Stanford LawSchool | Deborah L. Rhode Center on the Legal Profession

RETHINKING REGULATION OF LEGAL SERVICES: New Possibilities for Entity Regulation

AT A GLANCE:

- Jurisdictions pursuing **entity regulation** authorize and oversee legal service providers that are owned by non-lawyers and/or practice law, including provision of legal advice, using non-lawyers or technology.
- Currently, **Arizona and Utah** have implemented **major reforms to Rule of Professional Conduct 5.4**, allowing non-lawyers to have ownership interests in regulated legal service entities. These are generally known as Alternative Business Structures ("ABS").
- **Utah's reform also allows entities to deploy non-lawyers and technology** to provide legal services, relaxing the prohibition on unauthorized practice of law ("UPL").
- Over **100 entities** are authorized to provide legal services in the two jurisdictions. Most are **primarily serving consumers and small businesses**.
- There is **little evidence of harm to consumers** in either jurisdiction.
- **Opposition** to this reform approach is significant among lawyers.

Executive Summary

Traditional regulation of the practice of law limits not only *who* may provide legal services, but also how legal entities may be *owned and financed*. Section 6125 of the California Business & Professions Code states, for instance, that no person may practice law in California unless that person is an active licensee of the California State Bar (generally known as the ban on the unauthorized practice of law ("UPL").[1] Then, California Rule of Professional Conduct 5.4 prohibits lawyers from sharing fees with non-lawyers, forming a partnership or other organization with a non-lawyer if any of the activities of the business constitute the practice of law, or practicing law with an entity owned in any part by non-lawyers.[2] The theory behind each of these proscriptions is that they are necessary to protect the public by preventing unqualified people from providing legal services and by protecting lawyers' independent professional judgement from those outside the profession.[3]

Reforming the ban on UPL and Rule 5.4 to allow corporate organizations, including those owned by non-lawyers or using technology or non-lawyers, to practice law is highly controversial within the organized bar.[4] Champions of reform argue that ownership and fee-splitting restrictions insulate lawyers from competition, cut lawyers off from modern forms of capital financing,

1 Cal. Bus. & Pro. Code § 6125.

2 Cal. R. Pro. Conduct R. 5.4 (2021). California promulgates its own ethical rules which, generally, track those found in the American Bar Association's Model Rules of Professional Conduct.

3 Model Rule of Professional Conduct 5.4 is titled "Professional Independence of a Lawyer." Model Rules of Pro. Conduct r. 5.4 (Am. Bar Ass'n 2020); *see also* Nick Robinson, *When Lawyers Don't Get All the Profits: Nonlawyer Ownership, Access, and Professionalism*, 29 Geo. J. Legal Ethics 1, 47 (2016). *But see* Nora Freeman Engstrom & James Stone, *Auto Clubs and the Lost Origins of the Access to Justice Crisis* (on file with authors) (finding "compelling new proof that today's UPL [and Rule 5.4] bans—which continue to stymie the delivery of affordable legal services—have fundamentally rotten roots").

4 *See* Sam Skolnik, *Firm Ownership Debate Rages Amid ABA Innovation Leader Change-Up*, Bloomberg L. (Aug. 25, 2023), https://news.bloomberglaw.com/business-and-practice/firm-ownership-debate-rages-amid-aba-innovation-leader-change-up.

and prevent lawyers from partnering with experts across fields to build new kinds of services, thus impeding needed innovation in legal services, particularly for services targeting individuals and small businesses.[5] The justice gap is so large, they assert, that traditional legal service provision, particularly the one-to-one representation model, will never be sufficient to serve all consumers.[6] Consumer-facing businesses like LegalZoom and Rocket Lawyer are already trying to do this but are prevented from employing lawyers to provide comprehensive legal services and from leveraging increasingly sophisticated technology, including generative artificial intelligence, to best serve consumer need.[7]

Opponents to reform counter that permitting any non-lawyer ownership will allow a profit motive to enter the legal profession, undermining the independent legal judgement of lawyers and the quality of legal services.[8] They further argue that allowing non-lawyers into legal businesses will not impact the gap in access to justice.[9] The debates around this issue have not, until recently, been informed by empirical evidence and even present available data remains thin.[10]

In the midst of these debates, two states, Arizona and Utah, have moved forward to allow non-lawyer financing and ownership of legal service entities while regulating those entities to ensure the independence and quality of the legal work provided.[11] Called "entity regulation," this reform approach seeks to spur innovation and the scaled provision of legal services through the authorization of entities deploying new (to legal services, at least) corporate forms and financing and interdisciplinary leadership and expertise.[12] In Arizona and Utah, entity-level reforms have been deployed alongside other reforms, including paraprofessional licensing and authorizing community justice worker models. Efforts have been shut down or delayed in other states, including California.[13]

5 *See* David Freeman Engstrom, et al., Legal Innovation After Reform: Evidence from Regulatory Change 13-14 (2022); *see also* 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, 1193-94 (2016); Gillian K. Hadfield, *The Cost of Law: Promoting Access to Justice through the (Un)Corporate Practice of Law*, 38 Int'l Rev. L. & Econ. 43, 48 (2014).

