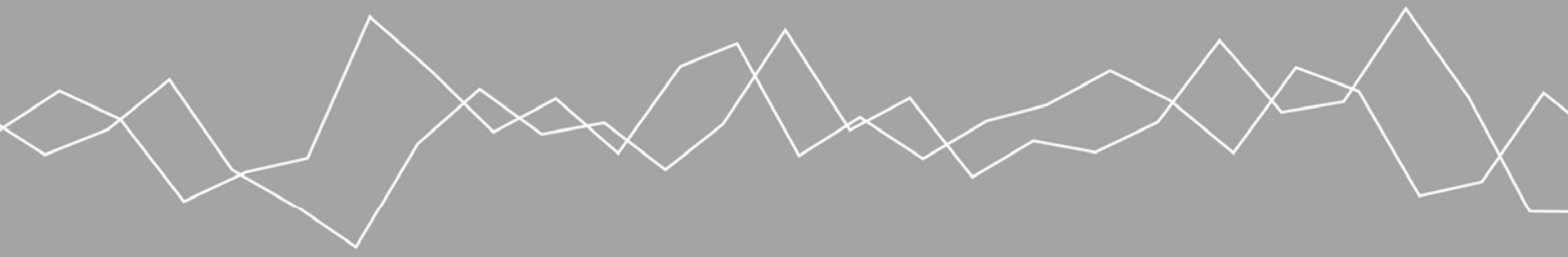
Regulation of the legal profession and access to law



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Regulation of the legal profession and access to law

An economic perspective

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Executive summary

This report gives an economic perspective on the regulation of the legal profession and access to law. A legal framework, which safeguards fair, easy and efficient access to law for all citizens and businesses, is, of course, of utmost importance for every country. The effect of regulation on access to law is, therefore, a very relevant topic. We hope this report stimulates an informed dialogue between jurists, economists and other social scientists involved in the debate on the regulation of legal services. Instead of resulting in criticism of the methodology at hand, we hope our findings provoke an open discussion of the costs and benefits of the current levels of national regulations. Our first finding is that high regulation is not necessary to achieve sufficient access to law. Secondly, governments should be able to justify high levels of regulation by indicating that social benefits in terms of better access to law are higher than the social costs of this regulation. In practice the net benefit of high regulation is not clear; meanwhile our findings indicate that regulation comes at a cost. These results are strong and robust enough to start such a policy discussion.

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 privileges to lawyers, among which is the monopoly on the conduct of a case. Much of this regulation or self-regulation is aimed at preserving professional quality, but it may also restrict competition. Consequently, the prices paid for the legal services provided by lawyers may be too high and this decreases access to law – precisely the opposite of what governments intended.

The International Association of Legal Expenses Insurance (RIAD) commissioned SEO Economic Research to conduct a study into the effect of the regulation of legal services and legal professions on access to law in several European countries. The central research question is:

> **'What is the effect of the regulation of the legal profession – predominantly lawyers – on access to law?'**

We answer this question for civil law, not punitive or public law. Moreover, we focus on the effect of 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). We also look at the effects on competitors (legal expenses insurers, trade unions and other legal counsels).

In this report we take an economic perspective when analysing the regulation of the legal profession. This involves answering the following three questions:

1. The 'what' question: Is there a problem? Why is it a problem? What is the public interest?
2. The 'how' question: How can one take action as effectively and efficiently as possible? What instruments are suitable for solving the policy problem in question?
3. The 'if' question: Is the welfare of society enhanced if action is taken with a certain instrument or instruments? Is the cost of intervention higher or lower than the benefit?

The economic perspective departs from a situation in which there is no government intervention and subsequently looks for justifications for government regulation. Viewed from an economic perspective, problems arise the moment that markets aren't functioning properly – a phenomenon known as 'market failure'. Thus, from an economic perspective the burden of proof rests on the government (or the Bar) to prove that more regulation creates more net benefit for consumers. From the public interest perspective, government regulation aims at obtaining social benefits by correcting market failures or by attaining particular political goals. At the same time, government regulation can entail social costs as a result of information problems, high transaction costs, regulatory insecurity and economic inefficiency. Economists describe this as 'government failure'. The benefit of correcting market failure and attaining political goals should be weighed against the cost in terms of government failure. The economic perspective does not depart from a bias towards a presumption that there is too much regulation.[1]

The ideal way to answer the central research question is to test whether access to law is more expensive or cheaper in highly regulated countries compared to less regulated countries. Because of the lack of data on the costs of the judiciary system and also because judiciary systems differ fundamentally between countries this question cannot be answered in this report. However, based on the data available that was also comparable between the countries in our sample, we conclude that the German situation stands out as quite expensive. This may be due to the fact that most cases are dealt with in court by lawyers; few out-of-court settlements and no external competition from non-lawyer legal experts.

In spite of the data limitations, an analysis of the level of regulation of the legal profession is very relevant when thinking about improving access to law. Our analysis focuses on regulatory differences of the legal profession and therefore leaves out the regulations and institutions that determine the performance of the judiciary system as a whole.

Below we answer the three questions: what, how and if.

'What' question (Chapter 1)

In policy practice, the 'what' question is often neglected and regulators move immediately on to the 'how' question. The disadvantage of skipping the first question is that it is left unclear if and to what extent the problem in question requires *government* intervention. In some cases regulation by *private parties* will suffice. For instance, in Finland lawyers do not have a monopoly on the conduct of a case. 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).

The answer to 'what is the public interest at stake' is safeguarding legal security. Legal security encompasses access to law, the fair and orderly conduct of legal proceedings and an efficient judicial process. It requires the availability of good quality legal services at reasonable prices. In

[1] We also looked for public interest arguments in favour of more regulation of legal services, but found no clues pointing to too little regulation – not in the documents studied, nor in the Bars surveys or in our analysis of alternatives to fee regulation. For instance, in our view fee regulation is not an efficient option because it evokes too many government failures. This approach imposes a rigid boundary upon the market, with a negative effect upon innovation, flexibility, and other incentives to improve efficiency. Moreover, it entails high regulation costs and there is a danger of cases being crowded out: The more complex and time-consuming cases are not taken up.

order to safeguard legal security, there is a need for some degree of regulation of the legal profession. The need to regulate, however, is less urgent than usually assumed by government agencies and Bars. Our analysis of market failures merely justifies the following regulation of the market of legal services:

- Information problems between consumers and providers of legal services can be addressed by a certification system in the case of one-off consumers or private regulation in the case of repeat consumers. Also, the provision of poor quality service that also affects the general public (e.g. legal misinterpretation) can be prevented with a quality certification system. Note that a certification or licensing system is not the same as a monopoly position for *lawyers*. It merely means that *anyone* who meets particular requirements is allowed to provide the monopolized service.
- Private provision of information concerning the quality of legal services provided by certain professionals may be inaccurate and inefficient. The public-good aspect of information on quality justifies mandatory disclosure with respect to professional quality.
- Network effects occur if the profession of lawyers becomes more valuable (i.e. the average fee rises) as more lawyers enter the profession. These effects imply either high fees or a shortage of legal service providers. A monopoly position of some legal experts (i.e., lawyers) would increase the problem of network effects. Therefore, abolishing the monopoly or admitting non-lawyer legal specialists to the monopoly would be the best option from this perspective.
- If court procedures are not followed properly, for example, there is a cost to the judicial system in time and hence money. However, these effects are not priced. The existence of non-priced sections in the judiciary system calls for some sort of mechanism to filter out cases in dispute that could be resolved more efficiently (out-of-court settlements).[2]

In reality most governments regulate the market for legal services much more strictly than the above-mentioned regulation.

In addition to economic rationales for government action, two non-economic, political rationales exist. 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 under certain circumstances, the paternalistic government hopes to achieve 'equality of arms' for all parties to legal proceedings. 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.

In practice regulation is often aimed at serving both public and private interests. Although 'rent-seeking' behaviour is intrinsically difficult to identify, we conclude that the conditions for successful rent-seeking are met in most national markets for lawyers' services. If we combine this conclusion with the conclusion from the public interest perspective – namely that the need to regulate is less urgent than usually assumed by government agencies and Bars – we conclude that the overregulation of the legal market also stems from safeguarding the private interests of legal professionals.

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[2] Although we focus on access to law in so far as it is linked to the quality of legal professionals (lawyers), we include this fourth market failure related to the administration of justice because in those cases the legal professions are also affected.

'How' question (Chapter 1 and Chapter 4, section 4.1)

Now that we have defined the public interest at stake, the subsequent question is how can the government best intervene to safeguard this public interest? The legal services market can be regulated in various ways – by either government regulation, self-regulation or private regulation. We have 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. These indices show that Finland and England/Wales are the least regulated markets. In Finland lawyers have no exclusive tasks and do not have to be a member of the Bar. In England/Wales the regulation level of solicitors is relatively low (please note, however, that barristers in England/Wales have a much higher regulatory index). Germany, France and Italy have the most regulation.

Actually, this is a surprising result. While the public interest at stake (guaranteed legal security) is exactly the same in all of these countries how can it be that they guarantee legal security 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 the legal security of their citizens than the latter.

Based on our surveys, data analysis and the literature we conclude that access to law is 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 12 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 business contract. However, we did not find a link between them. According to the surveys and data from desk research 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 is due to the fact that external competition exists in less regulated countries (England/Wales, Finland, Hungary, Netherlands), whereas no external competition exists in highly regulated countries with relatively high numbers of lawyers (Germany, Italy and Spain).[3]

From that the fact that the market for the services of lawyers is segmented and – in the view of many of those seeking justice – it is broader than the legal profession alone, we conclude this means that the public interest can best be safeguarded by regulating *services* rather than groups of *professionals*. Recognizing this and asserting the importance of examining the different segments of

[3] 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.

legal service markets separately is an important part of a mature debate on the role of the legal profession in legal service markets.

'If' question (Chapter 1, section 4.2)

Answering the 'if' question involves looking into the potential welfare effects of the regulation of the legal profession, that is, compulsory legal representation in court and the lawyers' monopoly over that representation.

The most important benefits of monopolization include lower search costs, improvements in service quality and a more adequate supply of information on the quality of professional services. These quality related benefits are – however – not back up by the literature. Another aspect is the reduced risk of meeting poor service. When consumers are risk-averse to poor service, perchance because it can lead to unbearably large losses, regulation of quality becomes a substitute for the theoretical possibility of insurance against poor service.

Besides these potential benefits, monopolization by lawyers has a negative effect in that the high cost of hiring a lawyer restricts the accessibility of the legal system. Why do lawyers cost so much? First, because their service is complex and demands sophisticated, careful reasoning. The exercise of careful judgement also takes time. Secondly, becoming a lawyer requires substantial intellectual training and sufficient practical experience. More importantly, however, is the market power of lawyers have over their clients. Most current regulation has clearly replaced market failure with serious government failure: monopolization is an attempt to solve an information problem. This has four causes.

- Compulsory representation in court is by lawyers only. An obligation to use services from only one type of supplier tends to lead to high prices and a lack of innovation.
- 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 authorization of salaried lawyers). We cite an empirical study by Winston and Crandall (2007) showing that this kind of self-regulation in the US does indeed give rise to supra-competitive rents.
- The client is effectively locked into their relationship with the lawyer because of high sunk cost and the tournament nature of competition among lawyers.
- 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.

Because of these reasons a lawyer has market power over his clients and is thus able to set a price above marginal cost and make more than a reasonable profit.

In addition to analysing these general qualitative costs and benefits we quantify the cost of regulation of lawyers by comparing the cost incurred by legal expenses insurers when a case is conducted by an external lawyer and what these costs are when the same case is conducted by an internal lawyer or non-lawyer legal expert. Based upon their experience with lawyers, legal expenses insurers often select their preferred supplier (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.

On an average case basis, a network lawyer costs two to three times as much as an insurer's jurist (paralegal) or salaried lawyer, while an external lawyer costs four to six times as much. From an economic point of view, there seems much to gain by (further) deregulating the national markets. The results indicate particularly that liberalizing the legal profession by allowing certified non-lawyer jurists to enter the monopoly may have a substantial impact on the prices in the legal profession.

The next question is whether the more stringent form of legal professionals regulation leads to greater costs to society than benefits, thereby reducing economic welfare? Due to the lack of available data we were unable to test whether the price for gaining access to law (for instance, the extent of the overcharge) is higher or lower in the more stringently regulated countries. Of course, our methodology may be criticized. Still, the fact remains that the level of regulation differs remarkably among the states in our sample whereas the level of access to law does not; it is considered sufficient in all states. Criticism remains a luxury if alternatives are unavailable; in this case there is a lack of empirical studies. Governments and Bars themselves are unable to prove that the benefits of regulating access to law are higher than the costs.

The report also describes alternatives to the widespread level of regulation. Currently in most European countries there are three ways of changing the monopoly: (1) restricting the domain it covers; (2) extending the group of legal practitioners to whom it applies; and (3) abolishing compulsory legal representation in civil cases (introducing, meanwhile, some covering measures).

Policy recommendations (Chapter 4, section 4.1 and Chapter 5)

What is needed is a broader economic perspective that weighs the pros and cons to welfare, that is, the benefit of correcting market failure versus the cost of government failure and the protection of public versus private interests. This weighing has not yet been done; it is merely asserted by governments and Bars that the benefits of the restrictions are large enough to justify current policy, without reference of the cost of this policy. The benefits of regulation (which are only possible and not quantified) dominate the discussion; any possible gains of re-regulating the market for legal services in consumer surplus are only mentioned in passing, if at all, and they are not discussed. Since cost-benefit analyses of various – less and more restrictive – regulatory schemes are lacking in all countries we recommend that national regulators should analyse the specific public interest in their national markets of legal services. Subsequently, we recommend that governments list various regulatory options next to the current regulatory scheme. We then recommend that a cost- benefit analysis be performed on the current level of regulation compared to other levels of regulation that also guarantee the public interest at stake. In this respect, our conclusions support the European Commission's 'Better regulation of professional services project'.

There are at least two approaches that policymakers could take to improve access to law. From economic theory we know that prices will fall if demand is reduced or if supply is increased. One way, then, is by reducing the demand for lawyers. In the long term, civil court proceedings and regulations should be redesigned (simplified, made more understandable for lay people) to reduce costs and increase accessibility. In the long term, then, the greatest benefits can be expected from

a combination of changes to procedural law, radically simplifying it, implementing private quality regulation, and the abolition of the representation requirement.

Another way may be to increase the number of qualified legal advisers by allowing qualified non-lawyers to conduct cases. Important steps forward include replacing excessive licensing requirements by other mechanisms such as certification, fully liberalizing advertising, and removing quantitative entry restrictions. Our research shows that opening up the monopoly to others than just lawyers, namely 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 or she 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 (more quality differentiation; 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.
2. Due to these price decreases insured parties pay lower premiums for their legal expenses policy (on condition that the market for legal expenses insurance is sufficiently competitive to pass these cost reductions at least partly on to consumers).

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. An option in line with easing the monopoly would be to allow for employed lawyers. If lawyers employed by non-law firms are allowed to operate in a country, it becomes important to give them the same rights and duties as self-employed lawyers.

Raising the statutory financial threshold below which no mandatory legal representation exists would not in itself solve the problem of mandatory representation by lawyers. Therefore, it is not to be recommended. Yet, this alternative does result in a greater freedom of choice for a larger part of the market, namely all those cases between the old threshold and the new one. More cases would be dealt with by the lower courts, resulting in faster and simpler proceedings.

In the following box we sum up our main results.

Box: Main results

- Access to law is sufficiently guaranteed in each of the 12 countries in our sample. It is not safeguarded to any greater degree in countries subject to more stringent regulations. Still, Levels of regulation differ remarkably among the 12 countries. The number of lawyers per inhabitant also differs substantially among the surveyed countries. In less regulated countries the number of lawyers per inhabitant is lower than in highly regulated countries.
- Governments and Bars should be able to show what the social costs and benefits of these different levels of regulation are and why they picked the level they did. Regulators simply assume that the social benefits of regulation are higher than the social costs. We hope that this report provokes discussion on this assumption.
- This study shows that in terms of increased or better access to law it is not at all clear that more stringent forms of regulations 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. On the other hand, we did find some evidence that the costs of hiring a lawyer are high compared to the costs of hiring a non-lawyer legal expert.
- The cost of the regulation of lawyers 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. 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.
- From an economic perspective, there seems much to gain by (further) deregulating the national markets. The results show that liberalizing the legal profession by allowing certified non-lawyer jurists to enter the monopoly may have a substantial impact on prices in the legal profession.
- Freedom of choice for consumers is likely to be the method to reduce the cost of access to law.

Source: SEO Economic Research

1 Introduction

The analysis of the regulation of legal professions has traditionally been in the hands of jurists. Economists have only recently entered this debate.[4] This report gives an economic perspective on the regulation of the legal profession and access to law. In this introductory chapter we first sketch the policy context of the research in section 1.1. Subsequently, section 1.2 introduces the research topic and methodology. In section 1.3 we explain the economic approach chosen for this report. Finally, section 1.4 gives an overview of the remainder of the report.

1.1 Policy context

Governments want to safeguard legal security for all those seeking justice.[5] 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. Most governments provide national Bar Associations with something akin to public-law status. Thus self-regulation of these professional bodies gains a legal or semi-legal status. Much 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 justice – precisely the opposite of what the governments intended.

At present the regulation of legal services, especially by lawyers, differs remarkably among various EU Member States. This is shown by the stocktaking exercises on the regulation of professional services that the Competition Directorate-General published in 2003 (EU-15)[6] and 2004 (EU-25). While the public interest at stake is exactly the same in all the countries, how can they guarantee legal security in such substantially different ways? From the fact that some governments regulate the market for legal advisors far less stringently than other governments, we cannot assume that the former are less concerned with legal security for their citizens than the latter.

In addition to the stocktaking exercises, the European Commission has published a report on competition in professional services. It has also formulated the Better Regulation agenda, which includes a proportionality test that involves checking whether a regulation has a clearly defined public-interest objective and is the method least restrictive of competition to achieve the desired objective. The proportionality test has provoked the taking of a more economic perspective on the regulation of legal services and professions on a European level.

4 Examples are: Faure et al. (eds.) (1993), Hadfield (2000), Lueck et al. (1995), Rosen (1992), Sander and Williams (1989), and Stephen and Love (1996).

5 For a definition of legal security see section 2.1.1.

6 Paterson et al. (2003): The report describes six professions: lawyers, notaries, architects, engineers, accountancy and pharmacists.

Besides the Better Regulation agenda and its underlying reports, the Directive on services in the internal market is playing an important role in current European policy discussions.[7] Called the Bolkestein Directive, this is an initiative of the European Commission aimed at creating a single market for services within the European Union, similar to the single market for goods already present. With the proposed legislation, the Commission wants to reduce the barriers to cross-border trade, principally by doing away with the service industry regulations of individual EU Member States, unless those regulations are non-discriminatory, objectively justified on the grounds of public interest and proportionate (i.e. least restrictive of competition to guarantee public interest). This Directive also affects legal services (cf. Appendix C).

Both the Better Regulation agenda and the Directive on services in the internal market are seen as an important start to the Lisbon Agenda which, launched in 2000, is an agreed strategy to make the EU 'the world's most dynamic and competitive economy' by 2010.

Further to the European policy discussions, the regulation of lawyers is a hot topic in several Member States. Here we take just a few of the many examples: Italy, England/Wales, the Netherlands, Denmark and Germany.

Italy

Recently, both tariff regulation for lawyers' fees and other sectoral regulation have been under attack as barriers to free competition and to the free circulation of lawyers within the EU.[8] This is one reason why the Italian government issued a new regulatory system concerning free market and competition, the 'Bersani Decree' (August 2006; Lirosi (2006)). The Italian parliament has converted this decree into law (Law 248 on 4 August 2006) with several changes, after many protests and a heated debate. The new law became effective on 12 August 2006.

Fees for civil work (*diritti* and *onorari*) are regulated. Varano and De Luca (2007) state that this limit is traditionally founded on the need to protect the 'dignity' and 'decorum' of the profession together with its financial independence. The Bersani Decree involves new provisions on competition and consumers' rights and introduces innovative facilities and opportunities with the purpose of enhancing open market, flexibility, employment opportunities, free competition and consumer protection tools. The most controversial reform introduced by the Bersani law is the possibility to abolish minimum fees (but not maximum fees); Luberti and Geatti (2006). The draft proposal of the decree tried to abolish every regulation referring to minimum fees but the final version, approved by the Italian parliament, established that only minimum fees may be abolished by written agreement between the client and the lawyer. This allows the lawyer to keep the minimum amount of fees for state-funded legal aid in favour of poor people.

The Bersani law also allows professionals and their clients to agree to a 'no win-no fee' system.[9] Multi-disciplinary partnerships (*società tra professionisti*) may also be formed by different categories of professionals. Moreover, since the Bersani law has been approved, lawyers and other

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7 Directive 2006/123/EC of the European Parliament and of the Council, of 12 December 2006 on services in the internal market, Official Journal of the European Union, L 376/36- L 376/68.

8 These restrictions prevent or hamper young lawyers from entering the market as they cannot charge the lower fees commensurate with their lack of experience. The existence of this limit is also seen as a barrier for foreign lawyers willing to practise in Italy. They cannot charge a fee below the Italian minimum even though in their country of origin such a limit does not exist (Varano and De Luca (2007)).

9 In practice this possibility is, however, rarely used.

professionals are allowed to advertise and promote their area of specialization, the kind of the services they offer and the fees they charge. According to Varano and De Luca, these measures have been strongly criticized by the legal profession.

England/Wales

In December 2004 Sir David Clementi submitted his review of the regulatory framework for legal services in England and Wales.[10] The reason for this wide-ranging review into the provision of legal services was threefold:

1. A concern about the current regulatory framework, because this framework was 'outdated, inflexible, over-complex and insufficiently accountable or transparent'.
2. A threefold concern about current complaints systems: (a) the efficiency with which the systems are run, (b) the overlapping powers of the oversight bodies, and (c) whether systems for complaints against lawyers, run by lawyers themselves, can achieve consumer confidence.
3. Concerns about the restrictive nature of current business structures which have remained unchanged over a considerable period, whereas business practices have moved on (i.e. the skills necessary to run a modern legal practice have developed) and whether the restrictive practices of the main legal professional bodies can still be justified (i.e. those which prevent different types of lawyers working together on an equal footing). The concern is also that professional rules on business structures are not set in the public interest and may be anti-competitive.

The UK government broadly accepted the main recommendations of the Clementi review. These were[11]:

- Setting up a Legal Services Board (LSB) – a new legal services regulator to provide consistent oversight regulation of front-line bodies such as the Law Society and the Bar Council.
- Statutory objectives for the LSB, including promotion of public and consumer interests.
- Regulatory powers to be vested in the LSB, with powers to devolve regulatory functions to front-line bodies, subject to their competence and governance arrangements.
- Front-line bodies to be required to make governance arrangements to separate their regulatory and representative functions.
- Setting up the Office for Legal Complaints – one independent body to handle consumer complaints in respect of all members of front-line bodies, subject to LSB oversight.
- The establishment of alternative business structures that could see different types of lawyers and non-lawyers managing and owning legal practises.

The potential consequences of the Clementi report could, according to Peter Wright (2005), bring about 'the most significant wave of change to the legal profession in its history, and create a markedly different landscape from that which you are working to enter right now'.

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10 The review covers the provision of all legal services, not only those offered by solicitors, barristers and legal executives, but also those offered by patent agents, licensed conveyancers, will writers and trademark attorneys.

11 http://www.dca.gov.uk/legalsys/lsreform.htm

The Netherlands

In the Netherlands, a special committee headed by Peter van Wijmen issued a review in April 2006.[12] The Committee recommended not changing the institutional context (for instance no 'no cure, no pay' arrangements), and to make sure that the key values of the lawyer's profession are embedded in current legislation. One exception is the reform of the current Dutch Bar Association from an organization with regulatory, (disciplinary) enforcement and lobbying tasks to two separate organizations, one of which to deal exclusively with regulatory tasks. The Dutch government has not accepted this recommendation. A special department consisting of non-lawyers will be installed within the current Bar and is meant as an external check on the degree of independence of regulation by the Bar. Other, less drastic changes are the establishment of an Ombudsman, to deal with consumers' complaints about lawyers, and the implementation of a certified quality system for law firms.

Denmark

In 2005 the Danish Ministry of Justice set up a committee to investigate the rules regulating the legal profession.[13] The committee investigated various liberalizations of the legal profession, including:

- Abolishing the monopoly of lawyers to represent clients in civil court cases;
- Modifying of the rules regarding ownership in legal firms;
- Abolishing the mandatory membership of the Danish Bar and Law Society;
- Changing the rules regarding complaints against lawyers;
- Abolishing the rules regarding 'the law on legal services, and debt collection and detective undertakings' which currently limits access to advertising of legal services.

The recommendations were published in 2006.[14] The Committee was not unanimous on the abolishment of the monopoly position of lawyers. The Danish government decided to abolish the monopoly for 'small cases' (the word small does not relate to the size or value of the case, but to the regulatory scheme that categorizes cases). Moreover, the Danish government modified the rules so that it is now possible to have a holding-ownership structure for law firms as long as the sole purpose of this holding is to own a law firm.

Germany

In July 2006 the German Monopoly Commission (*Monopolkommission*) published an analysis of the possibly anti-competitive character of the regulation and behaviour of free professions, and of lawyers in particular.[15] The main areas addressed are training requirements, monopoly rights, minimum fees, prohibition of conditional fees, fee regulation, business structures and advertising. The proposed changes are modest and generally in accordance with the recommendations of professional bodies.

In other European states as well, the regulation of lawyers is being discussed in reports and by committees. In several jurisdictions there have been proposals to remove some of the

12 http://www.justitie.nl/images/Advocatuur_tcm74-115174_tcm34-20054.pdf
13 Olesen & Nielsen (2006).
14 *Betænk 1479 Retsplejelovens regler om advokater Justitsministeriet* (2006); available at: http://jm.schultzboghandel.dk/upload/microsites/jm/ebooks/bet1479/pdf/bet1479.pdf
15 http://www.monopolkommission.de/haupt_16/kapitel06_h16.pdf

instruments used by the profession to regulate the market and to remove the general exemption of the profession from anti-trust or restrictive practices legislation. Some national markets have indeed been the subject of varying degrees of deregulation, whereas the regulation of other national markets has not changed significantly.

1.2 Research question

The International Association of Legal Expenses Insurance (*Rencontres Internationales des Assureurs Défense*, RIAD) commissioned SEO Economic Research to conduct a study of the effect of the regulation of legal services and legal professions on access to law in several European countries. Regulation is aimed at preserving the quality of legal professionals. Traditionally, the interest of legal security has been safeguarded by means of compulsory legal representation in court and the lawyers' monopoly over that representation. Both the government and professional bodies intervene on the market to preserve accessibility and quality for consumers. However, often both regulators do not take account of the negative side effects of their regulation or self-regulation. This report addresses both the negative and the positive effects of the regulation of lawyers.

The central research question is:

> **'What is the effect of the regulation of the legal profession – predominantly lawyers – on access to law?'**

We answer this question as it relates to civil law, not punitive nor public law. Moreover, we focus on the effect of the 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 the monopoly and associated self-regulation have on consumers (households and small and medium-sized enterprises (SMEs)). We also look into the effects on competitors (legal expenses insurers and others). Section 1.2.1 further defines the concept 'access to law'.

The principal services provided by the legal professions are legal advice and client representation before courts and other authorities in all aspects of the law. In some countries these are coupled with conveyancing of title to real estate, wills and family matters such as marriage contracts, tax advice, insolvency practice and patent law-related issues. As for the structure of the profession, both lawyers and legal advisers provide legal services. In this report we focus on the regulation of lawyers.

Legal needs fall across a spectrum ranging from basic information to full service representation by lawyers. Legal services are supplied by lawyers, business jurists, legal expenses insurers, trade unions, pro deo legal counsels and other legal counsels. From the standpoint of the functionality of the legal system, service providers can establish a variety of competence requirements based on how final in impact and how legally significant the service on offer is. Consumers of civil legal services are households, SMEs and large firms. We pay less attention to large businesses and government agencies as these clients often use lawyers' services. Moreover, large organizations often employ their own in-house legal executives who, because of their background in law, are in a better position to assess the quality of the external services received (cf. section 2.1.2).

In the research we looked at the regulation of national markets for civil legal services provided predominantly by lawyers. We conducted a survey in 12 countries:[16]

1. Austria (Aus)
2. Belgium (Bel)
3. Czech Republic (Cz)
4. England/Wales (E/W)
5. Finland (Fin)
6. France (Fr)
7. Germany (Ger)
8. Hungary (Hun)
9. Italy (It)
10. Spain (Sp)
11. Switzerland (Swiss)
12. The Netherlands (Neth)

We use the term 'lawyer' to refer to a person trained and licensed to prepare, manage, and either prosecute or defend a court action as an agent for a client and who also gives advice on legal matters that may or may not require court action. The term 'jurist' refers to a person trained in law but who, compared to a lawyer, is not officially licensed or registered as a lawyer. The qualification level may be the same but it may also differ between lawyers and jurists. The national names for lawyers in the 12 countries in our survey are presented in Box 1.1.

Another important term is the 'Bar' (Law Society, Bar Council, Bar Association or Order), which stands for the professional body for lawyers. The Bar licenses lawyers, provides representation and services for itself, provides guidance on issues of professional practice, and deals with the regulation of lawyers.

Box 1.1: National names for the term 'lawyer'

Austria, Germany, Switzerland:	Rechtsanwalt
Belgium:	Advocaat / Advocate
Czech Republic:	Advokát
England/Wales:	Solicitor / Barrister*
Finland:	Asianajaja (member of the Bar)/legal advisors with no specific title
France:	Avocat
Hungary:	Ügyvéd
Italy:	Avvocato
The Netherlands:	Advocaat
Spain:	Abogado / Precurador
General	Lawyer

Source: SEO Economic Research

* By and large, lawyers are comparable to the barristers of England and Wales in that they have the exclusive right to represent parties in court.

Ideally, the research question should be answered by addressing the following sub-questions:

1. Deduce the public interest at stake: Should the government intervene in the professional legal services market?
2. How can the public interest at stake be guaranteed: Who regulates the market and how is this done?

16 Note that although Finland is not a member of RIAD it is still included in our sample as this country may serve as a benchmark when comparing the level of regulation of the legal profession. The level of regulation in Finland is the least across the EU.

3. Is the public interest at stake sufficiently guaranteed in all 12 countries in our sample?
4. Is the public interest guaranteed comparatively better or worse in highly regulated countries than in the less regulated countries in our sample?
5. Is access to law comparatively more or less expensive in highly regulated countries than in the less regulated countries? More specifically, does more stringent regulation of the lawyers' profession bring about excess profits for lawyers?

To answer the first two questions, we needed no market data but, rather, economic analyses. The two analyses of the public interest are the same for each of the 12 countries in our sample (cf. Chapters 1 and 1). The remaining three questions do require data on the legal services market. To answer the third and fourth (cf. section 4.1) questions we surveyed legal expenses insurers and national Bars (cf. section 1.2.2). We also reviewed the literature and conducted desk research.

Due to lack of data we were not able to answer the fifth question. In order to be able to test the hypothesis that the price of access to law is higher in highly regulated countries, we needed data on the cost of the judiciary system to subsequently link these to the various levels of regulation. However, such data are not publicly available. Moreover, any comparison of judiciary system expenditure is complicated by the fact that systems differ fundamentally between countries. Besides primary legal rules, the judiciary system comprises rules on the use and interpretation of 'law', legal processes, specialized institutes for drafting and formulating laws, legal personnel to administer laws and legal culture. A survey on the effect of the regulation of the market for legal services on access to law should ideally take into account the whole judiciary system of a country – whereas we focus on regulatory differences of the legal profession and omit the regulations and institutions that determine the performance of the judiciary system as a whole. This is because procedural law not only forms the basis of short, cost-efficient proceedings, it also includes the organization of courts, the qualifications of judges and providers of legal services, as well as many other factors such as access to legal aid, the liability of legal services providers, an obligatory professional indemnity insurance, court costs, expert fees, translation costs, and so on. It is, therefore, somewhat unsatisfactory to look into just one aspect of a country's legal system to identify the effect of regulation on access to law.

In spite of these limitations, an analysis of the level of regulation of the legal profession is very relevant when thinking about improving access to law. If we consider the cost of regulation of the lawyers' profession merely in terms of their earnings, the ideal would be to test the relationship between regulation and excess profits – those above the normal competitive level.[17] In the absence of any profit data, however, this is impossible. We therefore used price-per-case data to determine the regulation costs to lawyers (cf. section 4.2.2).

1.2.1 Access to law

Barendrecht et al. (2006) give the following definition of 'access to law'. It refers to the methods by which individuals are able to get legal information and legal services and to resolve disputes. It includes access to court procedures, legal aid in general and out-of-court mechanisms to resolve conflicts. According to Ramsey (2003) the narrow definition equates access to justice with access

[17] Regulation may lead to market power of lawyers. The extent of market power is ideally measured in terms of the feasibility of lawyers to put prices (P) above marginal costs (MC). The Lerner index fitting this definition is: (P – MC)/P.

to legal institutions, whereas a broader approach is concerned with the general conditions of justice in society. Barendrecht et al. (2006) also take a broader approach. They state that access to law is not just about letting all disputants actually access courts, it is about inducing them to reach settlements that are fair reflections of their legal rights, in the shadow of non-cooperative enforcements by courts or other neutrals ('a rational defendant would not agree to a settlement, or only offer a low amount, if the threat of some kind of court intervention did not exist').

Here we primarily mean the broader definition. At the same time we depart from a narrow perspective of access to law. Access to law encompasses (1) the administration of justice, (2) the (quality of) laws and rules, and (3) the (quality of) the legal professional other than the judge, who is part of justice administration. We focus on the third part of access to law as defined above – the (quality of) the legal professional – and analyse how the regulation of lawyers enhances or reduces access to law.

In the civil domain of the legal system, access to law is cause for concern. For instance, access to law is restricted by the costs associated with a legal procedure. The effect of cost on access to law is usually addressed by introducing subsidized legal aid for low income groups or by allowing contingency fees (as is the case in the US). Of course, access to law is not the same as access to lawyers.[18] However, if governments force people seeking justice to hire a lawyer when going to court, access to law in practice becomes equal to access to lawyers. Governments will, therefore, have to consider the benefit as well as the cost of compulsory representation in court.

Rhode (2004) rightly states that access to law is not an end in itself; the goal is justice. That is why one sometimes speaks of access to justice instead of access to law. Access to justice is embedded in the United Nations Guidelines for Consumer Protection. Accordingly, governments should establish or maintain legal and administrative measures to enable consumers or, as appropriate, relevant organizations to obtain redress through formal or informal procedures that are fair, expeditious, inexpensive and accessible.

1.2.2 Research methods

This research is based on a study of the literature, which reviewed both academic and policy papers. A list of references is presented in Appendix A. Apart from this literature review and desk research, we conducted four surveys in the 12 countries:

- The first questionnaire was sent to RIAD contact persons in the 12 countries mid-May 2007.[19] Responses were collected via an online questionnaire in the period from the middle of May until the beginning of August 2007. Each of the 12 contact persons completed most of the questionnaire.

[18] Access to lawyers is specified in the Basic Principles on the Role of Lawyers. These Principles require governments to ensure that efficient procedures and responsive mechanisms for equal access to lawyers are provided, including the provision of sufficient funding and other resources for legal services to the poor and other disadvantaged persons; UNDP (2004).

[19] Since Finland is not a member of RIAD, for the purpose of this research we used a contact person at the Federation of Finnish Financial Services. This trade body represents the financial industry in Finland, including insurance companies.

- The second questionnaire was e-mailed to 56 legal expenses insurers on 21 September 2007. Responses were collected until 1 November 2007. Thirty-six legal expenses insurers completed all or part of the questionnaire (response rate: 66%).
- The third questionnaire was e-mailed to the 12 national Bars on 14 September 2007. Responses were collected until 1 November 2007. Five Bars completed part of the questionnaire (response rate: 42%).
- The fourth questionnaire was e-mailed to the 12 RIAD contact persons on 24 January 2008. Responses were collected until 27 February 2008. Every contact person completed most of the questionnaire.

Appendices D and E contain the questionnaires and give further details on response rates. The fourth questionnaire is not included in the appendices because it was restricted to two questions verifying information provided earlier.

All data and information obtained from the surveys was treated strictly confidentially and made available only to SEO Economic Research. The results are reported in such a way that they can not be linked to individual respondents.

1.3 An economic perspective

Our research analysed various national institutional arrangements from an economic perspective. What is economics and what is an economic perspective? Economics is a social science concerned with how to distribute scarce resources in such a way that human needs are satisfied as efficiently as possible and welfare is maximized. Note that the economic definition of 'welfare' is very broad; in fact, it includes everything that contributes to the satisfaction of human needs. Another term used for the same economic concept is 'utility'. Because that is not easy to measure, in everyday usage it tends to be equated with financial prosperity. That, however, has a much narrower meaning than economic welfare. 'Well-being' is probably a closer colloquial synonym for prosperity in the economic sense.

That brings us to the second question: what is an economic perspective? When solving policy problems (e.g. how to regulate legal services?) the economic perspective involves answers to the following three questions:

1. The 'what' question: Is there a problem? What makes it a problem? What is the public interest?
2. The 'how' question: How can one take action as effectively and efficiently as possible? What instruments are best suited to solve the policy problem in question?
3. The 'if' question: Would social welfare be enhanced if action is taken with a particular instrument or instruments? Is the cost of intervention higher or lower than the benefit?

1.3.1 'What' question

In policy practice, the 'what' question is often neglected and regulators move immediately on to the 'how' question. The disadvantage of skipping the first question is that it remains unclear if

and to what extent the problem in question requires *government* intervention. Depending on the problem at hand, intervention by private parties or perhaps co-intervention by private and public parties may be enough to solve the problem. However, if the problem is not clearly defined, the government might overreact or take the wrong action.[20]

The assessment framework supporting the 'what' question is based on economic theory, since it contains the basic criteria used to determine the answers to this question. Answering the 'what' question defines the public interest at stake. There is a difference between public and social interests. Public interests are always social interests, but not every social interest ultimately serves a public one in that it requires government intervention. For example, bakers delivering bread and butchers delivering meat are both social interests but not public interests (we don't have state bakeries or butchers). The first question, then, is: what social interests does the government deem to be public interests as well?

Viewed from an economic perspective, problems arise when markets aren't functioning properly – a phenomenon known as 'market failure' – or when the macro-economy is destabilized (high rates of inflation or sectoral unemployment) or if the market's outcome is socially or politically unacceptable. In the latter case, the government can intervene so as to set right an unequal division of income (redistribution) or to correct undesirable and wrong decisions or stimulate more desirable and correct choices. In these cases, economists speak of demerit and merit goods, or paternalism. Problems can also arise if markets do not come into being due to high transaction costs or if welfare-enhancing transactions cannot be made. This is explained in more detail in Chapter 1.

Anyone who believes in the primacy of politics could adopt the position that a democratically elected government is free to designate any objective of its choosing as being in the public interest. Political scientists and experts in public administration assert that the identification of public interest is the result of an interactive process between politics, government, society and market players; in other words, it is an issue of political administration. From this point of view, a public interest is anything the government considers as such – regardless of whether it involves market failures, unequal income distribution or individual errors in decision-making. For an economist who wants to answer policy questions, however, this definition is of little use. After all, it involves the danger of circular thinking: something is in the public interest because it falls under the responsibility of the government and it falls under the responsibility of the government because it is in the public interest.

From our review of the literature, we conclude that the political administrative approach does not start from an unambiguous position when addressing the question of what constitutes a public interest. This deviates from the economic view that welfare and market failures are at the heart of the matter. There is a broad spectrum of political and administrative reasons for taking government action and, ultimately, politicians decide what a problem is and what it is not. Consequently, the political administrative criterion – that politicians decide – is not a good way of identifying a public interest when asking what constitutes one.

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[20] 'Wrong' because it is difficult to find a good solution if the cause of the problem is unclear. To be able to find the cause, answering the 'what' question is imperative. 'Too much' because without answering the 'what' question it isn't clear whether or not there is a public interest.

In no way is this intended to suggest that economic theory is better than other theories and disciplines; it only says that this theory provides good reference points for answering the 'what' question. The existence of an economic framework of reflection detracts nothing from the political decision-making process. The framework supplies the arguments, upon which politicians base their decisions after weighing up the relative importance of the arguments, but it plays no part in the weighing process. That is and remains a political matter.

Nor does the economic framework of reflection provide any help in deciding whether the motives behind government interventions are 'good' or 'bad'. It does not judge motives; it merely reveals them so that politicians can consider them. In other words, the economic approach has no ready answers. Rather, it is simply a tool to help discover the motives behind interventions. Once the motives are known, we can look at how closely they correspond with current policy.

Using the economic approach, one can answer the question whether there is a public interest. If there is neither market failure nor prohibitively high transaction cost, then no public interest exists either and thus there are no grounds for government actions. In any case it would be welfare-decreasing if the government intervened. It could, however, be welfare-increasing to reduce actions that are currently in place.

1.3.2 'How' question and 'If' question

Once the public interest is clearly defined, the subsequent question is how government can best intervene to safeguard the public interest. When answering this question it is important to consider the wide range of available instruments.

While comparing instruments it becomes important to analysis the associated costs and benefits. Benefits accrue because of the correction of market failure or reduction of transaction costs. On the other hand, a government may have shortcomings and socially undesirable effects can ensue from government actions. This is called 'government failure' or 'regulatory failure'. The fact that regulatory failure might occur, however, doesn't mean that we should elect to let the market regulate itself exclusively.

In other words, the economic approach is not a matter of either government involvement or market discipline. Rather, an intelligent combination of both market and government is needed. This involves a government that defines frameworks and sets preconditions in advance, instead of interfering in business management and details, and that acts as a market superintendent, referee or watchdog afterwards. Thus, it involves weighing up the benefits of correcting for market failure and the costs of regulatory failure. This involves a cost-benefit framework to analyse which forms of regulation may cure the market failures in the provision of legal services, without causing disproportionate restrictions of competition or any other adverse effects.

1.4 Overview of the remainder of the report

In addition to the initial executive summary and this introductory chapter, this report contains four more chapters. Chapters 2, 3 and 4 address the 'what', 'how' and 'if' questions, respectively.

In Chapter 2 we give the rationale for regulating the legal profession (lawyers). Chapter 3 shows how the countries in our survey regulate their markets for civil legal services. To that end we have developed a regulatory index to compare the 12 countries. Chapter 4 gives an overview of possible welfare effects of various regulatory schemes. Chapter 5 provides the conclusions and policy recommendations.

The report closes with five appendices (A: bibliography; B: description of the legal expenses insurance market; C: description of the European institutional context; D: the two questionnaires sent to legal expenses insurers; and E: the questionnaire sent to the Bars).

2 The public interest at stake ('what')

In this chapter we derive the public interest at stake, that is, we explain why it may be necessary to regulate the market for legal services and professionals (lawyers). We discuss both public interest theories (market failure and political considerations, section 2.1) and private interest theories (section 2.2). Public interest theories explain why regulation should take place from a social welfare point of view. Although explanations of private interest offer no justifications for regulation, they do provide important insights. After all, both the public (government) and the profession have an impact on the current forms and contents of professional regulation. The chapter ends with our conclusions on this topic (section 2.3).

