

A FRAMEWORK FOR

Designing and Implementing Legal Regulation

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A FRAMEWORK FOR
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Regulatory Reform

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FRAMEWORK DISCUSSION

State court systems and state bar associations are rethinking legal regulation and designing and implementing a rapidly growing number of regulatory reforms. To date, these projects have explored a fairly small and relatively traditional design space. This white paper is intended to lay out a process map for legal regulation and to provide basic information and context for each step of that process.

Legal Regulation

Historically, state bars have acted as a combination of professional association and occupational regulator. In fact, there is a clear distinction between a legal professional association and a legal regulatory organization and decision makers should be clear about that distinction and how it impacts their work.

A professional association ideally seeks to further the interests of its members. That typically takes the form of maximizing the opportunities of its members to successfully pursue their profession and protecting them from potential competitors. Professional associations can have helpful training and advocacy functions. They can disseminate information about new technologies, rules, and other best practices for members and they can engage in advocacy activities that advance the policy goals of the membership. Any association sets criteria and requirements for membership—both initial and continuing. Membership criteria set the members apart, give them a sense of community and special purpose, and may serve to elevate the reputation of members in the eyes of the public. Criteria may also serve the interests of members by limiting membership in ways that increase the economic payoff to being in the association.

A regulatory organization ideally seeks to further the interests of the public. Its regulatory goals are to minimize harms and maximize benefits for the public. A regulatory organization seeks to ensure that the public is not significantly harmed and that it may enjoy increased benefits from the consumption of goods or services. It need not set any requirements for specific legal roles or impose any ethical conduct codes. Its mission is to ascertain, using objective empirical data, that the public interest is supported.

At this point, there is no truly independent regulatory organization regulating legal services in the United States (except for in Arizona and Utah). Lawyers, as members of the bar, are actually participating in a professional association that executes the function of self-regulation as delegated by the state supreme court. Although the interests of the public and of lawyers are not always automatically in conflict, they do frequently lead in different and sometimes conflicting directions. For example, the interest of the association in maintaining high walls around the profession and high barriers to entry may diverge from the interest of the public in having a range of legal services and solutions from a variety of providers at a range of prices. When the professional association conflates the interests of its members with the interests of the public and/or elevates the interests of its members over that of the public, the authority of the regulatory delegation is undermined and should be reconsidered.

Lawyers can be simultaneously regulated by a true regulatory organization and be members of a professional organization. Even though lawyers might fall under the authority of a regulator, there is nothing stopping them from forming a professional organization and enforcing its policies among its members so long as they are not contradictory to the requirements of the regulatory organization. Indeed, the regulatory requirements may be substantively different from the policies of the professional association.

What has become clear, however, is that separation of the legal regulatory function from the historical context and norms of the state bar structure is challenging without a serious reconsideration of what the regulation of legal practice should be. The discussion below is intended to pull the regulation of legal services out from its entrenchment within the professional association, to drive a real discussion of applied regulatory choice, and to present a regulatory reform framework with the ability to include a full range of provider types, including lawyers.

The Design Space

Regulation of legal services in the United States has been extraordinarily limited by the approach of state bar associations acting as occupational self-regulators, regulating lawyers as professional roles occupied by individuals. Some states have expanded on this approach through the creation of several new certified legal roles for non-lawyers, including navigators, advocates, and paraprofessionals (New York, Delaware, Arizona, and Utah). One alternative strategy has been the creation of new categories of legal service providers through authorizing Alternative

Business Structures (ABS) entities in Arizona. Another strategy has been the use of risk-based regulation of legal service entities via the regulatory sandbox in Utah.

The possible design space is much larger and more innovative than current experience suggests. Legal regulation has historically focused on barriers and limits. In fact, legal regulation could engender, facilitate, and even support entirely new mechanisms for the provision of legal services. For example, one might imagine an entity delivering legal services using a set of non-lawyers trained in specific narrow services, perhaps with lawyer oversight. Or one might envision a similar organization without any licensed lawyers involved that provides legal services solely through software driven by AI engines. Both possibilities would require entities to first analyze legal processes and break them down into small discrete steps with finite alternatives and to have the flexibility to determine which service mechanism is the most efficient to produce the required output and quality (“right-sourcing” the particular solution to the discrete legal or process need).

This activity is not unfamiliar in the legal world; this is essentially what we have termed “unbundling” legal services. This approach potentially allows a focus on more upstream interactions advising someone on “small,” discrete issues with legal implications, such as a contractor not getting paid for a small job, a tenant dealing with mold, or a purchaser of a house finding a structural defect. Corporate legal departments have long focused on breaking down their legal needs, creating a process map, and right-sourcing providers from a variety of sources (tech vendors, nonlawyers, alternative providers, in-house lawyers, and outside counsel). They recognize benefits in transparency, efficiency, and decrease in costs.

Key Design Decisions

There are multiple regulatory decision points and pathways to rethinking legal regulation. The combinations quickly become quite complex, so an algorithm for stepping systematically through the possibilities is helpful. This section will outline three key design choices: regulatory goals; regulatory focus; and regulatory approach. We have suggested an order to facilitate a process-oriented approach, but each of these decisions are interrelated.

DECISION 1: Regulatory Goals

The process of identifying and articulating a regulatory goal helps decision makers clarify the intent of the project, sets the guiding objective for the regulator, and establishes an overarching metric by which the effort can be assessed. When acting as a regulator, several current goals of traditional state bar organizations would be dropped, particularly any goals intended to curb potential competition within the legal market.

Projects should adopt a single overriding objective, to which any other objectives are subsumed when conflict occurs. This is partly to provide clarity to the regulator and all stakeholders but singularity of purpose also supports functional performance. It is, of course, possible and often politically necessary to have multiple objectives but this requires trade-offs and will lead to suboptimization of all goals. If multiple goals are politically necessary, the best practice is to minimize the number of goals and to identify clear prioritization of goals to prevent regulatory confusion when goals come into conflict. A regulatory entity trying to satisfy numerous and sometimes conflicting objectives will likely end up doing nothing well.

Appropriate regulatory goals might include

- 1 increasing competition and efficiency in the market (e.g. decreasing cost or increasing supply),
- 2 increasing access to legal services,
- 3 improving legal services quality and/or outcomes,
- 4 protecting consumers, or
- 5 increasing consumer participation, convenience, or control.

