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## **Towards Better Regulation of the Legal Professions in the European Union**

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# TOWARDS BETTER REGULATION OF THE LEGAL PROFESSIONS IN THE EUROPEAN UNION

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## **Abstract**

This article starts by discussing a number of public interest explanations for regulating the markets of legal services: information asymmetries, negative externalities and public goods. Since professional associations of lawyers meet the requirements for acting as effective lobbyists, the article subsequently investigates private interest explanations. Empirical work to test alternative theories of professional regulation so far remains limited and the results are ambiguous. Even if empirical studies are able to show that there exists a correlation between levels of professional regulation and profits earned, firm policy conclusions cannot be drawn as long as quality is not adequately assessed. After an overview of the theoretical and empirical literature, the article suggests a number of best practices for policy making. The two most important guidelines seem to be the following. Regulation should not be profession-focused but targeted at market failures in particular segments of the legal services markets. Changes of the regulatory infrastructure that create scope for competitive self-regulation may be the best way for coping with market failures and at the same time reducing the scope for rent-seeking.

**Keywords:** competition, legal professions, European Union, self-regulation

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## 1. Introduction

Traditionally, the legal professions have not been subjected to the competitive forces which operate in commercial sectors of the economy. This is true in both civil law jurisdictions (advocates, Latin notaries) and common law jurisdictions (barristers, solicitors, licensed conveyancers). Regulation of the legal professions has been achieved through a combination of direct government regulation and, to a large extent, through rules adopted by self-regulatory professional bodies. In recent years, the regulation of the legal professions has been criticized increasingly for its anti-competitive effects. The European Commission has launched an appeal to remove unnecessary and disproportionate restrictions of competition in the sector of the legal professions; meanwhile this has led to several changes of the regulatory policy at the EU Member States' level. Today, most commentators would agree that the particular characteristics of the markets for legal services require some form of regulation but that, at the same time, there is a risk that regulation (in particular self-regulation) may excessively restrict competition and promote the interests of the legal professions, without yielding corresponding benefits to the public at large. This paper draws upon the main insights from the economic analysis of the regulation of the legal professions; its main purpose is informing the policy discussion on potentially unwarranted limits on competition.

The structure of this paper<sup>1</sup> is as follows. The second section will discuss both public and private interest explanations of the regulation of markets for legal services. There are three market failures that may impede a full satisfaction of consumers' wishes: asymmetric information, negative externalities and undersupply of public goods. Besides market failures, also other considerations may play a role in policy making: distributional considerations, or mere paternalism. Regulation which adequately copes with these problems can be justified from a public interest perspective. However, rules regarding entry into the market for legal services and conduct on that market may also create unnecessary and disproportionate restrictions of competition. Anti-competitive self-regulatory rules may conflict with prohibitions of competition law. However, rules of competition law apply only to anti-competitive practices that have been initiated autonomously by (associations of) legal professionals and not to regulatory measures decided by states. The second section of this paper will conclude with a brief discussion

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<sup>1</sup> This paper draws upon a more extensive report written by the author for the OECD, DAF/COMP/WP2(2007)3. The OECD Report has a broader scope: it discusses also advertising restrictions, restrictions on forms of business organizations as well as the regulatory framework in non-European countries.

of how the EU legal system may overcome welfare reducing restrictions in the markets for legal services.

After the general economic and legal overview, the third section will elaborate on two types of professional regulation. Given the limited scope of this paper, which does not allow an in-depth discussion of all types of restrictions in different legal professions, the choice has been made to focus on exclusive rights and fee restrictions. This choice may be justified on grounds of the seriousness of the resulting anti-competitive restrictions and the availability of interesting empirical work on the abolishment of those regulations. The central question will be to what extent exclusive rights and fee restrictions in the legal professions can be justified on public interest grounds. Particular attention will be paid to the empirical work on effects of policy changes which took place in some EU jurisdictions (England/Wales, Netherlands) and to empirical studies that have been conducted on request of the EU Commission in support of its policy reform programme in the sector of the legal professions.

The fourth part of this paper will combine the insights from the economic and legal analyses in previous sections, in order to formulate a number of policy guidelines. These guidelines will focus not only on the assessment of exclusive rights and fee restrictions but will also discuss the features of the regulatory framework that seems desirable to enhance beneficial competition in the legal professions. In this respect, particular attention will be given to the proposed reforms of the regulatory framework in European common law jurisdictions (England/Wales, Ireland). These reforms create scope for competition between self-regulatory bodies, which may make it possible to fully profit from the advantages of self-regulation whilst at the same time minimizing its disadvantages. Finally, the fifth part will summarize the main conclusions.

## **2. Regulation of the markets for legal services: public interests, private interests and rules of competition law**

### **2.1. Public interest theories of regulation**

A vast economic literature has shown that free markets for legal services may not produce efficient outcomes. There are three market failures which may impede a full satisfaction of consumers' wishes: asymmetric information, externalities and undersupply

of public goods. Besides market failures, also distributional goals or mere paternalism may be the driving force of public interest regulation of the markets for legal services.

### 2.1.1. Information asymmetry

While the legal professionals have perfect information about the services they are selling, consumers may not be able to assess the quality before purchase (absence of search qualities) and may, therefore, base their decision mainly on prices. If consumers cannot judge the quality of the particular service to be acquired, they will not be willing to pay a high price for high quality. On markets for experience goods that are not regularly bought and credence goods, this may result in ‘adverse selection’, that is a process of overall quality deterioration which is neatly described as a ‘market for lemons’ (Akerlof 1970). Another problem resulting from information asymmetry is ‘moral hazard’. The services provided by the legal professions call for a high degree of integrity, characterized by direct or fiduciary relations with clients. Moral hazard is a problem common in principal-agent relationships plagued by information problems. It implies that there is a discrepancy between the goals of the provider of the service (agent) and the objectives of the client (principal). Since the principal cannot express the price-quality relationship he or she desires, the agent has an incentive to over-supply quality in order to charge higher prices, even if the client would be better served with a lower quality at a more reasonable price. There is also the risk that the agent will supply services the client does not need (supplier induced demand).

The quality of the services provided by lawyers has three dimensions (see Plug et al. 2003, p. 29): integrity (impartiality and trustworthiness), legal quality (quality of the given advice, adequacy of legal representation in courts, quality of notarial acts) and commercial quality (treatment of consumers). Only the latter dimension of quality is easily observable for consumers. As to the quality of legal counseling, the client does not know whether the lawyer has spent optimal efforts on the case and the given advice is appropriate. With respect to defending clients’ interests in courts, it is difficult to assess whether the advocate has used all arguments which could have had a positive bearing on the outcome of the case. In the field of services provided by Latin notaries, the key element of legal quality is how well the preferences of the contracting parties have been laid down in the authenticated legal document. It is hard to find out whether the notary requested and obtained all necessary information from the client. It is also time consuming to check whether the notary’s research (for example, on the existence of mortgages on the real estate sold) has been adequate (Nahuis and Noailly 2005, p. 30). In

some markets for legal services the information problems may be mitigated by the ‘repeat purchase mechanism’. Consumers may be professional buyers who regularly purchase the professional services, so that markets may function efficiently. Whereas large corporate clients, who may have in-house legal counsels, may be able to judge the quality provided, this is not always possible for small firms or individuals who occasionally need a lawyer.

