

Regulation of Legal Profession in Europe

Frank H Stephen

School of Law

University of Manchester

Outline

1. Empirical research on the regulation of the legal professions

- Market failure due to collusion
- Market failure due to information asymmetry

2. Lawyers and incentives

- 1. Rhetoric of profession vs economist's beliefs

3. A 'technological revolution' comes to lawyering ?

Regulation

- **Regulation justified by Market Failure**
- **Structural Failure**
 - **Market power**
 - Professional cartel?
 - **Incomplete information**
 - Information asymmetry
 - Credence good
- **Missing or Incomplete Markets**
 - **Externalities**
 - **Public Goods**

Information Asymmetry

(a) Adverse Selection

- **Adverse Selection**
 - Consumers cannot distinguish between producers on quality
- **Market for Lemons**
 - Consumers will not pay for high quality
 - Race to Bottom
 - Quality producers driven out of market

Information Asymmetry

(b) Moral Hazard

- Arises after selection of professional by client due to information asymmetry
- Two functions of professional
 - Agency function
 - Diagnosis and proposed solution
 - Service function
 - Deliver solution
- Supplier-induced demand
 - Excessive quality?
 - Over-supply?

Externality/Public Goods

- **Third parties benefit from quality of legal services**
 - Courts, heirs, future purchasers of property etc
 - Legal certainty
- **Is this any different from information asymmetry?**
 - Capitalised in value of transaction?
 - Purchaser cannot identify quality
 - Information asymmetry

Empirical studies of professional regulation

- **Cross US state studies of professional fees in the presence or absence of advertising**
 - Motivated by Stigler's work on advertising as substitute for costly consumer search
 - Average fees for standard transactions with dummy variable for advertising/no advertising
 - Advertisers have lower fees than non-advertisers

Impact of advertising by legal professionals

- **Schroeter, Smith and Cox (1987)**
 - Look at impact of advertising in a local market on the fees of non-advertisers as well as advertisers
- **Liberalisation comes to UK**
 - Stephen, Paterson and Love
 - Series of studies carried out across markets with varying levels of advertising

Other dimensions of professional regulation

- Price discrimination
 - Conveyancing fees based on value of property
 - Entry barriers due to monopoly rights
 - Licensed conveyancers
 - Captured by solicitors profession
- Evidence supportive of standard economic view but professions exploit ambiguities

Regulate Professional or Market?

- **Asymmetry of information justifies regulation**
- **Self-Regulation**
 - Reduces costs, particularly in making changes
 - Ultimate form of regulatory capture
 - Competitive Regulation
- **Not all clients suffer from asymmetry**
 - Individuals and households
 - Businesses and public bodies
 - Can compare different professionals
 - In-house counsel

Segmented Markets

- **Are both types of client in same markets?**
- **Are the same professionals serving both types of client?**
 - **England & Wales >75% of business of small law firms is with private clients**
 - **Netherlands 61% of lawyers in firms with focus on business clients**

Information for Infrequent Purchasers

- **Reputation**
 - Transfer of information between individual clients
 - Investment in brand reputation
- **Repeat purchasers as agents**
 - Selection of professional
 - Approved list

Professional rhetoric

- **Minimum quality assured by ethical codes**
- **All qualified lawyers are generalists**
- **High street law firms provide services in areas of law with which they are unfamiliar**
- **Economies of scale and specialisation?**

2. Recent Developments in England & Wales

- English Legal Professionals
 - Solicitors
 - Litigation, rights of audience in lower courts, conveyancing, solicitor-advocates
 - Barristers
 - Rights of audience in all courts
 - Licensed conveyancers
 - Conveyancing since 1987
 - Legal Executives
 - Appear before courts in uncontentious matters

Evolution of Policy before 2007 Act

- No change in reserved activities
- Competition in reserved activities
 - **Conveyancing**
 - Solicitors and licensed conveyancers since 1985/87
 - **Rights of audience in courts**
 - Barristers and solicitors who qualify as solicitor advocates
 - **Competitive Regulation?**

Lawyers and incentives

- **Professional rhetoric vs economic theory**
- **Almost no empirical evidence on individual lawyer behaviour**
- **A great number of theoretical papers**
- **Stephen and Tata study of legal aid fees in Scotland**

Fixed Payments Study

- Scottish government concerned about rise in legal aid expenditure in criminal cases moves from cost plus contract to fixed fee
- Stephen and Tata project to measure impact of changes on legal aid budget
- Provides a unique natural experiment because of the peculiarities of legal aid rules