2.1 Public interest theory

All standard works on micro-economics put forth the theoretical model so neatly: 'In a market with perfect competition, a Pareto-optimal allocation is realized automatically'. In plain English, this means that free market forces lead to the best price-quality ratio and the highest welfare levels for consumers (see section 1.3 for an explanation of the economic term welfare). When do economists refer to a situation of perfect competition? Perfect competition means that:

- There are many small producers and consumers who cannot influence market prices individually;
- There is perfect information on prices and the features of the goods; and
- All economic goods have a price (i.e. there are no external effects).

In everyday practice, however, the model conditions of perfect competition will in a strict sense virtually never be met. Consequently, the market does not provide a panacea for all economic problems. Economists speak of market failures. Depending on the severity of a market failure, sometimes it may be necessary for the government to intervene.

Economists generally begin from the premise that any economic activity should be free of regulation (or at least regulated only by the market) unless it can be shown that it is subject to market failure: left unregulated it will not generate socially efficient levels of output. So, from an economic point of view, competition is preferable to government intervention unless the latter (e.g. through regulation) leads to a higher degree of efficiency (Megginson and Netter (2001)). In this regard the government's role exists by virtue of market failure. In this section, we first describe the concept of legal security.

2.1.1 Legal security

When answering the question of whether a market fails – what constitutes the public interest? – the government is at first left out of the equation. We assume that there is no regulatory government.[21]

In the situation without regulatory government, proprietary rights are neither defined nor guaranteed. To resolve a dispute, parties will fight things out on their own, thereby creating an 'arms race' (everyone employs their own 'enforcement agency'). To prevent this, a government must do two things: first, create the opportunity to make binding agreements (i.e. define proprietary rights[22]); and second, appoint a 'referee' (i.e. establish and finance a legal system with one code of law). The parties to a contract dispute can then cite their proprietary rights and may turn to the courts for resolution. Individuals seeking justice, however, will find it difficult to assess whether they have any chance of obtaining redress in court and, if so, how best to go about it. For that, they need a specialist. Without government action we cannot be sure of 'legal security'. Consumers must be sure that their demand for legal services can be adequately satisfied. The definition of legal security encompasses access to law, the fair and orderly conduct of legal proceedings and an efficient judicial process. At the very least, fair, balanced and orderly legal proceedings require sufficient knowledge of relevant rules (such as procedural law) and of jurisprudence by those concerned; such knowledge the average citizen usually does not possess. It is therefore in the public interest that an adequate supply of identifiable, high-quality legal services exists so that all those requiring appropriate assistance are able to obtain it.

In a nutshell, this is the rationale for government action in the market for legal services. The public interest arises because of various types of market failures, which we describe in section 2.1.2; first in general terms and subsequently by checking whether a particular market failure plays a role on the market for legal services. In section 2.1.3 we discuss political motives for regulating legal security. The various sources of market failures and political considerations provide a prima facie case for considering public regulation of some goods, public investments in other and redistribution of incomes. All these measures, however, are also exposed to potential failings. We discuss these potential government failures in section 2.1.4.

2.1.2 Market failure

Economic theory describes four types of market failure: lack of competition, information asymmetry, external effects, and public goods. Below we discuss each of these in general terms and then apply them to the market for legal services. As explained in section 1.2.1 we focus on access to law in so far as it is linked to the quality of legal professionals (lawyers). Occasionally we also discuss market failures related to the administration of justice (i.e. when discussing external effects and public goods), because those cases also affect the legal professions.

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21 A situation without government is of course hypothetical, and not one to which policy-makers should aspire. Government should be disregarded only in so far as that helps us to clarify the underlying motives for intervention.

22 The position and role of an individual in the economic system are determined by his proprietary rights. An economist regards proprietary rights as a collection of legal standards that govern the relationships between people in relation to scarce resources in a specific way.

Monopoly/Dominance

One of the first grounds for government action is when competition is seriously threatened. Think, for instance, of a (natural) monopoly (e.g. the electricity grid), or a dominant supplier or the threat of one arising as a result of a merger or acquisition or cartel agreements. Market power enables producers to make excess profits over the normal rate (monopoly rents);[23] government action may be necessary to prevent under-provision and over-charging of goods.

Not all monopoly rents are bad for society. First, they are needed to cover the high fixed cost of investments. Second, the prevalence of network effects can make the establishment of a (natural) monopoly desirable.[24]

Monopoly/Dominance in the market for legal services?

The market for legal services provided by lawyers does not fail because of its monopolization, that is, no intrinsic market characteristic (e.g. the effects of scale) is involved in the formation of monopolies. Without government regulation, there would be no lawyers' monopoly. Current monopolization of the market is, therefore, not the cause but rather the consequence of government regulation.

Besides these artificial barriers to entry, there are also 'natural' barriers which, however, do not imply monopolization either. For example, the increasing benefits of specialization. A lawyer with experience in a particular field or sector learns more from each successive case than one with no such background. It is thus more efficient to use the specialist than to divide the work between two lawyers. And once he [or she] has specialized, the lawyer's market power only increases in comparison with the customer's. Although specialization may invoke market power, it is not a 'bad thing' that needs to be addressed by government action; it is not a type of dominance one would want to eliminate.

Economies of scale are another natural barrier, one that results in large law firms dominating the market, particularly in commercial business. The economies of scale in question are associated with the importance of information and knowledge that, in theory, can be used by others at no extra cost. Lawyers with lots of know-how could share this in meetings, interviews, presentations or written pieces. The greater the number of colleagues listening or reading, the grander the scale on which knowledge is shared. Because the learning process in the legal profession often involves working closely with a senior lawyer or partner, the economies of scale are potentially huge. That is not so much the case in procedural practice, since knowledge and experience are gained there by actually conducting a case at a given moment. In commercial practice, the work is carried out over a longer period – initial drafts can be prepared by a student or paralegal and then edited by a partner – and knowledge is passed on through documents.

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23 *Normal profit* means that companies make enough profit to reward the invested capital. No more than normal profit, also referred to as *economic profit*, means that no profit remains after the deduction of rewards for invested capital. It differs in this respect from the term *profit* in a bookkeeping sense or as used in normal conversation (Stephen Martin (2001)).

24 A network effect is a characteristic that causes goods or services to have value to a potential customer, dependent on the number of other customers who own the goods or use the services. The classic example of a network effect is the telephone. The value of a telephone is positively correlated with the number of telephone users.

Information problems

A second type of market failure is information asymmetry between the producer and the consumer. In most cases, the problem occurs when consumers cannot properly assess quality and therefore the incentive for suppliers to offer an optimal price-quality ratio is restricted. This gives suppliers the opportunity to overcharge consumers. In these cases, consumers cannot determine if the information they have on the goods or services is complete or correct.

If consumers cannot assess quality effectively, there is no incentive for producers to offer above-average quality. Information asymmetry can lead to adverse selection and deterioration in the quality of the products and services offered.[25] After all, most consumers are prepared to pay a price consistent with the average quality standard. In the case of adverse selection, poor quality providers will price good quality providers out of the market if there is no regulation, resulting in a vicious spiral with an increasingly poor price-quality ratio.

A second information problem for consumers is known as the principal-agent problem. It is a theory based upon two assumptions:

1. The relationship between the principal and agent involves a conflict of interests: the interests being pursued by the agent are different from those in the principal's mind.
2. The principal is in no position to follow the agent's activities or to assess their purpose, since the principal lacks the necessary information. It is too expensive for the principal to monitor everything the agent does, down to the smallest detail.

The supplier cannot credibly undertake to perform only those actions that serve the interests of the client and to refrain from any activity that harms those interests. No agreement (contract) regulating such activities can be regarded as credible, since it is far from easy for the client to check that the supplier is complying with the undertakings made. This may invoke opportunistic behaviour (moral hazard) on the part of the agent.

Yet another information problem for consumers is bounded rationality or rational ignorance. This theory deals with the process of collecting information on the different options for purchasing some type of good or service. The theory suggests that one would collect and process information up to the point where the marginal benefit of information equals the marginal cost of collecting and processing the information. If the situation concerns a complex matter, it is efficient for consumers to use simplified rules to process information rather than complex rational analyses. This is called bounded rationality or rational ignorance (Carlton and Perloff (1990)). Clients usually lack the education level, or perhaps the intellectual ability, to be able to understand all available information correctly. This may provide justification for some regulatory intervention if the regulatory body has more information and better knowledge on how the information should be processed (Maks and Philipsen (2002)).

In some markets, the suppliers rather than the consumers have the information problem of moral hazard. Certain insurance markets, for example, suffer from this information problem. Consider the case of a private insurer who offers cover for unemployment or bankruptcy. The risk of

[25] This phenomenon was described by Akerlof (1970), on the basis of the example of the second-hand car market.

losing one's job and the chances of finding a new one in the event of unemployment are largely dependent upon the subject's own behaviour. How the policyholder acts could increase the risk of unemployment or bankruptcy. This problem is referred to as moral hazard and it effectively precludes private insurance companies from providing certain kinds of cover. That is why the government steps in instead, in the form of social insurance.

Thus, imperfect information can result in existing markets not functioning properly or, as in the case of some kinds of insurance, in no private market existing at all. To tackle the problems caused by information asymmetry, the literature usually proposes that the market be regulated – either by government or by the industry itself – through, for example, the imposition of minimum quality standards, registration and rules of establishment or certification, or through the introduction of a social insurance regime.

Information problems in the market for legal services

The legal services provided by a lawyer are so-called 'experience goods'. In other words, their actual quality can only be assessed after they have been purchased (ex-ante uncertainty about quality). The services provided by a lawyer also feature characteristics of so-called 'credence goods' (or trust goods) if the consumer cannot rate quality through consumption or even repeated consumption. If clients cannot reliably judge the quality of the service, not even after having consumed it, the only way to save information costs is to trust in the professional providing the service. For most consumers most legal services are credence goods (Darby and Karni (1973)).[26] The ex-ante uncertainty declines, however, the more frequently consumers make use of a lawyer's services. This applies particularly to large companies and organizations, including legal expenses insurers. Based upon their experiences with lawyers, these insurers often select their preferred suppliers (network lawyers), which status provides the policyholder with a certain indication of quality. To these consumers (professional clients) legal services are experience goods.

In some cases it is possible to use 'win-loss' statistics as a quality indicator. These act as a sort of corrective mechanism: a lawyer who loses lots of cases is likely to lose market share as well. However, 'win-loss' statistics most certainly do not tell the whole story when it comes to performance and the quality of the services provided. The information asymmetry thus remains. As Hadfield (1999) puts it:

> 'So long as clients believe lawyers differ in quality – and in fact lawyers do – it is just very difficult to objectively determine when and how much prices will be buffeted by beliefs based on signs of quality that are more or less spurious. The extent to which a lawyer can extract the highest price a client is willing to pay – the monopoly price – will depend on

[26] Arruñada (2007) shows how changes in the conveyancing services market (notaries) undermine the information asymmetry rationale for regulating conveyancing, while institutional changes facilitate liberalising not only conduct but also license regulations. On the market side, many transactions feature large, well known parties and standardised transactions, which make professionals less effective or are necessary for protecting the parties to private contracts. On the institutional side, public titling makes it possible to dispense with a broadening set of their former functions. Arruñada concludes that restrictive professional licensing is less justified in that the comparative advantage in the provision of externalities now lies in public registers and that overcoming information asymmetries lies with large private firms.

> the strength of beliefs generated in a world where it is extremely difficult to test those beliefs.'

In the legal services market, information asymmetry between client and lawyer is also reflected by the principal-agent problem. The client and lawyer may have a conflict of interests. For instance, information asymmetry makes it difficult for the client to assess whether the time charged by a lawyer bears any relationship to the performance delivered (assuming the lawyer charges by the hour rather than agreeing to a fixed price in advance). The client is not only unaware of the quality of the actual service, he is unsure of the service he needs or if he even needs a service at all. The client has to rely on the expertise of the professional to assess and implement an adequate strategy (service function). The assessment of what strategy is needed is called the 'agency function' of the legal service provider. Implementation of the adequate strategy is called the 'service function'. Because legal professionals provide both the agency and service function to their customers, potentially there is a severe problem with supplier-induced demand.

This is known as the moral hazard problem (Alchian and Demsetz (1972)). Every principal-agent relationship entails the risk of moral hazard (opportunistic behaviour). To cope with moral hazard and supplier-induced demand, regulation may be necessary. When the service function is provided separately from the agency function, there is scope for revelation of information that limits opportunism (Emons (1997)). Third parties, such as legal expenses insurers, trade unions, subsidized legal aid, could fulfil this agency function.

Besides moral hazard there is also the threat of adverse selection. Potential clients know only the average quality of the market. If the market is unregulated and if providing bad quality is less costly for the professional than providing good quality, then only bad quality will be supplied. Lawyers offering a higher quality will make a loss and go bankrupt. As a result, the average quality will decline, again pushing down the market price, and so on (Akerlof (1970)). In an unregulated market, adverse selection would result in good lawyers being pushed out of the market so that only the bad ones remained, and prices would be too high for the quality of the service provided. As will be described in section 3.2.1, some kind of certification or equivalent mechanism is needed. Competition among the providers of legal services may not solve the problem due to the fact that good professionals may be driven out of the market by bad professionals given the inability of the market to pay for quality.

In order to prevent adverse selection, governments could subsidize high quality suppliers to ensure that they remain in the market and offer high quality, even if adverse selection persists. Penalties could be imposed on low quality suppliers. In practice, neither subsidies nor penalties are used in the market for legal services.

In the case of the legal profession, however, there is little danger of adverse selection. In the first place, this is because the market solves some of the information asymmetry. Both supply and demand are segmented in the market for the services of lawyers. On the supply side, the division is between large commercial firms working mainly for corporate clients and smaller organizations serving SMEs and consumers. On the demand side, large businesses and government agencies make frequent use of lawyers' services on the one hand and occasional customers on the other. The market segment made up of large commercial law firms and corporate clients (repeat buyers) needs no government regulation, or at any rate much less, since the market addresses – although it probably does not entirely solve – the information problem through the reputation mechanism.

That is, the long-term relationship between a professional client and a law firm reduces the danger of opportunistic behaviour.

Moreover, large organizations often employ their own in-house legal executives who, because of their background in law, are in a better position to assess the quality of the external services received.

Thus the public interest of legal security (as defined in section 2.1.1) is far more important in the market segment consisting of small law firms, SMEs and consumers. Even here, though, the information problem is solved in part by the assistance provided to those seeking justice through third parties: legal expenses insurers, trade unions, subsidized legal aid and so forth. Because they themselves are legal experts and have considerable experience in buying the services of lawyers, these third parties have a much better idea of the quality of the service being received. Furthermore, reputational effects may arise from social networks that reduce the need for severe regulation. A public interest does indeed exist in the SME and consumer segment, but this does not take in the entire information problem since the market itself has solved a part of it.

Secondly, adverse selection is not that big an issue since legal services are not solely about the absolute quality of the lawyer providing them, but also about their comparative quality with regard to the opponent's lawyer or legal adviser, or the public prosecutor. A client is willing to pay far more for one lawyer just a little better than another, because that small difference could be decisive in the case. Clients are still unable to assess quality objectively, but they appreciate its importance and they have some perception of who is a good lawyer or what is a good law firm.

In this regard bounded rationality or rational ignorance has a special implication for legal services. Legal services are often performed in a tournament, winner-takes-all setting (cf. section 4.2.1 for an explanation of the tournament model). The situation is even more complicated, as clients don't have good information on the quality of the service provider. Clients will try to assess *all* the information at hand to judge the quality of the lawyer. This implies that they will take *any* information into account (e.g. the interior decoration of the office) they believe has signalling value, although it often conveys no proper information on the quality of the service.

External effects and Public goods

A third type of market failure occurs through external effects, that is, the effects of production and consumption that influence production opportunities and welfare but do not have a price. Without regulation, negative external effects result in overproduction (e.g. 'excessive' noise pollution in aviation). In the opposite unregulated case, positive external effects result in underproduction. Innovation represents an example.[27]

As public goods[28] are an extreme case of the positive external effect, we will discuss the occurrence of public goods in the legal services market provided by lawyers together with the occurrence of external effects. Two distinctive features of public goods are 'non-exclusiveness' and 'non-rivalry'. Non-exclusiveness of benefits means that it is impossible to exclude anyone from using the property. Non-rivalry means that use by one consumer is not at the expense of

27 If the benefits of innovation can leak away to other companies, businesses will invest less in innovation and development than is socially desirable. Intellectual property law (patent law, copyright law and so on) enables innovators to (partially) keep benefits of innovation internal, i.e. within the company.

28 The term goods also refers to services.

another. In other words, the marginal costs of an extra user are zero. Public goods include such products as sea defences or dikes. Consumers will often be unwilling to pay for these goods on an individual basis. Without government intervention, either nothing or far too little will be produced, even though there is a need for such products.

Externalities/Public goods in the market for legal services

External effects occur because the consequences of problems concerning quality (e.g. legal misinterpretation) go beyond the direct customers and generate serious negative 'externalities' for the general public. If transaction costs are not too high, winners could in principle compensate the losers (called 'Coasian bargaining' in economics).[29] Concerning legal services, however, Coasian bargaining cannot take place because the costs, including the cost of determining the monetary value of bad quality, are probably too high due to information problems. Moreover, the negative effect of bad quality has an impact on many people; it is costly to organize all those affected and bargain with them. Consequently, some kind of public intervention can be justified to tackle the negative externalities related to the delivery of bad quality by lawyers. A quality certification system may be justified to prevent negative externalities.

On the other hand, there may also be positive externalities if a lawyer delivers good quality and thereby supports the development of case law, thereby creating value for others who will learn current 'case law' without paying for it. Another not-priced effect prevails if the result of a trial has a pre-emptive effect on other parties.

Another, less important external effect is the 'network effect' described by Shy (2001).[30] This refers to the phenomenon that the value of a network to an actor in it increases with the size of that network. In this case, the group of lawyers becomes more valuable (i.e. the average fee rises) when more lawyers enter the profession. This is sometimes called 'network externality' because the new lawyer does not include these benefits in his considerations to enter the profession. Shy notes that 'the counter-intuitive phenomenon where fees rise with an increase in the supply of service people is not observed in most industries.' He explains this counter-intuitive effect by building a network model. Basically, his model shows that every lawyer creates his own demand so that total demand rises every time a lawyer enters the market for legal services. The most important assumption in the Shy model is that every legal case requires more than one lawyer (the defence and the prosecution in a criminal trial, for example, each need at least one lawyer). 'This,' he says, 'is the core of our analysis, as it highlights the externality imbedded in each law suit.' In the model there are η citizens, each of whom is considering initiating a suit against another citizen (for 'citizens' here, we could just as easily mean a number of employees or another group of potential clients). Shy then shows that the fees charged would rise as long as the number of lawyers is less than the group of potential clients (η). In the case of high (potential) demand relative to the supply of legal services, both the number of lawyers and their fees will increase because, due to the assumed network effects, there is excess demand for lawyers.

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29 Coase (1960) demonstrated through a series of examples that bargaining among agents could lead to efficient outcomes despite the presence of externalities if private property rights were well defined and the costs of bargaining were zero.

30 For another paper on the same subject see: Sander and Williams (1989). Also, Halla (2007) shows that in divorce cases the network effect plays a significant role. Despite the zero sum nature of the game and the lawyers' fees, each spouse has an incentive to hire their own lawyer, whereas a joint lawyer would be socially efficient.

Shy's model is of practical relevance. Due to the societal development that more and more problems are being turned into lawsuits, most countries show an increased use of the courts. Recourse to the law has become a self-reinforcing process which society can neither resist nor control. This would call for government re-regulation of the market in order to lessen the shortage of legal services providers, for instance by opening the monopoly to non-lawyer legal specialists who fulfil minimum requirements.

A third type of external effect does not directly influence the regulation of the legal profession as it primarily influences the administration of justice. The externality occurs because sections of the legal system are not priced. If court procedures are not followed properly, for example, that costs the judicial system time and hence money. Given the enormous workload facing the courts, this is an important effect; access to law should be priced. Duggan (2003) concludes that the cost of the civil justice system discourages people from litigating too much. Thus, possible problems of over-investing in litigation at the expense of other methods of dispute resolution are controlled by the costs of bringing a claim. The problem, however, is that the legal cost burden discourages parties from litigating often enough to achieve equilibrium in the market of consumer justice. On the demand side, the high fixed component of the legal costs regime (parties must pay a set cost regardless of the amount at stake) discourages all but relatively large claims. According to Duggan, conventional methods of pricing legal services discriminate systematically in favour of large claims and against small claims. The costs regime also favours repeat players who may achieve economies of scale by spreading costs over a large number of claims, whereas one-shotters, often consumers and SMEs, are worse off. Duggan asks what happens if people are overly discouraged from litigation? He sees at least two likely consequences. First, there will be an undersupply of corrective justice. The implication is that some disputes that should have been resolved will not be resolved at all. Other disputes that should have been resolved by litigation are resolved by less efficient methods, for example costly self-help remedies, or defensive measures. Second, there will be an undersupply of deterrence. The implication is that some avoidable disputes will not be avoided.

Another example: when one of the two parties to a dispute is ordered to pay the legal costs, aside from the direct court fees these do not include the cost of the judicial system. Although this is understandable given that the principle of universal access to law is important, the fact that no price is put on that access has unintended repercussions for the workings of the market for legal services. For instance, these external effects result in a greater likelihood of waiting lists appearing in the judicial system. The existence of these non-priced sections in the judiciary system calls for some sort of mechanism that filters out the disputes that could be resolved by a more efficient alternative, out-of-court settlement. Often these cases are filtered based on the amount at stake and complexity. It may well be argued that a judiciary system that succeeds in filtering out the less complex cases is exactly for that reason highly efficient. If governments indeed decided to filter out the less complex cases, this probably would also affect the demand for legal services. If cases fall outside the filter, a lawyer might not be deemed necessary by the regulator and consumers can freely choose from a variety of legal advisors.

Market failure might also arise because of the existence of public good. Information is one type of public good: Information generally satisfies conditions of non-rivalry and non-exclusivity as it can be supplied to third parties without incurring extra costs. The professional competence of lawyers most often takes the form of provision of information. Of course, clients are often very

heterogeneous with respect to the information they need. Furthermore, they may find it difficult to evaluate the relevance of particular information. In this respect, the public good feature of the legal professional's service is of lesser concern and does not call for extra regulation of the professional services market.

RBB (2003) contends that professional services can be classed as a public good since once advice has been given, it can be passed on for free. This non-rivalrous nature is, however, limited to the extent that any advice is so specific that another client with slightly different circumstances may not be able to use it. In practice, legal services are almost never non-rivalrous.

Although legal services themselves are mostly not public goods, they do constitute an important element of the broader concept of 'legal security' (cf. section 2.1.1). The proper functioning of the law (as part of legal security) can be seen as a public good. To the extent that the proper functioning of the law is influenced by legal professionals, legal services do contain a public good feature.

There is a fourth point to be made regarding the public good features of legal services. Information on the characteristics and quality of legal services can be seen as a public good. Apart from the interests of 'bad professionals' to not reveal their bad quality, there is a general problem. Information concerning the quality of legal services provided by certain professionals satisfies the conditions of non-rivalry and non-exclusivity in consumption. Therefore, there is the possibility that private provision of information (by professionals) on their product quality may not be accurate and efficient. This may very well justify mandatory disclosure with respect to professional quality (Maks and Philipsen (2002)).

2.1.3 Political considerations

In practice, we see that the government intervenes not only to correct the above four forms of market failure, but also for other reasons. The issue is then to achieve objectives in various areas including justice, legal security, distribution of wealth, ethics and morality. In none of these areas can uniform statements be made on the basis of economic theory.

The non-economic motives for government intervention can be roughly divided into two situations: income distribution and paternalism.[31] In situations where the market outcome is regarded as unjust, intervention is aimed at achieving a fairer outcome, such as in the case of progressive income tax rates.

Intervention may also be introduced for paternalistic motives. This applies in relation to both the discouragement of production and the consumption of products that the government believes to be detrimental to citizens (e.g. demerit goods such as tobacco or drugs) and to the stimulation of production and consumption of products that the government believes are beneficial to citizens (e.g. merit goods such as educational courses, theatre visits and compulsory seat belts).

[31] In theory, government intervention in economic life may also be justified to stabilize the macro-economy (inflation, high unemployment). These considerations, however, do not play a role in the situation at hand (guaranteeing legal security).

Public interest theory: Paternalistic goals and redistribution

The complexity and formality of civil procedural law could well put any party without expert representation at a disadvantage. That is an important political reason for imposing compulsory legal representation in court in order to protect the vulnerable, inexperienced party to a case. By requiring everyone to hire a lawyer under certain circumstances, the paternalistic government hopes to achieve 'equality of arms' for all parties to legal proceedings. As enshrined by treaty, the principle of equality of arms means that those able to pay the costs of legal representation must not be favoured over a respondent without the means to mount a defence.

The government's justification of the procedural monopoly is not only to protect 'weak' clients, but also to make the judiciary system more efficient (this justification also bears upon the fact that sections of the legal system are not priced; see external effects). These two arguments are not distinct from one another. First of all, the lawyer has a filter function on behalf of the courts. According to this argument, lawyers are better capable of assessing the legal position of a party to a case, of negotiating out-of-court settlements and, if necessary, of taking the matter to court. If it comes to the latter, the lawyer's expert presentation of the case eases the judge's task. Moreover, a clear and concise presentation contributes to 'equality of arms' in court. Without it, the judge would be forced to go into the whole factual background of the case and the legal form of parties' positions on it.

A second political rationale is redistribution: to prevent low income groups from having less access to legal services, most governments have introduced a system of subsidized legal aid.

Finally, for the sake of presenting a complete list of arguments justifying regulatory intervention, here follows an argument that has been put forward but which – in our view – is questionable. A lawyer in a small town may have a socially valuable role or function that goes beyond the professional service he provides and for which he is not directly compensated (Ogus (2003)). According to this theory, some redistribution in favour of the professional against the consumer is justified for these non-priced services. However, it is unclear if this is indeed true and, if it is true, why big city lawyers who surely do not provide such social services should enjoy the same extra profit.

2.1.4 Government failure

For a long while, it was assumed that the government fulfilled a corrective role in the event of market failure or in politically undesirable situations. However, government intervention itself can lead to undesirable social effects. We then refer to 'government failure' or 'regulatory failure'. Often, five forms of regulatory failure are distinguished.

The first form of regulatory failure relates to the complexity of regulation. Reality is far more complex than the idealized picture presented in rational policy theory. After all, many complex decisions must be made in the political process of dealing with a policy problem, from the choice of an instrument to its implementation design and enforcement. Given such complex choices, government intervention can have unforeseen and unwanted effects.

For example, think of the complex regulation required in the market for legal services when a government opts to regulate lawyers' fees or implement a subsidized legal aid system.

How can a socially correct fee or subsidy be determined, and what are the adverse effects if the government picks the wrong sum? It is very difficult to set rates for such a heterogeneous range of services. At present in Germany, lawyers' fees depend on the sum in dispute. The amount and number of tariffs may vary according to the lawyer's activity. As well as the state of case, its difficulty and extent or complexity are also factors to be considered. One possible unwanted effect is 'crowding out'. Lawyers will be inclined to take on the valuable cases only, or not spend enough time on the complex ones. This is related to the inability to assess quality.

Yet another problem occurs because the government does not have any better knowledge of the quality of the profession's service than the profession provides itself (though the government may have better knowledge than the average consumer of the service; Miller (1985)).

Secondly, the policy process requires a great deal of knowledge and information on the area to be regulated. This often involves information asymmetry: as a rule, market parties have more and better information than the regulator (the government). Information asymmetry between the regulator and the regulated sector or sectors can lead to regulatory failure.

This failure may occur if the market for legal services is closed to non-specialist providers. For instance, if the procedural monopoly is based upon the notion that expert legal support is needed in more complex cases. This is in the interests of both effective justice and of the parties concerned. Equality of arms must exist, after all, whilst the judge must not be burdened with an injudicious presentation of the case. But how can the government distinguish a complex case from a simple one? Lawyers have better information to answer these kinds of questions than the government. This issue is further discussed in section 2.2.

Thirdly, regulation can give rise to transaction costs that outweigh the gains in efficiency. Regulation almost always involves transaction costs: (a) institutional costs and (b) compliance costs. Institutional costs are for maintaining the system. Strongly steering regulation has few built-in incentives for self-enforcement and so carries high institutional costs. Occasionally the government can benefit from economies of scale by instructing an institution to take on several regulatory tasks. This has its limitations, however, and can lead to overburdened government machinery. Compliance costs are those borne by companies because they have to adapt their conduct or production to the new rules.

Both categories of transaction costs occur in the market for legal services. The level of these costs depends on the concrete terms of the regulations and on how radical regulation is in a specific case. For instance, mandatory schooling requirements entail other costs than merely those related to mandatory quality systems.

Fourthly, there are economic costs: regulation can harm both static and dynamic efficiency.[32] The government is less flexible than market parties, which is a problem especially in dynamic markets where innovation is important. In 'normal, traditional' markets inefficiency can also occur as a consequence of government intervention. European agricultural policy is a good example of this. Because of political considerations, such as food security, and the strong sector lobby, agricultural production in Europe is kept artificially high. Consequently, both static and dynamic efficiency remain lower than they could be. For example, static efficiency is damaged in Europe in the sense of over-production, which is not cost-efficient compared to agricultural production in other parts

[32] Static efficiency is based on the short term and relates to the optimal distribution of scarce resources among alternative production targets. Dynamic efficiency is based on the long term and focuses on increasing welfare over time.

of the world. This also has consequences for dynamic efficiency, particularly the investment behaviour of private parties. In the absence of the Common Agricultural Policy, investments would flow to other locations (outside Europe) and to other sectors as well.

In the legal services market, regulation has created an unequal level playing field for the various providers of legal services. Lawyers may go to court, whereas other specialist cannot. By restricting the number of suppliers, competition is restricted and the possible benefits of competition – increased static and dynamic efficiency – cannot be attained.

Finally, another regulatory risk is related to the fact that the ex-ante regulatory framework may not be clear. Sometimes governments change the ex-post regulatory framework in order to look after public interest. We call this regulatory insecurity.

Current regulation of the legal services market is partly justified on non-economic, mainly paternalistic grounds. This implies that policy content is very sensitive to the political climate and cycles. Depending on the political background of parliament and the minister of Justice, the regulation will be more liberal or restrictive. This results in uncertainties for market parties. For instance, one minister may prohibit contingency fees, whereas the next minister may allow them.

2.2 Private interest (Rent-seeking behaviour)

Regulation is not only an answer to market failure, but also the result of rent-seeking behaviour by special interest groups that are in a position to influence government regulation. The private interest approach combines elements from different theories. The main characteristic of these theories is that interest groups influence political decisions (regulation) in order to seek rents for themselves. Rent refers to the difference between sales revenue and production costs of goods or services. Rent-seeking behaviour is aimed at gaining financial advantages. Competition eliminates rents. However, rents are generated in the absence of competition (resulting from either market or government failure) meaning that wealth transfers from consumers to service providers. The private interest approach points out that regulation not only exists because of public interest, but also results partly from (or the final design is influenced by) the rent-seeking behaviour of the special interest group. The private interest approach includes such models as the public choice theory, the capture theory, the economic theory of regulation, and the model of competition among pressure groups.

The literature on public choice explains how individual preferences are reflected in the voting procedures used by public institutions (Buchanan (1987)). The assumption is that politicians have a certain goal and act as rational economic agents to achieve that goal. For instance, politicians do not aim at maximising public interest, but at serving their own interests by maximising their own status, budgets or votes in order to be re-elected. If politicians behave rationally this may give rise to inefficient regulation, particularly if lobbies are involved. Lobbying can then be effective in influencing the final design of regulation.

The capture theory makes the point that regulatory agencies are subject to pressure and bribery from the interest group subjected to a particular regulation (Posner (1974, 1975)). Because of the influence exerted by the interest group, the final design of the regulation may serve the private interest to a greater extent than the public interest. From this perspective, we see that regulation

of markets for professional services rises and is sustained because it serves the interests of the members of the profession. It results in cartel-like behaviour. Capture theory predicts that the arising regulation decreases the supply of professionals below a socially optimal level, increases the prices charged and increases the existing professional income beyond marginal productivity, thus generating rents and quasi-rents (Stigler (1971); McChesriey (1987); Olsen (1999); Hadfield (2000); Kleiner and Kudrle (2000); Garoupa (2004a)).

The economic theory of regulation sees the government as the supplier of regulation, while the demand comes from private interest groups looking for protective regulation (Stigler (1971)). This demand will persist if the interest group cannot maintain a cartel based on self-regulation. Stigler argues that every branch powerful enough will lobby to try to convince the government to erect entry barriers.

Becker (1983) has modelled competition among pressure groups for influence. Becker asserts that once a government decides to grant protection, it will tend to choose efficient as opposed to less efficient ways of redistributing income via taxes and subsidies. Any protection – such as entry regulation – entails deadweight losses (a decline in consumer surplus that is not recaptured in tax receipts). According to Becker, government regulators will select the protection mechanism that entails the smaller deadweight loss. Becker models competition between interest groups, not interactions between interest groups and legislators per se. What matters is how much lobbying pressure each group applies. Each group's equilibrium level of pressure depends on the degree of pressure applied by the other group. The more pressure groups exist, the less effective lobbying is. Becker says: 'Greater competition among lawyers and law firms would also weaken the political pressure that the legal profession brings to bear on policymakers in support of inefficient public policies because the returns from the legal profession's "investments" in political influence would be lower and because politicians could not deliver the rents they once did.'

Rent-seeking in the market for legal services[33]

All the above-mentioned theories suggest that the regulation that emerges will serve rent-seeking. However, rent-seeking behaviour is intrinsically difficult to identify: Wealth transfers may not be recognized by the public in general and comparisons with other jobs and occupations can be difficult (Van den Bergh (1993)). Nonetheless, the detection of requirements imposed by professional ethics, which do not satisfy a legal proportionality test, can be seen as circumstantial evidence of rent-seeking activities.

When would we expect to see successful rent-seeking? The most successful groups in obtaining wealth transfers are likely to be small, usually single issue-oriented and well organized. For the success of this group it is important that those bearing the cost of paying rents are large fractions of the population, difficult to organize and with information problems. If these conditions are

[33] Rent-seeking behaviour and self-regulation are extensively researched in the literature: Dingwall & Fenn (1987), Donabedian, B. (1995), Faure et al. (eds.) (1993), Fine (2003), Garoupa (2004a), Grajzl & Murrell (2006), Hadfield (2000, 2007), Hägg (1997), Hau & Thum (2000), Hellingman (1993), Henssler & Kilian (2003), Kilian (2004), Leffler (1978), Lueck et al. (1995), Maks & Philipsen (2002), Moorhead, Sherr and Paterson (2003), Noll (1989), Ogus (1993, 1994, 1995), Olsen (1997, 1999), Pashigian (1979), Peltzman (1976), Posner (1974, 1975), Rosen (1992), Rubin & Bailey (1994), Shaked & Sutton (1981, 1982), Sheperd (2000), Shinnick & Stephen (2000), Sloan & Hall (2002), Stephen (2002, 2003), Stephen & Love (1996, 1999), Van den Bergh (1993, 1999), Van den Bergh & Faure (1991), Winston & Crandall (2007).

met, wealth transfers are expected to take place from the public as a whole to the well-organized interest group.

Legal professionals are well-organized. There are no start-up organization costs. Moreover, they can exclude 'free riders' through compulsory membership in public bodies. The wealth transfer can occur as the public cannot identify the magnitude of the wealth transfer. Clients also incur substantial transaction costs to oppose the wealth transfer. The profession faces no real countervailing power from client groups. It follows that the conditions for successful rent-seeking are present in the case of legal services.

When there are public interest arguments for regulation, rent-seeking and regulatory capture is a real threat. In that case lobbying is potentially more successful because there are sound public interest arguments to be made in favour of regulation. An effective lobby implies that the final design of regulation is more in the interest of the profession than in the interest of the public. Nevertheless, several ways of limiting rent-seeking and regulatory capture are possible. A first way out is promoting competition from outside the profession (professionals from abroad or new providers, such as legal expenses insurers; we call this external competition). Apart from external competition, economic analyses derived from audits of professional bodies may also contribute to uncovering rent-seeking and regulatory capture.

Several commentators maintain that rent-seeking has not been empirically proven (Van den Bergh (several publications), Kilian (2003, 2004), Henssler and Kilian (2003)). For instance, the latter state: 'One may have doubts as to whether a small number of rules regulating certain details of a particular professional law are clearly related to the public interest […] but the principle remains that every professional rule does not exist for its own sake or in the interest of the profession, but in the interest of the public.' It is, however, unclear whose principle this is and what guarantees that this principle is indeed followed. Moreover, rent-seeking is empirically 'proven' in the case of lawyers in the US (Winston and Crandall (2007), cf. section 4.2.2). Of course, the fact that rent-seeking is an issue for some re-regulation of the legal profession does not imply that all regulation of the legal profession is not in the public interest.

2.3 Conclusion

In this chapter we answered the 'what' question. It involved reviewing two different regulation theories: the public interest theory and the private interest theory. Both explain why regulation takes place – namely safeguarding the public interest of legal security and safeguarding certain private interests, respectively. However, these theories cannot explain what the optimal regulatory mix should be (cf. Chapters 1 and 1).

Assessment framework

According to an economic postulate, any government intervening in the market should be able to justify its intervention by making a reasonable case that the social costs of regulation are lower than the social benefits of correcting market failures. This postulate does not depart from a bias towards the presumption that there is too much regulation. From an economic perspective the

starting point of any discussion on regulation, or on government action in general, is a situation without government intervention. Only if the market fails do we have an economic justification for regulation. Therefore the burden of proof rests on the government (or the Bar) that decides to create a high level of regulation of legal services (lawyers). The burden of proof also rests on the government (or the Bar) to prove that more regulation creates more net benefits.[34] What governments (or the Bars) need is a broader economic welfare perspective to weigh the pros and cons, that is, balancing the benefits of correcting market failures against the cost of government failure and the protection of public versus private interests.

If a market (legal services market) is regulated too strictly in the sense that safeguarding the public interest at stake (legal security) could be achieved with less regulation, the degree of over-regulation probably stems from safeguarding the private interests introduced by lobbyists (i.e. the Bar).

Notwithstanding the insights from private interest theory, it is also possible that – from a public interest point of view – too little regulation exists in the market for legal services.[35] Where regulation has both benefits and costs, in an effort to curtail the costs, governments have possibly reduced the level of regulation below the optimal level (RBB (2003)).

Conclusions to the public interest theory

As put forward by public interest theory, the elements boil down to one concept: to safeguard legal security. This includes access to law, fair and orderly conduct of legal proceedings and an efficient judicial process. It necessitates the availability of good quality, reasonably priced legal services. At the very least, fair, balanced and orderly legal proceedings require sufficient knowledge of relevant rules (such as procedural law) and of jurisprudence by those concerned. The average citizen does not usually possess this specialist knowledge. Therefore, an adequate supply of identifiable, high-quality legal services should exist to serve the public interest so that all in need are able to obtain appropriate assistance.

The public interest of legal security arises because of two types of market failures: information asymmetry (the client is not in a position to effectively assess the quality of legal services) and external effects (most notably those associated with good/bad quality effects). Apart from these economic rationales for government action, two non-economic, political rationales also exist. One important political reason for imposing compulsory legal representation in court, for example, is to protect the vulnerable, inexperienced party to a case. By requiring everyone to hire

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34 In a recent European study on the conveyancing services market (Schmid et al. (2007)) this 'burden of proof' argument is also made in a non-economic context (p. 67):

> 'As the German *Monopolkommission* has plausibly argued, it is on account of the general commitment of the European and national economic constitution to competition and free markets that those who argue in favour of a necessary correlation between fixed fees and quality should bear the burden of proof for all steps of the proportionality analysis. This is also in line with the fact that the argument of consumer protection and quality cannot refute the finding of a restriction but is to be made at the level of proposing justifications for that restriction. At that level, the usual rule applies according to which those who want to benefit from a justification have to invoke it and prove that its conditions are met.'

Also, the *Cipolla* case (cf. Appendix C) the Court recognizes that governments should be able establish a causal link between the regulation (the setting of minimum levels of fees) and the expected benefits of this regulation (a high qualitative standard of professional services provided by lawyers).

35 We consider this possibility when describing the effects of lawyers' fee regulation in section 4.3.1.

a lawyer under certain circumstances, the paternalistic government hopes to achieve 'equality of arms' for all parties to legal proceedings. The second political rationale is income redistribution, that is, to prevent low income groups from having less access to legal services, the government has introduced a subsidized legal aid system.

Table 2.1: Situations in which government intervention may be desirable

Theory	*The public interest at stake ion the market for legal services is legal security, which is caused by:……*
Market failure	
Lack of competition	- None
Information asymmetry	- Experience and trust goods - Principal-agent problem/Moral hazard - Bounded rationality/Rational ignorance - (Adverse selection)
External effects	- Network effects - Non-priced bad/good quality effects - (Non-priced sections of the legal system)
Public goods	- None/Proper functioning of the law
Political considerations	
Unequal distribution of welfare	- Legal aid programmes: low income groups should have access to law
Paternalistic motives	- Protection of the vulnerable, inexperienced party to a case

Source: SEO Economic Research

Table 2.1 summarizes the rationale for undertaking government action in the legal services market. Government action, such as quality certification, may be justified on the grounds of information asymmetry. However, because the market itself solves some of the asymmetry the regulation need not be too restrictive. For instance, the segment for repeat buyers and clients with in-house legal executives needs little to no government regulation. Because third parties, such as trade unions and legal expenses insurers, also solve part of the information problem for one-off clients (SMEs and households), there is no need for government regulation to address the entire problem. Reputational effects may arise from social networks that decrease the need for severe regulation.

Network effects would call for government re-regulation of the market, for instance by opening the monopoly to non-lawyer legal specialists who fulfil minimum requirements. In most states this would imply less regulation.

In order to prevent negative externalities a quality certification or licensing system may be justified. That is not to justify, however, a monopoly position for lawyers. The existence of non-priced sections in the judiciary system calls for some sort of mechanism that filters out cases in dispute that could be resolved more efficiently out of court. This external effect has no implications for the regulation of legal professionals, but rather for the administration of justice.

The public good feature of the legal professional's service does not call for extra regulation of the market. Finally, the public good feature of information on the quality of legal services provided by certain professionals justifies mandatory disclosure with respect to professional quality. Without such regulation there is the possibility that the private provision of information by professionals on the quality of the product will not be accurate or efficient.

There is a need for some degree of regulation of the market for the legal profession because of the market failures described above. This chapter shows that the need to regulate is less urgent than is usually assumed by government agencies and Bars.

