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I am delighted to talk on this twentieth Congress of RIAD about the study we conducted for RIAD. Next year RIAD will turn forty. At the first International Meeting of RIAD in Rome on 8 May 1969 a leading German lawyer said: “Legal expenses insurance is a relatively young branch of insurance [...] for lawyers especially it has the very attractive bloom of youth [...] of its nature it is rich in problems, and places a number of difficulties in the way of those contemplating it.”<sup>1</sup>

Probably this lawyer would not have anticipated that RIAD and the legal expenses insurance business would grow to its current mature status. Moreover, he probably would not have anticipated that lawyers themselves would be part of the problems he refers to.

What problem is that?

Most legal expenses insurers have in-house jurists who have a broad experience dealing with legal problems. Still legal expenses insurers often are forced to hire lawyers to conduct lawsuits. This is so either because insured parties want to hire a lawyer (and the policy allows that a lawyer is hired) or because the law prescribes that a lawyer be hired to do the job. Since legal expenses insurers see so many lawyers' bills, they know that lawyers are expensive.

Also, households and firms seeking legal assistance and who are not insured know that lawyers are expensive.

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<sup>1</sup> This quote comes from the RIAD publication ‘Legal expenses insurance: origins and development’ written by Carlo Isola.

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Jokes on lawyers' fees are widespread. Lawyers don't think they're funny, and nobody else thinks they're jokes.

Of course this is no laughing matter, so let's get serious now.

Governments want to safeguard legal security for all those seeking justice. In order to guarantee this public interest most European governments have given certain exclusive rights to lawyers, including the monopoly on conducting a court case. Also national Bar Associations formulate rules to govern activities of lawyers. Much of this regulation and self-regulation is aimed at preserving professional quality, but it may also restrict competition. Consequently, prices paid for legal services provided by lawyers may be too high and thereby decrease access to law – precisely the opposite of what the governments intended.

In many countries, governments worry about the effect of expensive lawyers on access to law. In Italy, England/Wales, Denmark, Germany, The Netherlands and other countries this led to special governmental committees looking into the regulation of lawyers – often resulting in deregulation.

On a European level, the better regulation agenda was introduced in order to check whether a regulation has a clearly defined public-interest objective and is the method least restrictive of competition to achieve the desired objective.

A few months ago, the OECD published a report that is even thicker than our report.<sup>2</sup> The OECD report studies the regulation of 25 national markets for legal services world wide and concludes that part of the regulation of the legal professions, including self-regulation, is based – and I quote – “on rent-seeking and achieves cartel-like effects”. According to the OECD, the major policy challenge is to identify and remove the restrictions which are unnecessary or disproportionate to achieve public interest goals.

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<sup>2</sup> OECD (2008), *Competitive Restrictions In Legal Professions*, Directorate For Financial And Enterprise Affairs, Competition Committee, 28 January, DAF/COMP(2007)39.

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Our study fits in perfectly within this policy context. Our study looks into the effect of the regulation of the legal professions – predominantly lawyers – on access to law. In our research we take an economic perspective. What is an economic perspective?

Very briefly, it means that we depart from a situation without any government intervention on the market for legal services and then look where the market does not function properly. In these situations, government intervention may be justified if the social benefits outweigh the social cost of regulation.

We focus on civil law, not punitive or public law. Moreover, we focus on the effect of a national monopoly when it comes to conducting a case. As this monopoly is given to lawyers, the analysis predominantly looks into the regulation of lawyers. The research analyses the effects this monopoly and accompanying self-regulation have on consumers (households as well as small and medium-sized firms).

In total we have twelve countries in our sample. Austria, Belgium, Czech Republic, England/Wales, Finland, France, Germany, Hungary, Italy, the Netherlands, Spain, and Switzerland. These are all members of RIAD, except for Finland. Still Finland is included as this country may serve as a benchmark when comparing the level of regulation of the legal profession. After all, the degree of regulation in Finland is the most modest across the EU.

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How did we go about? We first identified the problems that arise if the government would not intervene in the market for legal services. One of the most important problems is the fact that consumers need a legal expert because legal proceedings are too complicated for them. But how does the consumer know that a legal expert is offering good quality services? These information problems between consumers and providers of legal services can be addressed by a certification system or private regulation – a monopoly for lawyers is not necessary from a public interest point of view.

Private regulation means regulation by *private parties* without governmental interference. For instance, in Finland lawyers do not have a monopoly on the conduct of a case and lawyers do not have to be a member of the Bar. Access to law is guaranteed, instead, by private regulation of legal expenses insurers who place all insured persons under the obligation to engage legal advisers who possess certain qualifications (mainly, advisers must have a law degree; it is not necessary to be a Bar-member-lawyer). Other than that, Finland has no compulsory legal representation in court.

Note that a certification or licensing system is not the same as a monopoly position for lawyers. It merely means that anyone who fulfils particular requirements is allowed to provide services.

