11501 The Law Society

The Legal Profession
Competition and liberalisation

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Table of Contents

Preface

A committee has been set up by the Danish Ministry of Justice to investigate the rules regulating the legal profession. The Committee shall investigate various types of liberalisation of the legal profession, including:

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

The Danish Bar and Law Society has asked Copenhagen Economics to carry out an economic analysis of the consequences of liberalising the legal profession.

Our report is to be read in supplement to the memos that The Danish Bar and Law Society have written regarding the legal consequences of liberalising. Therefore, we primarily focus on the economic competition aspects while the aspects regarding law and legal procedure have been considered in The Danish Bar and Law Society memos.

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Copenhagen, January 2006

Claus Kastberg Nielsen
Chief Executive Officer

Executive Summary

A committee set up by the Danish Ministry of Justice is investigating various types of liberalisation of the legal profession. The purpose is to increase competition. Liberalisation can strengthen competition in the legal profession and lead to lower prices and thus to economic gains. However, it is important to ensure that the liberalisation does not have consequences that damage the consumer or the society, and could counter or neutralise the potential gains. A liberalisation of the legal profession must therefore be balanced to the advantage of the Danish society. The Danish Bar and Law Society has asked Copenhagen Economics to examine how a liberalisation of the legal profession could be carried out most appropriately.

Liberalisations can *benefit consumers through increased competition*. This happens when liberalisations remove barriers that make it difficult to establish a business or when removing other barriers that restrict the law firms. For example, liberalisation can give more people the opportunity to provide legal services because the requirements for offering legal services will decrease. This will enhance competition and benefit consumers through lower prices and better quality. The specific conditions of the business in question will determine to what extent liberalisation will increase competition. A number of circumstances of the Danish legal profession indicate that the potential gain from liberalisation is limited.

There is a greater potential for enhancing competition through liberalisation if a profession is heavily regulated. But the Danish legal profession is not heavily regulated – compared to other countries. A survey conducted for the EU Commission shows that Denmark has one of the least regulated legal profession in the EU.

There is also greater potential for increasing competition through liberalisation if competition is weak. However, there is no indication of weak competition in the legal profession in Denmark. There is low concentration in the business, which indicates competition and lawyers compete against other advisers and foreign lawyers.

Finally, the potential for increasing competition is greater if consumers are very concerned about prices and react to price competition. However, all indications show that consumers are more concerned with quality than with price.

However, liberalisation could also *damage consumers and society*. It is already difficult for the clients to assess the quality of legal services. Therefore, if a liberalisation reduces the requirements for legal advisers it could affect the quality of legal services. In particular, the problem will hit private clients and small enterprises because large business clients have better opportunities for assessing the quality of the lawyer's work and therefore less need for protection. Liberalisation can also have damaging consequences if it decreases the independence of the lawyers or the quality of their court work. The citizen's access to

independent lawyers is a prerequisite for ensuring access to justice and the lawyers' work in court contributes to define 'case law' to the benefit of the whole society.

We conclude that there probably are gains to be made by liberalising the legal profession in a way which does not lead to damaging consequences that could risk being greater than the potential gains.

We suggest that the following initiatives will increase competition in various parts of the market without decreasing quality. Thus, these initiatives are probably advantageous to the society.

Firstly, 'the law on legal services, and debt collection and detective undertakings' should be abolished. 'The law on legal services, and debt collection and detective undertakings' prevents anybody – apart from lawyers – from marketing legal services and thus create entry barriers for other advisers. However, we argue that it will be necessary to give consumers a possibility for complaining, e.g. to the Consumer Ombudsman, to ensure the quality of the legal services from advisers who are not lawyers.

Secondly, education requirements, lawyers' monopoly of representing a client in a court of law, and ownership requirements should be modified. The education requirements create a bottleneck for entry to the legal profession, and a modification of the requirements would probably mean more lawyers and more competition.

Modification of lawyers' monopoly of representing a client in a court of law will probably create more competition in the less complicated legal cases. Furthermore, the number of legal cases will probably increase if other advisers with lower prices can represent clients in court. However, the effects on competition are modest because a modification of the monopoly only affects a minor part of the market. It will be important to tailor the modifications so they do not result in major decreases in quality.

We conclude that there will not be significant gains by modifying the ownership requirements because it is unlikely that other owners can own and operate the law firms more efficiently than lawyers. However, modifications can be implemented if these do not jeopardize the independence of the lawyers and do not undermine lawyers' client confidentiality obligation.

In turn we conclude that the following elements of present regulation in all significance should be kept. A modification or removal of this part of the regulation will in all likelihood not be beneficial for the society.

The rules for code of conduct (ethical rules for lawyers) should be preserved. The legal profession should continue to regulate the code of conduct because this ensures the lawyer's independence from the state and because lawyers themselves are best qualified to assess the quality of legal services. There are no signs that the rules for code of conduct are abused to restrict competition.

The mandatory membership of the Danish Bar and Law Society should be kept because it is a condition for the current regulation of lawyers' conduct and because the membership does not introduce any significant competition limitations.

Chapter 1 Overview chapter

The legal profession is of great importance to the economy. There is great value added and employment in the business. There are 4,635 lawyers employed in 1,471 different law firms, and in 2004 the turnover was approx. 8.5 billion Danish kroner[1], and the total employment in the legal profession is approx. 11,000 people.[2]. However, the importance of the profession for the economy is first and foremost that the legal profession creates the foundations for an efficient market economy: a well functioning legal system. Therefore, it is important to society that the legal profession is well functioning and delivers good quality advice at a fair price.

The legal profession is regulated in several ways. For example, lawyers must fulfil educational requirements and live up to certain standards in a code of conduct. The regulations must ensure that the consumer receives good legal service even if it may be difficult for them to assess the quality of the service (asymmetric information). The problem with asymmetric information is not unique to the legal profession, and many other professional businesses also have requirements for both education and conduct (e.g. estate agents and accountants).

However, there are certain aspects of the legal profession that the regulations must take into account. It is important for the access to justice that all its citizens have access to independent lawyers[3]. Therefore, lawyers cannot have conflicts of interest in specific cases, and lawyers must be independent of the state so they can act in legal cases against the state. The lawyers' work in courts is of great importance to society because the outcome of the case can be used as a guideline in other cases (both actual cases and in pre-emptive advice). The regulating of the legal profession must take these considerations into account.

However, the regulating of the legal profession can limit competition and for example create high entry barriers because of high requirements to education. It is therefore necessary to assess whether there is a fair balance between competition concerns and other goals for the regulation.

The Law Society has asked Copenhagen Economics to evaluate the economic effects of competition of liberalising the legal profession where various regulations are abolished or modified. Our evaluation consists of three steps:

*The first step w*as to examine the current competition situation in the market for legal services in order to assess the potential for improving competition through liberalisation.

[1] Statistics Denmark (2005), "News from Statistics Denmark", No. 239, 31st May 2005. 1 Danish Krone = 0.13 Euros (in Danish.

[2] Danish Competiton Authority (2004), "Competition Report 2004", page127 (in Danish).

[3] Jf. FN (1990), "Basic principles on the Role of Lawyers".

The Danish Competition Authority has assessed the legal profession as a sector with weak competition. The primary reasons are that the public regulation limits competition and that consumers do not put pressure on the lawyers to compete on price because quality is more important than price. However, we find that there is significant competition in the legal profession and that the aspects that limit competition in the business will not be affected significantly by liberalisations.

There is low concentration in the legal profession, i.e. there are many law firms who compete against each other. Lawyers also compete against other advisers on many areas, especially in the less complicated cases. Finally, there is also significant competition against foreign lawyers because Danish lawyers earn 6 percent of their turnover abroad and because foreign lawyers are active in Denmark.

However, we find that elements on the demand side limit competition in the legal profession. Consumers do not focus on price when they chose a lawyer because quality is far more important than price. This means that lawyers primarily compete on professional capabilities and reputation and less on price. Therefore, liberalisation will only have limited importance for prices on legal services. However, the Law Society has implemented a new rule regarding price information that will increase price competition because it becomes easier for the consumer to compare prices from different lawyers. The price information rule means that lawyers have to give a price estimate before they initiate a job or inform how the fee will be calculated.

We conclude that the Danish legal profession has relatively few competition restrictions compared with legal professions of other countries. The EU Commission has compared the regulations of various professional businesses in the member states[4]. The study shows that Denmark is one of the countries in the EU where the legal profession is least regulated, only surpassed by Finland and Sweden. The index for regulation in Denmark is 3.0 while the EU average is 5.2. As opposed to other countries there are no minimum prices or recommended prices in the Danish legal profession. This means that the potential for increasing competition through liberalisation is far less in the Danish legal profession than in other countries.

The second step was to investigate the regulation of entry to the market for legal services, i.e. educational requirements, marketing rules and ownership requirements. Entry regulations can result in high entry barriers and reduce the number of providers.

For example, 'the law on legal services, and debt collection and detective undertakings' prevents anyone apart from lawyers to advertise legal services, unless they – as accountants, estate agents or banks – have been given special permission by the Minister of Justice. The marketing reduces competition and could be abolished at an advantage. To protect the consumer, it would require a certain amount of regulation of the legal advisers who are not subject to the lawyers' regulation requirements because they are not lawyers.

We conclude that a modification of the education requirements can lead to an increase in the number of new lawyers. However, the modifications must be carried out following carefully considered considerations to avoid undermining the quality.

Finally, we conclude that the ownership requirements do not pose significant economic losses because other owners will probably not be able to run a law firm more efficiently than lawyers. On the other hand, modifications of the ownership requirements can make it difficult to

[4] IHS (2003) "Economic impact of regulation in the field of liberal professions in different member states. Regulation of Professional Services". Final Report. Study for the European Commission, DG Competition. January 2003.

maintain the lawyers' independence. Therefore, modifications must be carried out such that they do not compromise the independence of the lawyers.

The third step was to investigate the regulation of the lawyers' behaviour, i.e. mandatory membership of the Danish Bar and Law Society and the code of conduct. The code of conduct is regulated by the Law Society itself. This ensures the lawyers' independence from the state. At the same time the lawyers have the best prerequisites to assess the quality of other lawyers' work and to define the code of conduct. However, there is a risk that the code of conduct is used to limit competition, but we find no significant limits to competition in the code of conduct. Furthermore, the code of conduct is covered by the general competition law.

1.1. The need for regulation

The regulation of the legal profession must balance a number of goals. The regulation must satisfy a number of non-economic aspects; e.g. law and order for citizens and access to justice. However, from a purely economic point of view, it is also necessary to balance different aspects. The regulation of the legal profession can have both economic advantages and disadvantages that must be balanced. The advantages are that regulation can solve market failures that would otherwise occur in a free market. It is e.g. difficult to maintain good quality without regulation when the clients themselves find it difficult to assess the quality of the lawyers' work. The disadvantages of regulation are that it reduces competition by creating high entry barriers or by limiting the competition between existing law firms.

The usual starting point for an economist is that a free market without regulation gives the best economic solutions with optimal allocation of resources and the correct combination of price and quality. However, there are two important exceptions - asymmetric information and externalities – which mean that a totally free market for legal services will not function optimally. These exceptions are relevant to the legal profession and in turn make it advantageous to have a certain degree of regulation.

Asymmetric information

A free market will not function optimally due to asymmetric information between the lawyer and the client. The lawyer sells knowledge that the client does not possess, and there is an ambiguous relationship between the lawyer's effort and the outcome of the case. A good lawyer can lose a bad case and a bad lawyer can win a good case. Therefore, it is sometimes not even possible to assess the quality of the lawyer's work when the work is done. Hence it is difficult for clients, in particular private clients and small enterprises, to assess the quality of the legal services. The lawyer therefore possesses information regarding the quality that the clients do not; i.e. asymmetric information.

In an unregulated market, asymmetric information can lead to decreasing quality because some lawyers would not carry out good work. And the lawyers who maintain a high standard will not be rewarded for this if the clients are not able to assess whether the quality of the lawyer has been good or bad. Therefore, there will probably be a downward pressure on the quality in a free market. This will damage clients, but it will also damage the lawyers' position in the competition against other advisers because the reputation of lawyers will deteriorate.

The difficulties for the client in evaluating the lawyers' work are complicated further by the fact that the lawyer often has a double role. He has to advise on whether a case should be tried and he tries the case itself. This means that the lawyer makes the 'diagnosis' and sells the 'treatment'[5]. Therefore, it is important to ensure that the lawyer does not have vested interest in the case. An example of vested interest are contingency fees where the fee of the lawyer is

[5] Cox, C. & S. Foster (1990), "The Costs and Benefits of Occupational Regulation", Federal Trade Commission.

a percentage of the outcome of the case. Contingency fees are not allowed according to the current code of conduct.

A number of market mechanisms can be used to limit the problems of asymmetric information; guarantees, tests, and reputation. Therefore, it is not always necessary to regulate even if asymmetric information exists. These market mechanisms, however, not will function very well in the legal profession, especially for private clients and small enterprises. It is difficult to use guarantees because the outcome of the case depends both on the effort of the lawyer and the client's actions and because it can be difficult to determine whether the outcome was a success or not if a settlement is reached. It is not possible to make consumer tests of all the lawyers. Furthermore, private clients and small enterprises only buy legal services a few times and are therefore not familiar with the quality of the lawyer at the onset of a case. Therefore, private clients have to base their choice on the reputation of the lawyer, but this only gives a weak indication of the true quality of the lawyer. Thus, regulation is needed to ensure good quality from all lawyers. This is especially important for private clients and small enterprises. However, the part of this regulation that prevents conflicts of interest and ensures the client confidentiality is also very important to large business clients[6].

Externalities

A free market will not always function optimally when externalities affect third parties. Through their work with legal cases, lawyers are involved in uncovering 'case law', thus creating value for other people and companies who will learn the current 'case law' without paying for it. At the same time, the result of a trial can have a pre-emptive effect for other businesses and citizens. Thus lawyers' work in courts creates a positive value for others apart from the client, i.e. a positive externality. Therefore, the society has an interest in ensuring that the adviser delivers good work in court. If a client is subject to a wrong ruling because he did not use a lawyer, he will suffer a loss, but the economic loss for society of a wrong ruling can be far greater. The client does not have to pay the losses that will arise elsewhere in the economy because a wrong ruling gives wrong guidelines in other cases. Therefore, there is a risk that clients chose to use non-lawyers in cases even if this is not optimal for the society as a whole.

However, trials can also result in negative externalities, i.e. costs that will be born others than the client. Court fees only cover 35 percent of the law court costs while the state pays the rest. Furthermore, a plaintiff can also impose costs on the other side by raising a case. From an economic point of view, this means that too many cases can be raised because the plaintiff only carries a small part of the total costs[7]. This problem can be exacerbated if a modification of the lawyer's monopoly on court representation makes it cheaper to go to court.

Regulation solves market failures

To conclude, we find that there is a need for some degree regulation of the legal profession because a totally free market will lead to serious market failures. This conclusion is completely in line the EU Parliament decision regarding market regulation and competition rules for the professional services in which the EU Parliament concludes:

> *"that from a general point of view rules are necessary in the specific context of each profession, in particular those relating to the organisation, qualifications, professional ethics, supervision, liability, impartiality and competence of the members of the profession or designed to prevent conflicts of interest and misleading advertising, provided that they:(a) give end-users the assurance that*

[6] Danish daily finance newspaper 'Børsen' 20th June 2005, "Businesses satisfied with lawyers" (in Danish).

[7] Shavell, S. (1997), "The fundamental divergence between the private and the social motive to use the legal system", Journal of Legal Studies, vol. XXVI June 1997.

> *they are provided with the necessary guarantees in relation to integrity and experience, and (b) do not constitute restrictions on competition*[8]*".*

In the following section we examine whether it is possible to increase competition on the market for legal services by modifying some of the regulations.

1.2. Competition on the market for legal services

As a starting point for our assessment of the effects of liberalisation, we have analysed how competition works on the market for legal services today. The potential for increased competition is greatest if competition is weak and if the liberalisations are aimed at those aspects that limit competition. We have analysed whether there are aspects on the supply side and aspects on the demand side that limit competition.

We conclude that there are aspects on the demand side that inhibit competition while the supply side fulfils the prerequisites for effective competition. There are many competing lawyers on the supply side (low concentration). Furthermore, Danish lawyers compete with both other advisers and foreign lawyers on a large part of the market. However, the demand side does not put considerable pressure on the lawyers to compete on price. This is because clients are far more interested in quality than in price, and therefore, the lawyers compete more on professional capabilities and reputation than on price. Liberalising the legal profession will not change this fundamentally. However, the Law Society's new rules on price information will enhance the consumer's price awareness and increase price competition between lawyers.

Our report therefore draws a quite different picture of the legal profession different than the picture the Danish Competition Authority draws. The Competition Authority has specifically placed the legal profession on a list of sectors with competition problems[9]. The legal profession has been pointed out because of three indicators: public regulation, few new businesses and high salaries in the sector.

As previously mentioned, we find that the regulation restricts competition but the effects are rather limited. It is correct that there are few new law firms, but it does not require much capital to establish a law firm. Law firms need an overdraft facility to finance the fees due on work in progress, but there is only a limited need for long-term investment. The low rate of new law firms is caused by the client focus on reputation which often makes it more attractive to take over or enter as partner in an established law firm. When the Competition Authority calculates wage premiums[10] they do not account for the work pressure in the legal profession (changing working hours, lengthy working days etc.). And we find that there – despite high salaries – is a high degree of departure from the legal profession, so many lawyers do not find that the wages match the workload. This means that the salaries in the legal profession probably reflect the working conditions of the business and not weak competition.

All in all, our report draws a more positive image of competition in the legal profession than the Competition Authority does. Furthermore, our report shows that in particular it is aspects on the demand side that limits competition, and these aspects cannot be changed markedly by liberalisations.

[8] European Parliament resolution on market regulations and competition rules for the liberal professions 16. December 2003.

[9] The Danish competition Authority (2005), "Competition Report 2005" (in Danish).

[10] The salaries have been adjusted for age, length of education, work title, sex, marital status, no. of children and religion, cf. The Danish Competition Authority "Dokumentation: Competition Report 2004".

The client's choice of adviser

The clients' behaviour is important to competition in the legal profession because the law firms naturally want to compete most on the parameters that are important to the client. Price is not a very important factor in the choice of lawyer because it is far more important to obtain good advice than to obtain cheap advice. This is true for both private clients and business clients. Both Danish and Norwegian surveys[11] show that the clients put more emphasis on professional skills, reputation, personal contact and trust than on price when they choose a lawyer. Therefore lawyers compete more on professional skills and reputation than on price. The price is therefore not the most important competition parameter for lawyers. Liberalisations will not change this.

The Danish Bar and Law Society has however, introduced a new price information rule which will create greater price transparency. The rule states that the lawyer – prior to commencing the work – will inform the client what the assistance will cost. If this is not possible, the lawyer has to inform the client how the fee will be calculated. The information must be volunteered to private clients while business clients have to request the information.

The price information rule will make it easier for clients to compare prices from different lawyers, and the rule means that clients are aware of the price before the job is done. We therefore expect that in future there will be more focus on price, and thus more price competition. Such a development has already taken place in standard products, e.g. advice to house buyers, where there has been an increase in demand for fixed fees and much focus on prices.

Lawyers are exposed to competition

There is considerable competition in the legal profession, and lawyers primarily meet competition from four sides.

Firstly, lawyers compete against each other. Competition between firms is more intense the more firms there are in the business and the less the smaller of the large companies are, i.e. the lower the concentration is. We have calculated the so-called Herfindahl-Hirschman-index (HHI) to measure the concentration in the legal profession[12]. The HHI is a well recognised measure for concentration. The HHI is between 0 and 10,000 and an index below 1,000 is normally characterised as a low concentration. Our calculations show that the HHI for the whole legal profession is 50 and if we consider each professional area as a market, the HHI is on average 300. These are very low concentration indices. In comparison, the HHI in the estate agent business is 700[13].

Secondly, lawyers compete against other advisers. Lawyers meet competition from other advisers in the 85 percent of their turnover that is not subject to the monopoly of representation. Accountants advise on tax legislation, business establishment etc., estate agents advise on legal matters regarding property, and a number of organisations such as e.g. the Danish Federation of Motorists offer standard contracts. In particular, lawyers meet competition from other advisers when the clients have low willingness to pay and when the task is not too complex. In the area of tax legislation, it is possible to calculate market shares for various advisers in complaints cases where the state offers full or partial cost redemption[14]. Lawyers have a market share of 20 percent while accountants have a market share of 65 percent in the administrative part of the complaints system, i.e. before the cases reach High

[11] Ziirsen (2003), "Investigation for private client, part 1. Ciitzens' need for and use of legal services" (in Danish), and NOU (2002) "Right to justice". Norwegian Ministry of Justice (in Norwegian)JD-NOU 2002-18.

