed, the regulator will not wait for a complaint before investigating.

Proposed Recommendation: Recommend that the regulator implement any or all of the following proactive tools to provide robust regulatory oversight of sandbox providers:

1. Risk Assessment

- The regulator will screen each applicant and assign a level of risk according to established criteria.
- The assigned risk level will determine the level at which the other regulatory tools below will be utilized.

2. Provider Reporting

- Entrance into the sandbox would be conditioned on compliance with mandatory reporting requirements so that the regulator may assess the data and evaluate that the goals are being accomplished and the consumer is not being harmed. The frequency (quarterly vs. monthly) would depend on the assigned risk. Data reported may also vary by risk but may include number of consumer complaints, people served, geographic information, revenue, and financial and substantive outcomes for clients.
- Annual reporting may also be required to confirm ownership and controlling financial interests in the entity as applicable.

3. Compliance Auditing

- Audits can be utilized to test for legal quality and accuracy of the services provided by humans or software. The frequency and detail of the audits may be adjusted based on level of risk. The regulator may appoint a panel to review and consider the audits to ensure continued consumer protection.
- Expert review of redacted case files is one method that may be used during these audits.

4. Badge

- Approved entities receive a digital “badge” from the regulator that they are required to display on their advertisements, social media, websites, service platforms, and physical locations to signify authorization to operate.
- The badge will contain information about how to file a consumer complaint and a link to the regulator’s website.

5. Disclosure Requirements

- Depending on the service model, these may be imposed to advise consumers that the entity is not a law firm/ is owned by nonlawyers/ is not a lawyer. These would be required to be posted on the entity website, advertising, and service platform, and incorporated into terms of service or engagement letters.
- The subcommittee may want to consider here a disclosure akin to one recommended by the California Paraprofessional Program Working Group, currently out for public comment, which states to potential clients that a free attorney through a local legal services program may be available to those who qualify.

6. Security for Claims Requirements

- This might include bonding, insurance, or a common restitution fund, similar to the Client Security Fund, for clients who suffer financial loss due to the misconduct of their lawyers.

7. Secret Shopper Programs

- Investigators would act as consumers to utilize the product/service and evaluate the quality of the service received.

8. Communication

- The regulator will be in regular communication with the sandbox participants to discuss trends in data reporting, complaints if any, etc. The frequency of data reporting and communication with the regulator will depend on the assigned risk level and the regulator's observations over time.

9. Reporting between Regulator and Court/Legislature

- Regular reporting to the Supreme Court and Legislature would keep these decisionmakers apprised of the sandbox activity including number of consumers served, consumer complaints, demographics, practice areas, outcomes, etc.

10. Robust Consumer Complaint Mechanisms

- The regulator would maintain a robust system of accepting and processing consumer complaints, including potentially an ombudsperson who would be assigned to walk complainants through the process, and identify areas for the regulator to proactively investigate to ensure consumer protection.
- Additionally, each sandbox participant would be required to maintain its own mechanism for tracking consumer complaints, and report complaints received to the regulator on a regular basis.

11. Customer Satisfaction Surveys

- The regulator could require approved entities to include a customer satisfaction survey at the end of each engagement and include responses in regular reports to the regulator.

This list is not meant to be exhaustive or mandatory, but reflect the types of tools to be utilized as appropriate to maximize consumer protection.

RISK ASSESSMENT CRITERIA

At its October 18, 2021 meeting, the full working group identified the following risks of harm to consumers that will form the basis of the regulator's risk assessment:

1. The consumer receives inaccurate or inappropriate legal services.
2. The consumer fails to exercise legal rights through bad advice or incomplete information within the scope of the agreed-upon services.
3. The consumer receives an unnecessary legal service or pays an inappropriate amount for legal services.
4. The consumer experiences fraud, theft, loss of privacy, or abuse of trust by the service provider.

The working group also approved the following principle relevant to the risk assessment:

For the purpose of admission to the sandbox, the risk of harm to consumers should be measured relative to the experience the consumer would have had absent the legal services

provided. In addition, the applicant must demonstrate the capacity to provide competent legal service.¹

The working group must now develop a recommendation for assessing and measuring consumer risk relative to the risk of harm the target consumer population currently faces as the participants enter the sandbox. The assigned risk level at entry determines the level and degree of monitoring the regulator will undertake as to that participant – the higher the level of risk, the more data it must agree to provide to the regulator to enable the regulator to monitor its activities. This method differs from traditional models of regulation, which applies formal rules in all cases and contexts without considering outcomes.

At the October meeting, the full working group discussed SAGE’s considerations to date with respect to the criteria for assessing risk based on Utah’s model, as well as other items to be considered such as the service model, the nature of the service, the level of consumer sophistication, and the stakes of the services provided.

SAGE also proposed a couple of variations of matrices that the regulator might utilize as a tool for risk assessment, however several members expressed concern in voting to adopt model matrices that included service models (ie levels of lawyer ownership/involvement) which the working group has not yet determined will be permitted in the sandbox. The discussion as to “who” will qualify to participate in the sandbox is within the purview of the Scope Subcommittee.

In light of this discussion, staff proposes the following recommendations to bring back to the full working group at the December meeting, which set forth the general principles for risk assessment criteria consistent with the group’s discussion without specifying specific service models:

1. Recommend that the sandbox regulator implement an initial risk assessment process based on a combination of service model and nature of service model of risk categorization² to evaluate a sandbox applicant’s proposal and assign a risk level to each applicant based on identified criteria.
2. Recommend that the initial risk level assignment may be adjusted upon further consideration of level of consumer sophistication and the stakes of the services being delivered.
3. Recommend that the level of data collection and monitoring of sandbox participants will

¹ Note: as we discussed during the full working group meeting—this is a standard for assessing the level of risk for purposes of entry into and monitoring within the sandbox; it is not a standard of care for which providers will be held for purposes of discipline, malpractice liability, etc.

² This model would cross reference a list of service models – ie/ % non-lawyer ownership, intermediary platforms, nonlawyer provider, etc. with service level options such as legal information, form completion, and legal advice, and assign a risk level (low/moderate/ high). As a proposed model gets further from existing models of legal services, the risk level increases. The higher the risk, the more monitoring the sandbox regulator will conduct with respect to the provider so that the regulator can study the impact of the proposed model on consumer.

be based on the assigned level of risk, with greater data collection and monitoring assigned to the projects assigned a higher risk.

4. Recommend that authorization orders permitting practice within the sandbox clearly set forth the authorized practice areas, service model, reporting requirements, and nature of service for each applicant.

Once the working group determines which service models will be permitted, SAGE can develop a proposed risk assessment matrix to include in the final recommendation and report.