Raiding the Four Goldmines:
Some Thoughts on the Competition Authority's Preliminary Report on the Legal Profession.

Patrick Massey[1] and Frank Stephen[2]

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"All professions are a conspiracy against the laity."
George Bernard Shaw

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[1] Director, Compecon Limited.
[2] Professor of Regulation, School of Law, The University of Manchester

1: Introduction.

In many cases including the legal profession, market failure, the need to protect consumers and to maintain quality standards were frequently used to justify various regulatory restrictions including, *inter alia*, restrictions on entry to the profession, the setting of fees, restrictions on the form of legal personality under which a member of the profession could carry on business, and prohibitions or restrictions on advertising. Not surprisingly, economists have frequently voiced concerns that such restrictions might have adverse effects on competition. In 2001, the Competition Authority announced that it was undertaking a study of competition in a number of professional services and earlier this year it produced a preliminary report which concluded that "the legal profession is permeated with serious and disproportionate restrictions on competition." (Competition Authority, 2005, p.i). The Authority stated that it believed these restrictions emanated primarily from the rules of the professional bodies that represent barristers and solicitors. The report contained 41 proposals for reform of the Irish legal profession. The present paper analyses the main findings and recommendations made in the report.

In the past the Authority's predecessor, the Fair Trade Commission, had undertaken inquiries into restrictions on conveyancing and advertising by solicitors; the fixing of fees and advertising restrictions in accountancy and in engineering; and restrictive practices in the legal profession under the former restrictive practices legislation.[3] The announcement by the Authority that it was undertaking a study of competition in various professions followed a report by the OECD (2001a, p.80) which noted that "Ireland has already implemented substantial reform in the legal professions." It noted, however, that there was scope to increase competition in many professional services in Ireland. The Authority listed eight professions which it proposed to examine. In addition to barristers and solicitors, the Authority chose to review competition among doctors, veterinarians, dentists, optometrists, architects and engineers. The Authority has also previously investigated the practices of professional bodies representing optometrists and veterinarians.[4]

The Authority subsequently published a report on the selected professions prepared by Indecon (2003) which highlighted a number of potential restrictions on competition. In particular, it was critical of the control exercised by professional bodies representing solicitors and barristers over education and training, arguing that this limited entry and reduced competition, echoing points previously made by the FTC (1990). Indecon also criticised the distinction between barristers and solicitors. The Authority's preliminary report criticised many of the practices which had been highlighted in the Indecon report.

2: Economic Analysis of Regulation of Professions[5].

[3] Restrictive Practices Commission, (1982), (1987a), (1987b) and Fair Trade Commission, (1990). Prior to 1987 the FTC was known as the Restrictive Practices Commission.

[4] The rules of the Association of Optometrists were approved by the Authority following the removal of restrictions on advertising, (Authority Decision no. 374, 21.11.1994. The Authority issued court proceedings against the Irish Veterinary Union. These were withdrawn after the IVU gave undertakings to the High Court that it would not recommend minimum fees to its members for carrying out various veterinary services.

[5] This section draws heavily on Stephen (2001) and Stephen and Love (2000).

Economists generally begin from the premise that any economic activity should be free of regulation (or at least regulated only by the market) unless it can be shown that it is subject to *market failure*: left unregulated it will not generate socially efficient levels of output where the efficient level is that which maximises the sum of producers' and consumers' surpluses.

Market failure can arise from: (i) Structural Reasons; (ii) Missing or Incomplete Markets. The types of market failure most relevant to legal service markets come under the heading of structural reasons. The main structural reasons for market failure are the existence of *market power* and *incomplete information*. The market failure usually associated with professional service markets is incomplete information.

The competitive process will only generate an efficient outcome for a market if all actors in that market have full information as to market possibilities and alternatives. Producers require access to the same technology (and hence costs) while consumers need to have well ordered preferences over the alternatives. In particular, consumers must know what is available from different producers in the market and be in a position to make judgements about the nature of the goods or services provided including the price/quality trade off. For some types of goods and services the latter condition is difficult to meet. Potential consumers do not have the technical or expert knowledge to make judgements about the quality of what is being offered to them or in some cases whether what they are being offered will satisfy their requirements. Indeed, in the extreme, a situation can exist where even after the service has been provided the consumer is unable to judge whether what was supplied was appropriate. The term credence good has been used to describe this situation. Professional services fall into this category.