Conclusions to private interest theory

Private interest theories identify lobbying as a source of government regulation that is detrimental to welfare. These theories predict that regulation serves to increase producer welfare at the expense of the consumer, because regulation reinforces cartel-like behaviour, which allows firms to increase profits by collectively restricting output. In this theory, the sector itself calls for regulation, such as qualification standards, quality requirements or import protection. However, such regulations can lead to problems if they are too stringent from the point of view of competition, as they constitute entry barriers. These can easily be higher than necessary, because once entrepreneurs are active in the market, they have an interest in the highest possible entry restrictions and in a lack of competition in terms of quality or from imports. If the benefits are concentrated among the producers and the costs are divided over a large group of consumers, lobby groups are in a better position to push through inefficient regulation.

However, rent-seeking behaviour is intrinsically difficult to identify: Wealth transfers may not be recognized by the public in general and comparisons with other professions and occupations may be difficult. We conclude that the conditions for successful rent-seeking are met in most national markets for lawyers' services. If we combine this conclusion with the conclusion from the public interest perspective – namely that the need to regulate is less urgent than is usually assumed by government agencies and Bars – we conclude that the overregulation of the legal market also stems from safeguarding private interests of legal professionals.

Regulation by government or private body requires that the regulatory agency avoids capture and is able to do what consumers cannot: assess quality and signal it to potential clients (Stephen and Love (1999)). Apart from simple mandatory disclosure measures (e.g. professional speciality, professional education) and prohibiting obviously misleading advertising, effective quality regulation by the government is difficult. External competition (professionals from abroad or new providers) is also an effective manner of excluding rent-seeking and regulatory capture.

To sum up

Chapter 2 identifies the public interest at stake in the market for legal professional services as legal security. This public interest originates from the characteristics of the service (legal services are both experience and trust goods that suffer from principal-agent problems) and from the facts that (a) consumers cannot assess the quality of the service (bounded rationality and some chance of adverse selection) and (b) quality effects are not priced. In addition, governments are convinced that low income groups should have access to law and that the vulnerable, inexperienced party to a case needs protection. Based on the public interest perspective there is a need for some degree of regulation of the market for the legal profession. This regulation should mitigate the information problems concerning the delivered quality. Generally, a license or certification system suffices to deal with the information asymmetry.

In most European countries, the public interest is not analysed in any detail; it is usually *assumed* that the need to regulate exists. This chapter shows that the need to regulate is less urgent than is usually assumed by government agencies and Bars.

3 Intervention and regulation ('how')

Now that we have defined the public interest at stake, the subsequent question is how the government can best intervene to safeguard it. In this chapter we describe the various regulatory options governments have when regulating the market for legal services; we answer the 'how' question. In order to be able to answer the 'if' question, in the next chapter we sketch the most important costs and benefits of these regulatory options in a qualitative manner.[36]

The institutional framework has two important dimensions: who is regulating, and how is the market is regulated? In section 3.1 we discuss the pros and cons of the identity of the regulator ('who'): the government, an independent private body or the profession itself. In section 3.2 we discuss the rationale for and implications of the most common elements of regulation ('how'): restrictions on entry, restrictions on fees and fee contracts, restrictions on advertisement and other restrictions on conduct. For each element we explain why that aspect is being regulated and to what extent this can be justified from the public interest perspective.

The insights from these sections will lead to the construction of an assessment framework for the comparison of different institutional backgrounds in different countries (section 3.3). Also, we briefly discuss some previously developed assessment frameworks.

3.1 Who is regulating?

The institutional context is determined by both the public (the government or other independent bodies) and the profession. The final regulatory arrangement is usually a mixture of public and private regulation. Both public and private regulation have advantages and disadvantages. There are three ways to regulate the profession (cf. Box 3.1). The first option is that the state empowers the Bar association to regulate the profession without the full involvement of the state (section 3.1.2). Alternatively, the state retains the power to adopt the professional rules applicable to the legal profession in the last resort (section 3.1.1). In this case, the professional rules are considered state measures and therefore do not fall under the scope of EC competition law. In the *Wouters*' case (Appendix C), the EU court established that Bars are bound by Article 81 of the EU Treaty. This means that the Bars' rules must follow all the same competition rules that other businesses must follow. A final option is private regulation (section 3.1.3).

3.1.1 Regulation by the government

Chapter 1 discussed government regulation that aims at obtaining social benefits by correcting market failures or by attaining particular political goals (public interest perspective). At the same time, as noted in section 2.1.4, government regulation can entail social costs as a result of information problems, high transaction costs, regulatory insecurity and economic inefficiency.

[36] In Chapter 1 we try to quantify the most important costs and benefits. Unfortunately, however, due to lack of available data this is to a large extent impossible.

Such government failure is a hot topic in private interest theory: government failure as the result of capture and lobbying (section 2.2).

Box 3.1: Government, self-regulation and private regulation

With *pure government regulation*, the government sets a target, the resources to achieve it, as well as providing the relevant supervision and enforcement.

The government can also set a target and use the instrument of self-regulation to achieve it. In that case, we refer to *conditioned self-regulation*. This uses the advantages of self-regulation in relation to government regulation, while monitoring the government target to be achieved. Conditioned self-regulation occurs when the government deliberately permits or even encourages certain forms of self-regulation but at the same time attaches certain conditions to it.

Self-regulation means that, to a certain extent, the parties in society are responsible for setting up, implementing and enforcing their own rules. It can arise firstly as an alternative for government regulation. In such case, the underlying motive for self-regulation is similar to the potential justifications for government regulation (guaranteeing public interest). On the other hand, self-regulation can develop without the need for government regulation. There could be problems involving motives similar to those that ask for government regulation (information issues, external effects, etc.), but of a severity that does not (yet) justify government intervention. In such situations, the sector can decide on self-regulation on its own initiative and then we speak of *voluntary self-regulation or private regulation*. One example of self-regulation is the initiatives to improve the image of a sector in which information asymmetry is a problem. Joint efforts for corporate social responsibility fall into this category. Self-regulation is also an option in markets where fundamental rights are at issue, such as the media, where the right to free expression of opinion is an important issue. In such markets, the government is reluctant to take regulatory action.

Degree of government involvement increases in the direction of the arrows:
Private regulation/Voluntary self-regulation → Conditioned self-regulation → Government regulation

Source: SEO Economic Research

3.1.2 Self-regulation

A lawyer is expected to comply with both government-enforced regulations and with the rules for self-regulation laid down by the Bar, including its disciplinary procedures. The Bar is a statutory public body governing lawyers, but at the same time it is also a professional organization representing lawyers.

Self-regulation in the legal services market is *conditional self-regulation* (Box 3.1), which involves the government allowing and even encouraging self-regulation, but subject to a defined statutory and procedural framework. Within limits, market players and other groups in society are free to assume responsibility for compiling, implementing and enforcing their own rules. Self-regulation by professionals implies that the professional body formulates rules to govern the activities of its members.

Possible advantages
The natural tendency of subjects to observe its rules (spontaneous compliance) is much greater than would be if the regulation was imposed by a government body. This makes the enforcement costs considerably lower than in state regulation. As a general rule, regulatory costs – for creating,

enforcing, administering and amending a regulatory regime – are lower under self-regulation than under statutory regulation.

First of all, this is because devising and implementing self-regulation takes less time than the often lengthy legislative route; those involved find it easier to reach agreement and there are fewer bureaucratic obstacles to putting the rules in place. Self-regulation is (or could be) more flexible compared to regulation by public bodies.

Secondly, it is easier to match regulations to the profession's knowledge and experience because, for example, there is greater readiness to co-operate in their formulation and to provide information. The main advantage of self-regulation for professional services is that professional regulators are assumed to have better information to extract market signals for credence good. This argument is known as the specific knowledge argument put forward by Miller (1985).

Possible problems with the above arguments

As in many other liberal professions, the law claims that its self-regulation is in order because – due to the complexity of the subject – non-lawyers cannot and do not possess enough knowledge to establish an adequate regulatory regime. In general, however, the economics literature is negative about such arrangements: 'Self-regulation is characterised as, potentially, having the effect of a cartel, by controlling entry to the market [...] members of the profession earn economic rents.'[37]

Although self-regulation may solve the information problem, it is quite likely that professional bodies use their regulatory powers to restrict competition in some way. Such rent-seeking behaviour results in a loss of welfare, which economists call deadweight loss (excess burden of monopoly; people who would have more marginal benefit than marginal cost are not buying services because the price is kept artificially high). So, even if the information problem is to an extent solved, yet another problem arises and that is 'how to avoid regulatory capture?'

It is questionable whether the information problem is really solved by self-regulation. Though the professionals have better information, there is no guarantee they will pass this knowledge on to consumers. After all, it may not be in the interest of the profession to pass on information, and it is relatively easy not to do so. Since profit-maximizing professionals wish to exclude competition, they are better off giving the impression that the services of all professionals are equally good. This implies that it may be in the interest of the professional body not to give information on the quality of individual service providers. Professional bodies may lack incentives to control and enforce quality standards. Furthermore, the moral hazard problem is not solved: A professional is still interested in inducing a demand for services that fully informed clients might not want (risk of inefficient allocation of resources). If self-regulation impedes information on these quality differences, then the search costs are increased by self-regulation rather than decreased.

Another point is the supposedly better flexibility of self-regulation. If the profession is successful in restricting competition and earning rents, it will resist any change that might reduce rents.

Yet another point relates the specific knowledge needed for (self-)regulation: For legal services, it is the question to what extent the professional body can judge quality. As Hadfield (2000) points

37 For instance, Stephen & Love (1996) and Maks & Philipsen (2002) draw these conclusions.

out, the information problem for legal services is so severe that even colleagues cannot make a good judgement:

> 'The necessity and quality of legal services are not merely difficult for non-experts to judge; they are also difficult for experts, *even the expert providing the service*, to judge. This magnifies the credence problem dramatically.'

Thus most of the possible advantages of self-regulation do not actually hold in the market of legal professional services. Van den Bergh (1993, 1999) concludes that the current practice of professional bodies needs to be investigated to see whether self-regulation rules are used to assure minimum quality through sanctions for malpractice and are not instead mostly concerned with restricting competitive behaviour by professionals. Stephen (2003) states that it seems curious to many economists that the regulation of a market should be given over to those who act as suppliers in that market rather than to an independent body:

> 'Most economists would argue that this effectively puts the members of the profession in the position of a cartel. Whilst there may be complex historical and political reasons for the common emergence of such arrangements, some economists have argued that this system has arisen because it is the most cost effective.'

However, as Stephen adds, these benefits need to be compared to the potential efficiency losses due to the potential for cartel-like behaviour (remember, Bars are recognized as an 'association of undertakings' under the terms of Article 81 of the EC Treaty).

In line with the words of Van den Bergh and Stephen, the position of the national Bars has been the subject of discussion in some countries. In the first place, the debate has been concerned with the role of a self-regulatory body. On the one hand, the Bars represent a specific interest (that of lawyers), but on the other, they represent the public interest (that of individual citizens, business clients and others). Some voices have been calling for the creation of a separate 'Authority for the Legal Markets' that represents the regulatory tasks from the public interest perspective. Another idea is to choose the German model and deal with administration through a non-governmental public authority (Henssler and Kilian (2003)). The self-administrative body of the German legal profession, the *Rechtsanwaltskammer*, is not identical to the *Anwaltverein*, a body constituted on the basis of voluntary membership to represent the legal profession.[38]

A second debate concerns the type of lawyers represented and regulated by the Bars. Despite the fact that non-procedural and procedural practices are different markets, the Bars treat them as one and the same. Some commentators believe that lawyers who are not active in court are completely different in nature and should be organized separately. Large commercial law firms, in particular, are active well beyond the standard work of providing legal services in court situations. For instance, the former Dutch minister of Justice poses the question whether lawyers' special privileges should be linked to the practice they are in.

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[38] The German model of self-administration entails the obligation that each and every professional practice rule, without exemption, must be measured against law of a higher order. Unfortunately, we could not find any reports describing a quantitative measurement process for current regulations.

Other views on self-regulation

One view is that there is a social contract between the profession and the community in order to reduce the moral hazard problem. That is, the professional body, the Bar, is supposed to act in the public interest. Another view is that if more professional bodies were in competition with one another the reduced costs for extracting information by professionals more than compensate for professional losses due to cartel-like behaviour. It has been argued that the public interest would be protected best by having a number of professional bodies competing against each other (Ogus (1995); Stephen (2003)). Losses due to cartelization can be mitigated by a large heterogeneous profession (Shaked and Sutton (1982)).[39] Finally, adequate legal instruments such as tort law could also mitigate cartel-induced losses (Danzon (1985, 1991)).

3.1.3 Regulation by private parties

Of course, independent parties could also solve some of the problems in the market. These include, for example, independent rating agencies, liability arrangements, legal billing auditing and the requirements set by legal expenses insurers.[40]

Independent rating agencies

Independent rating agencies could perform the agency function on behalf of infrequent consumers (Stephen and Love (1996)).[41] Repeat consumers could design this agency. Another possibility is that one independent party serves as an impartial platform where those seeking justice can pose legal questions and several affiliated lawyers tender offers. This tendering mechanism exists in the Netherlands (XS2Justice) and has led to substantial price decreases for the tenders.

Influence of consumers through litigation (liability rules)

Deregulation and adequate liability rules (that are paralleled by a removal of informational barriers) are a way of leaving the regulatory tasks to private parties (Faure and Van den Bergh (1991)). Regulation by litigation is a form of ex-post regulation. The large scale of litigation in the US has forced changes of a regulatory nature and professionals to limit opportunism (moral hazard) (Viscusi (2002)). However, there are also objections to using litigation as a way of stimulating effective regulation (Garoupa (2004)):

- Consumers do not have the appropriate information to make comprehensive analyses of whether or not negligent behaviour, reckless attitudes or professional malpractice have been exercised (so that litigation is an inferior substitute to regulation);
- Consumers may be opportunistic and generate too much litigation;
- Litigation usually aims at compensation, so it may not create adequate incentives for efficient regulation;
- Litigation may fail in achieving efficient risk-sharing: restoring 'pre-accident' levels of utility may not be possible, especially in the context of health effects.

39 In section 2.2 we referred to this option as external competition.

40 Cf. Klein & Leffler (1981) for a general paper on the role of private regulation and competition in assuring contractual agreements.

41 Customers are unsure of the service they need. The assessment of the needed strategy is called the 'agency function' (see section 2.1.2).

Strengthening liability rules may, however, have a controversial impact on the way professionals conduct their practice. This has been documented in the context of medical services. Kessler and McClellan (1996, 1997, 2002, 2002a and 2002b) show that malpractice liability provides important incentives for medical care. For example, doctors in areas with greater malpractice pressure tend to use more defensive medicine. This might not be seen as beneficial by all clients. On the other hand, Kessler and McClellan show that better treatment and high medical productivity seems to be positively related to the willingness of patients to litigate. The optimal liability rule is a hot topic in academic literature.

Professional legal bill auditing

A third possibility is that professional legal bill auditing services 'regulate' the market. These auditing services exist mainly in the US, but also in Europe (e.g. by Legal Benchmarket). Software is being developed to look into the archived legal bills of companies and industries even to determine benchmarks. However, such auditing services are delivered to large corporate clients, whereas the information problems are most evident for small clients, the one-off consumers.

Legal expenses insurers

Legal expenses insurers can also be seen as private parties who influence the market outcomes and thereby regulate the market. This is because in most countries legal expenses insurers have long term contracts with lawyers – based upon their experience, those insurers often select their preferred suppliers – which can be seen as a form of regulating prices and quality.

Another example stems from the Finnish market where legal expenses insurers include additional clauses in their insurance policies, which oblige the insured party to engage a 'legally qualified' adviser for the legal procedure.[42] This means that the client has the freedom to pick any legal adviser, from *Asianajaja* (Bar member lawyer) to one with a title, as long as the adviser meets particular legal qualifications. According to the Federation of Finnish Financial Services the main qualification is that legal counsel should have a law degree. It is not required for the legal counsel to practise under the supervision of the Finnish Bar.

3.2 How is the market regulated?

As shown above, there are many potential problems in the market for legal services that could lead to lower social welfare. There are also many possible problem-solving instruments that could lead to improvements in social welfare. This section describes the various regulatory instruments. For each group of instruments we answer the following questions: (1) what is being regulated and (2) what is the economic rationale for regulating that element? This should give clues as to what degree of regulation is necessary. We need these insights to construct an assessment framework for the international comparison of the institutional background.

[42] Henssler and Kilian (2003) falsely assume that the policy clauses of Finnish providers of legal expenses insurance require that the insured has a duty to engage a lawyer 'who practises under the supervision of the Finnish Bar Association or is "legally qualified", or who is employed by a lawyer who satisfies these requirements.' See also: CCBE (2005).

We studied the following regulatory instruments:

- Restrictions on entry (section 3.2.1);
- Restrictions on fees and fee contracts (section 3.2.2);
- Restrictions on advertising (section 3.2.3);
- Other restrictions on conduct (section 3.2.4).

3.2.1 Entry restrictions

Ordinary people with a legal problem, or a potential one, find it difficult to assess the quality of legal services (see section 2.1.2). Traditionally, this has been tackled by creating so-called 'domain monopolies'. Certain activities are reserved for a select group, which can demonstrate that it is able to provide the quality required. Such a monopoly is maintained by imposing a legal ban on outsiders performing the tasks concerned. Examples of traditional domain monopolies include notarial services, bailiff services, the courts and representation in them. This latter monopoly is referred to as the procedural monopoly.

A certification or licensing system is not the same as a monopoly position *for lawyers*. It merely means that *anyone* who meets particular requirements is allowed to provide the monopolized services. In the practice of most states, the only providers allowed into the legal monopoly are lawyers. The entry requirements for the legal profession, including the compulsory training and permanent education that lawyers must undergo, are intended to guarantee that they command the knowledge and skills needed to take part in legal proceedings.

Entry restrictions define the conditions that must be met by potential entrants in order to be allowed to practise. Entry regulation usually takes the form of some sort of certification or licensing. Certification and licensing is an ex-ante control on quality: it regulates the professional before the activity takes place. Under certification or licensing a document (certificate or license) is awarded to an individual who satisfies certain conditions, which may be education or training. The government or a private agency may certify or license professionals and regulate professional education, compulsory periods of training and performance requirements.

Certificates or licenses may include many entry restrictions, such as:

- The requirement to obtain a specific diploma (where barriers to entry may also apply, e.g. requirements for prior education, entrance exam, numerous clauses on enrolments, etc.);
- Mandatory training after education;
- Mandatory traineeship;
- Mandatory exam after traineeship and postgraduate training;
- Mandatory registration requirements;
- Nationality requirements;
- Sometimes numerous clauses on the number of professionals.

The above requirements are only binding if meeting them leads to exclusive rights. There is a clear distinction between certification and licensing in that the latter goes further than the former. Certification (usually called title protection in this regard) is merely a signal that a certain service provider has satisfied some educational or possibly other, additional requirements. In theory

anybody can be active in the market, but those without the certificate are not allowed to use the protected title. In markets where consumers have heterogeneous preferences and where there are no severe externalities, certification or title protection works well if consumers are free to choose between certified and non-certified professionals.

When a profession is licensed, it means that the provision of its services is reserved for licensed professionals. The economic rationale for licensing is that the average quality in the market will increase, as the suppliers with inadequate education will be excluded. The validity of this argument depends of course on the relationship between the educational level of the supplier and the quality of his services. More specifically, it depends on the effects of education on the marginal costs of providing high quality. If someone is highly educated, the marginal costs of providing high quality are supposedly lower. However, human capital may depreciate over time, so periodical examinations, or regular participation may be necessary. Furthermore there is one important point to make: Licensing is too strict because there will always be consumers who would rather buy lower quality at a lower price. This holds even if we take into account that legal services are carried out in a tournament-like setting (see section 4.2.1), because there will always be clients with a willingness-to-pay level lower than the current price. That could be because of limitations on wealth or because the low stake of the case.

Generally, if the consequence of bad quality is really harmful and consumers are risk-averse rather than risk-natural, then licensing is more suitable than certification. Both licensing and certification can lead to inefficient overinvestment in education in order to signal high quality. Licenses can be used as entry barriers.

Scope of exclusive rights

The scope of exclusive rights matters a great deal. Depending on the scope of the exclusive rights potential professionals decide whether they are prepared to take all the hurdles to entry. If entry restrictions are high but do not lead to exclusive rights or the scope is very limited, then entry restrictions do not matter much. The scope of exclusive rights – the scope of the professional monopoly – limits external competition, that is, competition with other, comparable professions.

Sometimes the terms licensing and self-regulation get confused. In the case of pure self-regulation (private regulation) the profession regulates entry and performance. The consequence is that self-regulation promotes strong professional association, whereas licensing does not.

> 'A profession only becomes a real profession if it has the decisive power to fix remuneration; otherwise it is just a form of licensing. […] Entry restrictions should be more similar to certification rather than a very comprehensive and strict examination of candidates before, during and after education and training takes place.' (Garoupa (2004)).

Even if severe entry restrictions do not exist, this does not automatically imply competition: Professional markets tend to be spatially localized (Stephen and Love (1999)), hence mobility might be seriously undercut, and local monopolies could arise (Pashigian (1979)). For instance, in many jurisdictions lawyers may only appear before courts in the local area corresponding to the Bar to which they have been admitted.

While entry restrictions are justified in order to assure quality of professional services, they also undermine competition by creating professional monopoly rights (Shaked and Sutton (1981); Van den Bergh (1999)). Control over entry restrictions by the professional body can be exercised on three levels:

- By defining the content of intellectual and training requirements;[43]
- By exercising influence over the institutions that educate and train professionals (Shepherd (2000));
- By evaluating candidates following education and training (or some other type of screening) and possibly subjecting admission to some kind of numerous clauses.

For high quality services, accumulation of human capital is, of course, important. Self-regulation may increase the specificity of human capital investment and individual commitment to the profession (Donabedian (1995)). From the private interest perspective, some control over entry requirements is acceptable. But the profession should not be allowed to influence the institutions that educate and train candidates, or have any sway over the strict education of candidates.

Educational requirements do vary for lawyers. A law degree is enough for practising law in Spain and Finland, but not in most countries. In some countries there is extensive mandatory training followed by examination. In other countries licenses depend on the requirements of continuing education and in yet other countries additional training after law school is not mandatory for a license.

Self employment

In some countries it is possible to be a lawyer in the employment of a non-lawyer. For instance, in the Netherlands, a new Regulation on Practice by Salaried Lawyers entered force on 1 May 1997. This made it possible for lawyers employed directly by non-law firms to be called to the Bar, as long as their employer signed a declaration stating that the person was able to practise law independently. Five kinds of salaried lawyer were expected to apply for admission to the Bar: company lawyers, government lawyers, those employed by legal expenses insurers, non-profit sector lawyers and those employed by law centres or legal-aid bureaus. In the last three cases, where the employer is not the client, complications were expected and were addressed by means of supplementary rules.

Despite the high expectations – that between 1,200 and 1,600 salaried lawyers would be called to the Bar – the numbers were in fact far more modest. As of 31 December 2001, the Dutch Bar included only 280 salaried lawyers in the employment of non-law firms. Most of the new entrants were company lawyers, and in general the decisive factor in this move was personal reasons rather than cost-benefit considerations by employers. By 2001, not a single lawyer employed by a legal expenses insurer was registered. After 2002, the number of lawyers employed by legal expenses insurers slowly increased to 50 salaried lawyers in 2006. In Box 3.2 we explain how the reaction of the Bar slowed the entrance of lawyers employed by legal expenses insurers in the

[43] Entry restrictions could also apply to para-professionals. Entry of low-quality para-professionals could be welfare-improving (Shaked and Sutton (1981)), but could also be welfare-decreasing (Gehring and Jost (1995): 'Restrictions on paraprofessionals are expected to be undesirable unless profits of the profession are given a sufficiently high weight in the social welfare.').

Netherlands. There is no reason to assume the response to the concept of salaried lawyers would be substantially different in other European countries.[44]

Box 3.2: Reaction of the Dutch Bar to the entrance of lawyers employed by insurers and other organizations

The conservative attitude of the Bar towards the new concept of lawyers employed by non-law firms is obvious from the difficulties the legal expenses insurers met with their salaried lawyers. In 2001 not one lawyer employed by a legal expenses insurer was registered. The reason why legal expenses insurers initially did not take on salaried lawyers, or seek admission to the Bar for lawyers they already employed, is that the industry considered – as it still does – that the right to the free choice of a lawyer is too generously formulated by the Netherlands Bar Association (see Appendix B for details on the free choice regulation). The law states that the insured is entitled to the free choice of a lawyer (i.e. either an external lawyer or a lawyers employed by the insurance company) for judicial or administrative proceedings and if a lawyer is actually hired.

In many cases, however, that situation does not arise: A settlement is reached, or some other way of concluding the matter is found which does not involve the courts. Still, the insurance company is forced to present the insured with the free choice whenever legal support is required in reasonable expectation that court proceedings may ensue. Later this was changed to 'whenever a lawyer is called in'. These strict conditions make it risky for an insurer to entrust a case to a lawyer on its own payroll. This is because whenever a case is handed over to that person, the spectre of free choice raises its head, together with all its cost implications. Because the salaried lawyer has been unable to build up a reputation in his own right,[45] and also for geographical reasons – it is easier to be represented by a local lawyer than one working out of a distant insurance company office – the chances that policyholders will exercise their free choice and select an external lawyer are so great that it is not worth the insurer employing in-house ones.

Under these circumstances an insurer will prefer not to employ lawyers, say, who are members of the Bar because free choice comes into play as soon as they become involved in a case, quite possibly long before there is any question of court proceedings beginning. Under pressure of the Dutch Competition Authority the strict conditions of the Bar's Regulation have been removed. Since then the number of salaried lawyers has increased to about 50.

However, it is not only the prospect of lawyers being employed directly by legal expenses insurers to which the Dutch Bar has responded negatively. There was also resistance to their being hired by, for example, trade unions and legal-aid bureaus. Lawyers employed by a trade union, for example, are authorized by the Bar to appear in court proceedings but only as long as their work remains within the 'idealistic' domain of their employer's activities. And it is the Bar that decides what does or not constitute 'idealistic' work. Effectively, this means that union lawyers are excluded from everything but labour and social insurance law work. The trade union federation CNV tried to obtain recognition for one of its staff lawyers at the time, but was unable to for exactly this reason: The scope of their work was considered too broad by the Dutch Bar. Employees of legal-aid bureaus were also being frustrated in their attempts to achieve recognition because their work was not confined exclusively to the system of subsidized legal aid.

Source: Baarsma and Felsö (2005)

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44 The same applies in the US. For instance, Rhode (2004) studied the US market and concludes that for most people seeking justice, access to law has been limited not only by insufficient subsidised legal aid but also by restrictions on the delivery of (routine) legal services. 'Bar efforts to restrain lawyers' competitive practices have inflated the costs and reduced the accessibility of legal assistance; the Bar's regulatory structure has remained overly responsive to professional interests at the expense of the public. […] A similar point could be made about the profession's role in pre-empting competition from non-lawyers. Although Bar leaders have long claimed to "fight to stop unauthorised practice is the public's fight", the public has been demonstrably unsupportive of the effort.'

45 Unlike independent lawyers employed by law firms, salaried ones find it difficult to build up a personal reputation because their clientele is limited to policyholders.

The situation in England and Wales presents another example. Due to regulatory differences no level playing field exists for lawyers employed by non-law firms and self employed lawyers. In England and Wales salaried solicitors cannot recover the cost of handling a case from the other party if they win a case. This means that legal expenses insurers are sometimes forced to hire an external or network lawyer, although they have an in-house lawyer, in order to be able to recover the cost. The fact that the tariff of an external/network lawyer is much higher means that this often implies that the legal expenses insurer breaks even on a case basis after recovering the cost through the external/network lawyer. If they could recover the cost through their internal solicitor the insurers would earn a profit. The consequence of this regulation is that the insurance premium is higher than necessary, thereby reducing access to law.[46] Moreover, the party that loses the case has to pay too much when paying the costs of the case.

Most countries, however, abstain from the concept of salaried lawyers because the regulator is convinced that the core principle underlying the employment relationship – subordination to the employer – is incompatible with the freedom and independence required of practising procedural members of the legal profession. However, the same professional standards apply to lawyers employed by non-lawyers and self-employed lawyers. Often the employer has to sign a declaration stating that the lawyer is able to practice law independently. Moreover, just as a lawyer employed by a non-law firm is subordinate to his employer, so is the self-employed lawyer subordinate to his client.

Restrictions on organizational forms

Strictly speaking, restrictions on organizational forms are also a form of entry regulation. There are two common organizational restrictions excluding (1) incorporation and (2) multidisciplinary partnerships from possible organizational forms. The usual justification for these restrictions is agency costs: Effort in production and quality is difficult to measure by others outside the profession (Matthews (1991)). Obviously the problem is by banning these organizational forms, specialization of professionals beyond particular aspects and economies of scope are lost. These restrictions are difficult to justify by public interest. If some aspects of professional services may favour partnerships rather than incorporation, we should expect the market to solve this issue and not the professional body (Garoupa (2004)).

A second type of restriction on organizational forms concerns the separation between the service function (assessment or diagnosis of the problem) and the agency function (implementing the correct solution). UK solicitors and barristers form an example of such a separation (Box 3.3).

[46] Note that in the future, when others than lawyers are allowed to own a law firm in England/Wales, this problem will no longer exist as legal expense insurers can then own their own law firm and the concept of salaried solicitors is no longer relevant.

Box 3.3: A divided profession

In England and Wales, Northern Ireland and Scotland as well as the Republic of Ireland and certain states in Australia what is elsewhere a single legal profession is split into two branches: solicitors and barristers. Solicitors provide legal advice to the public on the whole range of legal matters and have rights of audience in the lower courts. Barristers have rights of audience in the higher courts and provide consultancy services to solicitors. The rules governing each of the professions prohibit its members from practising as members of the other profession. Although rights of audience in the higher courts of Scotland, England and Wales have changed recently as a consequence of legislation allowing solicitors who meet certain tests of experience in advocacy in the lower courts to appear in the higher courts, there has been no move to fuse the professions.

The separation into two professions can be analysed as a prohibition on vertical integration between successive stages in a production process: The preparation of a case and its prosecution through advocacy in the courts. It should be noted that specialization in advocacy may exist within a fused profession. Within law firms some practitioners may specialize in court advocacy while others specialize in diagnosis and case management. The issue then becomes whether or not any benefits from formally separating the roles outweigh the costs. From an economic perspective the question is whether the division into two professions enhances efficiency or is merely a restrictive practice.

Source: Stephen (2002, 2003)

3.2.2 Restrictions on fees (and fee contracts)

Conduct regulation imposes restrictions on the internal competition, that is, competition within the profession. Conduct regulation encompasses restrictions on fees (and fee contracts), restrictions of advertising (section 3.2.3) and other conduct regulation (section 3.2.4). (In a certain way, restriction on cooperation with other professions can also be seen as conduct regulation.)

Traditionally, restrictions on fees were seen as assuring the confidence premium to professionals. The confidence premium is closely related to the concept of credence good. For legal services, the quality uncertainty is replaced by trust or confidence in the professionals. In the non-economic literature on professionals, relationships based on trust are seen as a main characteristic of the services performed by professionals. (It is also the criterion for distinguishing between 'liberal professions' and 'commercial professions'.) The confidence premium is the reward for the professional not to cheat on the client. It is a way to protect the confidence. It is much like trademarks: it builds up goodwill. A confidence premium can be seen as an efficient way of tackling the adverse selection problem *if and when* the premium is less than the costs the clients would have to occur to acquire information on the quality in the absence of trust. A confidence premium is justified to the extent that trust economizes on information costs. The confidence premium argument supports quality regulation (that prohibits abusing trust) and even justifies to some degree fee regulation that guarantees the payment of the confidence premium (Van den Bergh referring to Graf von der Schulenburg (1999)).

The problem is, however, that professions may abuse the fee regulation by acceptance of the rewards for their monopoly without enforcing high standards. Moreover, even in the absence of abuses, it seems very difficult to determine the appropriate size of the confidence premium. Price fixing is very restrictive and it is unclear if it enforces high quality production.

Recommended fees suggest a more sophisticated approach to cartel-like behaviour. One would expect that these fees would become focal points, but empirical evidence suggests otherwise (Shinnik and Stephen (2002)). It is possible that recommended fees provide a focal point against which professionals discount thus colluding at a lower level (Stephen (2003)).

Fees can be subject to control by the profession itself, by the courts or by the government by use of mandatory fees schedules. Price fixing is not very common. In most jurisdictions the former mandatory scales have been transferred into recommendations. In most countries, the client and his lawyer can negotiate prices freely. Fees are usually based on hours worked, litigation value and the complexity of the case. Belgium does not allow fees based on litigation value, and Germany does not make a distinction between more and less competent lawyers.[47]

Limitations on conditional and contingent fee contracts

Contingent fee contracts are forbidden in most European countries. In these countries, it is forbidden for lawyers to agree with clients that the amount of their fee will depend upon the result of the case or that they will be paid a percentage of any damages awarded.[48] The argument put forward against contingency fees is that they are in conflict with the principle that lawyers should not have a vested interest in the cases they take. There could be a conflict of interest between client and lawyer over if and when to settle. However, the determination of an appropriate fee if settlement takes place would of course solve the problem. Another problem is that a consumer with not very secure perspectives of proving and winning the case – although he might be entitled – will be unable to find a lawyer to defend him if there is a strict conditional fee system.

Rules prohibiting contingent fees are intended to preclude 'undesirable' competition between lawyers. Sometimes, it also said that these rules prevent a flood of cases. Contingent fees would, however, solve the moral hazard problem because lawyers then have an incentive to work as effectively and efficiently as possible.

Legal aid fees

Legal aid is usually run by independent government funded bodies (e.g. the Netherlands), legal aid board (e.g. Spain) or courts (e.g. Germany). The fees in legal aid are usually much lower than normal fees (cf. section 3.2.5). However, the profession can sometimes use them as a way to attract customers.

3.2.3 Restrictions on advertising

Advertising is a common method to provide information and it may reduce search costs. From a social perspective, advertising should be allowed when it is productive, that is, if it conveys important and relevant information to consumers concerning the services. There is no reason to suppose that advertising of legal services should be different than those generally applied to other

47 Given the German rules, the only way would be to agree upon hourly-based fees. Since the refund of costs to the winning party is limited to the tariff rates, in most cases this is not a realistic option.

48 Other forms of fee contracts also exist, such as conditional fees in the UK which upgrade the rate of the normal fee if the case is won, unrelated to the value of damages.

experience and credence goods services. This argument conflicts with the claim used by professional bodies that advertising should be prohibited, because it threatens the integrity and ethical responsibility of the profession by commercializing it. According to most professional associations, competition would be contrary to the dignity of the profession.

Two kinds of advertising can be distinguished: price advertising and quality advertising. When information on prices is easier to obtain than information on quality, increasing the availability of price advertising might encourage price competition and discourage quality competition. This would lead to a degradation of average quality in the market. This argument might support some restrictions on price advertising, but would not necessarily support banning it. The empirical evidence on the effects of restrictions on advertising is mixed. However, usually no systematic distinction is made for the two forms of advertising. Quality advertising seems more common and in general it seems that restrictions on advertising increase the prices (Stephen (2003)).

According to Garoupa (2004), price advertising in the legal profession is banned in most jurisdictions, under the ruling that comparative advertising is strictly forbidden. Quality advertising is usually allowed for partnerships but not for sole practitioners. The arguments against deregulation of publicity for legal services that have been put forward in the literature include:

- Publicity misleads the public and it has a negative effect on the quality of the profession. However, this is not true for quality advertising and probably true for price advertising.
- Publicity may be very expensive. We cannot know this, since the current market is very thin due to restrictions. However, advertising through the Internet is much cheaper nowadays.
- Publicity generates unfair competition because only large firms can benefit from advertising (however, US evidence shows otherwise) and it is against professional ethics by violating the so-called principle of non-commercialization of legal services.

For those legal services, which qualify as experience goods (but not as trust goods), advertising could be more important, especially if reputation effects are strong. By advertising you target first time buyers. Even though the information value of the advertisement is low, there is a positive link between advertisement and good quality, as the service provider wants his clients to be satisfied and return later on.

The prohibition on advertising individual specialties will make consumers believe that all professionals are of the same quality. This restricts competition within the profession.

3.2.4 Other restrictions on conduct

Several other restrictions on conduct may exist besides the ones mentioned. Think, for instance, of professional standards, ethics or codes of conduct. Lawyers are subject to undertakings concerning freedom of judgement and independence, have a duty of confidentiality, are required to hold professional liability insurance and must maintain a separate bank account for the deposit of monies belonging to third parties. And they are also subject to a disciplinary regime. Offsetting these duties are traditional rights, in particular the procedural monopoly and the right of non-disclosure.

If professionals set their own professional standards, these will be set too high. Professionals will lobby for their own quality level and standards to reduce compliance costs to zero (Hau and Thum (2000)). Standards imply the administrative costs of defining, monitoring and enforcing the standard and compliance costs which suppliers make to fulfil the standard. These are direct costs. There are also indirect costs, such as the accompanying resistance to change. This effect is, of course, hard to measure. Moreover, with quality standards you exclude products from the market that some people might have wanted to buy if the market was unregulated and correct information on the quality was given. The question is if low quality products are a problem for others as well as these people. If it leads to serious negative externalities (conduct of the representative, for instance, claiming more time from judges and the legal representative of the other party), it might be a public interest problem (cf. section 2.1.2).

A code of conduct describes the tasks and duties of the profession. Disciplinary procedures are established in case restrictions on conduct are violated. These procedures have been put in place to reassure people who approach a lawyer with a legal problem that they will receive expert support. There are two reasons why the enforcement of restriction on conduct will not be 'optimal' if regulation is solely left to the profession:

- To avoid conflict within the profession.
- There is no reason to be strict: If a client is not satisfied with the disciplinary measure he could go to court, but that would be difficult as litigation also relies on expert witnesses, who would not be available.

If low quality involves only a small risk for third parties, private law in the form of liability rules may be a solution to quality problems. However, it is also important that damages caused by bad quality service should not be high for the client.

3.2.5 Legal aid system

Another way in which the government intervenes in the market for legal services is by offering subsidized legal aid. Legal aid provides for a scheme whereby those seeking justice may qualify for government-funded legal representation. Various alternatives exist (Zeeland and Barendrecht (2003)):

- A subsidized system with private contributions. For instance, in England civilians using subsidized legal aid must pay for part of the aid themselves. In the Netherlands this also applies, although the level of the private contribution is often lower than in England.
- A loan-based system. In Germany, civilians on low incomes have the right to borrow money from the state to purchase legal aid services. The loan must be paid back to the state (*Ratenzahlung*) if the household's financial situation enables this (in practice, in only 15% of the cases). The courts enforce this system.
- An insurance-based system. The Swedish government has set legal expenses insurance at the core of the legal aid system. Swedes do not have the right to government-subsidized legal aid. Instead, they are supposed to take out an insurance policy. In Sweden, 97% of inhabitants have an add-on legal expenses insurance.[49] This has a historical background,

[49] Zeeland and Barendrecht (2003).

as legal expenses insurance was included when households signed up for other insurance policies (in the early days, legal expenses insurance was given free of charge). In Finland, legal expenses insurance also plays a central role in the legal aid system. Of all Finns, 75% have a legal expenses insurance policy.[50] However, in some cases in Finland civilians are also entitled to subsidized legal aid.

These systems all safeguard access to law for those of limited means. Lawyers who have declared their willingness to work under the scheme provide legal aid services. In most countries, there is no free choice of lawyer in the subsidized market segment.[51] In some cases, notaries and bailiffs also provide subsidized legal-aid services.

The fees set by the government for legal-aid work are lower than lawyers' standard rates and so have a dampening effect upon pricing in this segment of the market. The legal profession complains that the sums paid are low, but provides the service anyway on the principle of 'noblesse oblige'. It is unclear whether these rates are enough to cover costs. If they are, then it can only be assumed that the margins in the non-subsidized part of this market segment are extremely high. If they are not, then there must be cross-subsidization of legal-aid business from the free segment of the market. The paying client is forced (in practice, there is almost no room for negotiation) to pay enough for the lawyer to recoup their losses on 'government work'.

3.3 Building the regulatory index

In this section we construct an assessment framework for the comparison of different institutional backgrounds in the 12 countries. However, before presenting our assessment framework we will briefly summarize the assessment frameworks of three known, international comparative studies on the institutional background of legal services:

- Faure et al. (1993).
- Paterson et al. (2003).
- Garoupa (2004).

There is one major difference between the assessment framework of these papers and ours. As all three studies are focused on the internal market in professional services, they all pay special attention to the reciprocity between state Bar associations. This is in line with results described in the academic literature that policy heterogeneity implies barriers to trade in the internal market. Kox and Lejour (2005), to name one example, show that regulatory differences between countries have a negative impact on bilateral service trade. Regulatory measures tend to affect fixed costs rather than variable costs. Many national measures primarily affect fixed costs of the service providers. Licences, qualification and certification requirements, and operational restrictions for (foreign) service providers tend to be one-off costs. The foreign service provider has to meet these requirements before entering the market, but the effort and costs to fulfil them

50 See footnote no. 49.

51 Council Directive 87/344/EEC of 22 June 1987 on the coordination of laws, regulations and administrative provisions relating to legal expenses insurance demands legal expenses insurers to guarantee the free choice of lawyers (see Appendix B).

are often unrelated to the trade volume. The fact that regulations often differ by market means that the fixed costs of complying with regulations in an export market are in fact sunk market entry costs.

All three papers see potential external competition coming mainly from lawyers from other countries. Instead, we focus on the possibilities for non-lawyer legal experts to enter legal services markets, which is a different kind of external competition.

3.3.1 Summary of indexes put forward in the literature

Faure et al. (1993)

Faure at al. (1993) is the first attempt to set up an international comparative study on the institutional background of legal services in a number of European countries and the US. This publication contains an overview of the institutional background for legal services (and doctors) in the US, Belgium, the Netherlands, England/Wales and Germany. Each country's regulatory system is discussed in a separate chapter. The discussions follow a similar pattern. First a general summary is given on the types of regulations applied. This is followed by an examination of whether the public interest argument can provide an adequate explanation for the emerged setting. Finally, the regulation is examined from the point of view of rent-seeking by the professional organization. The insights from these country studies are combined and summarized in a questionnaire used to develop a comparative institutional ranking in the chapter written by Finsinger.

This comparative institutional ranking defines three types of ideal 'worlds' (frameworks): the Libertarian World, the Efficient World and the Consumer Protection World.

