PUBLIC POLICY BRIEF

Innovation & Evolution in the Regulation of Legal Services

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SUMMARY

The current disconnect between legal services providers and legal consumers can only be described as a gap in the market caused, in part, by overregulation

The need for innovation in the legal industry has never been greater, and regulatory sandboxes for legal services provide a responsible solution.

Regulatory sandboxes provide a controlled environment for experimentation and close monitoring to prevent consumer harm.

The first, and to-date *only*, legal services sandbox in the United States is active in Utah.

Rather than relying on assumptions about regulatory policy change, the sandbox mechanism advances data-informed rule making.

Supporting the development of legal regulatory sandboxes—in Utah and other states—holds promise for bringing critically needed product and service innovation to legal consumers.

The Utah legal services sandbox is the path to better legal services that benefit more people.

The Existing Landscape

For many Americans, a simple traffic ticket creates a burdensome, emergency expense. In response, an entrepreneur in Florida developed an app called TIKD to connect people with attorneys to represent them in traffic court at a rate guaranteed to be lower than the cost of the ticket. The Florida Bar attacked TIKD, and although there was little to no evidence of consumer harm, the Florida Supreme Court ultimately ruled that the company was in violation of existing regulations. The entrepreneur took the app off the market.

This story and others illustrate the tension between innovation and regulation in the legal services sector. Companies serving consumers are facing numerous legal challenges—more often brought by market incumbents than consumers—that often make doing business overly burdensome. This policy brief will explore the need for regulatory innovation in the legal sector and will explain how regulatory sandboxes provide a promising solution for ensuring consumer protection while modernizing out-of-date regulatory rules.

Regulatory Innovation to Revitalize a Sector

There are two main sectors of the legal industry in the United States: (1) attorneys who serve large corporations and wealthy individuals and (2) attorneys who serve members of the general public and small businesses—often referred to as the PeopleLaw sector. The PeopleLaw sector is in decline and has been for several decades. A clear and growing disconnect between what attorneys are providing and what consumers are buying reflects the sector's troubled financial performance and inability to meet consumer needs.[1] This widening gap in coverage, and the detrimental effects on attorneys and consumers alike, makes clear that regulatory innovation must be part of the solution.

Law is a heavily regulated industry, given the rights, responsibilities, and liberties at stake in legal matters. But the regulatory framework governing the practice of law is largely based on a set of assumptions rooted in the late nineteenth and early twentieth centuries. Little empirical data supports the rules that dictate how legal services are delivered today.

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Unauthorized Practice of Law: Restrictions on Who Can Provide Legal Services

Each state has its own version of Unauthorized Practice of Law (UPL) rules that protect the public from unqualified service providers. With few exceptions, anyone other than an attorney who is providing legal services is likely engaging in UPL and can be punished—sometimes criminally. Legal consumers have few options for price point, and no other options when it comes to type of provider. This differs from consumer experience in many industries, including heavily regulated and complex professions.

The medical profession provides an apt analogy. In any given medical setting, patients may encounter certified nursing assistants, registered nurses, physicians assistants, phlebotomists, physicians, and specialized surgeons. These positions support doctors, not take market share away from them. This continuum of patient care (with accompanying tiers of fees for services) better meets consumer needs, but no such structure is available in the law. The choice is generally between an attorney or nothing.

Fee Sharing & Co-Ownership: Restrictions on Business Organization & Risk-Based Funding

Current state regulations on the practice of law prohibit attorneys from sharing legal fees or equity

in law firms with those who are not attorneys, and from forming partnerships with anyone other than attorneys if any of the partnership's activities consist of the practice of law.[2]

Attorneys cannot offer equity shares in the business to valuable employees or offer ownership arrangements to attract professionals who routinely comprise the C-Suite in other industries (e.g., business development professionals, marketing experts, technologists). These partnership restrictions constrain an attorney's ability to focus solely on practicing law and are also obstacles to meaningful innovation, which thrives on interdisciplinary collaboration and diversity of perspectives.

Innovation also thrives in environments that allow for high risk and that can absorb failure. This is why access to venture capital is critical for funding innovation across industries, yet current regulations on the practice of law prohibit equity ownership between attorneys and other professionals. Instead, attorneys and law firms are expected to fund massive innovation efforts with a high potential of failure from their own accounts. Most do not, because they cannot.