One important political reason for imposing compulsory legal representation in court is to protect the vulnerable, inexperienced party to a case. By requiring everyone to hire a lawyer, the paternalistic government hopes to achieve ‘equality of arms’ for all parties to legal proceedings.<sup>3</sup>

We conclude that the need to regulate is less pregnant – not absent, but less pregnant – than usually assumed by government agencies and Bars.

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<sup>3</sup> A second political rationale is income redistribution. To prevent low income groups from having less access to legal services, the government has introduced a system of subsidized legal aid.

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Subsequently we looked at how the market for lawyers is regulated in practice in the twelve countries in our sample.

We compared the level of three important regulatory instruments: entry restrictions, fee restrictions and restrictions on advertising. We have constructed regulatory indices using the insights from assessment frameworks developed in earlier comparative studies of national markets of legal services. Our comparison shows that the level of regulation differs remarkably among the 12 countries in our sample.

For Finland and England&Wales we give two different indices. Finland 1 refers to the legal adviser in general (lawyer but not a member of the Bar) and Finland 2 refers to the regulation of the Asianajaja (member of Bar). England&Wales 1 applies to the regulation of the solicitor and England&Wales 2 refers to the regulation of the barrister.

These indices show that lawyers who are not a Bar member in Finland and solicitors in England/Wales are the least regulated markets. In England/Wales the regulation level of barristers scores relatively high in our index.

Germany, France and Italy have the most regulation.

Actually, these large regulatory differences are surprising. While the goal of regulation (namely, guaranteeing access to law) is exactly the same in all of these countries how can it be that they guarantee access to law in such remarkably different ways? From the fact that, for instance, the Finnish or English governments regulate the market of legal advisors far less stringently than, for example, the German or French, we cannot assume that the former governments are any less concerned with access to law for their citizens than the latter.

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I will now give you the main conclusions of our study.

A first conclusion is that access to law is – according to the Bars and legal expenses insurers we surveyed – sufficiently guaranteed in each of the 12 countries in our sample. Access to law is not safeguarded to any greater or lesser degree in those countries subject to more stringent regulations than those where it is less so.

Access to law depends also on the availability of a legal aid system. All 12 countries, except for Italy, have a legal aid system. The way in which this system functions in each of the countries differs significantly, for example, in terms of the case numbers and expenditure. Our findings show no relation between the function and scope of the legal aid system and the level of regulation.

We also measured access to law in terms of the ease of enforcing a typical business contract for a SME-firm. However, we did not find a link between them. Here too there is no identifiable relation between access to law on the one hand and the level of regulation on the other.

There is one exception to this finding. The number of lawyers differs substantially among the 12 surveyed countries and there is a positive relation between the regulatory index and the number of lawyers per inhabitant. In less regulated countries the number of lawyers per inhabitant is lower than in highly regulated countries. Partly this has to do with differences in the level of external competition. External competition is competition from outside the profession, such as professionals from abroad or new providers, e.g. qualified jurists from trade unions or legal expenses insurers.

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This figure shows that less regulated countries have lower numbers of lawyers per capita.

External competition exists in less regulated countries like England/Wales, Finland, Hungary, and the Netherlands, whereas no external competition exists in highly regulated countries with relatively high numbers of lawyers like Germany, Italy and Spain.

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Our second conclusion is that the compulsory legal representation combined with a monopoly position for lawyers comes at a cost.

Governments and Bars are merely interested in benefits of regulation of legal professions. Benefits of monopolisation are assumed to include the decrease in search costs for consumers, improvements in service quality and more adequate supply of information concerning quality of professional services.

Governments and Bars seem to forget about the costs. Our study shows that in terms of increased or better access to law it is not at all clear that more stringent forms of regulation of legal professionals lead to higher benefits to society than costs. No proof can be found in the literature that in strictly regulated countries, lawyers perform better than non-lawyers legal experts.<sup>4</sup> What is clear is that most current regulation has replaced market failure with a serious government failure: monopolisation in an attempt to solve an information problem. This comes at a cost. The causes are fourfold.

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<sup>4</sup> On the contrary: see Moorehead et al. (2003) who compared the quality and costs of legal services in the UK delivered by lawyers (solicitors) and non-lawyers working in the state-funded legal assistance programme (legal aid scheme).

1. [Compulsory representation in court by lawyers only.] The first is that an obligation to use services from just one kind of supplier – only lawyers – tends to lead to high prices and a lack of innovation.
2. Secondly, the barriers to access erected by the Bars are high, and so reinforce the monopoly held by established lawyers (consider, for example, the restrictions on the authorisation of salaried lawyers). Empirical studies in the academic literature show that this kind of self-regulation does indeed give rise to supra-competitive rents.<sup>5</sup>
3. [The client is effectively locked into their relationship with the lawyer because of high sunk cost and the tournament nature of competition among lawyers.] Thirdly, the client is locked-in. Once a lawyer sets to work on the client's behalf, the costs to the client for changing lawyers increases with every chargeable hour. After all, payments made up to that point are unrecoverable and if another lawyer is hired to take on the case, those same costs will be incurred all over again. Also, the client is willing to pay a lot extra for a lawyer who is just a little better than another because that small difference could be decisive in the case. This means that the price clients pay is the monetary equivalent of what is at stake and is related not so much to the cost price of the service itself. This is a sign of market power.
4. The fourth cause of high lawyers' fee is the indirect effects of the procedural monopoly. The status which statutory protection affords the lawyer extends beyond the scope of the actual monopoly itself. In a market with insufficient competition, this 'reputation' effect can be converted into an additional premium for lawyers.