- The Libertarian World is characterized by the absence of restrictive rules. The optimal framework is here considered to be free competition without any limits. A value of 1 is assigned to each question whenever restrictive regulation is not used in the country and 0 when that type of regulation does exist in the country at hand. Intermediate cases are assigned fraction points. The points are added. The country with the highest sum comes closest to the ideal world type. The results suggest that the Netherlands comes closest to the Libertarian World, and Germany is the most distant from it.
- In the Efficient World regulations exist only for information asymmetries (i.e. the market failure commonly diagnosed by mainstream economists). If information asymmetries do indeed occur, then in the Efficient World title protection is justified: A certification system suffices. To require high quality service is also efficient, unless this is translated into extensive codes of conduct. The obligation to supply records to the disciplinary body to enable verification of the quality of advice is efficient as well. Detailed rules on what records must be supplied create costs and are therefore not seen as efficient. Again, the value of 1 is assigned to a country when the regulation is in line with the ideal of an Efficient World, and 0 otherwise. Again, the Netherlands ranks as the most efficient and Germany ranks as the least efficient.
- The Consumer Protection World assigns a value of 1 to rules that are taken to protect the consumer, even if it may cause more harm than good. These include detailed rules on

> documentation, continuing education, registration, best advice required by law and by the professional body with sanctions by the professional body, some degree of price regulation and so on. The US ranks closest to the ideal of Consumer Protection. Interestingly, the high score on this ranking is not accompanied by strict regulations (the US score in the Libertarian World is not 'bad' either). For Consumer Protection, Belgium ranks lowest, closely followed by Germany. Germany's poor performance is surprising. One would expect this most regulated of countries to do well in Consumer Protection at least, but that seems not to be the case. Germany seems not to perform well relative to any ideal.[52]

The aggregate ranking of countries in terms of ideals is suggestive of some important institutional differences and qualifications of the various institutional backgrounds. The drawback of this method is that the weights are somewhat arbitrary. In fact, as the author points out, as the questions are given equal weight and as some issues are covered by more questions than others, the ranking implicitly gives more weight to the variables based on more questions than those based on few questions. When using the methodology developed by Faure et al. it is, therefore, probably more instructive to use the disaggregate variables: (1) entry, (2) establishment, (3) prices or fees, (4) advertising, (5) quality and (6) structure (price, quality and advertising regulations).

Paterson et al. (2003)

Paterson et al. (2003) is the second extensive comparative study on the institutional background of legal services (as well as for accountants, architects/engineers and pharmacists). It is also known as the IHS study.[53] This study answers the question to what extent and in which areas does regulation differ between countries. In particular, it identifies the economic effects of different degrees of regulation. This study draws mainly on the results of a questionnaire sent to professional bodies, to the European umbrella organizations, as well as to some relevant government departments. As stated before, the main difference between the Paterson et al. and our study is that ours does not focus on interstate trade (internal market) but on the introduction of external competition by non-lawyer legal experts.

Paterson et al. have developed a 'market entry regulation index' and a 'conduct regulation index' that are combined to form an overall index. Within each regulation category (entry or conduct) a score is assigned to the particular form of regulation. The score for entry and conduct ranges from 0 as least restrictive to 6 as most restrictive. Paterson et al. produced an overall regulatory index by constructing a weighted sum of the scores, with the weights reflecting a judgement regarding the relative importance of each category of regulation. The score for the overall index is the sum of the market entry index and the conduct index. This produces an overall score (between 0 and 12) reflecting the severity of regulations in each country and each profession. These indexes show similarities to the Libertarian index of Faure et al. (2003).

Paterson et al. find that Greece has the most restrictive institutional framework, followed in turn by Austria, France, Germany, Spain and Italy. Showing the lowest overall indices are Finland,

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52 Please note that the results may be outdated as the data used are more than fifteen years old.
53 IHS stands for the Austrian Institute of Higher Studies in Vienna.

Sweden and Denmark. Table 3.1 gives an overview of the regulation indices in the surveyed Member States.

We conclude the following from the Paterson et al. results. The fact that while Finland and Sweden are the least regulated countries, they still guarantee sufficient access to law (their access is no less than any other European country, cf. section 4.1.1) shows that access to law can be guaranteed by private parties. Perhaps this is also due to the fact that Sweden and Finland have insurance-based legal aid systems (cf. section 3.2.5). Note that legal expenses insurers are better able to assess the quality of lawyers than one-off consumers and SMEs. A well-functioning legal expenses market renders restrictive regulation at least partly unnecessary.

Table 3.1: Regulation indices according to Paterson et al. (2003)

Member State	Index	Rank	Member State	Index	Rank
Austria	7.3	22	Ireland	4.5	7
Belgium	4.6	8	Italy	6.4	16
Czech Republic	6.2	15	Latvia	7.8	23
Cyprus	6.5	17	Luxembourg	6.6	21
Denmark	3.0	3	Lithuania	5.0	10
England/Wales	4.0	5	Netherlands	3.9	4
Estonia	6.0	13	Poland	4.9	9
Finland	0.3	1	Portugal	5.7	12
France	6.6	20	Slovak Republic	5.3	11
Germany	6.5	18	Slovenia	6.1	14
Greece	9.5	24	Spain	6.5	19
Hungary	4.4	6	Sweden	2.4	2

Source: Paterson et al. (2003), European Commission (2004)

The report then examines whether there is a relationship between the level of regulation in the professions, as measured by these indices and some key economic variables. The variables considered were the number of firms, employees and professionals within each industry, the total turnover of the industry, as well as the countries' total population and gross domestic product (GDP). In addition, the authors also measure the 'volume' of services, which they calculate by adjusting turnover for differences in price levels and GDP. For legal services the authors consider the correlation of the volume of output per firm and volume per employee with the regulation index. The authors then conduct a so-called 'gap' analysis, in which the economic variables are adjusted to try to control for the differences between each Member State.

Based on the calculated regulation index for different European countries Paterson et al. conclude that, in countries with a high level of regulation, there appears to be a proportionally smaller number of professions receiving a relatively high turnover per professional. Conversely, in Member States with a lower level of regulation, the same professions seem to produce a smaller volume of services per professional, but there is a proportionally higher number of professionals generating a higher level of overall turnover. Paterson et al. assume a connection may be surmised between volume of business per professional and excess profit. Consequently, high profits for a smaller number of professionals are associated with high regulation indices. In contrast, low regulation is associated with higher employment and greater overall wealth creation. In short, the main conclusion of Paterson et al. is that countries with low degrees of regulation have a proportionally higher number of practising professionals generating a higher turnover.

Reaction to Paterson 2003

The Paterson et al. study was commissioned by the European Commission and used to introduce the 'Better regulation agenda' for professional services (i.e. the proportionality test).[54] The Paterson et al. study has led to fierce debate between the profession[55] on the one side, and the Commission, consumer organizations and other stakeholders on the other.

The conclusions of Paterson et al. seem farfetched according to Van den Bergh and Montagnie (2007), since higher volume (turnover adjusted for differences in price levels and GDP) does not equal higher profit.

> 'By assuming that turnover is an indicator of profits, the researchers make the strong assumption that costs of the professional services are the same for all countries. If this is not the case, higher turnover does not imply higher supra-competitive profits. Turnover in a heavily regulated profession may be higher because the bureaucratic costs are higher and, hence, also the prices charged.'

RBB (2003) also makes this point and adds that if, in more regulated countries, there are fewer economies of scale, costs will be higher so that the higher turnover observed in those countries need not imply higher profits. These are valid considerations, which rightly point to the fact that high regulation can entail high bureaucratic and transaction costs. These costs should be weighed against the benefits of higher quality (assuming that a positive relation between regulation and quality does indeed exist). However, there is neither evidence nor reason to think that the quality of legal services delivered in highly regulated countries is higher than in less regulated European countries (cf. section 4.2).

This touches upon the second explanation for the higher turnover that Van den Bergh and Montagnie (2006) and RBB (2003) offer. Prices are higher since the quality of the services provided is superior:

> 'This last criticism stresses the crucial shortcoming of the IHS Report: it does not take into account the potential effect of regulation on the quality of the professional services. […] High fees may be nothing else but a just remuneration for previous investments of an educational and productive nature.'

Alternatively, perhaps this quality is too high in the sense that the bureaucratic and transaction costs of attaining the high or superior quality level do not weigh up against the benefits of extra quality. Is the consumer not better off with slightly lesser quality for a lower price? Consumers are better off if they have freedom of choice. The consumer in highly regulated countries without external competition has no freedom of choice – he can only choose from the pool of lawyers, whereas he might want to buy services from other legal advisors – and that means he is forced to pay a higher price for presumably higher quality.

Van den Bergh and Montagnie add another possible explanation for higher turnover, that a small number of professionals in highly regulated Member States work harder than in other Member

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54 European Commission (2004; 2004a; 2004b; 2007), Grady (2006), Kroes (2005).

55 CCBE (2005); and reports commissioned by CCBE: Henssler & Kilian (2003) and RBB (2003), legal scientists (Kilian (2003; 2004)); Van den Bergh & Montagnie (2006).

States. Although possibly true in theory, there is no reason to assume why it should be the case in actual practice.

Henssler and Kilian (2003) add that the significance of the 'size of firm' variable remains unclear. The size of an undertaking may not only be determined by professional regulations – as in Italy, for example – but also by the economic structure of the country in question. These authors think it is unclear why the size of a firm is relevant if the chosen efficiency indicator is not supposed to be profit, but turnover.

According to RBB (2003) the regulation indices are based on subjective assessments. Paterson et al. recognize this themselves, but state that the index is robust as slight changes in the weights do not lead to large changes in the clustering of countries. Moreover, the degree of subjectivity has been minimized by clearly stating the basis on which the judgements were made.

Another methodological criticism is that the results of information on professional law collected by standard questionnaires are only partly useful because they cannot say anything in particular about the motives for professional laws or about their relevance to a legal system (Henssler and Kilian (2003)). This criticism is, however, rather easy as it is virtually impossible to take all the details into account. This is especially true since both the profession as a whole and professional organizations are not very transparent when it comes to publishing information. This lack of data is further discussed at the end of section 3.3.2 and in section 5.1.1.

Garoupa (2004)

The third international comparative study is by Garoupa (2004). Garoupa's approach is an extended version of Faure et al. (2003). Besides calculating all the indices mentioned above (from both Faure et al. and Paterson et al.), Garoupa introduces the 'market failure approach index': A country receives 1 point if the answer to the question complies with the market failure approach and 0 otherwise. Complying with the market failure approach means that the answer is consistent with improving market performance. Note for example that Garoupa does not look at the details pertaining to length of education and training, but mainly to the question of who controls these aspects. If the government controls a certain regulation, rent-seeking behaviour is less of a threat.

To calculate the market failure approach index, Garoupa modifies a version of the Faure et al. (2003) questionnaire. He includes questions on professional schools, the management of legal aid and malpractice litigation; important topics that were not covered by the earlier indices. He also modifies the weighing of questions so that variables covered by more questions do not carry more weight in the final ranking. Furthermore, Garoupa presents different weighted averages.

Garoupa finds that the regulatory framework in the US seems closer to improving market performance of legal services than most European regulatory settings. Within the EU, Belgium and the Netherlands seem to produce results closest to the market failure approach. Portugal, Germany and Austria perform the poorest from the market failure point of view.

3.3.2 The operationalisation of our assessment framework

In this report we replicate the regulatory indices developed by Paterson et al. but with a slightly different methodology. We used four surveys and desk research to measure the regulatory indices per country.

- The first questionnaire was sent to RIAD contact persons in the 12 countries mid-May 2007. Responses were collected via an online questionnaire in the period from the middle of May until the beginning of August 2007. Each of the 12 contact persons completed most of the questionnaire.
- The second questionnaire was e-mailed to 56 legal expenses insurers on 21 September 2007. Responses were collected until 1 November 2007. Thirty-six legal expenses insurers completed all or part of the questionnaire (response rate: 66%).
- The third questionnaire was e-mailed to the 12 national Bars on 14 September 2007. Responses were collected until 1 November 2007. Five Bars completed part of the questionnaire (response rate: 42%).
- The fourth questionnaire was e-mailed to the 12 RIAD contact persons on 24 January 2008. Responses were collected until 27 February 2008. Every contact person completed most of the questionnaire.

The overall response rate to the legal expenses insurers' questionnaires is satisfactory. We used additional desk research[56] and telephone inquiries to check answers and supplement the collected information. Background data were verified against those of the OECD and Eurostat. The response rate in the Bars' survey was relatively low considering the fact that the research topic focuses on the core activities of the Bars.

To enable analysis of the results, we established a set of main variables:

(a) Entry restrictions;
(b) Price regulation;
(c) Regulation of marketing and PR opportunities.

We list the responses to the questions in relation to each of the main variables: (a) to (c). For example, for (a) this includes the extent of the exclusive right of lawyers to conduct legal proceedings, the duration of legal training (including the period spent as a trainee), self-employment and employment opportunities, and whether membership of the Bar is compulsory. We then look at how we should weigh the responses to these questions (sub-variables) to arrive at one index for each main variable. The variable to be explained is 'access to law'. In Chapter 4, we look at how access to law can be explained using the other main variables.

[56] Blank et al. (2004), *Conseil National des Barreaux* (2007), European Commission (2006), Faure et al. (2006), Kilian (2003), Lautjärvi (2006), Lirosi (2006), Lois (2007), Mäkinen (2006), OECD (2007), Sabel (2005), Taruffo (2005), Varano & De Luca (2007), Van Zeeland & Barendrecht (2003), as well as the websites listed in Appendix A.

Entry restrictions

We distinguished the following entry restrictions:[57]

- Duration of legal training: Total years of law school required to achieve a law degree/the title of jurist (2.1.2) + the total number of years/months of post-academic education to become a lawyer (2.1.5).
- Practical: Is an internship or position in a law firm a necessary part of the post-academic training to become a lawyer (2.1.6)?
- Additional training compulsory for lawyers: Once a person with a law degree has entered the profession of lawyer is there a requirement for regular additional training (2.1.11)?
- Number of entering lawyers regulated: The maximum number of lawyers admitted or appointed nationally, regionally or locally each year (2.1.10).
- Self-employment only: Possibility to become a lawyer in the employment of a non-lawyer or non-law firm (2.1.9).
- Bar membership compulsory for lawyers: Requirements to become a member of the Bar (2.1.12).
- Monopoly: Tasks exclusively assigned to lawyers (2.1.7 and 2.4.1).

When it comes to the exclusive tasks we distinguish three situations:

- *No monopoly*: Lawyers have no exclusive tasks. Finland is the only country where lawyers have no exclusive tasks.
- *Limited scope of the monopoly*: Lawyers have exclusive tasks, but under certain conditions these tasks may be performed by a non-lawyer or third person. The scope of the monopoly can be limited by:
    - The financial interest of the case: Cases under a certain financial threshold fall outside the monopoly of lawyers;
    - The subject of the case: In some countries the subject of the case determines if there is an obligation to be represented by a lawyer.

  To categorize as a monopoly of limited scope, the above limitations should apply to the larger part of the cases, not just to exceptions. Third persons may represent cases in the following countries which all have a limited scope of the lawyers' monopoly: Hungary (jurists), the Netherlands (jurists), Austria (jurists), Belgium (third persons) and England/Wales (jurists). Box 3.4 gives further details on the scope of these monopolies.
- *Extensive scope of the monopoly*: Lawyers have exclusive tasks; nobody else may perform these tasks but lawyers. In most countries there is the right to represent oneself in certain cases, but one is generally not allowed to be represented by a non-lawyer, third person (apart from some very minor exceptions).

  Court representation is in all cases exclusively assigned to lawyers in the following countries: Switzerland, Germany, France, Italy, Czech Republic and Spain. Box 3.5 gives further details on the scope of these monopolies.

[57] The numbers in brackets refer to the related question numbers in the questionnaire (cf. Appendix D).

Box 3.4: Countries with a limited scope of the lawyers' monopoly

Hungary
Representation in civil court is not part of the exclusive tasks of a lawyer in the following cases:
i. The person/SME with the legal problem, legal advisors, jurists (someone with a law degree who may or not have a specialisation) and family members can represent clients in court.
ii. In conveyancing services (transfer of property) only lawyers can represent clients in court.
iii. Cases before court require no representation at all, except cases before Supreme Court, where representation is obligated.

The Netherlands
Representation in civil court is not part of the exclusive tasks of a lawyer in the following cases:
i. Cases concerning a financial stake under € 5,000 (this will be increased to € 10,000).
ii. Labour disputes.
iii. Disputes related to renting or hiring and hire purchase.
iv. Social security disputes.
v. Disputes with governing bodies.
In these cases clients can be represented by anybody.

Austria
Representation in civil court is not part of the exclusive tasks of a lawyer in the following cases:
i. Jurists (a legal expert) can represent clients in the *Arbeiterkammer* (Labour court) in labour, contract and work proceedings.
ii. Jurists can also represent clients of the *Jugendwohlfahrtsträger* (youth with maintenance claims/ problems with parents).
iii. When litigation value is under € 4,000.
iv. In conveyancing services (transfer of property) jurists with a law degree and specialisation (such as a notary) can represent persons and SMEs.

Belgium
Representation in civil court is not part of the exclusive tasks of a lawyer in the following cases:
i. In labour cases clients can be represented by a person from the union.
ii. Government officials can represent the government in tax cases.
iii. In conveyancing services (i.e. transfer of property) anybody can represent persons and SMEs.
It is not possible to be represented by any one other than the persons mentioned above.

England/Wales
Everyone has the right to represent themselves in court; legal representation it is not a requirement. Any suitable person approved by the court can represent someone else. Representation in civil court is not part of the exclusive tasks of a lawyer in the following cases:
i. With Employment Tribunals, in some cases anybody, including a layperson as 'litigation friend' can represent; otherwise generally only lawyers.
ii. In the area of conveyancing services (transfer of property) generally only licensed conveyancers (non-lawyers) or practising lawyers can represent persons and SMEs.

Source: SEO Economic Research

Box 3.5: Countries with an extended scope of the lawyers' monopoly

Italy
Representation is only possible by lawyers. Representation is not obliged in civil cases with an interest below € 516.46. In conveyancing services notaries can also represent persons and SMEs.

Czech Republic
Representation in court for civil cases is not always obliged; the person/SME with the legal problem can sometimes represent themselves. In conveyancing services the person/SME with the legal problem can also represent themselves. It's not allowed to be represented by a third person.

Continued Box 3.5

Germany
Lawyers have the exclusive right to conduct legal proceedings in all cases that are handled in court. People cannot be represented by any other professionals than lawyers. In certain civil cases people can represent themselves:
i. Cases at *Amtsgericht* (civil cases in first instance with value of claim up to € 5,000), and
ii. Cases at *Arbeitsgericht* (labour court).
Besides the lawyers' monopoly, other German regulation also affects the scope of this monopoly. On 1 July 2008 a new law will be implemented to replaces the old *Rechtsdienstleistungsgesetz* of some 80–90 years ago. Although the new law is very similar to the old, a subtle but important difference is the fact that legal expenses insurers are not allowed to give legal advice themselves (the term legal expenses insurer is not used literally but obviously the law is aimed at insurers): '*Unvereinbarkeit mit einer anderen Leistungspflicht: Rechtsdienstleistungen, die unmittelbaren Einfluss auf die Erfüllung einer anderen Leistungspflicht haben können, dürfen nicht erbracht werden, wenn hierdurch die ordnungsgemäße Erbringung der Rechtsdienstleistung gefährdet wird.*' Consequently, legal expenses insurers can only serve as middleman between insured parties and lawyers. All cases conducted for insured parties will have to be outsourced to lawyers.

France
Article 4 of Law no. 71-1130 (31 December 1971) reforming the legal profession lays the basic principle of an exclusive right for lawyers to assist and represent parties, bidding and pleading before any judicial or administrative jurisdiction (the court). Any lawyer can represent, assist and plead before all the French jurisdictions, public bodies or administrative authorities. However, the lawyers do not have the exclusive right to conduct legal proceedings in every court in every field. Only lawyers can represent clients in higher courts, but the legal representation is only compulsory for jurisdiction with written procedure (*Tribunal de Grand Instance, Cour d'Assises* (criminal court)). For example, no monopoly before the inferior court (first degree) and execution judges where a party can be represented by others: non-jurists (consumer representative bodies, trade unions or other family members, employee or employer from the same specialized area, bailiff (before the commercial court). It is not compulsory to be represented by a lawyer for the following courts:
i. *Conseil de Prud'homme*: disputes due to contracts of employment,
ii. *Tribunal de police*: competent for minor offences, road traffic offences,
iii. *Tribunal paritaire des beaux ruraux*: disputes due to agricultural lease contracts,
iv. *Tribunal des affaires de sécurité sociale*: social/welfare tribunal,
v. *Tribunal d'Instance*: disputes between € 4,000 and € 10,000.
Notaries can represent persons and SMEs in conveyancing services (transfer of property).

Spain
As a general rule, in order to appear before a court in Spain, one needs to use a *Procurador* (procurator) for representation and an *Abogado* (lawyer) to conduct the case before the court. One can act without these professionals only when the dispute involves an amount of less than € 900. It is not possible to be represented by a non-lawyer, third person.

Switzerland
In conveyancing services (transfer of property) notaries can represent persons and SMEs. As a general rule, in civil cases everyone can represent themselves. There are a few exceptions where representation by a lay person is allowed.

Source: SEO Economic Research

To add these sub-variables in one index for entry restrictions we used the values as presented in Table 3.2. This also includes the variables for price regulation and advertisement restrictions that will be discussed below.

Table 3.2: Indexing the variables

Main variable	Index
Entry restrictions	Education (≤ 6 years = 0, 7–8 years = 1, > 8 years = 2)
	Additional training (no = 0, yes = 1)
	Bar membership (no= 0, yes = 1)
	Self employment compulsory (no = 0, yes = 2)
	Monopoly (no = 0; limited scope = 1.5 or 3, depending on severity; yes = 4)
Price regulation	Fixed/minimum/maximum (1 each; maximum 3)
	No cure no pay/success fees/negotiation (1 each if prohibited; maximum 3)
Advertisement and PR	Prices/specialization/success rates (0.5 each if prohibited; maximum 1.5)

Source: SEO Economic Research

Table 3.3 shows the resulting index for entry restrictions. For Finland and England/Wales we give two different indices: Fin1 and Fin2, and E/W1 and E/W2, respectively. Fin1 refers to the legal adviser in general (lawyer but not a member of the Bar) and Fin2 refers to the regulation of the *Asianajaja* (member of Bar). E/W1 applies to the regulation of the solicitor and E/W2 refers to the regulation of the barrister in England/Wales.

The maximum score related to entry restrictions is 10. Belgium, Czech Republic, France and Switzerland each score 8 and have the most strict entry regulation of the countries in our survey.

Table 3.3: Index for entry restrictions

Entry restriction	Aus	Bel	Cz	E/W1	E/W2	Fin1	Fin2	Fr	Ger	Hun	It	Neth	Sp	Swiss
Education	2	1	1	0	1	0	2	0	0	1	0	1	0	1
Self - employment only	2	2	2	0	2	0	2	2	2	0	2	0	0	2
Additional training	0	1	0	1	1	0	0	1	0	0	0	1	0	0
Bar member compulsory	1	1	1	1	1	0	1	1	1	1	1	1	1	1*
Monopoly	1.5	3	4	1.5	3	0	0	4	4	1.5	4	1.5	4	4
Index	6.5	8	8	3.5	8	0	5	8	7	3.5	7	4.5	5	8

Source: SEO Economic Research.

* Bar membership in Switzerland is not compulsory, but official registration as a lawyer is compulsory.

Price regulation

We distinguish the following price regulations:

- Tariff regulation (2.7.9 till 2.7.11): Minimum prices, maximum prices, and fixed prices.
- Regulation of fee arrangements (2.7.13 till 2.7.15): Success fees (contingency fees), 'no cure, no pay', and free negotiation with lawyers on the prices of legal expenses insurers (LEI).

Table 3.4 shows the resulting index for price regulation. Germany and Italy score relatively high as lawyers' fees are strictly regulated, and in Germany and France legal expenses insurers are not allowed to freely negotiate these fees.

In Italy lawyers are paid according to a tariff scheme (Law Decree 8 April 2004, no. 127) based on the value of the dispute and not the number of hours. Some exceptions are:

- Out-of-court phase: There is a specific tariff for the hours (or fractions of the hour) spent working on a consultancy. A distinction is made between phone calls or in-office conferences and collegial conferences with other lawyers or out-of-office conferences;
- Court phase: The lawyer participating in a court hearing receives a sum of money based on the hours (or fractions of the hour) worked.

However, in both cases the hourly tariff is closely related to the value of the dispute.

Table 3.4: Index for price regulation

Price regulation lawyers	Aus	Bel	Cz	E/W1	E/W2	Fin1	Fin2	Fr	Ger	Hun	It	Neth*	Sp	Swiss**
Fixed tariffs	0	0	0	0	0	0	0	0	1	0	1	0	0	0
Minimum tariffs	0	0	0	0	0	0	0	0	1	0	0	0	0	0
Maximum tariffs	0	0	0	1	1	0	0	0	1	0	1	0	0	0
Success fees pro-hibited	1	1	0	0	0	0	0	0	1	0	1	1	1	0
No cure no pay pro-hibited	1	1	0	0	0	0	0	1	1	0	0	1	1	1
Negotiation prohibited for LEI***	0	0	0	0	0	0	0	1	1	0	0	0	0	0
Index	2	2	0	1	1	0	0	2	6	0	3	2	2	1

Source: SEO Economic Research

* Recently in the Netherlands, a pilot project began experiments with success fees and no cure, no pay.

** In Switzerland one is not allowed to have long term contracts with external lawyers; long term relations are permitted but setting them down in a contract is not (this also applies to some other European countries, including France).

*** Legal expenses insurer.

Box 3.6 explains the French situation in relation to price regulation in more detail.

Box 3.6: The French rules on free negotiations between lawyers and insurers

In France, many lawyers (especially outside Paris) are willing to work for legal expenses insurers. In the beginning of 2007 a law was implemented that forbids insurers to negotiate with lawyers on fees (*loi no. 2007-210 du 19 février 2007 portant réforme de l'assurance de protection juridique (1)*). The law states that only the insured party is allowed to negotiate with the lawyer: '*Les honoraires de l'avocat sont déterminés entre ce dernier et son client, sans pouvoir faire l'objet d'un accord avec l'assureur de protection juridique.*'

Continued Box 3.5

Thus, not only is the legal expenses insurer obliged to hire a lawyer to handle court cases (the monopoly of lawyers), the insurer is also obliged to pay a price that he is not entitled to negotiate himself. It is not clear which public interest is served with this prohibition on free negotiations between lawyers and insurers:

1. After paying the insurance premium, the insured party has no incentive to negotiate on fees.
2. The insured party has bought the insurance policy because he no longer wants all the fuss and bother of a law suit and is therefore unwilling to spend much time on negotiation.

Due to these two factors, the insurer will most probably pay a relatively high price. In the long term this will lead to increased premiums for all legal expenses insurance policies and thereby decreased access to law.

Source: SEO Economic Research

Regulation of advertising and PR opportunities

We distinguish the following restrictions on advertising and PR:

- General advertising restrictions (2.8.1 to 2.8.4): Restrictions on advertising specialization, restrictions on advertising prices and restrictions on advertising success rate.

Table 3.5 shows the resulting index for restrictions in advertisement. Finland scores its only point, because it is forbidden to advertise success rates. Hungary has the most severe restrictions on advertisement. It is interesting to see that the regulation on advertisement is so different, while the relation between guaranteeing legal security and advertisement is even less obvious than with entry restrictions.

Table 3.5: Index for restrictions on advertisement

Advertisement regulation lawyers	Austr	Belg	Czec	Eng/ W 1	Eng/ W 2	Fin1	Fin2	Franc	Ger	Hun	Italy	Neth	Spain	Swiss
Specialization	0	0	0	0	0	0	0	0	0	1	0	0	0	0
Prices	1	0	0	0	0	0	0	0	1	1	1	0	0	0
Success rates	1	0	0	0	0	1	1	1	1	1	1	0	0	1
Index	2	0	0	0	0	1	1	1	2	3	2	0	0	1

Source: SEO Economic Research

Overall indices

We now take the indices of all three main variables together (entry restrictions, price regulation and regulation on advertising), and use the weights as presented in Table 3.2. We can summarize the regulation for each of the 12 countries in one overall index and compare these countries. Table 3.6 shows the procedure for the Netherlands by way of example.

Table 3.6: Summary of legal services regulation in the Netherlands

Main variable			Index
Entry restrictions	Education	7 years	1
	Additional training	Yes	1
	Mandatory Bar membership	Yes	1
	Self-employment compulsory	No	0
	Monopoly	Limited scope	1.5
Price regulation	Fixed/minimum/maximum	No	0
	No cure no pay/ success fees prohibited	Yes	2
Advertisement and PR	Prices/specialization/success rates prohibited	No	0
			6.5

Source: SEO Economic Research

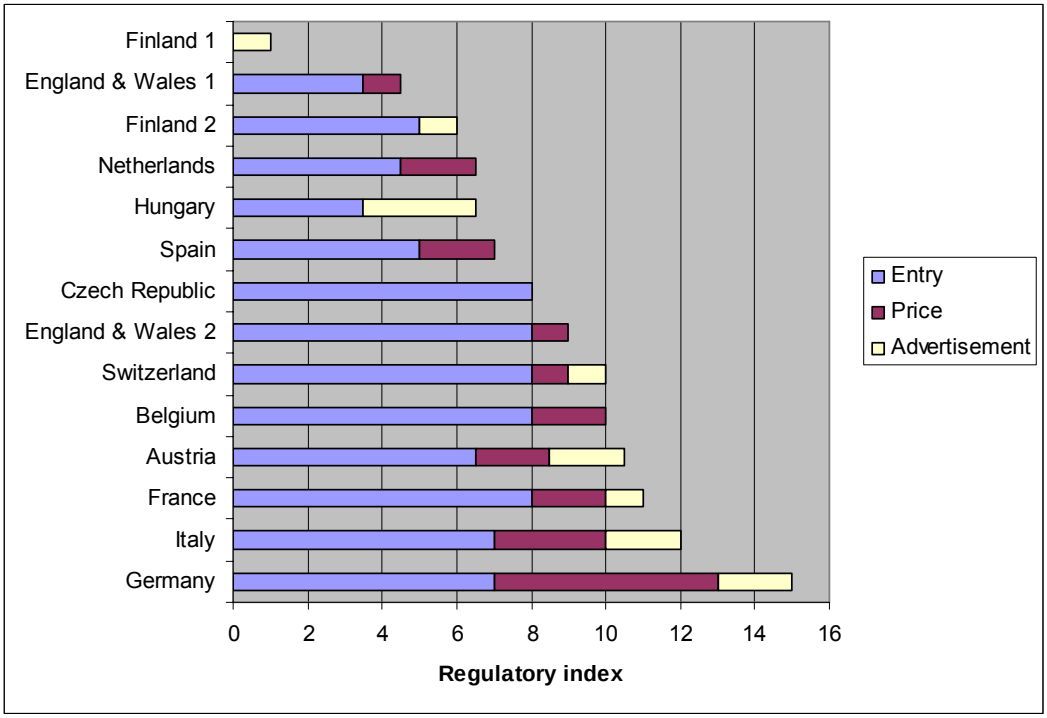
Table 3.7 and Figure 3.1 give the overall indices.

Table 3.7: Overall regulatory index

Totals	Aus	Bel	Cz	E/W1	E/W2	Fin1	Fin2	Fr	Ger	Hun	It	Neth	Sp	Swiss
Entry	6.5	8	8	3.5	8	0	5	8	7	3.5	7	4.5	5	8
Price	2	2	0	1	1	0	0	2	6	0	3	2	2	1
Advertisement	2	0	0	0	0	1	1	1	2	3	2	0	0	1
Index	10.5	10	8	4.5	9	1	6	11	15	6.5	12	6.5	7	10

Source: SEO Economic Research

Figure 3.1: Overall regulatory index subdivided per main variable



Source: SEO Economic Research

These indices show that Finland (Fin1; the legal advisor in general, no Bar membership) is the least regulated market. The Finnish institutional context is described in Box 3.7. The Finnish example provides 'circumstantial evidence'. Finland has no insurers specialising in legal expenses business whatsoever, only non-specialized writers. Moreover, all civil cases covered by insurers are handled by external lawyers. This is possible because lawyers are both widely available and inexpensive in Finland. From the fact that legal expenses insurers have no incentive to insource civil cases we can infer that the cost of having legal services delivered by a lawyer is relatively low.

Box 3.7: Regulation of the Finnish legal services market

In Finland, legal services are offered by a great diversity of providers, placed by the examination in eight groups including members of the Bar, lawyers (non-Bar members) working for businesses or a variety of advocacy organizations, lawyers offering services as a secondary occupation, other lawyers offering collection services, and public-sector counselling services. All these providers are regulated variously and have a variety of established competence requirements.

The strictest regulation applies to members of the Bar, whose activity and competence requirements are regulated by the Act on Advocates and directives approved by the Finnish Bar Association. A law degree is required for acting as an attorney or counsel in an adversarial civil case or a criminal case. Practitioners of collection activity are the only group that needs a license. A great portion of the providers may offer services without being subject to applicable regulations, other than enactments regarding civil-law liability that regulate all activity in general.

The Committee for the Development of the Court System has vigorously advocated the introduction of a licensing system for adversarial civil law cases. Non-adversarial civil and application matters, recording matters, and Land Court cases form the second group. No proposal is made to tighten the requirements for offering services falling within this group.

Source: Lautjärvi (2006)

Second in row is England/Wales (E/W1, solicitors), followed by Finland (Fin2, *Asianajaja*, Bar member). Germany,[58] France[59] and Italy are the most regulated countries. Spain's position may change after implementation of the reforms designed to increase requirements for lawyers by introducing a professional entry examination (EC (2005)).

Recently some of the markets we studied have been deregulated, for instance, Italy where the Bersani Decree (section 1.1) removed some of the most protectionist regulations in the European professional services sector. Minimum tariffs have been banned and advertising allowed to some extent. Note that abolishment of entry restrictions will only show its effect in due course (after a few years), whereas deregulation of advertisement and fees will in most cases have a more prompt effect on the functioning of the legal services market. The Bersani Decree removed many restrictions on the central level, but the behaviour of market parties has not changed accordingly.

58 According to the European Commission (2005) the German ministry of Justice has a project underway to consider changes to the law governing the provision of legal advice/counselling. The aim is to broaden the scope of the law to allow others rather than just lawyers the right to provide legal advice in certain areas. This may lead to a lower regulatory index.

59 With regard to fixed prices in France, work is underway to legally reinforce the requirement of lawyers to inform clients fully on how services are priced (European Commission (2005)). According to the same publication, in France a '*décret*' project is underway to reform the ethical code so that lawyers will not have to get ex-ante authorisation from the professional body for the way they propose to advertise. The *décret* will also allow lawyers to publicise (provide information) their services to prospective clients through, for example, a direct mail shot, but cold calling or canvassing will still not be allowed. This may lead to a lower regulatory index.

Moreover, the sector remains heavily regulated on the local level notably by zoning restrictions, creating the risk that vested interests might hamper the recent liberalization (OECD (2007)).

The ranking in our results differs somewhat from the ranking of Paterson et al. (2003). Table 3.8 compares the results from both studies focussing on the 12 countries in our survey. Spain has a relatively lower regulation index in our results, whereas Germany and Italy have relatively higher scores in our results compared to the Paterson et al. ranking. The deregulations discussed above do not explain this difference in ranking.

An explanation for why Spain scores relatively low on the regulatory index is that Spanish lawyers' fees are not formally maximized, fixed or minimized – so the score in Table 3.4 is correct. In practice, however, tariffs are based on standards that Bar Associations have established as guiding rules. There are 84 Bar Associations in Spain, mainly on the local or provincial level.[60] Each one of those Bar associations has its own standards. Excluding very specific exceptions, the method used to determine fees is based on the kind of proceedings in which lawyers take part and on the amount related to the case.

Table 3.8: Comparison of regulation indices: Paterson et al. (2003) and SEO

Paterson et al. (2003)			SEO Economic Research		
Member State	Index	Rank	Country	Index	Rank
Finland	0.3	1	Finland (Fin1)	1	1
Netherlands	3.9	2	England/Wales (E/W1)	4.5	2
England/Wales	4	3	Netherlands	6.5	3/4
Hungary	4.4	4	Hungary	6.5	3/4
Belgium	4.6	5	Spain	7	5
Czech Republic	6.2	6	Czech Republic	8	6
Italy	6.4	7	Belgium	10	7/8
Germany	6.5	8	Switzerland	10	7/8
Spain	6.5	9	Austria	10.5	9
France	6.6	10	France	11	10
Austria	7.3	11	Italy	12	11
			Germany	15	12

Source: Paterson et al. (2003), European Commission (2004), SEO Economic Research

Another conclusion from both our and the Paterson et al. results is that the degree of legal professions regulation is remarkably different in each of the surveyed countries. According to various commentators (Kilian (2004)) this is unsurprising. If we think, however, that the public interest at stake is the same in each of these countries, namely guaranteeing access to law and legal security, it is actually very surprising to find such a broad variety of regulatory schemes.

Our comparison focuses on regulatory differences in the legal profession and therefore leaves out the regulations and institutions that determine the performance of the judiciary system as a whole (section 1.2). Differences in legal systems do exist (section 4.1.5). The regulation of lawyers differs from country to country not just because governments have different ideas on how to guarantee public legal security and weigh private interests. The differences in regulation are also caused by the fact that they are embedded in their respective legal systems, which themselves differ substantially in part, as they have evolved over many decades quite differently in each

60 See: Consejo General de la Abogacía website www2.cgae.es/es/cgae/normativa.asp.

country. Civil law and especially civil procedural law were and still are largely subject to the competence of the individual Member States. For instance, legal procedures are far more complex in civil law than in the common law system (as in the UK).[61] Moreover, access to law may also be negatively influenced by the fact that initially, in most countries, each party must bear its own expenses. At the end of the proceeding the court will order the losing party to reimburse the adversary's expenses, including lawyer fees.

Our comparison is limited to the social costs of different regulations of legal service providers (lawyers) and does not extend to fairness issues. According to Rhode (2004): 'The primary objectives of a civil litigation system should be to resolve disputes, compensate victims, and deter violations of legal standards. Key criteria for assessing the performance of that system include its costs over time, money, and acrimony, and its procedural and substantive fairness.'

In spite of these limitations we believe that the aggregate rankings in Table 3.7 and Figure 3.1 to suggest some important differences between the 12 states.

3.4 Conclusion

This chapter has shown that the legal services market is regulated variously – by government regulation, self-regulation or private regulation – and many available regulatory instruments are used in practice. We compared the level of regulation for three important regulatory instruments: entry restrictions, restrictions on fees, and restrictions on advertising. We constructed regulatory indices using the insights from assessment frameworks developed in earlier comparative studies of national markets of legal services. We found that the level of regulation differs remarkably among the 12 countries in our sample. Finland and England/Wales are the least regulated while Germany, France and Italy are the most regulated.

This result is actually quite surprising. While the public interest at stake is exactly the same in all of countries, how can the way they guarantee legal security differ so remarkably? From the fact that, for instance, the Finnish or English governments regulate the market of legal advisers much less than, for example, the German or French governments, we cannot assume that the former governments are less concerned with their citizens' legal security than the latter. In the next chapter we will give more details on access to law in the 12 countries in our sample.

Chapter 2 informed us of the need for some degree of regulation of the legal profession because of market failures (information asymmetry and externalities). However, Chapter 2 also showed that the economic rationale for government action is less obvious than usually assumed by government agencies and Bars. Is it really necessary to have governments and Bars regulate the

[61] Djankov et al. (2002) measure and describe the exact procedures used by litigants and courts to evict a tenant for non-payment of rent and to collect a bounced check in 109 countries. The countries are grouped in 5 groups: English legal origin (common law), Socialist legal origin, French legal origin, German legal origin, and Scandinavian legal origin. The authors use these data to construct an index of procedural formalism of dispute resolution for each country. We find that such formalism is systematically greater in civil than in common law countries. Moreover, procedural formalism is associated with higher expected duration of judicial proceedings, more corruption, less consistency, less honesty, less fairness in judicial decisions, and inferior access to justice.

monopoly of lawyers in order to attain the potential benefits related to such quality regulation? For instance, private regulation may have similar advantages without imposing high costs on society. In Chapter 3 we have seen that government action is not always necessary to guarantee legal security and access to law. The Finnish example shows that private regulation, that is regulation by third parties, such as legal expenses insurers, can be just as effective as government regulation.

Moreover, from the fact that the market for the services of lawyers is segmented – the segment for large corporate clients needs little government regulation – and in the view of many of those seeking justice this market is broader than the legal profession alone, we conclude that public interest can best be safeguarded by regulating *services* rather than groups of *professionals*. This means that governments should not regulate lawyers but that it would be better to regulate the quality of a legal service. Everyone capable of delivering the required quality should be allowed to provide these services. Recognizing this and asserting the importance of examining the different segments of legal service markets separately is an important part of a mature debate on the role of the legal profession in legal service markets.

4 Welfare effects ('if')

Traditionally, the public interest of legal security has been safeguarded by means of compulsory legal representation in court and the lawyers' monopoly over that representation. In most countries this regulatory approach has been in place for many decades. In the meantime, however, the market of legal services has been changed by, for example, increasing recourse to the law in society and a segmentation of the market itself. This makes it extra important to examine whether current forms of intervention by governments and other parties are still the best way to safeguard legal security.

The question, then, is whether public interest can also be safeguarded through less far-reaching measures. There are three ways of changing the monopoly that currently exists in most European countries: (1) restricting the domain it covers; (2) extending the group of legal practitioners to whom it applies; and (3) abolishing compulsory legal representation for civil cases (and at the same time introducing a number of covering measures). In section 4.3 we describe these alternatives and analyse if they might save society money compared with the current institutional framework. Such savings are desirable, given the positive effect this will have on access to law (access is restricted by the costs associated with a legal procedure). We also consider the alternative of regulating lawyers' fees because that may suppress high fees and price increases in the market for services o f lawyers.

The fundamental hypotheses tested in this chapter are:

- Access to law is sufficiently guaranteed – as perceived by the respondents – in each of the 12 countries in our sample.
- Access to law is not safeguarded to any greater degree in those countries subject to more stringent regulations than in those where it is less so (as shown on the overall regulatory index in section 3.3.2).

In section 4.1 we test these hypotheses. If these hypotheses are accepted, then the question is whether the more stringent form of certain regulations (such as the exclusive right of lawyers to conduct legal proceedings) leads to greater costs than benefits to society, and therefore reduces economic welfare.

To test this third hypothesis, we surveyed the national Bars and sent another questionnaire to the legal expenses insurers to establish whether it is more expensive for legal expenses insurers, and therefore those needing legal assistance (households and SMEs), to hire the services of a lawyer compared to delivering their own legal services in-house.

The third hypothesis is tested in section 4.2.2. Litigation imposes direct and indirect costs on litigants (Duggan (2003)). The main direct cost is lawyers' fees. The indirect costs of litigation include information costs (the cost of finding and instructing a lawyer), opportunity costs (the cost of time off work), and emotional costs (the costs that stress imposes on parties in dispute). These indirect costs may occur in every case; what is meant here is that due to a high level of regulation these costs may be higher. An example of higher indirect costs due to higher

regulation are costs associated with the uncertain outcome of the dispute. Delay is an important contributing factor to the indirect costs of litigation. Pre-trial delay prolongs the uncertainty between parties, increasing transaction costs and emotional costs. In this chapter we look into the direct costs of litigation.

4.1 Access to law

Access to law was described in section 1.2.1. Access to law includes access to a court procedure, legal aid and extra-legal mechanisms to resolve conflicts. In this section we give the results of our survey with regard to the extent to which access to law is safeguarded. We look into the variables that are important when discussing access to law, such as the legal aid system and the number of lawyers.

4.1.1 Problems with access to law?

In the first questionnaire sent to legal expenses insurers we asked if access to law is sufficiently safeguarded in their country. All 12 contact persons replied that it was. There are enough lawyers available to conduct civil cases (no capacity problems) and there are no long waiting times to go to court or to find a suitable lawyer.