[12] The Herfindahl-Hirschman index is broken down as the sum of all companies on the market's squared market shares.

[13] Our own calculations based on "the Competition Authority", " Competition Report 2004" (in Danish).

[14] The Danish Ministry for Tax, "Survey of cases regarding cost refunding in 2004", May 2005 (in Danish).

Court or Supreme Court. There is clearly competition between lawyers and accountants in tax complaints cases.

Thirdly, Danish lawyers compete against foreign lawyers. Danish lawyers obtain approx. 6 percent of their turnover from export. Primarily, the export consists of business advice. However, not only Danish lawyers export, and therefore, Danish lawyers are also exposed to competition in Denmark from foreign competitors. No statistics exist on the extent of the import of legal services. However, the import probably has about the same extent as the Danish export.

Fourthly, approx. 1,800 people (equal to about 40 percent of the active lawyers) have surrendered their licences to practice law even though they have not yet reached retirement age. These people could return to the business of practicing law and are therefore potential competitors to current lawyers. It is in fact, quite common for lawyers who have surrendered their licences to return to the legal profession. The Law Society's database shows that more than a third of those lawyers who surrender their licences return to the profession again.

Entry barriers

The entry barriers are important to competition. The easier it is for new firms to establish themselves on the market, the harder it will be for already established firms to increase prices, more than temporarily, because this will invite new businesses.

We have analysed the entry barriers in the legal profession by investigating key figures for the business and by looking at the challenges that a newly established law firm faces. We conclude that the most significant entry barrier is establishing a client basis. A sound client basis demands a good reputation and this takes time to build up. Furthermore, it is necessary to have an overdraft facility in order to finance outstanding fees on work in progress, but there is no significant need for investment.

When comparing other profession services, the key figures seemingly indicate high entry barriers to the legal profession because relatively few law firms are established and because – relative to the turnover – large amounts of capital are tied up in the business.

The reason for the low number of new law firms is probably that good name and reputation is very important in the legal profession. Therefore, it is often more attractive to take over or enter into an existing law firm than to establish a new one.

The reason for the high amount of capital tie-up is, as mentioned, the need for financing outstanding fees from work in progress. The amount of capital tied up in fixed assets is smaller compared with other professional services.

Prices

Lawyers do not normally operate with fixed hourly rates. Instead, the fee is determined by a number of parameters such as: time used, size of the case, outcome of the case, value of the advice to the client, lawyer's responsibilities, time pressure. This price setting makes it difficult for clients to compare prices from different lawyers. When clients find it difficult to evaluate the price, it becomes easier for lawyers to increase their prices without loosing clients. Therefore, the price setting method can limit competition.

The Law Society's new price information rule will however, create improve price transparency and make it easier for clients to compare prices between lawyers'. This will increase price competition and mean that a lawyer risks losing more clients if he increases his fees.

The Competition Authority has suggested that lawyers must break down their fees in hours and hourly rate such that clients have a better view of what they are paying for. Such a rule will create improve price transparency, but can on the other hand give other problems. Fees are only calculated from hours used could give some lawyers a vested interest in using more hours on a case than necessary. There is a risk that fees only calculated from hours used lead to complaints regarding the amount of hours used by lawyers[15].

Only in a few of the working areas of lawyers is it possible to compare prices with the services provided by other advisers. On the tax area and on advising buyers when buying property there is a tendency towards lawyers charging higher prices than other advisers (approx. 20-25 percent). This difference can be due to weak competition in the legal profession, but it can also reflect that lawyers deal with more complicated the cases than other advisers do.

1.3. Regulating entry

Legislation sets a number of requirements that lawyers must fulfil to practice law. The entry requirements ensure a minimum standard and give the clients surety of a certain quality of the services they buy. But the entry requirements also mean that fewer people can sell legal services. This reduces competition which can lead to higher prices. Therefore, it is important that the entry requirements are not stricter than necessary.

We have analysed four entry requirements: the education requirements for lawyers, lawyers' monopoly on representing clients in court, ownership rules for law firms and the marketing rules. We have chosen to treat the marketing rules together with the entry requirements instead of treating them with the code of conduct requirements because the marketing rules of 'the law on legal services, and debt collection and detective undertakings' pose a large entry barrier to other adviser than lawyers. In turn making it very difficult for these advisers to establish a business.

Education requirements

Lawyers have to fulfil three education requirements. They must have a legal master's degree, they must complete a theoretical bar education, and they must have three years' practical experience. These requirements ensure that the lawyers are well qualified to solve their tasks. But the education requirements can also mean fewer lawyers.

There is significant change among lawyers. There is more than double the amount of changes (approx. 5 percent entering and exiting annually) among lawyers than there is among state authorised chartered accountants (approx. 2 percent annually). This indicates that the entry barriers to the legal profession are low. If anything, it is the exiting from the legal profession rather than the entering into the legal profession that limit the number of lawyers. However, more entry will in the long run also mean more lawyers.

Modifying the education requirements can increase the number of lawyers and will result in increased competition among lawyers. The quality of the legal services can however, not be maintained on a free market without education requirements because clients find it difficult to assess the quality of the lawyer (asymmetric information). Modifying education requirements needs careful professional consideration in order that the modification does not harm the consumer because the professional capabilities of the lawyer decrease. We have not considered which professional requirements should be demanded of the lawyer's education, but we have highlighted how various modifications will affect the basis for recruiting/selection.

[15] Polinsky, A.M. and D.L. Rubinfeld (2001), "Aligning the Interests of Lawyers and Clients", The Berkeley Law and Economics Working Papers. Vol. 2001, issue 2. Fall 2001.

Today, 40 percent of law graduates take the education to become assistant attorney. This share could be increased by modifying the requirements for practical experience, e.g. shorten the length of time required in practical experience or by giving better opportunities for gaining experience outside the legal profession. Another possibility could be to modify the theoretical education. The current education amounts to 12 full days of teaching per year that is equal to approx. 6 percent of the working time. Access to the lawyer's education could also be modified be letting other master's degrees give access to the legal profession. For example, the selection basis would increase by 7 percent if the MSc in Business Administration and Commercial Law gave access.

Monopoly on representation in court

Only lawyers are allowed to represent others in court. However, interest groups can lead trials on behalf of their members (the mandate rule). Furthermore, all people are allowed to represent themselves in court – i.e. it is not compulsory to use a lawyer in court. The monopoly rule is to ensure the quality of the court work. This quality is important to the individual client. But the quality of the court work is also important to society, partly because of access to justice, partly because rulings define the case law that citizens and companies act according to, and partly because the quality of the court work affects the costs of the courts.

It is therefore important that the monopoly rule is not modified in areas where considerations for the individual's due process are very important (e.g. criminal cases). Neither should the monopoly on representation be modified where the court rulings are of great importance to case law (e.g. Supreme Court rulings). On the other hand, it would be possible to modify the monopoly rule for cases that do not have a significant impact on case law (e.g. debt collection cases). In order to protect the client, it is still necessary to have a certain amount of regulation of the advisers who are not lawyers, and therefore not subject to the disciplinary system for lawyers.

A modification of the monopoly rule in civil lawsuits will probably lead to lower prices. The prices will decrease partly because of increased competition and partly because advisers who are not lawyers must charge lower prices than lawyers to be competitive (because lawyers are better qualified to carry out the court work). The decrease in prices will affect the market in two ways. Firstly, advisers who are not lawyers will probably take over some of the less complicated case where the willingness to pay is low and the price sensitivity therefore high. Secondly, the market will increase in size because more people will be interesting in trying a case if the price falls. Normally, it is an economic advantage for society that consumer buys more. However, this is not necessarily true for trials because the parties only carry 35 percent of the court costs. More trials will therefore increase the public costs of the courts, and these added expenses could outweigh the advantages that clients obtain by having more trials.

All in all, the economic gains by modifying the monopoly rule are limited, and the modifications should only comprise areas where considerations for the individual's due process are not essential, and where the rulings are not of great significance to case law.

Ownership requirements

Only lawyers can own law firms. Therefore, multi-disciplinary practices, e.g. joint accountancies and law firms are not allowed to practice law.

The ownership requirements must ensure the independence of the lawyers in order that no conflict of interest arise which results in the lawyer not maintaining the client's interest fully. It is also an advantage to society to have independent lawyers because this ensures a well functioning legal system.

Regulating business structure can however, have economic costs if others owns can own and operate law firms more efficiently than lawyers. This could be the case if other owners have better access to capital, are better at reducing costs or better at developing new business ideas.

However, we conclude that other owners are not likely to operate the law firms significantly more efficiently than the lawyers. This is partly due to the fact that new owners can lead to conflicts between the lawyers and the owners. Furthermore, ownership is probably the best way to motivate and retain lawyers, and the most important asset of the law firm is the lawyers. Neither are there any indications that access to capital is a relevant hurdle for law firms, as law firms do not require large investments. The ownership rules do not prevent co-operation with other advisers – the rules merely prevent that co-operation takes place in joint business/jointly owned business.

Therefore, there will only be small gains by opening up to other types of ownership. On the contrary, a change of the ownership rules could damage the independence of the lawyers. And there is a real risk that other types of owners (e.g. banks) would want to own their own law firms in order to increase the price towards their loyal clients.

Therefore, ownership requirements should only be modified with great care and preserve the independence of the lawyers. At the same time it must be ensured that client confidentiality can be maintained fully and not undermined by the fact that other owners do not have to observe the client confidentiality rule. Therefore, the code of conduct should cover all owners. A modification, which fulfils these criteria, could consist of letting employees who are not lawyers own part of the law firm.

Marketing rules – 'the law on legal services, and debt collection and detective undertakings'
The marketing rules are different for lawyers and for other advisers. Lawyers only have to follow the common rules of marketing legislation, but 'the law on legal services, and debt collection and detective undertakings' prohibits any other person apart from lawyers to advertise legal services. The Minister of Justice, however, has given a number of advisers such as accountants, estate agents and banks the right to advertise legal services.

We conclude abolishing 'the law on legal services, and debt collection and detective undertakings', will increase competition because there will be more legal advisers when all advisers can market their services. Large business clients, who are often willing to pay more than private clients, will probably primarily prefer lawyers to other advisers because of lawyers' qualifications. Therefore, abolishing 'the law on legal services, and debt collection and detective undertakings' will primarily affect the market segments with the lowest willingness to pay, i.e. private clients and small enterprises.

Abolishing 'the law on legal services, and debt collection and detective undertakings' will benefit clients in two ways. Firstly, prices will decrease due to more competition and because other advisers will offer cheaper services than lawyers (they would have to in order to be competitive). The lower prices will increase the market, i.e. more people will buy legal services. Secondly, the clients will have better opportunities for choosing an adviser whose qualifications match their needs. For example, a client with a small case can use an adviser who does not have the same high professional qualifications as a lawyer, but who is cheaper. However, the advantage of such options is less than it would be on other markets because the clients can find it difficult to assess how complicated their case is.

However, abolishing 'the law on legal services, and debt collection and detective undertakings' is not only an advantage for consumers. Abolishing the law would affect those clients who have the most difficulties in assessing the quality of the advice, i.e. the private clients and small

enterprises, and the clients will not have the same level of protection when they use an adviser who is not lawyer.

1.4. Regulating code of conduct

Currently, regulation of lawyers' conduct is based on two principles: mandatory membership of the Danish Bar and Law Society and quasi-regulation. All lawyers are obliged to be members of the Law Society, which determines the rules of the code of conduct and supervises that the rules are adhered to. At the same time, lawyers are subject the decisions of the Disciplinary Board. The Disciplinary Board is an independent complaints committee; half its members are lawyers and the other half made up by judges and lay members. Quasi-regulation means that legislation only stipulates the overall framework for the legal profession and that the Law Society itself establishes the guidelines of the code of conduct.

One of the advantages of quasi-regulation is that it utilises that the legal profession has better information than the public authority. This often results in a more tailored and better targeted regulation, which is easier to enforce and observe. Furthermore, quasi-regulation often results in better acceptance of the rules in the business because the regulation has come from within. However, there can be a risk that quasi-regulation could be abused to limit competition.

We conclude that, in the legal profession, quasi-regulation is better than legislative regulation of the code of conduct. Quasi-regulation utilises that lawyers are better placed to assess the quality of other lawyer's work. The legal profession has a huge interest in maintaining a good reputation, and therefore there is no great risk that the share regulation will lead to lower quality than public regulation.

We have analysed the professional conduct rules and conclude that these are not being used to limit competition. The conduct rules do not contain recommended prices, limits to marketing or other rules that restrict competition. Furthermore, lawyers do not constitute the majority of the Disciplinary Board, which determines in practice what the code of conduct should be. Finally, the code of conduct is subject to the general competition law, which prohibits agreements that restrict competition. Therefore, neither are there signs that the lawyers' code of conduct rules in their present shape are limiting competition, nor that there is risk of the Law Society implementing competition limiting rules.

We also assess that the mandatory membership of the Law Society should be maintained. The membership fee, unchanged for 10 years, is a modest expense (7,000 DKK), and the membership does not limit the lawyers freedom of action, apart from the code of conduct. The mandatory membership is a prerequisite for the quasi-regulation and for the Law Society being able to efficiently supervise the lawyers. Abolishing the membership would undermine the current disciplinary system. The quality will decrease if lawyers can avoid the disciplinary system. Therefore, the current disciplinary system would probably be partly or fully replaced by a public complaints system. Therefore, the choice in reality is between keeping the mandatory membership and establishing a public complaints system. A public complaints system will, however, not have the advantages of quasi-regulation. We therefore assess that abolishing the mandatory membership will entail negative consequences.

Chapter 2 The market for legal services

In this chapter we describe the competitive situation in the market for legal services, which comprises lawyers and other legal advisers.

The legal profession is very heterogeneous. Lawyers cover different areas and there are big differences in the legal complexity of the services offered, and big differences in the types of clients. It is important to recognise these distinctions of the market when assessing the effects of liberalising the legal profession because the liberalisations will affect different parts of the profession very differently. In this chapter we describe the competitive situation on the market for legal services.

It is important to distinguish between on the one hand private clients and small enterprises, and on the other hand large business clients. Private clients and small enterprise are often one-time buyers who find it difficult to judge the quality of the legal services they buy. Therefore, it is of particular importance to protect these clients through regulation. On the contrary, the large business clients are often better placed to judge the quality of the legal services and therefore have a lesser need for protecting regulation.

We conclude that there are aspects of the demand side that limit competition. Clients are far more interested in quality than in price, and therefore lawyers compete more on professional capabilities than on price. Liberalising the legal profession will not fundamentally change this, and intense price competition cannot be expected in the market for professional services. However, the new pricing information rule from the Law Society will sharpen consumer price awareness and increase price competition between lawyers.

On the contrary, the supply side fulfils the conditions for effective competition. There is low concentration in the legal profession, i.e. many law firms that compete against each other. Furthermore, Danish lawyers compete with both other advisers and foreign lawyers on a significant part of the market. Finally, there is significant potential competition from the approximately 1,800 people (equal to 40 percent of the active lawyers) who have deposited their licenses even though they have not reached retirement age. It is quite common for lawyers who have deposited their licences to return to the business.

Our report therefore draws a picture of the legal profession different to the one the Danish Competition Authority draws. The Competition Authority has specifically placed the legal profession on a list of businesses with competition problems[16]. The legal profession has been pointed out because of four indicators: public regulation, few new businesses, high investments and high salaries in the business.

[16] Competition Authority (2005), "Competition Report 2005" (in Danish).

We conclude that there is a low degree of regulation in the Danish legal profession compared with other EU countries, and estimates indicate that the regulation only results in prices three to four percent higher. We also find that there are no high entry barriers to new law firms. No large investments are required to start a law firm. Financing needs mainly consist of an overdraft facility to finance outstanding fees on work in progress. The low number of new companies in the legal profession is due to client focus on reputation. This makes it more attractive to take over or enter an existing law firm than to set up a new law firm. High salaries are prevalent in the legal profession, but there are also a large number of exits from the profession. This indicates that salaries are not high in relation to the workload. The Competition Authority estimation of wage premiums[17] does not take into account the pressure of work in the legal profession (changing working hours, long working days etc.).

2.1. What do lawyers do

We will describe the area work of the lawyers from two points of view: turnover and the nature of the legal service. The figures for turnover show that business clients are the most important group of clients for lawyers. More than 50 percent of the turnover comes from services primarily targeted towards business clients while 30 percent of the turnover comes from services primarily targeted towards private clients and 20 percent of the turnover comes from services targeted toward both business and private clients. The majority of the work consists of legal services outside the trials. In fact, the trials constitute merely 15 percent of the turnover of lawyers. There is a tendency to lawyers primarily working on complicated cases. The more complex and significant a case is, the more likely it is that a client will chose a lawyer as adviser.

Composition of the turnover

Our description of the legal profession is based on a survey of law firms, which Statistics Denmark carried out for the Law Society in the spring of 2005. The survey shows that the most important areas of business for lawyers are business advising, advising on property, private advising and civil trials. These four products comprise 65 percent of the turnover in the legal profession.

Different legal services are aimed toward different types of clients. A number of services are primarily aimed toward business clients. Other services are primarily aimed at private clients while a number of services are aimed at both business clients and private clients. Those services primarily aimed toward business clients generates more than half the turnover of the business, cf. Table 2.1.

[17] The salary is that part of the difference between a business and the furniture industry (benchmark) which cannot be explained by differences in age, length of education, job title, sex, marital status, no of children and region, cf. the Competition Authority, documentation for the Competition Report 2004" (in Danish).

Table 2.1: Business areas of lawyers

Service	Share of total turnover percentage	Turnover Million DKK
Business clients	**52**	**3,906**
Business advice	31	2,306
Debt collection	6	462
Company advice	5	413
Bankruptcy	5	395
Patents and copyright ownership	1	69
Technology	1	65
Labour market legislation	2	153
Environment	1	43
Private clients	**29**	**2,145**
Private advice	10	753
Fixed property	14	1,038
Criminal law	5	346
Notary public services	0	8
Both	**19**	**1,460**
Civil trials	10	735
Other services	3	230
Other legal services and information	3	188
Administration	2	179
Accounting, book keeping and tax	2	128
Total	**100**	**7,511**

Source: Statistics Denmark (2005) and our calculations.

Statistics Denmark has also examined what types of clients make up the turnover for lawyers. The replies draw a similar picture to the one above. Business clients are clearly the most important group and create approx. 50 percent of the turnover. Organisations and private individuals are next at 30 percent of the turnover while only 8 percent of the turnover is from the public sector, cf. Table 2.2.

Table 2.2: Turnover on client type 2004

Type of client	Percentage
Industry	23
Business services, fixed proporty and letting	24
Organisations and private individuals	30
Public sector	8
Other sectors	15
Total	**100**

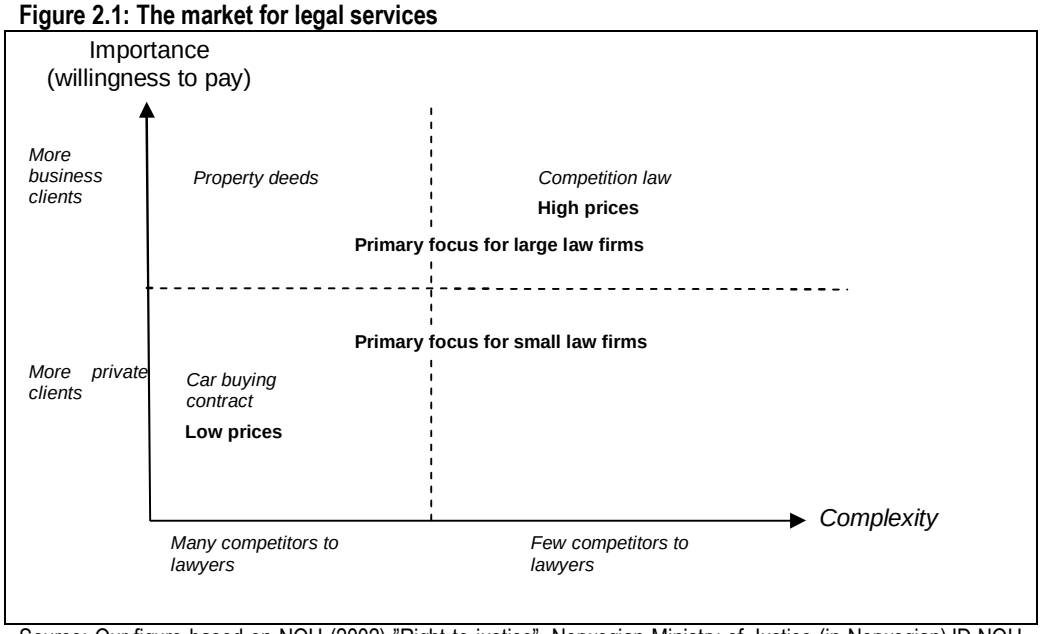
Source: Statistics Denmark (2005).