Increasing Competition and Efficiency

Significantly impacting access to and the cost of legal services requires an approach that increases competition. Elevated competition will incentivize innovators to radically redesign the way legal services are produced. Innovation is also required to efficiently scale up such services using either automation or the use of less expensive human inputs to lower costs. Although lawyers currently compete vigorously for the economically viable business that is available (predominantly corporate), that is precisely what leaves almost all low income people, most middle income consumers, and most small businesses out of the market. It will require a fairly radical relaxation of the types of individuals and/or organizations that could provide legal services to increase competition for the consumers that are now mostly out of the market.

Increasing Access to Legal Services

Increasing consumer access implies a fairly radical approach enabling many different avenues for innovation. The access gap is estimated to be so large that no strategy allowed under the current regulatory approach, primarily subsidized services via legal aid and pro bono work from lawyers, could possibly solve the problem. Access has traditionally been perceived as a problem of indigence, i.e. that the access problem is only a problem of the lowest end of the economic spectrum. In fact, the gap extends much higher up the spectrum, including moderate income families and small businesses. Greater impact on the lowest end of the spectrum would also require a radical rethinking of legal services, including potentially entirely deregulating free, simple legal advice.

Improving Legal Services Quality and/or Outcomes

Improving legal services quality and/or outcomes would use process monitoring and data analysis to determine which service variables improve the quality of legal services and, potentially, legal outcomes. This approach would serve to align legal services regulation more closely with healthcare regulation. There are a number of challenges with implementing this approach, including the lack of benchmark quality data and the lack of agreement on quality metrics.

Better Protecting Consumers

The current system of lawyer regulation—setting bar exam and law school qualification requirements and other admission requirements (moral character), overseeing continuing legal education, and lawyer discipline—falls short of adequately controlling for risk of consumer harm. A consumer protection regulator would require appropriate data reporting by service providers and be empowered to tie enforcement to evidence of consumer harm shown in the reported data. The main difficulty and cost in pursuing this goal is that traditional legal service providers (lawyers) have no history or internal organizational machinery for characterizing and reporting the data in the ways that would be necessary. New providers, particularly those from outside the legal sector, should have little problem conforming to this requirement.

Increasing Consumer Convenience and Control

Although increasing consumer convenience and control may seem to be a subset of either increasing competition or increasing access, it is distinct. Such a regulatory goal would require the regulator to situate the consumer experience before any other priority, require careful rethinking of many current rules, and incorporate activities such as public education on legal rights and engagement. Increasing consumer convenience involves the provision of various services that

can be accessed through a range of modalities, including online. Increasing consumer control would require addressing a slightly different range of issues. For example, consumers consistently report a strong dislike for services with indefinite costs. They would prefer that legal services be broken down into small narrow services with definite fixed costs that can be transparently provided up front. Consumers also like the ability to change providers in the middle of a larger legal process without significant disruption—again partly by purchasing a set of narrower legal services individually.

There may be other appropriate regulatory goals. Decision-makers should be cautious however, in assuming too much. Many concerns may be addressed through regulatory systems outside the legal regulatory scheme. Protection of consumer data, for example, may be adequately addressed by statute or other administrative bodies.

What should be clear from the above discussion, however, is that protecting the legal profession or lawyers' business or careers is not an appropriate regulatory goal. Again, if the priority is the protection of the profession, the project is not one of regulation but of professional association.

CASE STUDY

DECISION 1 FRAMEWORK APPLIED: Utah & Arizona's Regulatory Choices

UTAH'S REGULATORY OBJECTIVE FOR THE LEGAL REGULATORY SANDBOX PROJECT IS:

To ensure consumers have access to a well-developed, high-quality, innovative, affordable, and competitive market for legal services.

The task force which recommended licensing paraprofessionals cited the ABA's model regulatory objectives.

ARIZONA HAS THE FOLLOWING REGULATORY OBJECTIVES FOR ABS:

- A protecting and promoting the public interest;**
- B promoting access to legal services;**
- C advancing the administration of justice and the rule of law;**
- D encouraging an independent, strong, diverse, and effective legal profession; and**
- E promoting and maintaining adherence to professional principles.**

DECISION 2: Unit of Regulation

The assumption that all legal services must be provided by lawyers is one relatively unique to the United States and intertwined with self-regulation by the professional monopoly. It is effectuated through the rules and doctrine of the unauthorized practice of law (UPL), which prevents anyone or anything other than licensed lawyers from performing a wide range of activities defined as “the practice of law.”

Lawyers are, in fact, only one modality of service in what could be a diverse market containing a variety of service mechanisms reaching consumers across the spectrum of potential legal need. In many countries, other providers perform activities defined as the practice of law in America. In England, for example, only a limited list of legal activities is reserved to lawyers (e.g., rights of audience before a court, conduct of litigation, and probate activities). Activities such as legal advice and document completion, including the preparation of estate documents, can be performed by anyone, including a company or a software program. In other countries, including Sierra Leone, India, South Africa, and England, community-based legal helpers can provide advice and assistance on a variety of issues. A reconsideration of the regulation of legal services in the United States should start with the agreement to focus the regulatory choice considerations upon legal services, not the legal profession. The regulatory question is then how to regulate the supply of legal services to ensure the regulatory goals are met.

Legal services can be thought of as being delivered either by individuals in occupations or by entities. State bar associations currently regulate individuals in occupations. They generally do not regulate entities, with a few very limited exceptions (lawyer referral services). In the U.S., the Utah legal policy sandbox project and the Arizona ABS project are the most robust examples of legal entity regulation.

One key point of clarification: while there is certainly a regulatory decision point turning around this question of who to regulate, it does not have to be an either/or decision. A well-designed regulatory framework, particularly one with the goals of increasing innovation, diversification, and scale of consumer legal services, could incorporate both roles and entities.

DECISION 2A: If Individual, What Roles

If a regulator oversees individuals in occupations, then one must decide which occupations are to be allowed and regulated. In role regulation, all regulatory and licensing requirements and functions are aimed squarely and entirely at roles. Only individual people can satisfy the licensing requirements, which usually include educational, testing, and moral character criteria.

This is the historical approach to legal regulation in the United States and continues to be the dominant approach. For a long time, there was only one legal role in the United States: lawyers licensed by state bar associations. Traditional paralegals are another legal service role but cannot actually perform any legal services unless under the supervision of a licensed lawyer. They are not separately licensed and regulated and do not have the status of a licensed paraprofessional. One potential direction for regulatory reform is expanding the number and type of authorized legal roles.