### 2.1.2. Negative externalities

When a legal professional provides sub-optimal quality, not only the consumer of the service but also other individuals, not involved in the transaction, may be harmed. A first legal remedy to the problem of negative externalities is liability law. The prospect to be held liable in damages should give incentives to potential wrongdoers to adapt their behaviour. Economic analysis of law has shown that liability rules may achieve optimal deterrence of wrongful acts under a limited set of assumptions (Shavell 1987). In the case of a strict liability rule, compensation is due if there is a causal link between the act of the wrongdoer and the harm suffered. This rule only provides incentives to take efficient care if the amount of compensation equals the actual size of the harm. This will not be the case if the judge cannot perfectly assess the size of the externalities. In the case of a negligence rule, the judge must decide whether the wrongdoer has chosen the legally required level of care. Again, the awarded compensation must equal the actual harm. An additional problem under the negligence rule is that it will only lead to an efficient outcome if the legally required level of care equals the efficient level of care. This will not be the case if the judge has insufficient information to assess the marginal benefit and cost of additional care. Moreover, under both negligence and strict liability, the requirement of causation may not be easily satisfied, so that liability rules will not be able to fully internalize the negative externalities caused by poor performance of legal professionals. All of the above shortcomings of the liability system manifest themselves in the markets for legal services, and thus seem to justify regulation.

Regulation may overcome quality deterioration caused by negative externalities. In contrast with liability law, which operates *ex post* after harm has occurred, regulation fixes quality standards *ex ante* and may thus prevent that unqualified professionals enter the market. Economic analysis of law has advanced a number of reasons why regulation may be preferred to liability rules: i) governments may have better information than judges to decide optimal levels of care; ii) regulation is enforced by criminal sanctions which may have a greater deterrent effect than the duty to compensate, in particular when

the defendant is ‘judgement proof’<sup>2</sup>, and iii) liability claims may not be brought if the damage is widely spread among individuals (rational apathy problem) or causation cannot be proven (Shavell 1984). However, in the field of legal services, information deficiencies may also exist on the side of public authorities and the administrative costs of fixing quality standards may be (very) high. To set efficient quality levels, the legislator must know how to measure quality, which may be as difficult as it is for courts to handle malpractice cases. Therefore, input related regulatory measures, such as requiring appropriate education and on-the-job training may be preferable to output related quality standards. The information problems faced by public regulators also provide an important argument in favour of self-regulation (see section 2.2.2).

### 2.1.3. Under-provision of public goods

In a free market public goods tend to be under-produced, since the producer cannot exclude non-paying beneficiaries. To guarantee that public goods are provided, states may decide to enact regulations on the provision of public services. Legal professionals generate important positive externalities that are of great value for society in general. Lawyers play a crucial role in the proper administration of justice and Latin notaries contribute to legal certainty by authenticating transfers of legal property. The regulation of the transfer of ownership (conveyancing services) may be considered necessary because there is a strong public interest in ensuring that property rights are well-defined and cheaply enforced. For example, the Latin notary exerts an *ex ante* control of the quality of the transactions (including existence of debts for which the buyer may be liable and availability of building permits). In this way *ex post* transaction costs, such as litigation costs, are reduced or even totally eliminated (Arruñada 1996). This intervention does not only create benefits for the direct contract parties but also for third parties (banks providing loans, later buyers) and society at large (legal certainty), which is why the Latin notary’s task is classified as a public function.

### 2.1.4. Other public interest arguments

Regulation of markets for legal services may also pursue public interest goals other than correction of market failures (information asymmetry, externalities, public goods). Governments may be inspired by goals of distributive justice or by mere paternalism.

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<sup>2</sup> This means that the amount of compensation due is higher than the assets of the defendant. If the latter is unable to pay full compensation, he or she will not consider the full size of the externalities in reaching decisions on law compliance and will not sufficiently be deterred to engage in harmful behaviour. Criminal sanctions, in particular imprisonment, may solve this problem of under-deterrence. See Shavell 1986.

Price regulation (maximum prices) may ensure access to legal services for low-income individuals and guarantee protection of constitutionally safeguarded rights. Besides distributional motives, governments may also consider it necessary to force laymen to get legal assistance when they engage in important transactions.

## 2.2. Private interest theories of regulation, in particular self-regulation

The public interest theories are challenged by private interest theories of professional regulation, which stress that regulatory measures may be enacted to reduce competition and increase profits for professionals, without generating outweighing benefits for society at large. This risk is deemed to be particularly serious if regulatory powers are delegated to professional associations.

### 2.2.1. Rent-seeking and regulatory capture

In contrast with public interest theories, many commentators argue that regulation of professional services is better explained by rent-seeking behaviour and regulatory capture. Given the large number of professionals, cartels are difficult to organize and to monitor. Regulation ensures the stability of cartels and generates economic rents (Arnauld and Friedland 1977). Cartels will not endure in the absence of entry barriers, but professional regulation prevents new firms or firms active in other areas to enter the market. Restrictions on entry decrease the supply of professionals below the social optimum; rules on conduct (in particular regulated fees) increase prices and income of professionals. Public Choice theories<sup>3</sup> suggest that the professions may be effective lobbyists and that politicians, seeking re-election, will not be open to changes that eliminate the economic rents of the professionals. As long as the number of new entrants to a profession generates a flow of political rents from the restrictions of competition exceeding the one-time gains from eliminating them, politicians will not have an incentive to change the rules on entry and conduct. According to the theory of regulatory capture, regulators will tend to identify with the interests of the regulated industry, rather than the public interest. This is not because government officials are corrupt but because they must rely on information provided by the industry to enact regulation. The professions may abuse their information advantage to prevent the government, which exercises regulatory oversight, from striking down disproportionate anti-competitive rules. Self-regulation has been described as the ultimate form of regulatory capture (Kay 1998).

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<sup>3</sup> See in general Mueller 2003 and on the professions Van den Bergh and Faure, 1991

Relying on theoretical economic literature, several arguments can be advanced to support the hypothesis that the legal professions may abuse their self-regulatory powers to restrict competition and earn substantial economic rents. The legal professions satisfy all criteria to be qualified as powerful interest groups: they are small, well organized and able to cope with the free riding problem through compulsory membership of the professional bodies. Such small groups will become effective lobbies if the financial interests are sufficiently concentrated so that the potential benefits from organising and lobbying for governmental favours will exceed the associated costs. Consumer interests are more diffuse; the costs of organising consumers to avoid wealth transfers are relatively high and will exceed the expected gains from doing so. When there are sound public interest arguments in favour of regulation, the scope for regulatory capture increases since it is difficult to identify the rent-seeking behaviour and private interest restrictions may be more easily enacted. Conversely, the mere fact that restrictions of competition are the result of self-regulation does not imply that professionals earn excessive economic rents since those restrictions may also be consistent with public interest arguments (for example, remedies to asymmetric information). As a consequence rent-seeking is difficult to detect and regulatory capture by powerful professional associations becomes more likely.