Fixed Payments

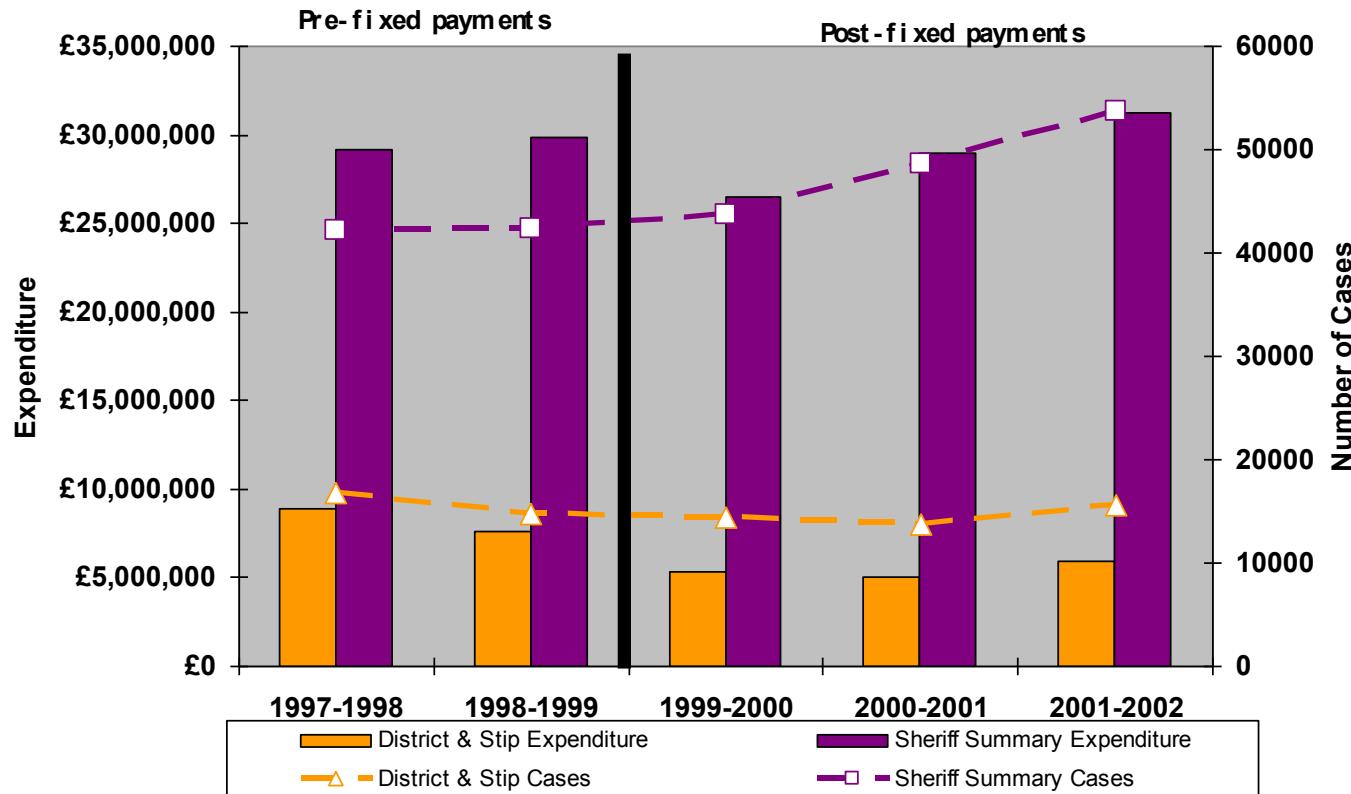
- No legal aid for ‘Guilty’ plea
- Fixed fee set lower than prevailing average fee
 - To save £10m p.a.
 - 20-25%
- Changes after first 30 mins of trial
 - Monitoring by judge
 - Precognitions covered by fixed payment

Triangulation of Results

- Legal aid expenditure data
- Panel data across all courts at this level
- Interviews with the trial lawyers