In the second survey of legal expenses insurers we asked if the respondents thought there were problems with access to law in their country. They could pick any of the following options:

- No, the current level of regulation properly safeguards access to law.
- Sufficient access to law, but there are problems with one or more of the following:
    - Proceedings take too long
    - Limited availability of legal representatives (in some areas of the law)
    - Quality of the legal profession (in some areas of the law)
    - Costs for resolving a legal dispute are too high (including representation costs)
    - Access to subsidised legal aid
    - Other (please describe): …
- Access to law is insufficiently provided.
    - This is because (please provide reason): …

The results show that the legal expenses insurers consider access to law is sufficiently guaranteed by current levels of regulation in both Germany and England/Wales. None of the legal expenses insurers think that access to law is provided insufficiently. While most insurers indicated that there is a sufficient level of access to law, they also selected problems. Table 4.1 gives the results for the problems selected. If at least half of the respondents from a country indicated they experienced one of the selected problems, the problem concerned is marked by an X in the table. It is noteworthy that in 8 of the 10 responding countries half the respondents think that access to law is restricted because the costs of resolving a legal dispute are too high (including the costs of legal representation). We discuss the perceived high costs in section 4.2.2.

Please note that no responses were collected from Hungary and Finland in the second survey.

Table 4.1: Perceived access to law according to legal expenses insurers (n=36)

Problems with access to law	Aus	Bel	Cz	E/W	Fr	Ger	It	Neth	Sp	Swiss
No problems				X		X				
Proceedings take too long		X	X		X		X			X
Availability of legal representatives										
Quality of legal profession			X							
Costs of resolution of dispute	X	X	X		X		X	X	X	X
Access to subsidised legal aid			X							
Other										

Source: SEO Economic Research

In the third questionnaire, sent to the national Bars in the 12 countries, we posed the same question about access to law. The results are presented in Table 4.2. Since only five Bars replied, our results are necessarily restricted to this small group. It is noteworthy that the Bars seem to think more positively about access to law than the legal expenses insurers.

Table 4.2: Perceived access to law according to national Bars

Problems with access to law	Austria	Belgium	Czech Rep	France	Germany
No problems	X*				X
Proceedings take too long		X	X		
Availability legal representatives					
Quality of legal profession					
Costs of resolution of dispute					
Access to financial legal aid				X	
Other				X**	

Source: SEO Economic Research

* Comment from the respondent: 'Individual cases giving rise to complaints are criticized in the "*Wahrnehmungsbericht*", a report issued yearly by the Austrian Bar about shortcomings of the administration of justice and administration in Austria.'

** Comment from the respondent: 'The insufficiency of the budget allocated by the State to finance the legal aid does not ensure a sufficient remuneration of lawyers, which could have consequences on the quality of their service. In addition, the thresholds of admissibility to the legal aid are often criticized as not including a rather broad panel of individuals.'

We also conducted desk research to determine whether access to law is considered problematic. Box 4.1 describes the problems with access to law in Italy according to three Italian scientists. We have not come across similar studies in other European national markets.

Box 4.1: Issues with access to law in Italy

Varano and De Luca (2007) state that the administration of justice in Italy is in 'deep crisis' because of delayed procedures: 'The problem of delay is actually so serious, that it results in a denial of justice.' This affects the very idea of justice itself among the general public. The available statistics indicate clearly how civil justice has deteriorated through the years. The 1999 figures indicate that a rough average of ten years was needed for the final determination of an ordinary civil dispute through first instance (1,343 days before the *tribunali*), appeal (952 days) and supreme court (829 days). The causes of delay are certainly many and cannot be referred exclusively to a dramatic litigation explosion, which is not confirmed by the figures, or to a shortage of judicial resources.
According to Varano and De Luca (2007) one aspect of the problem is the cost of access to justice. 'Generally speaking, the costs of justice include the fees charged by the state for access to the courts and for other related services, lawyers' fees and other expenses – especially expert fees. Lawyers fees are the most important heading.' High lawyer fees by themselves do not cause legal delay (the opposite is true: high delay causes high bills). It is, however, true that the expectation of having to pay high tariffs and bills stops people from litigating.

Taruffo (2005), citing a study on the administration of justice in an economic perspective published in 2003, points to other causes. Among them are 'the tendency of most lawyers to increase their incomes by multiplying briefs and hearings, also because of the existing system of determination of the lawyers' fees […]. [T]he existing procedural rules favour […] this inclination […].'

The outlook for alternatives to fund litigation costs in Italy is poor. Legal expenses insurance has been in the system a long time. In general it is inexpensive, sold as ancillary to household policies but is not widespread. Furthermore, there is no pro bono tradition, partly because working without remuneration for indigent people has long been imposed as a duty of the legal profession.

Instead, trade unions have traditionally been involved in offering subsidized legal services to their associates and when workers have a legal problem they are usually the source of advice turned to first. More recently, consumers groups and tenants' organizations have also begun providing legal services to their members. Ordinary people are, however, less aware of the existence of this kind of organization and often turn directly to a lawyer for advice whenever they have a legal problem. This is particularly true for low educated persons and for those living outside the major cities. It can be safely said that, except for labour disputes, lawyers are the first source of advice for legal problems.

Source: Varano and De Luca (2007), Taruffo (2005)

4.1.2 Availability of a legal aid system

An important aspect of access to law is the availability of a legal aid system. Based on our survey and desk research we know that all 12 countries have a legal aid system, except Italy (Box 4.1). How legal aid is awarded differs among the countries. In some countries the system is very restrictive. For instance in the Czech Republic it is not well known and some insurers did not know of it at all (cf. Box 4.2).

Box 4.2: Legal aid system in the Czech Republic

If a person needs a lawyer but cannot afford one and their case is to be held before the court, they can submit a request for a court-appointed lawyer. The state then covers all legal expenses. If the person seeking justice is not given a lawyer by the court, he can ask the Czech Bar for a lawyer. Householders entitled to legal aid are those who can prove their low income status. Legal aid is not limited to legal representation in court; it includes legal advice (e.g. drafting legal documents) but only when the lawyer has been appointed by the Bar. The costs of legal advice are initially covered by the lawyer who can claim at least partial reimbursement from the Czech Bar.

Source: SEO Economic Research

In Table 4.3 we give further details on the national legal aid systems. As this table shows, the systems differ substantially per country. For instance, England/Wales spend a relatively high amount on legal aid programmes and conduct a relatively high number of legal cases.

In all countries (except Italy; no data for Switzerland, situation in 2004), legal aid for other than criminal cases includes representation in court and legal advice. Also, in all countries (except Czech Republic and England/Wales; no data for Switzerland, situation in 2004) the legal aid scheme includes an income and asset test for granting legal aid for other than criminal cases.

Table 4.3: Further details on legal aid (2004)*

	Annual budget allocated to legal aid per inhabitant as % of per capita GDP	Number of legal aid cases per 10,000 inhabitants: Total number (and number of cases other than criminal cases)
Austria	0.010%	30 (-)
Belgium	0.011%	95 (-)
Czech Republic	0.014%	- (-)
England/Wales	0.235%	459 (161)
Finland	0.035%	152 (99)
France	0.018%	134 (77)
Germany	0.021%	- (-)
Hungary	0.001%	52 (38)
Italy	0.005%	17 (4)
Netherlands	0.077%	211 (131)
Spain	0.014%	- (-)

Source: CEPEJ

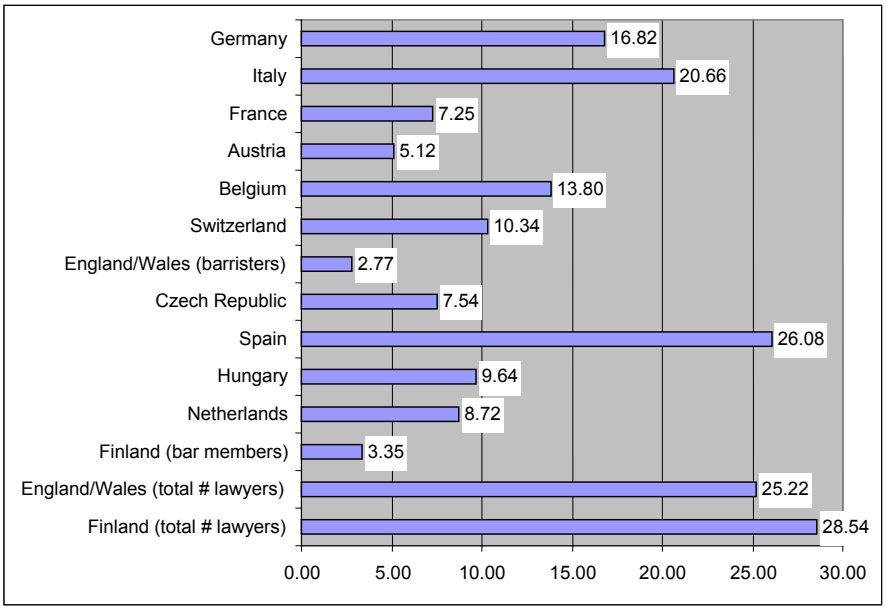
* No data available for Switzerland.

4.1.3 Number of lawyers

Yet another important aspect of access to law is the availability of lawyers. The number of lawyers differs remarkably among the 12 countries in our survey. Figures 4.1 and 4.2 show the number of lawyers relative to the population. In Finland there is neither a monopoly of the Bar members nor a compulsory use of Bar members in court proceedings or in legal counselling. We have, therefore, included Finland twice in the tables below: (1) the number of Bar members (lawyers with the title *Asianajaja*) and (2) the total number of legal advisors (lawyers). Based on this second total Finland is the country with the highest number of lawyers per inhabitant (28.54 per 10,000 inhabitants), whereas if we take the first total (Bar members) it is the country with the lowest number of lawyers (3.35 per 10,000 inhabitants). The lawyer density is relatively high in Spain (26.08), England/Wales (25.22) and Italy (20.66) and relatively low in Austria (5.12), France (7.25) and the Czech Republic (7.54).

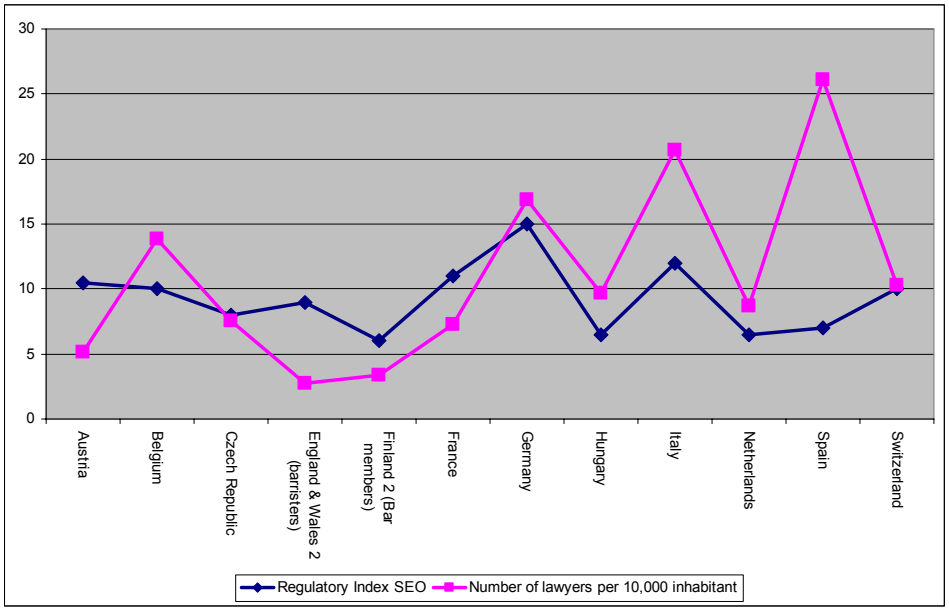
In Figure 4.1 we rank the countries from most to least regulated (based on our regulatory index; section 3.3.2). On first glance it may look as if no relation exists between the level of regulation and the number of lawyers per inhabitant. But if we look closer we see that the number of lawyers and the level of regulation is linked: a high level of regulation involves a high number of lawyers (Figure 4.2). This link between regulation and the number of lawyers is less perfect in Spain and Italy. As said earlier, the Spanish legal services market is probably more regulated than our regulatory index describes (cf. text above Table 3.8 in section 3.3.2); the index takes no account of some restrictive practices and the total should therefore be higher. Excluding Spain, the correlation between the number of lawyers and the regulatory index is 61.7%.

Figure 4.1: Number of lawyers per 10,000 inhabitants (2006)



Source: Number of lawyers (all countries): CCBE (http://www.ccbe.org)
Finland: total number of lawyers: http://www.asianajajaliitto.fi)
Population statistics (all countries except England/Wales): Eurostat/U.S. Bureau of the Census
Population statistics England/Wales: Office for National Statistics

Figure 4.2: Number of lawyers (2006) and regulatory index



Source: Number of lawyers: see Figure 4.1; regulatory index: SEO economic Research

The Italian regulatory index is relatively low as a result of recent deregulations. However, the number of lawyers depends a great deal on past entry restrictions, that is, a strong path dependence exists. The recent Italian liberalizations have not yet led to changes in the behaviour of the suppliers of legal services. Such things take time (cf. text below Figure 3.1 in section 3.3.2).

Moreover, note that in Figure 4.2 we left out both the Finnish lawyers without Bar membership and the solicitors from England/Wales; instead we took the Finnish *Asianajaja* and the UK barrister. The fact that *Asianajaja* and barristers experience a great deal of external competition from non-Bar member and solicitors, respectively, implies that their numbers are low. On the other hand, the relatively high number of lawyers in Germany, Spain and Italy is due to the fact that those countries have no external competition. This positive correlation between regulation and lawyer number is contrary to the Paterson et al. (2003) finding that in countries with low degrees of regulation, there are proportionally higher numbers of practising professionals.

4.1.4 Access to law for SMEs

We also looked for information on access to law for small and medium-sized enterprises (SMEs). No information is available that can be compared across the 12 countries in our sample. However, one publication by the World Bank and International Bank for reconstruction and Development is useful – although not specifically aimed at SMEs it is for the most part based on information from SMEs. A benchmark of the regulatory cost of doing business was conducted in 178 economies. Economies are ranked on their ease of doing business. A high ranking on the ease of doing business index means the regulatory environment is conducive to the operation of business. Part of the benchmark is the ease with which contracts can be enforced.

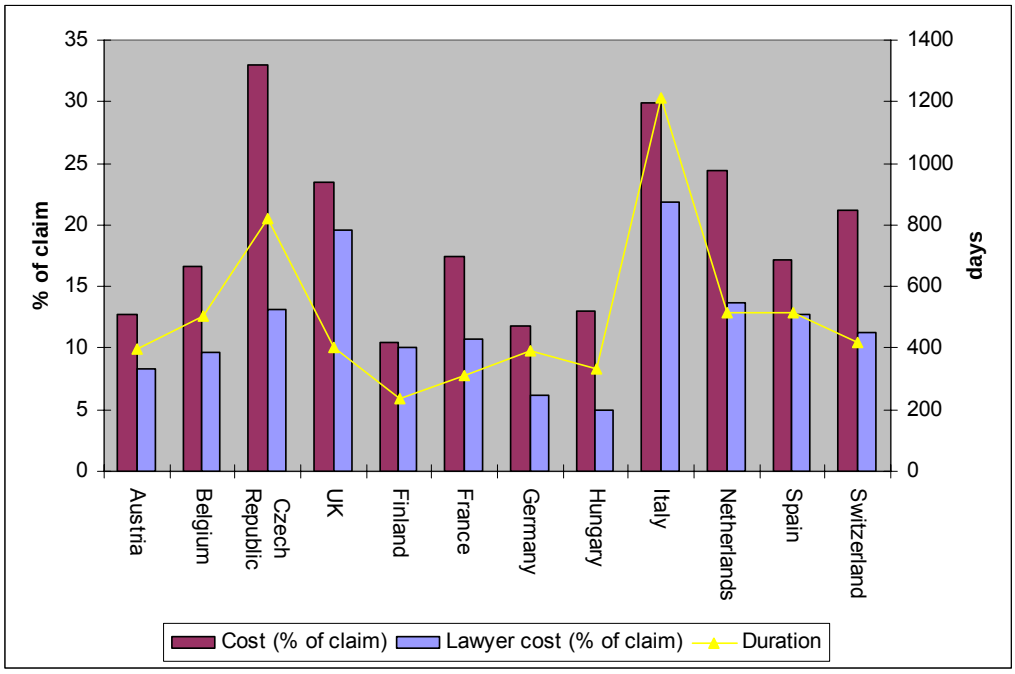
It tracks the efficiency of the judicial system in resolving a commercial dispute, following the step-by-step evolution of a commercial sale dispute before local courts. The data are collected through a case study of the codes of civil procedure and other court regulations as well as surveys completed by local litigation lawyers and judges (current data as of 1 June 2007). The dispute, between two businesses (the seller and the buyer) located in the country's most populous city, concerns a contract for the sale of goods. The seller agrees to deliver the goods, worth 200% of the country's income per capita, to the buyer. After receiving and inspecting the goods, the buyer concludes that their quality is inadequate. The buyer sends the goods back without paying for them. The seller disagrees and argues that their quality is adequate. The seller seeks full payment from the buyer, arguing that the goods cannot be sold to a third party because they were custom-made for the buyer. The seller sues the buyer to recover the amount due in the sales agreement (200% of the country's income per capita). Because the claim is termed as a percentage of GDP the results are corrected for welfare differences between the various countries.

Figure 4.3 gives the duration of enforcing a contract, which counts the number of days from the moment the plaintiff files the lawsuit in court until the moment of payment. This measure includes both the days on which actions take place and the waiting periods between actions. Also, the costs of enforcing a contract are given. First the total cost, which measures the official cost of going through court procedures, expressed as a percentage of the claim. The costs include court costs, enforcement costs and lawyers' fees where the use of lawyers is mandatory or common.

Second, Figure 4.3 gives the lawyers' fees as a percentage of the claim. For instance in Austria, the total cost of enforcing the contract is 12.7 % of the claim. This 12.7% consists of the lawyers' fees (8.3%), court costs (4.1%) and enforcement costs (0.3%) (the last two are not included in Figure 4.3). On average it takes 397 days to enforce a business contract in Austria.

In terms of duration Italy (1,210 days) and Czech Republic (820 days) perform worse than the other countries in our sample, whereas Finland (235 days) and France (313 days) perform relatively well. Lawyers' costs are relatively high in Italy (21.8%) and the UK (19.6%; no data are available for England/Wales alone), and relatively low in Hungary (5%) and Germany (6.2%).

Figure 4.3: Cost of enforcing a business contract and duration for SMEs (2007)



Source: International Bank for reconstruction and Development/The World Bank (2007), edited SEO Economic Research

4.1.5 Conclusion to first and second hypotheses

Based on our surveys, data analysis and the literature we conclude that the first hypothesis is accepted – access to law is sufficiently guaranteed in each of the 12 surveyed countries. Moreover, we can also accept the hypothesis that access to law is not safeguarded to any greater degree in those countries subject to more stringent regulations than those where it is less so (as shown in the overall regulatory index in section 3.3.2).

In our survey we asked Bars and legal expenses insurers if access to law is sufficiently safeguarded, if legal aid is in place and if so, in what form. We tried to measure access to law in terms of legal aid schemes (number of cases, expenditure on legal aid), the availability of lawyers, and the ease of enforcing a business contract. However, based on our surveys and desk research data we were unable to identify a relation between access to law and the level of regulation.

For instance, the less regulated countries score no differently on access to law than highly regulated countries. To name another example: The ease of enforcing a contract is sometimes better in strictly regulated countries (Germany) and sometimes not (Italy); overall no relation exists between the ease of enforcing a contract and the regulatory index. A final example: Accessibility of legal aid schemes is sometimes better in less regulated countries (England/Wales) and sometimes not (Hungary).

There is one exception to this general finding: We do find 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 is due to existence of competition in the less regulated countries (England/Wales, Finland, Hungary, Netherlands), whereas there is no external competition to be found in highly regulated countries with relatively high numbers of lawyers (Germany, Italy and Spain).

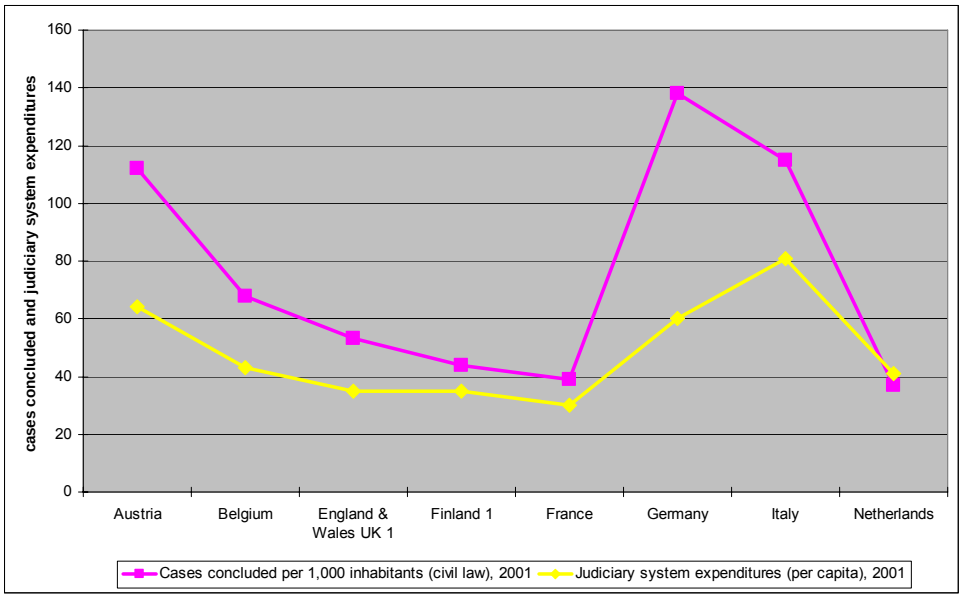
The reason why it is difficult to establish a relation between access to law and the regulatory index is probably because our comparison focuses on regulatory differences and therefore excludes the regulations and institutions that determine the performance of the judiciary system as a whole. Nonetheless, differences in legal systems do exist. We described how the legal aid systems differ per country in section 4.1.2). Here, we take the example of filter mechanisms (Blank et al. (2004)). Numbers of concluded cases per capita vary strongly across countries indicating serious differences in the filter mechanisms determining whether or not cases are submitted to court. Strong filter mechanisms lead to more cases in court with large case loads on average. The filter mechanism is an important determinant of performance differences: A stronger filter mechanism often coincides with lower performance in terms of costs per case dealt with in court. It is also an important determinant of differences in the costs of the judiciary system: A stronger filter mechanism often coincides with lower total costs of the judiciary system. England and Germany take relatively extreme positions. Germany has almost no entry barriers for prospective litigants seeking to use the judiciary system. As a result, many light cases slide into the system. Moreover, German fees are relatively low (or at least highly predictable) because of regulation. This is also an incentive to bring cases to court and may lead to high performance figures expressed per number of civil court cases. However, performance may be mitigated by the complex court structure and by discouraging (more efficient) out-of-court solutions. England/Wales, by contrast, have a high restriction on cases entering the judiciary system so that ultimately only complex cases are addressed by the judiciary. As a consequence, performance outcomes tend to be rather low.

Figure 4.4 gives the number of civil law cases conducted per 1,000 inhabitants and the judiciary system expenditures per capita in 2001 for 8 of the 12 countries in our sample (no data are available for the other four countries). Note that the expenditures on the judiciary system include all kind of cases (civil, punitive and administrative law). The expenditures per capita are highest in Italy (€ 81), Austria (€ 64) and Germany (€ 60) and lowest in France (€ 30), Finland and England and Wales (both € 35). Figure 4.4 shows that the number of civil law cases per 10,000 inhabitants is relatively high in Germany (138), Italy (115) and Austria (112). The lawyers' profession in these three countries is strictly regulated and few incentives for out-of-court settlement exist.

Figure 4.5 gives the total number of civil cases in courts (litigious and not litigious) per 1,000 inhabitants and the annual budget allocated to the judiciary system per inhabitant (courts and prosecution, but without legal aid) in 2004 based on data from the European Commission for the Efficiency of Justice (CEPEJ) (no data are available for Switzerland). Because the number of cases conducted in Austria is very high (over 585 in 2004), we used a smaller scale. The CEPEJ data give a different picture from the data used to construct Figure 4.4. The number of cases as well as the judiciary expenditures is no longer very high in Italy. The number of cases in Germany and Austria is high, but the judiciary system expenditures are relatively low in Austria. The fact

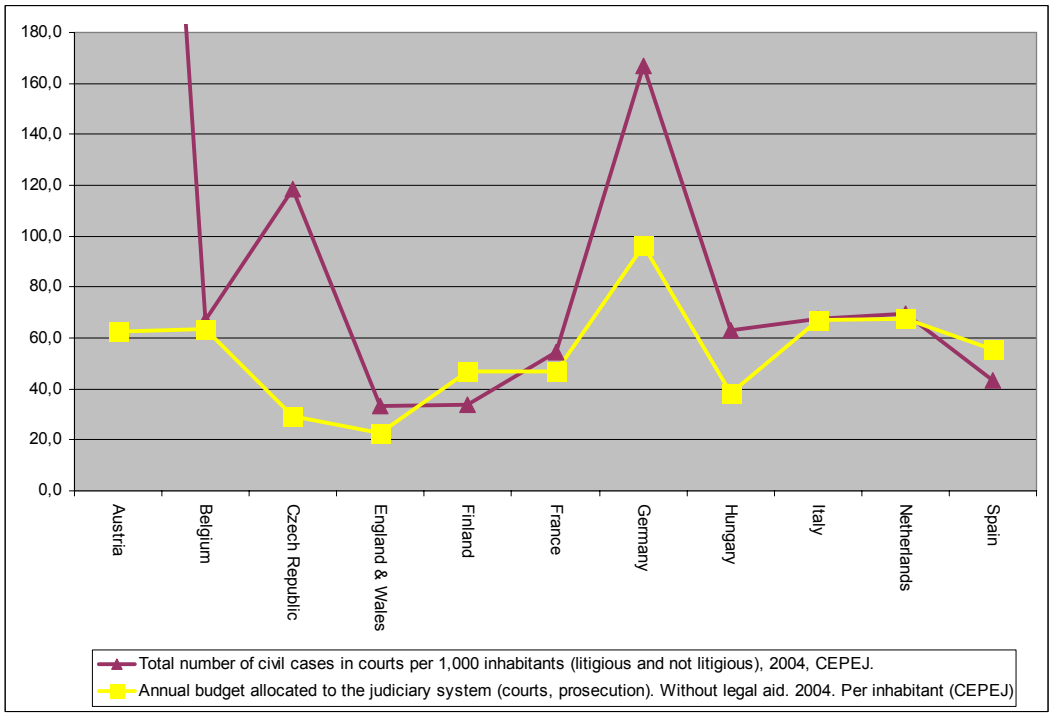
that Germany and Austria solve cases relatively often in court (instead of with out-of-court settlements) is a longstanding tradition (Wollschlager (1998)).

Figure 4.4: Civil law cases concluded and judiciary system expenditures in 2001



Source: Blank et al. (2004), edited SEO Economic Research

Figure 4.5: Cases concluded and judiciary system expenditures in 2004



Source: CEPEJ (2006), edited SEO Economic Research

The number of civil cases in courts (litigious and not litigious) is low in England/Wales, Finland and Spain. Judiciary expenditures are relatively low in Hungary and Czech Republic. If we correct the judiciary expenditures for differences in GDP, the CEPEJ numbers indicate that the judiciary expenditures on courts and prosecution are relatively high in Hungary (0.5% in 2004 per inhabitant as % of per capita GDP) and in Germany (0.4%) and relatively low in England/Wales (0.1%) (these statistics are not presented in tables or graphs in this report; cf. CEPEJ (2006), pp. 32-33).

In both figures the German situation stands out as quite expensive. This may be due to the fact that most cases are dealt with in court by lawyers; there are few out-of-court settlements and no external competition from non-lawyer legal experts.

4.2 Effects of monopolization by lawyers

Now that we know that access to law is sufficiently safeguarded in the 12 countries in our sample, we can look into the question of whether the most stringent form of certain regulatory instruments (mainly the exclusive right of lawyers to conduct legal proceedings) leads to greater costs than benefits to society, and therefore reduces economic welfare.

When discussing costs and benefits of regulation we should not only include the costs for consumers, but also the costs for the profession itself. For instance, in a highly regulated state, the costs of education are probably much higher. However, due to the monopoly position of lawyers they are able – at least partly – to pass these costs on to consumers. Education costs are therefore in most cases largely discounted in the lawyers' costs.

Here we first discuss possible benefits of monopolization by lawyers. Next, we discuss objections to the procedural monopoly for lawyers. In section 4.2.1 we describe in more detail the drawbacks of the monopoly of lawyers. Subsequently, we look into the extent to which this entails extra costs (section 4.2.2).

Benefits of monopolization by lawyers

The most important benefits of quality regulation such as mandatory representation in court by lawyers include a decrease in search costs, improvements in service quality and more adequate supply of information on the quality of professional services. The most important arguments underpinning the procedural monopoly are effective access to law, a fair trial and safeguarding 'equality of arms'. The complexity and formality of the civil procedural law could well disadvantage any party to a case who does not have expert representation.

Although it is generally assumed that the quality provided by lawyers is higher and that this justifies monopolization, Moorehead et al. (2003) show that quality provided by non-lawyers is at least as good as provided by lawyers. Box 4.3 discusses their empirical study on the quality effects of the monopoly position of lawyers. The Moorehead et al. study shows that deregulation of market access conditions does not have to imply negative quality effects. Moreover, monopoly and licensing requirements to provide legal services may only create the perception of quality and increase the demand for credentialed lawyers even in situations where a lawyer is not required (cf.

indirect effects discussed in the next section). Generally speaking, greater access for non-lawyer providers is not problematic as these paralegals are often at least as qualified as lawyers to provide assistance on routine matters where legal needs are greatest. Concerns about unqualified or unethical paralegal assistance could be addressed through more narrowly drawn prohibitions and licensing structures for non-lawyers providers (cf. section 4.3.3).

Box 4.3: Comparison of quality provided by non-lawyers and lawyers in the UK

Moorehead et al. (2003) 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). In the early days, the fund was administered by the solicitors' professional body, the Law Society. When the administration was removed from the Law Society in 1989, a government agency, the Legal Aid Board (now renamed the Legal Services Commission), was created to manage the scheme. The Board slowly introduced non-lawyer providers of legal services into the scheme by way of pilot projects. Following the pilot programme of 2000, the market for publicly funded legal help, historically the preserve of solicitors in private practice, became a contested market. Non-lawyer agencies and profit-making solicitors' firms now seek contracts from the same cost-limited funds. The price of contracts is fixed by reference to standard formulas. As a result, the market is contested (both parties seek contracts) but not subject to price competition.

The comparison between non-lawyer and solicitor organizations covered advice and assistance work in all civil areas other than family work. Moorehead et al. considered welfare benefits, debt, housing, and employment cases in detail. The assessment did not cover litigation but did include cases handled within administrative tribunals.

The professional model of service does not always provide higher levels of service than the paraprofessional. The control on entry into legal practice, years of legal education, and regulation of conduct and competence have done little or nothing to distinguish lawyers from their non-lawyer competitors. The authors cite other empirical evaluations that in different contexts tend also to question the supposed supremacy of lawyers; it is specialization, not professional status, which appears to be the best predictor of quality.

Moorehead et al. used an external peer-review process to assess the quality of the work (peers are solicitors only). An assessment of the relative quality of lawyers and non-lawyers was possible in three ways: assessment of client satisfaction, the judgments of peer reviewers (solicitors only), and assessment of outcomes. All of these pointed in the same direction, namely non-lawyers provide higher quality than lawyers (solicitors). A thorough statistical analysis enables the confident assertion that taken as a group non-lawyers perform to higher standards than lawyers.

The findings were that non-lawyers were more expensive and less accessible. This is likely to be caused by the particular conditions of the legal aid contracting scheme. Although the hourly rates were higher for solicitors, non-lawyers were under a contractual incentive to increase the amount of time spent on cases. The form of contract allowed (indeed encouraged) the significant differences in time spent per matter between non-lawyers and solicitors. They lie at the heart of the differences in cost between the two sectors.

Source: Moorehead et al. (2003)

Another study on the relation between quality and lawful privileges for legal professionals is provided by Schmid et al. (2007). They study the market of conveyancing services (associated with buying and selling land or real estate). Based on an empirical study of 21 countries, they found no support for a connection between high regulation and high service assessment of choice, quality, certainty and speed. 'To the contrary, the results support more a slightly negative relationship between regulation and service assessment than the existence of a positive one.' (p. 23). These results are relevant to our study since in 4 of the 12 countries in our sample

conveyancing services are mainly provided by lawyers, namely Austria, Czech Republic, England/Wales and Hungary; in all other countries hiring a notary is mandatory (the report does not include information on the Swiss situation).

Another potential benefit of monopolization is the reduced risk of having 'bad' service. When consumers are risk-averse to 'bad' service, possibly because it leads to large losses they cannot bear, quality regulation is a substitute for the theoretical possibility of insurance against 'bad' services.[62]

4.2.1 Drawbacks of monopolization by lawyers

From the economics point of view, the attribution of a monopoly position to a select group in order to eliminate a quality problem is an outdated concept. For those seeking justice, the monopoly means that they are forced to hire a lawyer whereas they perhaps might have liked to hire another less expensive legal expert. This lack of freedom of choice thus generates costs that make it unrealistic to pursue smaller claims through the courts – particularly for the less prosperous in society.

From a social perspective, individuals are becoming increasingly confident and making their own decisions in more and more domains. Or, where others make the choices, they expect to have a real say in them. Specific objections to the monopoly have been voiced from the legal angle.

- Compulsory procedural representation increases people's 'distance' from the legal system.
- The monopoly prevents judges from being more 'customer-friendly'.
- Barendrecht (2004, 2004a) states that procedural monopoly – like other monopolistic arrangements within the legal system – maintains the incomprehensibility of the law. Justice is a discussion between lawyers and judges in language that is totally unfathomable to the ordinary person. 'Judicial proceedings are still organized as a written exchange of standpoints with no real dialogue and subject to formalistic procedural rules. Anyone who has ever worked with it feels that this 19th-century system is obsolete. […] Why can it not be conducted in normal language?' Barendrecht believes that opening the monopolies will make the law more accessible, not least because the material will be easier to understand.

In the remainder of this section we describe in more detail the economic drawbacks of current regulation of the market of legal services, mainly the exclusive right of lawyers to conduct legal proceedings. The scale of the procedural monopoly is determined by the scope of its coverage and the opportunities available to enter the profession.

When competition is heavily restricted, standard economic theory predicts high prices and high profit margins. Due to government and self-regulation, competition in the market for legal services in most European countries is (severely) restricted. As described in section 2.1 economists use the ideal of free competition as the benchmark against which they measure the actual situation. In most states, the following four factors are particularly important with regard

62 This insurance product does not exist and probably would not be possible to introduce as it is difficult for the client to establish that bad service has taken place.

to the lack of competition: (1) compulsory legal representation in court; (2) high barriers to access; (3) high costs of transferring the case to another lawyer; and (4) the indirect effects of the procedural monopoly. We discuss all four factors below.

Compulsory legal representation in court

The most striking imperfection is the existence of a statutory procedural monopoly whereby only lawyers accredited by the national Bar may appear in certain court cases. There are exceptions but in many cases this forces people to buy the services of a lawyer. Economic theory predicts that when a monopoly exists (permitting a single profession exclusive rights to a market) prices are too high and production is too low, with society as a whole suffering a loss of prosperity as a result.

The academic literature suggests a variety of explanations for rising lawyers' fees and the level of their profit margins. Below we look briefly at the analyses made by Shy (2001) and Hadfield (1999).[63]

Shy sees two reasons for the rise in the lawyers' fees and relates these to the sharp rise in the number of lawyers between 1970 and 1995 (cf. section 2.1.2 to read how Shy models network effects and explains how fees rise with an increase in the supply of lawyers). First, he mentions the trend towards specialization and a separation between the work of advisory and practising lawyers. And secondly, he says that – thanks to higher fees – it is increasingly profitable to be a lawyer. Shy develops this point by referring to network effects, the phenomenon that the value of a network to a participant in it (in this case a lawyer) increases in line with the size of the network (cf. section 2.1.2).

Hadfield wonders why lawyers cost so much. In search of the answer, she investigates market imperfections and concludes 'the market for lawyers is fundamentally non-competitive.' The high fees mentioned by Hadfield and others are, at least part, linked to this procedural monopoly.

According to some, the fact that the numbers of cases and lawyers have increased sharply in recent years shows that this is no 'ordinary' monopoly but one experiencing at least some competitive pressure from actual and potential entrants. Countering that argument are the facts that network effects play a role and the number of cases per lawyer remains stable.

High barriers to entry

The competitive pressure from actual and potential entrants increases as the barriers to entry decrease. One such major barrier is the professional training required to become a lawyer. Only once that and the associated work placement have been completed does a person qualify to practise law. Because this training often falls under the responsibility of the Bar and the number of places is limited and determined by the law firms themselves, established lawyers have a major say over new entrants to the profession (Pashigian (1979)). The limit on the number of places is naturally also related to their high costs (Rosen (1992)). Another barrier is formed by restrictions

63 These subjects are also covered in Rosen (1992) and Sander & Williams (1989).

on procedural work imposed upon lawyers in the employment of organizations other than recognized law firms (see also section 3.2.1).

The barriers mentioned are artificial in nature and largely the work of the profession itself, as embodied by the Bar. As well as artificial barriers to entry, there are also 'natural' ones. In section 2.1.2 we described the increasing benefits of specialization and economies of scale. However, these natural barriers are small compared to regulation. In particular, regulation can act as an entry barrier, preventing new firms, or firms active in other areas from entering the market. Barriers to entry are required for a cartel to function effectively – where no such barriers exist, high prices will attract new entrants who can undercut the cartel. Even where no cartel exists, barriers to entry may reduce competition and support unilateral price increases. Of course entry regulations do not necessarily imply rents. After all, competitive prices can result even with barriers to entry due to competition between service providers already in the market.

Sunk costs and transfer costs

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 sunk (unrecoverable) and if another lawyer is hired to take on the case, those same costs will be incurred all over again. The client is effectively locked into a relationship with the lawyer, which position gives the latter considerable market power. The lawyer can shift down a gear or add hours to the bill, spend more easily on experts, research, paralegals and the like, and concentrate upon those aspects of the case which interest him or his office rather than those which are important to the client.

The sunk costs argument is also pertinent in the tournament model. In this model, it is worth the client paying a lot extra for a lawyer who is just a little better than another because that small difference could be decisive in the case. Hadfield (2000) states:

> 'What makes the relativity of performance so important is then the fact that this is a tournament – the winner takes the prize. Having a lawyer who is marginally better pays off disproportionately. [...] Clients are therefore (rationally) willing to pay a lot for a little.'

Clients are still unable to assess quality objectively, but under the tournament model they appreciate its importance and have some perception of who a good lawyer or what a good law firm is. And so they should because otherwise they could not win their case. This means that the price clients pay is the monetary equivalent of what is at stake. The fact that the price of a lawyer's service is related not so much to the cost price of the service itself but to the value placed upon it by the consumer is a sign of market power. According to Hadfield every hour a lawyer works has, in a sense, the same value as the first hour: The entire amount at stake. This puts lawyers in a powerful position to extract sums not governed by the 'value' of their services but rather by the wealth of clients. This market power increases the more frequently a lawyer or firm emerges victorious in the 'winner-take-all and tournament nature of the competition among lawyers'. This means that people seeking justice –certainly those who are insured – will always try to hire a good and hence expensive lawyer. (They could of course also hire a good non-lawyer but in most countries no such freedom of choice exists). This would explain the low elasticity of

demand:[64] Insured parties do not themselves pay the high fees directly and are therefore less sensitive to lawyers' fees.

Note also that the high prices corporate clients can afford to pay do have an impact upon the consumer market, to the detriment of public access to law. That business customers can offset their lawyers' charges against tax and VAT-liable firms can deduct VAT as well, whereas private customers cannot, only increases this impact.

Ashenfelter and Bloom (1993) empirically test the tournament model and find that parties face a tournament-like setting that puts them in a 'prisoner's dilemma' situation. The costs and benefits of legal representation are structured in such a way that each party seeks representation in the hope of exploiting the other party while knowing full well that failing to do so will open up the possibility of being exploited.

Indirect effects of the procedural monopoly

The effects of the procedural monopoly are felt well beyond the domain to which it actually applies by law. In most countries, the lawyers' profession has been given statutory protection in the areas covered by the monopoly and in criminal cases, but that status is effective in a far wider field. As a result of these indirect effects, which are due solely to procedural monopoly, lawyers have an advantage over other legal services providers when it comes to setting their fees. These effects are described in the economic literature by, for example, Shapiro (1983) and Rogerson (1983). In a market lacking sufficient competition (no external competition or relatively few lawyers), such as the legal profession, suppliers are able to command a premium in terms of the prices or market share. Without external competition (Germany, Spain, Italy or France) lawyers can draw a larger part of the market for legal services to the exclusive domain of the lawyers' profession, thereby increasing market share.

Of course, indirect effects are not just about the status of lawyers but also about efficiencies. Calling in the services of a lawyer is attractive to the client even when a dispute can be settled out of court. Should recourse to formal justice prove unavoidable, there is no duplication of the costs of the legal advice obtained in the early stages of the procedure: The lawyer is already familiar with the brief. During negotiations, moreover, only a lawyer can credibly threaten with formal proceedings. Lawyers also have competitive advantages to offer in the case of contracts, since they have a 'feel' as to how those documents will stand up in court.

The indirect effects of the procedural monopoly are thus associated with considerations of efficiency as well as reputation. According to the theory, these effects can be reflected through higher fees or a higher market share for lawyers in non-monopoly cases. In practice, as far as fees are concerned, in most cases we see indeed that prices charged within the monopoly domain are often no higher than those outside it (in other words, lawyers frequently charge the same hourly

[64] The demand for legal aid is not only determined by the number of legal problems households and firms meet with but also by the elasticity of demand. In general, the price of elasticity of demand is negative as a fall in the price of a good is expected to increase the quantity demanded. According to a recent Dutch study the elasticity of demand for legal services is null (Torre (2005)).

rate for procedural and non-procedural work). So the margins achievable with monopoly protection are also obtained without it. The extent of these indirect effects is unknown.

4.2.2 High prices and rents

The main criticism of the regulation of lawyers is that it contains anti-competitive measures that raise prices and allow the members of the profession to earn supra-competitive economic rents. With supra-competitive rents we refer to remunerations above costs (including previous investments of an educational and productive nature). This means that profit remains after the deduction of rewards for invested capital (rents are defined as an excess of profit over the normal rate). The level of regulation is too strict relative to the social benefits in terms of dealing with the information problems and preventing negative externalities. Here we first describe empirical data on rent-seeking. Subsequently, we use data from our surveys to measure the price difference between insourced and outsourced legal work by legal expenses insurers.

