Conference of Regulatory Officers

'The Future of Regulating the Legal Profession: Is the Profession Over Regulated?'

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16 September 2009
Kings Park Function Centre
Perth, Western Australia

Introduction

It is a pleasure and an honour to have been asked to address this conference of those engaged in the regulation of the legal profession of Australia. I would like to commence my remarks by acknowledging the traditional owners of the lands on which we meet, the Noongar people of South-Western Australia, and by paying my respects to their Elders, past and present.

The title to my address poses a rhetorical question that has already been answered by no lesser persons than the Prime Minister and the Attorney General of the Commonwealth. In their joint media release announcing the creation of a taskforce charged with the responsibility for planning the national regulation of the legal profession, the Prime Minister and the Attorney observed:

> The regulation of the legal profession in Australia remains overly complex and inconsistent, with up to 55 different regulators across the country.
>
> As a result, different practices apply in different jurisdictions, including for example costs, disclosure and billing, admissions and practicing certificates and complaints handling and professional discipline.
>
> Australian lawyers and consumers no longer operate in just one State or Territory.
>
> To deliver a seamless national economy we can no longer justify such disparate regulation for just one profession.
>
> National regulation of the legal profession will benefit consumers, lawyers and firms alike:
>
> - Consumers of legal services will benefit through increased competition, reduced compliance costs and billing arrangements that are simplified and more transparent;
> - Lawyers will benefit by being able to easily operate across jurisdictions; and
> - Legal firms will benefit by being more competitive in both the national and international arena.

In a recent edition of the Australian Law Journal, its editor, Justice Peter Young observed that 25 years ago, when he was at the Bar, it was self-regulating, and that all regulatory activities were undertaken by the members of the Bar on a voluntary basis, at the total cost of salaries for a registrar and secretary. By contrast, as he observed, the regulation of the legal profession in Victoria for the 12 months ended June 2008 cost $13.3 million, or about $937 for each and every member of that profession.

So, at a general level, it is relatively easy to say that there is too much regulation of the legal profession in Australia. That answer prompts the obvious next question - 'what should we do about it?' The answer to that question is much more complicated. In this paper I would like to suggest some considerations that might inform current deliberations with respect to the appropriate manner and extent of regulation of the legal profession.

Why do we regulate the legal profession?

Before we can identify the extent to which the legal profession is 'over regulated' or the parameters of an appropriate level of regulation, or the appropriate mechanisms of regulation, we need to first identify the objective of regulation. The diverse aspects of the regulation of the legal profession make it difficult to enunciate the objective of regulation in a single pithy phrase. That diversity is evident in the various components which are generally accepted as constituent elements of the regulatory function, including:

(a) regulation of entry into the profession;

(b) the identification of appropriate standards of professional conduct, and the encouragement of adherence to those standards;

(c) the investigation of complaints and the administration of discipline with respect to legal practitioners, including expulsion from legal practice;

(d) the regulation and supervision of arrangements relating to trust accounts, public liability insurance, and fidelity funds.

Doing the best I can to unite these various aspects of regulation under a single banner, it seems to me that they are all justified, or ought to be justified, by an objective expressed as:

> The promotion of the public interest in the provision of efficient, accessible and ethical legal services and the provision of avenues of redress for consumers adversely affected by inadequate or improper services.

The right degree of regulation

Once this or some other objective of regulation has been identified, it is then possible, at least in theory, to test any existing or proposed regulatory framework by asking, in respect of each and every element of that framework, whether it contributes to, or enhances the achievement of the fundamental objective. If the answer to that question is in the negative, obviously that element of the regulatory framework should be dropped. However, if the answer to that question is in the affirmative, there is a further question which then has to be asked. That question is whether the benefit to be derived from the extent to which the particular aspect of the regulatory framework under consideration enhances achievement of the fundamental objective justifies the cost which that element of the regulatory framework imposes upon the providers of legal services, and through them, the consumers of legal services.

Understandably, economists are inclined to answer questions posed by reference to a comparison of benefit to cost in economic terms. However,

as Spigelman CJ has pointed out in his paper 'Are Lawyers Lemons?', the public interests involved in the regulation of the legal profession cannot be evaluated in purely economic terms[1]. That is because the role of the legal profession in the administration of justice cannot be characterised simply as the provision of services to consumers. The courts are a vital component of the constitutional structures created for the governance of our society. Those structures, and the peace, order, stability and security of our society depend upon the rule of law. The rule of law in turn depends upon a system of courts for the administration of justice. The courts in turn depend upon the assistance of legal practitioners fulfilling their important functions as officers of the court.