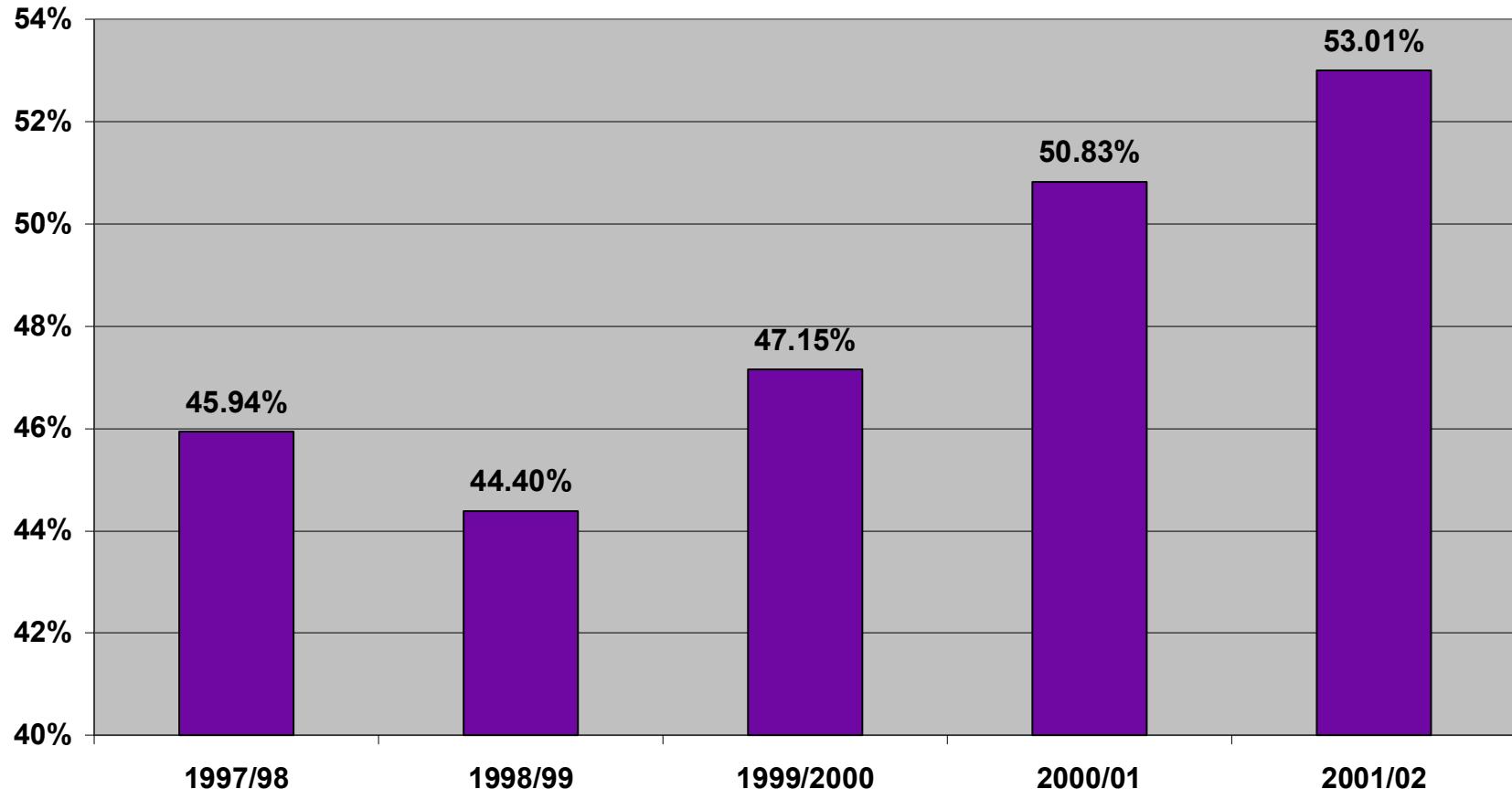
Observed Effects

Expenditure and Number of Cases



Change in Behaviour?

**Sheriff Summary Courts:
Legally-Aided Cases as Percentage of Complaints Initiated**



Impact on Firms

- **Differential Reaction (Stephen, 2001)**
 - **Specialists** – top quartile
 - **Non-specialists** – bottom quartile
 - **Generalists** – middle 50%
- **Regression Method**
 - **Panel method**
 - **Firm fixed effect**
 - **System-wide time effects**