Rents

Some commentators state that the rent-seeking argument is largely theoretical and not sufficiently supported by facts (Van den Bergh and Montagnie (2006)). Winston and Crandall (2007), however, perform an empirical study to determine the amount of rents earned by lawyers. The US regulatory situation is comparable to the European one in that both have compulsory representation by lawyers where the scope of the monopoly may vary across the America states and the EU Member States (US states are generally speaking less regulated). They document aggregate annual earnings of lawyers working in the US for law firms, government, and the rest of the private sector during 1975-2004 and estimate the share of these earnings that can be characterized as rents (excluding secondary rents to law professors in the form of higher salaries, to law schools in higher tuitions, and so on). Their methodology specifies an individual's wages or earnings as a function of supply and demand factors and allows occupational dummy variables to capture wage or earnings premiums or rents. They compare various occupations (lawyers, physicians, dentists).

Winston and Crandall (2007) find that lawyers earned sizable rents at the beginning of the sample period and that these rents have grown significantly over time. This growth can be explained by changes in government policies towards intellectual property, liability issues, and regulatory matters that increased the demand for lawyers. In sum, the increase in lawyers' earnings premiums may reflect changes over time in government policy that have benefited lawyers but have not particularly benefited workers in other professions (with the possible exception of economists who work directly or indirectly with lawyers).[65] Aggregate lawyers' earnings premiums or rents totalled US$64 billion by 2004 or US$71,000 per lawyer. These substantial rents can, according to the authors, not be explained by the earnings of a handful of 'superstars' but are widely shared among the legal profession. The authors also conclude that by constraining their supply, lawyers are able to exert greater pressure on policymakers to increase rents.

[65] Lawyers' earnings premiums relative to earnings in other occupations are not generated by overall growth of the economy (that is independent of regulatory, liability, and patenting activity) but by specific changes in government policy.

Based on a regression of lawyers' rents on the total number of lawyers in the US, Winston and Crandall (2007) show that the number of lawyers has a positive and statistically significant effect on rents, indicating that the licensing constraint is enabling lawyers to increase their rents. The authors cite earlier work from Winston and Maheshri showing that by limiting their size to eliminate free-riding, interest groups are able to exert greater political pressure on policymakers to institute policies that benefit them at the expense of other members of society.

Winston and Crandall recognize that specific legal training may be essential for providing certain legal services and that some unlicensed lawyers may not be able to adequately perform the most complex legal services. Given that rents have been broadly earned throughout the legal profession, they state it is likely that eliminating the licensing requirement would enable a sufficient cohort of intellectually qualified people to spur competition in most legal services and reduce rents. The authors expect this greater competition among lawyers and law firms would also weaken the political pressure the legal profession brings to bear on policymakers in support of inefficient public policies because the returns from the profession's 'investments' in political influence would be lower and because politicians could not deliver the rents they once did.

High prices: Overcharge

Now we test the hypothesis that the more stringent form of regulation (such as the exclusive right of lawyers to conduct legal proceedings) leads to greater costs to society than benefits. To gather data, we sent a questionnaire to all the national Bars and a second one to legal expenses insurers. The aim of both questionnaires included establishing if it is more expensive for legal expenses insurers, and therefore those needing legal assistance (households and SMEs), to hire the services of a lawyer than it is to hire non-lawyer legal experts. In both questionnaires the response was incomplete for the question on the average price of civil law cases, that is, none of the Bars and only half of the legal expenses insurers answered. Therefore, we can only use the data collected from the insurers.

As is explained in Appendix B, policyholders have the right to a free choice of a lawyer: It is entirely up to the client who defends, represents or appears for them. This person may be either a jurist or lawyer employed by the insurer, if that is permitted in the country concerned, or a self-employed lawyer. To reduce the cost of the second option, many legal expenses insurers – if regulation permits (cf. Table 3.3 in section 3.3.2) – have agreed partnerships with certain law firms. In exchange for favourable rates, these network lawyers receive more or guaranteed business. The major insurers process many cases and are thus able to negotiate bulk discounts. If the policyholders exercise their right to freedom of choice and select another representative than the network lawyer or the lawyer employed by the legal expenses insurer, the terms of the policy allow for setting a maximum limit to the non-network lawyer's fees and the potential costs to be reimbursed by the insurer.

The cost of handling cases in-house may differ from the cost of outsourcing cases to a network or external lawyer. We call this price difference 'the overcharge'. In order to estimate to what extent lawyers overcharge their clients, we compare the internal and external prices legal expenses insurers pay for lawyers' services on a per case level. Legal expenses insurers can draw their own

comparisons because they conduct their own cases, through a jurist or salaried lawyer, and also contract others out to external or network lawyers.

Ideally we would have tested the relationship between regulation and excess profits – that is profits above the normal competitive level (cf. section 1.2). In the absence of any profit data, this is not possible. Therefore we use data on price-per-case to determine the overcharge.

The second questionnaire for legal expenses insurers asked respondents to consider these cases:

- Case 1: A dispute between an employer and an employee.
- Case 2: A personal injury claim.
- Case 3: A consumer dispute.
- Case 4: A dispute between two SMEs about the supply of goods and services.

Subsequently, the respondents were asked to estimate the average cost of conducting such a case:

- If the legal expenses insurance company were to deal with the costs themselves (insourcing). Note that this may be a hypothetical question as in some countries insurers are not allowed to conduct cases.
- If the company were to use a network lawyer (outsourcing to lawyers with whom prior price arrangements have been made).
- If the company were to outsource the case to an external lawyer.

Table 4.4: Extent of overcharge

Case 1: A dispute between employer and employee	Average index number
Insourcing: Cases handled by internal practitioners	100
Outsourcing: Cases handled by a network lawyer	269
Cases handled by an external lawyer	489
Case 2: A personal injury claim	**Average index number**
Insourcing: Cases handled by internal practitioners	100
Outsourcing: Cases handled by a network lawyer	274
Cases handled by an external lawyer	606
Case 3: A consumer dispute	**Average index number**
Insourcing: Cases handled by internal practitioners	100
Outsourcing: Cases handled by a network lawyer	229
Cases handled by an external lawyer	414
Case 4: A dispute between SMEs about supply of goods and services	**Average index number**
Insourcing: Cases handled by internal practitioners	100
Outsourcing: Cases handled by a network lawyer	316
Cases handled by an external lawyer	526

Source: SEO Economic Research, based on data from legal expenses insurers

There was item non-response from several of the surveyed countries, with no data forthcoming from Finland, England/Wales, and Hungary, the less regulated countries. Therefore, the net sample of legal expenses insurers who did answer these questions completely is smaller than the 36 responses in our sample (19; see Table D.1 in Appendix D). Based on the answers we did receive, we analysed the cost estimates given for the various cases when insourced, or outsourced to a network lawyer or external lawyer, respectively. The sample size and non-response in some

countries did not allow us to differentiate the extent of overcharge to the level of regulation. Also, due to differences in legal system and details in regulation not included in our regulatory index (cf. section 3.3.2), we were unable to compare the overcharge between countries. We could, however, determine the average extent of overcharge for the remaining nine countries (Austria, Belgium, Czech Republic, France, Germany, Italy, Spain, Switzerland and the Netherlands). As Table 4.4 shows, on a case basis a network lawyer costs on average two to three times more than an insurer's jurist or salaried lawyer, while an external lawyer costs four to six times as much.

The European survey results are in line with one we conducted in the Netherlands (Table 4.5).

Table 4.5: Extent of overcharge in an earlier study for the Dutch market (2004)

Average over all cases in 2004	Average index number
Insourcing: Cases handled by internal practitioners	100
Outsourcing: Cases handled by a network lawyer	215
Cases handled by an external lawyer	400

Source: Baarsma and Felsö (2005), based on data from legal expenses insurers

We asked for the average cost of conducting a case in-house and externally. Obviously it is not easy to quantify the various costs of litigation because they depend on many different factors not always included in our analysis, for instance the judiciary system used or the particular steps required in each case. Another factor we excluded is the complexity of the case. Possibly, outsourced cases are more complex on average than cases conducted in-house by the insurer. This might explain some of the cost differences in Figures 4.3 and 4.4. Although our calculations should be interpreted with some caution we are convinced they provide a useful indication of the magnitude of the impact of regulation (cf. section 4.3.3).[66] Our results are strong and robust enough to initiate policy discussions.

According to our survey, legal expenses insurers in the surveyed countries contract out 60% of all their cases to the lawyers. As the price variations in Table 4.4 show, the unavoidable cost of hiring lawyers in cases covered by the procedural monopoly are substantial. As a result, policy premiums of legal expenses insurances are currently much higher than they would be if the requirement to outsource due to the monopoly did not exist. This restricts access to law.

Olesen and Nielsen (2006) also looked at the costs of lessened competition caused by the monopoly of lawyers. These figures are calculated using a methodology developed by Olesen and Nielsen. Using their methodology Olesen and Nielsen assess how much the individual regulations of the legal profession will affect the prices and the costs. As shown in Table 4.6 Olesen and Nielsen estimate that the regulation of the legal profession results in 3.7% higher prices (2.6%

[66] As described at the start of section 4.2, differences in the costs of insourcing and outsourcing are not explained by quality differences in services provided by internal jurists/lawyers and (network/external) lawyers. Also, the cost differences cannot be explained by the suggestion that legal expenses insurers turn down an insured/client more often than lawyers by saying that a case has no chance of winning and should therefore not go ahead. After all, the costs differences are based on conducted civil law cases and not on the mean of all potential cases or claims. Moreover, lawyers have exactly the opposite incentive: Whereas legal expenses insurers may have an incentive to turn down too easy a case, lawyers have an incentive to take on a case too easily because any case – win or lose (leaving success fees out of the picture) – will earn the lawyer an income. So both parties have 'adverse' incentives that in their own ways diminish access to law.

plus 1.1%). The main part of this price increase is caused by barriers that increase the costs to law firms (2.6%), in particular the law restricting the marketing of legal services (0.1% plus 0.9%). Unfortunately, Olesen and Nielsen do not consider the effect of opening the monopoly to certified non-lawyer specialists, only the abolishment of the monopoly. Abolishment would induce economic losses because of loss of quality, whereas these losses are less or non-existent when the monopoly is opened up to the non-lawyer specialist as well (cf. section 4.3.3 and 4.3.4). A second effect of only considering abolishment of the monopoly is that the analysis by Olesen and Nielsen does not reckon with a possible price decrease if non-lawyer professionals enter the market. This severely underestimates the social costs of regulation. Another difference from our analysis is the fact that we consider civil cases only whereas Olesen and Nielsen also include punitive law cases.

Table 4.6: Cost/price analysis of individual regulations by Olesen and Nielsen (2006)

Regulation	Cost increase, %*	Pure price increase, %*
Authorizations	0.8	0.1
Education requirements	0.6	0.1
Ownership requirements	0.3	0.0
Code of conduct	0.4	0.05
Indemnity insurance requirement	0.4	0.0
Law on restrictions on marketing of legal services	0.1	0.9
Total	2.6	1.1

Source: Olesen and Nielsen (2006)

* Regulations can affect the cost of enterprises (cost-creating barriers) and result in higher prices because the enterprises can inflate prices above costs (rent-creating barriers). One cost-creating barrier could be 'educational requirements', for instance, because salaries increase with educational requirements. An example of a rent-creating barrier could be 'marketing restrictions' which may reduce competition and thus enable firms to increase prices.

Recent research by Schmid et al. (2007) also looks into the costs of lessening competition by implementing monopolies for certain legal professionals. Looking at the economic impact of restrictive professional regulation on conveyancing service markets, Schmid et al. distinguish four different regulatory models:

- Traditional highly regulated Latin notary system, characterized by mandatory involvement of notaries even though the scope of involvement differs widely (Spain, France, Italy, Belgium, Germany, and Austria).[67]
- Deregulated Dutch notary system: No *numerus clausus*, fees are negotiable and market structure and conduct regulation is generally less strict.
- The lawyer system, characterized by quality control of professionals through licensing and professional exams only, negotiable fees and lower levels of regulation on market structure and conduct (UK, Czech Republic and, to a lesser extent, Austria where both notaries and lawyers have a high presence on the market).
- The Scandinavian licensed agent system under which real estate agents also provide legal services (Finland).

[67] Although Latin notaries exist in Hungary, this country is classified as a hybrid model given the required presence of an additional one or two lawyers in the average transaction.

According to Schmid et al., the Latin notary system is the most strictly regulated (regulatory index equals 13.7), followed by the Dutch notary system (7.1), the lawyer system (4.8) and the Scandinavian system (1.5).

Our empirical analysis of the relationship between regulation, price and perceived quality inspected the correlations between these three sets of variables and estimated various regressions by measuring the effect of regulation on prices (fees). The main finding demonstrates empirical evidence that low regulation leads to lower prices thus showing a potential financial benefit for consumers by deregulation (cf. Table 4.7). We also made a national comparison using relative fee levels (fees adjusted by net earnings across countries). The results show the same pattern: Traditional Latin notary systems are on average more expensive. The first conclusion is, in short, that high tariffs are related to high levels of regulation of notaries.

Table 4.7: Results of a cost analysis of conveyance models by Schmid et al. (2007)

Countries*	Fee as a % of average house price
Latin notary system	*0.99*
Austria	1.04
Belgium	1.48
France	1.20
Germany	0.68
Italy	1.93
Poland	0.68
Portugal	0.51
Slovenia	0.81
Spain	0.60
Dutch system	*0.56*
The Netherlands	0.56
Lawyer system	*0.75*
Czech Republic	0.85
England/Wales	0.47
Ireland	0.80
Scotland	0.84
Slovakia	0.81
Scandinavian system	*0.59*
Denmark	0.68
Finland	0.75
Sweden	0.34
Average over all sampled countries	*0.92*

Source: Schmid et al. (2007)

* Greece (2.96%) and Hungary (1.73%) are not included as neither country fits unambiguously into any of the four service models.

As mentioned earlier in section 4.2 (Drawbacks of monopolization by lawyers) we found no empirical support for a positive connection between high regulation and high service assessment of choice, quality, certainty and speed. On the contrary, the results support a slightly more negative than positive relationship between regulation and service assessment. Also, the empirical results of Schmid et al. (2007) do not support the argument that high prices are needed to assure high levels of service assessment. Thus, we can conclude that high prices (resulting from high regulation) are not necessary to deliver higher quality of notary services. Now that we know that

high regulation does not lead to better legal security (better contracts), it is very important that governments can point out what the benefits of high regulation are.

4.3 Alternative regulation schemes and their effects

In this section we discuss alternatives to current forms of government intervention (lawyers' monopoly on representing clients in courts of law) and the comparative effect of these alternatives on the current institutional framework.

1. Regulation of fees: Fixed or maximum fees (section 4.3.1);
2. Changes related to the procedural monopoly:
   - Restricting the monopoly by raising the statutory financial threshold below which no mandatory legal representation exists (section 4.3.2);
   - Easing the monopoly by opening it up to non-lawyer legal experts (section 4.3.3);
   - Abolishing the monopoly (section 4.3.4).

4.3.1 Fee regulation

If the current institutional framework with compulsory procedural representation by a lawyer is to be retained, then in theory it is possible to opt for a system of price regulation to suppress high prices and strong price increases in the market for the services of lawyers. This alternative derives from the situation in Germany where lawyers' fees are based on *'Rechtsanwaltsvergütungsgesetz'*. This defines either a fixed fee or a charge band for each professional activity a lawyer can perform.

If fee regulation is chosen, then it is important calculate this on a per-activity basis rather than by the hour; otherwise the temptation exists to simply charge for more hours than have actually been worked.[68] Fee regulation could involve either a fixed or maximum charge per activity and would result in the following benefits:

- The government can prevent potential overcharging.
- Those seeking justice know where they stand. Fixed charges benefits clients because they know in advance how much it is going to cost them to use the services of a lawyer and to estimate the cost of going to court with reasonable accuracy. Repeat buyers, in particular, can use the set fees to better calculate their own cost prices.

[68] The billable hours system (instead of charging per activity or case) is according to the American Bar Association the 'villain of the piece' (ABA (2002)). Also problematic is what some call the 'treadmill' – the continuous push to increase billable hours: 'How can a practitioner undertake pro bono work, engage in law reform efforts, even attend Bar association meetings, if that lawyer also must produce 2,100 or more billable hours each year, say 65 or 70 hours in the office each week.' The allocation of total hours spent by lawyers on legal work is increasingly skewed towards the business segment of the profession, and thus towards the efficiency and away from the individual justice goals of the justice system. 'The billable hour is fundamentally about quantity over quality, repetition over creativity.' The Commission on Billable Hours of the ABA has begun to combat the problem by examining the billable hour itself and look into alternatives that encourage efficiency and improve processes.

It is sometimes suggested that fee regulation (the German system[69]) is a prerequisite for ensuring a market for legal expenses insurance (Henssler and Kilian (2003); Kilian (2003, 2004)). Their reasoning is as follows:

> 'Fixed lawyers fees allow the development of a functioning and effective insurance market, where consumers can obtain insurance at a reasonable price against the risk of having to pay legal expenses. Insurance products can only be offered at reasonable prices, provided the insurer has a possibility of risk-pooling and provided the insured risk can be estimated. If the insured risks are the costs for the enforcement of a right, an estimate is possible only if the expenses for the lawyer and the court that would have to be covered by the insurer in the event of a claim can be assessed by the insurer on the basis of insurance mathematics. This requires a flat rate determination of remuneration. […] As a result, Germany has the biggest market for legal expenses insurance worldwide.'

It is true that fixed fees make things easier for repeat buyers, such as legal expenses insurers, but it is not true that these fees are necessary for insurers to produce insurances at a reasonable price. Insurance companies have other ways of estimating insured risks besides the system of fixed fees. The fact that the German market for legal expenses insurance is successful could and should never be the rationale behind fixed fees. This would be akin to serving the private interest instead of the public interest. Moreover, the legal expenses insurance market in other countries besides Germany also function effectively. For instance, Scandinavia, France and the Netherlands also have high densities of legal expenses insurers.

From an economic perspective, fee regulation is a sledgehammer measure. In our view, the drawbacks are insurmountable and are not compensated by the benefits. The most important drawbacks are:

- A rigid boundary is imposed upon the market, with a negative effect upon innovation, flexibility and other incentives to improve efficiency.
- High regulatory costs. It is very difficult to set rates for such a heterogeneous range of services. At present, in Germany, lawyers' fees depend on the amount in dispute. The amount and number of tariff rates can vary depending on the lawyer's activity. Difficulty and extent or complexity are factors to be considered as well as the state of case. Moreover, fee regulation would entail a raft of new rules and related administrative costs.
- Both the regulator and the client have an information problem: It is difficult to assess what category a case falls into.
- There is a danger of 'crowding out' related to the inability to assess quality. Lawyers will be inclined to take on simple cases only, or not to spend enough time on complex ones.
- Finally, in order to create a level playing field in the legal services market, fee regulation should apply to the market rather than the profession. For example, the market segment 'procedural law for consumers and SMEs'. The other suppliers in this segment would also have to be regulated, with all the cost implications of that.

69 www.brak.de/seiten/pdf/RVG/Grundlagen_english.pdf

4.3.2 Restricting the monopoly by raising the financial threshold

In some countries mandatory legal representation only exists for cases with a financial stake above some minimum statutory financial level. One possible alternative to the current monopoly is to reduce its domain by raising this financial threshold. Consequently, a larger part will fall outside the lawyers' monopoly. In some countries there are separate courts to deal with cases of minor financial value. It is often stated that these courts are less formal and more straightforward, with fewer special procedures and a judge more likely to make faster decisions. The shorter and simpler procedures in these courts help not only those seeking justice to save money, but also the state (although fewer out-of-court settlements may be reached). In order to assess the potential effects we analysed the Dutch situation of 1999 when the financial threshold was raised from 5,000 to 10,000 guilders (cf. Box 4.4 for highlights).

Raising the financial threshold creates freedom of choice in a larger section of the market. The extent to which this greater freedom will actually be used depends very much upon the type of cases in the segment concerned. Whether even more use of bailiffs or other service providers can be expected is a product of the nature of the cases in the new liberalized segment and of the parties in this new segment. These providers will see their market enlarged by the raised threshold. On the demand side, the following players benefit:

- Claimants in particular types of case where representation by legal services providers other than lawyers is possible, for example, debt-recovery cases (bailiffs).
- Repeat buyers seeking representation in large numbers of standard cases, or wanting to employ their own legal specialists to conduct them, for example, telephone companies and mortgage lenders.
- Defendants without a strong defence who can appear to represent themselves at no significant cost, in the hope of arranging a payment plan or other settlement with the claimant at the last moment.
- Respondents with such a strong defence that makes legal support unnecessary.
- Indirectly, all those involved in a case worth between the old and the new financial threshold who hire a lawyer to represent them. This is because that service is cheaper because lawyer's fees have come under pressure in the face of increased competition. However, the effect of raising the threshold must not be overestimated in this respect. Inflation has been pushing it down in real terms in recent years, and the financial value of cases continues to increase (more and more is at stake).
- Consumers and SMEs with legal expenses insurance: their premiums will rise less quickly.

The social benefits of raising the competency threshold are as follows:

- If more cases fall outside the monopoly and can be handled in 'lower' courts, with faster and more straightforward proceedings, time and costs for going to court diminish.
- Freedom of choice for those seeking justice, with representation tailored to their needs. This applies to everyone but how the freedom is used differs somewhat for claimants and defendants. The nature of cases and of the parties to them is an important factor in the actual freedom of choice and cost-savings open to those seeking justice.
- Larger access to law in general due to cost savings (slower increases in the premiums for legal expenses insurance).

- No cause for concern regarding the quality of the legal services provided by non-lawyers as a result of the threshold being raised. The Dutch case study shows that there are no indications that bailiffs and legal executives who entered the newly opened market when the threshold was raised have not been performing their task satisfactorily.

Box 4.4: Effects of increasing the financial threshold in the Netherlands in 1999

The most important effects of raising the financial threshold are as follows.

- Where procedural representation was once the sole domain of specialist lawyers, now there is large scale freedom of choice.
- Now claimants frequently hire bailiffs for representation; explainable by the high portion of debt-recovery cases in the liberalized segment.
- The respondents' rate of failure to appear has not fallen substantially. When respondents do mount a defence, they frequently use the opportunity for self-representation.
- Where legal representation is not compulsory (district division and administrative proceedings), it is possible to actually conduct cases without a lawyer. In general, there seems to be no problem with leaving it up to the parties involved to decide on hiring a lawyer or another kind of representative, or whether they will represent themselves.
- It is often assumed that the number of legal cases will rise if other advisers with lower prices may represent clients in court. That raising the threshold will supposedly increase the numbers of cases in court cannot be proven in the Dutch situation. So the argument that raising it further would put even more pressure on the overworked judiciary is unendorsable. On the contrary, in fact: more cases are now being completed faster and more straightforwardly. On the other hand, the assumption that raising the competency threshold improves access to law – in terms of making it more frequent – is also unendorsable.
- The rise in the number of cases in the liberalized segment was attributable primarily to migration effects from 'normal' courts (where you need a lawyer to represent your case) to 'lower' courts (where you can freely select the legal advisor of your own choice). The intake figures issued by lower courts show a striking fall in the number of cases in other segments while the number of cases in the liberalized segment was rising. It seems that the financial value of cases was being kept artificially below the lower threshold prior to the raising of the competency threshold, so that these could be dealt with by a district court rather than at the circuit level. The reason for this artificial manipulation is that claimants prefer to appear before a 'lower' court because of such factors as speed, informality or lower costs (expenditure is kept down by the lack of a requirement to be represented by a lawyer and by the lower court fees).
- More cases are being dealt with by a cheaper form of justice, which saves society money.
- One significant negative effect of the change is that fewer settlements are being reached out-of-court, linkable to the removal of the requirement to be represented by a legal expert in the majority of debt-recovery cases. However, no difference exists between the extent to which settlements and other extra-judicial solutions are reached between lawyers and other legal experts (bailiffs, lawyers employed by trade unions, legal expenses insurers).
- A neutral effect is that the value of the claims in debt-recovery cases rises because the issuing of summons can be deferred for longer and because there is no longer any need to divide claims (it is cheaper to conduct cases in the district court than in the circuit court).
- In tort cases appearing before the district court, the maximum amount possible (the threshold amount) tends to be claimed. So raising the threshold is likely to result in the amounts claimed rising. However, judges do not go along with those increases. It seems that 'pitching high' has simply become part of the game.

Source: Baarsma and Felsö (2005), based on the Dutch study by R. Eshuis and G. Paulides in 2002 'From district court to subdistrict court', published by the Ministry of Justice/WODC.

The social drawbacks of raising the competency threshold are as follows:

- Concerns about the quality of cases presented by clients opting for self-representation or 'another appointee', that is, an acquaintance, with or without legal training. As shown in section 4.2 it is not at all clear that these quality concerns for non-lawyer representation are indeed necessary.
- In the Dutch situation we saw that when at least one of the parties has no professional representation, fewer cases are settled out-of-court.
- No freedom of choice and possibly even higher prices above the competency threshold.

4.3.3 Easing the monopoly by opening it to non-lawyer legal experts

Another alternative is to extend the monopoly beyond self-employed lawyers to a wider group of practitioners.[70] This is absolutely not about admitting people uneducated in procedural representation. Precisely the opposite, in fact: It is about opening the courts to people with training and experience. Quality standards must be imposed and maintained; the workload on courts should not increase (the efficiency of the legal process must not be endangered) and the basic principles of a fair trial and equality of arms should be safeguarded.

One option is to allow for employed lawyers. If lawyers employed by non-law firms were allowed in a country, it is important to give them the same national rights and duties as self employed lawyers (cf. section 3.2.1).

If it is decided to open the monopoly to legal advisers other than lawyers, then they should comply with yet-to-be formulated criteria. An appropriate regulatory structure should take account of the ability of non-lawyer specialists to provide adequate assistance, the risks of injury if they do not, and the ability of consumers to evaluate providers' qualifications and to remedy problems resulting from ineffective performance. Prohibitions on non-lawyer practitioners should be replaced with license and certification systems that impose competence qualifications, maintain ethical standards and provide effective malpractice remedies.

In order to be eligible for the title of 'procedural practitioner', non-lawyers should fulfil a number of requirements, taking the following as examples:

- Knowledge of substantive law.
- Knowledge of formal law.
- Knowledge of the judicial infrastructure.
- Knowledge of administrative procedures.
- Guaranteed and adequate liability cover.
- Guaranteed safeguards regarding the management of third parties' money.
- Adherence to an accessible, objective complaints scheme for clients and for opponent's representatives.

The quality problem ('How do I choose a good procedural practitioner?') would be addressed by these entry requirements for authorized practitioners.

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[70] We did not consider the option to ease the monopoly by modifying the education requirements (Olesen and Nielsen (2006)). Education requirements create a bottleneck for entry to the legal profession, and a lessening of these would probably mean more lawyers and more competition.

The principal problem with expanding the range of authorized procedural practitioners is that this alternative requires considerable changes to the framework of entry and other rules, regulation administration and the organization of other matters associated with the practice of law, such as client-counsel confidentiality, the right of non-disclosure and disciplinary powers. At present, the national and local Bars and Councils of Supervision are responsible for ensuring that lawyers comply with the rules, for the administration of disciplinary procedures and for punishing unprofessional conduct. The question in the case of this alternative is: Who should regulate the authorized non-lawyer procedural practitioners? Their own association? A second or third Bar would be regarded by judges as confusing, and thus undesirable.

Of course, current Bar standards already cover lawyers, but that does not mean that they should also apply to all practitioners on a one-to-one basis. For example, a lawyer is expected to be competent in a wide range of legal domains, such as family law, fiscal law, criminal law, asylum law and so on. But there is no reason why every procedural practitioner should master all these disciplines. After all, we do not require an orthopaedist to operate on an appendix or a teacher of German to lead a chemistry practical. When defining the criteria applicable to procedural practitioners, it is important that these rules be compiled by an independent body. It would not be sensible for practitioners to be empowered to define their own professional requirements; the temptation to raise the barriers to entry too high could well prove irresistible (cf. rent-seeking). With this mind, it is inadvisable to leave the authorization of procedural practitioners – be it through accreditation, registration or certification – to the Bar. A more obvious option would be to remove responsibility for regulating the procedural monopoly from the Bar and hand it over to an independent accreditation body.

There is perhaps one way in which the Bars could retain responsibility for the authorization of procedural practitioners. That would be the formation of a 'departmental board' within the organization, on which consumers, SMEs, legal expenses insurers, trade union executives and the likes sat alongside members of the Bar and collectively held the majority of the votes. Such a structure has been adopted in England and Wales, in the form of the Legal Services Board. This solution precludes the creation of an entirely new body, yet still satisfies the widely supported demand for the genuinely independent authorization of procedural practitioners.

Because expansion in the range of authorized procedural practitioners applies to all civil cases, this alternative significantly increases the freedom of choice open to those seeking justice. In every case, they can choose from a variety of new providers of legal services: procedural practitioners from trade unions, legal expenses insurers, professional associations, automobile associations, legal consultancies and so forth. Since a variety of parties would probably want, for cost reasons, access to the widened monopoly, it seems likely that increased competition would exert pressure on prices.

Who profits directly from expanding the range of authorized procedural practitioners? In any event, the paralegals who become authorized to appear in court under the measure, their clients and – perhaps – other people involved in legal cases who benefit from lower lawyers' fees over all. The extent to which people could benefit from this change depends upon how much they are being 'overcharged' for legal representation now. The only group for which we have relevant figures is the legal expenses insurers (cf. section 4.2.2). They are capable of drawing a comparison because they conduct some of their own cases, through a salaried lawyer or paralegal, and

contract others out to external or network lawyers. As shown in Tables 4.4 and 4.5, network lawyers cost two to three times more than a paralegal or salaried lawyer, and an external lawyer costs four to six times as much. The results indicate that liberalizing the legal profession by allowing certified non-lawyer jurists to enter the monopoly may have a substantial impact on the fees lawyers currently charge.

If this alternative were to be adopted and easing the procedural monopoly did reduce costs, then it is important from the public interest standpoint that insurers actually pass on the cost reduction to their policyholders in the form of less sharply rising premiums. If the national market for legal expenses insurance can be characterized as competitive than this offers a good guarantee that that will indeed happen (cf. Appendix B). Helpfully, in most countries it is now quite easy, through such media as product-comparison web sites, to find out how much cheaper policies actually would be if the procedural monopoly were to be relaxed.

Lawyers might 'suffer' under this measure. The competitive pressure would certainly be felt by lawyers whose practice includes a large degree of representation in court. However, it also seems that procedural work forms only a modest portion of most lawyers' total practice. Liberalization would not entail the disappearance of participation by lawyers, but does require them to refocus their services. Law professionals are required to tailor complex cases where such tailoring is most valuable. Liberalization also encourages all sorts of providers to offer additional services. That is not to say that certain law firms with a relatively high proportion of procedural work will not be disadvantaged by the opening of the procedural monopoly to certified non-lawyers. On the other hand, large commercial firms for which advisory work is the main source of income will barely notice the difference.

The social benefits of this alternative are as follows.

- Freedom of choice, with more scope for different kinds of legal services across the whole spectrum of civil cases.
- Lawyers' hourly fees are no longer protected by the procedural monopoly. As a result prices will lower (or increase less), and hence access to law improves for consumers across the whole spectrum of civil cases.
- Less rapid increases in the premiums for trade unions, legal expenses insurers, legal consultancies and other legal experts, and better access to law in general.
- There is no reason to assume that fewer out-of-court settlements will be reached. The Dutch example discussed above shows that no difference exists between the extent to which settlements and other extra-judicial solutions are reached between lawyers and other legal experts (bailiffs, lawyers employed by trade unions, legal expenses insurers).
- As described in section 2.2, external competition (competition from new providers) is also an effective manner of excluding rent-seeking and regulatory capture.

The social drawbacks of this alternative are as follows.

- This is a fairly substantial institutional change. The current arrangement, with regulation concentrated in the hands of national and local Bars, is probably not appropriate for the new situation.

- This is and will remain a market with barriers to entry (a monopoly still exists). In that sense, prices will always include a mark-up over cost. But the mark-up will be reduced as a consequence of the lowering of the barriers to entry.
- The law might well become less appealing as a profession of it loses its exclusive rights over procedural practice.

4.3.4 Abolishing the monopoly

The most far-reaching alternative is the complete abolition of procedural monopoly. It would then be left to the judge to decide whether the support of a lawyer is desirable in certain cases. One legal drawback of this alternative is that it strains the principle of 'party autonomy'. In civil law it is in principle the parties to a case who decide what it covers and who have the decisive say over the framework within which the dispute is settled. It is vitally important, therefore, that the case be handled expertly from the very outset. Without expert legal support, there is a danger that procedural errors will be made and that these will play a decisive role in the outcome of the proceedings. These are mainly key steps, such as declaring somebody liable or an admission of guilt. So, in civil proceedings in particular, the client is heavily dependent upon expert legal assistance. This may be different, however, if the huge complexity of procedural law is simplified. Without such simplifications the government's room for manoeuvre is restricted: Removing the procedural representation requirement can only take place subject to the condition that the proceedings concerned are straightforward enough that the principles of a fair trial and equality of arms are safeguarded even without expert support.

Rhode (2004) states that simplification of procedural law also gives a better answer to the main problem. The debates about access to law have traditionally assumed that the main problem is inadequate access to lawyers and that the solution is to make their services broadly available. According to Rhode such frameworks mischaracterize both the problem and the prescription.

> 'What people seeking justice want is more justice – a way of handling legal needs that is timely, fair and affordable – not necessarily more lawyering. Most lawyers have resisted reform efforts that would help individuals help themselves, and most courts have failed to adopt sufficient strategies to make self-representation feasible and effective. […] On issues like procedural simplification and lay services the legal profession has often contributed more to the problem than to the solution.'

Reforms that minimize the need for costly representation could enable many individuals to more effectively address their law-related problems. Strategies also include readily accessible self-help materials and document preparation assistance.[71] This is, however, not enough to guarantee access to law. Especially for individuals who need help most, those of limited income and education, such forms of assistance fall short.

[71] Rhode (2004) describes the rapid growth in self-representation in the US and in related materials and businesses during the last 25 years. 'Kits, manuals, interactive computer programs, on-line information, firm processing services, and courthouse facilitators have emerged to assist those priced out of the market for lawyers.'

Simplification of procedural law could make compulsory representation unnecessary. Such a change is favourable if the substantive law and the associated procedural law can be organized more simply. Barendrecht (2004a), for instance, asks why rules cannot be simplified, especially by basing their design more upon the needs of private individuals and entrepreneurs. He calls for a client-oriented legal system, arguing that the law could become a sort of instruction manual:

> 'Laws are for us, aren't they? …But judicial proceedings are still organized as a written exchange of standpoints with no real dialogue and subject to formalistic procedural rules. Anyone who has ever worked with it feels that this 19th century system is obsolete.'

Such simplification does require extensive study, however.
Another possibility that could make compulsory representation unnecessary is the implementation of private regulation of the quality of legal advisors. The Finnish example, discussed in section 3.1.3, shows that regulation by third parties can also be effective in safeguarding access to law as a monopoly implemented by government and executed by Bars. This would entail substantial changes in the national judiciary systems in countries that are currently regulated by the government and professionals themselves. For instance, it could require a shift from government-funded legal aid programmes to a system based on insurance (cf. section 3.2.5). This would take considerable time and further study on adverse effects.

To summarize, abolishing the procedural monopoly cannot – in our view – be achieved without far-reaching simplification of procedural law or by changing the legal system to an insurance-based system (à la the Finnish market). And even then it will probably be necessary to put in place safeguards, such as empowering the judge to order parties to seek legal expertise. Because this alternative involves much more than just tackling the procedural monopoly, no direct comparison of its effects with those of the other two options described is really possible.

- The benefits of this option are clear. It provides a more efficient, simpler, more up-to-date and cheaper legal system, perhaps one which stimulates case settlement by mutual agreement. That is, expanded opportunities for informal dispute resolution may arise. Formal proceedings or representation by lawyers are not always the most effective way of addressing legal concerns. Out-of-court settlements are often preferable and therefore one objective of reform is to promote more informal dispute resolution. Further details of the benefits is not possible, since that depends much upon how civil law is simplified.
- The drawback is that it is a far-reaching measure, which cannot be introduced from one day to the next. It will require time, research and fundamental cultural change and the involvement of many – judges, lawyers, other legal professionals, but also individual citizens and SMEs. All will have to learn how to make use of the new opportunities.

4.4 Conclusion

In this chapter we address the 'if' question by testing the following hypotheses:

- Access to law is sufficiently guaranteed – as perceived by the respondents – in each of the 12 countries in our sample.

- Access to law is not safeguarded to a greater degree in those countries subject to more stringent regulations than those where it is less so (as shown from the overall regulatory index in section 3.3.2).

Based on our surveys, data analysis and the literature we conclude that the first hypothesis is accepted. Moreover, we can also accept the hypothesis that 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 legal aid. All 12 countries, except Italy, have a legal aid system. The way in which each legal aid system functions in the 12 countries differs significantly in terms of the number of cases and expenditures on legal aid. There is no relation between the function and scope of the legal aid system and the level of regulation. We also measure access to law in terms of the ease of enforcing a business contract. However, we do not find a link between the level of regulation and the ease of enforcing a contract. Based on the surveys and data from desk research we are unable to identify a relation between access to law and the level of regulation.

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 is due to external competition in the less regulated countries (England/Wales, Finland, Hungary, Netherlands), whereas external competition does not exist in highly regulated countries with relatively high numbers of lawyers (Germany, Italy and Spain).

The reason why it is hard to establish a relation between access to law and the regulatory index is probably because our comparison focuses on regulatory differences and therefore leaves out the regulations and institutions that determine the performance of the judiciary system as a whole.

Benefits and costs

After accepting the two hypotheses, we look into the potential welfare effects of compulsory legal representation in court and the lawyers' monopoly of that representation. Box 4.5 describes in general terms the potential benefits and cost of the regulation of lawyers.

Apart from these general qualitative costs and benefits we quantify the costs of the regulation of lawyers by comparing the costs incurred by legal expenses insurers when a case is conducted by an external lawyer and when this same case is conducted by an internal lawyer or non-lawyer legal expert. Based upon their experience of lawyers, legal expenses insurers often maintain a selection of preferred suppliers (network lawyers), a status which provides the policyholder with a certain indication of quality. We sampled the population of these insurers to produce an indication of the price differences.

On an 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. From an economic point of view, there seems much to gain by deregulating the national markets. The results particularly indicate that liberalizing the legal profession by allowing certified non-lawyer jurists to enter the monopoly may have a substantial impact on prices in the legal profession.

Box 4.5: Benefits and cost of regulation of lawyers

The most important benefits of lawyer monopoly include reduced search costs, improvements in service and better information on professional service quality. These benefits are however not backed by the literature. Another aspect is reduced risk of 'bad' service. If consumers are risk-averse to 'bad' service, possibly because it leads to large losses they cannot bear, quality regulation substitutes for the theoretical possibility of insuring against 'bad' services.

A drawback of lawyer monopoly is that the high cost of hiring a lawyer decreases access to the legal system. Why do lawyers cost so much? First, because their service is complex and demands sophisticated reasoning. The exercise of careful judgement also takes time. Secondly, qualifying as a lawyer requires substantial intellectual training and practical experience. Most important, however, is the market power lawyers have over clients. Current regulation has replaced market failure with a serious government failure: monopolization attempts to solve an information problem. This has four causes.

- Compulsory representation in court by lawyers only. An obligation to use services from just one kind of supplier tends to lead to high prices and lack of innovation.
- The barriers to access erected by the Bars reinforce the monopoly held by established lawyers (consider the restrictions on authorization of salaried lawyers). An empirical US study by Winston & Crandall shows that self-regulation gives rise to supra-competitive rents.
- The client is effectively locked into the relationship with the lawyer because of high sunk cost and the tournament nature of competition among lawyers.
- 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.

The market power of lawyers enables price-setting above marginal cost and more than reasonable profit. That most European lawyers and clients are allowed to negotiate on price does not alleviate the power asymmetry or improve the status of one-off consumers, such as households and SMEs.

Source: SEO Economic Research

The next question is whether the more stringent form of regulations of legal professionals leads to greater costs to society than benefits, and therefore reduces economic welfare. Due to a lack of available data we were unable to test whether the price of gaining access to law (for instance the extent of the overcharge) is higher or lower in the more stringently regulated countries:

(1) Information on fees and on costs of the judiciary system are not freely available and the costs of the judiciary system are difficult to compare between countries due differences in their judicial systems.
(2) Due to the small sample size it was not possible to link our data on cost differences between insourcing and outsourcing cases by legal expenses insurers to various levels of regulation (cf. section 4.2.2).

Alternatives

In this chapter we describe four alternatives to the current level of regulation. There are three ways of changing the monopoly that currently exists in most European countries: (1) Restricting the domain it covers; (2) extending the group of legal practitioners to whom it applies; and (3) abolishing compulsory legal representation for civil cases while introducing a number of covering measures. We also consider the alternative of (4) regulating lawyers' fees because that may suppress high fees and price increases in the market for services of lawyers.

Each has its own benefits and drawbacks, but weighing these up against each other in short and medium terms we consider the most promising alternative to be easing the monopoly to admit legal practitioners other than lawyers. This alternative is also in line with our earlier conclusion that it is better to safeguard the public interest by regulating services rather than professional groups given the fact that the legal services market is segmented and in the view of many of those seeking justice extends beyond the traditional legal profession. Easing the procedural monopoly regulates the entire market for services in this field, not just the profession of lawyers.

Admission to the monopoly domain should not be the preserve of the national Bars – at least not under the current structure since this raises too many questions regarding independence. If the Bar's structure is changed to give other actors a majority say on the procedural monopoly through a special 'regulatory board', however, then it might be possible to leave responsibility for the authorization of procedural practitioners to the Bar (à la the structure adopted in England and Wales). Otherwise, an independent regulator would have to be set up to control accreditation.

In our view, fee regulation is not an efficient option because it evokes too many government failures. It imposes a rigid boundary upon the market, with a negative impact upon innovation, flexibility, and other incentives to improve efficiency. Moreover, this regulation entails high regulation costs and there is a danger of 'crowding out': the more complex and time-consuming cases are not taken up.

Because raising the statutory financial threshold below which no mandatory legal representation exists does not in itself solve the problem of mandatory representation by lawyers, it is not recommended. This alternative does result in a greater freedom of choice for a larger part of the market, namely all those cases between the old threshold and the new one. More cases would be dealt with by the lower courts, resulting in faster and simpler proceedings.
Completely abolishing the procedural monopoly is not recommended in the short or medium term because of the danger that those seeking justice will be denied access to law, since they are unable to find their way through the current complicated procedural rules without help. In the long term, however, the greatest benefits can be expected from a combination of changes to procedural law, radically simplifying it, implementing private quality regulation, and the abolition of the representation requirement.

Conclusions

Opening up the monopoly to qualified non-lawyer professionals is beneficial to the consumer in at least two ways:[72]

1. Individuals seeking access to justice have more choice; they can pick from different kind of professionals to have their case or problem resolved. Therefore, they are better able to find the level of advice needed for a particular problem (more quality differentiation; different quality levels for different legal problems). Consequently, the average price will fall as individuals pay only for what they need and no more. Moreover, external

[72] Another possibility is that the tax payer pays fewer taxes because the freedom of choice also lowers the government expense to the judiciary system. This will lead to lower expenses paid to legal aid programmes and lower expenses paid by governmental agencies who hire lawyers to settle legal disputes.

competition (competition from new providers) is an effective manner of excluding rent-seeking and regulatory capture behaviour.