As Spigelman CJ points out, the nature of the legal profession and the broader public interest in values such as independence and the ethical standards of the profession make it unwise, at the very least, to evaluate the regulation of the profession by asking 'only whether or not a particular restriction provides economic benefits to consumers which are capable of countervailing the economic detriment of a restriction on competition'.

Rather, as Spigelman CJ points out, evaluation of the appropriate degree and form of regulation of the legal profession necessarily requires an assessment of values which cannot be measured in purely economic or financial terms. Let me provide an example drawn from my own experience when President of the WA Bar Association.

In those post-Hilmer days, the Australian Consumer and Competition Commission (ACCC) investigated the extent to which the Conduct Rules of the WA Bar Association contravened the principles of competition

[1] Are Lawyers Lemons?: Competition Principles and Professional Regulation - (2003) 77 ALJ 44

policy embodied in the *Trade Practices Act 1974* (Cth). One of the Rules which attracted their attention was the rule which prohibited barristers from practising in any form of economic combination with any other practitioner - such as a partnership. They were concerned that this inhibition upon the business structures that might be adopted by lawyers practising as barristers inhibited competition by preventing the adoption of more efficient business structures and thereby added to costs, which are, of course, recovered from the consumers of barristers' services.

For my part, I had some difficulty seeing how a Bar comprising 150 or so sole practitioners competing aggressively against each other in relation to the quality of the services delivered, and on price, could be less competitive than a Bar made up of, say, three partnerships each comprising 50 barristers. My lack of comprehension of a proposition which the representatives of the ACCC regarded as self-evident is no doubt a reflection of my economic ignorance.

The confidence with which the representatives of the ACCC expressed their views showed that they had no doubt that they were right, so let us assume that they were, and that the prohibition upon barristers practising in partnership imposes a cost which is passed on to consumers. But the prohibition upon practising in partnership also ensures that each barrister is independent of every other barrister, and that the cab rank rule, which requires a barrister to provide services to any client who seeks those services, can operate without the significant restrictions that would be inevitable if barristers practised as part of a large partnership. The independence of each and every barrister significantly enhances the availability of their services. It also enhances the quality of those services, because of the impartiality with which advice can be given.

Independence and impartiality are vital components of the contribution made by the Bar to the administration of justice. The value which one attributes to those characteristics of the services provided by barristers is necessarily subjective, and depends very much upon one's perspective. With respect to the economists, it is impossible to meaningfully compare, in dollar terms, any increased cost to consumers arising from the inability of barristers to practise in combination, to the benefit derived by the community from an insistence upon business structures which ensure independence and impartiality. Those benefits are incapable of measure, in dollar terms, and their value depends very much upon one's subjective perspective.

Competition policy

Much of the debate with respect to the regulation of the legal profession over the last 20 years or so has been dominated by the impact of contemporary competition policy upon such regulation. The passage I have set out from the joint media release of the Prime Minister and the Attorney General of the Commonwealth announcing the project for the national regulation of the profession shows that competition policy objectives have been influential in the adoption of that project by the Council of Australian Governments. While nobody could deny that multilayered and inconsistent regulation adds to cost, there is I think a real question about the extent to which conventional competition policy can be applied to the legal profession without modification.

Because, as you have already seen, I am a very poor economist, I will try and illustrate my point by reference to a fairly basic economic concept which even I can understand. That concept concerns barriers to entry to a market. Conventional economic theory is that barriers to entry into a

market inhibit competition within that market and increase price and reduce quality.

There is of course a barrier to entry into the market for the provision of legal services. Nobody can enter that market unless they possess the stipulated qualifications and are admitted into the market by the relevant regulatory authority. So, according to conventional economic theory, those barriers to entry can be assumed to be contributing to what the public consider to be the high cost of legal services. Complaints with respect to the cost of legal services are often most vociferous in the area of commercial law, where hourly charge rates are undoubtedly substantial.

