

## **Position paper**

on the study carried out by the Institute for Advanced Studies, Vienna:

*„Economic Impact of Regulation in the Field of  
Liberal Professions in Different Member States“*

commissioned by the Hans-Soldan-Stiftung

drafted by

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## **I. Introduction**

The object of the position paper is the Study carried out by the Institute for Advanced Studies (*Institut für Höhere Studien, IHS*), Vienna, which was commissioned by the Competition Directorate-General in January 2003: “Economic Impact of Regulation in the Field of Liberal Professions in Different Member States”.

The authors of the present position paper have been researching and comparing the regulations governing the legal profession across Europe for many years. Professor Henssler, one of the authors, is also the Director of the Documentation Centre for the Law of the Legal Profession in Europe, a unique research institution in Europe in the area of the professional rules and regulations governing the professions of lawyer and notary. He is also the publisher of the fundamental work of reference “Anwaltliche Tätigkeit in Europa”, which was used by the IHS for the Study (cf p. 21 of the Study). Co-author Dr. Kilian is also a member of the board of the Institute for Law Firm Management which conducts empirical research into the legal profession and was established by the Hans-Soldan-Stiftung.

The position paper on the IHS Study discusses the main findings of the Study (ad II) before examining its methodology (ad III) and evaluating individually various problem areas selected by the Study (ad IV).

## **II. The IHS Study**

The IHS Study examines the question to what extent certain liberal professions – auditors/tax advisers, ‘legal advisers’, architects/engineers, and pharmacists – are regulated in the EU Member States. On the basis of its findings, the Institute established a regulation index resembling a ranking. The methodological approach underlying this index was freely chosen by the IHS and no further explanation is given regarding their choice. The Study – rather unsurprisingly – comes to the conclusion that the degree of regulation in the liberal professions examined varies considerably from one EU Member State to the next. There is no further examination of the reasons for these differences in the degree of regulation.

The interpretation of the regulation index offered by the authors of the Study is that, from an economic point of view, the aim should be as low a degree of regulation as possible, since from the economist’s and the consumer’s point of view, more intensive regulation would not lead to better results. This conclusion is drawn mainly only the basis of the assumption that

in markets with a low degree of regulation – e.g. Finland and Sweden – no market failure could be detected.

### **III. Methodology**

#### **1. Approach**

##### *a) Reservations*

A basic problem of the present Study is that in the introductory remarks regarding the chosen methodology, the authors themselves point out their reservations regarding the expressiveness of the data obtained and in particular that they mention their doubts as to the extent of professional rules and regulations being the cause for the economic effects which form the basis of the Study (cf. pp 1, 4, 5). These fundamental methodological reservations gradually disappear into the background as the Study proceeds; especially in the *Executive Summary*, which will be the only text consulted by the hasty reader, they are not made sufficiently clear.

##### *b) Indicators*

In simplified terms, the Study tries to ascertain the correlation between a certain profession's degree of regulation and the economic productivity of that profession.

According to the Study, the indicator of a profession's economic productivity is per capita turnover. This premise - that turnover is supposed to be a valuable indicator - gives rise to considerable doubts already. A more interesting and probably more appropriate indicator would surely be per capita profit, since the quota of costs varies considerably between the legal professions in the different Member States. However, the profit alone would not be a sufficient indicator in an economic assessment either since the general interest plays a major role for the liberal professions. Against this background, the focus should be on the benefit of a lawyer's services for the consumer.

Furthermore, the significance of the variable 'size of firm' within the framework of the Study remains unclear. The size of an undertaking may be determined by professional regulations – like in Italy, for example -, but also by the economic structure of the country in question. Thus, even in Member States with a high level of centralisation of the legal advice market – e.g. the Netherlands and England – we find undertakings that are larger than the average size although the conditions for incorporation are not more favourable than in Germany, for example. It is not understandable why the size of a firm is relevant if the chosen efficiency indicator is supposed not to be profit, but turnover. Large firms have a considerably higher

quota of costs (up to 70%) than small, specialist firms or across-the-board firms. Thus, the profit is relatively lower in comparison with the turnover, which means that there is no apparent relevance in the data on volume of turnover and size.

c) The purpose of regulation

Whatever one's position regarding this – decisive – choice of methodology may be, the fact remains that a purely economic approach leaves out the core problem: the question as to the function of the regulation of a certain aspect of professional activity. The purely economic approach chosen by the authors of the Study is ultimately based on the assumption that regulation serves the interest of the professionals in a sealed-off market and in optimizing their profits.

This approach has nothing to do with the original function of professional rules and regulations, since the relevant regulations governing professional practice must indeed not serve the interests of a particular group (e.g. the legal profession), but have to be justified by 'sensible considerations in the public interest', in order to be valid under constitutional law. Under European law and according to ECJ case-law, taking up and practising certain liberal professions may be made dependent on compliance with certain legal and administrative regulations, such as regulations regarding organisation, qualification, professional duties, control and liability, which are justified with overriding reasons in the public interest (*Thieffry* [1977] ECR 765, paragraph 12). As a condition, these must be non-discriminatory and appropriate for ensuring attainment of the objective they pursue and must not go beyond what is necessary for that purpose (cf. *Kraus* [1993] ECR I - 1663, paragraph 32).