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<sup>5</sup> Winston, C. & Crandall, R.W. (2007). Aided and Abetted: Lawyers' Rents and Government Policy. Paper presented on October 11th at the conference 'Cost-benefit analysis of regulations: lessons learned, future challenges', Northwestern University, School of Law, the Searle Center.

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Like the benefits, costs of regulation are also not quantified. In the report we provide an estimate of the cost of the regulation of lawyers. It can be estimated by comparative analysis of the costs incurred by legal expenses insurers outsourcing a case to an external lawyer as opposed to insourcing the same case to an internal lawyer or non-lawyer legal expert. Based upon their experiences with lawyers, legal expenses insurers have often made a selection of preferred suppliers (we call them network lawyers), a status which provides the policyholder with a certain indication of quality. We have sampled the population of these insurers to produce an indication of the price differences for four different kinds of cases.

On the average case basis, a network lawyer costs two to three times more than an insurer's jurist (paralegal) or salaried lawyer, while an external lawyer costs four to six times as much.

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I want to end this talk with the recommendations from our study.

Governments and Bars should be able to show what the social costs and benefits of the different levels of regulation are and why they picked the level they did. Regulators merely assert that the benefits of the restrictions are large enough to justify current policy, without any reference of the cost of this policy. The benefits of regulation (which are only possible and not quantified) dominate the discussion; the possible gains of re-regulating the market for legal services are only mentioned in passing, if at all, and they are not discussed. Is it really necessary to have a monopoly for lawyers? Isn't a certification system enough? What is the optimal scope for compulsory legal representation?: should it include all cases or merely cases over and above a certain financial threshold? Why isn't it possible to become a lawyer in the employment of a non-lawyer? Why is advertising restricted for lawyers? Is fee regulation really necessary?

Because we are in Germany let me briefly look into that question. I do not think that tariff regulation is necessary. Yes, tariff regulation may be effective in bringing tariffs down, but tariff regulation is not efficient. First of all, tariff regulation imposes a rigid boundary upon the market, with negative effects on innovation. For instance, other non-lawyer-legal-experts are not able to enter the monopoly whereas external competition is probably the most efficient way to get prices down and to get innovative, new services that better fit the needs of those seeking justice.

Another drawback of tariff regulation is that it drives good quality out of the market. Complicated, time consuming cases will be handled outside the tariff system, where the lawyer negotiates hourly fees with the consumer.

Also high regulatory cost is made to implement this regulation ('set the tariffs right') and check compliance.

The regulation in Germany may lead to lower tariffs, but at the same time the government expenditures on the judiciary system are the highest across Europe (figures by the CEPEJ, an official EC organisation). So the tax payer pays 97 euro per capita to have the legal system work, whereas this amount is less than 20 euro in England/Wales. So looking at only tariffs does not tell the entire story.

Since cost-benefit analyses of various – less and more restrictive – regulatory schemes are lacking in all countries we recommend that national regulators should analyze the specific public interest in their national markets of legal services. What are the specific problems when guaranteeing access to law?

Subsequently, we recommend that governments list various regulatory options next to the current regulatory scheme.

We then recommend a cost benefit analysis be performed of the current level of regulation compared to other levels of regulation that also guarantee a sufficient level of access to law.

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Our research shows that compulsory representation in court is probably necessary since procedural law is very complicated (too complicated). At the same time we show that opening up the monopoly to others than just lawyers, namely jurists from legal expenses insurers, trade unions and other legal counsels, is beneficial to the consumer in at least two ways:

1. The individual seeking access to justice has more choice; he can pick from different kinds of professionals to have the case solved. Therefore, the individual is better able to find the level of advice needed for a particular problem. This leads to more quality differentiation; that is, different quality levels for different legal problems. Consequently, the average price will lower as these individuals pay only for what they need and no more. Moreover, external competition (from new providers) is an effective manner of excluding rent-seeking and regulatory capture (that is, regulatory agencies become less sensitive to pressure from one interest group of several groups when other providers enter the market).

Of course, these new counsels would have to satisfy the same minimum requirements that lawyers do, where these requirements will have to be set by an independent body – generally not the Bar.

An option in line with easing the monopoly would be to allow for employed lawyers. Of course it is important to give lawyers employed by non-law firms the same rights and duties as self-employed lawyers.

2. Due to these price decreases insured parties pay lower premiums for their legal expenses policy – that is: on condition that the market for legal expenses insurance is sufficiently competitive to pass these cost reductions at least partly on to consumers.

Freedom of choice for consumers by introducing external competition to lawyers is likely to be the method to reduce the cost of access to law.

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Thank you for your attention.