Legal complexity and willingness to pay

The working area of lawyers can be described from the nature of the job. The market for legal services can be split into two dimensions: the complexity of the case and the importance of the case. The importance of the case is important for the clients' willingness to pay. Business clients often are often willing to pay more than private clients. The legal complexity is critical to how many other advisers compete with the lawyers. The more complex the case is, the fewer competitors to lawyers.

Advice in competition cases is an example of a service with high complexity and high degree of willingness to pay where lawyers in reality do not meet competition from other advisers. Contrarily, purchasing contracts between private individuals is an example of a service with low complexity and a low degree of willingness to pay where lawyers meet competition from many other players, e.g. the Danish Federation of Motorists and the internet vehicle buying and selling site; Bilbasen. Drawing up of property deeds is an example of a standard service with great value where lawyers compete against other advisers (estate agents). The market split is outlined in Figure 2.1.

Figure 2.1: The market for legal services



Source: Our figure based on NOU (2002) "Right to justice". Norwegian Ministry of Justice (in Norwegian)JD-NOU 2002-18.

It is not financially viable to seek advice in cases with low value (low willingness to pay) and high complexity unless the costs are covered by free legal aid or by insurance. I.e. there is potentially a market that is not covered today. A consumer survey carried out on behalf of the Law Society also shows that half the people who choose not to use a lawyer for a legal problem do so because they think the legal service is too expensive[18].

There are marked differences between large and small law firms when comparing the composition of their turnover. Large law firms mainly focus on business clients and obtain more than 60 percent of their turnover from these clients. On the other hand, small and medium sized law firms obtain almost half their turnover from private clients, cf. Table 2.3.

Table 2.3: Turnover composition

	Number of employees			
	0-4	**5-9**	**More than 10**	**All**
Business clients	30%	35%	62%	52%
Private	46%	43%	21%	29%
Mixed	25%	22%	17%	19%
Total	100%	100%	100%	100%

Note: the turnover is split according to the same key as in table 1
Source: Statistics Denmark (2005) and our own estimations.

[18] Ziirsen (2003), "Investigation for private client, part 1. Ciitzens' need for and use of legal services" (in Danish),

Steps of a case history

The work of lawyers can also be divided into three typical steps of a case history. It is of course not all cases that go through all three steps but the division is a useful way of gaining an overview of the nature of the case work. Step one is gathering general information on current legislation in an area. Step two is seeking specific advice in a specific case (case handling). Step three is resolving disputes in court or arbitration, cf. Box 2.1.

Box 2.1: Three steps of a typical case history

Step one consists of looking for general information and offering standard advice such as standard contracts, standard wills etc. The general advice only has a limited impact on the earnings of the lawyer. There are many providers of general legal information and standard advice, and lawyers compete against interest groups, public authorities, accountants, consultants etc. The internet also plays an important role in this part of the market: approx. a third of the private clients who have used the services of a lawyer also use the internet to look for legal information[19].

Step two consists of the actual case handling, i.e. where the client gets specific advice on a specific case. Handling of the case constitutes the majority of the lawyer's earnings. Lawyers meet competition from other advisers in various market segments. For example, accountants are very active in the tax legislation area, and both lawyers and estate agents offer advice to buyers in property deals.

Step three is when a case develops into a dispute that needs solving in court by arbitration. Lawyers – because of the monopoly of representation – the only ones who can offer to represent others in court. However, the mandate rule grants the right of representation to interest groups allowing them to represent their members. Civil law suits and criminal cases constitute 5 and 10 percent respectively of the turnover of lawyers.

Source: NOU (2002) "Right to justice". Norwegian Ministry of Justice (in Norwegian)JD-NOU 2002-18 and Copenhagen Economics.

The largest area of work is clearly step two, i.e. specific advice in specific cases (not court cases). The turnover figures from Statistics Denmark give an indication of how important the different areas are. We have allocated the turnover by allocating the different professional areas to one of the three steps[20]. Naturally, this does not give a precise picture, because for example advice regarding fixed property can constitute specific advice (step 2) and selling of standard documents (step 1). However, we believe that the allocation is a reasonable indication of how important the different steps are to the earnings of lawyers. Out split shows that lawyers get 80 percent of their turnover from this type of advice while general information only makes up 5 percent of the turnover, and trials (disputes) make up 15 percent of the turnover, cf. Table 2.4.

Table 2.4: Turnover and competitors in the three steps of a case history

	Content	Share of the turnover of lawyers	Example of competitors
1st Step	General information	5	Information services, interest groups, public authorities
2nd Step	Specific advice	80	Accountants, estate agents
3rd Step	Disputes	15	None

Source: Copenhagen Economics.

Many competitors exist to lawyers in step 1, fewer in step 2 and hardly any in step 3[21]. This means that there are many others apart from lawyers who supply general legal services and

[19] Ziirsen (2003), "Investigation for private client, part 1. Ciitzens' need for and use of legal services" (in Danish), graphics 81 og 83.

[20] Step one comprises the professional areas: other legal services and information and other services. Step three comprises civil trials and criminal trials while the other professional areas fall under step two

[21] Lawyers may encounter competition from other advisors in arbitration and in trials, lawyers might meet competition from interest organisations representing their members in court (representation rule).

that there also are many others apart from lawyers who can advice in specific services – especially if the cases are less complicated. On the contrary, only lawyers can represent others in court[22], and it is the contents of the agreement that determines whether the parties need a lawyer in a dispute.

2.2. The demand for legal services

In this section we describe the demand for legal services.

Firstly, we show that price is not significant for clients when choosing a lawyer. Therefore, lawyers first and foremost compete on other parameters than price (such as professional skills, reputation and personal contact).

Secondly, we show that the market is characterised by asymmetric information because the client find it difficult to assess the quality of lawyers' work. It is difficult to apply the market mechanisms[23] that are used to limit the problems of asymmetric information on some other markets. Therefore, there is need for some regulation to protect the clients. In particular, private clients and small business clients need protection because these types of clients rarely buy legal services and thus do building up knowledge of the quality of the lawyer's work. On the other hand, business clients have a lesser need for protection because they often are in a better position to assess the lawyer's work and because they frequently buy legal services and thereby learn the quality the lawyer's work[24].

Choosing a lawyer

It is far more important to get good advice than to get cheap advice and therefore price does not play an important role when choosing a lawyer. This applies to both private clients and business clients and is confirmed by several consumer surveys.

The marketing analysis institute Ziiersen Research has examined the demand for legal services from private clients. The survey shows that the most important thing when choosing a lawyer is professional capabilities. Further to this, the reputation of the lawyer and that the lawyer is local are important parameters for private clients when choosing a lawyer. Contrarily, price of less importance, cf. Table 2.5.

Table 2.5: The most important criteria when choosing a lawyer

Criterion	Percentage
Professional capabilities	31
Reputation	15
Lives locally	12
Random	11
Price	9
Other criteria	22

Source: Ziirsen (2003), "Investigation for private client, part 1. Citizens'' need for and use of legal services" (in Danish), Graphic 70.

A Norwegian survey shows the same pattern. Professional capabilities and personal relations are more important than price, cf. Table 2.6.

[22] Apart from when the rule of representation is applied.

[23] See Table 2.3.

[24] On the contrary there can be larger externalities in the cases regarding large business clients than in cases for private clients. An erroneous ruling in a large business case (e.g. a competition case) could have a greater economic impact than a ruling regarding e.g. a property deal because distortions in case law in business cases will affect the conduct of many businesses.

Table 2.6: Client priorities when choosing a lawyer

Criterion	Score
Result and quality	3,8
Good contact between lawyer and client	3,6
Special knowledge	3,2
Price	2,9

Source: NOU (2002) "Right to justice". Norwegian Ministry of Justice (in Norwegian)JD-NOU 2002-18.

This means that lawyers have to compete more on professional capabilities and reputation than on price. Price is therefore not the most important competition parameter for lawyers, nor will it be following a liberalisation of the legal profession. The new pricing information rule from the Law Society, which we discuss below on page 25, will however, increase price competition.

Since professional capabilities and reputation are very important parameters, the clients are very loyal to their lawyer. Consumer surveys[25] clearly show that most clients are satisfied with their lawyer as 85 percent of the people who used a lawyer would recommend the lawyer to somebody else. At the same time, two thirds of the clients have chosen a lawyer who they knew in advance or who was recommended to them by family, friends or colleagues. Thus, reputation has significant importance for client recruitment

The research company Ziirsen, conclude in a satisfaction survey[26] that:

> *The most important factor for the satisfaction of a private client is that during the contact a personal relationship is developed. The personal relationship is developed through conversations and meetings between lawyers and the private client.*

A survey carried out among business clients by Danish daily finance newspaper 'Børsen' and the research institute Greens [27] shows that there is also great satisfaction with lawyers among business clients. Nine out of ten clients are either satisfied or very satisfied with their lawyer. And eight out of ten have a very high degree of confidence in their lawyer.

Quality and asymmetric information

It is difficult for the client to judge the quality of the service the lawyer provides. Lawyers sell knowledge that the client does not have himself, and lawyers can have concealed interests in the case. Asymmetric information exists between client and lawyer because the lawyer is better placed to assess the quality of his services than the client. Asymmetric information can lead to two problems that in turn would deteriorate the quality of legal services.

The first problem is that the clients are not, in advance, able to deselect the bad lawyers. This would undermine the market for the other lawyers because it spoils the reputation of the legal profession thus making the business less attractive for the good lawyers. The result can therefore very well be a general deterioration of the level of quality. Economists call this problem 'adverse selection', and the problem arises *before* the agreement between the client and the lawyer is entered.

The second problem is that the lawyer not necessarily honours the client's interests. This problem is called 'moral hazard', and the problem arises *after* the agreement between client and lawyer has been made. In the legal profession, 'moral hazard' can arise in several ways. One possibility is that the lawyer does not deliver the services most beneficial to the client, e.g. tries a case not needing to go to court. Problems can also arise when lawyers abuse the trust

[25] Ziirsen (2003), "Investigation for private client, part 1. Ciitzens' need for and use of legal services" (in Danish).
[26] Ziirsen (2003), "Investigation for private client, part 2, Actual solutions base don the private client investigation" (in Danish).
[27] Danish daily business newspaper 'Børsen' 20th June, 2005, "Business satisfied with lawyers" (in Danish).

of the client because the lawyer typically both defines the problem and provides the solution for the client[28]. There is a temptation to advise clients to take on cases that do not really make sense to take on[29]. A different type of 'moral hazard' is that the lawyer is not thorough enough in doing his job.

Box 2.2: Classic examples of 'adverse selection' and 'moral hazard'

The standard example of the 'adverse selection' problem is used car selling. Let us assume that there two types of cars good and bad. The seller knows whether it is a good or a bad car he is selling but the buyer cannot readily determine the quality. The buyer therefore risks buying a bad car and this reduces his willingness to pay. The result is that most sellers with good cars choose to keep their cars because they can only get a low price on the market. Therefore, there will only be bad cars on the used car market and the market for good used cars disappears.

The standard example of a 'moral hazard' is insurance for cars. If the car is not insured, the owner has a stronger incentive to look after his car than if the car is insured. The car owner is therefore less careful when parking his car than if it is insured.

Source: Akerlof, G. (1970), "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism". Quarterly Journal of Economics. 84(3) and Holmström, B. (1979), "Moral hazard and observability", Bell Journal of Economics 10(1).

There are a number of different mechanisms that can reduce the problems of asymmetric information, including regulation and licenses, guarantees, tests and reputation, cf. Table 2.7.

Table 2.7: Methods for limiting problems of asymmetric information

Instrument	Example	Type
Regulation and licences	Appointing, code of conduct and supervision by the Disciplinary Board	Regulation
Guarantees	'No cure no pay'	Market mechanism
Tests	Appointing the right to represent at the High Court and Supreme Court International rating	Market mechanism
Good name	Repeat purchase, 'good name and reputation'	Market mechanism

Source: Copenhagen Economics, NOU (2002) "Right to justice". Norwegian Ministry of Justice (in Norwegian)JD-NOU 2002-18.

Regulation and licences is used to in the Danish legal profession where lawyers must fulfil education requirements to be appointed. This reduces the problem of 'adverse selection' because all lawyers fulfil a minimum standard[30].

The conduct of lawyers is furthermore regulated following the professional code of conduct for lawyers to ensure a proper code of conduct. The Disciplinary Board sets the standards for the code of conduct. Most cases handled by the Board concern conduct cases where clients complain about a too slow case handling, not being thorough enough, conflicts of interest for the lawyer etc. The Board's rulings reduce the problem of 'moral hazard' in the legal profession because the lawyers are encouraged to deliver a good effort in order to avoid having a ruling made against them by the Disciplinary Board. The rulings of the Board also reduce the problem of 'adverse selection' because some of the rulings are publicised thus enabling the clients to deselect bad lawyers.

Furthermore, the Board of the Law Society also supervise the legal profession. The board can independently raise cases against lawyers breaking the code of conduct rules. In several

[28] Cox, C. & S. Foster (1990), "The Costs and Benefits of Occupational Regulation", Federal Trade Commission.
[29] Similarly, car mechanics could be tempted to replace too many spares when a car is in the workship.
[30] Firstly, lawyers need a legal degree exam, secondly they need to have practical experience from a legal business, and thirdly, they must complete the mandatory assistant attorney education.

cases, the Board has raised cases following media attention even though no complaint was present. This type of supervising also gives a disciplinary effect on the legal profession.

Another tool is guarantees, which can be used to reduce the problems of asymmetric information. However, guarantees only work if it is possible subsequently to assess whether the guarantee has been fulfilled. And this is difficult for legal services because the clients do not know whether outcome of their case could have been better with a better lawyer. Legal services are thus credence goods where the buyer does not even become aware of the quality after the purchase. Another problem of using guarantees is that the outcome of a case often depends on how the client acts during the case. A lawyer can therefore risk loosing a case due to a client's actions during in the case. However, some lawyers do use a type of guarantee 'no cure, no pay' and by letting the fees depend on the outcome of the case.

Tests where a professional third party assesses the quality of various lawyers' work can also be used to reduce the problems of asymmetric information. In Norway, a type of test is used to reveal the quality of the lawyer - experienced lawyers are asked to assess and prioritise colleagues[31]. In Denmark, the right to represent clients in the High Court and the Supreme Court can be considered a test that gives a signal of the quality of the lawyer. Furthermore, employment in a highly reputed law firm can be seen as a seal of approval showing that the lawyers' colleagues acknowledge the quality of the lawyer. Finally, international legal reference books, e.g. European Legal 500, carry out a rating of the large law firms where the firm is judged by their transactions in the year and from interviews with in-house lawyers employed by Danish and foreign firms. However, the private clients do not really benefit from these tests because these clients often use small law firms that are not included.

Reputation is probably the most important tool for reducing the problems of asymmetric information. Lawyers making a good effort will be able to build up a good reputation enabling them to attract new clients and maintain present clients. Reversely, a poor effort will damage the reputation and make it more difficult for the lawyer to attract clients. If the client uses the same lawyer in several cases the problems of asymmetric information will decrease in time because the client learns the quality of the lawyer.

The problems of asymmetric information are greater for private clients and small enterprises than for large business clients[32]. This is primarily due to the fact that large business clients have skills within the company (e.g. employees who are lawyers) that enables them to assess the quality of the lawyer's work. Secondly, large business clients are often able to buy services again where the same lawyer is used in different cases. In this way, the client gets better knowledge of the quality of the lawyer's work, and the lawyer has an extra incentive to provide a good effort to maintain the business with the client.

2.3. The supply of legal services

In the following we will describe the supply side of the legal profession from two points of view, a people point of view and a company point of view.

Firstly, we will describe the group of people who offer legal services, i.e. the approximately 4,500 Danish lawyers. We show that there is much change in the legal profession and many temporarily surrendered licences. This means that there is a large group of potential competitors to the present lawyers, i.e. former lawyers who can have their licenses back.

[31] NOU (2002) "Right to justice". Norwegian Ministry of Justice (in Norwegian)JD-NOU 2002-18.

[32] Stephen, F.H. & J.H. Love (1998), "Regulation of the legal profession", in: Bouckaert & De Geest (eds.): "Encyclopedis of Law and Economics", 1998.

Secondly we will describe the companies in the legal profession. We will show that the costs of setting up businesses are small and that a very large number of law firms exist. Furthermore, we show that the degree of concentration is very low in the legal profession.

Further to lawyers, there are also a number of other legal advisers. Accountants advice on tax legislation, setting up companies etc, estate agents advise in legal matters regarding fixed property and a number of organisations such as the Danish Federation of Motorists offer standard contracts etc. However, we have chosen to only focus on lawyers in this section.

The lawyers

Lawyers have to be members of the Danish Bar and Law Society who therefore hold a detailed description of the people making up the legal profession. There are 4,635 lawyers employed by 1,471 law firms.[33].

The legal profession is signified by large turnover in people. Approximately 2-300 new lawyers obtain their licences a year, and approximately 200 are surrendered annually. I.e. 5 percent of the lawyers 'change' every year. In comparison, the change among state authorised chartered accountants is only 1-2 percent.[34].

At the moment, approximately 1,800 people have surrendered their licences even though they have not yet reached retirement age. This is equal to approximately 40 percent of the active lawyers. These people could return to the legal profession and are therefore potential competitors to the present lawyers.

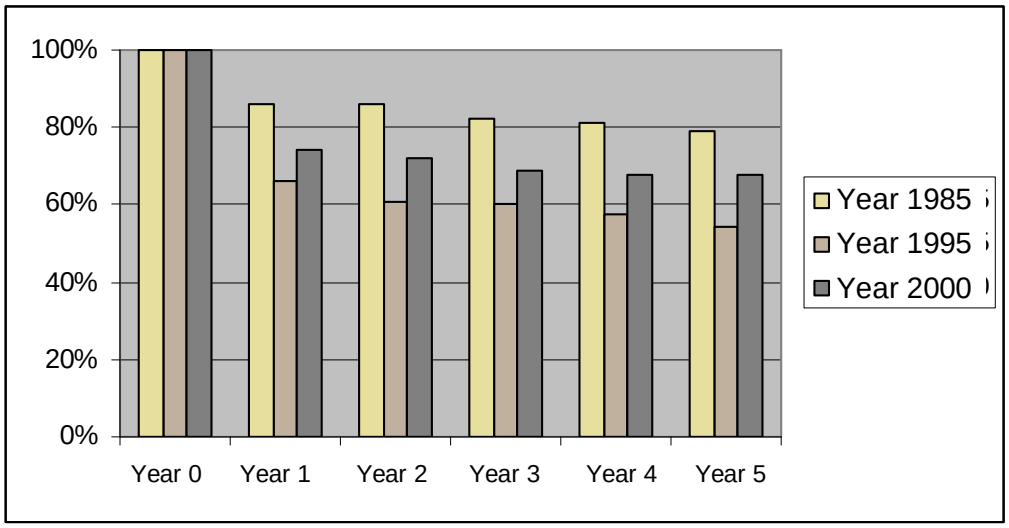
To get a picture of the regress from the legal profession we have examined three year-groups (1985, 1995 and 2000) in the Law Society membership database. The surrendering of licences takes place in particular during the first year after the lawyers have obtained their licence. Between a quarter and a third of the lawyers who obtained their licences in 1995 and 2000 surrendered their licences within the first year[35]. In 1985, in was only as sixth that surrendered within the first year. Many young lawyers surrender their licences after only working a short time as lawyers, cf. Figure 2.2.

[33] The Competition Authority (2004), "Competition Report 2004", page 127 (in Danish).