Several states have authorized independent paraprofessional roles, including Washington State, Utah, and Arizona. The regulation and licensing of these new roles follow the pattern long established for lawyers, but with somewhat “watered down” qualification requirements and restrictions on areas of practice. In Arizona, for example, “Legal Paraprofessionals” can offer limited services in family law, civil cases, criminal cases where there is no threat of jail time, and state administrative law where otherwise permitted by the agency. They can draft, sign, and file documents, provide advice, opinions, and recommendations on legal rights and strategies, appear before court, and, in certain cases, negotiate on behalf of a client.

Several states have also regulated a variety of other roles related to the delivery of legal services. Perhaps the most common type is so-called “document preparers.” This role is generally only permitted to help consumers complete forms and only at the consumer’s direction, and the role is not permitted to advise consumers what to put into the form or anything else that might constitute legal advice and assistance. Most often, the documents concerned are those necessary for common real estate transactions or simple family law issues (e.g., uncontested divorce). Legal document preparers exist in a gray area between the traditional regulation of legal services by state supreme courts via delegation to state bars versus the regulation of all other occupational roles by the state legislatures and executive branches. In some cases the role is licensed and in others it is not; in some cases, it is regulated by the state bar, in others by another government entity such as those in charge of consumer protection.

Several states are now experimenting with a new kind of legal role usually called a legal advocate or navigator. The degree of formal training required varies significantly. Most do not require a license, but some do require a credential of some kind. Many are recruited from roles that are already trusted in communities. Examples include navigators in New York City (e.g., housing navigators), tenant representatives in Delaware, and legal advocates in Arizona (e.g., housing and family law navigators). Some of these new roles can even go into court with their clients though they are often limited in what they can say within the court. Typically, people in these roles work for non-profits or other similar entities and charge no fee for their services.

States also vary significantly in the exceptions they have created for the practice of narrow areas of law without any regulation or license. These exceptions are typically stated as “carve-outs” from the ban against UPL and are generally a “grab bag” of specific areas with no overall logic or consistency. A relatively common example is in real estate. In Utah, for example, a subsection of the rule defining the practice of law states that real estate agents or brokers completing state-approved forms related to the sale of real estate and personal property is not the practice of law. In essence, these exceptions have been created over time as the political balance between consumer convenience and regulatory cost shifted toward easier access and provision. Often, these carve-outs reflect areas of low revenue for lawyers or strong political power in the benefitted group (e.g., real estate agents).

DECISION 2B: If Entities, What Types

Another (not mutually exclusive) approach to regulatory reform is to authorize and regulate legal service entities. Entity regulation means that the target of the government regulation is the entity (company or nonprofit or even governmental body). Any licensing and regulatory requirements are directed at the entity, the entity holds the license, and regulatory enforcement targets the entity. Entity regulation can take place alongside role regulation and regulated roles can work within regulated entities (think doctors working within a hospital or registered investment advisers working within banks). However, entity regulation does not itself require that services be provided by regulated roles. Regulating at the entity level theoretically permits more freedom and flexibility around service provision modality as long as the entity itself remains compliant with the regulatory requirements.

Entities that provide legal services can be conveniently placed into one of three categories. The first type are traditional law firms, whether a single practitioner or large AmLaw 100 firms or anything in between. The second category are non-traditional entities that employ traditional lawyers and/or other regulated roles in the provision of legal service (e.g. ABSs). They could be law firms that have partial non-lawyer ownership or management, law firms that share fees, revenue, or profits with non-lawyers, or law companies (such as Rocket Lawyer) that employ lawyers to practice law for their consumers. A third category are non-traditional entities that do not employ traditional lawyers but provide legal services, through software or nonlawyers. No term of art yet exists for this type of legal entity because it does not yet exist anywhere in America, though we are beginning to see the possibility in entities such as the nonprofit Upsolve and the i4j Lab affiliated with the Universities of Arizona and Utah. These models may be the most promising for high-volume, low-complexity needs such as eviction and debt collection.

As will be discussed further below, there are different regulatory approaches that may be applied to effectuate entity regulation. Perhaps ironically, the minimum degree of regulatory reform for entities would be to regulate existing law firms in addition to, or rather, than the lawyers who work for them. The next incrementally more extensive regulatory scope would be to add ABS in some form (Arizona's approach). More inclusive extensions would allow entities to provide legal services using either non-lawyers (or other licensed legal occupations), by software, or by both (Utah's approach).

Entity regulation has two potential advantages distinct from role regulation alone: (1) enabling beneficial role diversification, and (2) enabling technological innovation.

ENTITY REGULATION: Enabling role diversification

If the provision of legal services were regulated in a more market-driven way, one could imagine a broad and varied set of people helping to provide those services. They would not necessarily be separate formal roles. Think about legal services as being divided up into literally hundreds of small services—some of which only complete a single step in a larger legal process. It is through this vision that we can begin to see how entity regulation may truly drive innovations and efficiency for consumers of legal services. If regulation is targeted not only at legal roles but at legal services entities, then those entities can devise the right sourcing of legal work across a variety of provider mechanisms, including technology, unlicensed nonlawyers, and licensed legal roles. Even if the individual provider is not licensed, the regulation of the entity ensures compliance and quality standards. Consumers need not be concerned about who provides what piece of

their legal service, just that the entity performs as it has promised to do. Consumers would need to trust the entity, which is associated with the brand—not the individual providing a service. That same entity might have a number of staff providing services in different roles without the consumer necessarily being aware of or caring about their detailed capabilities.

How much oversight these service providers receive from lawyers could also vary over a wide range from none to constant. Some providers might be able to deliver high-quality services once completely trained without any oversight. Others might require periodic quality checks or partial retraining. Mandatory reviews might be required only for certain legal services that are more complicated or require more legal judgment. Finally, some services might be so impactful that lawyer oversight is required for every service, or the consumer is simply required to receive that service from a fully trained lawyer or formally licensed legal role.

This variety of staff training and capability is common in many other industries and consumers do not think twice about it. This happens because consumers evaluate service providers on their brands as entities and assume that the entities will competently train their own staff. If that assumption proves false, consumers change providers or write bad online reviews or complain to regulators or sue. This is, of course, the normal situation in a market economy.