Setting the Stage for Regulatory Experimentation

The problems on both the supply and demand side of the PeopleLaw sector are well documented. Yet, there is almost no experimentation in state legal regulatory structures

to find ways to offer legal services in a way that keeps up with existing demand. Part of the resistance to change relates back to the policy assumptions underlying these rules.

Public protection is the foundational goal of the regulatory structure governing the practice of law. Unauthorized Practice of Law (UPL) rules are designed to provide consumers with consistent quality standards. Restrictions on fee sharing and ownership purport to protect an attorney's independent professional judgment on a client's behalf. Yet, there is no evidence that these regulations are necessary to meet the regulatory objective.

UPL enforcement does not require evidence of actual harm—the act alone is sufficient, even if the product or service is beneficial. In fact, almost all UPL claims are filed by state bars or competing attorneys; they are rarely filed by consumers.[3] Moreover, expanding the sources of authorized legal advice could be done in a way that ensures the training and quality of new providers.

Similarly, there is little, if any, evidence that fee sharing and co-ownership compromise the independent judgment of attorneys—and certainly not in any way that requires their categorical prohibition. Attorneys work in corporations, insurance companies, and accounting firms, and have been doing so for years. Further, an attorney's independent judgment has protections elsewhere in the rules governing the practice of law.

Instead of offering public protection, these regulatory provisions restrict growth and innovation. They also incentivize anticompetitive behavior. Innovative companies that successfully attract consumers also draw the attention of prospective competitors—attorneys. The reaction is often to use regulations to close these businesses, with little to no evidence of consumer harm. Innovative companies that do navigate regulations use considerable resources

ensuring compliance just to end up offering significantly restricted legal services.

The status quo is not working. What is needed is experimentation with new regulations that ensure quality while encouraging innovation.

Sandboxes as a Mechanism for Innovation

The United Kingdom developed the first regulatory sandbox in 2015 to test innovative products and services for financial technologies without excessive red tape.[4] Regulatory sandboxes have since been established around the world and are increasingly part of the national landscape.[5] Most state sandboxes focus on innovative technologies in heavily regulated industries, such as finance, insurance, and energy.[6]

While specifics vary, a regulatory sandbox is generally a controlled environment with relaxed regulatory requirements. Public protection remains a primary regulatory goal, and comprehensive, routine data collection is designed to mitigate risk of harm to consumers. Sandboxes are tools only. They are data informed and outcome oriented, but their regulatory structure is otherwise agnostic to the specific products, services, and technologies that are developed within them.

Why Legal Services are Different: Sources of Regulatory Authority

Regulatory sandboxes can benefit the legal industry, but legal services regulations have their own unique dynamics to consider.

The most important difference is that legal services regulations are primarily judicial, not legislative. Each state supreme court is the ultimate regulatory authority for practicing law. In some states, these courts retain that authority. In many states, though, state supreme courts have delegated this authority to state bar associations—professional associations of attorneys. These same organizations—whose members are market incumbents—are also regulators.[7]

While the judiciary is the primary legal services regulator, the legislative branch may still retain some regulatory power. Some state legislatures have acted to address public need when the judiciary was slow to react, suggesting that legislators also have authority in certain instances.[8] In addition, UPL laws are statutory, putting them in the legislative realm. Similarly, depending on the state, some of the mechanisms for a regulatory sandbox may require legislative approval too, including funding. Ultimately, the relative authority of the legislature and the supreme court within a state will depend on the constitutional framework.

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Utah's Legal Services Regulatory Sandbox

Despite the often complicated interplay between legislative and judicial branches, some states are already leading the way in reregulating legal services to open the door for more innovation.

In 2020, the Utah Supreme Court implemented significant regulatory reforms to address the need for more innovation in legal services. Recognizing that "[t]echnologies and market forces keep undermining the fundamental premise that lawyers, and lawyers alone, can provide suitable legal services as consumers are increasingly finding tools to meet their needs outside of the regulated legal profession," Utah's focus was designing a regulatory system to allow innovation without creating intolerable levels of risk for the consumers of legal services.[9] To reach this goal, the Utah Supreme Court adopted a regulatory sandbox in which participating entities could innovate without the limitations on fee sharing or ownership and UPL.

Sandbox Structure and Operations

Under the supervision of the Utah Supreme Court, the Office of Legal Services Innovation (Innovation Office) authorizes entities to practice law in the Sandbox through a nontraditional

service model without being subjected to discipline by the Utah State Bar. The state bar continues to regulate individual attorneys, but Utah attorneys are permitted to work for or with an entity in the sandbox as long as they are able to still comply with the body of rules that are not waived through Sandbox participation.[10]

Within this structure, there are three additional key features.