### 2.2.2. Governmental regulation or self-regulation?

There is a vast literature (both economic and legal) discussing the advantages and disadvantages of self-regulation. On the positive side, several arguments have been advanced to support the superiority of self-regulation over regulation issued by the state.<sup>4</sup> First, a self-regulatory regime profits from the fact that the members of a profession possess significant information advantages. Compared to the state, the professions have better knowledge of the ways to guarantee quality and are also better able to monitor compliance and enforce the necessary rules. Self-regulation minimizes the information costs for the formulation and interpretation of quality standards. Second, enforcement costs of a self-regulatory regime may be lower. Thanks to the information advantages of self-regulatory agencies monitoring and enforcement costs are reduced. Professionals also will feel more committed to rules protecting the high standard of the profession enacted by themselves than to statutory regulations on quality. Third, self-regulatory bodies may be less bureaucratic than the state and may therefore draft and review regulations more easily. The argument goes that rules enacted by professional

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<sup>4</sup> The classic reference is Miller, 1985. See also Ogus 1995 and Van den Bergh 2006.

associations are more flexible and therefore less likely to stifle innovation or excessively limit consumer choice. The fourth argument in favour of self-regulation relates to its lower administrative costs. Public regulation is costly to tax payers, some of whom do not consume the product. In the case of self-regulation, costs are borne by the regulated sectors of the economy. Professional bodies can finance the costs of regulation through fees on their membership.

On the negative side, problems arise due to the lack of democratic legitimacy and the increased scope for unnecessary and disproportionate restrictions of competition. Self-regulatory bodies are not accountable through normal democratic channels and third parties usually do not participate in establishing the self-regulatory regime. In a democracy, it is not necessarily justified that members of a profession can enact rules on market entry and conduct without any control of democratically elected Parliaments. The absence of a significant lay/consumer input into the decision making process exacerbates the problem. If consumers are not well-organized and if there is no countervailing power at the buyers' side, the views of consumers will not be sufficiently taken into account. In addition, it should be emphasized that the benefits of self-regulation will materialize only if self-regulatory bodies do not abuse their powers to restrict competition. Self-regulation has been described as a social contract between society and the profession which mitigates the problems arising from the information asymmetry (Dingwall and Fenn 1987). However, the reduction of information costs will be achieved only if the self-regulatory bodies have sufficient incentives to control and enforce quality standards. Also the contentions about the greater flexibility of self-regulation are subject to the *caveat* that self-regulation is not misused to restrict competition. If the professions can limit competition, they may be able to successfully resist the competition from newcomers adopting more liberal rules. Finally, also the argument that all of the costs of regulation are borne in the market in which it is imposed does not hold if restrictions on competition persist. It is hard to see why the distribution of the costs of regulation would be split in an efficient fashion between the sellers and the buyers in non-competitive markets.

### 2.3. Rules of competition law

Competition law plays a crucial role in banning restrictions that are based on private interest motives only. These prohibitions, however, apply only to conduct of undertakings and do not extend to state measures. In the sector of the legal professions, actions of governments may be more detrimental to competition than those of (associations of) private professionals. States may cause damage to consumers and reduce overall welfare

by including restrictions of competition in their statutory laws and regulations. If the legal professions may escape from the application of the rules of competition law by invoking a ‘state compulsion defence’, the ultimate responsibility not to enact or maintain unnecessary and disproportionate restrictions of competition rests with the EU Member States.

The applicability of the EU competition rules to the liberal professions has been confirmed in the decision practice of the European Commission and the case law of the European Court of Justice. Since lawyers are to be qualified as undertakings, it logically follows that the professional body representing independent members of the legal profession is to be considered as an association of undertakings. It makes no difference that the professional body enjoys public law status, as long as it regulates the economic behaviour of its members and does not carry out typical governmental prerogatives or social tasks based on the principle of solidarity.<sup>5</sup> However, a professional body regulating professional conduct is not an association of undertakings if it is composed of a majority of representatives of public authorities and it is required to observe pre-defined public interest criteria. If the public authorities define the rules with which the professions need to comply and retain the power to adopt decisions in the last resort, the professional bodies may escape the qualification as association of undertakings, so that Article 81 EC no longer applies.<sup>6</sup>

Contrary to US antitrust law<sup>7</sup>, an important exception to the general applicability of the competition rules in the sector of the legal profession has been created in the *Wouters* case. The European Court of Justice held that not every decision of a professional body restricting competition necessarily infringes Article 81(1) of the EC Treaty. The prohibition of inter-professional co-operation between lawyers and accountants was considered “necessary for the proper practice of the profession, as organized in the Member State concerned”, despite the effects restrictive of competition that are inherent in it.<sup>8</sup> The Court was of the opinion that the lawyer’s independence, his or her duty to act in the best interest of the client and the respect of the rule of professional secrecy would be jeopardized if the lawyer is also a member of a business structure which has to control and certify the accounts of the client. As a consequence, the prohibition of multidisciplinary practices between lawyers and accountants (contained in the ethical

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<sup>5</sup> Joined cases C-159 and 160/91, *Poucet* [1993] ECR I-637; joined case C-264/01, C-306/01, C-354/01 and C-355/01, *AOK* [2004] ECR I-2493.

<sup>6</sup> Case C-309/99, *Wouters* [2002] I- 1577, at 58-64 and 68-69.

<sup>7</sup>

<sup>8</sup> Case C-309/99, *Wouters* [2002] ECR, I-1577.

rules of the Dutch Order of Advocates) escaped the prohibition of Article 81 EC. In its Communication on Competition in Professional Services, the European Commission has indicated how it will apply the *Wouters* test: i) account must be taken of the objectives of professional regulation, which are connected with public interest goals, ii) it must be examined whether the anti-competitive effects are inherent in the pursuit of the public interest objectives (necessity test), and iii) the anticompetitive effects must not go beyond what is necessary in order to ensure the proper practice of the profession (proportionality test). Meanwhile, the European Commission applied the *Wouters* test in a Belgian case and concluded that a scheme of recommended prices is not necessary to guarantee the proper practice of the profession of architect.<sup>9</sup> The Commission's view opens the door for economic analysis of public and private interest motives of self-regulation, in order to assess the necessity and proportionality of restrictions on competition.