ENTITY REGULATION: Enabling Technological Innovation

Another potential advantage of entity regulation is the ability to permit innovation in the software provision of legal practice services. So far we have discussed roles and entities in which all legal services are provided by humans. This need not be the case. Many legal services could be provided entirely by software without any human assistance or intervention. Many legal services can be “decomposed” into smaller simpler steps that are completely routine and limited in complexity. Such steps are ideal for provision by software.

Like all modern software, the legal services provided this way may be created in one of two ways. In traditional software, an expert defines a deterministic algorithm that can be tested for appropriateness. A deterministic algorithm is one that applies rules such that, given a particular input, the same output will result. One common type of algorithm is a so-called “expert system” that contains a decision tree for all possible choices for a problem. In contrast, much new software incorporates the results of so-called “artificial intelligence.” Services of this type are usually based on machine learning that trains on a large database of past cases or services and can have a variety of outcomes dependent on how the algorithm weights various input variables.

With a simple deterministic algorithm, lawyer oversight will be needed in two ways: (1) to provide input on the development of the algorithmic rules, and (2) in assessment of the appropriateness of the outputs. Ongoing oversight, assuming no rule changes, will not be needed. If the algorithm does well with some steps in a service, but not with others, an entity may provide a hybrid service that is part software and part human. In the case of an algorithm driven by machine learning, the expert lawyer may not understand why the system is making the recommendations it does, but presumably that lawyer could still assess if the service recommended is an appropriate one. Lawyers could conceivably provide oversight in a broad range from occasional reviews to reviews of every service provision. It would depend on the quality of the services provided by the software and the potential risk to consumers.

Software provision of legal services may hold significant potential for increasing access to affordable legal services. Software can often provide more consistently high-quality services than human experts in many contexts. Software may even be better at complex decisions that humans currently do not trust it to perform (landing a plane in bad conditions or writing a legal brief, for example). However, because there is still much we do not know about the use of software in legal decision making or about the kinds of outcomes (beneficial or harmful) produced by software tools, regulatory oversight is particularly important. A regulatory approach that is able to assess outputs and possibly outcomes will be most useful (see Decision 3).

CASE STUDY

DECISION 2 FRAMEWORK APPLIED: Utah & Arizona's Regulatory Choices

Both Utah and Arizona have implemented both entity regulation and role regulation.

UTAH ENTITY REGULATION: Utah's legal sandbox is open to a wide range of entities, including those which would qualify as ABS (using employed lawyers to provide legal services) and those in which nonlawyers are not only owners but also providers or those in which software provides the legal services.

ROLE REGULATION: Utah authorized licensed paraprofessionals.

ARIZONA ENTITY REGULATION: ABS licensing authorizes entities in which nonlawyers are part or full owners and/or managers.

ROLE REGULATION: Arizona authorizes licensed paraprofessionals and several navigator/advocate roles.

DECISION 3: Regulatory Approach

While there are many different approaches to regulation, this design framework identifies four and explains those four as applied in the context of legal services: prescriptive, management, outcomes, and risk. These four possible approaches can be categorized into ex ante regulatory strategies and ex post regulatory strategies. Each approach comes with different pros and cons. They also differ in the difficulty and cost of implementation. It will most likely be the case that the optimal regulatory framework for a particular jurisdiction is a hybrid of two or more of these approaches. Because this decision will influence everything else in a regulatory reform project, we will explore each alternative in more detail.

Ex ante regulatory approaches

Ex ante regulation sets qualifying standards that predispose and enable persons or organizations to develop and deliver services within specified boundaries. After those standards are met in the past or present, the assumption is that services are permissible into the future without directly regulating the outputs, outcomes, or impacts. The process of qualification is actively monitored, whereas the results of that qualification are either monitored passively or unmonitored.

A. Prescriptive rule regulation seeks to achieve its goals by establishing a detailed set of specific rules for legal service providers in the areas of training, qualifications, licensing, and business models.

There are significant benefits to this regulatory approach—and potentially significant downsides. Benefits include the certainty and clarity that rules provide regulated entities and the market as a whole, the potential improved compliance that clarity may support, the potentially lower cost to the government, and the familiarity of the approach, particularly in the legal sector.

One downside, at least as this approach has historically been deployed in the legal sector, is the lack of objective verification of the actual impact of the rules on the assumed ends (e.g., consumer protection). This lack of empiricism drives other significant downsides, including the potential inadequacy or actual negative impact of the rules on the goals of regulation, such as consumer protection, and the possibility of the rules deterring or preventing activities which may be beneficial to the public. Further downsides include the lack of flexibility in the face of external change (technological, economic), the restrictive impact of rules on innovation, and the potential high cost of compliance imposed on individual providers and consumers.

Traditional legal regulation falls firmly into this category. Courts, through bars, establish rules for lawyers to follow and ethical conduct codes with which to comply. They administer law degree programs and licensing tests. These actions are intended to instill sufficient quality up front and to prevent hypothetical abuses. The key characteristic of this approach is that once all of these initial measures are in place, the bars do little in the way of active empirical oversight. They only act if someone asserts a claim of misbehavior that violates the ethical rules.

The Arizona entity regulation of ABS also remains within the ex ante prescriptive regulatory approach. The only significant difference is that the regulatory target is legal service entities rather than individual roles. The Arizona ABS framework has a series of qualification requirements which, once satisfied, qualify the entity to provide service. There is a standards of conduct rubric, essentially importing many of the rules governing lawyers to the entities. Once an entity is authorized, there is little to no proactive ongoing oversight. Enforcement against ABS is folded into the disciplinary activity of the bar.

B. Management-based regulation seeks to specify requirements for the management of internal operational processes. The concept assumes that management-focused standards will incentivize increased ethical behavior in entities and that ethical behavior in entities will result in better legal quality for consumers. The management approach is a means to the end; the goal will almost never be just better internal management of legal service providers. Australia has implemented this approach for legal entities. Both England/Wales and Arizona incorporate management focused features in entity regulation (in particular the compliance officer role). Several of the Canadian provinces, Colorado, and Illinois have implemented a form of management regulation for individual lawyers. Other industries are partly regulated this way, including corporate banking and airlines.

One potential advantage of this approach is that it would appear to be relatively low cost. In Australia, there is little active regulatory oversight; rather, the regulator sets a general set of management duties (e.g., having competent work practices; timely and courteous communication; timely identification of conflicts; avoiding breaches of trust accounts). The regulator can audit firms for compliance and issue directions to firms found to be wanting.