6 Hadfield, *supra* note 5, at 45-46 ("Meeting demand will require a massive shift in the production technology for legal services to dramatically reduce costs."). They note the lack of engagement by American consumers and the declining productivity of the "PeopleLaw" market. *See* William D. Henderson, Legal Market Landscape Report (2018).

7 Benjamin H. Barton, *The Lawyers' Monopoly: What Goes and What Stays*, 82 Fordham L. Rev. 3067, 3072-73 (2014).

8 *See* Stephen P. Younger, *The Pitfalls and False Promises of Nonlawyer Ownership of Law Firms*, 132 Yale L.J.F. 259, 267-74 (2022).

9 *Id.* at 275-83.

10 Hadfield, *supra* note 5, at 44; Engstrom, et al., *supra* note 5, at 47 (noting that it is still very early into reforms to the regulation of the practice of law to draw major conclusions from available data).

11 *See* Arthur J. Lachman & Jan. L. Jacobowitz, *Arizona and Utah Jumpstart Legal Regulatory Reform*, A.B.A. L. Prac. Today (Nov. 13, 2020), https://www.lawpracticetoday.org/article/arizona-utah-jumpstart-legal-regulatory-reform/. The District of Columbia has allowed a very limited model of non-lawyer ownership, permitting an individual non-lawyer owner in a firm with the sole purpose of providing legal services and if the non-lawyer agrees to abide by the Rules of Professional Conduct. D.C. Rules of Pro. Conduct, R. 5.4.

12 *See* Hadfield & Rhode, *supra* note 5, at 1215.

13 Stephanie Francis Ward, *California Bill Signed into Law Restricts State Bar Sandbox Proposals*, A.B.A. J. (Sept. 21, 2022), https://www.abajournal.com/news/article/california-bill-signed-into-law-restricts-state-bar-sandbox-proposals; Conrad J. Jacoby, *Practice Innovations: Nonlawyer Ownership of Law Firms–Are Winds of Change Coming for Rule 5.4?*, Thomson Reuters (Mar. 29, 2022), https://www.thomsonreuters.com/en-us/posts/legal/practice-innovations-april-2022-non-lawyer-ownership/. The United States remains one of the most restrictive regulatory environments for legal services. Entity regulation allowing full non-lawyer ownership was authorized in Australia (2001) and England and Wales (2007) and many other jurisdictions allow for some form of business engagement between lawyers and non-lawyers. Steven Mark & Georgina Cowdroy, *Incorporated Legal Practices - A New Era in the Provision of Legal Services in the State of New South Wales*, 22 Penn St. Int'l L. Rev. 671, 673 (2004); Legal Services Act 2007, c. 29 (UK). Other jurisdictions permit non-lawyer participation in legal practice entities in some form,

Case Studies

Arizona and Utah have taken different approaches to entity regulation. As illustrated in Figure 1 below, they differ in terms of the rules that have been relaxed and also the mechanism used to relax those rules.[14] Arizona made a permanent rule change, targeting the ban on non-lawyer ownership only. By contrast, Utah created a "regulatory sandbox," an experimental space within which entities can seek authorization to deliver services in ways that normally be prohibited, and it allows entities to seek waiver of rules prohibiting UPL, non-lawyer ownership, or both.