One might test the hypothesis that barriers to entry have contributed to those hourly rates by comparing them to rates charged by comparable service providers. In the area of commercial law, the most comparable service providers would be accountants, commercial advisors and merchant bankers. No regulatory authority inhibits entry into any of the markets for the provision of those services. However, the rates charged by the providers of services in those markets are at least comparable to if not greater than the rates charged by commercial lawyers. On this comparison, the hypothesis that barriers to entry imposed by regulatory authorities add to cost is not made out. The hypothesis is further undermined by the observation that in every jurisdiction in Australia, there are many persons who are entitled to practice law but who do not exercise that entitlement. The gap between the number of those on the Roll of Practitioners, and those taking up practice certificates is substantial, and growing, in each jurisdiction. There is, therefore, a large

pool of potential market entrants who, for one reason or another, choose not to enter the market.

Information asymmetry

As Spigelman CJ has pointed out in the paper to which I have referred, when applying economic market theory to the market for the provision of legal services, account must be taken of what economists call 'information asymmetry'. That is a term used to describe a market in which one or other of the participants, either sellers, or buyers, have greater information than the other participant.

Some aspects of the market for the provision of legal services come within this description, because of the limited information which the acquirer of those services has in relation to the quality or efficacy of the services to be supplied prior to their acquisition. It is not a description that applies to all aspects of the market, because there are sophisticated consumers of legal services who are in a position to compare and contrast the quality and value of the services they have acquired, because of their experience in the acquisition of such services. However, while such consumers represent a portion of the market for legal services, there is a significant portion of that market in which the acquirer of the service has no realistic way of knowing, in advance, of the quality or value of the service being acquired. In that sector of the market, information asymmetry inhibits the capacity of the market to derive true value for any transaction, to promote quality through competition, and also inhibits the capacity of the market to drive inefficient and incompetent suppliers of services out of the market all together. The constraints which information asymmetry place upon the efficient operation of the market for the

provision of legal services create a gap which should be filled by the regulators of the profession.

How then does a regulatory authority fill the gap created by information asymmetry in the working of the market place? As I have suggested, that gap inhibits competition on price and quality, because at least some consumers are ill equipped to assess the quality of service supplied. And in a perfect market, those who are unable to compete by reference to the quality and price of services supplied will be forced from that market. But of, course, the market with which we are concerned is less than perfect.

On the subject of price, scales of costs are promulgated in most jurisdictions. In practice however, the market price for the provision of legal services operates quite independently of those scales. My own personal view is that any attempt to regulate and control the prices at which legal services are delivered is doomed to fail, and even if successful, would give rise to many of the stultifying effects of price regulation in other areas of the economy.

But how do regulatory authorities encourage the delivery of quality legal services in a market environment in which at least some of the consumers of those services are ill equipped to assess or evaluate quality? And what does quality mean in this context? Because of the constitutional and social significance of the services provided by lawyers, 'quality' must surely include reference to the maintenance of proper standards of ethical behaviour.

If standards of ethical behaviour are a yard stick against which the success of regulatory authorities in encouraging the delivery of quality legal services can be measured, I suspect there would be many in the community who would not give our current systems of regulation high marks for achievement. Public dissatisfaction with the ethical standards of the legal profession is not new, although Shakespeare at least understood the constitutional significance of the legal profession when he attributed to a follower of Jack Cade, a rebel who sought to overthrow the government, the immortal words 'the first thing we do, let's kill all the lawyers'. The speaker of that famous line was given the evocative name 'Dick the butcher' by the bard. Happily Cade and his followers failed to kill all the lawyers or to overthrow the government, which showed its displeasure by placing Cade's head on a pike on London Bridge for public display, and cutting his body into quarters for display in different English cities. However, by the time of Dickens' 'Bleak House', a rather different sentiment relating to the legal profession was evident in English literature.