A major difficulty is the almost total absence of knowledge about what specific internal processes should be required to achieve the legal regulatory goals. Indeed, this is a significant problem even

in industries, such as banking, with a long history of using this regulatory approach. The limited evidence from Australia does indicate possible benefits to the consumer experience: complaints against firms dropped considerably after implementation of a government required self-assessment process for assessing compliance with the management requirements.

Another potential disadvantage of this approach is its limited scope focused on relatively traditional entities in which lawyers are the legal service providers. In Australia, the appropriateness of a management system is not measured by direct evidence of consumer harm but rather by applying the existing ethical rules and norms for lawyers. The potential of this approach to drive innovation or increased access by consumers could thus be limited.

Ex post regulatory approaches

Ex post regulation is regulation that takes place after the regulated conduct occurs. Ex post regulation, which seeks to deter loss or harm through imposing negative repercussions after the fact, is thought to be optimal where the impact of loss or harm is lower and where the cost of complying is less than the threatened sanction.

The two choices outlined below—outcomes-based and risk-based regulation—may be seen as two sides of the same coin. Each of these approaches is focused on ends, rather than means, and each leaves a great deal of agency with the regulated entities to determine the best means to reach the desired ends. The risk-based approach outlined here could be seen as a subset or specific application of outcomes-based regulation, but we have outlined it separately to highlight our specific focus on regulation based on evidence of consumer harm.

C. Outcomes-based regulation seeks to ensure that providers achieve certain performance results. Performance outcomes or results are clearly outlined but regulated entities themselves are able to decide how they will meet the outcome targets. The regulatory focus moves from the front end (qualification and admission) to the back end (measuring outcomes). Empirical data are necessary to execute this approach. The goals themselves, the outcomes, can be defined in a variety of ways depending on the overarching regulatory goals. Much environmental regulation is outcomes-based regulation—the regulator sets an emissions target and the regulated entities are required to meet it using whatever technology or approach they choose.

Outcomes-based regulation opens up a variety of possibilities. For example, if the regulatory goal is a more equitable distribution of legal services, the regulator could measure and collect data, such as demographic information about consumers of regulated entities, toward that outcome. This could come at a cost however; many consumers are reluctant to provide such data to service providers and the friction of that reluctance could chill the market. Striking a balance between the information the regulator needs and the burden on the regulated providers is a critical task.

There are several difficulties with outcomes-based regulation when applied to legal services. If the regulatory goal relates to protecting consumers from bad quality services or ensuring a minimum quality of legal services, then setting appropriate outcome metrics requires some knowledge of the current actual quality of legal services. There is very little known about the current actual quality of legal services; indeed, there is little agreement on how to measure or what would be measured to assess quality. Further, we know that for most people the baseline would not be the quality of legal services provided by a lawyer, but rather the quality of the person muddling through their legal issue on their own. We know from other jurisdictions and the few U.S. contexts where they are permitted that alternative providers such as trained nonlawyers can be of high quality. Collecting data on quality would be expensive and complex. Even the consistent and objective assessment of legal quality becomes problematic for more complicated legal services.

D. Risk-based (harm-based) regulation is an approach in which the regulator uses data to better estimate the likelihood of events. Typically, risk-based regulation focuses on the occurrence of negative events (if the negative events have occurred, they are harms; if the negative events could occur, then they are threats). In this way, risk-based regulation attempts to use data to move from uncertainty to identification of risks of harm and to better monitor for and respond to harms. Resources are deployed to identify, predict, respond to, and prevent harms. As this has been implemented in the context of legal services, the threat of primary concern is the possibility of consumer harm experienced through legal services and the subsequent development of regulatory intervention and prevention strategies that are primarily constructed ex-post. Threat (risk of harm) is tracked and evaluated empirically using an objective and systematic assessment framework. The necessary data come from both providers and consumers. As data flows into the regulator, the regulator can then make increasingly informed allocation of resources and further maximize risk assessment and prevent harms based on that information.

The Utah sandbox is an example of a risk-based approach. The regulator has identified three specific legal consumer harms and collects a range of data from regulated entities designed to show whether and to what extent such harms may be occurring. If evidence indicates harm is occurring at a substantial level, the regulator can take action, including suspension or termination of authorization to provide services. Utah does incorporate a very basic ex ante risk assessment through an initial risk categorization of entities but the main regulatory function is ex post.

The benefits of this approach include potential responsiveness and flexibility to adjust regulatory requirements and resources as evidence is gathered around risk of consumer harm. The approach also has considerable benefits when considering the regulation of software provision of legal services, and particularly software using sophisticated artificial intelligence. A risk-based approach focused on consumer harm does not necessarily require the regulator to assess or understand how an algorithm produces a particular result for a consumer. It is concerned with identifying whether that result is harmful to the consumer or not. If it is harmful, then the regulator can act, requiring the entity to make the necessary changes to address the harm.

An important downside of this approach is that the regulatory action occurs after a loss has occurred. The regulatory actions are driven by evidence of harm that has already occurred. Of course, few ex ante rules are 100 percent effective at preventing harm themselves. It is likely worth considering, however, whether there are potential consumer harms both sufficiently probable and with such negative impact that a preventative rule may be useful. For example, the regulator may establish a rule that forbids regulated providers from either participating in capping and running activities or paying anyone who performs such activities for the referral of legal work.

Another downside with this approach is collecting the necessary data in the required formats. Legal service providers have no history of doing this, so their internal systems are not designed to provide the data efficiently. There is also almost no objective data to benchmark quality of services provided by innovators compared to that currently exhibited by traditional providers. The cost of identifying, collecting, and analyzing the data will also likely be higher than ex ante approaches, particularly during the development phase of the regulatory approach.

CASE STUDY

DECISION 3 FRAMEWORK APPLIED: Utah & Arizona's Regulatory Choices

UTAH Prescriptive regulation applies to lawyers and to licensed paraprofessionals.
Risk-based regulation applies to entities authorized in the legal sandbox.

ARIZONA Prescriptive regulation applies to ABS licensing and paraprofessionals.
The ABS structure also has some aspects of management-based regulation.

Key Implementation Decisions

Once a policy maker has made the key regulatory design decisions, there remain multiple implementation choices requiring careful consideration. Although full description of the implementation framework requires a separate paper, we have outlined several of the most important choices for legal reform here: reform targets, reform mechanisms, hosting, and funding.