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 – e.g. the limitation of the number of main areas of activity which may be mentioned under German competition law applying to lawyers – 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. The Study fails to take this reason for the existence of professional rules governing the legal profession into account; it treats all limitations identically without asking for the reasons of their existence and without weighing them accordingly.

Professional rules and regulations exist mainly to

- ensure access to justice,
- admit only high-quality services on the market, with a view to attaining material justice

- reduce as much as possible the potential of disadvantages for the consumer which is inevitable because of the very nature of the client-lawyer relationship (principal/agent relationship).

This objective of professional rules has been recognised repeatedly by the ECJ. The Court has confirmed provisions which safeguard quality standards in the provision of legal advice despite the resulting restriction placed on the free movement of goods and services.

In the decision C-76/90, European Court report 1991, 807, paragraphs 16 and 17, the Court is very clear:

*“In that respect, it should first be pointed out that national legislation, such as that described by the national court, is clearly intended to protect the recipients of the services in question against the harm which they could suffer as a result of legal advice given to them by persons who did not possess the necessary professional or personal qualifications. It should next be stated that the public interest in the protection of the recipients of the services in question against such harm justifies a restriction of the freedom to provide services.”*

d) The objective of deregulation

If we follow the assumption which is apparently the basis of the present Study and according to which a low level of regulation of lawyers spurs the market of lawyers' services in the interest of the economy and thus indirectly in the interest of the individual, the fundamental question still remains to be answered: In such a market - which is apparently considered to be the ideal - will access to justice for the citizen be improved, will the citizen receive higher-quality services or at least services of the same quality and will possible disadvantage potentials be met as effectively as in a regulated market? To all these questions - essential for the policy deliberations on deregulation - the Study does not provide empirically robust answers; the Study's findings are rather based on mere assumptions.

e) Benchmarking

Another problem arises from the fact that the Study does not only compare an ideal, deregulated and abstract market with a regulated and really existing one, but defines a largely deregulated market as a benchmark for markets with a higher level of regulation. A comparison is only thinkable, however, when there is certainty as to whether in this market which is defined as a benchmark,

- the demand for legal services, which is a result of the legal environment, the social and economic structure of the society in question, is comparable
- access to justice is really better

- the quality of problem-solving is the same
- consumer protection is at least equally good

compared with more strictly regulated markets.

The Study fails to provide such a comparison, not least because 15 legal professions which act in markets with hardly identical structures and whose work substance, the national law, varies greatly, cannot be compared by way of indexation. The reference framework of their activity, i.e. the legal system, is not – in contrast to other liberal professions like doctors, engineers or, to some extent, auditors – identical across the Member States, but characterised by national particularities. These may make a certain rule necessary in one legal system and at the same time make such a rule seem expendable in another. The chosen benchmarking approach, however, creates the impression that one particular legal regime which may have - because of its structure and tradition – specific requirements as to the regulation of lawyers working in that system, may also be regarded as the foundation underlying the regulatory provisions for lawyers in the other 14 Member States. The regulation of a profession which is characterised by the national particularities of the legal framework it acts in, can hardly be the object of serious benchmarking. It is exactly these national particularities of the legal profession, however, which are emphasised in established ECJ case-law.

f) Market failure

The chosen benchmark rests on the assumption that no market failure can be identified in markets with a low degree of regulation. The authors do not give any facts to corroborate this assumption. It would be impossible to support it with the employed methodology anyway since such an assumption cannot be based on the comparison of data which were collected from isolated bodies which do not possess legal comparative knowledge and are not capable of a *relative* assessment of the situation in their legal system.

Market failure has to be assessed on the basis of the extent to which regulation prevents the satisfaction of the population's needs regarding legal services. Thus, in the framework of a study, it should be clarified to what extent regulation creates access barriers through, for example, costs, information deficits or threshold anxieties, instead of removing them. An appropriate evaluation is however impossible if it is done simply by analysing existing professional rules and regulations; it requires an analysis of the legal system as such. Some provisions, when they are put into the context of the overall system, improve access to

justice even though they appear to have the opposite effect when we look at them separately (cf. below).

The authors of the present Study do not seem to have taken such considerations into account, which would have served as 'control mechanism'. The Study does not even analyse the deregulated Finnish market, which is presented as the ideal market, in greater detail, in order to verify if there is indeed no market failure. Nor do the authors make an effort to establish any kind of indicators for market failure and substantiate these empirically. Thus, the question remains open as to why Finnish providers of legal expenses insurance decided in the early 1980s, in spite of deregulation of the legal services market, to include additional clauses in their insurance policies according to which the insured had a duty (!) to engage a lawyer for the legal procedure 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 (*Arti*, Legal protection in Europe 1984/3, pp.8, 13).

Also, it would have been worthwhile to look into the fact that the Finnish State employs around 10% of all lawyers as civil servants in 67 legal advice centres which are run by the State (with a population of only 4 million), thus investing a considerable amount of its resources into providing access to legal advice by lawyers to the population. 75% of the Finnish population have a right to make use of such services and do not have to 'buy' them on the free, deregulated market.