When EU Member States approve professional rules that limit competition, the question emerges whether the State rather than the professions will bear ultimate responsibility for infringing Article 81 of the EC Treaty. There exist two possible outcomes: i) either the professions and the State are jointly liable or ii) only the State bears responsibility for the infringement of rules of European law and the professions can rely on a 'state compulsion defence'. It is settled case law that a Member State infringes Articles 3 (1)(g), 10(2) and 81 (1) of the EC Treaty if it requires or favours the adoption of agreements, decisions or concerted practices, which violate the competition provisions of the Treaty, or reinforces their effects, or where it divests its own rules of the character of legislation by delegating to private economic operators responsibility for taking decisions affecting the economic sphere.<sup>10</sup> Member States do not violate the rules of the Treaty if they exercise effective control over self-regulatory measures.<sup>11</sup> A 'state compulsion defence' operates where the State by measures of public authority requires certain anti-competitive behaviour and undertakings cannot be held accountable for infringement of Article 81 EC.

Even though EU competition law does not apply to Member States, the latter are not totally immune from liability if they enact anti-competitive regulations. State laws may be challenged on the ground that they have restrictive effects on the freedom of

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<sup>9</sup> European Commission, Decision COMP/A.38549 of 24 June 2004, *Belgian Architects' Association*, OJ 06.01.2005, L 4/10.

<sup>10</sup> Case 13/77, *Inno/ATAB* [1977] ECR 2115; case 267/86, *Van Eycke* [1988] ECR 4769; case C-2/91 *Meng* [1993] I-5751, case C-245/91, *Ohra* [1993] I-5851; case T-513/93, *CNSD* [2001] ECR II-1807.

<sup>11</sup> Case C-35/99 *Arduino et al.* [2002] ECR I-1529. The *Arduino* judgement states that a Member State does not infringe Articles 3(1)(g), 10 (2) and 81(1) of the Treaty by adopting a law or regulation which approves, on the basis of a draft produced by a professional body of Members of the Bar, a tariff fixing minimum and maximum fees for members of the profession.

establishment and/or the freedom to provide services. In the recent *Cipolla* case, the European Court of Justice decided that a minimum fee scale for in-court services reserved to licensed lawyers constitutes a restriction on the freedom to provide services (Article 49 EC Treaty). However, such restriction may be justified by overriding requirements relating to the public interest, including the protection of recipients of legal services provided by persons concerned in the administration of justice and the safeguarding of the proper administration of justice. It is for the national courts to decide whether a minimum fee scale is necessary to protect the public interest and does not go further than necessary to reach that goal. In their appreciation of the proportionality criterion, national judges should take into account that minimum fees may prevent that price competition in a market characterized by an extremely large number of lawyers leads to quality deterioration. However, the national court will also have to determine whether education requirements, rules of professional ethics and liability suffice in themselves to attain the objectives of consumer protection and the proper administration of justice.<sup>12</sup>

### **3. Theory and evidence on the effects of exclusive rights and fee restrictions in the markets for legal services**

#### 3.1. Exclusive rights

In several EU jurisdictions solicitors/barristers or advocates have the exclusive right to represent parties in courts. In many EU countries the task of drafting and authenticating certain legal documents is entrusted to Latin notaries; their professional monopoly covers real estate services (conveying real property, creating or canceling mortgages), family services (drawing up or amending marriage contracts and partnership agreements, drawing up or altering last wills, gifts and donations) and services in the area of corporate law (incorporating companies and establishing associations and foundations). At this moment, the most debated exclusive right relates to conveyancing services, *i.e.* a bundle of professional legal services related to buying and selling real estate property. In several jurisdictions, citizens and firms are required to engage one or more licensed legal professionals when they want to sell real estate property. In EU Member States, there are four regulatory models. They range from the highly regulated Latin notary system, to a less regulated lawyers' system (exclusive rights for solicitors, eventually in competition

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<sup>12</sup> Joined cases C-94/04 and C-202/04, *Cipolla*, judgement of 5 December 2006, not yet published at paras 55-70.

with licensed conveyancers), a deregulated Latin notary system (the Netherlands) and a model where legal services are provided by non-lawyers, such as real estate agents.

### 3.1.1. Economic theory

On a theoretical level, arguments may be advanced both in favour and against exclusive rights. An important positive external effect of exclusive rights is lowering the cost of judicial administration (public good). Pleading of cases in court by non-lawyers may place a high burden on judges (particularly in complex cases), whereas qualified professionals may produce better argued cases and more valuable precedent. On this basis, the common law division of the legal profession in solicitors and barristers has been defended economically (Bishop 1989).

Regulation of transfer of titles to property is deemed necessary to ensure that sellers have a valid legal title prior to a sale, that debts for which the buyer may be liable (guaranteed by mortgages on property) are identified and paid off during the course of the transaction, that taxation obligations are fulfilled and that the sales contract is properly executed. All this implies the need of a number of preliminary legal checks (control of the Land Register, building permits and compliance with environmental regulations), legal assistance in drafting the sales contract and the accompanying mortgage loan, certification of the signatures on the final contract documents and measures of execution (carrying out the payment, registration of the new ownership in the Land Register). It may be argued that the Latin notary profession provides a greater degree of legal certainty than a less regulated transfer of real estate property. The Latin notary system also allows cheaper enforcement of property rights since 'authentic acts' have imperative evidential value and can be enforced without judicial intervention, so that litigation costs are reduced. In this way, substantial negative externalities for third parties, which are due to invalid transactions, are avoided and enforcement costs are minimized. Benefits also flow to society at large since legal certainty may be considered as a public good (see also Van den Bergh and Montangie 2006). Moreover, the Latin notary system may lead to efficiency gains in terms of standardization, economies of scope (since the Latin notary performs many functions which in a deregulated market would need to be done by several service providers) and high quality of Land Registers thanks to the professional input of Latin notaries. However, if reserved tasks are coupled with numerical restrictions on entry, Latin notaries may achieve high profits to the disadvantage of consumers. Welfare losses may be substantial if exclusive rights are granted for standardised services which can be provided at a lower cost by non-regulated providers (para-professionals).

### 3.1.2. Empirical evidence

Theoretical arguments point into different directions, so that the desirability of exclusive rights remains ultimately an empirical issue. At the outset it should be noted that propositions like those of Bishop (1989) that specialisation is more efficient are difficult to test empirically: quality is very difficult to measure. Deregulation provides excellent opportunities for empirical studies, which compare market outcomes before and after the liberalisation. In the European Union, there are two interesting test cases: i) the abolishment of the monopoly of solicitors for conveyancing services in England and Wales, and ii) the deregulation of the notary profession in the Netherlands. The empirical studies on the English conveyancing market are summarized below. An overview of the empirical work on the deregulation of the Dutch notary profession is presented in section 3.2., which focuses on the economic effects of fee restrictions. Besides empirical studies on effects of deregulation, researchers may engage in a cross-country analysis comparing market outcomes in (more or less heavily) regulated markets and liberal markets. Recently, the European Commission has commissioned two such studies. The results of these studies are briefly summarized and commented upon below.