DECISION 4: Reform Targets

As described above, the history of legal regulation in the United States is deeply intertwined with the mission of the bar as a professional association. The ethical rules that govern lawyers' legal practice are, at their core, ideas about how we should constrict lawyers' behavior to ensure consumer protection and the monopoly of the profession. We are so used to these constraints that it is difficult to imagine their absence. Lawyers and those who have traditionally been active in the state bar system instinctively turn to the Rules of Professional Conduct when considering regulatory goals. If the appropriate goal of protecting consumers from harm is adequately developed within the regulatory framework, however, many of the rules, which often act as proxies for evidence of actual harm, may fall away.

A rethinking of legal services regulation should be prepared to (1) separate out the regulation of legal services from the role of the lawyer, and (2) completely reassess the necessity and question the assumptions built into the ethical rules. A true rethinking of legal services regulation should start with a blank slate and should build from the identified regulatory objective. Everything should be on the table. Experience in other industries teaches us that consumers are sometimes willing to give up hypothetical protections in return for lower service costs. In fact, we all do this every day when we consume "free" internet services in return for our data being monetized

by service providers. Assuming the rules—including confidentiality, conflicts, and client money rules—are always necessary undermines the potential for innovation without evidence.

While everything should be on the table, there are many ways to go about regulating legal services that can build alongside or upon the existing regulation of lawyers. In Utah, for example, there now exists a dual system of regulation: lawyers and paraprofessionals are regulated by the bar under traditional conduct rules; entities providing legal services through corporate structures or taking nonlawyer investment, etc. or entities using nonlawyers or tech to perform legal practice services are regulated using risk-based regulation by the Office of Legal Services Innovation. Lawyers can practice in traditional ways or by joining these new entities; they remain subject to discipline for rule violations no matter what. The new entities are subject to risk-based regulation and subject to enforcement based on evidence of consumer harm. They are not independently subject to any of the Rules of Professional Conduct. A lawyer working in an entity is not independently subject to enforcement by the Office, but she may lose her ability to practice with that entity if it gets its authorization terminated. The Office can also refer complaints about individual lawyers working for or with its entities to the bar.

We know that there are two main restrictions impacting the structure and provision of legal services: (1) the ban on fee-sharing ensconced in Rule 5.4, which impacts lawyers' behavior, and (2) the ban on practice of law by nonlawyer providers (including humans, corporate entities, and software), which impacts both lawyers and nonlawyers behavior. Modifying either of these bans, both, or more may be a priority for a state considering regulatory reform. Below are some of the ways in which these bans may be reformed.

Rule 5.4

Rule 5.4's ban on revenue sharing impacts only the behavior of lawyers; reforming it means expanding the range of business arrangements in which lawyers may participate. Reform may be accomplished in several possible ways:

REPEAL RULE 5.4 The ban on nonlawyer ownership or management is rooted in the assumption that a ban is necessary to protect the independence of lawyers and legal judgment. However, this concern is arguably sufficiently addressed in the conflict of interest rules and the lawyer's fiduciary duty of loyalty. Repealing Rule 5.4 would permit outside investment and ownership, lawyer employment, joint ventures and other business formations, and referral fees.

REVISE RULE 5.4 There are a variety of ways in which Rule 5.4’s broad ban could be revised to permit more flexibility. For example, the ban could be narrowed to apply only to paying referral fees to “cappers” or “runners.”

REPEAL OR REVISE AND REGULATE Revise the rule to permit lawyers to partner with non-lawyers and establish a regulatory structure governing the participation of nonlawyers. This is the approach in both Arizona and Utah, though the new regulatory structure in each state is different.

Unauthorized Practice of Law

Reforming the ban on nonlawyer practice may also be accomplished in several ways:

DEREGULATE CERTAIN ACTIVITIES WITHIN THE PRACTICE OF LAW The practice of law has a notoriously broad definition, encompassing almost all of the legal activities performed by lawyers, in and out of court. This is not the case in every jurisdiction globally; in the UK, for example, legal advice and most legal document completion is not regulated. It could be determined that certain currently regulated legal practice activities, such as legal advice, will-writing, debt collection disputes, or document completion, do not need to be regulated.

CREATE ADDITIONAL LEGAL PRACTICE ROLES Create and authorize additional legal provider roles to perform practice of law activities, such as independent paraprofessionals, legal navigators, or legal document assistants. This regulation can operate via rules (similar to those for lawyers—see LP programs in Utah and Arizona); outcomes (set quality targets and assess on an ongoing basis via audits or secret shoppers); or risk (collect data on services performed and assess for actualized risk (harm)).

ENTITY REGULATION Allow entities to practice law using a variety of service mechanisms, including regulated roles (lawyers and paraprofessionals) and other nonlawyers (human and tech) and regulate the entities:

Entities and rules: Create an ABS licensing regime like Arizona.

Entities and management: Create requirements for legal practice entity management like Australia.

Entities and outcomes: Set outcomes targets for legal practice entities such as “consumers receive adequate legal service in more than ___% of service instances,” establish metrics by

which adequacy is measured, and collect data to determine whether that is happening.

Entities and risk: Collect data from entities to assess the frequency and impact of actualized risk of consumer harm like the Utah sandbox.

Waivers

If starting from a blank slate, then it should not be assumed that the larger body of the Rules of Professional Conduct need apply within the new regulatory framework, whether applied to roles or entities. This is particularly true if the regulatory approach is one focusing on outcomes or risk of consumer harm because the ex post approach enables coherent and direct regulation for outcomes or risk. However, if any of the rules are retained in the new framework, the regulator could retain the authority to consider other rules for repeal or waiver to increase the potential for innovation. For example, Rule 1.6 (confidentiality) could be waived to permit anonymized data to be sold to third parties, thereby activating a revenue stream which could incentive the development of legal products and services in areas where there may not be an otherwise viable business model. Rule 1.15 could be waived to permit innovative payment models (this has happened in Utah). This gives the opportunity to providers to build innovative business models and increases the potential for consumer choice.

CASE STUDY

DECISION 4 FRAMEWORK APPLIED: Utah & Arizona's Regulatory Choices

UTAH Rule 5.4 and UPL are both the primary targets of the legal regulatory sandbox which allows nonlawyer investment, ownership, and revenue sharing and new legal service providers through entity regulation. The Court can also authorize additional rule waivers sought through the legal regulatory sandbox.

The Court has also reduced the scope of the UPL ban through the licensing of paraprofessionals.

ARIZONA Arizona has repealed Rule 5.4 and permits nonlawyer ownership and investment in legal practice entities through the ABS licensing approach.