Nor has any relevant literature been taken into account which criticizes the quality of legal services provided by non-lawyers in Finland. *Lindholm* (cf. *Fran advokatens arbetsfalt*, Helsinki 1994, p.227) and *Letto-Vanamo* (cf. *Ylöstalo, Asianajajaoikeutta*, Helsinki 1985, pp. 12, 13), for example, report major quality deficits which the public is not entirely aware of because there is no clear-cut distinction between lawyers and non-lawyers providing legal advice.

*Prima facie* these random examples clearly speak against the thesis that market failure in deregulated markets is not more pronounced than in more intensively regulated ones.

#### g) Result

Against the background of the aforementioned deficits, it is unclear how valuable the regulation indices that were established are actually supposed to be. Ultimately, the present Study is a collection of hypotheses and assumptions. Only to a very limited extent does it provide an empirically sound model which, in order to provide albeit a limited insight into the

matter, would have to be checked against the status quo of the legal advice markets in the Member States.

## **2. Selection criteria and sources**

### *a) Subject*

It is incomprehensible why Denmark, England and Wales, France, Germany and Italy were selected for the case studies in the field of legal services.

Three out of the four criteria mentioned in the Study (p. 10), according to which the countries were selected (size, availability of data, geographical balance), are in no understandable way linked with the subject of the Study – regulation of the liberal professions – and thus provoke arbitrary results. The fourth selection criterion, the degree of ‘liberalisation’ that was known before the Study, is unsuitable with regard to most of the aspects under discussion because - and this is a general problem of the Study – it comes down to a limitation of the regulated aspects of professional activity from the viewpoint of professional law only. But very often professional rules and regulations can only be understood within the overall context of constitutional law, procedural law, competition law, contract law, etc. since they do not exist for their own sake. If the legal system of a Member State renounces these rules and thus creates what seems to be the intended ideal version of a deregulated market for legal services, it is thinkable that general legal principles interfere in a similar way with the market behaviour of those concerned. One should think in particular of the provisions of competition law and the law of torts which are not specifically linked with the profession. Thus, resorting only to professional rules and regulations is neither an appropriate selection criterion nor, as remains to be demonstrated, a suitable assessment criterion. An agenda which aims at deregulation of the legal services market through liberalization of professional law, ignores the fact that often professional law simply defines general legal principles in the specific context of a particular profession.

A particularly serious shortcoming of the Study is the fact that the two countries with a low degree of regulation, Finland and Sweden, which are ultimately presented as the ideal marketplace, are not analysed in detail. This is even more deplorable since a detailed and recent study on the legal profession in Sweden and Finland does exist (*Pretzell, Rechtsanwaltschaft in Finland, Schweden und Norwegen, 1997*).

b) Sources

The sources which form the basis of the Study are not convincing. For the main part, the Study rests on questionnaires which were sent to the professional organisations – and returned only by a few – and on secondary sources which were chosen for incomprehensible reasons.

According to our own experience with the collection of information on professional law by way of standardized questionnaires, the results obtained are only partly useful. They cannot say anything about, in particular, the reasons behind professional laws nor about their relevance in a legal system. However, information about these two aspects is indispensable with a view to assessing the need for such rules and their effects on the behaviour of market participants.

Therefore it is generally necessary to substantiate the results through independent interpretation of primary and secondary sources. At least for the profession of lawyer there is a large number of reference works which have not been evaluated in the framework of the Study. There are comprehensive studies on the legal profession in Sweden, Finland, Norway (respectively *Pretzell*, *Anwaltsrecht in Schweden, Finnland und Norwegen*, 1997), France (*Hamelin/Damien*, *Les règles de la profession d'avocat*, 2000; *Damien*, *La Profession d'avocat*, 1991, *Martin*, *Déontologie de l'avocat*, 1995; *Soulez Larivière*, *L'avocature*, 1995, *Henrichfreise*, *Frankreichs Anwaltschaft im Wandel*, 1992; *Nießén*, *Frankreichs Anwaltschaft*, 1995), England and Wales (*Remmert*, *Anwaltschaft zwischen Tradition und Wettbewerb - Das Berufs- und Standesrecht der Rechtsanwälte in England und Deutschland*, 1996; *Wegerich*, *Das englische Anwaltsrecht*, 1992), Ireland (*O'Callahan*, *The Law on Solicitors in Ireland*, 2000), Italy (*Vockenber*, *Berufsrechtliche Probleme des deutschen und italienischen Berufsrechts*, 2000), Spain (*Odenbach*, *Spanisches Anwaltsrecht*, 1995), Portugal (*Arnaut*, *Inicição à Advocacia*, 1996), Denmark (*Blomquist*, *Lawyers Ethics*, 2000) and Austria (*Loimer*, *Der österreichische Rechtsanwalt in der Europäischen Union*, 1996). Comparative studies on EU lawyers' advertising rules are available, too (*Mälzer*, *Werbemöglichkeiten für Rechtsanwälte in der Europäischen Union*, 1995), as are studies on the rules governing remuneration (*Lenz*, *Preiswettbewerb unter Rechtsanwälten*, 1998). Furthermore, there are global overviews of the legal professions in the EU Member States by *Tyrell/Yaqub* (*The Legal Professions in the New Europe*, 1995) and *Donald-Little* (*CCBE Cross-Border Practice Compendium*, loose-leaf) which help understand the professional rules and regulations in the Member States by applying standardized sorting criteria. The evaluation of these comprehensive studies would undoubtedly have made it possible to

understand certain professional rules and their actual relevance, and to classify them accordingly.