ARIZONA

In 2020, the Arizona Supreme Court repealed Rule 5.4 and established a licensing regime for Alternative Business Structures ("ABS"), entities owned in whole or in part by non-lawyers in which lawyers are practicing law.[15] The task force recommending this course of action relied specifically on the high cost of legal services to the public and the economic challenges facing lawyers who tried to serve regular people.[16] The task force agreed with scholars who have identified Rule 5.4, among other rules, as significant barriers to innovation, noting that during the "great recession" many lawyers expressed the desire to partner with other professionals to serve more consumers with more efficiency."[17] Further, the task force concluded that "no compelling reason exists for maintaining [Rule] 5.4 because its twin goals of protecting a lawyer's independent professional judgment and protecting the public are reflected in other ethical rules which can be strengthened."[18] The task force recommended the court establish a system of entity regulation to solidify the protection of lawyer independence within non-lawyer owned entities.[19]

Figure 1

including New Zealand and Singapore, which permit non-lawyer ownership of law firms; and several European countries where non-lawyer minority ownership is allowed up to a certain point, including Scotland (up to 49% non-lawyer ownership), Italy (33%), Spain (25%), and Denmark (10%). *See generally* Memorandum from the Am. Bar Ass'n Comm. on the Future of Legal Servs. to the Am. Bar Ass'ns et al. (Apr. 8, 2016).

14 The figures used in this brief are taken from the report produced in September 2022 by the Deborah L. Rhode Center on the Legal Profession. Engstrom, et al., *supra* note 5.

15 Order Amending the Ariz. Rules of the Sup. Ct. and the Ariz. Rules of Evid. (Aug. 27, 2020); Task Force on the Delivery of Legal Servs., Report and Recommendations (2019).

16 Task Force on the Delivery of Legal Servs., *supra* note 15, at 8 (finding that the average small firm lawyer earns $422 per day before paying overhead costs).

17 *Id.* at 10, 16.

18 *Id.* at 13.

19 *Id.* at 16.

Arizona's ABS licensing regime focuses on licensing and regulating legal service entities owned in whole or in part by non-lawyers and in which only lawyers are providing legal services to the public. Applications are reviewed by a committee of the supreme court and the court itself votes on each application.[20] Regulatory requirements include identification and background checks of all entities or persons holding a controlling financial interest in the company or a role which may control the company, requiring entities to have an Arizona lawyer in a compliance officer role, compliance with a code of conduct, and subjection to disciplinary action through the state bar, possibly resulting in loss of license and/or fines.[21] ABS are required to, among other things, maintain client confidentiality, protect against conflict of interests, ensure that lawyers' professional judgement remains inviolate, and develop managerial systems to ensure compliance with all requirements.[22]

UTAH

In 2020, the Utah Supreme Court approved the launch of a legal regulatory sandbox in which entities either with non-lawyer ownership and/or nonlaywer providers, including technology-based providers, are authorized to provide legal services.[23] A regulatory sandbox is a policy space in which new kinds of businesses or services can seek regulatory waivers to enable their proposed model and data is gathered by the regulatory authority on the outcomes to inform future policy making.[24] As noted by the work group's recommendations to the court, the goal of Utah's reforms was to "provide[] for broad-based investment and participation in business entities that provide legal services to the public."[25] The reforms sought to achieve this by substantially loosening the restrictions on both who can provide legal services and how they may be financed and by establishing a new regulatory body using a "risk-based, empirically-grounded" regulatory approach.[26] The court has noted specifically that these reforms are meant to address a broad definition of the access to justice gap, "unmet legal needs of all kinds and across all sociodemographic groups."[27]

Similarly to Arizona, entities are required to identify financial and managerial controlling persons and those entities/individuals are required to undergo background checks and entities conform with a similarly structured code of conduct, including protection of confidential information and against conflicts of interest and preservation of independent legal judgement.[28] The primary focus of the Utah model's regulatory approach, however, is the regular

20 Ariz. Sup. Ct. R. 33.1(a).

21 Ariz. Code of Jud. Admin. § 7-209 (2022).

22 *Id.* § 7-209(K).

23 Utah Sup. Ct. Standing Order No. 15 (Aug. 14, 2020); Utah Working Grp. on Regul. Reform, Narrowing The Access-to-Justice Gap by Reimagining Regulation (2019).

24 Regulatory sandboxes developed in response to the rapid development of technology, particularly in the fintech space. *See generally* World Bank Grp., Global Experiences from Regulatory Sandboxes (2020).

25 Utah Working Grp. on Regul. Reform, *supra* note 23, at 2.

26 *Id.*

27 Letter from the Utah Sup. Ct. to the Kirsten K. Woods, President, Utah State Bar (Mar. 28, 2023), https://utahinnovationoffice.org/wp-content/uploads/2023/07/Letter-to-Utah-State-Bar-3.28.23.pdf.

28 *Id.* at 15-16.

data reported by regulated entities to the Office of Legal Services Innovation, the body tasked with overseeing authorized entities.[29] Entities are required to report detailed data on the legal services provided, including what kind of provider was used, how long the service took, what was paid, and whether the consumer complained.[30] Even without any other regulatory violation, sufficient evidence that the services provided are harming consumers can result in suspension or termination of authorization.