[34] The Association of state authorised chartered accountants has approx. 3.250 members and in the last four years the number of members has increased annually by 70-80 members and the annual exit has been approx. 50.

[35] No changes have taken place during the last 5 years (i.e. from 2000 to 2005) in the number of active lawyers among the 1995-year. Since 1990, 10 percent of the lawyers receiving their licence in 1985 has left the business – in the first five years since receiving their licence, 20 percent of this year left the business.

Figure 2.2: Active lawyers in the first five years following obtaining their licences (3 year groups)



Note: the figure shows the development in the number of active lawyers who obtained their licences in 1985, 1995, and 2000 respectively.
Source: The Law Society membership database and Copenhagen Economics.

Those lawyers who surrender their licences at a young age can return to the legal profession and are therefore potential competitors to present lawyers. It is quite common that lawyers temporarily surrender their licences and later return as active lawyers again, i.e. get their licences back. In the three year groups that we have examined approximately half of all lawyers have at some point deposited their licences, but approx. 40 percent of these people have returned to the business again as active lawyers, cf. Table 2.8.

Table 2.8: Surrendering and re-obtaining (3 year groups)

	The whole year group	Surrendering	Re-obtaining
Year 1985	186	83	40
Year 1995	220	134	43
Year 2000	236	102	38
Total	642	319	121

Note: The table shows how many of the lawyers who obtained their licences in 1985, 1995 and 2000 respectively that at a given time has surrendered their licences and how many of them got their licences back at a given time. A person only counts once even if surrendering their licence several times.
Source: The membership database of the Law Society.

A large share of the potential competitors is previous lawyers currently working for the State. The Danish Association of Law Graduates and Economists has examined the migration between business sectors. The survey shows that the legal profession primarily gives law graduates to the private sector, and that the legal profession recruits the majority of law graduates from the state cf. Table 2.9.

Table 2.9: Migration between the legal profession and other sectors

	State	**Council authorities**	**Private**
Migrating from the legal profession to …	78	16	88
Entering the legal profession from…	81	11	55

Note: the figures show the average number of people who have changed business area from 1997 to 2001.
Source: University of Copenhagen (2005), "Commission Report on the law degree edcucations (Betænkning om jurauddannelserne)", pp.. 23-24. Faculty of Law (in Danish).

The Danish Association of Law Graduates and Economists has also investigated the reasons for the large migration from the legal profession[36]. In particular, it is the problems of combining family life and working as a lawyer that makes lawyers move away from the business. Therefore, a number of these people will possibly return to the legal profession when their children are older.

The legal profession is facing a generational change. In 2004 the average age of all lawyers was 47, and more than every third one-man office must go through a generational change within 5 years, and more than half within the next ten years[37]. It is therefore important that an adequate number of lawyers graduate in the years to come. We will examine the education requirements on page 42.

Many law firms and low concentration
It is important to examine the concentration in the business, because it is easier to increase the price and limit competition if there are only a few (large) competitors. The legal profession is characterised by low concentration.

In the 1990s, there was a merger wave in Danish legal profession and the number of law firms decreased by approx. 10 percent. This merger wave has however ceased and during the previous three years, the number of law firms has increased slightly[38].

The market consists of many one-man law firms and few very large law firms. Two out of three of the law firms are one-man firms, and almost every fifth lawyer is employed by one of the 10 largest law firms. This means that the number of law firms does not say a lot about concentration in the business because the competitive conditions are very different on a market with many small and few large firms than on a market where all firms are the same size.

We have calculated the so-called Herfindahl-Hirschman-index (HHI) in order to assess the degree of concentration in a business area and take into account that it is important how the market shares are split on the companies (a market with few large companies and many small ones gives a higher index than if all the companies are the same size). The Herfindahl-Hirschman index is calculated as the sum of all companies on the market's squared market shares.

Box 2.3: The Herfindahl-Hirschman Index

The Herfindahl-Hirschman Index is the sum of the squared market shares *(s_i)*

$$HHI = \sum_{i=1}^{N} s_i^2$$

Example: A market with six companies with market shares of. 40, 20, 15, 15, 5 and 5, the HHI is equal to 2500 ($40^2 + 20^2 + 15^2 + 15^2 + 5^2 + 5^2 = 2500$). This in turn is equal to the market consisting of four equally sized companies.

Source: Copenhagen Economics.

The HHI Index is between 0 and 10,000: 0 if complete competition between many small providers exists and 10,000 if there is a monopoly situation. The American competition authorities' rule of thumb is the concentration is low if the HHI is below 1,000 while concentration is moderate if the HHI is between 1,000 and 1,800 and high if the HHI is above

[36] Danish association of lawyers and economists DJØF (2003), Migration from the legal profession to public employ (in Danish)
[37] Law Society (2005), "Law firms in numbers. Busines area analysis 2005" (in Danish).
[38] Law Society (2005), "Law firms in numbers. Busines area analysis 2005" (in Danish)..

1,800. Our calculations clearly show that the legal profession is characterised by low concentration, i.e. many small companies competing against each other.

If consider the legal profession as a whole and assume that all law firms compete on the same relevant market, the HHI is 50, which is very low. In comparison, the corresponding index for the estate agent business is 700[39]. However, not all lawyers compete on the same relevant market[40], and we have therefore calculated the HHI for various segmentations of the market.

Firstly, we have calculated the degree of concentration for each professional area. This is corresponds to the assumption that only lawyers from the same professional business area compete against each other. However, our calculations show that the degree of concentration is still low (on average[41] 300). It is only the niche markets for patent advice which has a high degree of concentration especially advice on technology. These markets are, however, small niche areas and each constitutes only approx. 1 percent of the turnover in the business.

There is competition between the business areas because lawyers can use their basic legal training to advise within several professional areas. This means that if the price within a professional area increases, more lawyers will offer legal services on this professional area (supply substitution). The very specialised lawyers find it more difficult to change to a different area of business than lawyers with general knowledge, but the large law firms can move their focus to other business areas by employing new lawyers, and the individual lawyers can over time chose to change business area. Therefore, the degree of concentration will be too high when calculated for each business area separately. However, even calculating based on this assumption, the degree of concentration is still low in the legal profession.

Secondly, we have calculated the degree of concentration for the large law firms. If we look at business advice from large law firms with at least 10 employees as an individual market, the average HH-index is 650, i.e. low concentration. This calculation assumes that large law firms only compete against other large law firms because there are many tasks that the small law firms cannot solve.

The assumption that large law firms only compete against each other and against large foreign firms[42] is probably realistic. The large law firms with at least 10 employees dominate 80 percent of the market for services primarily aimed at business clients, cf. Table 2.10.

Table 2.10: Market shares for small, medium and large law firms

	No. of employees			
	0-4	**5-9**	**Above 10**	**All**
Business clients	11%	9%	80%	100%
Private clients	32%	19%	49%	100%
Mixed	25%	15%	60%	100%
Total	20%	13%	67%	100%

Note: the turnover is allocated according to the same key as in Table 2.1.
Source: Statistics Denmark (2005) and own calculations.

[39] The HHI-index is calculated based on the market shares for the estate agents as stated in the Report by the Competition Authority from 2004.

[40] The relevant market is a concept identifying the services and the companies that limit a lawyer's options for increasing his fees. The definition is both geographical and product based.

[41] The number has been calculated as a weighted middle value (in relation to turnover).

[42] The foreign law firms have not been included in the concentration index, which therefore over estimates the actual concentration.

The small and medium law firms therefore have 20 percent of the services primarily aimed at business clients. However, the majority of this turnover is generated from business advice services and debt collecting services, i.e. services typically aimed at small enterprises.

Competition between Danish lawyers is also limited by the fact that the clients prefer to use locally based lawyers. However, we assess that from a competition economy point of view it is more correct to view Denmark as one market. This is because markets in question overlap and bind Denmark even though the individual lawyers only compete against closely situated lawyers.

Our analysis thus shows that the legal profession has a low degree of concentration regardless of which market segmentations we consider. This is not surprising because the rules regarding conflicts of interest set a natural limit to how high the concentration can become in the legal profession. If one a law firm is representing a business the law firm cannot represent the opposite party in other cases. There are therefore limits to how large the Danish law firms can become on the Danish Market[43]. This means that is difficult to imagine situations where individual law firms achieve such a large market share that it becomes dominant in a competitive sense, i.e. achieves a market share of more than 30-40 percent.

The appendix on page 25 contains a very detailed explanation of the results of the calculations of the HHI.

Entry barriers for new law firms
Entry barriers are important to competition. If it is easy for new companies to enter a market, the existing firms can only raise prices temporarily because increased prices will attract new business to the market. The most important entry barrier in the legal profession is the availability of a client basis as establishing a law firm does not require a major investment.

The entry barriers can be assessed in several ways. One possibility is to look at key figures for the business, e.g. the number of new law firms and the capital intensity. Another possibility is to look directly at what it takes to set up a new law firm, e.g. capital requirements and client basis.

The Competition Authority uses two key figures for the entry barriers in their Competition Report: the number of new businesses and the rate of turnover of the assets.

The measure for the number of new businesses is the number of new businesses as a percentage of existing companies. Generational changes and company mergers do not count as new businesses.

The rate of turnover of the assets is a measurement of the capital requirements. The rate of turnover of the assets is calculated as the net turnover divided by the total amount of assets, i.e. how much is turned over for each DKK tied in the business.

The legal profession has a lower number of new businesses and a lower rate of turnover than other services. This could indicate higher entry barriers in the legal profession than in other services, cf. Table 2.11.

[43] According to the chairman of of the Board of the LAw Society, Sys Rovsing, this upper limit has already been reached. Danish business newspaper, 'Børsen' 3rd June, 2005.

Table 2.11: Number of new businesses and rate of turnover of assets

	Number of new businesses (percentage)	Rate of turnover
Law firm	2%	0,9
Accounting and book keeping firm	7%	1,3
Consulting engineers, architects etc.	9%	1,2
Advertising and marketing	13%	2,5

Note: Statistics Denmark has not made a census of the number of new businesses since 2001.
Source: Own estimations based on Statistics Denmark (2001), general company statistics and Statistics Denmark (2001). Number of new businesses 2001.

The low number of new law firms is probably caused by the importance of good name and reputation in the legal profession, and therefore there are probably more generational changes in this sector than in other sectors. Many of the generational changes take place concurrently and without the paying of goodwill[44] and does therefore not create extra entry costs.

The reason the rate of asset turnover is lower in the legal profession than in other types advisory businesses is primarily that lawyers have more current assets. A very large part of the assets is probably outstanding fees on work in progress. I.e. the capital in the legal profession is tied up for a shorter period of time than in other advisory businesses. Lawyers need a large overdraft facility but less long-term debt and equity than other advisers.

The legal profession is less capital intensive than other types of business offering advice as regards the importance of the fixed assets. In relation to other types of advisers, law firms have fewer fixed assets, less equity (risk bearing capital) and higher rate of turnover of the assets, cf. Table 2.12.

Table 2.12: Significance of the fixed assets

	Fixed assets – part of total assets	Shareholder's equity share of assets (solidity)	Rate of turnover of the fixed assets
Law firm	17%	21%	5,0
Accounting and bookkeeping	39%	26%	3,3
Consulting engineers, architects, etc.	38%	40%	3,1

Note: The rate of turnover of the assets is calculated as turnover divided by fixed assets
Source: Our own calculations based on Statistics Denmark (2001) General Firms Statistics 2001 (In Danish), and Statistics Denmark (2001) Entry of new firms 2001(In Danish)

Further to considering key figures for the business, you can also examine the entry barriers by investigating the cost structures. Statistics Denmark has examined the costs of law firms[45]. The survey showed that the personnel costs constitute more than 51 percent of the total costs Other than personnel costs, the costs for office accommodation is by far the largest cost item and constitutes approx. 15 percent of the total costs. This means there are few fixed asset cost. The legal profession is therefore not particular capital dependent.

If you look directly at the challenges that a newly established law firm faces, the biggest challenge is clearly ensuring an adequate client basis. The clients are often loyal and it can therefore be difficult to attract clients from well-established lawyers. Contrarily, capital

[44] Interview 7th July 2005 with Christian Lundblad, Managing director of Ret og Råd (a major Danish law firm).

[45] This part of the investigation was not compulsory by law and the reply rate is therefore lower than in the investigation of the turnover of the business area. However, the investigation does give a good indication of how the costs split in the legal profession.

requirements are less significant. There is no need for large, long-term depreciable investments. The largest set up costs relate to the office accommodation which is often rented, cf. Box 2.4.

Box 2.4: Set up costs

The following items typically constitute the budget for setting up a law firm:

- Rent (rent, deposit and down payment)
- Fitting up (builders and painting)
- Office furnishings (Furniture, IT-equipment, telecoms and photo copier)
- Advisers (Accountant and IT-consultant)
- Office stationery (Letter headed note paper, business cards and printer cartridges).

Source: The Danish Bar and Law Society (2005) "Good advice to new independent lawyers (Gode råd til nye selvstændige advokater)" (in Danish).

In summary, we conclude that the largest entry barrier in the legal profession is entrance to clients because the reputation of a law firm is an important factor for clients when choosing a lawyer. A new law firm first and foremost needs a sound client basis and an overdraft facility. But no large investment and financing requirements exist.

A Norwegian survey[46] of the competition aspects of the legal profession reach the same conclusion:

> *"The informal barriers to setting up a business in the legal profession primarily consist of building up client contact and a good reputation in the business. […] furthermore, the capital requirements of setting up a business are relatively modest."*

2.4. Competition on the market for legal services

The potential for increasing competition through liberalisations depends on the level of competition before the liberalisations. If there are major competition problems there is a large potential for competition gains by liberalising. While on the other hand it is not possible to gain more if effective competition already exits. In the section, we examine competition on the market for legal services.

Initially, we examine the background to the Competition Authority pointing out the legal profession as a sector with weak competition. The business has been pointed out because of three indicators: public regulation, few new businesses and high salaries in the business. However, an examination of the indicators raises doubts as to whether the indicators actually indicative competition problems in the legal profession. For example, the high wages have probably more to do with the workload of the business than competition problems. Therefore, we have more positive assessment of competition in the legal profession than the Competition Authority.

Subsequently, we examine the price formation on the market. Previously, we described that the clients are more concerned with quality than price when choosing a lawyer. The price setting has not been transparent in the legal profession, which has made it difficult for the clients to compare prices for different lawyers. These aspects have limited price competition in the legal profession. However, we expect that the new pricing information rule from the Law Society will change this. The pricing information rule will give the clients the information they need to be able to choose a lawyer based on the price of the lawyer.

[46] NOU (2002) "Right to justice". Norwegian Ministry of Justice (in Norwegian)JD-NOU 2002-18.

We have also compared the price level with prices of other advisers. The comparison indicates that lawyers charge more than other advisers. But the comparison is ambiguous, and does not explain whether difference in price is due to the lawyer dealing with more complicated cases than other advisers.

Subsequently, we examine the competition that lawyers face and show that lawyers are subject to considerable competition. Firstly, lawyers compete among themselves, secondly, Danish lawyers compete against foreign lawyers – both on the export markets and on the home market – and thirdly lawyers compete against other advisers.

The competition authority's assessment of competition in the legal profession
The Competition Authority has placed the legal profession on a list of sectors with competition problems. The legal profession has been pointed out because of three indicators: public regulation, few new business and high salaries in the business. Therefore, it is three out of the total of the nine indicators in the Competition Authority method which points out the legal profession as a sector with weak competition, cf. Table 2.13

Table 2.13: Indicators of competition problems

Indicator	Criterion for problem	Problem in the legal profession
Public regulation	*Competition is limited by public regulation.*	*Yes*
Domestic concentration	The four largest companies together hold more than 80 percent of the market share	No
Import adjusted concentration	The four largest companies together hold more than 50 percent of the market share (incl. import)	No
Access rate	*The share of new business in a given year is less than 8 percent of the total number of businesses*	*Yes*
Mobility of market shares	Less than 10 percent of the market changes between businesses in a given year.	No
Productivity spread	The spread in the total factor productivity of the businesses is more than 25 percent higher than the average for all businesses.	No
Salaries	*Employee salaries in the business –further to aspects explained by education, age, experience, location, sex etc. is more than 15 percent higher than the wages in the furniture industry.*	*Yes*
Investment return rate	For the business in question, the average profit after tax in percent is more than 50 percent higher than the average for all business in Denmark.	No
Price level	The prices are more than 3 percent higher in Denmark in comparison with the EU9 countries when correcting for differences in VAT and taxes.	No

Source: the Competition Authority, "Competition Report 2005" samt "Competition Report 2004".

It is correct that there are few new businesses in the legal profession. But as described above, this is due to the fact that it is more attractive to take over or enter an existing law firm than to establish a new law firm. Many of these generational changes take place concurrently and without paying for goodwill. Therefore, the low number of new firms is not a indicator of competition problems.

It is also correct that salaries are high in the legal profession. But the calculation by the Competition Authority does not take into account a number of aspects of great significance to the salaries in a sector, e.g. working hours and pressure of work. The calculations only adjust salaries for age, length of education, work title, sex, marital status, number of children and location.

Above, we have described that a there is a large exit from the legal profession, therefore the salaries are not high enough to keep the lawyers in the profession. This indicates that high

salaries in the legal profession are caused by working conditions in the business rather than lack of competition. Therefore, it is problematic to conclude that the salaries in the legal profession are high in relation to the workload. The average working week is more than 45 hours in the legal profession[47].

Finally, it is correct that current legislation restricts competition in the legal profession. We will investigate these rules in the next two chapters, and our conclusion is that the regulation inhibits competition but only a limited extent.

There are therefore a number of problems with the three indicators that the Competition Authority has used to point out the legal profession as a sector with weak competition.

The Competition Authority has, however, also argued that certain liberalisations can solve the competition problems of the business.

> *"It is the opinion of the Authority that eliminating the competition limiting rules in the legal profession would entail that the business could be removed from the list of businesses with weak competition."*

The Competition Authority suggests that the legal profession is liberalised by changing the representation monopoly in courts and changing the ownership requirements, and by implementing requirements for specifying fees. We treat these suggestions in the subsequent chapters.

Price setting
Normally, lawyers do not operate with fixed hourly rates. Instead, the fee is determined from a number of parameters such as: time used, size of the case, the result of the case, the value of the advice to the client, the responsibility of the lawyer, time pressure etc. This is in accordance with article 126 of the 'law on administration of justice act', which rules that

> *"A lawyer may not charge fees for his work higher than what is considered reasonable."*

The 'law on the administration of justice act' thus defines an upper limit to how much a lawyer can charge as fees. The Disciplinary Board practices determine the guidelines to what reasonable fee is and the rulings of the Board are based on the above-mentioned parameters.

The largest law firm in Denmark, Bech-Bruun, set their fees this way:

> *"Bech-Bruun's fees are based on the scope of work requested, including work outside normal hours, the importance of the matter to the client, the value added by the services provided by Bech-Bruun, the responsibility associated with the work, the complexity of the matter, the degree of specialist knowledge required and the result achieved."*
>
> *Source: www.bechbruun.com*

There is no great pressure from the demand side for lower price and more price transparency in the legal profession because clients are more interested in professional capabilities and reputation than price.

The Law Society has, however, implemented a pricing information rule from 1st May 2005. The rule means that lawyers must either give the client an estimate of the fees or inform which main

[47] Jyske Bank (2005), "Business area analysis; lawyers and accountants – a time to change" (in Danish).

elements will constitute the calculation of the fees. This information must be volunteered and in writing to private clients while business clients have to ask for this information. The pricing information rule will make it easier for the consumer to compare prices from different lawyers and at the same time the rule means that the consumer is more aware of the price before the work is carried out. We therefore expect that clients in future will focus more on price and that this will increase price competition. This development has already happened during the last few year for standard products, e.g. advice to buyers of fixed property the where demand for fixed price packages and focus on prices increased.

The pricing information rule is therefore expected to improve competition and increase the market. In particular, we expect that more private clients will use lawyers because of the price information rule. The reason is that increased price competition will result in lower prices and that the price information rule will reduce the uncertainty of how large the bill will be.

Prices on legal services

The price setting in the legal profession makes it difficult to compare the level of prices of the legal profession with the pricing level in other businesses because only limited information about prices is available publicly. However, in some segments it is possible to compare the fees of lawyers with the fees of other advisers because the costs partially of fully are covered by the State or because the Competition Authority has examined the prices.