#### a. The abolishment of the solicitors' monopoly for conveyancing services in England and Wales

As far as the impact of exclusive rights on prices is concerned, the most interesting test case in Europe is the abolishment of the exclusive rights for conveyancing services in England and Wales. Since 1804 solicitors held a monopoly right for conveyancing services. In 1985, the Administration of Justice Act was passed which created a para-profession called 'licensed conveyancers', the members of which have been allowed to offer conveyancing services in competition with solicitors. Actual entry of these licensed conveyancers took place as of 1<sup>st</sup> May 1987. The abolition of the solicitors' monopoly for conveyancing services in the 1980ies was driven by public opinion that the services provided are basic and should be offered at lower prices and without undue delays.

This liberalisation was the focus of a number of empirical studies of the market changes between 1985 and 1992. A first study by Farmer, Love, Paterson and Stephen (1988) focused on the market for conveyancing services towards the end of 1986, that is after the decision on abolishing the solicitors' monopoly was taken, but before the first licensed conveyancers actually entered the market. The authors found that at that time solicitors' fees showed a downward tendency. This could be explained by the fact that solicitors

may already have been lowering their fees in anticipation of the entry of the licensed conveyancers. A later survey by Gillanders, Love, Paterson and Stephen (1992) focused (among others) on fees charged by a representative sample of solicitors for a routine conveyancing transaction in November and December of 1989, *i.e.* after the entry of the licensed conveyancers. They found lower conveyancing fees in areas where licensed conveyancers had been most active. This seems to confirm the assumption that a monopoly right causes fees to be higher and thus works to the disadvantage of clients. In 1992, Stephen, Love and Paterson (1994) undertook a similar research covering the same locations as the earlier 1989 survey and using similar data, *i.e.* quoted fees for conveyancing transactions. The researchers found that the fees quoted by solicitors were on average higher than those quoted by licensed conveyancers. However, a striking result of the research was that licensed conveyancers' fees also had risen between 1989 and 1992. Furthermore, the fees of licensed conveyancers had risen faster than those of solicitors in markets where both professions were active. The latter result seems to contradict the assumption that abolishing monopoly rights will lead to lower fees benefiting consumers.

#### b. Cross-country comparisons

In the policy debate reference is regularly made to the IHS study written for the European Commission (Paterson, Fink and Ogun 2003). This report covers a broad range of (liberal) professions: lawyers, accountants, architects, engineers and pharmacists. To simplify the very complex picture of diverging forms of professional regulation in different EU Member States and to make these data comparable, the researchers compute a regulation index. Three types of indices are constructed: one for market entry (covering rules on licensing, education requirements and quotas or economic needs tests), one for conduct (covering rules on prices/fees, advertising, location, diversification, form of business and inter-professional cooperation) and one overall index. The higher the respective index score, the more restrictive the regulation of the profession is assumed to be. According to the computed indices, the intensity of regulation clearly varies across EU Member States and professions. The relevant indices are then brought in relation with some key economic variables, which may indicate that extensive regulation serves the private interests of the regulated professions. In countries with a high level of regulation, there appears to be a proportionally smaller number of professionals who receive a relatively higher turnover per professional. Assuming a connection between volume of business per professional and excess profit, the positive relationship between the level of regulation and the volume of turnover per practising professional seems to offer some support to the private interest theories of professional regulation. The IHS Report reaches

the conclusion that “the lower regulation strategies which work in one Member State might be made to work in another, without decreasing the quality of professional services, and for the ultimate benefit of the consumer” (Paterson, Fink and Ogus, 2003, p. 6). This far-reaching conclusion has been criticized strongly.<sup>13</sup>

In 2006 the European Commission asked for an independent study of the different levels of regulation and their economic effects in European conveyancing services markets. At the moment of writing (December 2006), the final report is not yet available but preliminary findings on levels of regulation and transaction costs have already been published (see: <http://ec.europa.eu.comm/competition>, click Professional Services). As in the IHS study, the researchers calculate regulation indices and bring them into relation with market indicators. Four regulation indices are constructed: MERI (market entry regulation index), MCRI (market conduct regulation index), MII (mandatory intervention index) and CPI (consumer protection index). The researchers find that the MERI index is high in all countries with Latin notaries, with the exception of the Netherlands where important liberalisations took place (see section 3.2.2). The same result holds for the MCRI index (with the exception of the Netherlands and Austria). Also the CPI is rather high in countries with Latin notaries. Interestingly, the CPI reaches its maximum of 6 in the deregulated Dutch and Austrian market (but also in Italy) and decreases to a problematic 2,6 (very poor consumer protection) in the most heavily regulated Greek market for notarial services. Overall indices (MERI+MCRI+MII) range from a maximum of 18 (Greece) to 7,1 (Netherlands). Many countries have indices between 15 and 14 (Portugal, Belgium, Poland, France, Germany, Italy and Spain).

As far as market outcomes are concerned, the preliminary results only provide information about prices. For a sample transaction of 250.000€ with mortgage, the Nordic countries (no mandatory intervention or services provided by real estate agents) and the deregulated Dutch notary system are the cheapest: legal costs amount to 0,56 or 0,54% of the transaction value. Traditional notary systems are the most expensive: on

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<sup>13</sup> See RBB Economics 2003 for specific criticisms. On a general level, it must be stressed that correlations between regulation indices and market outcomes do not provide sufficient support for strong policy conclusions. There are both technical and conceptual problems with the methodology used. On a technical level, the index is not sufficiently precise if it does not capture the full specificity of (very) detailed legal rules. Moreover, the analysis often looks only at ‘law in the books’ and does not account for differences in levels and modes of enforcement. On a conceptual level, the regulatory indices cause problems relating to the functionality of the comparisons and institutional complementarities. The same problem (a particular market failure) may be targeted by different combinations of rules and the indices may not be sufficiently broad to cover the full interplay of country-specific legal arrangements having a bearing on the market failure under consideration. Finally, rules must be analysed within their institutional context: for example, in some countries apparently ‘soft’ prohibitions (with little regulation involved) may be enforced by means of a well-established system of social norms.

average 0,89 % of the transaction value (varying from 0,6% in Germany to 1,5 % in Italy and 2,7% in Greece). The researchers also find that in notary countries fees are incremental conditional on the value of the transaction, whereas they are flat or nearly flat in the Scandinavian countries and England. They consider the last outcome as market-driven and more just since transfers of ownership of real estate with different value will usually involve the same amount of work. The researchers concede that there may be (limited) cross-subsidization between higher and lower fees but that monopoly rents in the case of high value transactions under fixed fees are high. Finally, overall findings show a statistical positive correlation between high regulation indices and high costs (real percentages of legal fees to the transaction value) and thus seem to support the private interest theory of regulation.

### 3.2. Restrictions on fees

Mandatory fee schedules have been challenged by competition authorities as anti-competitive and against the public interest. As a response to these criticisms, governmental fee regulation has been abolished for services provided by advocates (with some exceptions, such as Germany where the liberalisation applies only to out-of-court services) but remains in place for services provided by Latin notaries (with the Netherlands as the most remarkable exception). Self-regulatory bodies have transformed mandatory fees into recommended fees' schedules. However, in the view of competition authorities, recommended fees have effects similar to mandatory fee schedules.