2. Due to these price decreases insured parties pay a lower premium for legal expenses insurance (on condition that the market for legal expenses insurance is competitive enough to pass these cost reductions at least partly on to consumers; see Appendix B).

5 Conclusions and recommendations

This report gives an economic perspective on the regulation of the legal profession and access to law. A legal framework, which safeguards fair, easy and efficient access to law for all citizens and businesses is naturally of utmost importance for every country. Such a framework is essential for the success of enterprise and thus an important factor for the economic situation of a country. The effect of regulation on access to law is, therefore, a very relevant topic.

On the national level we often observe that liberalizing professional services markets gives rise to heated debates between the ministry of Economic Development and the ministry of Justice. That is a pity because ultimately all that matters is consumer welfare and access to law. We hope this report does not provoke further heating of the debate on re-regulating the legal services market but instead encourages an informed dialogue between the jurists, economists and other social scientists involved in the discussion.

In this final chapter we present the conclusions and recommendations of our research in sections 5.2 and 5.3, respectively. First, section 5.1 explains the difference between an economic and a legal perspective on regulation of the legal services market. Section 5.1 also discusses the absence of available data in this kind of research and some methodological issues.

5.1 Economic and legal perspective

The legal and the economic perspective differ principally. The economic perspective departs from a situation without government intervention and subsequently looks for justifications for government regulation. In contrast, the legal perspective departs from the current institutional context and tries to find justifiable reasons for changing current regulations in case the government would like to make these changes. So, from an economic perspective the burden of proof rests on the government (or the Bar) to prove that more regulation creates more net welfare, that is, by weighing the benefits of correcting market failures against the cost of government failure and balancing the protection of public versus private interests. A government deciding to regulate the legal services market should be able to answer this question: what form of regulation can cure market failures in the provision of legal services without causing disproportionate restriction of competition.

This is quite the opposite of the legal perspective, as put by Sforzolini of the Council of Bars and Law Societies of Europe (CCBE). In his speech to the conference on professional services on December 13, 2006 in Brussels he states:

> 'The burden of proof that a rule is anti-competitive rests firmly with the Commission (or the Member States' antitrust agencies). […] A sound reform of the legal profession should be based on the outcome of a serious cost/benefit analysis. Before promoting a "deregulation crusade", the Commission should carry out an economic analysis on the functioning of the market for legal services in order to outline the pros and cons of both regulation and deregulation.'

An often heard critique of the economic perspective is that it is too narrow and only looks into monetary facts. That, however, is a misunderstanding. As stated in section 1.3, the economic definition of welfare is very broad and includes everything that contributes to the satisfaction of human needs, including those that cannot be monetized. It is another misunderstanding to think there are pro or contra regulation theories in economics (RBB (2003) and Kilian (2004)). There is only the public interest and private interest theory, quite different from simple pro or contra regulation. A further misunderstanding is that economists (or the economists at the Commission) are 'obviously biased' in their views and 'believe in deregulation' (RBB (2003)). However, it has nothing to do with bias or belief; it relies on factual costs and benefits.

Our analysis departs from the economic postulate that any government intervening in the market should be able to justify its behaviour by making a reasonable case that the social costs are lower than the social benefits of correcting certain market failures. The economic perspective does not depart from a bias towards the presumption that there is too much regulation.

Despite these fundamental differences about the starting point of the analysis – no regulation versus current regulation – and about the question on whose shoulders rests the burden of proof – governments who want to deregulate versus governments who want to regulate – economists and jurists seem to agree on the method of analysis: a social cost-benefit analysis.

5.1.1 Lack of empirical data

In order to be able to perform regulatory cost-benefit analysis, one needs empirical data. A major finding of this study is the distinct lack of data made available by the countries under review.[73] Consequently, it is difficult to compare the costs of each country's regulation of professional services in general and the lawyers' profession in particular. Another bias stems from the fact that national judiciary systems are not identical. Consequently, it is difficult to compare the differences in regulatory schemes of lawyers and the market for legal services. However, in spite of these shortcomings in data and differences between judiciary systems, the key figures – the regulatory indices and extent of overcharge – presented in this study do reveal some remarkable differences between states.

This lack of empirical data is an issue in many other studies on the effect of regulation of national legal services markets. Various critics of deregulation have pointed to this lack of empirical data. The deregulation agenda of the Commission is, according to them, insufficiently supported by the facts. The Paterson et al. (2003) report serves as the main basis for justifying the European Commission's deregulation initiatives. The European Commission (2004b) states that 'a significant body of empirical research shows the negative effects that excessive or outdated restrictive regulations may have for consumers.' This is true in general but the empirical data in the market of legal services is still quite limited. Note, however, that this applies to the costs as well as the benefits of regulation. So, it is equally valid to state that the 'strict regulation agenda' of some national governments and Bars is insufficiently supported by the facts.

[73] For instance, we surveyed the national Bars and looked for information through desk research (including Internet searches, policy documents and literature).

It is not our goal to specify exactly whether there is too much or too little regulation. Our goal is to make clear that current levels of regulation involve both costs and benefits and – basing this view on the evidence found in Finland -- that access to law can indeed be safeguarded with low regulation. Whereas regulation levels are relatively high in most of the sampled countries, we could find no extra benefits in terms of better access to law under strictly regulated conditions. We also looked for public interest arguments supporting further regulation of legal services but found no clues pointing towards too little regulation – not in the literature, nor in our Bar surveys or our analysis of the fee regulation alternative in section 4.3.1.

A broader welfare economic perspective is needed to weigh the pros and cons, that is, to balance the benefits of correcting market failure against the cost of government failure as well as the protection of public versus private interests. This weighing has not yet been done; it has merely been asserted that the benefits of restrictions have enough value to justify current policy without reference to its cost. The benefits of regulation (hypothetical only and not quantified) dominate the discussion; the possible gains of re-regulating the legal services market in consumer surplus are only mentioned in passing, if at all; they are not under active discussion.

5.1.2 Methodological issues

Current levels of regulation are often taken as a simple given and regarded as the result of a historical process influenced predominantly by jurists. Private interest theories suggest that professional bodies have strong lobbying positions and so politicians, seeking re-election, will tend not to address the issue of regulation. Similarly, regulators will tend to identify more with the interests of the industry, rather than the public interest. This is also apparent from the strong lobby on national and EU levels in the ongoing discussion of legal services regulation. The documents used by this lobby tend mostly to undermine the methodological aspects of any papers or reports critical of the exclusive monopoly of the profession instead of contributing positively to the contentious debate.

Clementi (2004) warns that reform will not be easy and that studies concluding that deregulation of the market for lawyers may very well be welfare-enhancing will meet criticism (cf. section 1.1).

> 'Whilst there is pressure for change, from consumer groups and also from many lawyers, reform will be resisted by other lawyers who are comfortable with the system as it is. Lawyers who are opposed to the reforms in this review will either argue that I am mistaken and have failed to understand the special characteristics that set the law apart, or call for further research and consultation, kicking reform into the long grass. Changes will require significant political commitment, partly to meet the expected criticism from some lawyers and partly because reform will need primary legislation, which requires scarce Parliamentary time.'

The ideal way to answer the research question is to test whether access to law is more expensive (or cheaper) in highly regulated countries compared to less regulated countries. Because of lack of data on the costs of the judiciary system and because judiciary systems differ fundamentally between countries this question cannot be answered in this report. In spite of these limitations, an analysis of the level of regulation of the legal profession is very relevant when thinking about

improving access to law. Our comparison focuses on regulatory differences of the legal profession and thus excludes the regulations and institutions that determine the performance of the judiciary system as a whole. If we consider the impact that the cost of professional regulation has on lawyers' fees the ideal would be to test the relationship between regulation and rents – those excess profits above the normal competitive level. In the absence of any profit data, however, this is impossible. Naturally, our methodology (cf. section 3.3.2 and 4.2.2) may be criticized. Nonetheless the fact remains that regulation levels differ remarkably between states whereas the level of access to law does not; access to law is considered sufficient in all states in our sample. Criticism is a luxury when alternatives are unavailable; in this case the lack of empirical studies. The basic facts, however, remain and deserve an open discussion with all those involved in the provision, consumption and regulation of legal services.

We hope our finding that high regulation is evidently not required to achieve sufficient access to law (cf. Finland and England/Wales) as well as the economic need to justify (higher) regulation provokes open discussion of the costs and benefits of current levels of national regulations. Our results are strong and robust enough to start such a policy discussion. While the net benefit of high regulation remains unclear, our results indicate that regulation does come at a cost. Governments that have implemented high levels of regulation should be able to justify this as an extra benefit in terms of better access to law.

5.2 Conclusions

This section repeats the conclusions drawn in Chapters 2 to 4 where we answered the three central questions introduced in section 1.3:

1. The 'what' question: Is there a problem? What makes it one? What is the public interest?
2. The 'how' question: How can one take action as effectively and efficiently as possible? What instruments are suited to solve the policy problem in question?
3. The 'if' question: Is the welfare of society increased if action is taken with a certain instrument or instruments? Is the cost of intervention higher or lower than the benefit?

5.2.1 Answer to the 'what' question

What is the public interest at stake? The answer: 'safeguarding legal security'. Legal security involves access to law, the fair and orderly conduct of legal proceedings and an efficient judicial process that necessitate the availability of good quality legal services at reasonable prices. In order to safeguard legal security, there is a need for some degree of regulation of the legal profession. Chapter 2 shows that the need to regulate is less urgent than is usually assumed by government agencies and Bars.

From the public interest perspective, the rationale for government intervention in the legal services market is provided by information asymmetry and externalities. Government action, such as quality certification, may be justified on the grounds of information asymmetry. However, because some of the asymmetry is solved by the market, regulation should not be too restrictive. For instance, the segment for repeat buyers and clients with in-house legal executives

needs little to no government regulation. Also, because third parties such as trade unions and legal expenses insurers already solve part of the information problem for one-off clients (SMEs and households), government regulation does not need to address the entire problem either.[74] Network effects would call for government re-regulation of the market in order to lessen the shortage of legal services providers, for instance by opening the monopoly to non-lawyer legal specialists who fulfil minimum requirements. In most states this would imply less – not more – regulation.

In order to prevent negative externalities, a quality certification system may be justified. That is not to say, however, that the monopoly position for *lawyers* is justified. It merely means that *anyone* who fulfils particular requirements is allowed to provide the monopolized services. Moreover, the existence of non-priced sections in the judiciary system calls for some sort of mechanism that filters out the cases that could otherwise be resolved more efficiently by out-of-court settlements.

The public good feature of legal services does not call for extra regulation of the professional services market. Finally, the public good feature of information on the quality of legal services provided by certain professionals justifies mandatory disclosure with respect to professional quality. Without such regulation the provision of private information by professionals on the quality of their product may not be strictly accurate or efficient.

Apart from these economic rationales for government action, there are also two non-economic, political rationales. 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 under certain circumstances, a paternalistic government hopes to achieve 'equality of arms' for all parties to legal proceedings. A second political rationale is income redistribution, that is, in order to prevent low income groups from having less access to legal services, governments have introduced subsidized legal aid systems.

Besides the public interest perspective, we looked at the legal market from a private interest perspective. Although rent-seeking behaviour is intrinsically difficult to identify, we conclude that most national markets for lawyers' services meet the conditions for successful rent-seeking. Adding this conclusion to our public interest conclusion – the need for regulation is less urgent than usually assumed by government agencies and Bars – leads us to conclude that overregulation in the legal market also stems from safeguarding the private interests of legal professionals.

5.2.2 Answer to the 'how' question

Now that the rationale behind government action is clear, we turn to the question of how much regulation is required to correct market failure and prevent rent-seeking behaviour. Chapter 1 addresses this question and shows that the legal services market is regulated variously, by either government regulation, self-regulation or private regulation.

From the public interest perspective, government regulation aims at obtaining social benefits by correcting market failures or by attaining particular political goals. At the same time, government

[74] These third parties are legal experts themselves and have considerable experience in buying the services of lawyers. They therefore have a much better idea of the quality of the service being received.

regulation entails social costs resulting from information problems, high transaction costs, regulatory insecurity and economic inefficiency. Such government failure is also a topic in private interest theory: government failure as the result of capture and lobbying.

An advantage of self-regulation is that the natural tendency of its subjects to observe the rules (spontaneous compliance) is much greater than it would be if regulation was imposed by a government body. This makes the enforcement costs much lower compared to state regulation. As a general rule, regulatory costs – for creating, enforcing, administering and amending the regulatory regime – are lower under self-regulation than under government regulation.

Self-regulation also has drawbacks. It is questionable whether the information problem is really solved by self-regulation. Although professionals possess better information, there is no guarantee they will pass this knowledge on to consumers. After all, it may not be in the interest of professionals to pass on information and it is relatively easy for them not to do so. Furthermore, the moral hazard problem is left unsolved: The professional has a vested interest in inducing a demand for services that fully informed clients might not want (risk of inefficient allocation of resources). If self-regulation impedes information on these quality differences, then search costs are increased by self-regulation rather than decreased. Another point is the supposedly better flexibility of self-regulation. If the profession successfully restricts competition and earns rents, it will resist any change that reduces rents. Moreover, how well the Bars can judge quality remains unclear. Consequently, we conclude that most of the potential advantages of self-regulation do not hold in the market for legal professional services.

An important question is if it is necessary to have governments and Bars (self-)regulate the monopoly of lawyers in order to attain the potential benefits related to quality regulation. For instance, private regulation may have similar advantages without imposing high costs on society.

It is, therefore, interesting to look at the possibilities of an independent party solving some of the problems in the market. Examples of such private regulation include independent rating agencies, liability arrangements, and legal billing auditing and requirements set by legal expenses insurers. An interesting example stems from the Finnish market where legal expenses insurers have included additional clauses in their policies specifying that for legal procedures the insured is obliged to engage 'legally qualified' counsel, that is, not just a lawyer any legal counsel with a law degree. The legal counsel is not required to practise under the supervision of the Finnish Bar.

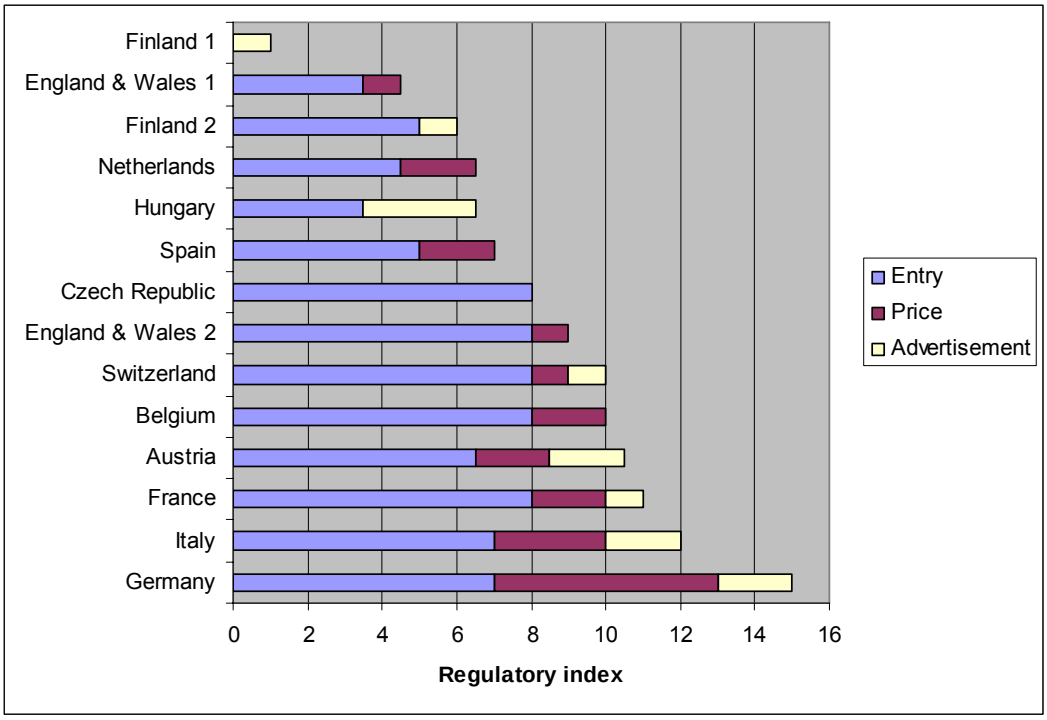
Regulatory indices

Many regulatory instruments are available and used in practice. We compared the level of regulation for three important regulatory instruments: entry restrictions, restrictions on fees, and restrictions on advertising. We constructed regulatory indices using the insights from assessment frameworks developed in earlier comparative studies of national markets of legal services.

As is clear from Figure 5.1 we find that the level of regulation differs remarkably among the 12 countries in our sample. These indices show that Finland (Fin1; the legal advisor in general, no member of the Bar) is the least regulated market. In second place are England/Wales (E/W1, solicitors), followed by Finland again (Fin2, *Asianajaja*, member of Bar) in third place. Germany, France and Italy are the three highest regulated countries.

This result is actually surprising. While the public interest at stake is exactly the same in all of these countries (guaranteeing legal security), how can the way they all guarantee legal security differ so remarkably? The fact that the Finnish or English governments regulate legal advisers far less stringently than the German or French governments do, does not permit us to assume that the former governments are less concerned with legal security for their citizens than the latter.

Figure 5.1: Overall regulatory index subdivided per main variable



Source: SEO Economic Research

In Chapter 1 we conclude that access to law is sufficiently guaranteed in each of the 12 countries in our sample and that access to law is not safeguarded to any greater or lesser degree in countries subject to more stringent regulations than in those subject to less. Access to law also depends on the availability of a legal aid system. All 12 countries, except Italy, have a legal aid system. The way in which the legal aid system functions in each country differs significantly in terms of case number and expenditure. There is no relation between the functioning 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 business contract. However, we find no connection between the level of regulation and the ease of enforcing a contract. Our surveys and desk research data were unable to identify a relation between access to law on the one hand and the level of regulation on the other.[75]

There is one exception to this finding. The number of lawyers differs substantially in the 12 surveyed countries and we also find 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 is due to the existence of

[75] The reason why it is hard to find a relation between access to law and the regulatory index is probably because our comparison focuses on regulatory differences and therefore leaves out the regulations and institutions that determine the performance of the judiciary system as a whole (cf. section 5.1.2).

external competition in the less regulated countries (England/Wales, Finland, Hungary and the Netherlands). There is no external competition in highly regulated countries with relatively high numbers of lawyers (Germany, Italy and Spain).

Moreover, the fact that the market for the services of lawyers is segmented and – in the view of many of those seeking justice – broader than the legal profession alone leads us to conclude that public interest can best be safeguarded by regulating *services* rather than groups of *professionals*. In recognizing this we assert the importance – to a mature debate on the legal service market – of separately examining the role of legal professionals in different segments of legal service markets.

5.2.3 Answer to the 'if' question

In Chapter 1 we look into the potential welfare effect of compulsory legal representation in courts and lawyers' monopoly over that representation. We ask whether more stringent forms of regulation lead to greater costs than benefits to society and thus reduce economic welfare.

The most important benefits of monopolization include decreased search costs, improvements in service quality and a better supply of information on the quality of professional services. However, these quality-related benefits are not substantiated by the literature. Another aspect is the reduced risk of 'bad' service. When consumers are risk-averse to 'bad' service, possibly because it leads to large losses they cannot bear, regulation of quality becomes a substitute for the theoretical possibility of insuring against 'bad' services.

On the other hand, is the level of quality regulation not too high in that the administrative and transaction costs of attaining a superior level of quality do not weigh up against the benefits? Is the consumer not better off with slightly less quality at lower prices? We find consumers better off if they have freedom of choice. Consumers in highly regulated countries without external competition are not free to choose between lawyers or other legal advisors and this forces them to pay a higher price for presumably higher quality.

Besides the potential benefits, the lawyers' monopoly has a negative impact in that the high costs of hiring a lawyer decrease access to the legal system. Litigation imposes direct and indirect costs on litigants (Duggan (2003)). The main direct cost is lawyers' fees. The indirect costs of litigation include information costs (finding and instructing a lawyer), opportunity costs (time spent off work), and emotional costs (imposed by stress on parties in dispute). Obviously indirect costs occur in any case; here we mean that a high level of regulation increases these costs further. For example, the higher indirect costs associated with the uncertain outcome of a dispute are due to higher regulation. Delay is an important contributing factor to the indirect costs of litigation. Pre-trial delay prolongs uncertainty for parties, increasing transaction and emotional costs. However, we draw no further conclusions on indirect costs as this report focuses on the direct cost of litigation, the lawyer's fee.

Why do lawyers cost so much? First, because their service is complex and demands sophisticated careful reasoning. Also the exercise of careful judgement takes time. Secondly, becoming a lawyer requires substantial intellectual training and practical experience. More important, however, is the market power of lawyers over their clients. Clearly, most current regulation has replaced market

failure with a serious government failure: monopolization in an attempt to solve an information problem. This has four causes.

- Compulsory representation in court by lawyers only. An obligation to use services from only one kind of supplier tends to lead to high prices and lack of innovation.
- The barriers to access erected by the Bars are high and reinforce the monopoly held by established lawyers (consider the restrictions on the authorization of salaried lawyers). An empirical study by Winston and Crandall (2007) shows that this kind of self-regulation in the US does indeed give rise to supra-competitive rents.
- The client is effectively locked into the relationship with the lawyer because of high sunk cost and the tournament nature of competition among lawyers.
- 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.

Because of this lawyers have market power over their clients and are able to set their price above marginal cost and thereby make more than a reasonable profit.

Further to these general qualitative costs and benefits, we quantify the costs of the regulation of lawyers by comparing the costs incurred by legal expenses insurers when a case is conducted by an external lawyer and when this case is conducted by an internal lawyer or non-lawyer legal expert. Based upon their experience with lawyers, legal expenses insurers often select preferred suppliers (network lawyers), a status which provides the policyholder with a certain indication of quality. We sampled the population of these insurers to produce an indication of the price differences.

On an 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. From an economic point of view, there seems much to gain by further deregulating the national markets. The results indicate that liberalizing the legal profession by allowing certified non-lawyer jurists to enter the monopoly may have a substantial impact on prices in the profession.

The next question is whether the more stringent form of regulations of legal professionals leads to greater costs than benefits to society and therefore reduces economic welfare. Due to lack of available data we were unable to test if the price of gaining access to law (extent of overcharge) is higher or lower in the more stringently regulated countries.

Alternatives

Chapter 1 described four alternatives to the commonly spread level of regulation. There are three ways of changing the monopoly currently found in most European countries: (1) Restricting the domain it covers; (2) extending the group of legal practitioners to whom it applies; and (3) abolishing compulsory legal representation for civil cases while introducing a number of covering measures. We also consider the alternative of (4) regulation of lawyers' fees because that may suppress high fees and price increases in the market for services of lawyers.

Each alternative has its own benefits and drawbacks, but weighing these up against each other we consider in the short and medium term the most promising alternative is (2) easing the monopoly to admit legal practitioners other than lawyers. This alternative is also in line with our earlier conclusion that it is better to safeguard the public interest by regulating services rather than professional groups given the fact that the market for the legal services is segmented and, in the view of many of those seeking justice, extends beyond the traditional legal profession. By easing the procedural monopoly, the entire market for services in this field would be regulated, not just the profession of lawyers.

An option in line with easing the monopoly is to allow for employed lawyers. If lawyers employed by non-law firms were allowed to practise in a country, it is important to give them the same rights and duties as self-employed lawyers.

Admission to the monopolized domain should not be the preserve of the national Bar, at least not under the current structure, since this raises too many questions regarding independence. If, however, the structure of the Bar were changed to give other actors a majority say through a special 'regulatory department' in the procedural monopoly, then it might be possible to leave responsibility for the authorization of procedural practitioners to the Bar (such as the structure adopted in England and Wales). Otherwise, an independent regulator would have to be set up to control accreditation.

In our view, (4) fee regulation is not an efficient option because it evokes too many government failures. It imposes a rigid boundary upon the market, with a negative effect upon innovation, flexibility, and other incentives to improve efficiency. This approach entails high regulation costs and runs the danger of crowding out the more complex and time-consuming cases.

We do not recommend raising the statutory financial threshold – below which is no mandatory legal representation – because it alone will not solve the problem of mandatory representation by lawyers. This alternative does result in a greater freedom of choice for a larger part of the market, namely all those cases falling in between the old threshold and the new one. More cases would be dealt with by the lower courts, resulting in faster and simpler proceedings.

Completely (3) abolishing the procedural monopoly is not recommended in the short or medium term because of the danger that those seeking justice will be denied access to law since they are unable to find their way through the complicated procedural rules without help. In the long term, however, the greatest benefits can be expected from a combination of changes to procedural law, radically simplifying it, implementing private quality regulation, and the abolition of the representation requirement.

5.3 To sum up

Governments want to safeguard legal security for all those seeking justice. In order to guarantee this public interest European governments have given certain exclusive privileges to lawyers, among which is the monopoly on conducting a case. Much regulation or self-regulation is aimed at preserving professional quality but may simultaneously restrict competition. Consequently, the

price of legal services provided by lawyers may be too high and thus decreases access to law – precisely the opposite of what the governments intended.

This report studies the effect of the regulation of legal services – predominantly the monopoly of lawyers in representing clients in court – on access to law for civil cases for households and SMEs. For our comparative assessment of various alternative policies, we developed a qualitative cost-benefit analytical framework. Although we are unable to pin down all possible monetary costs and benefits, this report makes a substantiated contribution to the debate on the optimal regulation of the legal services market. We hope, therefore, that on the European policy level the report will stimulate discussion of national regulation of legal services. The European institutional context is briefly described in Appendix C.

Since cost-benefit analyses of various – less and more restrictive – regulatory schemes are not always to be found in all 12 sampled countries we recommend that regulators analyse the specific public interest of their national legal services market. We also recommend that governments list various regulatory options alongside their current regulatory scheme. We then recommend performing cost-benefit analyses of current levels of regulation compared to other levels of regulation that also guarantee the public interest at stake. Our conclusions support the European Commission's Better regulation agenda for professional services.

Our analysis of market failures merely justifies the following regulation of the legal services market:

- Information asymmetry can be addressed by a certification system (one-off consumers) or private regulation (repeat consumers). Negative externalities due to the provision of poor service can be avoided by a quality certification system. Note that a certification or licensing system is not the same as a monopoly position for lawyers.
- The public good feature of information on the quality of legal services provided by certain professionals justifies mandatory disclosure with respect to professional quality.
- Network effects imply either high fees or a shortage of legal service providers. A monopoly position for some legal experts (lawyers) only increases problematic network effects. Admitting non-lawyer, legal specialists to the monopoly is the best option from this perspective.
- The existence of non-priced sections in the judiciary system calls for a mechanism to filter out disputes that could be resolved more efficiently (out-of-court settlements).[76]

In reality most governments regulate the market for legal services much more strictly than the above-mentioned regulation. There are at least two approaches that policymakers could take to improve access to law. From economic theory we know that prices will fall if demand is reduced or supply is increased. One way, then, is to reduce the demand for lawyers. In the long term, civil court proceedings and regulations should be redesigned (simplified, made better understandable for lay people) to reduce costs and increase accessibility. Another way may be to increase the number of legal advisers by allowing qualified non-lawyers to conduct cases. Important steps forward include replacing excessive licensing requirements by other mechanisms such as

[76] Although we focus on access to law in so far as it is linked to the quality of legal professionals (lawyers), we include this fourth market failure related to the administration of justice because those cases also affect the legal professions.

certification, fully liberalizing advertising, and removing quantitative entry restrictions. Our research shows that opening up the monopoly to others than just lawyers, namely legal expenses insurers, trade unions and other legal counsels, benefits the consumer in at least two ways:

1. Individuals seeking access to justice have more choice; they can pick from different kinds of professionals to have a case or problem solved. Therefore, they are better able to find the level of advice needed for a particular problem (more quality differentiation; different quality levels for different legal problems). Consequently, the average price will fall as individuals pay only for what they need and no more. External competition (from new providers) works effectively to exclude rent-seeking and regulatory capture.
2. Due to these price decreases insured parties will benefit from lower premiums for legal expenses insurance subject to the condition that the market for legal expenses insurance is sufficiently competitive to pass these cost reductions at least partly on to consumers; see Appendix B.

Of course, the other legal counsels would have to satisfy the same minimum requirements as lawyers. The requirements would have to be established and maintained by an independent body. Box 5.1 sums up the main results.

Box 5.1: Main results

- Access to law is sufficiently guaranteed in each of the 12 countries in our sample. It is not safeguarded to any greater degree in countries subject to more stringent regulations. Still, Levels of regulation differ remarkably among the 12 countries. The number of lawyers per inhabitant also differs substantially among the surveyed countries. In less regulated countries the number of lawyers per inhabitant is lower than in highly regulated countries.
- Governments and Bars should be able to show what the social costs and benefits of these different levels of regulation are and why they picked the level they did. Regulators simply assume that the social benefits of regulation are higher than the social costs. We hope that this report provokes discussion on this assumption.
- This study shows that in terms of increased or better access to law it is not at all clear that more stringent forms of regulations 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. On the other hand, we did find some evidence that the costs of hiring a lawyer are high compared to the costs of hiring a non-lawyer legal expert.
- The cost of the regulation of lawyers 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. 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.
- From an economic perspective, there seems much to gain by (further) deregulating the national markets. The results show that liberalizing the legal profession by allowing certified non-lawyer jurists to enter the monopoly may have a substantial impact on prices in the legal profession.
- Freedom of choice for consumers is likely to be the method to reduce the cost of access to law.

Source: SEO Economic Research

Appendix A Literature

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European Judicial network: http://ec.europa.eu/civiljustice/legal_prof/legal_prof_gen_en.htm

Country links:

- Belgium: http://ec.europa.eu/civiljustice/legal_prof/legal_prof_bel_en.htm
- Czech Republic: http://ec.europa.eu/civiljustice/legal_prof/legal_prof_cze_en.htm
- Germany: http://ec.europa.eu/civiljustice/legal_prof/legal_prof_ger_en.htm
- Spain: http://ec.europa.eu/civiljustice/legal_prof/legal_prof_spa_en.htm
- France: http://ec.europa.eu/civiljustice/legal_prof/legal_prof_fra_en.htm
- Italy: http://ec.europa.eu/civiljustice/legal_prof/legal_prof_ita_en.htm
- Hungary: http://ec.europa.eu/civiljustice/legal_prof/legal_prof_hun_en.htm
- The Netherlands: http://ec.europa.eu/civiljustice/legal_prof/legal_prof_net_en.htm
- Austria: http://ec.europa.eu/civiljustice/legal_prof/legal_prof_aus_en.htm
- Finland: http://ec.europa.eu/civiljustice/legal_prof/legal_prof_fin_en.htm
- UK: England and Wales: http://ec.europa.eu/civiljustice/legal_prof/legal_prof_eng_en.htm

CEPEJ: The European commission for the efficiency of justice:
http://www.coe.int/t/dg1/legalcooperation/cepej/

CEPEJ: Country profiles:
http://www.coe.int/t/dg1/legalcooperation/cepej/profiles/default_en.asp

Council of Bars and Law societies in Europe: http://www.ccbe.eu/index.php?id=227&L=0

European Legal Forum: http://www.simons-law.com/

Introduction to the EC Law on Mutual Recognition of Professional Qualifications:
http://elixir.bham.ac.uk/menu/country/default.htm

Extra information per country (depending on our ability to translate) has been taken from:

England and Wales: http://www.lawsociety.org.uk/home.law, http://www.barcouncil.org.uk/ and http://www.barstandardsboard.org.uk/

France: http://www.avocatparis.org/avocatparis/index.aspx

Germany: http://www.anwaltverein.de/ and http://www.brak.de/; Lawyer fees. *General principles of German lawyers' fees.* www.brak.de/seiten/pdf/RVG/Grundlagen_english.pdf

Hungary: http://www.magyarugyvedikamara.hu/

Austria: http://www.rakwien.at/

Italy: http://www.ordineavvocati.roma.it/

The Netherlands: http://www.advocatenorde.nl/home.asp

Finland: http://www.barassociation.fi/

Spain: http://www.cgae.es/portalCGAE/home.do

Belgium: http://www.advocaat.be/

Czech Republic: http://old.cak.cz/1250/akomora/anj/frame.html

Switzerland: http://www.swisslawyers.com/

Appendix B The market for legal expenses insurance

A legal expenses policy covers services provided and costs incurred in making recourse to the law, in particular for attempts to redress losses suffered by the policyholder and for their representation and defence in legal actions, both in and out of court. In this appendix we describe whether market failure and non-economic motives are a rationale for government regulation of this market. We then go into the requirement that a policyholder has a free choice of lawyer.

Market failure

As in every insurance market, the market for cover against legal expenses is not one of perfect competition (see section 2.1 for definition). The market works imperfectly because there is information asymmetry between the insurer and policyholder. Despite comparative information available on, for instance, the Internet and from Consumers' Associations, a policyholder cannot be sure whether their insurer covers the right legal services until they actually make their first claim. Conversely, the insurers do not know how a person wishing to take out a policy will actually behave afterwards. For example, holding such a policy may actually encourage moral hazard or opportunistic behaviour ('I'm insured now, so I don't have to be so careful and there is no reason to shy away from legal disputes'). Another problem associated with information asymmetry is 'free-rider behaviour'. This is stimulated by the reputation of the legal profession and uncertainty regarding quality ('How do you know that a lawyer is good? Because they charge high fees!'): a policyholder will be more inclined to hire an expensive lawyer in the hope of receiving good quality service. This counts as free-rider behaviour because the policyholder does not consider the fact that their own relatively high legal costs increase the premiums for all insured.

However, the market itself limits this problem through the use of no-claim bonuses and premium differentiation. A legal expenses insurer is better able than, say, a health insurer to distinguish between high and low-risk customers and is entitled to do so. Transparency in the market for legal expenses insurance is improved because very high risk businesses are screened out in advance. On the other hand, families are regarded by these insurers as a homogeneous group; only if a policyholder makes frequent and unjustified claims is the insurer likely to cancel their cover.

In most European countries, the market in which legal expenses insurers operate can be characterized as competitive because dozens of providers, offering a wide variety of products, are active on the market. This gives the consumer choice. The market for legal expenses insurance in most countries is also quite transparent (that is, prices and conditions are available and a consumer does not need a broker to enter into a legal expenses insurance). Legal expenses insurance is a relatively simple and easy-to-compare financial product. With the information available, the consumer is able to make a considered choice from the products on offer. Naturally, policy terms and premiums are not uniform since insurers compete on the content,

price and quality of their products. The range of policy terms offered by the insurers can be consulted and compared by consumers. The terms are sent with the quote, and they are often available on the Internet as well. Moreover, there are several ways to compare legal expenses policies: product-comparison websites, information provided by Consumers' Associations and information provided by brokers and the insurers themselves. Although this section does not hold exactly for each of the 12 countries in our sample, it gives an accurate picture of most of the countries in our sample.[77]

Paternalistic intervention: Free choice of the lawyer

Government intervention in the market for legal expenses insurance is not designed to correct market failure. Instead it is prompted by paternalistic motives. To protect consumers against any potential conflict of interest within insurance companies and to put them in a stronger position in the event of a dispute with an insurer, the European Commission issued a directive in 1987.[78] This directive was designed to harmonize the systems in place in the various EU Member States, and in so doing also to protect the consumers from conflicts of interest within insurers. Article 4 of the directive, for example, says that any contract of legal expenses insurance shall expressly recognize that:

> '(a) where recourse is had to a lawyer or other person appropriately qualified according to national law in order to defend, represent or serve the interests of the insured person in any inquiry or proceedings, that insured person shall be free to choose such lawyer or other person;
> (b) the insured person shall be free to choose a lawyer or, if he so prefers and to the extent that national law so permits, any other appropriately qualified person, to serve his interests whenever a conflict of interests arises.'

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77 This section fits the actual situation in seven of the 12 countries in our sample: Belgium, Finland, France, Germany, Italy, the Netherlands and Switzerland. Below we explain why the section does not entirely fit the actual market situation in Austria, Spain, England/Wales, Czech Republic and Hungary.
In *Austria* the variety of insurance products on offer is too large so that consumers of legal expenses insurance policies cannot easily compare the prices.
There are few legal expenses insurers in *Spain*, despite the fact that many public liability insurers also offer legal services; in 2005 the market included 26 legal expenses insurers (http://www.dgsfp.mineco.es/). With regard to the transparency of the market: consumers can compare different products with the aid of intermediaries or by consulting several insurers' websites. Policy terms and premiums are not uniform but in any event *Dirección General de Seguros* (DGSFP) oversees policy terms and insurers' solvency. DGSFP is the regulator of insurance activity in Spain. It is important to note that policy terms are not sent with the quote, but with the insurance policy itself. Moreover, they are rarely available on the insurers' websites.
In *England and Wales* insurers' policy texts are not always available online to personal and commercial consumers or intermediaries. Often the wording is only available through an intermediary acting for the insurer. The rest of the section is broadly correct for the UK. According to the Association of British Insurers in 2006 there were 30 active legal expenses insurance writers (including Lloyds' syndicates) with five main suppliers. Personal consumers are aware of the legal expenses insurance market in the UK. As policies are sold as add-ons to household or motor insurance policies from a principal insurer, the level of detailed policy knowledge varies from customer to customer. The commercial consumer purchases legal expenses insurance through an intermediary as part of their business insurance. The principal insurer and intermediary select the legal expenses insurance. A Ministry of Justice report (July 2007) describes the market for before-the-event legal expenses insurance and makes product comparisons. (http://www.justice.gov.uk/docs/market-bte-legal-expenses-insurance.pdf).
The section does not fit the actual situation in *Hungary* and *Czech Republic* because the market for legal expenses insurance is still very young with only one or two specialist suppliers and only a low demand.

78 Council Directive 87/344/EEC of 22 June 1987 on the coordination of laws, regulations and administrative provisions relating to legal expenses insurance.

Although the general principle of free choice of a lawyer in civil cases is reasonable, Directive 87/344/EEC has major drawbacks and restricts effective competition in the market for legal services. Emphasizing free choice suggests that somebody with a legal problem is correctly able to assess what kind – and quality – of service they need and that they are able to evaluate whether the services on offer match the nature of the case (for example, that the relationship between the legal costs and potential financial gains is not skewed). This assumption is probably incorrect. By requiring freedom of choice of a lawyer, the regulator actually adds to the information problem that legal expenses insurers could reduce. After all, insurers know better than the average consumer who the good lawyers are and have probably set up contracts with them. Thus the paternalistic motive does not solve the problem of information asymmetry but rather worsens this market failure.

The choice of a particular kind of service – a court case, say, versus possible arbitration or mediation – is not determined by one party alone since the first party is in part dependent upon the choice made by the other party. These decisions can be taken jointly, but it has to be borne in mind that there is an established problem of communication or co-operation between the parties – otherwise the issue would, by definition, have been resolved before it reached the legal arena.[79] If it has proven impossible to talk out the problem, then there is very good chance that it will not be easy to discuss how you are going to solve it (Ashenfelter and Bloom (1993)). Any proposal to opt for a particular procedure is likely to be viewed with mistrust by the other party. And when parties to a dispute are unable to agree on a path towards resolution, by default they end up in a standard court procedure which, because of their cooperation problems, turns into a trap catching them both when another option – such as mediation – would in fact have been better for all concerned.[80] Probably many parties are embroiled in civil court proceedings when they should not be at all. This problem is only exacerbated by the fact that the standard procedure is also the most commonly encountered by legal services providers, making them more and more expert in it and increasingly likely to believe that it is the one and only solution.

The free choice of a lawyer is a fine idea but whether it should have been extended to civil cases in European countries is questionable.

We have not examined any alternatives that would encroach upon the 1993 Insurance Industry Regulation Act. Still, a debate at the European level about the compulsory free choice of lawyers in court and out-of-court cases would be useful. That might make it clear why such free choice is required in the case of legal expenses insurance but not in respect of health insurance. The health insurer is entitled to offer a range of different policies: from basic cover excluding physiotherapy, maternity care and dentistry, for example, to full cover for all medical treatment. Moreover, the health insurer can require a policyholder to seek treatment from specific contracted providers. Whereas this arrangement has aroused little debate within the health sector – probably due to the greater political emphasis upon costs-savings – it would probably cause a storm were a legal expenses insurer to decide that policyholders could only be represented by contracted lawyers.

Other government intervention

Strict entry and operating requirements apply in the legal expenses insurance industry. Active companies must meet certain general and organizational standards and comply with rules

79 Sometimes for various, often strategic reasons, a party wants a court decision anyhow.

80 Similar to lawyers, legal expenses insurers begin – if feasible – by attempting to solve legal disputes out of court (a settlement is reached, or some other way of concluding the matter is found which does not involve the courts). Sometimes, however, it is necessary to start immediately with court proceedings and there is no time to wait for the possible outcome of an out-of-court settlement.

concerning the terms of the policies they offer. The basic requirement is a licence from the authority regulating the insurance sector. Organizationally, the main rule is that legal services must be separated from any other kinds of insurance offered by the company. When a claim for legal expenses is made to an insurer, it must check that the cover is valid and that no so-called 'internal conflict of interest' exists – that is, that no multiple policies cover the same item, since that can result in an internal conflict of interest for the insurer – and there are no outstanding disputes with the policyholder. Finally, the specific product-related requirements include clear arrangements for dealing with disputes and rules on what happens in the event of a conflict of interest.

Appendix C European institutional context

This appendix gives a brief overview of some relevant elements of the European institutional context influencing the (national) markets for legal services provided by lawyers.

European Directives

The Council of Bars and Law Societies of Europe (CCBE (2005)) describes lawyers' directives. The free provision of lawyers' services was recognized and has been governed by Directive 77/249 since 1977 (Directive 77/249/EEC of 22 March 1977 to facilitate the effective exercise by lawyers of freedom to provide services). Then, through the application of the 1988 'Diploma' Directive, the integration of the migrant lawyer was organized in the Community (Directive 89/48/EEC of 21 December 1988 on a general system for the recognition of higher-education diplomas awarded on completion of professional education and training of at least three years' duration). Note, however, that this directive was repealed by another: Directive 2005/36/EEC of 7 September 2005 on the recognition of professional qualifications. The basis of the European directive is the assumption that the study programmes for regulated professions in the various member states are in principle equivalent and therefore give access to the same regulated professions in other member states, provided that certain minimum conditions have been fulfilled.

Finally, the right for lawyers to establish themselves in another Member State was recognized by Directive 98/5/EC of 16 February 1998 to facilitate practice of the profession of lawyer on a permanent basis in a Member State other than that in which the qualification was obtained.

Some important case law

The *Wouters* case is named after the Dutch lawyer Wouters who had become a partner in an accounting firm and filed suit against the Dutch Law Society because it would not accept him as a lawyer due to possible conflict of interest.[81] In this case the Court stated that certain types of regulation may be necessary for the proper practice of certain professions – even when they restrict competition – and should therefore be permitted. The Court found that the possible anti-competitive effects of professional regulations may be justified by public interest considerations. For instance, the Court decided that the ownership requirements are necessary to maintain the independence of the legal profession.