Where we can compare the lawyers' prices with other advisers' prices, there is seemingly a tendency to lawyers charging more. However the fees for appointed lawyers is an exception.

There are several reasons to expect higher prices in the legal profession than in other areas of business offering professional advice. For example, the prices are higher the more complex the counselling is because it requires a better adviser. In some cases, e.g. tax cases, there may be a tendency toward clients using lawyers for the more complex cases while they use other advisers for less complex cases. The hourly fee rate is higher the quicker the case has to be resolved because it can be necessary to set aside other cases and because it can be necessary to operate with a certain amount of slack to be able to handle large cases at short notice. Lawyers often work under time pressure because they advise in times of crisis. The hourly fee rate is also higher the more secretary hours etc are included in the price. Normally, in the legal profession, an hourly fee includes the cost of secretarial assistance etc. The fee rate is also higher the greater the risk is. Lawyers some times have to reduce their fees because it turns out they have spent more hours working the case than the case can carry. This risk may be smaller for other advisers.

The Competition Authority has compared the price of advising a buyer of fixed property between estate agents and lawyers. The price comparison shows that lawyers charge – on average – 20 percent more than estate agents, cf. Table 2.14.

Table 2.14: Prices of advising buyers of houses

	Advising a house buyer	Index
Lawyer	9,500 DKK	110
Estate agent	7,500 DKK	90
Average	8,500 DKK	100

Note: Further to their fee from the buyer, estate agents normally also receive a transaction fee for the loans they sell. Due to independence considerations, lawyers are prohibited from receiving such fee.
Source: The Competition Authority (2004), Competition Report 2004, chapter 4.

Clients could be willing to pay more for advise on house buying from a lawyer than when buying the advise from an estate agent because the client have greater faith in the work of the

lawyer than that of the estate agent. I.e. the consumers expect lawyers to deliver better service than estate agents. One reason for this is that lawyers are independent advisers whereas estate agents usually have a co-operation agreement with a mortgage or credit financing organisation[48].

In tax cases, the State fully or partially reimburses the client's costs in complaints' cases. Therefore, it is possible to compare the prices of lawyers with the prices of other advisers. The price comparison shows that the hourly fee rates of lawyers is 20 percent above average in all complaints' cases while the prices of accountants are 10 percent below the average, cf. Table 2.15.

Table 2.15: Hourly fee rates in tax cases

	Hourly fee rate	Index
Lawyer	2,000 DKK	120
Accountant	1,500 DKK	90
Others	900 DKK	60
Total	1,600 DKK	100

Source: Our calculations based on the Ministry of Taxation, "Report on cases regarding cost compensationin 2004" (Redegørelse om sager om omkostningsgodtgørelse i 2004)", May 2005 (in Danish).

One reason why lawyers charge more than other advisers in tax cases is probably that lawyers take on the largest and most complicated cases. Approx. 60 percent of costs charges for lawyers originate from trials at the High Court and the Supreme Court where other advisers do not lead cases. Another reason can be different invoicing methods. The fee rate of a lawyer includes all costs. The hourly fee rates for other advisers normally only cover the costs of the advisor himself while e.g. secretarial assistance is invoiced separately. This suggests that the price comparison overstates the actual price difference.

When a client is appointed a lawyer at a trial, the State pays 1,200 DKK per hour to the lawyer. This payment is significantly lower than the payment other advisers are rewarded for their work at court cf. Table 2.16.

Table 2.16: Hourly fee rates for court trial work

	Hourly fee rate
Appointed lawyer	1,200 DKK
Legal adviser to the Government	1,800 DKK
Other professionals (e.g. accountant)	2,000 DKK

Note: The State only pays the legal adviser to the Government 1,200 DKK per hour plus an annual fee because the Legal adviser to the Government have entered a fee agreement which entails that the adviser is paid 2/3 of the level of a reasonable fee
Source: the Danish Bar and Law Society (2004), "Revision of recommended fees" (in Danish), June 30th 2004.

Lawyers compete
Lawyers meet competition from several sides.

Firstly, there is competition among Danish lawyers. Above, we have show that there is low concentration rate in the Danish legal profession. I.e. there are many law firms competing amongst each other.

Secondly, there is competition between Danish and foreign lawyers. Danish lawyers compete on the export market and obtain approx. 6 percent of their total turnover from exports, e.g. advising foreign clients. The export is mainly carried out by large law firms with at least 10

[48] The Competition Authority (2004), Competition Report 2004, chapter 4 (in Danish).

employees, carrying out 89 percent of the total export. The export primarily originates from advising business clients, cf. **Fejl! Henvisningskilde ikke fundet.**.

Table 2.17: Export share of turnover

	Percentage
Business clients	10%
Private clients	1%
Mix	2%
Total	6%

Note: the turnover is allocated according to the same key as in Table 2.1.
Source: Statistics Denmark (2005) and our calculations.

In the same way that Danish lawyers export, there are also citizens and companies that buy legal services from foreign lawyers. We do not know the scope of this import, but we know it exists.

However, several aspects limit the international competition between lawyers. Lawyers must in-depth knowledge of the legislation of the country, and clients often prefer a local lawyer[49] and language barriers will limit the scope of export and import. But in large international transactions, the contract language will be English and in reality there is no language barrier and in such cases the legal basis will primarily be EU legislation which reduces the need for knowledge of national legislation. It is therefore primarily a question of national markets, however, despite these limitations, 10 percent of legal services is exported

Thirdly, there is competition between lawyers and other advisers. Not only lawyers offer legal services. Lawyers meet competition from other advisers in most professional areas. Accountants advise on tax legislation, setting up businesses etc, estate agents advise on legal questions regarding fixed property, a number of organisations such as e.g. the Danish Federation of Motorists offer standard contracts and when banks' advice clients they touch upon questions that lawyers can offer advice on. In particular, lawyers meet competition in the areas of legal services to private clients, and primarily legal services at the preliminary stages of a case and advice that can be standardised (e.g. standard contracts). As an example, accountants cover the major part of the market for tax advice, and lawyers are brought into the case when a specific dispute with the tax authorities arises[50].

Competition from other advisers is however, limited by 'the law on legal services, and debt collection and detective undertakings' and the monopoly of representation for lawyers. We will analyse the effects of these regulations in the next chapter

2.5. Regulating the market for legal services

The effects of liberalising depend on the starting point. The more regulation limits competition, the greater the potential for improving competition is through liberalising. However, compared to other EU countries is not much competition limiting regulation in the Danish legal profession. Estimates based on the currently best method for assessing the effects of barriers in the services trade show that regulating the Danish legal profession only will affect the prices by 3 to 4 percent.

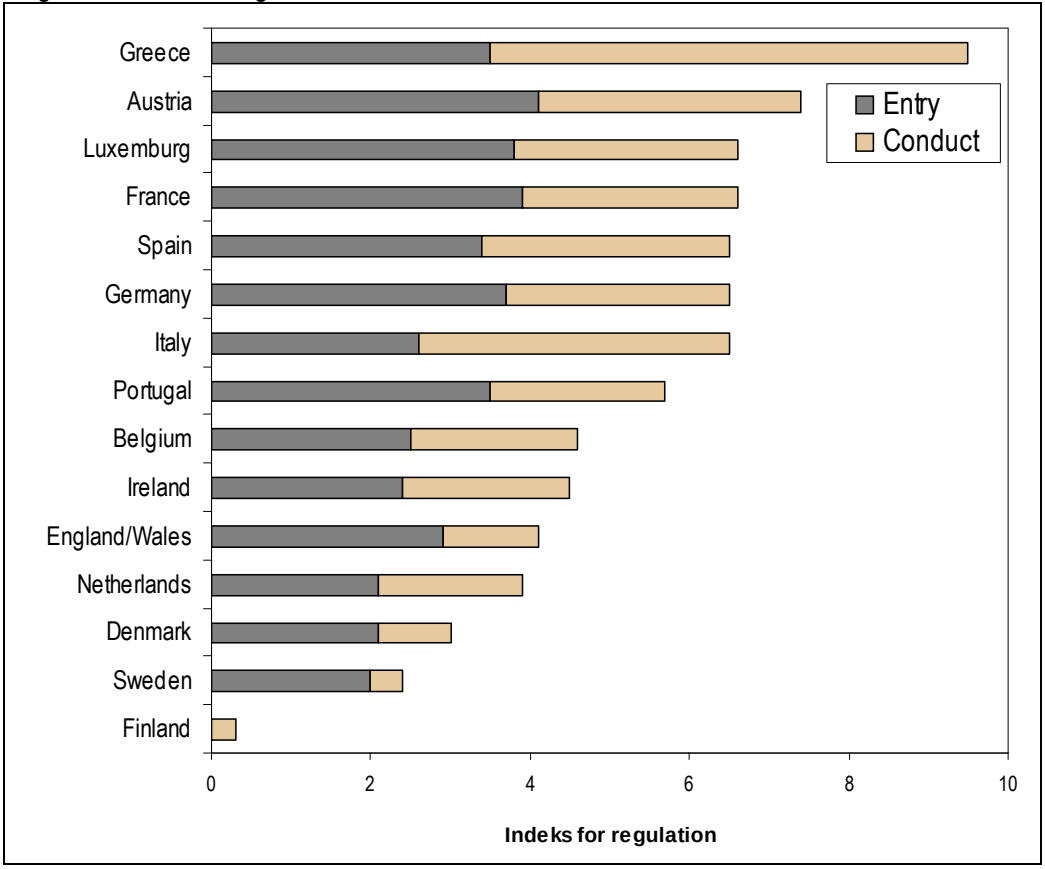
[49] NOU (2002) "Right to justice". Norwegian Ministry of Justice (in Norwegian)JD-NOU 2002-18.; and Ziirsen (2003), "Investigation for private client, part 1. Ciitzens' need for and use of legal services" (in Danish).

[50] Source: Bryde Andersen, M. (2003) "The different hats of the lawyer – which does he keep and who takes the rest" printed in the magazine "Juristen, no. 6, 2003 (in Danish).

Comparing with other EU countries

The EU Commission has compared the regulation of various professional businesses in the member states[51]. The survey shows that Denmark is one of the member states where the legal profession is least regulated, only surpassed by Finland and Sweden. The index for competition limitations of the Danish regulation is 3.0 while the EU average is 5.2, cf. Figure 2.3.

Figure 2.3: Index for regulation in EU Countries



Note: The index for access comprises the requirements a legal advisor has to fulfil, e.g. the education requirements of a lawyer. The index for 'conduct' comprises requirements to how legal services is to be carried out, e.g. marketing requirements. Amongst others, the law on restrictions of marketing contributes to the Danish index for regulating the code of conduct.

Source: IHS (2003) "Economic impact of regulation in the field of liberal professions in different member states. Regulation of Professional Services". Final Report. Study for the European Commission, DG Competition. January 2003.

As opposed to other countries, there are for example neither minimum prices nor recommended prices in the Danish legal profession. This means that the potential for increasing competition through liberalising is far less in the Danish legal profession than in other countries.

In a new report, the Commission highlights Denmark as the pioneering member state as regards liberalising the professional businesses. Denmark is one of the member states with the lowest levels of regulation and is at the same time one of the countries which has already started a process towards further liberalising[52]. In an EU perspective, Denmark already has a

[51] IHS (2003) "Economic impact of regulation in the field of liberal professions in different member states. Regulation of Professional Services". Final Report. Study for the European Commission, DG Competition. January 2003.

[52] The EU Commission (2005), "Professional businesses – possibilities for further reforms. Follow up to the report on competition in the professional businesses". COMM(2005) 405 (in Danish).

low degree of regulation in the legal profession, and there are therefore significantly fewer possibilities for further liberalisations in Denmark than in other member states.

The economic impact of the EU service directive
The EU Commission has proposed a service directive. The service directive gives lawyers the right to offer legal services in other EU countries and the service directive gives lawyers the right to set up a business in other EU countries. Most of the liberalisations in the proposed service directive have already been carried out in the legal profession. However, there will be further effects of the services directive on the market.

Copenhagen Economics has conducted a comprehensive study of the economic impacts of the service directive for the EU Commission. Our analysis of the Services Directive is based on a comprehensive empirical analysis of the relation between barriers and the actual costs and prices of enterprises. We have developed a number of indices for barriers to international trade in services. We have then estimated the relation between these indices for barriers and the enterprises' prices and costs. We utilised a database with more than 275,000 companies for these estimations. There is therefore significant statistical basis behind our estimates.

This analytical framework enables us to assess how much the individual regulations of the legal profession will affect the prices and the costs. The regulations can both affect the costs of the enterprises (cost creating barriers) and result in higher price because the enterprises can inflate prices above costs (rent creating barriers)[53]. An example of cost creating barriers could be 'educational requirements' because salaries increase with the educational requirements. An example of rent creating barriers could be marketing restrictions which may reduce competition and enable the firms to increase prices.

Our estimations show that the regulation of the legal profession results in 3-4 percent higher prices. The main part of this price increase is caused barriers that increase law firms' costs, in particular the law on restrictions on marketing of legal services, cf. Table 2.18.

Table 2.18: Quantifying the regulation of the legal profession

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

Source: Calculations based on Copenhagen Economics (2005), "Economic Assessment of the Barriers to the Internal market for Services". Report carried out for the EU Commission, DG Enterprise. January 2005.

There are of course many assumptions behind such estimations, and the results should therefore be interpreted with great caution. However, we the methodology behind these estimates is currently the best available methodology for quantifying the effect of regulation, and we believe the calculations give a useful indication of the magnitude of the impacts from regulation. The results therefore indicate that liberalising the legal profession only will have a limited impact for the prices in the legal profession.

[53] That is higher mark-ups for the enterprises. Mark-up is the profit share of price, i.e. (price-cost)/price.

Chapter 3 Regulating entry

In this chapter, we assess the competitive effects of the requirements the legal service providers must fulfil. The entry requirements pose a number of minimum requirements to the service provides thus ensuring the consumer a certain quality of the services they buy. However, entry requirements also limit competition because fewer people may sell legal services.

The entry requirements include: educational requirements for lawyers, the lawyer's monopoly right of representation in court, and the ownership rules for law firms. Furthermore, we have also categorised the law regarding restrictions on marketing of legal services as an entry barrier because it is a significant obstacle for advisers who are not lawyers because the law prohibits these advisers from marketing their services.

We conclude that modifying the education requirements will cause a modest rise in the number of lawyers. This will enhance competition among lawyers. The quality of the legal services can however, hardly be maintained on a completely free market without educational requirements because the clients cannot assess the quality of the lawyer (asymmetric information). Modifying the educational requirements therefore needs thorough professional consideration in order that the modification does not harm the consumer because the professional qualifications of lawyers decrease. We argue that the competitive effects of modifying educational requirements will be relatively modest.

We conclude that modifying lawyers' monopoly right of representing others in court will increase competition on part of the market. Firstly, other advisers will take over part of the less complicated cases where the willingness to pay is low. Secondly, the market will increase because more cases will be taken to court when the price decreases due to greater supply. However, it is not unconditionally an economic advantage to society that the number of cases increases because the parties only cover 35 percent of the courts' costs.

We argue that abolishing the law on restrictions on marketing of legal services will increase competition in legal services because other advisers will have the opportunity to market their services. Abolishing the law on restrictions on marketing of legal services will result in lower prices because there will be more legal advisers. This is an advantage for consumers who will probably buy more legal services, i.e. the market will grow. At the same time, consumers will have better opportunity to choose an adviser who matches their needs, e.g. use a cheaper adviser in a case where a lawyer is not needed. First and foremost it will be private clients and small enterprises that will be affected if the law on restrictions on marketing of legal services is abolished. The reason is that these clients normally have the lowest willingness to pay. However, these clients have also the greatest need for consumer protection because it is more difficult for these clients to assess the quality of the adviser's work. Clients will not obtain same

consumer protection rights if they use an adviser who is not subject to the lawyer's code of conduct. Hence, abolishing the law on restrictions on marketing of legal services is not an unconditional advantage to the consumer. However, we suggest that the considerations for the consumer can be taken care of by ensuring that consumers have access to complaining, e.g. through the Consumer Ombudsman.

We conclude that modifying the ownership requirements could damage the independence of lawyers and would hardly imply significant efficiency gains because other owners are unlikely to run a law firm more efficiently than the lawyer. Ownership is probably the best way to motivate and maintain lawyers, and lawyers are the most important asset of the law firm. A new group of owners could lead to conflicts between the lawyers and the owners. Therefore, there are clear economic advantages of law firms being owned by lawyers. And the access to capital is not really a relevant obstacle for law firms as law firms are not heavily capital dependent. This means that the ownership restrictions have only minor impact on the efficiency of the law firms. The ownership rules do not obstruct multi-disciplinary co-operation – the rules merely prohibits the multi-disciplinary co-operation to take the form of a joint company. There will therefore only be minor gains from allowing multi-disciplinary advice firms. However, we argue that a modification of ownership rules that enable employees who are not lawyers to own a part of the law firm can give economic benefits without damaging consumer protection.

3.1. Educational requirements

To become a lawyer three conditions must be fulfilled. Firstly, you must have Danish master's degree in law. Secondly, you must have three years of legal practice. Thirdly, you must complete a compulsory junior attorney education finishing with an exam.

The purpose of the educational requirements is to ensure that the consumer gets a high quality on a market where they find it difficult to assess the quality of the services they buy. Educational requirements is therefore one way to limit the problem of asymmetric information. The EU Commission writes the following:

> *Qualitative access requirements combined with exclusive rights ensure that people with the right qualifications and the right experience can only carry out certain tasks. Thus they may make a valuable contribution to ensuring the quality of the professional services.*[54]*.*

However, educational requirements can limit competition because they reduce the supply, i.e. the number of lawyers. Therefore, it is relevant to assess whether the educational requirements can be modified without damaging the level of quality.

Approximately 270 new lawyers are appointed each year. The supply of lawyers could be increased if more people with a master degree in Law become lawyers or if people with other types of educations get the possibility of becoming lawyers. Today, approx. 45 percent of a year's master graduates from law schools become junior attorneys[55].

The number of law graduates taking the lawyer education probably be increased if the requirements for the practical and/or the theoretical lawyer education are modified. The requirements for the practical education could e.g. be modified by reducing the time

[54] The EU Commission (2004) "Report on Competition within the professional businesses" (in Danish).

[55] During the last 5 years, approx. 270 people have completed the law degree education each year, cf. the Law Society (2005) "Law firms in numbers, business area analysis 2005", pp. 11-12 (in Danish). From 1994-2003, there has been approx. 600 law graduates a year cf. the education statistics from the Ministry of Education based on reportings by the education establishments to Statistics Denmark on http://www.uddannelsesstatistik.dk. (In Danish).

requirement or by allowing the practical experience to be obtained outside the legal profession[56].

Reducing the number of course days could reduce the theoretical part of the lawyer education. The current education consists of 36 course days across three years, which is equal to approximately 6 percent of the working hours. 12 course days a year is a strain that might limit the number of people opting for the education to become a lawyer. Compared to other organisations 12 course days annually is a high number even though newly graduated academics such as assistant attorneys are to be expected to have more course days than the average employee, cf. Table 3.1.

Table 3.1: No. of course days per employee in various organisations

Organisation	No. Of course days per employee
Danish Patent and Trademark Office	12
Danish Financial Supervisory Authority	6
Danish National Tax Tribunal	5

Note: The numbers cover all employees.
Source: Danish Financial Supervisory Authority (Finanstilsynet), Further Education (Efteruddannelse) www.ftnet.dk/sw9315.asp (in Danish). The Danish patent and trademark office (Patent og varemærkestyrelsen) (2000), "Knowledge accounts (Vidensregnskab) 2000" (in Danish). pp. 20, National Tax Tribunal (2005), "Annual report 2004" (in Danish). pp. 38.

The supply of lawyers could also be increased if the 'law on administration of justice act' is changed such that other educations apart from the MSc in Law and Business Administration grant admission to the lawyer education. From 1994-2003, on average 600 law graduates were educated per year and approx. 100 graduates per year in Business Law and Administration (cand. merc.(jur))[57]. In principle, the recruitment basis could therefore be increased by 15 percent if graduates in Business Law and Administration could become lawyers. The real increase in the recruitment basis will, however, probably be significantly less because graduates in Business Law and Administration probably are less interested in becoming lawyers than the law graduates are[58]. Furthermore, it will probably be more difficult for graduates in Business Law and Administration than for law graduates to obtain a qualifying job as assistant attorney because they do not have the same broad legal education.