#### 3.2.1. Economic theory

In defence of fee restrictions, it may be argued that such measures may benefit recipients of legal services and generate positive effects on social welfare. First, fee regulations can be a useful tool to prevent the problem of 'adverse selection' (see section 2.1). Fixed fees or minimum fees may maintain the quality of services offered. Second, a maximum fee schedule may be helpful in dealing with the problem of 'moral hazard' by protecting consumers against excessive charges. Third, recommended fees can be a tool to inform consumers of the average fees to be paid for certain services. They can also alleviate the burden of drafting offers and/or negotiating individual fees. This is especially important in markets where search costs are high and where it may be useful for consumers to have information readily available.

The other side of the coin is that fee restrictions may cause considerable negative effects on social welfare. A fee restriction reduces the level of uncertainty on the supply side and may limit or exclude competition between the professionals. This is particularly true for fixed and minimum fees, which prevent any competition on prices and threaten to deprive consumers of the benefit of lower prices in a competitive market. While maximum fees at first glance would seem to be solely in the benefit of consumers, they may have the effect of leading to a levelling of prices towards the maximum fee and thus have an effect equal to that of a fixed price. Recommended fees can have a similar effect: they can facilitate co-ordination of the competitive behaviour of professionals and thus lead to higher prices to the disadvantage of the consumer. However, it is generally agreed that it may not always be possible to prevent 'cheating' or 'chiselling', and that the stability of a price cartel declines when the number of members of a certain profession is large. Finally, even though fee restrictions may be theoretically justified, they remain a very far-reaching regulatory intervention. Quality may be guaranteed by less restrictive means and, from this perspective, regulation of fees may be disproportionate.

### 3.2.2. Empirical studies

The available empirical work on fee restrictions deals either with the effects of recommended fees on prices or the consequences of deregulation.

#### a. Recommended prices

Empirical work shows that cheating or chiselling on recommended fee schedules for lawyers does indeed exist. An investigation by Stephen (1993) into the effects of recommended fees for conveyancing services in Scotland showed that the fee schedule did not prevent a large number of solicitors charging a fee that was considerably lower than the fee recommended by the professional association. Shinnick undertook research among Irish solicitors on the fees charged for conveyancing services and found that a large number of solicitors charged fees that were considerably lower than the recommended fee.<sup>14</sup> His findings were once more confirmed by joint research of Shinnick and Stephen (2000) who also undertook a survey among Irish solicitors. They found that the recommended fee was disregarded at a large scale and that a large number of solicitors were charging fees considerably lower than the recommended fee.

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<sup>14</sup> Shinnick, E. (1995), *The Market for Legal Services in Ireland*, paper presented at Irish Economic Association conference, quoted by Stephen and Love, 2000, p. 1001.

## b. Deregulation of the Dutch notary profession

Within the European Union, the 1999 Dutch Notary Act has been the most ambitious deregulation initiative in the sector of the notary profession. Whereas there was a *numerus clausus* under the old Act, in the new regime the total number of notaries in the Netherlands is no longer capped. However, entry into the Dutch notary profession is not fully liberalised. Even though quantitative entry barriers based on demographic criteria have been abolished, entry into the notary profession remains regulated. Junior notaries must submit a business plan to a supervisory committee of the public notarial oversight body for approval. Compared to the pre-liberalisation period, the mandatory work placement for junior notaries also has doubled from three to six years. The most innovative element of the new Notary Act is the change from fixed to unregulated notary fees. The fees for family services and corporate services became free immediately after the entry into force of the new Notary Act, whereas the fees for conveyancing services were gradually liberalised. As of July 2003, all notary fees in the Netherlands are free.

The deregulation of the Dutch notary profession is regularly evaluated in order to check whether the new law reaches its goals. The number of Latin notaries did not increase, as was expected, and there is a continuing concentration of notaries' offices. There are different possible explanations why the entry is slower than expected. First, the requirement of a detailed business plan may deter junior notaries who find it risky to start a new practice and prefer to join existing notary offices. Even if very few business plans are turned down, the effort of constructing one remains a burden that is not necessarily proportionate to the goal of guaranteeing professional quality (in particular validity of legal acts). Second, the so-called 'ministering duty', according to which notaries must offer a full range of services (real estate transactions, legal documents in family matters and services relating to incorporation of enterprises) has been kept intact. This implies that there is no room for specialisation and it may inhibit entry into particular segments of the markets of notarial services.

On the basis of the private interest theory of regulation, one could have expected that tariffs would decrease. Strikingly, however, the liberalisation caused a substantial increase in fees for services relating to wills, while the consumers' perception on the quality of services remained basically the same. Empirical data show that the price of a will almost doubled (increase of 97%) whereas the prices of a marriage contract and a partnership agreement increased by 60% and 39%, respectively (Commissie Evaluatie Wet op het notarisambt 2005). According to Aalbers and Dykstra (2002), the increased

tariffs were nothing more than the reflection of the normal cost-based price level. This explanation implies that the previously fixed tariffs did not cover the cost of services in the family practice and that notaries had been cross-subsidizing. The prices for real estate transactions (conveyancing services) were fully liberalised in 2003. A report by the Netherlands Bureau for Economic Policy Analysis (CPB) shows that average fees for real estate services have gone down. In the period between 2002-2004 notary fees decreased proportionate to the transaction value: for a property value of 113.500 € fees went down by 7%; more substantial price reductions were observed for transfers of more valuable real estate: 13% for a property value of 245.000 € and 21 % for a property value of 363.000 € (Nahuis and Noailly 2005).

Assessments of the Dutch deregulation also try to incorporate an analysis of the effects on quality, including aspects of integrity and accuracy of the notarial services. In this respect, it is interesting to contrast the Report of the Commission on Evaluation of the 1999 Notary Act ( Hammerstein Commission) and the Report of the Netherlands Bureau for Economic Policy Analysis (CPB), both published in September 2005. The Hammerstein Commission did not find hard evidence to support the claim that competition has led to a substantial loss of quality and reduction of professional integrity, but nevertheless admits that there is a reduced offer of information and advice to clients in the family practice. To investigate whether the fear that price competition lowers quality is justified, information on the number of corrections in the Land Register for the year 2004 was collected. It was found that errors (lack of registration or mistakes requiring corrections) were made in 1.2 percent of all acts authenticating transfer of property and creating mortgages. Differences appeared to be great across notary offices and regions, but price fighters did not perform worse than other notaries. Interviews with large commercial clients (real estate agents, mortgage agents and real estate project managers) also revealed that customer satisfaction had increased. The Report by the Netherlands Bureau for Economic Policy Analysis is more critical (Nahuis and Noailly 2005). This study casts serious doubts about the effectiveness and desirability of the reform. The authors found support for the fear that competition may deteriorate quality. Two different aspects of quality were investigated: service satisfaction as measured in consumer surveys and quality aspects that are not observable by consumers. Consumer surveys indicated that competition has a negative effect on quality, notably on the friendliness and the time spent to carry on the transaction. A comparison of the number of corrections in notarial acts at the Land Register for the years 1995 and 2003 showed that in the former year notaries in more competitive areas had a lower rate of corrections

compared to notaries in concentrated areas. This was no longer the case in 1995 and it suggests that competition leads to a deterioration of quality.