More contemporary public attitudes towards the legal profession have been shaped by the conspicuous involvement of members of that profession in public and commercial scandals, both here and abroad. When John Dean testified before the Senate Watergate Committee, he was asked about the stars he had placed next to certain names on a list he had compiled. Dean responded that he had placed 'a little asterisk beside each lawyer, and that his reaction was how in god's name could so many lawyers get involved in something like this'[2]. More recently, Harvey Pitt, when Chairman of the Securities and Exchange Commission rhetorically

[2] Rochvarg - 'Enron, Watergate and the Regulation of the Legal Profession - 43 Washburn Law Journal 61

asked members of the American Bar Association at the time of the collapse of Enron - 'where were the lawyers?', and 'what were the lawyers doing to prevent violations of the law?'[3]

Closer to home, in his report following the Royal Commission into the failure of the HIH Insurance Group, Justice Neville Owen observed that there were many occasions upon which the advice given by lawyers to HIH fell short of the ethical standards that might be expected, including advice as to arrangements that could 'get around' certain provisions of the law[4]. Justice Owen recommended that the education system, particularly at tertiary level, should take seriously the responsibility which it has to inculcate in students a sense of ethical method[5]. I know from personal experience that he has put that recommendation into practice, in his role as Chancellor of Notre Dame University.

More recently still, the inquiry conducted by David Jackson QC into James Hardie Industries found that the in-house counsel and external lawyers advising the company actively cooperated in the deliberate deception of the community at large as to the reasons for the relocation of the company's headquarters to the Netherlands, which was, in truth, to avoid paying billions of dollars in additional compensation for asbestos-related diseases caused by the company's building products. One of the firms providing advice to James Hardie was asked, during the inquiry, whether they had ever stood back and asked themselves what they should be advising their client to do. Their response was to the

[3] Rochvarg (above)
[4] The Failure of HIH Insurance (2003) Vol 1 pages XIII - LXV
[5] The Failure of HIH Insurance (above)

effect that 'they were advising their client on the letter of the law, no more and no less'[6].

I recently tried a case in which it was clear that senior and experienced lawyers for both sides considered it was appropriate to provide advice to their clients as to ways in which the substance and object of the law might be avoided by mechanisms aimed at exploiting weaknesses in the letter or form of the law.

It seems to me that there is a mounting body of evidence to suggest that those responsible for the regulation of the legal profession have failed to inculcate within that profession a prevailing culture of adherence to appropriate ethical and moral standards. I do not exclude the courts from that criticism because, of course, it is the courts who are ultimately responsible for the maintenance of proper standards of conduct on the part of legal practitioners, who are all officers of the court. As Spigelman CJ has pointed out[7], the transition of the relationship between lawyer and client from a professional paradigm to a commercial or business paradigm over recent decades may have contributed to less weight being placed, within the profession, upon the ethic of service to the community and to the courts which represent the interests of the community. As he points out, the rigid application of competition policy to the legal profession may exacerbate this tendency by reinforcing the notion that lawyers are conducting a business. In that context, as he observes 'the ethic of service which emphasises honesty, fidelity, diligence and professional self restraint may, progressively, be lost'[8].

[6] Evans & Palermo - Preparing Australia's Future Lawyers: An exposition of changing values over time in the context of teaching about ethical dilemmas - 11 Deakin Law Review 103
[7] Are Lawyers Lemons? - Competition Principles and Professional Regulation (2003) 77 ALJ 44
[8] Are Lawyers Lemons? (as above)

The policing/punitive model of regulation

In this contemporary context, it seems to me that the regulation of the legal profession may have placed too much emphasis upon a policing/punitive model, and insufficient emphasis upon other methods of encouraging appropriate standards of professional behaviour. In the course of my duties assisting Justice Owen in the HIH inquiry, it became abundantly clear that even in the most heavily regulated sector of Australian commerce, the financial services sector, it was impossible to have a regulator sitting at the elbow of everybody engaged in the conduct of the business, closely monitoring everything which was done. Even the most assiduous auditing and investigative techniques can only expect to identify a small percentage of departures from appropriate standards. In the case of HIH, the many egregious departures from appropriate standards only emerged in the course of an exhaustive inquiry conducted following the collapse of the Group. The breadth and depth of the dubious transactions undertaken within the Group left me in no doubt that there was a pervasive culture of non-compliance throughout not only HIH, but the company with which it merged - namely, FAI Insurance.

HIH had a board of directors which included senior and experienced lawyers and accountants who were well respected in their fields. It had an audit committee. Its accounts were audited by one of the 'big five' accounting firms and it received advice from senior and well respected lawyers, accountants, actuaries and merchant bankers. If there had been a cultural ethic of compliance within the various groups and entities guiding and advising HIH, it seems highly improbable that the culture of non-compliance could have flourished within the company, as it did. The policing/audit model of compliance was quite ineffective. It seems to me to be at least possible that a model which had emphasised the

encouragement of a culture of compliance through education, training and risk assessment programmes including programmes of self-assessment would have improved the prospects of compliance.