Emerging Data

While it is still early to discern the impact of non-lawyer ownership reforms recently implemented in two relatively small states, the available data indicates certain trends in these emerging markets.[31] As of December 2023, there are 69 Arizona ABS entities and 50 entities authorized in Utah.[32] Entities fall into five general categories as outlined in Figure 2 below.

Many entities retain a structure close to that of a traditional law firm. Although it can be difficult to discern from the available materials, some of the reasons for firms to take on non-lawyer investment include increasing marketing and litigation capacity, retention of non-lawyer staff/partners, and investing in technology.[33] A growing number of entities in both Arizona and Utah are better characterized as law companies or new entrants into the legal market. These entities are hiring lawyers to provide direct legal services

Figure 2

1	2	3	4
TRADITIONAL LAW FIRMS making changes Give non-lawyers **equity ownership** or take non-lawyer **investment** to expand	**LAW COMPANIES practicing law** Provide legal services with **non-lawyer ownership** (*e.g.,* LegalZoom, Hello Divorce)	**NON-LAW COMPANIES expanding into law** **New entrants:** holistic "one-stop-shops" (*e.g.*, law+accounting) **and offshoot services** (*e.g.*, travel services ➔ visas)	**INTERMEDIARY PLATFORMS** **Marketplaces** (connect consumers with lawyers)

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ENTITIES USING NON-LAWYERS AND TECH TO PRACTICE LAW **New ways to provide legal services**; may also have non-lawyer investors or owners

29 Office of Legal Servs. Innovation, Innovation Office Manual, 23-29.

30 *Id.* at 23.

31 *See* Engstrom, et al., *supra* note 5, at 36-48; *see also Legal Innovation Clearinghouse*, Deborah L. Rhode Center on the Legal Pro., https://clp.law.stanford.edu/legal-innovation-clearinghouse/ (last visited Jan. 3, 2024) (gathering and coding the available public information on entities authorized in Arizona and Utah). Please note: The publicly available materials differ across jurisdictions; Arizona releases ABS applications redacted to remove personal information only in response to public records requests. Utah publishes the recommendation and court order authorizing the Sandbox entities on its website. However, across both jurisdictions, the publicly available information may not match up exactly with the actual authorized entities.

32 *See Legal Innovation Clearinghouse*, *supra* note 31.

33 *See e.g.*, Case Partners LLC, Arizona ABS Application (authorized Aug. 24, 2022), https://drive.google.com/file/d/1kzsfxy700pIqFYg3Dfzir4xsU719QJkg/view (leveraging increased marketing expertise and capacity); Arizona Redwood Partners, Arizona ABS Application (authorized Sept. 20, 2022), ://drive.google.com/file/d/19EaSHRmI5rtbnUrIQau_tPOfKwO97u4i/view (describing increased capacity for litigation and retention of staff); Hive Legal, Arizona ABS Application (authorized Nov. 30, 2021), https://drive.google.com/file/d/1SpT_i4u5PzJLe1GQxeeKxEOT2kNrMx-K/view (describing strategy to serve consumers' estate planning needs through technology platform).

(e.g. LegalZoom, RocketLawyer, and Hello Divorce), building legal verticals into pre-existing businesses (e.g. Law on Call, Trajector Legal), or offering one-stop-shop professional services (e.g. Affinex Legal, Heritage Family).[34]

Almost all entities across both jurisdictions are primarily serving individual consumers and small businesses; only a very few are focused on corporate clients (e.g. Elevate, Axiom).[35] Entities across both jurisdictions have identified technology as a part of their strategy for serving their target market.[36] A significant number of Arizona's ABS entities are in the personal injury and mass tort area of law.[37] The following legal areas are also well-represented across both jurisdictions: end of life planning, small business legal needs, and immigration.[38]

In what appears to be a key difference between Arizona and Utah, the only nonprofit entities are authorized in Utah. This is primarily because Utah's entity regulation is structured to authorize not only entities with non-lawyer ownership, but also those entities seeking to deploy nonlaywer providers to perform limited legal tasks.[39] The nonprofits in Utah, including Timpanogos Legal Center and Innovation 4 Justice, are building community justice worker models within the regulatory sandbox. For profit entities are also taking advantage of this Utah-specific reform and incorporating differentiated tiers of legal services, tech-based DIY, limited nonlaywer assistance, lawyer assistance, within a single entity.[40]

Available data do not show that consumers have been harmed by the reforms deployed in Arizona and Utah. Arizona does not publicly release disciplinary information but it does not appear that any ABS has lost its license to offer services. Utah, which proactively seeks consumer complaint information both from regulated entities and the public and reports the aggregated information out monthly, has observed 1 complaint related to consumer harm per 7441 legal services provided.[41] Although we lack specifically comparable data on harms caused by lawyers, back-of-the-envelope calculations suggest that this is a significantly lower incidence rate.[42]

34 *Legal Innovation Clearinghouse*, *supra* note 31.