The Court has also reduced the scope of the UPL ban through the licensing of paraprofessionals and authorization of advocates/navigators.

DECISION 5: Regulatory Mechanisms

Regulatory reform can be implemented either through the traditional rulemaking or codification, as was done in Arizona for ABS and LPs and in Utah for LPs, or through regulatory sandbox as in Utah.

The regulatory sandbox, at least as it has been deployed in Utah, is not itself a regulatory approach. It is a mechanism by which regulatory choice has been deployed. Thus, in Utah, the regulatory sandbox serves as the gateway mechanism by which the Court is opening the legal services market and it is the policy testing space through which the Court is shifting the regulatory framework from roles to entities and from ex ante to ex post for nontraditional legal entities. Although the sandbox may not have been necessary to implement the shifts underway in Utah, the mechanism is particularly useful to drive home the priority of the empirical regulatory goals of Utah's Court.

Although the sandbox was deployed with a time limit (7 years) in Utah, a policy sandbox does not necessarily have to be a time-limited pilot concept. The potential usefulness of a regulatory gateway—a regulatory space through which innovative proposals must pass and submit to oversight and monitoring – likely outlasts the pilot concept. This is particularly so when considering the range of innovation possible with algorithmic products and services.

CASE STUDY

DECISION 5 FRAMEWORK APPLIED: Utah & Arizona's Regulatory Choices

UTAH The regulatory sandbox has been authorized as a pilot program running seven years. The paraprofessional program was implemented through rule changes.

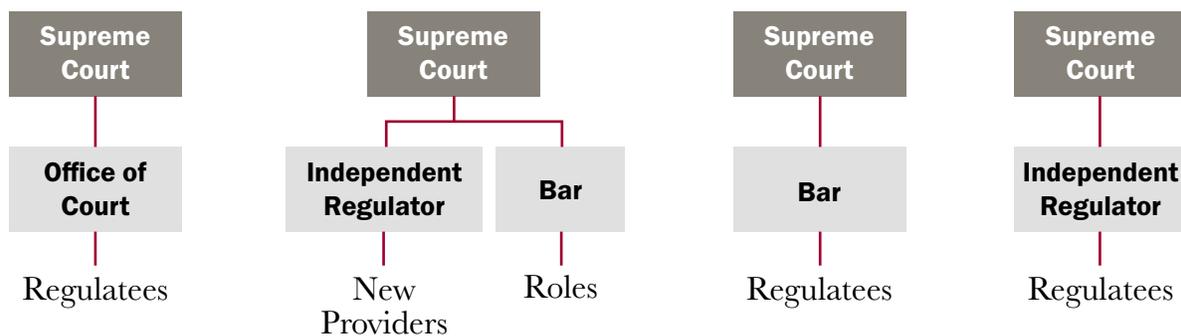
ARIZONA Both ABS and paraprofessional licensing were implemented through rule changes.

DECISION 6: Hosting

A regulator of legal services must live somewhere; there are a range of potential options to consider. Legislatures could regulate legal service providers, as they currently regulate all other occupations and entities via their executive branches by statute. This would likely raise separation of powers issues however, as in most states, the state supreme court holds the power to regulate the practice of law. The court could exercise that power directly, forming a regulatory

office within the court. The court could also delegate the power to regulate to a separate regulatory entity, similar to the current delegation in many states to the state bar. A regulator could also be housed within a state bar. In Arizona, for example, the admission and licensing of paraprofessionals and ABS are run through an office of the Court; enforcement is run through the bar’s disciplinary system. Depending on the regulatory choices made, there may be distinct advantages to establishing a new, independent regulatory entity, including potential for scaling across state lines if other state supreme courts delegate similar authority.

Where should this regulation be housed?

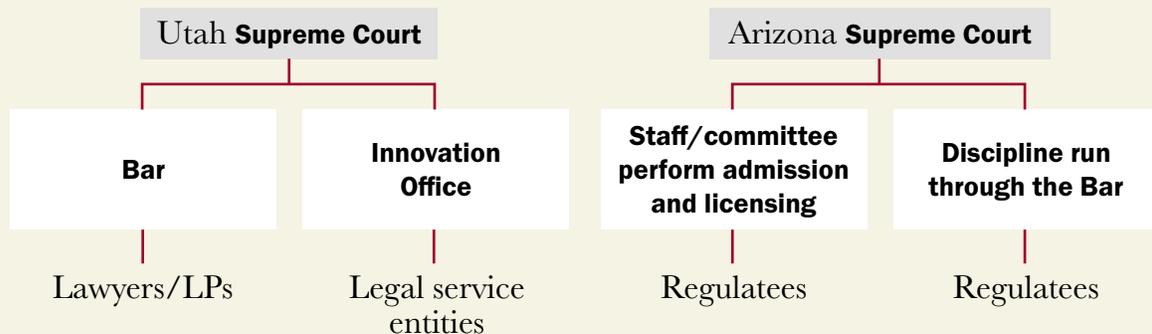


CASE STUDY

DECISION 6 FRAMEWORK APPLIED: Utah & Arizona’s Regulatory Choices

UTAH The regulatory sandbox is administered through the Office of Legal Services Innovation which is an office of the Court. The paraprofessional program is administered by the Utah State Bar.

ARIZONA Both ABS and paraprofessional authorization are hosted directly within the Arizona court system. Enforcement against both ABS and paraprofessionals will be run through the Arizona State Bar’s discipline system.



DECISION 7: Funding

Legal regulators have almost no experience with funding alternatives beyond the membership fees required by state bar associations. Lawyers are numerous enough to adequately fund the light occupation regulation carried out by the state bars. More active regulation of occupations or entities that seeks to empirically monitor consumer safety or provider performance requires significantly higher levels of funding. Because non-traditional legal providers, whether ABS entities or nonlawyer providers, are few in number, especially at the beginning of regulatory reform, any economically feasible fees will be grossly inadequate to cover the regulatory costs.

Funding and hosting decisions are inextricably entwined. If a branch of state government hosts the regulator, then it makes sense for the regulatory agency to be totally funded by the state and be staffed by state civil service employees. This is how most occupation and industry regulation currently operates—with the single exception of legal services. This approach seems odd to courts, because their only experience with regulation is done entirely differently by state bar associations. This exception also shields them from any experience or expertise with running such an agency or funding it.