There are other problems with a regulatory model which places significant emphasis upon the investigation and punishment of transgressions. In my experience of service on the body which regulates the legal profession in this State, there were many occasions upon which we were effectively forced to watch from a distance the tragic trajectory of a legal practitioner whose conduct could be confidently predicted to deteriorate to the point where he or she would ultimately be struck off the Roll of Practitioners. Often it was a bit like watching a train wreck in slow motion, powerless to do anything to stop it.

That was because we had adopted a model which was analogous to the punitive approach of the criminal law. One of the assumptions which is inherent in that model is the imposition of a punishment that fits the crime. So, if the practitioner's transgression was not particularly serious, ineffective sanctions like admonition or a fine were generally utilised, even though the nature of the transgression might have demonstrated a basic lack of aptitude or character necessary for the practice of law. Although the judicial decisions in this area faithfully adopt the mantra that the fundamental purpose of disciplinary proceedings is the protection of the public, the adoption of a model largely derived from criminal practice has meant that sanctions have some times been imposed more by reference to proportionality than by reference to public protection.

Recent years have seen a significant variation in the traditional processes adopted by criminal courts, with the advent of what are often described as

'problem-solving' courts. Those courts, such as the Drug Court or the Family Violence Court, proceed upon the assumption that the best way of protecting the community from reoffending behaviour is to identify the cause of that behaviour and address it at source. It seems to me that there is much to be said for the adoption of a similar philosophy by disciplinary bodies which exist within the framework for the regulation of the legal profession. When a practitioner comes to the attention of such a body, it should be seen as an opportunity for therapeutic intervention, aimed at modifying the practitioner's behaviour and values, rather than, as tends to be the case at present, an occasion for often lengthy and expensive inquiries into guilt or innocence, followed by the imposition of penalties which are often ineffective in modifying behaviour. It seems to me that regulatory authorities should have available to them an array of flexible responses to possible departures from appropriate standards of conduct, which include and emphasise education, management programmes, supervision and so on.

Consistently with these sentiments, in my opinion the complaints and disciplinary function should not be the central focus of that part of the regulatory framework aimed at the encouragement and maintenance of proper standards of professional behaviour. I agree with those like NSW Legal Services Commissioner Mark, who have suggested that greater emphasis should be placed upon the creation of what has been described as 'ethical infrastructure' - formal and informal management policies, procedures and controls, work team cultures and habits of interaction and practices that support and encourage ethical behaviour, accompanied by programmes of education, both at university and post-tertiary level, augmented by programmes of self-assessment, including risk assessment, and risk management programmes. A regulatory framework which

emphasises this ethical infrastructure seems to me to be more likely to have a greater impact than a more punitive model. Because of the information asymmetry to which I have referred, many of those adversely affected by departures from appropriate standards of professional behaviour will not be aware of that fact, with the consequence that those departures will not be brought to the attention of any regulatory authority. What is needed is a focus upon encouraging ethical behaviour and the provision of quality services, rather than upon punishing non-compliant behaviour.

Consistently with the framework of evaluation which I have suggested, it is necessary to ask whether the benefits likely to be derived from such a regulatory approach are proportionate to the costs which would flow to consumers as a result of the adoption of these proposals. It seems to me that, if anything, the costs of the creation of the 'ethical infrastructure' to which I have referred together with programmes of self-assessment and risk management may be greater overall than the current costs arising from regulation. And they would be spread across the entire profession, and not concentrated on the administrative costs of running the relevant regulatory authority. However, when those costs are placed on a set of scales which has, in the other pan, the cost to the community of scandals like Watergate, Enron, HIH or James Hardie, and when proper weight is given to the constitutional significance of the legal profession, it seems to me that the benefits likely to be derived from the creation of this 'ethical infrastructure' justify the imposition of these costs.

Conclusion

I do not envy those charged with the task of identifying an appropriate framework for the national regulation of the legal profession. The issues

involved in the design and creation of such a framework are many and varied. All I have endeavoured to do in this paper is to proffer some observations which might encourage debate on some of the important issues involved.