The consumer of a professional service needs the professional's services precisely because she/he does not have the specialist knowledge of the professional. There is an information asymmetry between professional and client. This asymmetry can have two consequences: adverse selection and moral hazard.

Adverse selection affects the client's choice of professional. If clients are unable to distinguish between high quality and low quality providers before engaging one, the price they are willing to pay for the services will be lower than what they would be willing to pay to a high quality provider if they could identify one. If the cost of providing the high quality service is greater than for a low quality provider, the price consumers will be willing to pay may be insufficient to keep high quality providers in the market. Consequently, high quality providers will exit the market reducing the average quality of suppliers in the market. This will lead to consumers revising downwards the price they are willing to pay, possibly generating a race to the bottom or a 'lemons market'. The typical solution to this problem has been, historically, to regulate entry to professional markets by some form of certification or licensing. In most European and North American jurisdictions this has taken the form of giving monopoly rights over some legal services to those who are members of a professional body requiring an educational qualification and a period of professional training[6]. The

[6] It should be noted, however, that in Sweden and Finland there are no restrictions on who can provide legal advice and representation in the courts while in Spain only a university law degree is required.

professional body reduces the adverse selection problem by setting and policing a minimum quality standard.

Moral hazard arises after a client has selected a supplier. As discussed above, the client is often not in a position to judge whether the service being provided by the professional is necessary or adequate. Indeed, most professional services involve two separate functions. First, there is the diagnosis of the problem and the identification of the services necessary to deal with it. Secondly, there is the supply of these services. In some fields these are separate activities e.g. architects are employed to design buildings to satisfy a client's specified needs but they do not provide construction services. On the other hand, when a party to a dispute consults a solicitor, the latter will usually diagnose the legal problem, suggest a remedy and implement it. In such circumstances, a solicitor motivated solely in terms of financial gain may be tempted to suggest an expensive remedy in the knowledge that he/she will receive a higher fee for providing that remedy. By definition the client is not in a position to judge whether that remedy is the only one possible or even if it is likely to be successful. In the economic literature on the professions this is often described as giving rise to as 'supplier-induced demand'. In these circumstances a market for professional services is likely to generate a level of professional services which is above the optimal (or efficient) level and thus there will be market failure. This suggests that such markets in professional services require regulation to ensure that suppliers do not exploit their informational advantage.

However, it can be argued that this is too sweeping a conclusion. Not all clients of professionals are necessarily at an informational disadvantage. Clients who are repeat purchasers of a particular professional service will gain experience of a professional's diagnostic efficiency. Such repeat purchasers may also be able to use different professionals at different times and compare their relative efficiency leading to the choice of the most efficient supplier over time. Alternatively, the frequent purchaser may be in a position to generate competition between purchasers resulting in a more efficient specification of service and price. If frequency of demand by the purchaser is sufficiently high, direct employment of a professional may also be an option. In the legal field such repeat purchasers are likely to be large commercial organisations or public bodies. This suggests that there is no need to regulate the supply of legal services to such organisations. The market can be relied on to generate the efficient level of service and cost.

On the other hand, individuals and households require legal services less frequently. For them purchasing a house, writing a will or disputing a contract are relatively infrequent occurrences. Individual expertise and experience cannot be built up. These are the clients who suffer from an informational disadvantage with respect to the professional. Thus there is a *prima facie* case for regulation of the market for such legal services. However, the fact that individual clients lack expertise and information on quality does not mean that the market will inevitably fail. What if such information can be transferred between clients? If such experience can be easily transferred between purchasers, reputation will play a role in disciplining suppliers. In particular, if repeat purchasers can easily transfer their experience to inexperienced clients (by acting on their behalf in the selection of the professional, perhaps) information asymmetry may be overcome[7].