### 3. Data

The authors concede in the Study that occasionally – from the authors' point of view – surprising data was used as a basis for the Study. The interpretation of this surprising data bespeaks a certain helplessness; no serious attempt is made to understand surprising results. For the benchmarking and the establishment of the index, the data is however used without prior correction. It is impossible to analyse the data material in detail in the framework of this position paper. Let us just point out the most conspicuous examples:

#### a) Structure of the legal profession in Germany

According to the Study there were 105,000 'professionals' in Germany in 2000. This is the basis on which per capita turnover is calculated. This leads to an imprecise result since the relatively high number of in-house lawyers has not been taken into account. According to our German understanding, in-house lawyers exercise their legal activity only in their law firm, but not in the framework of their work as employed counsel. Since according to empirical data in-house counsel use 86% of their capacities as employed counsel, i.e. not as lawyers, the income of this group of lawyers from their activity as 'lawyers', who appear in the statistics of 'Rechtsanwälte' as 'fully qualifying' professionals, is low. Since in-house counsel have been included in the calculation of the profession's overall turnover, the picture is distorted considerably because the low volume of turnover of these approximately 10,000 lawyers leads to a marked decrease in the per capita figures. It becomes even more distorted by the relatively high number of titular lawyers who, similar to in-house counsel, maintain their admission as lawyers out of an interest in the profession's pension scheme, but without significant income. There is no concept comparable to the German theory of 'double profession' of lawyers who are not exclusively active in their own legal practice, in any other legal system. The resulting imprecision may be less important if it is reflected by absolute figures which are only used for an assessment at the national level. However, if imprecise data are used in comparison with data from other countries without prior correction, they devalue the respective benchmarking exercise considerably.

#### b) Interpretation of structural data

The authors of the Study do recognise that the figures obtained simply by dividing the overall volume of turnover by the number of admitted professionals, are not representative. According to their hypothesis, one would have expected the comparably high degree of

regulation in Germany to result in a relatively high per capita turnover. However, the latter is rather at the bottom end of the ranking. The Study does not provide a sound explanation for this result; rather, the authors speculate that the reasons might be sought in German reunification (p. 96). This assumption could have been verified on the basis of the STAR-Analyses, for example, which are studies on the income structure of the German legal profession that are commissioned regularly by The German Federal Bar from the Institute on Liberal Professions. Surprisingly, these Analyses are used in the Case Study on Germany, but disregarded in the collection of benchmarking data for interpretation purposes.

*c) Up-to-dateness of data*

Furthermore, the used data material is partly outdated. Thus, the authors believe that only 45% of all university (law school) graduates in Germany become lawyers, 18% judges or public prosecutors, 27% go into civil service and 10% will work in the business sector (p. 199). This obsolete information is probably used as an indicator for the existence of market access barriers for lawyers. According to reliable estimates, much more than 70% of all graduates are now becoming lawyers.

*d) Result*

In summary it can be noted that the Case Study for Germany does present quite a lot of data, but this material is partly obsolete or it is interpreted wrongly because of a lack of detailed knowledge of the market situation. There is no way of assessing, however, if and in how far the Case Study data and the evaluations have influenced the benchmarking and the establishment of the index at all, since the Study does not reveal the respective bases that were used.

#### **IV. Evaluation of individual problem areas**

##### **1. General remarks on the Case Study**

The Case Study on the German legal profession is only seven pages long. On another eight pages economic data on lawyers as well as notaries is covered. Thus, the Case Study can only give a very brief overview of German professional rules and regulations, which is basically limited to the main provisions made by German law. The function of the Case Study in the overall context of the Study remains unclear since the results of the Study refer essentially to the regulation index and the Case Studies are ultimately reduced to ornamental accessories.

The Case Study contains imprecise information not only regarding empirical data, but also regarding presentation of the professional rules and regulations, which makes one doubt if at another stage, namely for the establishment of the regulation indices, the Study has used the correct assumptions.

- Thus, the Study maintains that the main task of German lawyers is providing advice in the areas of tax law, pension law, insurance law, patent law and insolvency law (p. 177). This is simply not the case.
- In order to describe the role of the lawyer as a representative in all legal matters, the authors refer to § 1(3) BORA (*Berufsordnung für Rechtsanwälte*, Code of Conduct) which leaves us in doubt as to whether the authors are sufficiently aware of the relationship between the statutory law governing the profession and the profession's own Code of Conduct (p.177).
- When describing the scope of the RBerG (*Rechtsberatungsgesetz*, Law on Legal Advice), the so-called *Annexkompetenz*, ancillary competence, to provide legal advice, which is very important in the corporate world, is left out. The Study also fails to mention entirely the restrictions of the monopoly granted through the RBerG which are imposed by case-law (p.178).
- In the description of the fee system, which is in principle correct, the Study does not point out that lawyers follow the statutory fee scale so closely not least because of the market power held by the insurance companies offering insurance for legal expenses (p.179).
- Clarity is also lacking with respect to the fact that the statutory fee scale also has a social dimension (p. 177), since it rests on the concept of cross-subsidization.
- Imprecision has been noted also with regard to interdisciplinary professional practice which, according to the authors, has only been permitted since the mid-1990s (p.181).
- The presentation of the ban on branch offices is ambiguous. It remains unclear if the authors start out from the idea that inter-regional firms are illegal (p. 182).