On the other hand, in the Wouters case, the EU Court established that the Dutch Law Society is bound by Article 81 of the EU Treaty. This means that the rules of the Law Society must follow all the same competition rules that other businesses must follow.

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81 Case C-309/99, *Wouters, Savelbergh, Price Waterhouse Belastingadviseurs v. Algemene Raad van de Nederlandse Orde van Advocaten*, [2002] ECR I-1577.

In the *Cipolla* case (2004) five question are asked:[82]

(1) Does the principle of competition under Community law, as set out in Articles 10 EC, 81 EC and 82 EC, also apply to the provision of legal services?
(2) Does that principle permit a lawyer's remuneration to be agreed between the parties, with binding effect?
(3) Does that principle preclude an absolute prohibition of derogation from the lawyers' fees?
(4) Does the principle of free movement of services, as laid down in Articles 10 EC and 49 EC, also apply to the provision of legal services?
(5) If so, is that principle compatible with the absolute prohibition of derogation from lawyers' fees?

We cite paragraph 46 from the case:

> 'According to settled case law, although it is true that Articles 81 EC and 82 EC are, in themselves, concerned solely with the conduct of undertakings and not with laws or regulations emanating from Member States, those articles, read in conjunction with Article 10 EC, which lays down a duty to cooperate, none the less require Member States not to introduce or maintain in force measures, even of a legislative or regulatory nature, which may render ineffective the competition rules applicable to undertakings (see, in particular, the order in Case C-250/03 *Mauri* [2005] ECR I-1267, paragraph 29, and the case-law cited).' (Emphasis added SEO)

The answer to the first three questions is that Articles 10 EC, 81 EC and 82 EC do not preclude a Member State from adopting a legislative measure which approves, on the basis of a draft produced by a professional body of lawyers such as the *Consiglio nazionale forense* (National Lawyers' Council), a scale fixing a minimum fee for members of the legal profession from which there can generally be no derogation in respect of either services reserved to those members or those, such as out-of-court services, which may also be provided by any other economic operator not subject to that scale. The Cipolla case influenced the abolishment of minimum tariffs under the Bersani Decree (cf. section 1.1 of the main report). In this respect an important part of the case is paragraph 63:

> 'According to the Commission, no causal link has been established between the setting of minimum levels of fees and a high qualitative standard of professional services provided by lawyers.'

Although the objective of ensuring proper operation of that profession is legitimate, the Italian government has, according to the Commission, not demonstrated that there is a correlation between the level of fees and the quality of the services provided, and in particular that services provided for a low fee are of an inferior quality.

The answer to the fourth and fifth question is probably more relevant in the light of this report:

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[82] Judgment of the Court (Grand Chamber), December 5, 2006, In Joined Cases C94/04 and C202/04, Federico Cipolla (C94/04) versus Rosaria Fazari, née Portolese; and Stefano Macrino, Claudia Capodarte (C202/04) versus Roberto Meloni.

> 'Legislation containing an absolute prohibition of derogation, by agreement, from the minimum fees set by a scale of lawyers' fees, such as that at issue in the main proceedings, for services which are (a) court services and (b) reserved to lawyers constitutes a restriction on freedom to provide services laid down in Article 49 EC. It is for the national court to determine whether such legislation, in the light of the detailed rules for its application, actually serves the objectives of protection of consumers and the proper administration of justice which might justify it and whether the restrictions it imposes do not appear disproportionate having regard to those objectives.'

In short, the Cipolla case (2004) tells us that Member States are not allowed to forbid lawyers to work under minimum tariffs, unless this is detrimental to consumers.

The Services Directive

Article 17 ('Additional derogations from the freedom to provide services') of the Services Directive states that Article 16 ('Freedom to provide services'; cf. box C.1) shall not apply to – among other things – matters covered by Council Directive 77/249/EEC of 22 March 1977 to facilitate the effective exercise by lawyers of freedom to provide services (sub 4) and matters covered by Title II of Directive 2005/36/EC (free provision of services). Above and foremost the freedom to provide services does not apply if a Member State requires that a certain activity is reserved for a particular profession (sub 6). In practice this means that Member States are given the opportunity to build up market barriers in order to protect their national service providers from competition from abroad.

The Services Directive enlarges the scope for the proportionality test. According to the CCBE (2005):

> 'There is no basis in EC competition law for the proportionality test for state measures as proposed by the European Commission, and therefore Member States are not under a duty under EC competition law to amend their existing regulations in order to comply with such a test.'

This is true for state regulations but not for the Bar's regulation (cf. the Wouters case described above). Note, however, that the *Consorzio Industrie Fiammiferi* (CIF) judgment may change this lack of duty for state regulations as mentioned by CCBE. The CIF judgment of the European Court of Justice decided that where undertakings engage in conduct contrary to Article 81 (cartel prohibition) and where that conduct is required or facilitated by State measures which themselves infringe Articles 3(1)(g), 10(2), and 81/82, a national competition authority has a duty to decline those State measures and give effect to Article 81.[83] The consequence of that judgement is that when a decision by a national competition authority to decline national legislation has become definitive, the State compulsion defence is no longer available.

At the same time, Article 16(1)(c) of the Directive on services in the internal market states that Member States shall not make access to or exercise of a service activity in their territory subject in compliance with any requirements which do not respect proportionality. Moreover, from a public

[83] Case C-198/01, *Consorzio Industrie Fiammiferi* (CIF) [2003] ECR I- OOOO paras. 54-55.

interest perspective, it would suit any government to make sure that regulation is indeed proportional rather than serving the private interest of the professionals.

Box C.1: Article 16 from the Directive on services in the internal market

Paragraphs 1 and 2 of Article 16 deal with free movement of services:

1. Member States shall respect the right of providers to provide services in a Member State other than that in which they are established.
   The Member State in which the service is provided shall ensure free access to and free exercise of a service activity within its territory.
   Member States shall not make access to or exercise of a service activity in their territory subject to compliance with any requirements which do not respect the following principles:
   (a) non-discrimination: the requirement may be neither directly nor indirectly discriminatory with regard to nationality or, in the case of legal persons, with regard to the Member State in which they are established;
   (b) necessity: the requirement must be justified for reasons of public policy, public security, public health or the protection of the environment;
   (c) proportionality: the requirement must be suitable for attaining the objective pursued, and must not go beyond what is necessary to attain that objective.

2. Member States may not restrict the freedom to provide services in the case of a provider established in another Member State by imposing any of the following requirements:
   (a) an obligation on the provider to have an establishment in their territory;
   (b) an obligation on the provider to obtain an authorization from their competent authorities including entry in a register or registration with a professional body or association in their territory, except where provided for in this Directive or other instruments of Community law;
   (c) a ban on the provider setting up a certain form or type of infrastructure in their territory, including an office or chambers, which the provider needs in order to supply the services in question;
   (d) the application of specific contractual arrangements between the provider and the recipient which prevent or restrict service provision by the self employed;
   (e) an obligation on the provider to possess an identity document issued by its competent authorities specific to the exercise of a service activity;
   (f) requirements, except for those necessary for health and safety at work, which affect the use of equipment and material which are an integral part of the service provided;
   (g) restrictions on the freedom to provide the services referred to in Article 19.

Paragraph 3 of Article 16 provides a way out of the Freedom to provide services:

3. The Member State to which the provider moves shall not be prevented from imposing requirements with regard to the provision of a service activity, where they are justified for reasons of public policy, public security, public health or the protection of the environment and in accordance with paragraph 1. Nor shall that Member State be prevented from applying, in accordance with Community law, its rules on employment conditions, including those laid down in collective agreements.

Appendix D Questionnaires legal expenses insurers

This appendix contains two questionnaires. The first questionnaire is given as Appendix D.1. It was sent to RIAD contact persons in the 12 countries in mid-May 2007.[84] Responses were collected online from mid-May until the beginning of August 2007.

All 12 contact persons completed most of the questions, but unfortunately in many cases 'the item non-responses' occurred, that is, answers were simply left out or not given in full. We managed partly to fill the gap using desk research and telephone inquiries. Background data have been verified with those of the OECD and Eurostat.

The responses to the first survey show that by no means all questions highlighted interesting differences which is why we did not include data from every question in the main report. Some important, not properly answered questions were reworded and repeated in the second survey.

Appendix D.2 contains the second questionnaire. This was sent to RIAD members (some of whom were also the RIAD contact persons) and to some legal expenses insurers not associated with RIAD because in some countries the number of RIAD members is too limited.

Table D.1: Response rates regarding the second questionnaire (legal expenses insurers)

Country	Number of surveys sent to different insurance companies	Response
Germany	7	5
Austria	3	1
Belgium	6	4
Spain	3	2
France	13	9
England	6	4
Hungary	1	0
Italy	6	3
The Netherlands	4	4
Czech Republic	1	1
Switzerland	5	4
Finland	1	0
TOTAL (56)	56	36 66.1%

Source: SEO Economic Research

This second questionnaire was e-mailed to 56 legal expenses insurance companies on 21 September 2007. Responses were collected until 1 November. Thirty-six legal expenses insurers completed (part of) the questionnaire (cf. table D.1). Although the overall response rate is over 66%, the response to some of the most important questions (the average price of several civil law

[84] Finland is not a member of RIAD. For the purpose of this research our contact person was at the Federation of Finnish Financial Services. This is a trade body that represents companies operating in the financial industry in Finland, including insurance companies.

cases) was not as complete as we had hoped. Consequently, when determining the overcharge (section 4.2.2) the net sample consisted of 19 insurers.

Appendix D.1 First questionnaire legal expenses insurers

Introduction to the survey

RIAD is interested in a survey of the regulation of access to justice in several European countries. The goal is to stimulate on a European level a policy discussion on the (often national) regulation of legal services and to find out if this regulation actually allows the different providers of legal service to operate on a level playing field.

The central research question is: "What is the effect of the regulation of the legal profession – predominantly lawyers – on access to law?" This question is answered for civil law and not criminal or public law. We focus on the effect of the (national) monopoly when it comes to conducting a case. As this monopoly is in most countries exclusively given to lawyers, the analysis predominantly looks into the regulation of lawyers. Furthermore, the research analyses the effects this monopoly and accompanying self-regulation have on both consumers (households and SMEs) and competitors (legal expenses insurers and others). The ultimate goal would be to perform a social cost benefit-like analysis of the legal monopoly of lawyers and estimate the relation between the level of government regulation and the cost of access to justice.

If you have questions or need help with this questionnaire, please feel free to contact Dr. Barbara Baarsma, b.baarsma@seo.nl

To fill out this part of questionnaire on-line please click on the link you received by e-mail.

2.1 Entry to the profession of lawyers: (im)possibilities to enter the market as a professional

2.1.1 Are there specific requirements to be admitted to law school (like a numerus fixus based on minimum high school grades or a lottery)?

Yes, please specify

_____

_____

No

2.1.2 What is the minimum number of years of law school required to achieve a law degree / a jurist title?

Years

2.1.3 Which professional tasks can a jurist (who is not a member of the Bar) perform?

a. General legal information Yes / No
b. Individual information and advice before officially filling a claim Yes / No
c. Legal assistance (e.g., claim handling) Yes / No
d. Court representation Yes / No
e. Enforcement, execution of judgments Yes / No
f. Do you know other professional tasks? Please specify if jurists can perform other professional tasks than the one mentioned before: _____

2.1.4 If jurists cannot perform the tasks mentioned in question 2.1.3 to the full extent please specify any kind of restrictions which apply (e.g., monetary thresholds etc.):

a. General legal information _____
b. Individual information and advice before officially filling a claim _____
c. Legal assistance (e.g., claim handling) _____
d. Court representation _____
e. Enforcement, execution of judgments _____
f. Other, please specify _____

2.1.5 What is the total number of years/months of post-academic education to become a lawyer?

Example: X years and Y months

Years and Months

2.1.6 Is an internship or job in a law firm a necessary part of the post academic training to become a lawyer?

Yes / No

2.1.7 Which tasks are exclusively assigned to lawyers?

a. General legal information Yes / No
b. Individual information and advice before officially filling a claim Yes / No
c. Legal assistance (e.g., claim handling) Yes / No
d. Court representation Yes / No
e. Enforcement, execution of judgments Yes / No
f. Do you know other tasks? Please specify if there are other tasks exclusively assigned to lawyers? _____

2.1.8 Are there other legal specializations besides lawyer and notaries in your country that require post-academic education?

Yes, please specify the procedures/ restrictions which apply:

_____

_____

No

2.1.9 Is it possible to become a lawyer in the employment of a non-lawyer or non-law firm? (For instance an insurance company or trade union)
Yes, please specify the prerequisites/ procedures/ restrictions which apply _____
Yes, how many lawyers employed by a non-lawyer or non-law firm were active in 2006 _____
No

2.1.10 Is there a maximum number of lawyers that is admitted/appointed nationally, regionally or locally each year?
Yes, please specify how this is regulated _____
No

2.1.11 Once a person with a law degree has entered the profession of lawyer is there:
Requirement of regular additional training?
Yes, please specify the procedures/ restrictions which apply
_____
_____
No

2.1.12 What are the requirements to become a member of the Bar?
a. Be a jurist (have a law degree)
b. Be a lawyer
a. Other: please specify
_____

2.1.13 Are there any other entry requirements to become a lawyer?
Yes, please specify these requirements:
_____
_____
No

2.2 Entry to the business: (im)possibilities to enter the market as a law firm

2.2.1 What are the requirements to start a law firm?
a. Be a jurist (have a law degree)
b. Be a lawyer
b. None, anybody can start a law firm
c. Other: please specify _____

2.2.2 Is there a form of goodwill costs involved in becoming a partner in a law firm?
Yes, the amount and kind of goodwill cost* are regulated, please specify this regulation:
_____
_____
Yes, but the amount and kind of goodwill cost are not regulated
No

* Goodwill costs: Goodwill costs are the costs that a lawyer has to pay when he takes over another lawyer's practice or firm. The costs represent the commercial value of the practice, insofar as this value is based on the achieved position, status, clientele, et cetera. In fact the starting lawyer pays for the widely known name and clientele of his predecessor.

2.2.3 Can a non-lawyer own a law firm?
Yes
No, please specify the restrictions (which laws or rules):
_____

2.2.4 Can a legal entity own a law firm in your country?
Yes
No, please specify the restrictions (which laws or rules):
_____

2.2.5 Can a foreign legal entity own a law firm in your country?
Yes
No, please specify the restrictions (which laws or rules):
_____

2.2.6 Is it possible to start a Multi-Disciplinary Practice? (With a Multi-Disciplinary Practice, we mean a firm that practices other than lawyers' services, for instance notaries, accountants, tax advisors and patent officers)
Yes / No

2.2.7 Are there any other requirements to start a law firm?
Yes, please specify these requirements:
_____
_____
No

2.3 Access to law

Could you please give the demanded numbers for the year 2006 and the source you based the answer on?

2.3.1 The number of jurists _____ persons
Source: _____

2.3.2 The number of lawyers _____ persons
Source: _____

2.3.3 The number of legal expenses insurance companies _____ companies
Source: _____

2.3.4 The number of multi-branch legal expenses insurers _____ companies
Source: _____

2.3.5 The number of legal expenses specialized legal expenses insurers _____companies
Source: _____

2.3.6 The number of jurists working for legal expenses insurers (as a lot of part time occupations exist we ask you to fill the number out in terms of Full Time Equivalent – FTE)
_____ FTE
Source: _____

2.3.7 The number of lawyers working for legal expenses insurers (if allowed)
_____ FTE
Source: _____

2.3.8 The number of law firms _____ firms
Source: _____

2.3.9 The number of civil cases handled in your country per year
_____ cases
Source: _____

2.3.10 The number and percentage of households with a stand alone legal expenses insurance households
_____ % of households*
Source: _____

2.3.11 The number and percentage of households with an add-on legal expenses insurance households
_____ % of households
Source: _____

2.3.12 The number of cases handled by legal expenses insurance outside of court
_____ cases
Source: _____

2.3.13 The number of cases handled by legal expenses insurance in court
_____ cases*
Source: _____

2.3.14 Please define the term SME* (small and medium sized enterprise) regarding the situation in your country before answering the following questions:
_____
_____

* see: European Commission, "The new SME definition: User guide and model declaration" for the European definition which took effect on 1/1/2005. "Enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million." http://ec.europa.eu/enterprise/enterprise_policy/sme_definition/sme_user_guide.pdf

2.3.15 The number and percentage of SMEs that have a stand alone legal expenses insurance

_____ SMEs

_____ % of SMEs

Source: _____

2.3.16 The number and percentage of SMEs that have a add-on legal expenses insurance

_____ SMEs

_____ % of SMEs

Source: _____

2.3.17 The number of cases handled by legal expenses insurance companies

_____ cases

Source: _____

2.3.18 Are there enough lawyers available to conduct civil cases? (Are there capacity problems, e.g., long waiting times to go to court or to find a suitable lawyer?)

Yes / No

2.3.19 Please specify the average time to find a suitable lawyer to conduct the civil law case

_____ days

2.3.20 How much time does the conduct of a civil law case take on average? (From the originating of the problem until the sentence in first instance)

_____ weeks

2.3.21 What is the average income of a lawyer?

If you answer 'other currency' please specify the average income in that currency

_____ Euro

_____ Other currency

2.3.22 What is the average percentage of the total income of a lawyer coming from the conduct of civil cases?

_____ %

2.3.23 What is the average hourly tariff asked by a lawyer for conducting civil cases?

If you answer 'other currency' please specify the average hourly tariff in that currency

_____ Euro

_____ Other currency

2.3.24 Is there subsidized legal aid for low income groups for civil cases?

If you quote another currency than Euro please specify the currency

Yes, please specify the maximum income above which a person is not awarded subsidized legal aid: _____

No

2.4 Presence of various kinds of legal services

2.4.1 If representation in court for civil cases is not part of the exclusive tasks of a lawyer, who else can represent persons and SMEs in court?

a. Anybody
b. The persons/SMEs with the legal problem themselves
c. Legal advisors (for instance a representative of a trade union)
d. Jurists (someone with a law degree)
e. Jurists with a law degree and specialization (like a notary or legal tax advisor)
f. Only lawyers can represent clients in court
g. Other, please specify _____

2.4.2 Who can represent persons and SMEs in the area of conveyancing services (i.e., transfer of property)

a. Anybody
b. The persons/SMEs with the legal problem themselves
c. Legal advisors (for instance a representative of a trade union)
d. Jurists (someone with a law degree)
e. Jurists with a law degree and specialization (like a notary)
f. Only lawyers can represent clients in court
g. Other, please specify _____

2.4.3 Are there certain civil cases that require no assistance/representation at all? (for example: no assistance would be required if the financial effect related to subject of the case are lower than a certain amount?)

Yes, please specify the kind of cases_____
No

2.5 Self-regulation bodies

A practicing procedural lawyer is expected to comply with both government-enforced regulations and with the rules for self-regulation – often laid down by the National Bar Association, including its disciplinary procedures. That association is a statutory public body governing procedural lawyers.

2.5.1 Are there, one or more, self-regulation bodies for the legal profession in your country?

No
Yes, please give the name(s) of these organizations

a._____
b._____
c._____

2.5.2 Are these Bar organizations indeed statutory public bodies?

a. Yes / No / Not applicable
b. Yes / No / Not applicable
c. Yes / No / Not applicable

2.6 Government regulation

2.6.1 Are the educational requirements to the profession of lawyers prescribed by law?
Yes, please fill out the name of the law: _____
No

2.6.2 Are the exclusive rights to perform certain tasks by lawyers prescribed by law?
Yes, please fill out the name of the law: _____
No

2.6.3 Does the introduction of the Better regulation agenda* influence the regulation of the legal profession in your country?
Yes, please specify any initiatives that fit in the strategy of the Better regulation agenda:
_____
_____
No

* The Better regulation agenda: The European Commission published a report on Competition in professional services. On top of these reports, the commission has developed the Better regulation agenda. Apart from other things, this agenda implies a proportionality test, which – in a nutshell – involves checking whether a regulation has a clearly defined public interest objective and is the method least restrictive of competition to achieve that desired objective. The proportionality test has provoked a more economic perspective on the regulation of legal services on a European level.

2.6.4 Do you know of any Regulatory impact assessments* or Cost-benefit analyses** that have been conducted in the past five years concerning the regulation of the legal profession?
Yes, please specify the titles of these studies:
_____
_____
No

*A Regulatory impact assessment is a tool to enable the government to weigh and present the relevant evidence on the positive and negative effects of an intervention, including by reviewing the impact of policies after they have been implemented. It is a policy tool which assesses the impact, in terms of costs, benefits and risks of any proposed regulation.
** Cost-benefit analysis is the statement of the monetary value of all advantages and disadvantages experienced by all parties in the (national) community in the implementation of a project, supplemented by (preferably quantitative) information about effects that cannot be reliably expressed in monetary terms.

2.7 Price regulation; information on the costs of a professional service ex ante

2.7.1 Is information on the costs of common legal information generally available for consumers?
Yes, please specify:_____
No

2.7.2 Is information on the costs of specific legal advice generally available for consumers?
Yes, please specify:_____
No

2.7.3 Is information on the costs of legal assistance outside of court generally available for consumers?
Yes, please specify:_____
No

2.7.4 Is information on the costs of representation in court generally available for consumers?
Yes, please specify:_____
No

2.7.5 Is information on the costs of common legal information generally available for SMEs?
Yes, please specify:_____
No

2.7.6 Is information on the costs of specific legal advice generally available for SMEs?
Yes, please specify:_____
No

2.7.7 Is information on the costs of legal assistance outside of court generally available for SMEs?
Yes, please specify:_____
No

2.7.8 Is information on the costs of representation in court generally available for SMEs?
Yes, please specify:_____
No

2.7.9 Are there minimum prices for legal services by lawyers?
a. No, minimum prices do not exist
b. Yes, but only recommended prices by the sector/ Bar
c. Yes, legally determined. Please fill out the name of this law:
_____

2.7.10 Are there maximum prices for legal service by lawyers?
a. No, maximum prices do not exist
b. Yes, but only recommended prices by the sector/ Bar
c. Yes, legally determined. Please fill out the name of this law:
_____

2.7.11 Are there fixed prices for legal service by lawyers?
a. No, fixed prices do not exist
b. Yes, but only recommended prices by the sector/ Bar
c. Yes, legally determined. Please fill out the name of this law:
_____

2.7.12 Are there fixed prices for legal aid to low income groups by lawyers?
a. No, fixed prices do not exist
b. Yes, but only recommended prices by the sector/ Bar
c. Yes, legally determined. Please fill out the name of this law:
_____

2.7.13 Are success fees* prohibited?
Yes, please fill out the name of this law: _____
No

* Success fees (other terms: contingency or conditional fees): payment of the lawyer is determined beforehand as a % of expected benefits of the case.

2.7.14 Is 'no cure, no pay'* prohibited?
Yes, please fill out the name of this law: _____
No

* 'No cure, no pay' (other term: 'no win, no fee' system): any fee for services provided where the fee is only payable if there is a favourable result.

2.7.15 Is a legal expenses insurer allowed to negotiate with lawyers about prices?
a. Yes
b. Yes, but only on a case-by-case basis
c. No, this prohibited. Please fill out the name of this law:
_____

2.8 Advertising

2.8.1 Are there sector specific restrictions on advertising for lawyers in your country?
a. No, restrictions do not exist
b. Yes, restrictions are determined by the sector/ Bar
c. Yes, restrictions are legally determined. Please fill out the name of this law:
_____

2.8.2 Are lawyers allowed to advertise their specialization?
Yes / No

2.8.3 Are lawyers allowed to advertise their prices?
Yes / No

2.8.4 Are lawyers allowed to advertise their success rates?
Yes / No

2.9 Complaints

2.9.1 Is it possible for households and SMEs to file a complaint against a lawyer/ law firm?
Yes / No
If yes go to question 2.9.2; if no go to part 2.10

2.9.2 Is there an organization where clients (households and SMEs) can complain and that administrates disciplinary procedures? It is possible to mark more than one organization:

a. No, there is no such organization
b. Yes, complaints can be filed at the Bar
c. Yes, complaints can be filed at the Court
d. Yes, complaints can be filed at the national Association of Insurers
e. Yes, complaints can be filed at a consumer organization. Please fill out the name of this organization: _____
f. Yes, other, please specify _____

2.9.3 Is it possible for legal expenses insurers to file a complaint against a lawyer / law firm?
Yes / No

2.9.4 Are the complaints published in public documents?

a. Yes, information about the number and content of the complaints is generally available
b. Yes, but only information on the number of complaints is generally available
c. No

If yes: please specify the number of complaints in 2006 (or 2005 if 2006 is not yet available)
_____

2.9.5 Are there barriers for a client to switch lawyers during the handling of a complaint against the lawyer against whom a complaint is filed?
Yes / No

2.10 General macro-economic information for the year 2006

Could you please give the requested informational on the following macro-economic variables?:

2.10.1	Number of inhabitants
2.10.2	Number of households
2.10.3	Net Income per household per month/year
2.10.4	Number of companies
2.10.5	Number of SMEs
2.10.6	Number of motorists (drivers of motor driven vehicles)
2.10.7	Gross Domestic Product (GDP)

2.11 End of the questionnaire and space for additional remarks

Please note: after finishing this last question you will not be able to return to the questionnaire to make any corrections.

Are there other specific details about the profession of law in your country, which were not addressed in this questionnaire?

_____

_____

_____

_____

Thank you very much for your time!

Appendix D.2 Second questionnaire legal expenses insurers

Introduction to the survey

This survey focuses on the question "What is the effect of the regulation of the legal profession – predominantly lawyers – on access to law?". The specific aim of this study is to analyse in detail whether existing legislation provides a level playing field for providers of legal services and to establish how legislation actually influences access to law. Also, the goal is to stimulate on a European level a policy discussion on the (often national) regulation of legal services and to find out if this regulation actually allows the different providers of legal service to operate on a level playing field. RIAD has asked SEO Economic Research (Amsterdam) to conduct this research.

This question deals with civil law only and not criminal or public law. We focus on the effect of the (national) monopoly when it comes to conducting a case. As this monopoly is in most countries exclusively given to lawyers, the analysis predominantly looks into the regulation of lawyers. Furthermore, the research analyses the effects this monopoly and accompanying self-regulation have on both consumers (households and SMEs) and competitors (legal expenses insurers and others). The ultimate goal would be to perform a social cost benefit-like analysis of the legal monopoly of lawyers and estimate the relation between the level of government regulation and the cost of access to justice. We have approached Legal expenses insurers in the following 12 countries: Austria, Belgium, Czech Republic, England, Finland, France, Germany, Hungary, Italy, Spain, Switzerland, and The Netherlands.

To guarantee a successful conduct of our study we need your support. Therefore, we kindly ask you to take part in the survey. If you have questions or need help with this questionnaire, please feel free to contact:

- Kieja Janssen, k.janssen@seo.nl (0031-20-5251670), or
- Dr. Barbara Baarsma, b.baarsma@seo.nl (0031-624204707/5251652).

We will contact you in the coming week to find out if you have any questions.

How to go about with this survey?
We would kindly ask you to respond to the questionnaire before October 4, 2007. To fill out the questionnaire please write your answer underneath the question in this e-mail and reply to us, or you could open the attached file and answer the questionnaire in Word and then send it back as an attachment to us.

This questionnaire contains 9 questions and will take about fifteen to thirty minutes of your time.

Remarks:
All data and information obtained from this questionnaire will be treated strictly confidential and will only be available to SEO Economic Research and will by no means be communicated to any legal expenses insurer. Moreover, results will be reported in such a way that they can in no way be linked to individual respondents.

If you have language problems regarding the questionnaire you can contact the RIAD representative of your country. Please find the list with the contact information for the RIAD representatives.

In this questionnaire the term "lawyer" or "advocate" means a person trained and licensed to prepare, manage, and either prosecute or defend a court action as an agent for another and who also gives advice on legal matters that may or may not require court action. The term jurist means a person trained in law but who, in comparison to a lawyer or advocate, is not officially licensed or registered as a lawyer or advocate. The qualification level may be the same but may also differ between lawyers/ advocates and jurists.

A network lawyer is a lawyer with whom the Legal expenses insurer has made prior arrangements about prices (quantity discount because the insurer hires this lawyer on a regular basis). An external lawyer is a lawyer with whom no prior arrangements have been made (no structural cooperation).

The Bar is the name of the professional body for lawyers. The Bar licenses lawyers, provides representation and services for the Bar and guidance on issues of professional practice, and deals with the regulation of lawyers.

SME stands for small and medium sized enterprise, that is enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million.

Questions

0. General information about your organization
   Country: ……..……..
   Contact Person: ……..……...
   Street: ……...
   Zip Code, City: …….
   Telephone: ……...
   e-mail: ……..

1. The regulation of the legal profession is aimed at safeguarding access to law. Do you believe there are problems in relation to access to law in your country?
   - No, the current level of regulation properly safeguards access to law;
   - Sufficient level of access to law, but there are problems with access to law in relation to:
     - Proceedings taking too long
     - Limited availability of legal representatives (in some areas of the law)
     - Quality of the legal profession (in some areas of the law)
     - Costs of the resolution of a legal dispute that are too high (including the costs of legal representation)
     - Access to financed legal aid
     - Other matters,……..
       …….
   - Access to law is insufficiently provided.
     - The reason for this is:…… ……...
       ……..

If you have any national reports on this subject, could you please give us the title/author/date, summary and conclusions?

……
……..……

2. Is membership of the Bar compulsory for lawyers?
   - No
   - Yes

3. Could you please give the number of households with legal expenses insurance in your country?

……..……
……..……

4. Could you please give the number of SMEs with legal expenses insurance in your country?

……..……
……..……

5. Could you please give the number of civil cases settled by your legal expenses insurance company (preferably for the years 2000 and 2006)?

……..……
……..……

Could you also give an estimate for this number on a national level?

……..……
……..……

6. What percentage of all civil cases taken up by your legal expenses insurance company was settled out of court in 2006?

……% of civil cases settled out court

……% of civil cases settled in court (incl. settlements after the case is brought to court)

7. What percentage of all civil cases that your legal expenses insurance company has taken up was handled in-house in 2006? What percentage was handled via outsourcing to either a network lawyer (outsourcing to lawyers with whom prior arrangements about prices have been made) or an external lawyer?

……% of civil cases handled in-house

……% of civil cases handled via outsourcing, of which

……% outsourced to a network lawyer

……% outsourced to an external lawyer

8. Please consider the following four civil cases.

- Case 1: a dispute between an employer and an employee.
- Case 2: a personal injury claim.
- Case 3: a consumer dispute.

If you have SME as a client, please also consider:

- Case 4: a dispute between two SME-companies about the supply of goods and services.

What would – on average – be the costs of conducting such a case:

A. if you as a legal expenses insurance company were to deal with the costs yourselves (insourcing). Note that this may be a hypothetical question, as in some countries insurers are not allowed to conduct cases.
B. if your company were to use a network lawyer (outsourcing to lawyers with whom prior arrangements about prices have been made).
C. if your company were to outsource the case to an external lawyer.

If possible, could you subdivide the total costs per case into a cost per hour and the total hours spend per case?
Could you also differentiate your estimate for cases handled out of court and in court?

Could you also please give the average percentage of these cases that are insourced and outsourced?
Finally, could you give the average percentage of these cases that are handled out of court and in court?

Case 1: a dispute between an employer and an employee.

	A. Cost of insourcing ……% cases is insourced	B. Cost of outsourcing to network lawyer ……% cases is outsourced to network lawyer	C. Cost of outsourcing to external lawyer ……% cases is outsourced to external lawyer
Handled out of court ……% cases is handled out of court	€…….. in total per case That is: €……. per hour and ……. hours per case	€…….. in total per case That is: €……. per hour and ……. hours per case	€…….. in total per case That is: €……. per hour and ……. hours per case
Handled in court …...% cases is handled in court	€…….. in total per case That is: €……. per hour and ……. hours per case	€…….. in total per case That is: €……. per hour and ……. hours per case	€…….. in total per case That is: €……. per hour and ……. hours per case

Case 2: a personal injury claim.

	A. Cost of insourcing ……% cases is insourced	B. Cost of outsourcing to network lawyer ……% cases is outsourced to network lawyer	C. Cost of outsourcing to external lawyer ……% cases is outsourced to external lawyer
Handled out of court ……% cases is handled out of court	€…….. in total per case That is: €……. per hour and ……. hours per case	€…….. in total per case That is: €……. per hour and ……. hours per case	€…….. in total per case That is: €……. per hour and ……. hours per case
Handled in court …...% cases is handled in court	€…….. in total per case That is: €……. per hour and ……. hours per case	€…….. in total per case That is: €……. per hour and ……. hours per case	€…….. in total per case That is: €……. per hour and ……. hours per case

Case 3: a consumer dispute.

	A. Cost of insourcing ……% cases is insourced	B. Cost of outsourcing to network lawyer ……% cases is outsourced to network lawyer	C. Cost of outsourcing to external lawyer ……% cases is outsourced to external lawyer
Handled out of court ……% cases is handled out of court	€…….. in total per case That is: €……. per hour and ……. hours per case	€…….. in total per case That is: €……. per hour and ……. hours per case	€…….. in total per case That is: €……. per hour and ……. hours per case
Handled in court …...% cases is handled in court	€…….. in total per case That is: €……. per hour and ……. hours per case	€…….. in total per case That is: €……. per hour and ……. hours per case	€…….. in total per case That is: €……. per hour and ……. hours per case

If you have SME as a client, please also consider:

Case 4: a dispute between two SME-companies about the supply of goods and services.

	A. Cost of insourcing ……% cases is insourced	B. Cost of outsourcing to network lawyer ……% cases is outsourced to network lawyer	C. Cost of outsourcing to external lawyer ……% cases is outsourced to external lawyer
Handled out of court ……% cases is handled out of court	€…….. in total per case That is: €……. per hour and ……. hours per case	€…….. in total per case That is: €……. per hour and ……. hours per case	€…….. in total per case That is: €……. per hour and ……. hours per case
Handled in court …...% cases is handled in court	€…….. in total per case That is: €……. per hour and ……. hours per case	€…….. in total per case That is: €……. per hour and ……. hours per case	€…….. in total per case That is: €……. per hour and ……. hours per case

Please let us know if it is possible to supply (anonimized) registration data on these expenses, where each case handled is a record, where it is known what type of case it concerned and where the total costs of legal representation are known.

9. Are there other specific details about the access to law in your country, which were not addressed in this questionnaire?

……..…….

……..…….

Thank you very much for your time!

Appendix E Questionnaire Bars

This appendix contains the third questionnaire. On 14 September 2007, it was e-mailed to the Bars in the 12 countries in our sample. Responses were collected until 1 November 2007.

Table E.1: Response rates to the third questionnaire (Bars)

Country	Response
Austria: Österreichischer Rechtsanwaltskammertag	1
Belgium: Ordre des barreaux francophones et germanophones / Orde van Vlaamse Balies	1
Czech Republic: Ceská Advokátní Komora	1
England/Wales: General Council of the Bar / The Law Society	0
Finland: Suomen Asianajajaliitto	0
France: Barreau de Paris / Conseil National des Barreaux	1
Germany: Bundesrechtsanwaltskammer/ Deutscher Anwaltverein e.V.	1
Hungary: Magyar Ügyvédi Kamara	0
Italy: Consiglio Nazionale Forense	0
Spain: Consejo General de la Abogacía Española	0
Switzerland: Swiss Bar Association	0
The Netherlands: Nederlandse Orde van Advocaten	0
TOTAL (12)	5 (41.7%)

Source: SEO Economic Research

Five Bars completed (part of) this questionnaire (Table E.1). The response rate (less than 42%) was relatively low considering the fact that the research topic focuses on the core activities of the Bars. Also in this survey, the response to some of the most important questions was incomplete, that is none of the Bars answered questions on the average prices of several civil law cases. In addition, none of the Bars supplied answers to how often cases are settled out of court and how many cases are outsourced as well as the questions on average prices for the four typical cases. Consequently, we used this third questionnaire merely to check answers on regulation as given by the insurers and for information on the level of access to law as perceived by the Bars.

The fact that most Bars did not respond to our survey – also after being reminded – made it difficult to get all the information required because very few empirical data are publicly available.

Appendix E.1 Questionnaire

The University of Amsterdam (SEO Economic Research) is currently conducting a research on the topic of the access to law. This research is commissioned by RIAD (International Association of Legal Expenses Insurance, http://riad-online.net). As part of this research we would like to get information on this subject from various stakeholders, among which the national Bars and Law Societies. We have approached the Bars in the following 12 countries: Austria, Belgium, Czech Republic, England, Finland, France, Germany, Hungary, Italy, Spain, Switzerland, and The Netherlands. We have taken your contact information from CCBE (http://www.ccbe.org/en/ccbe/membres_en.htm).

This survey focuses on the question "What is the effect of the regulation of the legal profession – predominantly lawyers – on access to law?". This question deals with civil law only and not criminal or public law. The ultimate goal would be to perform a social cost benefit-like comparison of the existing legislation of legal services.

To guarantee a successful conduct of our study we need your support. Therefore, we kindly ask you to take part in the survey. If you have questions or need help with this questionnaire, please feel free to contact:

- Kieja Janssen, k.janssen@seo.nl (0031-20-5251670), or
- Dr. Barbara Baarsma, b.baarsma@seo.nl (0031-624204707/5251652).

We will contact you in the coming week to find out if you have any questions.

How to go about with this survey?

We would kindly ask you to respond to the questionnaire before October 1, 2007. To fill out the questionnaire please write your answer underneath the question in this e-mail and reply to us, or you could open the attached file and answer the questionnaire in Word and then send it back as an attachment to us. Please add any comments you might have after every question.

This questionnaire contains 13 questions and will take about fifteen to thirty minutes of your time.

The term "lawyer" or "advocate" means a person trained and licensed to prepare, manage, and either prosecute or defend a court action as an agent for another and who also gives advice on legal matters that may or may not require court action.

The term jurist means a person trained in law but who, in comparison to a lawyer or advocate, is not officially licensed or registered as a lawyer or advocate. The qualification level may be the same but may also differ between lawyers/ advocates and jurists.

0. General information about your organization

Country: ……..……..

Contact Person: ……..……...

Street: ……...

Zip Code, City: …….

Telephone: ……...

e-mail: ……..

1. The regulation of the legal profession is aimed at safeguarding access to law. Do you believe there are problems in relation to access to law in your country?
   - No, the current level of regulation properly safeguards access to law;
   - Sufficient level of access to law, but there are problems with access to law in relation to:
     - Proceedings taking too long
     - Limited availability of legal representatives (in some areas of the law)
     - Quality of the legal profession (in some areas of the law)
     - Costs of the resolution of a legal dispute that are too high (including the costs of legal representation)
     - Access to financed legal aid
     - Other matters,……..
       …….
   - Access to law is insufficiently provided.
     - The reason for this is:…… ……...
       ……..

If you have any national reports on this subject, could you please give us the title/author/date, summary and conclusions?

……..……
……..……

2. An important component of access to law is the quality of the lawyer (the legal representative). It is partly for that reason that in many countries, lawyers have the exclusive right to conduct legal proceedings in court. Does this exclusive right exist in your country?
   - Yes, for all cases that are handled in court
   - Yes, for some cases, namely ……..……..……
     …..……..
   - No

If so, in which Act(s) or law(s) is this enshrined?
   - Name(s) of the Act(s) or law(s)

……..…….
……..…….

In your country, who may conduct legal proceedings in court?
   - Lawyers/advocates only
   - Any jurist
   - Non-jurists:
     - Representative bodies (e.g., for consumers)
     - Trade unions
     - Others, namely……..…….……..…
       …..……..

3. Is the number of lawyers entering the Bar regulated/are the numbers fixed (something like a numerus clausus)?
   - No
   - Yes, namely …….. admitted per year

4. Is membership of the Bar compulsory for lawyers?

- No
- Yes

5. Another way of safeguarding access to law is legal aid.

- What percentage of households is entitled to legal aid? …….
……..…….
……..…….

- To what extent are expenses for legal services paid for: what kinds of cases or costs are *not* included in the legal aid system? E.g., is legal aid limited to legal representation before court or include also legal advice? ……...…
……..…….
……..…….

- Are lawyers' fees for legal aid regulated, and if yes, how (e.g., maximum fees or fixed fees)?
  - No
  - Yes, …….…….
    ……..…….

- Is there also legal aid for SMEs?
  - No
  - Yes

6. Could you make an estimate of what percentage of all civil cases in your country was settled out of court in 2006?

……% of civil cases settled out court

……% of civil cases settled in court (incl. settlements after the case is brought to court)

7. Please consider the following four civil cases.

- Case 1: a dispute between an employer and an employee.
- Case 2: a personal injury claim.
- Case 3: a consumer dispute.
- Case 4: a dispute between two SME-companies about the supply of goods and services.

What would – on average – be the costs of conducting such a case in your country? Please note, that by no means we refer to advisory prices (which are probably non-existent in your country); we instead refer to the average cost for a private individual or a SME seeking justice.
If possible, could you subdivide the total costs per case into a cost per hour and the total hours spend per case?
Could you also differentiate your estimate for cases handled out of court and in court?
Finally, could you give the average percentage of these cases that are handled out of court and in court?

Case 1: a dispute between an employer and an employee.

	Average cost of such a case
Handled out of court ……% cases is handled out of court	€…….. in total per case That is: €……. per hour and ……. hours per case
Handled in court …...% cases is handled in court	€…….. in total per case That is: €……. per hour and ……. hours per case

Case 2: a personal injury claim.

	Average cost of such a case
Handled out of court ……% cases is handled out of court	€…….. in total per case That is: €……. per hour and ……. hours per case
Handled in court …...% cases is handled in court	€…….. in total per case That is: €……. per hour and ……. hours per case

Case 3: a consumer dispute.

	Average cost of such a case
Handled out of court ……% cases is handled out of court	€…….. in total per case That is: €……. per hour and ……. hours per case
Handled in court …...% cases is handled in court	€…….. in total per case That is: €……. per hour and ……. hours per case

Case 4: a dispute between two SME-companies about the supply of goods and services.

	Average cost of such a case
Handled out of court ……% cases is handled out of court	€…….. in total per case That is: €……. per hour and ……. hours per case
Handled in court …...% cases is handled in court	€…….. in total per case That is: €……. per hour and ……. hours per case

Could you please answer the final five questions by giving the number on a national level. If you are however a regional or local Bar organization, you could also give the number on a regional level (please indicate which region the numbers relate to).

8. How many lawyers were employed by non-law firms in 2006 (or a different year for which figures are available)?

……..…….

……..…….

9. Number of law students who graduated in 2000 and 2006 (or other years for which figures are available).

……..…….
……..…….

10. Number of people who became lawyers in 2000 and 2006 (or other years for which figures are available).

……..…….
……..…….

11. Number of law firms in 2006 (or a different year for which figures are available).

……..…….
……..…….

12. Total number of civil cases handled in court in 2000 and 2006 (or other years for which figures are available).

……..…….
……..…….

13. Are there other specific details about the access to law in your country, which were not addressed in this questionnaire?

……..…….
……..…….

Thank you very much for your time!