[7] This is done through legal expenses insurers and through organisations such as trades unions.

The foregoing suggests that there is the potential for oversupply in the legal service markets for those categories of service sought by infrequent purchasers (usually individuals) where the mechanism of reputation or the use of experienced agents do not operate. In such cases an unregulated market cannot be relied upon to generate efficient levels of output and prices.

Where the market cannot be relied upon what form should regulation take and who should be the regulator? In most jurisdictions regulation takes the form of self-regulation by the profession itself.

Many economists would argue that self-regulation is tantamount to creating a cartel. A contrary view is that self-regulation is the most cost effective form of regulation. It may reduce the cost to the regulator of acquiring information and makes adjustments to regulations easier. (Ogus, 1995). However, these benefits need to be compared to the potential efficiency losses due to the potential for cartel-like behaviour. Even where regulation by a professional body is deemed an appropriate solution some have argued that the public interest would be protected best by having a number of professional bodies in competition with each other. (Ogus, 1995). A more philosophical approach is to view the right to professional self-regulation as implying a social contract between society and the profession which mitigates the moral hazard problem. (Dingwall and Fenn, 1987). However, the terms of the social contract may need to be reviewed from time to time to ensure that cartel-like behaviour has not evolved. The question to be addressed in the current context is whether or not the current arrangements achieve the balance between correcting for information asymmetry and creating a cartel.

Markets for legal services have been the subject of varying degrees of deregulation in U.S.A., Europe and elsewhere. In several jurisdictions there have been proposals by government to remove the general exemption of professions from anti-trust or restrictive practices legislation. Many of the instruments used by professions to regulate the market have been removed or restricted in use in recent years. A detailed empirical review of regulation of professions (including the legal profession) in Europe has been carried out for the European Commission. (Paterson et. al., 2003). The Commission's Competition Directorate published a report in February 2004 requiring member states to review professional rules and regulations and identify any that could be seen as hindering effective competition within the professions. In addition to the Competition Authority's investigation a similar approach has been taken by the Office of Fair Trading in the UK. Differing approaches have subsequently been taken for England & Wales (the Clementi Review) and Scotland (where the Justice Department has set up a research Working Group which is shortly to report). In the Netherlands a study is being carried out by the van Wijman Commission.

The literature has identified a number of instruments typically used by self-regulators of the legal profession which may work against the public interest: (i) restrictions on entry; (ii) restrictions on advertising and other means of promoting a competitive process within the profession; (iii) restrictions on fee competition; (iv) restrictions on the nature of fee contracts between lawyers and clients e.g. contingent fee contract; and (v) restrictions on organisational form. Many of these issues are considered in the Authority's report.

(i) Restrictions on Entry to Professional Service Markets

There are really two elements to restrictions on entry to professional markets. The first involves restricting entry to the profession itself. The second is the granting of an exclusive or monopoly right to a designated profession for the supply of a particular service. Where these exist there is the danger that the professional body is able to maintain an excess demand for its members' services by restricting entry to the profession. Without the 'monopoly right' those outside the profession could enter the market when there was excess demand. Entry to the legal profession has continued to grow in most jurisdictions[8].

The spacially localised nature of many personal legal; service markets means that the absence of severe restrictions on entry to the profession in general does not necessarily imply competition in specific service markets. In such cases geographical restrictions on movement may provide barriers to entering particular markets as has been the case historically even within a single country. Such restrictions are being removed throughout the EU and the Establishment Directive makes it possible for lawyers qualified in one member state to become full members of the profession in another member state without further examinations[9]. In addition other restrictions such as prohibiting advertising may raise the cost of entry (through an inability to quickly generate goodwill) and thus constitute a barrier to entering a specific spatial market. Alternatively prohibitions on 'undercutting' or 'supplanting' existing suppliers may reduce the incentive to enter a local market where rents are being earned. Thus, barriers to entry may exist even where there is no formal restriction on entry to local markets.