In a separate paragraph, the Study gives a brief overview – one printed page – of current developments in professional rules and regulations. With a view to the Study's objective – discovering deregulation potential - it would have been indispensable to mention reform projects which are relevant from a competition point of view. Unfortunately, the Study fails to

do so. The Study only highlights the extension of denominations for specialist lawyers and the introduction of the *Partnerschaftsgesellschaftsgesetz*, a law regulating co-operation between professionals. We learn nothing about the more recent developments concerning possibilities of incorporation as a corporate enterprise – their absence is traditionally viewed as an indicator of the lawyers' detachment from the world of competition – or about the RBerG reform debate which will restrict existing advice monopolies even further than this is already being done by rulings of the German Federal Constitutional Court. The reform of the German fee scale is mentioned in passing, but the most important piece of information in the context of the Study, which is that the objective of this reform is the complete deregulation of remuneration for extrajudicial legal activity, is missing.

## 2. 'Self-regulation'

Even though self-regulation as such is not examined, it does play a role as one of the basic assumptions underlying the Study. Self-regulation is often met with criticism because it is said – according to theory – to create disadvantage potentials for those market participants who interact with this self-regulated group. Typical concerns mentioned in connection with self-regulation are a tendency towards closing the market regarding access to the right to provide services, prevention of effective price competition and other kinds of self-restraint which inhibit competition among service providers.

Against the background of the problems which are commonly associated with self-regulation, it is essential to be aware of the fact that the German system of *Selbstverwaltung* (self-administration) of the profession through *Kammern* (bars) instituted by public law is fundamentally different from the meaning of the English term 'self-regulation' as used throughout the IHS study. The German system of professional self-administration and self-control is unknown in almost every other EU Member State. 'Self-regulation' is not identical with German self-administration as a part of indirect supervision by the State. The German model is about administration by means of a non-governmental public authority. This is made clear, for example, by the fact that the self-administrative body of the legal profession - the *Rechtsanwaltskammer* (bar) – is not identical with the *Anwaltverein* (bar association), a body constituted on the basis of voluntary membership to represent the legal profession. A merging of these functions in one body, as it is typical for example in the Anglo-Saxon legal system, is unknown under German law.

The German model of self-administration entails the obligation that each and every professional practice rule, without exemption, has to be measured against law of a higher order. In other words: The question which was also raised by the Commission in the framework of the consultation process, whether certain practice rules serve the public interest, has already been answered by the German system with the introduction of the respective norms: They can only be introduced – either by the legislator or by way of legislative powers conferred to a democratic body of the legal profession – provided they are sustained by sensible concerns for the common good and they are proportional. This criterion which follows from German constitutional law, is all the more significant since in its very core it corresponds to ECJ case-law on the admissibility of restriction on the free movement of goods and free establishment (cf. above).

The question as to which market entry regulations and conduct regulations aim at achieving a laudable objective and serve the public interest has already been answered with the particularities of German law, which are *Selbstverwaltung* and a written constitution. The concerns that are mentioned in connection with the public interest are always access of the population to justice and to high-quality legal advice, consumer protection and the guarantee of a functioning administration of justice.

On the other hand, such a system makes a number of modern forms of legal practice admissible because of the strict public interest requirements regarding regulation, and because these forms are not opposed by legislative barriers: We would like to point out legal practice in multidisciplinary partnerships, incorporation as a corporate enterprise, the possibility to take up a second occupation, the admissibility of unsolicited advertising or liability restrictions.

The Study remains unclear as to whether the valuation of the degree of regulation regarding the German legal profession is aware of the fact that professional regulations of the parliamentary legislator and those coming from the lawyers' self-administration interlock in such a way that the same questions are addressed by statute law (*Bundesrechtsanwaltsordnung*, Federal Lawyers' Act) on the one hand and the profession's Code of Conduct (*Berufsordnung*), which is elaborated by the profession's Statutory Assembly, on the other. Therefore, the evaluation of the Study, which only looks at the quantity of professional rules, may give rise to the erroneous impression that regulation is particularly intensive.

In the following we should like to concentrate on three aspects which received particular attention in the Study: Firstly, the aspect of market entry regulation, secondly, in the field of conduct regulation, the regulation of remuneration and thirdly, in the same area, advertising.