It is very difficult to determine the impact of modifying the educational requirements. But if the modifications for example result in an increase in the number of law graduates taking the lawyer education from 45 to 50 percent, and if the recruitment basis at the same time grows by 10 percent because more educations give admission, then in the long run there will be 20 percent more lawyers. However, it is not certain that the effects will feed through fully. For example, the modifications could result in more lawyers leaving the legal profession because of increased competition between lawyers. Furthermore, the number of job positions as assistant attorneys will be a bottleneck.

In the short term, the primary effect will probably be that the salaries for the assistant attorneys decrease because there will be more candidates for the job positions. Therefore, the law firms will probably employ more assistant attorneys, and in the long run this will mean more lawyers and more competition. It will however, take a whole generation to obtain the full impact of the modifications. A 20 percent increase in the number of newly graduated lawyers is equal to less

[56] Today, at least two of the three years of practical experience as junior attorney have to be obtained by dealing with trial cases in a legal position working for a court, the public prosecutor or the police

[57] The education statistics from the Ministry of Education based on the reportings by the education establishments to Statistics Denmark on http://www.uddannelsesstatistik.dk. (In Danish).

[58] According to a survey from the Association of Business Lawyers, at least half of the graduates in Business Law and Administration are not interested in the legal profession

than a 1 percent increase in the number of lawyers per year. In the first 10 years, modifications of the educational requirements will therefore hardly have a marked impact on competition.

3.2. Monopoly on representation

Only lawyers may represent others in court. There is however, no obligation to use a lawyer, i.e. people may represent themselves in court, and organisations etc. my represent their members in court in cases regarding the interest area of the organisation (mandate rule). There is no monopoly on representation in bailiff and probate cases unless a dispute is to be dealt with.

The advantage of only allowing lawyers to represent others in court is that it ensures a qualified court process. This benefits consumers who are ensured qualified advice on a market where the consumer finds it difficult to assess whether the advice is good or not (asymmetric information). Lawyers' monopoly on representing others in court ensures quality in the work in court. A well-qualified court process is however also an advantage to society because the trials also define case law.

The disadvantage of the lawyer's monopoly on representing others in court is however that it prevents others apart from lawyers to take a case and thus limit competition. In order to assess whether the monopoly should be modified or abolished, it is therefore necessary to weigh the impact of the monopoly to the quality of the court process against the impact on competition.

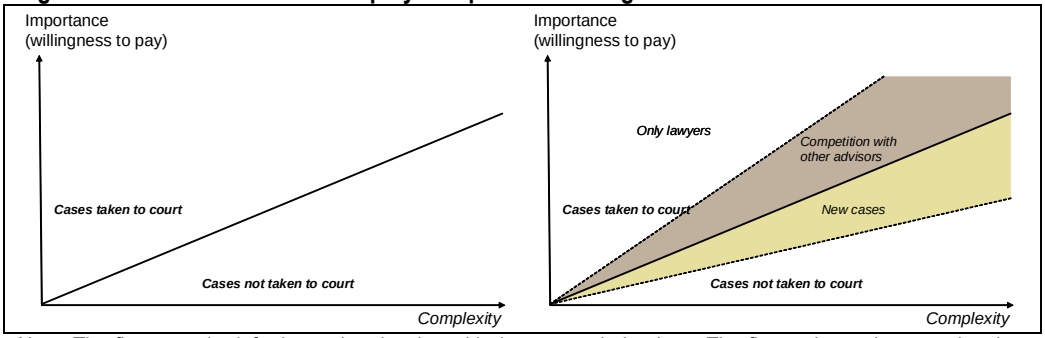
We conclude that abolishing the monopoly will only have a limited impact on competition, but that it could induce economic losses. The courts' costs will increase when more cases are taken to court, and rulings can distort the case law. However, there can be types of trials, e.g. debt collection cases where it may be advantageous to abolish the monopoly right for lawyers because competition can be increased without damaging the quality of the trial process.

Abolishing the monopoly will have a direct and an indirect effect on competition. The direct effect is that other advisers will take over part of the trials. The indirect effect is that other adviser will more easily obtain cases that have not yet reached the courts but which could end up in court. The reason is that some clients will prefer an adviser who can take the case 'all the way'.

Direct effect

The direct effect of abolishing the monopoly is that lawyers will meet other competitors on the part of the market that concerns cases in court. In 2004, criminal cases constituted 5 percent of the turnover in the legal profession while civil court cases constituted 10 percent of the turnover. The direct effect of abolishing the monopoly will therefore only affect a modest share of the market. We expect that the cases where the clients will use other advisers especially will be less complicated cases of less importance. Contrarily, lawyers will probably maintain the market regarding large, complicated and expensive cases. Finally, we expect that more people will take more cases to court if the price decreases, i.e. the market increases. The likely direct effect of abolishing the monopoly is therefore that other advises will take over some of the less complicated cases and that the number of court cases will increase, cf. Figure 3.1.

Figure 3.1: The effect of the monopoly of representation right



Note: The figure on the left shows the situation with the monopoly in place. The figure shows that complex, less significant cases (cases below the straight line) are not taken to court because they are too expensive[59]. The figure on the right shows that the market grows (the line dividing which cases it pays to take moves down) and that there will be competition between lawyers and other advisers on part of the market.
Source: Copenhagen Economics.

From am economic point of view, it is an advantage that other advisers take over part of the small cases, presuming that the quality does not deteriorate. This will increase competition and thus lead to lower prices, and it will give consumers more alternatives and better possibility to choose the adviser who meets his individual requirements. However, the value of having more choice is less on a market with asymmetric information than on other markets because it is more difficult for the consumer to assess what quality of advice they need.

However, it is not necessarily optimal that the number of court cases increases because the parties do not carry the full cost of the trials. Therefore, there is a risk that courts will spend extra resources on cases of little importance. Therefore, clients can take more cases to court than what is optimal for society from an economic point of view[60]. If modifying the monopoly of representation for lawyers makes it cheaper to lead a trial, this problem could increase.

It increase public spending if abolishing the lawyers' monopoly on representing others in court leads to more trials. The court fees only cover approx. 35 percent of the courts net costs[61] and the courts therefore costs the State approx. 700M DKK annually (excl. the costs of criminal cases). If the number of cases increases by 5 percent because of a modification of the monopoly of representation, this will mean increase the costs to the State by 35 M DKK annually. The actual cost could however be both more or less. Firstly, it is not possible to calculate by how much the number of cases will increase should the monopoly be modified. Secondly, the new cases may be less complicated than an average case is today, but contrarily new and less experienced advisers (compared to lawyers) could mean more errors and more work for the courts.

[59] The figure does not take into account that the price is not decisive in cases where the client is covered by insurance or is awarded free legal aid.

[60] Shavell, S. (1997), "The fundamental divergence between the private and the social motive to use the legal system", Journal of Legal Studies, vol. XXVI, June 1997.

[61] The net costs are calculated as the deficit of the courts before court fees. The costs of criminal cases have not been included. In 2004, the courts' net costs (excl. Costs of criminal cases) where approx. 1.2 billion DKK and the court fees where approx. 450 million DKK (Annual Report of the Danish Courts, 2004). The Ministry of Justice estimates that the court fees will decrease by 90 million DKK in 2005 as a consequence of a decrease in fees in civil cases and debt collection cases. (Source: Legislative proposal for changing the administration of justice act and the law on court fees, and comments to these).

Indirect effect

The indirect effect of abolishing the monopoly is that lawyers will meet increased competition in legal services not directly related to trials because some clients will prefer to use an adviser who can take the case 'all the way'. A typical case can be divided into three steps: general advice (information service), specific advice (handling the case and trials and arbitration. By far, the majority of a lawyer's earnings come from case handling, i.e. advice in specific cases that are not trials, cf. Table 3.2.

Table 3.2: Three steps of handling a case

Step	Turnover Million DKK	Share of total turnover
1st Step: Information and standard services	188	5%
2nd Step: Handling the case	6,242	80%
3rd Step: Trials and arbitration	1,081	15%

Source: Our calculations based on Statistics Denmark (2005).

The indirect effects of abolishing the monopoly on representation depend on how strong the connections between the three steps are, i.e. how important the monopoly on representing others in court is for the recruitment of other cases. Two conditions indicate that the monopoly on representing others in court is so very important to the cases that are not court cases.

Firstly, abolishing the monopoly would not give all advisers the right to 'take the case all the way'. Only advisers with the right to represent clients at the High Court and Supreme Court can 'take the case all the way'. And there would probably still be special requirements for people who want to represent others at the High Court and the Supreme Court even if the monopoly on representation was abolished[62].

Secondly, many clients already use advisers who cannot take the case to completion. This is true for both lawyers without the right to represent in the High Court or the Supreme Court and other advisers. There are many examples of clients who only use a lawyer if the case ends up in court while they use another adviser for preliminary other steps in the case. The clearest example of this is in the area of tax legislation.

Example: tax complaints cases

In the area of taxation, the direct effect of abolishing the lawyers monopoly on representing others in court would be that accountants and other advisers would take over some of the tax cases settled in the High Court and the Supreme Court. The direct effect would most likely be quite modest because lawyers presumably are better at handling court cases than other advisers and because other advisers could not immediately gain access to representing clients in High Court and Supreme Court.

In the tax area, the indirect effect of abolishing the monopoly would be that other advisers take over a larger part of the advising which takes place before the cases go to the High Court or to the Supreme Court. The tax complaints' system is described in Box 3.1.

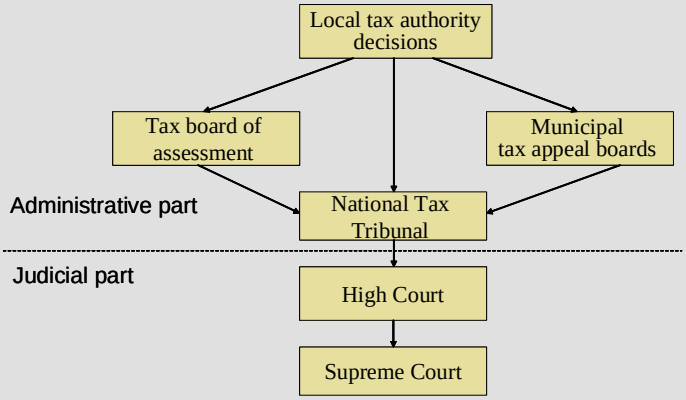
[62] Currently, the lawyer has to pass an exam in pleading to obtain the right to represent clients at the High Court, and Supreme Court representation requires the lawyer to obtain a declaration from the High Court that he is experienced.

Box 3.1: Tax counselling and tax complaints cases

The first step of tax advice consists of the initial tax advice, e.g. filling in tax return forms and tax accounts and strategic tax advice. Lawyers play a very limited role in this work[63].

The second step of tax advice arises when there is a complaints' case. The public complaints' system consists of an administrative part and a judicial part. Lawyers only have the monopoly of representation on the judicial part of the complaints' system, cf. Figure 3.2.

Figure 3.2: Route to complaints on the tax area



Note: Further to the above, there are a number of tax and customs units. As these mostly deal with more formal complaints, they are not included in this overview.

The municipal tax appeal boards deal with approx. 10-12,000 complaints annually. The tax board of assessment together with the tax authority is the supreme tax assessment authority. In 2002, the board of assessment dealt with approx. 70 cases. The Danish National Tax Tribunal is the supreme administrative complaints authority in tax cases and in 2002 it dealt with approx. 3,300 complaints.

Table 3.3: Number of tax cases treated in 2002

Complaints' authority	Monopoly on representation	No. of cases
Municipal tax appeal boards	No	11,200
Tax and customs' regions	No	910
Tax board of assessment	No	70
National Tax Tribunal	No	3,335
High Court	Yes	300
Supreme Court	Yes	50

Sources: The Government (2003) Government committee on modernisation. Report from the committee on municipal boards and councils etc. published 28.05.2003. The Danish Ministry of Taxation (2004) Complaints and trial statistics per 31.12.2002. January 2004.

Reviewing the market shares for different advisers show that lawyers only serve a very small part of the market for tax advice before the cases go to High Court and the Supreme Court, cf. Table 3.4.

[63] Interview 7th July 2005 with Christian Lundblad, Managing director of Ret og Råd (a major Danish law firm).

Table 3.4: Market shares for different advisers on the tax area

Type of advice	Lawyer	Accountant	Others
General tax advice	Almost 0 %	Almost 100 %	
Complaints (administrative part, not representation monopoly)	20%	65%	15%
Disputes (High Court and Supreme Court, representation monopoly)	100 %	0%	0%

Note: The market shares have been calculated from the State's cost cover in complaint's cases. We have assumed that the total costs in the court part of the complaints system goes to the lawyers.
Source: Our estimations based on The Danish Ministry of Taxation (2005), "Report on cases regarding cost compensation in 2004 (Redegørelse om sager om omkostningsgodtgørelse i 2004)" (in Danish), May 2005.

Accountants provide most of the general tax advice and 65 percent of the market for complaints cases on the administrative part of the complaints' system. This indicates that lawyers' monopoly on taking tax cases to court is not a serious barrier for the accountants' access to tax cases. Abolishing the monopoly would therefore probably only have limited indirect effect, i.e. only a very modest decrease in the market share for lawyers on the administrative part of the complaints' system.

'The law on restrictions on marketing of legal services'
Marketing restrictions can limit competition because it becomes more difficult for consumers to gather information and compare different service providers. This means that the 'search costs' increase and that consumers become less likely to change to another seller. Thus, firms can increase their prices without loosing too many clients. A number of empirical studies from the USA show that marketing restrictions do in fact lead to increased prices[64].

There are no marketing restrictions for lawyers. The rules for marketing of legal services follow the rules of the law on marketing.

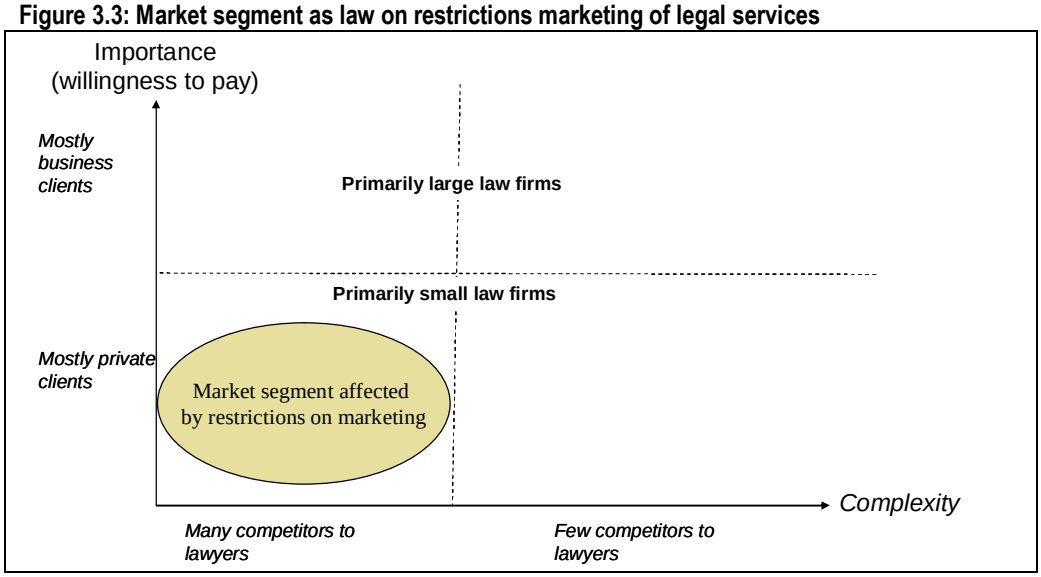
However, not all advisers have the right to market legal services because 'the law on restrictions of marketing of legal services' prohibits anybody apart from lawyers to market legal services. However, the Ministry of Justice has granted some other advisers the right to market those types of legal services which is a natural part of their services. These exemptions include *accountants* (tax advice), *patent agents* (patenting and registration of patterns and trademarks), estate agents, *finance institutions and mortgage credit financing companies* (preparing title deeds for registration) and finally *anyone* may advertise assistance in name cases or statements of assets and liabilities of the estate.

In 1948, when 'the law on restrictions of marketing' was imposed, the purpose was to protect the consumer against unqualified advisers. However, 'the law on restrictions of marketing' creates entry barriers for advisers who are not lawyers and not on the exceptions' list from the Ministry of Justice (cf. above). Therefore, the Government considers abolishing 'the law on restrictions of marketing'. In return the Ministry of Justice must set up code of conduct rules for legal service providers, and the Consumer Ombudsman must oversee that these rules are adhered to.

First and foremost, abolishing the law on restrictions of marketing would affect the private share of the market, and in particular less complicated legal services to private clients, c.f. Figure 3.3. This is because the willingness to pay is low on this part of the market and because less complicated cases do not always require a lawyer's qualifications. However, it is also that part of the market where the clients find it most difficult to assess the quality of the advice.

[64] Cox, C. & S. Foster (1990), "The Costs and Benefits of Occupational Regulation", Federal Trade Commission.

Figure 3.3: Market segment as law on restrictions marketing of legal services



Source: Copenhagen Economics.

Abolishing 'the law on restrictions of marketing' will have two positive effects: the market will grow and competition will intensify. The market will grow because more people will buy legal services when there are better possibilities for using a cheap service provider. Competition will intensify because lawyers will compete against other advisers. In particular, this will affect standard services where other advisers can build up the expertise necessary. But this is actually the part of the market where price competition already is strongest because there is a high degree of price transparency on standard services and because the willingness to pay is low.

Therefore, we expect that abolishing 'the law on restrictions of marketing' will entail a limited decrease in prices, primarily to the benefit of private clients. In return, the consumer will not have the same level of protection when they use advisers who are not lawyers because these advisers will not have to comply with the same educational requirements and are not subject to the same controls. Therefore, it will probably be necessary with some regulation of the market for legal service providers who are not lawyers, e.g. by making the consumer ombudsman the complaints authority.

Regulating ownership

A certain degree of regulation is necessary to ensure the independence of the lawyer because the clients themselves do not have the opportunity to assess whether the lawyer has conflicting interests in a specific case. Regulation, which ensures the independence of the lawyer, is an advantage to the individual clients because it protects against hidden interests. But independent lawyers are also an advantage to society because this is a prerequisite for a well functioning legal system.

Ownership rules is a tool for hindering conflicts of interest and for ensuring the independence of the lawyer. The ownership rules state that only lawyers may own a law firm[65]. I.e. law firms are not allowed to be owned by multi-disciplinary companies, e.g. joint accounting and legal firms.

The ownership rules do not have a direct effect on the number lawyers[66], but may still affect the price of legal services indirectly. The ownership requirements can limit productivity in the

[65] Cf. article 124 of the administration of justice act.

[66] There could be an indirect effect if new owners make the law firms more attractive to work in.

legal profession if there are other owners who could own and operate law firms more efficiently than the lawyers do. And such productivity gains will eventually benefit the clients through lower prices. The crucial question when assessing the ownership requirement is therefore: can other owners operate the law firms more efficiently than the lawyers?

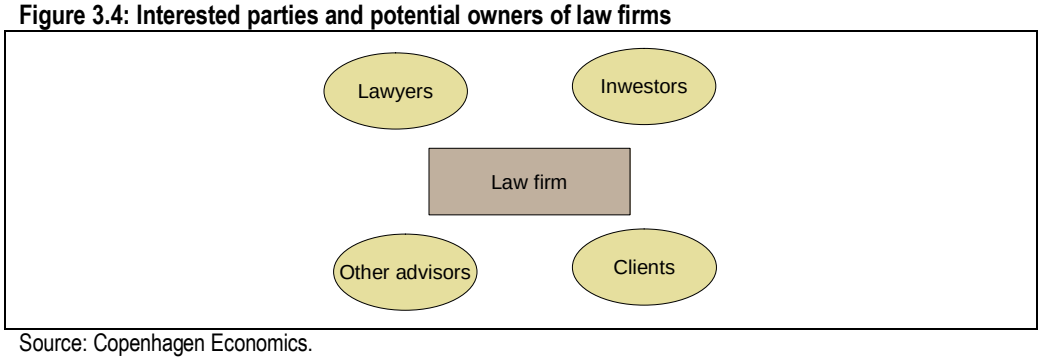
We conclude that other owners can probably not operate the law firms significantly more efficiently than the lawyers. Partly, this is because introducing new owners could lead to conflicts between the owners and the lawyers. Further, ownership is probably the best way to motivate and keep lawyers, and the lawyers are the most important assets in a law firm. If ownership is shared with others than lawyers, ownership will not be as effective a tool to tie the lawyers to the law firm. There are no indications of the access to capital being a real obstacle to law firms because law firms are not heavily capital dependent. And the ownership rules do not prevent co-operation with other advisers – the rules merely prohibit that the co-operation is carried out in a jointly owned company.