In sum, the Dutch experience shows that concerns about the effects of deregulation on the accessibility of legal services provided by notaries may be justified. On the positive side, competition has led to cost-based prices and innovation. Since cross-subsidisation of the unprofitable family practice by high fees for real estate transactions has come to an end, market transparency has increased. On the negative side, competition tends to benefit above all larger clients, since prices decreased most notably for high-value real estate closings. Ideally, liberalisation should lead to flat fees for standardised transactions. Currently, small consumers suffering from information asymmetries in the market for notarial services may be worse off: their financial benefit is lower and may be outweighed by the decreased provision of information.

#### **4. Policy guidelines**

A comparative analysis of different rules and institutions across EU countries allows discovering 'best practices' in the field of regulation of the legal services markets. Policy makers are facing the following two challenges: i) to develop 'better regulation', not necessarily less regulation, and ii) to create a regulatory framework in which the anti-competitive consequences of self-regulation are minimized while at the same time its major advantages are preserved.

##### 4.1. Guidelines for better regulation

###### 4.1.1. Regulate markets and not a profession

A completely free market carries the risk of poor quality legal services. However, asymmetric information is not a problem which can be generalized with respect to the entire legal profession. The need to regulate exists only for particular markets for legal services. From this perspective there is both too little and too much regulation. The existing regulation is also inconsistent. Uniform rules relating to entry and conduct are imposed upon professionals (advocates, solicitors/barristers), irrespective of the existence of information asymmetries in the markets where they offer their services.

The problem of too little regulation should be cured in all areas of law where laymen lack sufficient expertise and legal representation is not yet required. Concerns about adverse

selection may be justified with respect to the non regulated market for legal advice and the fields of law (administrative law, labour law) where representation in court is not required. The White Paper of the British government mentions that damage occurs often on the markets of non regulated services and mentions explicitly the practice of claims managers (Department for Constitutional Affairs 2005, p. 52). The regulatory deficit may be cured by requiring representation by legally qualified professionals in all areas of law where citizens lack sufficient expertise to assess quality. The problem of too much regulation should be cured by abolishing legal representation or the duty to buy services from licensed legal professionals in markets for standard transactions where there is a sufficiently large group of informed consumers. In such markets, competition from non lawyers may reduce prices and benefit consumers.

#### 4.1.2. Investigate the proportionality of regulation by means of a cost-benefit analysis

The requirement of proportionality has been firmly established in European law, but its implementation in practice still causes problems. How can it be assessed that self-regulatory rules do not go further than necessary to achieve a goal of public interest, in particular correction of market failures? A first indication may be the co-existence of several restrictions which are all justified by the same public interest motive. In such cases, one might conclude that the cumulative effect of existing restrictions makes the achievement of the public interest goal too costly. Besides from the cumulative effect of restrictions, the proportionality of (self-) regulation may be assessed on the basis of a cost-benefit analysis. A recurrent problem is that costs are relatively easy to quantify but that benefits (in particular, the quality of services offered) are much more difficult to capture in economic terms. However, in many cases a rough assessment of the benefits in qualitative terms (either high or low) may be possible. As a guideline for policy making one could then adopt a rule of thumb according to which (self-)regulation with high costs and low benefits should be removed, regulation with low costs and high benefits should be kept and other regulation should be modified (Copenhagen Economics 2006).

##### a. Exclusive rights

In some markets for legal services it may be possible to remove exclusive rights and to guarantee quality through less restrictive means. Under title protection, the regulated legal profession enjoys protection of its title but is not able to exclude competing providers of services. For example, the title of advocate may be used only by individuals

who are member of the professional body but other providers of legal services may become active on the market. Depending on their education and the fields of their activities each group of professionals will use a different title. Since title protection functions as a quality signal it mitigates the problem of information asymmetry. At the same time it possesses the advantage of preserving freedom of choice, which gets lost if quality is regulated. Title protection may be a viable alternative to the current system of exclusive rights in legal markets involving standardized and less complex legal services. Title protection may be made dependent on the fulfilment of education requirements which guarantee a minimum level of legal knowledge. In this way, some legal services markets may be opened up to para-professionals who have a limited legal training (for example, one or two years including a period of apprenticeship) sufficient for executing standardized tasks. An inspiring example is the market for conveyancing services, where real estate agents could be allowed to compete under their professional title with Latin notaries and licensed conveyancers. Conversely, reserved tasks should be kept for complex legal services. In the latter case the requirement of legal representation in court generates high benefits since it cures three market failures: it is a remedy to severe problems of asymmetric information and the ensuing risk of adverse selection; it prevents negative externalities for judges who will not be burdened by inadequate advocacy; and contributes to a better administration of justice (supply of a public good). At the same time, the costs of exclusive rights are low since beneficial competition is not restricted by the exclusion of unqualified providers.

#### b. Fee regulation

A cost-benefit reappraisal of regulated fees may profit from the following insights. Even though a theoretical argument can be made in favour of minimum prices to guarantee quality, such a remedy seems disproportionate given the substantial negative effects on competition and the availability of alternative measures to prevent quality deterioration. By contrast, maximum prices deserve a more benign treatment since they may be method to overcome the double monopoly mark-up problem (Spengler 1950). For example, maximum fee schedules may reduce prices to be paid by English and Irish consumers who cannot buy services from legal disciplinary practices and have to pay solicitors and barristers separately. In addition, a maximum fee schedule may be helpful in dealing with the problem of moral hazard. Also, fee regulation may be considered as an instrument to guarantee equal access to justice. Finally, a more lenient approach toward recommended fee schedules seems advisable. Economic analysis has shown that competition authorities too easily assimilate recommended fees with fixed fees. There is empirical evidence

showing that there is a lot of ‘cheating’ on recommended prices (see section 4.2.2). In addition, recommended fees can be a useful tool to inform consumers of the average costs of certain services and they can also alleviate the burden of drafting offers and/or negotiating individual fees. That way, recommended fees may reduce transaction costs and thus lead to lower fees. This is especially true in markets where search costs are high and where it may be useful for consumers to have information readily available. In a cost-benefit analysis, the savings in transaction costs should not be neglected and a serious enquiry is necessary as to whether the recommended fees are effectively charged.