### **3. Market entry**

#### *a) Problem areas under discussion*

Under the heading 'market entry regulation', the Study regroups two different problem areas: On the one hand, access to the profession (the issue of qualification) and secondly the possibilities to provide legal services without appropriate qualification (the issue regarding monopolies). The Study is based on the assumption that competition decreases with increasing barriers to market entry and broader monopoly rights. This approach is based on a purely economic point of view and fails to do justice to the particularities of the legal services market:

#### *b) The objective of entry regulations*

Ultimately, the hypothesis is premised on two things: On the one hand, that the respective regulations are introduced in order to close off the market. On the other hand, that closing off the market is detrimental to the national economy because it leads to higher costs for the consumer when he makes use of the service required. However, neither of the two premises apply:

aa) Entry barriers as well as monopoly rights exist in the interest of the public and their interest in high-quality legal advice. In contrast to the participants in many other service markets, consumers acting on the legal services market are at a disadvantage because of the very nature of the lawyer/client relationship (principal/agent relationship) between the consumer and the legal adviser and due to the fact that the consumer is in most cases a one-shot-player. The State (or, in the case of genuine 'self-regulation', the profession) must therefore guarantee high-level qualification standards of the service providers and must keep unqualified legal services at bay in order to maintain a well-functioning administration of justice as well as the consumer's trust in this administration. The fact that this legislative concern should be approved of has also been upheld repeatedly by the ECJ (cf. above).

A different judgement would only be indicated if the State did not only control the quality of legal services by way of qualification requirements and monopoly rights, but also the number of service providers. This is however not the case in Germany. The State grants every University graduate access to the next step in the qualification process, and not only by

providing for the respective training position. The State even finances this training by employing these young lawyers for a certain period of time. Once this freely accessible training period has been finished successfully, everybody has access to the legal profession and there are no additional professional preconditions. Anyone who is qualified to exercise the functions of a judge is automatically qualified for the legal profession, too. Membership in the professional organisation neither depends on demand nor are the numbers limited. There is no entrance examination or any other kind of selection procedure.

bb) Neither can the second implied hypothesis be verified, according to which deregulation of market access conditions results in the required service being available at a lower cost. Empirical research carried out in Great Britain, for example, shows that regarding services for the provision of which lawyers compete with non-lawyers, there is no cost advantage for the public. The decisive element is that non-lawyer service providers regularly provide more specialized services than all-round lawyers. This specialisation frequently leads to higher prices for specialized services provided by non-lawyers and for which there is less competition (cf. *Moorhead/Sherr/Paterson*, *contesting Professionalism: Legal Aid and Non-Lawyers in England and Wales*, 2003).

c) *The Study's interpretation of market entry regulations*

Furthermore, we have noted that the market entry regulation index developed in the Study draws conclusions from the mere existence of certain regulations, conclusions which do not correspond to actual fact. The following examples will make this clear:

aa) The index's main emphasis is on the duration of training and the number of exams which have to be passed. The shorter the training and the lower the examination requirements, the better the market entry – apparently. This train of thought rests on the assumption – without proving that it is correct – that the quality of a service does not depend on the duration of the training and the professional selection of the service providers. This idea leaves ample room for discussion, of course. But, apart from that, it is furthermore inappropriate since the duration of training does not necessarily allow conclusions as to the possibilities of market entry and because examination requirements for graduate lawyers can have a variety of effects on market access:

bb) Thus, the German system does not differ from other legal systems as far as the number of exams is concerned - index criterion ERED4 - , but regarding the importance of the exams for those who want to enter the legal services market. In other legal systems, University graduates have to fight for a limited number of training contracts without the guarantee of

ever obtaining one (England and Wales), are themselves directly responsible for finding a 'stagiaire' position – an endeavour with an uncertain outcome (Netherlands), or they are forced to pass a highly competitive selection procedure for a law academy (France). In Germany, by contrast, every young lawyer who succeeds University education has a guaranteed training position. 97.12% of jurists pass the ensuing final examination which gives access to the legal services market without any additional professional preconditions. In many other legal systems, University education is followed by a strict selection procedure. This example demonstrates that looking at examination requirements alone is not a useful criterion, if it is employed in a purely formal way. This becomes very obvious from a comparison with the situation in Finland, which is rated with an index of 0.0 and is used as a benchmark. Apparently, the only thing that has been taken into account is the fact that in Germany, access to the legal services market is only possible following two successful State Examinations, whereas in Finland no University training is required, or no final examinations are held in the framework of University training. The initial question should have been in how far legal advice of an acceptable quality is possible if there is no legal training altogether. If the answer to this question is that legal training is fundamental as well as indispensable, we can say that in the past, Germany has given 100% of all those who were interested and who were in possession of the certificate proving they have achieved University entrance level, a possibility for legal training, whereas Finland gave only 11.2% this opportunity (*Pretzell*, a.a.O., p. 73, figures for 1994). In Finland, the selection of those who will get the opportunity to enter the legal services market after the respective training, starts already at pre-University level, with a University entrance examination. This examination even covers legal problems. In view of the Finnish example, the absence of two State Examinations and a 'Referendariat', which at first sight seems to have a positive effect on market access, is put into perspective. A comparison should have been made as to whether the situation in Finland does in fact close off the market much more than conditions in Germany, since in Finland only a well-chosen few University graduates are released into the market and not everyone with an interest in becoming a lawyer has a chance to obtain the necessary qualification.

cc) Nor is the criterion 'duration of education', ERED1/2, with a weighting of 70%, very helpful. The conditions in Spain, in particular, which is the only European country where a one-step (University) education is sufficient for access to the legal profession, demonstrate that a starting position which *prima facie* appears to be rather conducive to competition, has in fact the opposite effect: A much deplored Spanish grievance is, for example, the fact that – due to the lack of a structured qualification system – Spanish University graduates are forced to work in law firms for no or very little money in order to get practical training. Only this practical training will enable them to act on the market with any prospects of success. On the

other hand, Italy, where according to the Study barriers to market entry are high, has a particularly high density of lawyers. This only proves how doubtful the chosen approach is.