Generalist, Non-Specialist and Specialist Firms

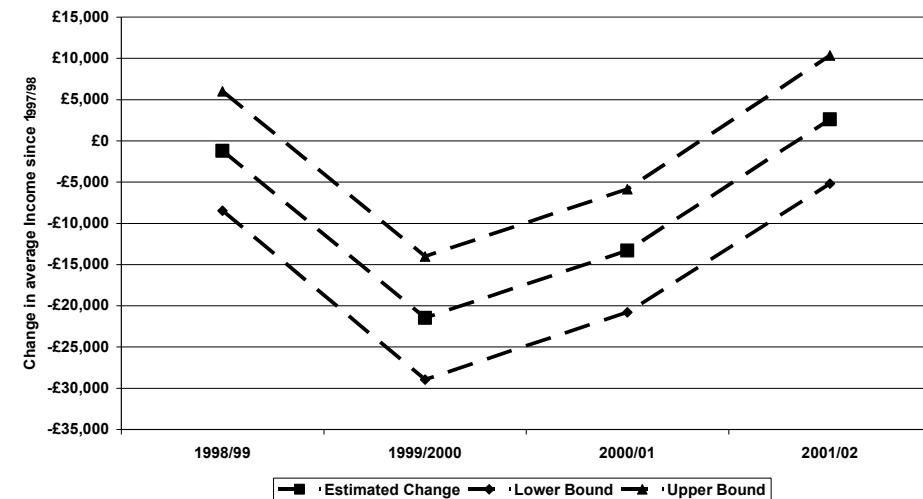
- **No statistically significant change for generalists and non-specialists**
- **Change in behaviour of specialists with a lag**

Specialist Firms

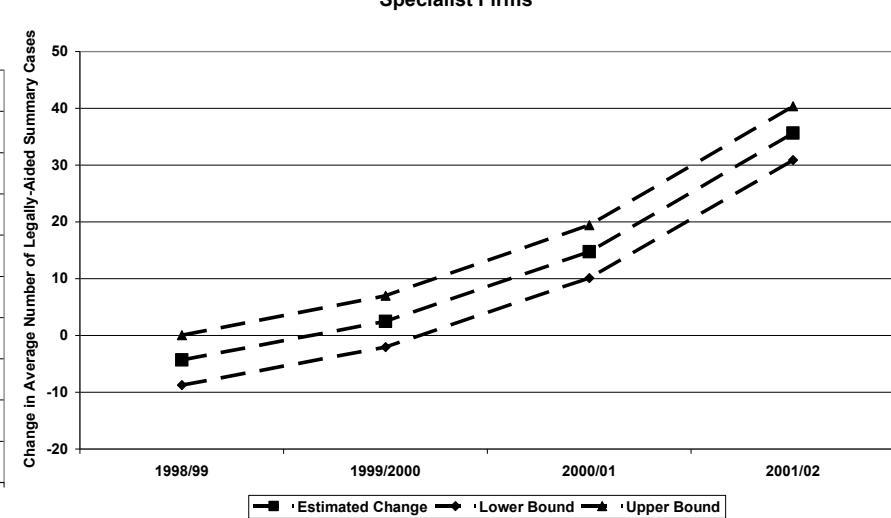
Change in Average Income

Change in Average No. Cases

Change in Income of Specialist Firms



Specialist Firms



Solicitors' Views on Volume

'what's happened is you are now getting larger firms chasing and specialising in the business and churning them through like a sausage machine and you have other practitioners who do not have a lot of criminal business have virtually given up doing what business they had'.