#### 4.2. The desirability of an independent Regulatory Authority for the Legal Services Markets

Self-regulation is criticized mainly because it enables the legal professions to restrict competition and harm the consumers' interests. In spite of these criticisms, it is important to preserve the valuable input of experienced, knowledgeable legal professionals into the regulatory process and keep the benefits of better compliance with self-regulatory rules (lower enforcement costs). The new regulatory framework proposed in England/Wales <sup>15</sup>, which is based on the findings of the Clementi report (Review of the Regulatory Framework for Legal Services in England and Wales 2004), may be able to maximize the net benefits of self-regulation. The Legal Services Bill proposes the creation of a single external oversight body for all legal professions in England and Wales (solicitors, barristers, trademark attorneys, patent agents, conveyancers, ...) The newly created Legal Services Board will be composed of a majority of members who may not be practicing members of the legal professions. Also the head of the new authority will be a non-lawyer. The Legal Services Board may enact new regulations relating to the provision of legal services, in particular the establishment of minimum quality requirements. In addition, the new authority may delegate regulatory functions to already existing self-regulatory bodies. Regulatory functions may be vested also in newly created self-regulatory bodies when new providers of legal services (eventually in the form of alternative business organisations) enter the market. These self-regulatory bodies are called ‘front line regulators’. These regulators that sit underneath the Legal Services Board are not permitted to exercise representative functions, next to their regulatory functions. The Legal Services Board has the power to issue regulatory guidance to the front line regulators, to direct them to take a specific regulatory action, to amend or to veto rules of front line regulators and to remove the authorisation of one of the latter bodies in a particular area or areas of regulation. A final key point is that also a separate

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<sup>15</sup> A similar proposal has been made in Ireland, see Irish Competition Authority 2006.

body for handling consumer complaints will be established. The Office for Single Complaints should handle cases with adequate speed and efficacy.

Under the new English regulatory structure, day-to-day regulation is left in the hands of the front line regulators, such as the existing self-regulatory bodies, which can fully profit from their information advantages in formulating rules which should guarantee an optimal quality of legal services. At the same time, the risk of anti-competitive practices is reduced since the front line regulators remain subject to constant oversight by the Legal Services Board, which has the power to veto rules, ask to enact new rules and even withdraw the authorisation to regulate a specific legal services market. Moreover, democratic legitimacy is guaranteed by creating an independent, transparent and accountable oversight body which is composed of a majority of non-lawyers. A major advantage of the Clementi model is that it allows competitive self-regulation, *i.e.* competition between different groups of qualified legal professionals which each decide their own rules of conduct. Competitive self-regulation is in essence no different from competition between national public regulatory regimes (see Kerber 2000 and Van den Bergh 2000). In spite of the important benefits such a competition may bring about in terms of more efficient and innovative legal rules, it is heavily debated whether regulatory competition will lead to a ‘race to the bottom’ rather than a ‘race to the top’. However, the proposed Regulatory Authority may counter the potential risk of quality deterioration in the markets for legal services by making the delegation of regulatory powers dependent on the respect for certain minimum quality standards. Under traditional forms of co-regulation, a central regulator (usually the competent Minister) approves the rules, practices and procedures of the professional bodies *ex post*. Under competitive self-regulation, the role for the state is to organise the competition between the different professional self-regulatory bodies and, if necessary, subject this competition to a set of minimum quality standards (*ex ante* control). The Clementi model of competing self-regulatory bodies, which are subject to oversight by an independent Regulatory Authority, combines traditional co-regulation (approval of self-regulatory rules by governmental bodies) with modern competitive-self-regulation.

Policy makers should fully investigate the potential advantages of competitive self-regulation for overcoming harmful restrictions on competition. Existing self-regulatory bodies may decide diverging rules on fees: some may retain the traditional method of calculating fees based on hours spent, whereas others may opt in favour of flat fees (in particular for standardised transactions) and different types of contingent-fee contracts (‘no cure no pay’, *pars quota litis*, mark-up if the case is won). Moreover, the Clementi

model allows delegation of regulatory powers to new entrants in the legal services markets, who can establish their own self-regulatory bodies. New self-regulatory bodies may enhance competition by adopting innovative ways of doing business: for example, new forms of multi-disciplinary partnerships or hiring non-lawyers as managers of the law firm. The advantages of competitive self-regulation will be the more significant the more competing self-regulatory bodies will become active in the different segments of the broad legal services markets. Different self-regulatory bodies may compete in the markets for legal advice in different areas of law, representation in courts (again further divided based on the field of law), and conveyancing services. For example, business lawyers, legal employees of insurance companies, and trade union lawyers may all be granted the right to conduct litigation, subject to the 'accreditation' of their self-regulatory bodies by the oversight Regulatory Authority. In civil law jurisdictions, the number of competing self-regulatory bodies may be further increased by breaking-up existing monopolist 'Orders of Advocates'. One should acknowledge that the current group of advocates is very diverse, ranging from one-person enterprises active in many areas of law to mid-size firms and large international law firms specialised in particular fields of law. It is by no means evident that this large and diverse group of lawyers should be regulated by a single regulatory body.

## **5. Conclusions**

The main conclusions of this paper can be briefly summarized as follows. Regulation of the legal professions, including self-regulation, contains several restrictions of competition, such as exclusive rights and regulated fees. These restrictions of competition may be justified by public interest arguments. They may be a remedy to market failures (asymmetric information, negative externalities, public goods) and may also be based on distributional motives or paternalistic grounds. However, public interest theories of regulation are challenged by private interest theories. Professional regulation is seen as successful rent-seeking, since it generates cartel-like effects. In particular self-regulation is often thought to be abused to serve mainly the private interests of the legal professions since the scope for anti-competitive effects increases if professional bodies enact their own rules. Since regulation, including self-regulation, of the legal professions can be explained on both public and private interest grounds, the major policy challenge is to identify the restrictions which are not necessary or disproportionate to achieve public interest goals. Competition law may play a major role in this respect, except for restrictions that are contained in state regulation and, therefore, need to be removed by legislative action.

With respect to the regulation of the legal professions in England/Wales and the Netherlands, many of the theoretical insights of the Law and Economics literature have been empirically tested. The results are ambiguous: whereas there is some evidence to confirm the private interest theory of regulation, there is also some support for the public interest theory. On the one hand, the threat of new entry lowers fees of incumbent professionals, which indicates that super-competitive profits were earned by the regulated profession. The English experience also shows that effective price competition for standardised legal services (such as conveyancing) requires a large number of suppliers, including both legal and non-legal service providers. On the other hand, the concern about decreasing quality after the deregulation of the Dutch notary profession indicates that the risk of adverse selection may support regulation. Price competition brings an end to cross-subsidisation and may incite professionals to decrease costs by lowering the level of information provided.

A comparative and economic analysis of the regulation, including self-regulation, of the legal professions reveals a number of best practices and allows the formulation of policy conclusions. There should neither be too much nor too little regulation. Regulation should not be profession-focused but targeted at market failures in particular segments of the legal services market. Cost-benefit analysis is useful to assess the proportionality of the restrictions of competition. Competition authorities attach great priority to abolishing restrictions on fees and advertising. Even though this may be an important way forward, more important issues remain. Removing control over entry and conduct from monopolist regulatory bodies and creating scope for competitive self-regulation may allow maximising the net advantages of self-regulation in the legal professions. In this respect, the new English regulatory infrastructure may become a blueprint for other European jurisdictions.

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