In principle, experience shows that requirements regarding the duration of education and regarding examinations at the national level do not influence a graduate's decision whether he will try to enter the market or not. In the past decades the average duration of University education varied between 4.5 and 6 years (due to legislative intervention), that of post-University training (*'Referendariat'*) between 2 and 3.5 years. The respective changes in the duration of education, which followed changing legal stipulations, did not have any noticeable influence on the demand for training. Against this background it seems rather inappropriate, superficial and theoretical to assign the criterion of duration a weighting of 70% within the ERED category and almost 30% in the market regulation index.

dd) These very brief observations are yet sufficient to show that the criteria chosen as a basis for indexation in the category 'market entry' lead to a distorted overall picture.

#### **4. Remuneration**

One of the Study's main aspects is the study of regulations regarding lawyers' remuneration. A basic problem arising during research into this area is that the Study is limited to the analysis of regulation as such and does not look at the effects of regulation on the market price of legal services. The underlying assumption seems to be that the regulation of remuneration, i.e. minimum fees, is supposed to serve the profession's interest in a decent income.

##### *a) Ensuring access to justice*

However, this notion is only a secondary pillar of the German law on lawyers' fees, which provides for minimum tariffs for forensic work. The regulations regarding lawyers' fees are rather intended to ensure equal access to justice for the public. This is achieved on the one hand by making fees dependent on the value in dispute and by applying the concept of mixed fee calculation on the other. The high fees charged by a lawyer in cases with a high value in dispute are to compensate for the low fees which do not cover the costs in cases with a low value in dispute. Especially those citizens with a low income should not be deterred by high fees from enforcing claims with a low value in dispute ('cross-subsidization'). This kind of fee scale is the only way to allow citizens to enforce minor claims with the help of a lawyer, since remuneration according to the fee scale, which is not

sufficient to cover the lawyers' costs in this kind of case, is 'cross-subsidized' by the income from higher fees charged in other cases. Such a social component within the fee system is only thinkable in connection with a fee scale; it is also based on the condition that the lawyer is granted a minimum fee which allows the lawyer - from an economic point of view - to work on smaller claims and to charge fees established on the basis of mixed calculation. In the event of complete deregulation, which would inevitably have to result in remuneration on the basis of billable hours, minor claims – which can be assumed to be made by the lower income brackets - could not be enforced in an economically sensible way for the client. Even though this may seem acceptable in an economic 'cost-benefit' analysis, it would nevertheless lead to a loss of justice in the individual case and to a differential in legal protection within the population which is hardly desirable. The fact that the legislator has refused to increase the rates for more than ten years despite continuing protest of the legal profession, clearly shows that fee scales are not established in the interest of the profession, but in the interest of ensuring access to justice.

b) Ensuring the recovery of procedural costs

The Study furthermore fails to take into account that the German law on lawyers' rates is a subsidiary and optional law which gives a price estimate. It is only binding with respect to the amount of lawyers' fees that can be reimbursed and to the lawyers' minimum fee for forensic activities. It is necessary to prescribe this minimum fee in view of the mechanisms involved in the recovery of costs, in order to prevent that the client receives a reimbursement of lawyers' fees which is higher than the fee he actually owes the lawyer according to their internal arrangements; and which he might use to pay the lawyer a contingency fee, which is illegal not only in Germany but also in many other legal systems. A scale of lawyers' fees also allows an effective system of reimbursement mechanisms and makes legal aid possible. When comparing the regulations governing lawyers' fees in the different countries, it is absolutely essential to find out to what extent the non-optional regulation – because only this type of regulation can attract the Commission's attention – affects lawyers' fees as such or the issue of recovery of costs. In Belgium, France, Luxembourg, Spain and Portugal, for example, there is either no *de lege lata* or no factual reimbursement of procedural lawyers' costs and thus no model for the assessment of costs which could be reimbursed is needed. In other countries there may be no – in the case of Germany only a very limited – binding law on the remuneration of lawyers, but there is a scale which sets forth the costs that can be reimbursed by way of a 'reimbursement rate' or a similar rate. Thus, in the Netherlands the level of reimbursable costs is fixed by the *Liquidatietarief Rechtbanken en Hoven* which is established by the Presidents of the *Arrondissementsrechtbanken* on the basis of an agreement between the Bar and the *Nederlandse Vereniging voor Rechtspraak* at regular

intervals. The *Liquidatietarif* contains a detailed list of individual procedural activities for which the lawyer can charge from 0,5 to 2 points which represent a certain amount of money that is in turn dependent on the value in dispute. A similar system is applied in Sweden, where the reimbursable costs – only from a certain value in dispute onwards - are fixed annually by the Swedish court association. The Study ignores that the German law on lawyers' fees is binding only in those areas where this is indispensable in order to ensure the reimbursement of procedural costs.