As a bridging strategy toward becoming a state agency, one could imagine a state court using one-time project funding or one-time grants to pilot a new regulatory agency. Such an approach would not be practical for more than a very limited period. If a new regulator were to eventually oversee all legal service providers, then the resulting license fees might cover a more extensive proportion of the regulatory costs, as they do for other occupations and industries. There is no example, however, of such fees covering most or all of the costs.

CASE STUDY

DECISION 7 FRAMEWORK APPLIED: Utah & Arizona's Regulatory Choices

UTAH The regulatory sandbox has been funded by philanthropic donors; the Court is currently requesting operational funding from the Judicial Council. Fees have not yet been imposed on entities.

ARIZONA ABS entities and paraprofessionals pay licensing fees and the Court is supplementing from its own budget.

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REGULATORY REFORM GLOSSARY

Alternative Business Structure: An alternative business structure or ABS is an entity that involves non-lawyers in ownership or management. Only lawyers or licensed paraprofessionals can provide legal services. Examples include entities in the United Kingdom, Utah, and Arizona.

Certified Legal Roles: Non-lawyer non-paraprofessionals who provide legal services after receiving some kind of certification. Usually involves a level of legal training significant and experience significantly less extensive than that required for licensed legal roles. These roles are often regulated by organizations other than state bar associations. Examples include legal navigators in New York and certified document preparers in California and Arizona.

Consumer Service Regulator: A regulator whose primary focus is consumer protection. The Consumer Financial Protection Bureau is an example.

Entity-based Regulation: The regulation of organizations instead of individuals in roles.

Licensed Legal Roles: New roles for paraprofessionals like paralegals. State bar associations typically regulate these roles and require extensive formal training and experience. Examples include the Limited

License Legal Technician in Washington and Licensed Paraprofessionals in Arizona and Utah.

Management-based Regulation: A regulatory approach with the primary focus is the internal management processes of legal service providers. An example is Australia, which calls it Proactive Management-based Regulation (PMBR).

Non-traditional Legal Service Entities: Entities that use non-traditional business models for either ownership/management or service provision or both. The term includes alternative business structures and the provision of legal services by non-licensed providers or software.

Occupation Regulator: A regulator whose primary focus is specific formal professional roles. Examples include every state bar association.

Outcomes-based Regulation: A regulatory approach with the primary focus of specific performance results. Examples include the United Kingdom and Utah. There are numerous examples in other service industries, such as environmental regulation.

Prescriptive Regulation: A regulatory approach with the primary focus on the

detailed specification of rules for training, qualifications, licensing, and business models. Examples include most state's regulation of lawyers.

Professional Association: An organization whose primary focus is the promotion and support of a specific group of individuals or entities. It specifies formal requirements for membership and usually requires dues. It is not a regulatory body. Examples include all state bar associations (who also all simultaneously act in the conflicting role of occupation regulator). A professional association can have either individuals or entities as members. Examples of the former are realtor associations or aviation pilot associations. Examples of the latter are the U.S. Chamber of Commerce or xx.

Risk-based Regulation: A regulatory approach with the primary focus of consumer risk. Risks are empirically evaluated in compliance with an objective assessment framework. Risk-based regulation uses data-driven assessments of market activities to target regulatory resources to those entities presenting increased risk of consumer harm. The United Kingdom operates a version of this approach. The sole American example is the Utah sandbox project.

Role-based Regulation: The regulation of individuals providing services in a specific occupation. Examples include lawyers and paraprofessionals licensed by bar associations. Almost all other occupations are examples, but they are typically regulated by state legislatures via statutes and dedicated regulatory commissions.

Legal Services Policy Sandbox: The opportunity to waive one or more existing rules for providing legal services to consumers under specific conditions established and monitored by a regulatory body. The only American example in legal services is in Utah; England and Wales and four Canadian provinces also have legal sandboxes. There are numerous examples of fintech sandboxes around the world.

REGULATORY REFORM DESIGN EXERCISE

A state supreme court has directed a committee of experts to design a regulatory reform project. Some preliminary work was done by the state court administrator and the court solicited comments from various stakeholders and the public. That work was summarized into a starting document for the design committee.

TASK: Use the framework for legal regulation and the information below to make recommendations about the design of a state regulatory reform project.

Stakeholder Input Summary

The state bar association and several judicial associations strongly recommended that the court do nothing that could potentially undermine either the employment or revenue of existing lawyers. Others stressed the need to close the access to justice gap, make the market for legal services more innovative, or increase competition. Most of the existing legal stakeholders like the bar emphasized the overriding importance of protecting the public from harm. In order to achieve this goal, the bar strongly recommended that any non-lawyer providers of legal services must comply with all existing bar rules. In contrast, many stakeholders outside the legal profession want to see more consumer choice and convenience. Several groups want the possibility of completing some legal actions with limited assistance.

The state bar also insisted that any new non-lawyer provider roles be regulated by the bar through a traditional licensing approach based on education and experience. Other stakeholders want to see the project open the market to companies that are not law firms. Still other groups want to see new legal roles that are not based on the traditional lawyer template and can provide “lightweight” legal assistance.

Stakeholders split right down the middle on the ability of any new providers to appear in court. The bar and judicial associations want to prevent that possibility across the board. Some other stakeholders stressed the value of such appearances to help people who now must appear unrepresented.

All sorts of input was received about how to go about the reform. Some groups want to start with the current bar rules for lawyers and add new rules to insure the safety for the public of any innovations. An example is a requirement for a large insurance bond. Other groups want to have significant insight into how any providers operate internally to provide legal services in order to insure quality and prevent abuses. Legal aid groups in particular want to see a focus on the access gap. Groups disagreed on what constituted the access gap. Some wanted only services for low income people who could not be economically served by the bar. Others wanted cheaper services for middle class people and small businesses. Some groups want to make sure that big companies, tech or consumer retail, for example cannot offer legal services.

The bar also insisted that it was the only qualified entity to host any regulatory reform. Others strongly disagreed, arguing that there was an inherent conflict of interest for the bar, and any reform should be regulated by some other entity. Candidates included the supreme court, a new non-profit entity, or an approach patterned on the traditional legislative regulation of occupations.

Funding for reform is very uncertain. The bar wants the supreme court to pay for any reforms but the court has very little budget for such efforts. Legal aid organizations agree. Supporters of the legislative approach want the state to set up a new group in the executive branch to implement the reforms. Others want a more independent entity that operates with fees imposed on new providers.