1. The Innovation Office's board and staff are not limited to attorneys—they include professionals with diverse backgrounds ranging from economists and data analysts to sociologists.[11]
2. Instead of a vague sense of consumer protection, the court defined the regulatory objective: "To ensure consumers have access to a well-developed, high-quality, innovative, affordable, and competitive market for legal services."[12]
3. The court designed a risk-based regulation framework for the Sandbox that is outcomes oriented and focuses on factors such as quality, affordability, or access. This framework uses data-driven assessments of market activities to understand risks in terms of impact and probability, allowing the regulator to use targeted, proportionate, and responsive interventions.[13]

Data Reporting & Collection

The Innovation Office assesses data to measure risk in three main areas: (1) inaccurate or inappropriate legal result, (2) failure to exercise legal rights through ignorance or bad advice, and (3) purchase of an unnecessary or inappropriate legal service. If an entity meets a threshold risk assessment, the Office recommends the Utah Supreme Court approve the application.[14]

Once authorized, an entity must maintain its risk threshold and submit de-identified service-level data on a quarterly or monthly basis, depending on the entity's risk profile. In addition to regular audits, consumer complaints are another key source of information on authorized entities and their services.

The result is proactive regulation in real time. The Innovation Office can spot risks or trends from the data it collects and intervene to mitigate or, if necessary, recommend the court rescind authorization. And the Office can revise its risk profiles based on evidence, instead of relying on assumptions. This system offers far more protection than disciplinary actions against attorneys, which are solely reactive and addressed only if they are reported.

Transparency and clarity are also touchstones for the Innovation Office. The Office maintains a website that offers detailed information, including its recommendations to the Utah Supreme Court. Every month the Office posts Sandbox activity reports, which summarize details including types of services offered, number of services delivered, and number of consumer complaints received and addressed.[15] Authorized entities are required to display on websites and offices an Innovation Office "badge" for the public.[16]

Practical Considerations

The Utah Sandbox offers systemic reform that has transformative potential. But it is not without its challenges.

The struggle for resources is paramount. Proactive, risk-based regulation is far more involved than a reactive disciplinary system and requires more funding. The Utah Supreme Court chose to forego fees so it could attract as many applicants (and therefore as much data) as possible. It was able to do so in part through support of independent national research and policy centers.[17] Costs should shift down as data shows some risk profiles do not require as much monitoring as was initially assumed, but continual funding and sustainability are constant concerns.

Time is also an issue. The Utah Supreme Court authorized the sandbox as a seven-year pilot project, to carefully measure the impacts of fundamental regulatory change before making more permanent recommendations. But creating new markets takes time. Beyond building awareness and confidence among service providers and consumers, it takes time to gather and analyze data needed for robust research.

Defining Success and Measuring Impact in the Utah Sandbox

The Utah Sandbox is the most comprehensive regulatory reform for legal services in the United States today, but measuring its success can be difficult. The reality is that more time is needed before any

firm conclusions can be made. But evidence from Utah—available through data that is impossible to gather under the current regulatory structure in other states—suggests that fears of unethical practices and low-quality services may be misplaced.

The November 2022 Activity Report[18] provides the following data points:

- forty-seven active entities approved to offer services
- 35,870 legal services sought by approximately 24,000 unduplicated consumers
- 31,215 (87.0%) legal services delivered by a lawyer (or lawyer employee) or software with lawyer involvement
- 4,655 (13.0%) legal services delivered by non-lawyers (software or person) with lawyer involvement
- thirteen consumer complaints received in total, or approximately one complaint per 2,759 services delivered
- six harm-related complaints received (approximately one complaint per 5,679 services)
- adequate and acceptable entity response reported for all harm-related complaints

Naturally, there are limitations to the data. The regulatory structure overseeing Sandbox entities is far more rigorous, transparent, and responsive than the structure currently regulating attorneys, but in order to gauge relative outcomes in terms of quality or harm, the data must be compared to similar baseline data for attorneys. No fully reliable data exist on complaints against attorneys, but estimates based on available data suggest approximately one complaint for every 2,150 lawyer-provided services—a similar, if not higher, rate than the complaint rates reported in Utah.[19]

Regarding whether legal services are more easily available (e.g., lower cost, easy access) to more people, we do not know whether the roughly 24,000 people that have received legal services from the Sandbox would have turned to an attorney if there was not an alternative. Third-party researchers are identifying metrics and conducting empirical research to evaluate the outcomes of the Sandbox, including impacts on access to justice and the legal market.