Modifying the ownership requirements would therefore probably only bring modest gains. Contrarily, changing the ownership requirements could jeopardise lawyers' independence. Furthermore, there is a risk that other advisers (e.g. banks) would own law firms in order to be able to increase prices to the loyal clients.

Therefore, the ownership rules should only be modified with great caution and the continued independence of the lawyer should be maintained. At the same time, it must be ensured that the client confidentiality obligation of the lawyer is unaffected and not undermined by other owners not being subject to the client confidentiality obligation. All owners should therefore be governed by the code of conduct for lawyers. One way of modifying the ownership rules without jeopardising these requirements is to give employees (who are not lawyers) opportunity to own part of the law firms.

Potential owners of law firms
If the ownership requirements are abolished or modified there would be many potential owners of law firms cf. Figure 3.4.

Figure 3.4: Interested parties and potential owners of law firms



Source: Copenhagen Economics.

Economic literature regarding ownership of firms[67] points to a number of conditions for an ownership structure to be well functioning. Many of these conditions point to the traditional law firms where lawyers themselves own and operate the law firm as the optimum ownership structure.

[67] See e.g. Hansmann (1996), The Ownership of Enterprises. Harvard University Press.

Lawyers as owners of law firms

There are a number of clear economic advantages of lawyers owning the law firms themselves[68].

Firstly, there is *no conflict between owners and lawyers* when the lawyers own the law firm themselves. Hence, law firms avoid the classical problems following the separation of owners and management. It is well know from economic theory that separating ownership and management can lead to problems of ensuring efficient management of the firm because management can have different objectives to the owners and because the owners have difficulties in assess the efforts of management. The chairmen of the Danish Economic Council writes the following:

> *"separating management and ownership may lead to the weakening influence by the owners on the operating of the company. This many reduce the efficiency of the company to the disadvantage of both owners and society[69]".*

If law firms are not owned by lawyers conflicts could arise between lawyers and owners regarding the strategy and the management of the company. Furthermore, the motivation for the lawyers would decrease as they no longer reap all the rewards of their efforts because the profits are to be shared with the owners. The motivation for younger lawyers could also decrease because they no longer have the incentive to work hard to become partners. Economic literature therefore often points the legal profession as a business where it is optimal to have workers owning the firm, i.e. the lawyers, because it is difficult to control the effort of the lawyers[70].

Secondly, ownership is an effective way of *retaining lawyers* – who are the most important asset of the law firm. Lawyers and other advisers can easily take their knowledge, client network and reputation to another company. Therefore, it is important to retain the lawyers, and the best way to retain lawyers is probably to ensure that the lawyers receive the whole profit of the law firm, i.e. when the lawyers are also the owners.

Thirdly, lawyers are a *homogenous group of owners.* This ensures effective decision making in the law firms with relatively few conflicts between the owners. Naturally, internal conflicts can arise within the law firms owned by several lawyers and these conflicts may be expensive to the law firms. However, the scope of such conflicts should be compared with conflicts that could arise with a different group of owners. And compared with other ownership groups, the ownership interests of lawyers are very similar. Therefore, economic literature[71] often highlights that is optimal that lawyers own the law firms because lawyers often make up an ownership group with very homogeneous interests, amongst others because the profit is shared equally between the partners or by other simple rules.

Finally, lawyers normally have *adequate access to capital and management qualifications.* Law firms are not capital intensive firms. The capital requirements are relatively modest[72]. And many lawyers have leadership experience from various boards, and this experience can of

[68] See e.g. Hansmann (1990), "*When does worker Ownership work? ESOPs, Law Firms, Codetermination and Economic Democracy*", The Yale Law Journal, vol. 99, no. 8, june 1990.
[69] Danish Economic Council (1999), Chairmanship Report, Danish Economy 1999.
[70] Alchian, A. & H. Demsetz (1973), "The property rights paradigm". Journal of Economic History, vol. 33, no.1, pp. 16-27.
[71] See e.g. Hansmann (1996), The Ownership of Enterprises. Harvard University Press.
[72] See also Table 2.12.

course also be used in the law firms. A review of the boards of the companies listed on the Copenhagen Stock Exchange shows that approx. 11 percent of board members are lawyers[73].

However, leadership problems do exist in some law firms, and 'bad management' is one of the frequently stated reasons for lawyers wanting to leave their profession[74]. Management is probably one of the areas where new owners would push for improvements. However, it is not obvious that modifying the ownership requirements would improve management in law firms. Firstly, the legal profession itself is working to improve management[75]. Secondly, the ownership requirements do not prevent the law firms from hiring managers who are not lawyers[76]. However, such solutions could be more attractive if it was possible to make management co-owners of the law firms even though management did not (only) consist of lawyers.

Other workers as owners
A possible modification of the ownership requirements could be to let other employees in law firms be co-owners[77]. It could be a reasonable to let key employees who are not lawyers, e.g. the head of human resource management, become co-owners of law firms.

In principle, there are the same advantages and disadvantages of letting other workers own law firms as when lawyers own the companies. Thus, co-ownership will make it easier to motivate and retain other employees, e.g. a chief executive officer who is not lawyer. Extending the group of owners can however lead to conflicts between the owners because the owners would have differing interests in the business. For example, conflicts of interest could arise between the lawyers and the other owners (employees) about projects the company should invest in (prestigious projects or profitable projects) and conflicts regarding ethical and professional issues.

Consumers will not really experience any changes if the ownership requirements are modified so the code of conduct applies for all owners, also those who are not lawyers, and if it is ensured that lawyers maintain majority in the group of owners.

Other advisers as owners
Other advisers, e.g. accountants, undertakers or banks could also be interested in owning law firms.

However, cross-disciplinary companies that offer both legal services and other professional services could cause problems in maintaining the lawyers' client confidentiality obligation. It is difficult to combine lawyers' client confidentiality obligation with obligations of other advisers within the same company. For example, lawyers and accountants basically have different functions in society. An accountant works as the controller for society and is its confidant, and is therefore under reporting obligation whereas a lawyer is the confidential adviser of the client and is therefore under the client confidentiality obligation. Multi-disciplinary firms could also experience problems with the independence of the lawyers. A client might not be so certain that the lawyer would point out an error made by an accountant employed by the same company.

[73] Rose, C. (2004), "Board composition and financial performance of Danish companies listed on the stock exchange", WP-2004-2, Institute of Financing, CBS, Copenhagen (in Danish).
[74] Jyske Bank (2005), "Business area analysis; lawyers and accountants – a time to change" (in Danish).
[75] The Law Society's "Best Practise Guide" (in Danish).
[76] For example, the managing director of Plesner, one of the largest Danish law firms, is not a lawyer.
[77] In principle, other employees could also own the whole of the law firm. However, this does not seem a realistic alternative because the lawyers are the biggest group of employees.

Furthermore, internal tension could also arise in the group of owners if both lawyers and other advisers own the company. This would damage the economic efficiency of the company. Lawyers and other advisers could have opposing interests in a number of questions, e.g. profit sharing and strategic investments.

However, there could be advantages of multi-disciplinary firms because the company could offer its clients a wider range of services[78] such that clients only have to go to one provider (one-stop-shopping). Cross-disciplinary advice could also lead to increased innovation. However, there are two conditions that indicate that modifying the ownership requirements would not increase the scope of cross-disciplinary advice considerably.

Firstly, it is already possible for law firms to have co-operation agreements with other advisers, to share offices and offer joint advice packages. Advisors do not have to have the same owners in order to co-operate, and therefore there is a limit to what joint ownership would contribute.

Secondly, there does not seem to be a great demand for multi-disciplinary advice. There are only a few law firms with co-operation agreements other advisers today. This indicates that there is no great demand for multi-disciplinary advice. In Sweden, accounting firms have attempted to take over law firms, but had to recognise that the demand for multi-disciplinary advice was too small to overcome the management difficulties that the ownership model posed, cf. Box 3.2.

Box 3.2: Accounting firms' experience of running law firms in Sweden

In Sweden, two large accounting firms, KPMG and Ernst & Young have tried to integrate with law firms. In 2000 and 2001, KPMG Legal and Ernst & Young Law were set up with 15 and 60-70 lawyers respectively. These investments were however not successful and had to close again after a couple of years.

The previous head of KPMG, Lars Isacsson, explains that the clients, especially after the Enron scandal, were very sceptical of the accounting firm offering legal services. The interest in multi-disciplinary advice was also less than expected. At the same time, there were large company cultural differences that made it difficult to run legal business and accounting in the same company.

Source: The Law Society of Sweden (Sveriges Advokatsamfund) (2003), printed in the magazine: "Advokaten 2003 nr. 3., Reasons why the targetting of the accounting firms in the legal profession did not work (Därför fungerade inte revisionsbolagens juristsatsningar)" (in Swedish).

However, other advisers could have another motive for owning a law firm, a motive which would not benefit competition. Other advisers could be interested in owning a law firm either to ensure a client basis for their own services or to exploit their own loyal client basis to sell legal services. For example, a bank might want to own a chain of law firms to refer the bank clients to this chain of law firms, and undertakers could be interested in referring clients to their own lawyers on matters of inheritance. Seen from a consumer point of view, there would be both advantages and disadvantages from this. The advantage is that the consumer does not have to look for a suitable lawyer, however, there are two significant disadvantages:

Firstly, the ownership could result in lower quality of advice if the lawyer is not independent of other interests. For example, it is not certain that a lawyer would point out an error made by the bank when he is advising a private client on a property matter if the bank in question owns the law firm that the lawyer works for.

Secondly, it could lead to increased prices if other advisers refer to their own law firms. Especially, private clients find it difficult to assess the quality of the lawyer and therefore base

[78] EU Commission (2004), KOM(2004) 83, "Report on competition within the professional businesses" (in Danish).

their choice on the recommendation of other advisers. This way, the price could be even less significant to the consumer than it is now, when the consumer has to find a lawyer himself.

In the estate agent business it is very common that financial organisations (banks and mortgage credit financing institutes) own estate agent chains. However, it is not multi-disciplinary service that is the motivation behind these ownership relations, because the estate must work in independent companies with their own locations. This means that the clients do not receive cross-disciplinary services. The primary motivation for the finance organisation owning the estate agent chains is probably that the ownership ensures a large client basis for the financial organisations such that they can earn more on their financial products, cf. Box 3.3.

Box 3.3: Ownership relations in the estate agent's business

Today, more than half the agents belong to chains that are partially or fully owned by finance organisations. Agents are obliged to further the sale of financial products from the owners. Furthermore, the biggest chains are owned by finance organisations, cf. Table 3.5

Table 3.5: Estate agent chains co-operating with finance institutes

	Market share in percent 2004	Mother company and type of chain
EDC	18	BRF, 50 % - voluntary chain
Nybolig	13	Nykredit Mægler A/S – Franchise
Home	12	Realkredit Danmark and Danske Bank – Franchise
Danbolig	9	Nordea Kredit – Franchise
Other chains etc.	25	The co-operation between the individual agents is typically looser than in the four big chains mentioned above. The individual agent may have fixed agreements with several finance organisations.
Independent	23	
Total	100	

The co-operation agreements and the ownership of the estate agent chains is an important food chain for the finance organisations. Most consumers do not obtain financing offers from other companies than the one the estate agent works with.

Source: The Competition Council (Konkurrencerådet) (2003), "Realkredit Danmark A/S' procurement agreements with estate agents (Realkredit Danmark A/S' formidlingsaftaler med ejendomsmæglere". Council meeting, 29.01.2003 (Rådsmødet) (in Danish).

Clients as owners

Clients could also be interested in owning law firms themselves, i.e. hiring lawyers. This has the advantage that the clients are certain that the lawyer only looks after their interests. However, it is already possible for clients to hire lawyers. At the moment there are 593 company lawyers, i.e. lawyers not working in law firms but in banks, interest organisations, insurance companies, trade unions, and private firms such as Maersk and Carlsberg. It is therefore not necessary to modify the ownership requirements to give clients the possibility of hiring lawyers.

Investors as owners

One possible modification of the ownership requirements would be to open up the possibility of investors fully or in part owning law firms. In particular, there are two general advantages of investor ownership that makes this the preferred form of ownership in large companies (e.g. listed companies).

The main advantage of investor ownership is that it gives access to cheap capital. However, law firms do not have large capital requirement, and long-term investments are not in question. The access to cheap capital is therefore not significant when choosing ownership form in the legal profession.

Another advantage of investor ownership is that the value of the company can be monitored when the shares of the company are traded. This provides management and owners with a good management tool because it is possible to measure the value of e.g. branding and marketing. However, this advantage only arises if the shares of the company are traded freely on the market, but this would not likely be the case for law firms. Law firms are very vulnerable to conflicts of interest and it would be very easy for a large firm to disable essential lawyers if the shares were traded freely. For example, if there were five law firms with the actual core skills for advising on IT-contracts in Denmark, Microsoft would in effect avoid the essential lawyers by buying five percent of the shares in these five law firms[79]. Therefore, it will probably not be attractive for law firms to have their shares traded freely on the market because the law firms would loose control of which conflicts of interest the company could end up in.

The most significant disadvantage of investor ownership is that the separation of ownership and management could lead to motivation and control problems. For example, it would become more difficult to motivate and retain lawyers. And if investors only own part of the company while the rest is owned by lawyers, tensions would occur in the group of owners. For example, the investors would want a high return on their capital while the lawyers would prefer high salaries. It would therefore be a challenge to get such a mixed company to work.

Therefore, we conclude that investor ownership will not likely entail significant efficiency gains for the law firms. This is because law firms are not heavily capital dependent and because the general advantages of investor owned companies are not fully applicable to the legal law firms. Contrarily, the separation of ownership and management could lead to management problems in law firms and make it more difficult to ensure lawyers' independence and to keep the client confidentiality obligation.

[79] Source: the Law Society (2003). Note on ownership of law firms and trustees.

Chapter 4 Regulating the code of conduct

In this chapter, we examine the competitive effects of the regulation of lawyer's behaviour, i.e. rules on how to operate as a lawyer. The current regulation of the code of conduct is based on two significant principles: *mandatory membership* of the Danish Law and Bar Society and *quasi-regulation*. The *mandatory membership* of the Law Society means that all lawyers are obliged to be members of the Law Society which stipulates the rules for the code of conduct and supervises that the rules are followed. At the same time the lawyers are subject to the rulings of the Disciplinary Board. The principle of *quasi-regulation* means that the legislation only stipulates the overall framework for the legal profession while the Law Society itself determines the guidelines for the code of conduct.

One of the advantages of quasi-regulation is that the regulation form utilise that the business itself often possesses better information than public authorities. This gives a more targeted regulation, which is easier to enforce and observe. Furthermore, quasi-regulation often results in a better acceptance of the rules in the business because the business itself has been involved in the regulation. Quasi-regulation has a disadvantage if the profession uses quasi-regulation to restrict competition.

We conclude that quasi-regulation of the legal profession is preferable to legislative regulation of the code of conduct. Quasi-regulation utilises that lawyers are better than the authorities to assess the quality of a lawyer's work and that the legal profession has significant interest in maintaining a good reputation and therefore emphasises ensuring a proper code of conduct. Furthermore, we conclude that the ethical rules for lawyers are not used to restrict competition. This conclusion is based on three observations. First, the ethical rules for lawyers contain no rules that limit competition, i.e. no recommended prices, nor limits to marketing etc. Second, lawyers do not hold majority on the Disciplinary Board that determines in practice what good code of conduct is. Third, the ethical rules are subject to common competition law[80], which prohibits agreements in professional associations that restrict competition.

We also conclude that the mandatory membership is a prerequisite for the quasi-regulation to continue. The mandatory membership does not impose any significant restriction of competition because the membership does not comprise competition restrictions and because the membership fee is a modest expense (DKK 7,000). Abolishing the mandatory membership will undermine the current disciplinary system. The quality will decrease if lawyers can avoid the disciplinary system by opting out of the Law Society. Therefore, the current disciplinary system would probably be partially or fully replaced by a public system. But this system would loose the advantages of quasi-regulation. Furthermore, it will become unclear to consumers what they can expect from a lawyer and how they can complain.

[80] In particular Article 81 of the EU treaty.

4.1. Quasi-regulation

Regulation can take different forms with different degrees of public involvement. At one end of the spectrum, the public authority may determine rules through legislation – at the other end of the spectrum, the business in question may determine standards without public authority involvement. This is called self-regulation. Further to this, there are in between solutions called quasi-regulations[81] where the regulation is the result of a co-operation between public authorities and private organisations etc, but without the regulation being part of the legislation.

Regulating the legal profession is a mix between legislation and self-regulation, i.e. quasi-regulation. The Law Society guidelines supplement the rules in the 'law on administration of justice act' regarding lawyers, and the Law Society guidelines have been approved by the Minister for Justice.

General advantages and disadvantages of quasi-regulation

The Danish Government – like a number of foreign governments – has assessed the advantages and disadvantages of different forms of regulation[82]. The governments outline a number general advantages and disadvantages which legislators must be aware of when they choose how to regulate[83].

The primary advantage of quasi-regulation is that the special knowledge within the business is utilised. This can lead to better regulation which in turn results in the lower administration costs for the professional associations and authorities and lower compliance costs for the firms.

Another advantage of quasi-regulation is that the profession is involved in the regulating process and will therefore feel greater responsibility for the regulation. This results in greater acceptance of the rules in the business and therefore better compliance. Finally, it is easier to change rules that are merely to be approved by a business interest organisation than by changing legislation.

A third advantage is that quasi-regulation ensures that lawyers are independent of the State because the lawyers need not fear that the State will react with sanctions should members of the profession become ostracised by the State e.g. because a lawyer is leading a case against the State.

The primary disadvantage of quasi-regulation is that some business could use the quasi-regulation to implement competition restrictions, e.g. minimum prices, marketing restrictions, high entry barriers etc.

Another disadvantage of quasi-regulation may be too lenient enforcement. It is therefore necessary to have a strong business organisation to ensure efficient enforcement.

A third disadvantage of quasi-regulation is that it may lead to several alternative sets of rules if the profession cannot agree a common set of rules[84]. Therefore, quasi-regulation is most suitable when the business is homogenous with common interests and incentives.

[81] The Danish Ministry of Economic and Business Affairs (Erhvervsministeriet) (2000), "Quality in regulation (Kvalitet i reguleringen)" (in Danish).".

[82] See e.g. the Ministry of Business (2000) "Quality in regulation" (in Danish); Office of Regulation Review (1998), "A Guide to Regulation"; Victoria Department of Treasury and Finance (2005) "Victorian Guide to Regulation"; and Cabinet Office (2003) "Better Policy making: A Guide to Regulatory Impact Assessement". Regulatory Impact Unit.

[83] The same arguments can also be found in the economic literature. See e.g. Stephen, F.H. & J.H. Love (1998), "Regulation of the legal profession", i: Bouckaert & De Geest (eds.): "Encyclopedis of Law and Economics".

[84] Contrarily, quasi-regulation could result in the choice of the consumer being reduced if there is only one standard in the business.

The advantages and disadvantages of quasi-regulation pointed out by the governments are summarised in Table 4.1.

Table 4.1: Advantages and disadvantages of quasi-regulation

Advantages	Disadvantages
• Utilises expertise of industry or professional associations • Rules which are tailored to specific needs and thus better targeted • Low administration costs and low compliance costs • The involvement of the profession will lead to greater acceptance of the rules in the profession • Greater flexibility and quicker adjusting of rules	• Could limit competition • Lack of enforcement. • Minimum standards may limit the consumer choice. • Disagreements could lead to several alternative sets of rules.
Especially suitable when	
• The independence of the business is important. • A homogenous business with common interests and incentives. • A strong professional association with a broad membership basis.	

Source: The Danish Ministry of Economic and Business Affairs (Erhvervsministeriet) (2000), "Quality in regulation (Kvalitet i reguleringen)" (in Danish).

The legal profession is especially suitable for quasi-regulation
The legal profession fulfils all the criteria for being a business suited for quasi-regulation.