### c) Ensuring a market for legal expenses insurance

Another issue which is completely ignored by the HIS Study is the significant consumer-friendly aspect of fixed lawyers' rates. They 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 risk 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. Germany satisfies this precondition thanks to the existence of the BRAGO (*Bundesrechtsanwaltsgebührenordnung*, Federal Fee Scale for Lawyers). As a result, Germany has the biggest market for legal expenses insurance worldwide. In 1999 the German insurers' income from premiums amounted to no less than 2.75 billion EUR. At the global level, Germany, with over 25 million legal expenses insurance contracts for 81 million inhabitants, is by far the country with the highest density of legal expenses insurance. Approximately 44% of the population have this type of insurance cover (German insurers achieve 60% of the total European revenue from premiums in this particular insurance sector). The German taxpayer's burden of an elaborate legal aid system is – not least thanks to the fee scale - significantly lower than in other countries which are 'deregulated' in this respect.

Those deregulated countries which are presented as model countries do not provide for a similarly effective system which would guarantee the citizens' access to justice. Thus, the tax authority for England and Wales, where the introduction of legal expenses insurance failed in the 1970s not least because it was impossible to estimate the risk, had to invest until fairly recently and per inhabitant more than ten times (!) the amount invested into legal aid by the German tax authority. The only way out of this financial dilemma was the authorization of

contingency fees, which is a much less attractive financial instrument for the public than legal expenses insurance.

The same applies to the deregulated Swedish market. Here, the lack of a fee scale has forced insurance providers to set a high retention percentage (20%) and relatively low upper limits (11,300 EUR) in order to be able to provide any insurance cover at all. This was not a problem as long as the Swedish welfare state operated a generous state aid system which the public could fall back on primarily. In the meantime, this system has been severely curtailed. Today, the public has to turn to legal expenses insurance which – for the aforementioned reasons – is not in the least as attractive and effective as the respective insurance contracts available on the German market. Result: The number of proceedings funded by both the aforementioned financial instruments dropped to 40% between 1995 (=100%) and 2000; access to justice for the particularly low income brackets has thus deteriorated significantly.

#### d) Conclusion

These examples prove that an isolated observation of an individual aspect of professional regulation, in this case remuneration of lawyers, is worthless, if it is not at the same time put into an overall context. The larger picture shows that the total deregulation of lawyers' remuneration (which the Study does not take into account) could indeed have unexpected negative effects. Either it results in a deterioration of access to justice for large sections of the population, or savings potentials are more than used up because other elements of the overall system are burdened with higher taxes.

## **5. Advertising**

The evaluation of advertising restrictions is also characterized by a very narrow approach. The Study provides a fairly detailed examination of the existing regulations regarding lawyers' advertising rights and also refers to the far-reaching deregulation in this area in 1994, when the BRAO was amended. However, an analysis of professional provisions concerning advertising only makes sense if lifting these regulations – as the Study assumes - really led to a liberalization of advertising law.

In this respect the Study fails to realise that professional advertising rules are largely specific competition rules which are codified for the respective profession. If these *leges speciales* were abolished, the more general rules of fair trading would apply in most cases. They do not

claim applicability to the different professions. But since they are clauses of a general nature, comprehensive case law has been established regarding the admissibility of advertising in certain groups of professions. Therefore, some expert voices in German legal literature advocate that there should not be any independent advertising rules in professional law since all the aspects covered there are already covered by the general rules of fair trading. Thus, un-objective, false, impertinent and misleading advertising of lawyers is covered by §§ 43 b BRAO, 6-10 BORA and § 1 and § 3 UWG (Unfair Competition Act) (cf. the comprehensive and recent work of *Pohlmann*, *Die Beschränkung anwaltlicher Werbung in Berufs- und Wettbewerbsrecht und deren Verhältnis zueinander*, Leipzig 2002). Against this background, an analysis of the regulation of lawyers' advertising rights under professional law is not propitious. It would be necessary to verify on a case by case basis if in legal systems with a fairly low regulation index regarding professional rules on advertising, lawyers really have largely unrestricted advertising possibilities, or, if regulation is effected through competition law or judge-made law, which is indeed quite likely in view of what has been noted above.

## **V. Final remarks**

The Study presented by the Vienna Institute for Advanced Studies contains a number of interesting information and ideas.

However, due to the chosen methodology which for the aforementioned reasons has numerous deficits; to a necessarily fragmentary evaluation of the sources; to an often unconvincing interpretation of the information obtained, as the effects of certain regulations at the national level have not been sufficiently taken into account; the Study cannot be used as a basis for further legislation. Massive intervention in the administration of justice of the individual Member States cannot be based on a Study which admittedly had to work on an unsatisfactory empirical foundation and numerous unverifiable hypotheses.

Even more importantly, a purely economic evaluation, as chosen by the Study, has to be complemented by an appreciation of the objectives pursued by professional rules and regulations. Insofar as provisions aim at enhancing access to justice, strengthening consumer rights and guaranteeing high-quality lawyers' services, these important concerns in the public interest cannot be sacrificed for deregulation, which would then become deregulation merely for its own sake.

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