Given the complexity of the problem, however, jumping to access to justice without other key metrics is the wrong way to frame the issue. We cannot know ahead of time what new delivery models will be created in this new regulatory environment, but we can foster innovation and efficiency. And if we do, we can expect new and inventive ways to reach people over time.

So far, the evidence clearly suggests that safety is not an issue. And the evidence also strongly suggests that the Utah Sandbox is, in fact, spurring innovation.

What Legal Services Innovation Looks Like

A 2022 report from the Stanford Law School Center on the Legal Profession suggests that substantial innovation is taking place in the sandbox.[20] The Stanford researchers found numerous innovations in entity type and service delivery model,[21] and the majority of Utah Sandbox entities are developing technological and other, non-tech innovations—for example, delivering services through software and nonlawyers or offering tiered services that progressively mix in nonlawyer and attorney guidance.[22]

In addition, most entities are serving the consumers and small businesses that are at the heart of the PeopleLaw sector. By allowing entities to seek

UPL waivers, the Utah Sandbox also includes nonprofits that serve indigent and low-income people.

The following entities are just a few examples of what innovation for legal services looks like in practice:

- LawPal, a TurboTax-like platform that can generate legal documents in divorces, custody cases, evictions, and debt-related property seizure cases
- Rasa Legal, a Public Benefit Corporation that uses software and nonlawyers to help people expunge their criminal records
- Law on Call, a $9 subscription service provided by a team of lawyers for small businesses and independent contractors with more in-depth legal services available at low-cost or à la carte
- Holy Cross Ministries and AAA Fair Credit, non-profit community organizations working in partnership with the Innovation for Justice (i4J) to assist with medical debt by providing free legal advice, assistance in completing documents, and negotiation[23]

The complexity of business models, technology use, and service delivery vary, but what these entities have in common is that they would not be allowed under traditional regulations.

Proposal: Support the Utah Sandbox & the Development of Sandboxes in Other States

Regulatory sandboxes are quickly becoming best practice for modernizing regulations across industries. Sandboxes allow regulators to experiment with new rules and practices, monitor risks to consumers, and develop data-informed regulations. In the area of legal services delivery, regulatory sandboxes can revitalize a declining market for consumers and providers alike.

Supporting—fiscally and otherwise—the Utah Sandbox is critical for the long-term success of regulatory innovation across states, as the data collected in Utah will inform regulatory innovation in Utah and beyond. But now is also the time to set the foundation for legal regulatory sandboxes in states across the country. The Utah Sandbox provides the model states can look at when erecting their own innovative, effective, and sustainable sandboxes.

Endnotes

1. Between 2007 and 2012, money spent on legal services by clients in the PeopleLaw sector declined by almost $7 billion while money spent on legal services by business clients increased by $21 billion. Bill Henderson, The Decline of the PeopleLaw Sector (037), Legal Evolution (Nov. 19, 2017), https://www.legalevolution.org/2017/11/decline-peoplelaw-sector-037/.
2. These prohibitions are enshrined in the American Bar Association's Model Rule of Professional Conduct 5.4 and state adaptations.
3. See Gillian K. Hadfield & Deborah L. Rhode, How to Regulate Legal Services to Promote Access, Innovation, and the Quality of Lawyering, 67 HASTINGS L.J. 1191, 1192-1203 (2016); Ralph Baxter, Dereliction of Duty: State-Bar Inaction in Response to America's Access-to-Justice Crisis, 132 YALE L.J. F. note 74 (Oct. 19, 2022), https://www.yalelawjournal.org/forum/dereliction-of-duty.
4. The Impact and Effectiveness of Innovate, FINANCIAL CONDUCT AUTHORITY 3-4 (Apr. 2019), https://www.fca.org.uk/publication/research/the-impact-and-effectiveness-of-innovate.pdf.
5. Matthew Nicaud, Regulatory "Sandbox" Reforms Advance Across the Nation, Mississippi Center for Public Policy (June 23, 2021). https://mspolicy.org/regulatory-sandbox-reforms-advance-across-the-nation.

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For the remainder of the endnotes, please visit Libertas.org/legal-services

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