Firstly, lawyers have a special expertise and lawyers are best suited to assess the quality of another lawyers work and to formulate the requirements that must be made of the lawyer's work. The American competition authority writes:

> *Professionals may be in the best position to determine what entry requirements are necessary to insure high quality and identify poor quality professionals within their ranks. They may be the only group that can adequately evaluate the skills and competence of professionals who provide complex services. A fellow lawyer, for example, may be the best person to determine if another lawyer is incompetent*[85]*.*

Secondly, the legal profession is relative *homogenous profession* where the members share interests. This means that the business has good possibilities for defining common rules. At the same time, all lawyers are members of the Law Society and there is therefore a strong association to take care of the regulation. We discuss the mandatory membership in section 4.2.

Thirdly, there is a strong enforcement of the rules. All lawyers are subject to the rules of the code of conduct due to the mandatory membership. And the business has a strong interest in maintaining a good reputation by ensuring that the lawyers live up to the code of conduct. A lawyer who does not comply with the code of conduct does not only damage his own reputation but also the reputation of the legal profession. The legal profession therefore has a clear interest in ensuring that consumers get high quality service from the lawyers.

The Disciplinary Board therefore has strong sanction possibilities, including warnings, reprimands, fines and revoking of the lawyers licence. Disciplinary Board practice also shows

[85] Cox, C. & S. Foster (1990), The Costs and Benefits of Occupational Regulation. Federal Trade Commission.

that the board, to a high degree, uses tough sanctions such as fines in disciplinary cases cf. Table 4.2

Table 4.2: Rulings of the Disciplinary Board in cases regarding code of conduct, 2004

Ruling	Number
Acquittal or rejection	120
Warning	10
Reprimand	61
Fine	154
Disbarment	1
Total	346

Source: Disciplinary Board, Annual report 2004 (In Danish).

Rulings from the Disciplinary Board have a strong disciplining effect on the lawyers since one of the most important competition parameters for a lawyer is his reputation. Therefore, a published ruling from the Disciplinary Board against a lawyer has great impact on his business. The Law Society has suggested that all rulings which impose a disciplinary sanction against a lawyer should be made public on the website of the Disciplinary Board[86]. Finally, professional pride is important to lawyers and therefore lawyers will want to make an effort to avoid criticism from the Disciplinary Board.

Fourthly, the legal profession is a business where independence is important. The quasi-regulation is a prerequisite for the independence of the business enabling lawyers to maintain the client's interests in cases against the state without conflicting interest.

To conclude, there are a number of clear advantages of using quasi-regulation to regulate the conduct of lawyers.

The ethical rules are not used to restrict competition

The primary potential disadvantage of quasi-regulation is that the profession could use quasi-regulation to restrict competition. However, there are three reasons why this is not a problem in relation to the current ethical rules for lawyers: the ethical rules do not restrict competition, lawyers do not hold the majority in the Disciplinary Board who determines the code of conduct in practice, and the ethical rules are subject to the general competition legislation.

An investigation of the ethical rules shows that the rules do not contain any significant competition limitations. Economic literature[87] and the EU Commission point to five types of regulations of professional services that restrict competition[88]. An investigation of the Law Society's rules shows that these do not contain any of these five types of regulations. Contrarily, the Danish legislation (especially the 'administration of justice act' and 'the law on restrictions on marketing of legal services') contain some of these competition restrictions[89], cf. Table 4.3.

[86] The Disciplinary board must reserve the right to omit publication of cases of a serious nature. Furthermore, cases regarding violation of client account rules and rulings regarding fee cases do not have to be published.

[87] See e.g. Stephen, F.H. & J.H. Love (1998), "Regulation of the legal profession", i: Bouckaert & De Geest (eds.): "Encyclopedis of Law and Economics".

[88] The EU Commission (2004). The regulations could be necessary to repair market errors because e.g. asymmetrical information (in Danish).

[89] We have dealt with these rules in Chapter 3.

Table 4.3: Competition limiting regulation in the Danish legal profession

Restriction	Code of conduct	Legislation
Fixed prices	None	None
Recommended prices	None	None
Advertising restrictions	Follows the general marketing law	*General limitations:* Marketing law *Specific to legal services:* 'Law on restrictions of marketing of legal services'
Entry restrictions and reserved tasks	None	*Requirements of education and practical legal experience:* Article 119 in the 'administration of justice act' *Monopoly of representation:* Articles 131-136 of the 'administration of justice act'
Business structure restrictions	None	*Ownership requirements:* Article 124 of the 'administration of justice act' (No limits in cross disciplinary co-operation except the ownership requirements)

Source: Our table based on The Law Society (2005), "Ethical rules for lawyers" (in Danish) and 'administration of justice act' (Danish legislation).

There are no rules regarding fixed prices or recommended prices in code of conduct (i.e. The Law Society's ethical rules for lawyers). The code of conduct only contains a stipulation regarding advertising, i.e. "*Advertising must not contain incorrect, misleading or unreasonably deficient indications*[90]". The advertising rules in the code of conduct thus follows the rules of the general marketing law in Denmark. In Chapter 3 we discussed the entry restrictions for legal advisers in the present legislation, and there are no further entry restrictions in the code of conduct.

The code of conduct contains four rules regarding lawyers' fees that limit the freedom of action of the lawyer, however, the rules cannot be defined as competition restrictions.

The first fee rule is the pricing information rules which demands that a lawyer must give an estimate of the fee or inform the client of how the fee will be calculated when the agreement is made with the client. The information must be given in writing to private clients whereas business clients only need to be given the information upon request. The price information rule enhances competition between lawyers because the consumer can compare offers from different lawyers. Therefore, the price information rule is not restricting competition.

The second fee rule is that lawyers may not charge more than 'a reasonable fee'[91]. This requirement protects the consumer from lawyers taking advantage of clients with major legal problems to ensure themselves unduly high fee. Hence, the requirement means lower prices for the clients and is therefore not restricting competition[92].

[90] Point 2.5.1. of the Law Society's ethical rules.

[91] The requirement is stated in article 126, point 2 of the 'administration of justice act'.

[92] Maximum prices could cause competitive problems because maximum prices make it easier for the companies to co-ordinate their prices if all the firms charge the maximum prices. This concern is however, not relevant in this case because it is very difficult to find a general price level based on the rulings of the Disciplinary Board in fee complaint cases because the calculation of fees is based on a number of factors including time used, the importance of the case, the result of the case etc. Furthermore, firms can only maintain a co-ordinated practice where they all charge high prices if it is possible to detect and punish the companies who do not follow the standard. This possibility does however not exist in the legal profession because it is not possible to monitor whether a lawyer charges a too low price.

The third fee rule is that lawyers are not allowed to use contingency fees where the fee is a percentage of the outcome of the case. The purpose of the requirement is to prevent mixing the economic interests of the lawyer and the client where the personal interests of the lawyer would overshadow those of the client. The fee can however depend of the outcome of the case, and lawyers can use 'no cure, no pay' fees. This requirement reduces the lawyer's possibilities for competing on different fee structures, but it does not limit the possibility for competing on price. Therefore, the rule is not likely to restrict competition.

The fourth fee rules specifies that lawyers are not allowed to charge a fee when referring a client to another lawyer. This requirement is to prevent conflicts of interest, and the requirement can hardly be said to have any effect on pricing.

Thus, the code of conduct does not contain any of the restrictions that the Commission finds particularly restrictive to competition or any other competition restrictions for that matter. The reason is that the Law Society in the latest revisions of the code of conduct has removed the rules that could restrict competition. The code of conduct from 1987 and 1993 did contain some competition restrictions that have been removed in the current code of conduct, cf. Table 4.4.

Table 4.4: Competition limitations that have been removed from the current code of conduct

Restriction	Rules for code of conduct 1987	Rules for code of conduct 1993
Fixed prices	None	None
Recommended prices	Recommended fee rates, restriction against "*obtaining business in a disloyal manner, by e.g. undercutting colleagues*".	Recommended fee rates
Advertising restrictions	Restrictions on the contents of adverts and they way in which advertising is carried out.	Restrictions on the contents of advertising.
Entry restrictions and reserved tasks	Restriction against "*participating in carrying out any legal undertaking at a non-lawyer's office*".	None
Business structure restrictions	Prohibition against assisting non-lawyers.	None
Fixed prices	Prohibition against soliciting other lawyers' clients.	A lawyer can only take over a case from an other lawyer if he ensures that the previous lawyer's fee has been paid.

Source: Our table based on the Law Society (1987 and 1993), "Ethical rules for lawyers" (In Danish).

The second reason that the code of conduct is not used to restrict competition between lawyers is that the Law Society's rules are subject to the general competition rules including article 81 of the EU treaty regarding horizontal agreements. Article 81 prohibits agreements that limit competition, both agreements between firms and regulations of professional associations[93]. In the Wouters' case, the EU court has established that the Dutch Law Society is encompassed by article 81 of the EU Treaty. This means that the Law Society rules must follow all the same competition rules that other businesses must follow, cf. Box 4.1.

[93] According to item 3, the prohibition on competition limiting agreements does not apply if the parties can document that the agreements entail efficiency gains to the benefit of the consumer. However, it is a prerequisite that the gains cannot be attained by less competition limiting means at that the agreements do not eliminate competition.

Box 4.1: The Wouters ruling

The Dutch lawyer Wouters who had become partner in the accounting firm Arthur Andersen filed a suit against the Dutch law society because the Law Society would accept him as lawyer due to possible conflicts of interest. The EU court acquitted the Dutch law society because the ownership requirements are necessary to maintain the independence of the legal profession. But the EU Court determined that the Law Society is comprised by Article 81.

"*A regulation concerning partnerships between members of the Bar and other professionals, […] is to be treated as a decision adopted by an association of undertakings within the meaning of Article 85(1) of the Treaty (now Article 81 EC).*"

Source: the ruling of the EU Court of 19th February 2002 in case C-309(99: Wouters et all against the Dutch Law Society.

The third reason that the code of conduct is not used to restrict competition is that it is the Disciplinary Board and not the Board of the Law Society who through its rulings determines the standards in practice. The Board of the Law Society defines the code of conduct rules but these rules are only a guide to the Disciplinary Board. Lawyers hold half the seats on the Disciplinary Board but the Chairman is a Supreme Court Judge and he holds the deciding vote should a tie of votes occur. I.e. the lawyers do not hold the majority on the Disciplinary Board, thus the lawyers cannot use the Disciplinary Board to enforce competition-limiting rules[94].

Box 4.2: Composition of the Disciplinary Board

The Disciplinary Board has 18 members. 3 members are judges from the Supreme Court, the High Court and the County court, respectively. The Judges are appointed by the president of the Supreme Court. 6 members are representatives of the public authorities, not lawyers. These members are appointed by the Minister for Justice. Finally, 9 members are lawyers selected by the Law Society.

Source: www.advokatnaevnet.dk.

The practice form the Disciplinary Board shows that the Board does not always enforce the code of conduct as defined by the Board of the Law Society. An actual case regarding a company name shows that the Disciplinary Board only enforces the code of conduct if there are consumer interests at stake[95], cf. Box 4.3.

Box 4.3: The ruling of the Disciplinary Board in the case against the "Fredericia Advokaterne"

In 2000, a law firm in Fredericia changed its name to 'Fredericia Lawyers' (In Danish 'Fredericia advokaterne'. This caused more or less all the other lawyers in Fredericia to file a suit against the firm because they thought it against the code of conduct which states in point 2.5 that "*the company name of a law firm should suited to uniquely and specifically identify the law firm in question*".

However, the Disciplinary Board rejected the complaint on the basis of "*the question regarding the name of a law firm should be settled by the courts based on current legislation regarding marketing and competition".* I.e. the Disciplinary Board does not enforce the rules of the code of conduct that do not concern clients but only concern disloyal behaviour between lawyers.

Source: Disciplinary Board, March 22nd 2002 (In Danish).

4.2. Mandatory membership

According to the 'law on the administration of justice act', all lawyers must be members of the Danish Bar and Law Society. The mandatory membership means that all lawyers are subject to

[94] Recently, the Board of the Low Society has suggested that the Disciplinary Board is increased by three members, so there would be an equal number of lawyers and representatives of the public. Source: The Law Society, "The control and disciplinary system of lawyers", July 2005 (in Danish)

[95] In the case mentioned, the Disciplinary Board assessed that a question regarding company was not a question of consumer protection. However, the opposite argument is that the rules regarding company names should in fact ensure that the consumer knows which lawyer they are using, i.e. making it easier for the consumer to complain over a specific lawyer.

the Law Society monitoring, inspections and the disciplinary system through the Disciplinary Board.

Firstly, we conclude that there is no competition argument for abolishing the mandatory membership because it does not restrict competition. Previously in this report, we concluded that the Law Society's the rules for code of conduct does not restrict competition. And the mandatory membership does not increase the entry barriers to the business. The conditions for obtaining a licence to practice as a lawyer would be the same regardless of whether there is a mandatory membership or not, i.e. the same education requirements. And the fee of DKK 7,000 per annum does not constitute a significant entry barrier. Furthermore, the fee would be replaced by an expense to finance a public disciplinary system.

Secondly, we conclude that abolishing the mandatory membership could lead to decreasing quality within the legal profession. Without a mandatory membership, the Law Society's possibilities for ensuring high quality of the services of a lawyer would be undermined because lawyers could avoid sanctions by cancelling their membership. Furthermore, the current disciplinary system would probably be fully or partially replaced by a public disciplinary system, such that clients can complain about all lawyers regardless of whether they are members of the Law Society or not. Implementing a public disciplinary system would mean that the lawyers loose their independence from the State. Furthermore, it would lead to uncertainty for the consumer if a public disciplinary system was to operate in parallel with the disciplinary system of the Law Society.

The mandatory membership does not restrict competition
Above, we have shown that those rules that restrict competition in the legal profession are found in the legislation and not in the rules of the Law Society. The legal requirements will be the same regardless of whether a lawyer is a member of the Law Society or not, e.g. the same education requirements, the same ownership requirements, and the same marketing rules. Abolishing the mandatory membership would not remove the competition restrictions in current legislation but would only mean that lawyers are not required to comply with the rules for code of conduct defined by the Law Society. Therefore, abolishing the mandatory membership will not remove any competition restrictions.

Neither will abolishing the mandatory membership reduce the entry barriers for new lawyers significantly. By cancelling their membership of the law society, a lawyer could save DKK 7,000. On average this amounts to 0.4 percent of turnover. The fee is therefore so modest that it cannot be said to constitute any real entry barrier. Furthermore, abolishing the mandatory membership will probably mean that the lawyers have to finance a public complaints system thus neutralising a significant part of savings.

Therefore, should the mandatory membership be abolished, the entry barriers and the freedom of action for the individual lawyer will not change significantly. The lawyers will face the same entry restrictions regardless of mandatory membership or not, and the requirements for the code of conduct will also remain etc. cf. Table 4.5.

Table 4.5: Requirements for lawyers with or without mandatory membership

	With mandatory membership	Without mandatory membership
Access requirement	Education requirements Ownership requirements	Education requirements Ownership requirements
Code of conduct 'good practice'	The ethical rules of the Law Society	Public rules for code of conduct
Supervision	The Board of the Law Society	Public authority
Disciplinary system	Board of appeal/tribunal	Public complaint's authority
Economy	Fee, DKK 7,000	Financing public disciplinary system

Source: Copenhagen Economics.

Lawyers will probably have to comply with some requirements for code of conduct if the mandatory membership was abolished, cf. article 126 of 'law on justice act'. However, there could be differences in the requirements of the code of conduct determined by the Law Society and those defined by a public authority. It is to be expected that lawyers have the best pre-requisites to stipulate the rules for code of conduct, and it is therefore an advantage to let the legal profession formulate the rules for code of conduct. In other words, abolishing the mandatory membership might lead to less efficient rules for code of conduct and this would be a disadvantage for both lawyers and clients.

The current disciplinary system requires mandatory membership

The mandatory membership is a condition for the quasi-regulation to continue and for the Law Society to be able to effectively enforce the code of conduct. Abolishing the mandatory membership would undermine the current disciplinary system. Therefore, the current disciplinary system would partially or fully be replaced by a public complaints' system. The choice in fact is therefore between keeping the mandatory membership and implementing a public complaints' system.

Currently, the Board of the Law Society monitors the lawyers and may file suits through the Disciplinary Board. It is not realistic that the Board of the Law Society can continue to carry out this monitoring and control without mandatory membership. Efficient monitoring and control requires that the Board of the Law Society does not fear that reprisals will lead to members leaving the society. The monitoring and control would therefore likely be left to a public authority if the mandatory membership was abolished. But a public authority does not have the same insight into the business as the Board of the Law Society has is therefore less suited to exercise control. In the same way the disciplinary system would be undermined if a lawyer could avoid sanctions from the Disciplinary Board by cancelling their membership of the Law Society should a suit be filed against him or her.

If the mandatory membership is abolished it would be necessary to implement a public disciplinary system comprising all lawyers, both members and non-members of the Law Society. This is because the Disciplinary board is part of the Law Society and would not have any authority over non-members. The lawyers independence from the State would be weakened in a public disciplinary system, and the other advantages of quasi-regulation would also disappear.

In Norway, membership of the Law Society is not mandatory, but 90-95 percent of the lawyers are members of the Law Society. However, the complaints' system is very complicated because it has to consider those lawyers who are not members of the Law Society. This means that there are two complaints' systems in place: a public system and the system of the

Law Society. Thus, the situation with different types of lawyers (members and non-members) is hardly advantageous to consumers.

Our conclusion is therefore that the mandatory membership should be retained. Abolishing the membership would not improve competition but would lead to a number of disadvantages. A committee set up by the Ministry for Employment going through a number of exclusive agreements reached the same conclusion. The Committee thus recommends that the mandatory membership would be retained, cf. Box 4.4

Box 4.4: Conclusions from the Government Committee on exclusive agreements

In 2001, the Government set up a committee under the Ministry of Employment to investigate requirements of membership of certain organisations as a prerequisite to get work or carry out a certain type of work. The Committee assessed whether there is a need to maintain such membership requirements for certain organisations.

The committee recommends that mandatory membership of the Law Society is maintained. The Committee emphasises the following conditions:

- The arrangement has more or less existed unchanged since the first 'law on administration of justice act' was passed in 1916, and the considerations made at that time for the introduction of the arrangement are according to the committee still relevant and essential.
- Lawyers hold a special role in society which needs independence from the State
- The existing arrangement ensures the independence of lawyers from that State and takes into consideration the interest of the public in efficient exercise of control of the conduct of lawyers and dealing with specific cases.
- The mandatory membership involves that the individual lawyer automatically is subject to the supervision and control of the Board of the Law Society and the disciplinary authority of the Disciplinary Board.
- That the Board of the Law Society can exercise its supervision and disciplinary authority without fearing members leaving.
- The mandatory membership involves that the Board of the Law Society whether acting internally or externally can do so with the authority that comes from the Board representing the whole of the legal profession.

Source: Ministry of Employment (2002) The Danish Ministry of Employment (Beskæftigelsesministeriet) (2002), "Committee on Exclusive clauses (Udvalget om eksklusivbestemmelse)". Commission report no 1419, the Danish Ministry of Employment (Betænkning nr. 1419. Beskæftigelsesministeriet)June 2002 (in Danish).

Appendix: Concentration index for the legal profession

We have calculated the so-called Herfindahl-Hirschmann index (HHI) to measure the degree of concentration in the legal profession. The HHI is calculated as the sum of the squared market shares for all companies. The results show that the degree of concentration is low in the legal profession, cf. Table 5-1.

Table 5-1: HHI-index

	All companies	Companies with at least 10 employees	Concentration
Total	**51**	**110**	**Low**
Business clients	**173**	**269**	**Low**
Business advice	471	644	Low
Debt collection	104	206	Low
Company advice	293	478	Low
Bankruptcy	252	375	Low
Patents and copy right	2,202	2,646	High
Technology	1,162	1,708	Moderate
Employment law	571	629	Low
Environment	763	1,120	Low/moderate
Private clients	**19**	**67**	**Low**
Private counselling	37	120	Low
Criminal law cases	63	216	Low
Notary public cases	386	1,581	Low/moderate
Fixed property	56	170	Low
Mixed	**59**	**150**	**Low**
Civil law suits	129	353	Low
Other services	637	1,125	Low/moderate
Other legal services and information	141	384	Low
Administration	89	276	Low
Accounting, bookkeeping and tax	920	1,317	Low/moderate

Source: Copenhagen Economics based on data from Statistics Denmark.

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