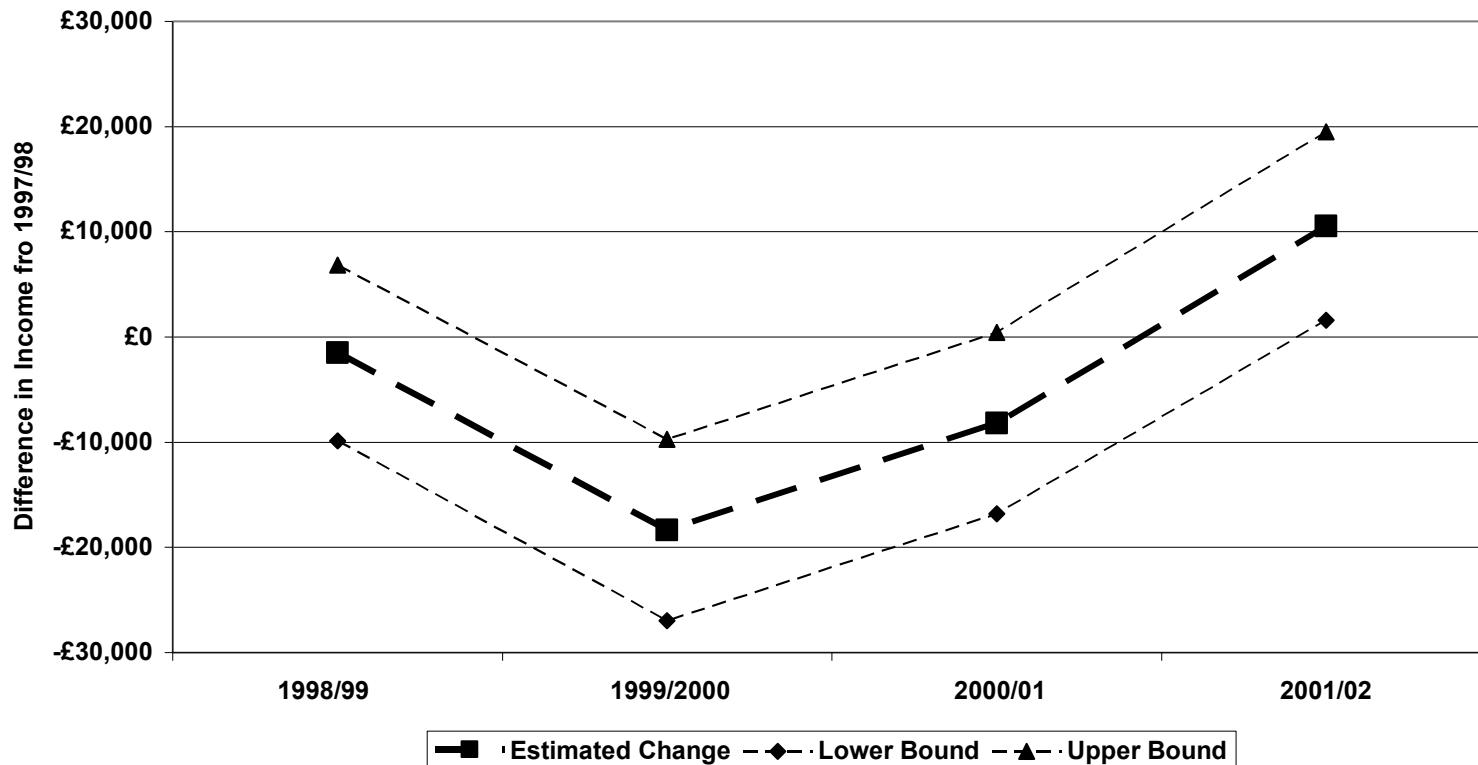
[Face-to-face interview, non-stakeholder defence solicitor]

'Well the more you do, the more efficient the firm is and therefore the more economically you can deal with fixed fees. Yep. So the more you have, the more attractive fixed fees are likely to be because you're maybe there for ten five minute appearances and you've got ten fixed fees at the end of the day'.

[Face-to-face stakeholder interview, defence solicitor]

Combined Income from Summary L A and A&A

Change in Income from Summary Legal Aid and Criminal Advice &
Assistance of Specialist Firms



Industrial Revolution in Lawyering?

- **Legal Services Act 2007**
 - Implements many of the market reforms called for by economists
 - Regulatory competition between the different legal professions
 - **Solicitors, barristers, licensed conveyancers, legal executives**
 - External ownership of law firms
 - Apart from NSW and Nordic countries lawyers employed by non-lawyers cannot provide certain legal services to third parties

Why ‘industrial revolution’

- Move from handicraft industry to mass production
- Economies of scale and specialisation
- Threat to ‘high street’ generalists
- No threat to Anglo-American multi-national legal practices
- Threat to continental European legal profession?

Outside Ownership

- **Clementi Report**
 - Access to capital blocked
 - Changing employment practices in law firms
- **'Tesco Law'**
 - Brand reputation of 'owner'
 - Commodification of legal service
 - Drive out 'High Street' law firm

Outside Ownership (cont.)

- **Independence of legal advice?**
 - **Lawyer serves employer not client**
 - Issue raised with Jt Comm. By German Bar
 - **Agency problem already exists**
 - What are the incentives?
 - Problems with sole practitioners
 - **Less pressure on employed lawyer**
 - Human capital being put at risk
 - What if lawyer equity stake greater than human capital

Conclusion

- Policy seems to be evolving in line with conceptual analysis
 - Competitive regulation
- May lead to transformation of lawyering
 - Customer service orientation
 - Commodification/standardisation of some aspects of legal service
- Recognition of different roles of legal professionals in different markets

**Maybe rent seeking model of
professional regulation is
correct after all!**