35 *Id.*

36 As of December 2023, according to available data, approximately 56 entities specifically identified the development and deployment of technology as part of their business strategy. *Id.*

37 As of December 2023, according to available data, approximately 25 of Arizona ABS entities are involved in personal injury and/or mass tort litigation. *Id.*

38 *Id*; *see also* Office of Legal Servs. Innovation, Sandbox Activity Report (2023).

39 *See* Engstrom, et al., *supra* note 5, at 40.

40 *Id.* at 38; *see also* Office of Legal Servs. Innovation, Utah Sup. Ct., Sandbox Authorization Packet: Lawgeex (2021).

41 The Office of Legal Services Innovation reviews complaints received and categorizes them as related to consumer harm caused by legal service provision or not. The regulatory oversight is focused on consumer harm. *See* Office of Legal Servs. Innovation, *supra* note 38, at 7.

42 *See* Engstrom, et al., *supra* note 5, at 46 (calculating a rate of 1 complaint for every 2,150 lawyer-provided services).

Success & Challenges

SUCCESSES

Increased Innovation in Consumer-Focused Services. Most entities in Arizona and Utah are serving individual consumers and small businesses and many are using technology to facilitate consumer access. In both Arizona and Utah, entities are using technology to augment lawyers or increase their reach both in terms of marketing and efficiency. In Utah, where waiver of both UPL reform and non-lawyer rules is available, entities are using both non-lawyers and technology to deliver legal services directly to consumers.

Central Role of Lawyers. In innovative entities across both Utah and Arizona, lawyers remain central to the development and delivery of services—whether as employee practitioners, through oversight and compliance roles, or through entity ownership and leadership. In Utah, innovation also takes the form of services delivered via non-lawyers and software. Even here, traditional law firms are driving innovation by seeking authorization to offer tiered services at different price points, such as DIY services via technology at the bottom price tier, with higher tiers of service that progressively mix in non-lawyer and lawyer guidance.

Little Evidence of Consumer Harm. Reform efforts to this point do not appear to pose a substantial risk of consumer harm. Data and information reported by Utah and Arizona regulators indicate that authorized entities do not appear to draw a substantially higher number of consumer complaints, as compared to their lawyer counterparts.

CHALLENGES

Unclear Impact on Access for Lowest Income Populations. While the existing body of evidence indicates that authorizing non-lawyer owned entities may contribute to an increase in the number and kind of legal products and services available for middle income consumers, it is much less clear whether and how such legal service entities will impact low-income consumers. This challenge may be particularly relevant in jurisdictions which do not incorporate UPL reform alongside Rule 5.4 reform, thereby potentially preventing the development of significantly lower cost services provided through technology and non-lawyers.

Scalability. The promise of entity authorization and regulation to meaningfully address the justice gap is that organizational providers can achieve economies of scale and serve more people at lower cost. However, scale is difficult to achieve given state-by-state regulation of legal services in the United States and almost impossible when only two relatively small states permit such entities.

Funding and Capacity to Regulate. Building new regulatory systems requires substantial financial investment and operational capacity. Utah, which sought to drive innovation by reducing barriers to entry (including fees) as much as possible, has faced funding and staffing difficulties. The Office of Legal Services Innovation is now housed, for operational purposes, with the Utah State Bar.[43] Arizona, which imposed relatively robust licensing fees from the start and has a regulatory history within its state supreme court, has faced fewer fiscal and capacity barriers but has also found the operational demands of entity regulation challenging.

43 *See* Letter from the Utah Sup. Ct. to the Kirsten K. Woods, *supra* note 27.

Opposition From the Organized Bar. While lawyers have not been supportive of any regulatory reform options, there is particularly strong opposition to allowing non-lawyer financial participation in legal businesses. Lawyer opposition has stymied efforts in California and Florida and presents a significant political challenge to state supreme courts considering reform.[44]

44 *See supra* note 13; *see also* Texas Access to Legal Servs. Working Group, Report and Recommendations 95-250 (2023) (incorporating the many comments related to the proposed reforms including entity regulation).