Empirical evidence on mobility restrictions for the legal profession in the U.S.A. find, for example, that lack of reciprocity between state bar associations leads to lower numbers of practising lawyers and higher lawyer incomes. However, it has also been found that it is 'market forces' rather than licensing restrictions that affect the price of legal services. (Lueck et. al. 1995). There are a limited number of studies on the effects of monopoly rights or their relaxation.

(ii) Regulation of Fees

In most jurisdictions, including Ireland, mandatory fee scales have given way to recommended fees or the complete removal of published scales. This has largely been in response to criticisms of fee scales by competition authorities.[10] There is a paradox here because economic theory suggests that cartel price fixing is difficult to enforce when a cartel has a large number of members and when prices cannot be observed. The impact of recommended fee scales on conveyancing fees in Scotland and Ireland suggests that such scales may not have the impact usually attributed to them.[11] (Shinnick and Stephen, 2000). These markets did not meet the criteria for successful detection of deviations from nationally fixed prices. Indeed the observed fees revealed that suppliers did not treat the recommended scale fees as if they were mandatory. However, the data did not allow the researchers to determine whether actual fees were a result of

[8] Of course what is relevant here is the growth in supply relative to demand

[9] The implication of the Establishment Directive for the future organisation of law firms in the EU is analysed in ''Stephen (2000).

[10] MMC, (1970) and LECG ( ).

[11] The study covered the period prior to the removal of such fee scales in Ireland.

competition or price fixing in local markets. Interviews carried out in Ireland suggested that the scale fees may have acted as focal points against which to discount.

(iii) Restrictions on Fee Contracts

In most European jurisdictions, unlike the US, contingent fee contracts under which if the case is lost the lawyer receives no fee and if the case is won the winning party's lawyer receives a percentage of the quantum at stake, are prohibited. An alternative fee contract (known as a conditional fee) where the lawyer of the successful party receives an uplift to the normal fee is now permitted in some European jurisdictions. It has been argued that contingent fees change the nature of the moral hazard problem between client and lawyer. In this case lawyers are likely to wish to settle sooner than clients. Contingent fee contracts are prohibited in Ireland, although the Competition Authority (2005) argues that the system of taxing legal costs means that fees are effectively determined on a contingency basis.

3: Overview of the Irish Legal Profession.[12]

Like the UK and the legal profession in Ireland is split between solicitors and barristers. Solicitors deal directly with clients. They provide legal advice to their clients, engaging barristers on their behalf where necessary (clients cannot approach a barrister directly), make practical preparations for litigation. Barristers act as advocates representing litigants and pleading before the courts on their behalf. Only solicitors and barristers can offer legal services for payment.

Solicitors and barristers each have their own separate representative bodies - the Law Society and the Bar Council. Both bodies are also responsible for regulating their respective professions.

Solicitors in private practice operate either as sole practitioners, or as associates or partners in firms. Solicitors firms range with some having up to fifty or more partners. According to the Competition Authority, however, the majority (approximately 70%) of solicitors' practices are small, having just one or two solicitors. In August 2004 there were 2,044 solicitors' firms. Over the past decade an average of 70 new solicitors' firms were created annually, while 20 closed, resulting in a net increase of 50 firms per annum. Figures on lawyer numbers are given in the following chart. Between 1992 and 2003 the number of solicitors increased from 3,808 to 6,593, while the number of practising barristers increased from 809 to 1,412 over the same period.[13]

[12] Unless otherwise stated, this section is drawn largely from Competition Authority (2005).

[13] The figures for barristers are for barristers practising at the bar. It does not include qualified barristers who are not members of the law library, e.g. employed barristers.

Chart 1: Lawyer Numbers in 1992 and 2003

Source: Competition Authority (2005)

Expenditure on legal services increased from €320m in 1992 to €1.1bn in 2001. In real terms this represents an increase of 171%. Expenditure on legal services accounts for around 1% of GDP, compared with an annual average of around 0.8% of GDP in the early 1990s. The Competition Authority reported that personal injury cases and conveyancing each accounted for almost one third of solicitors' total fee income in 1999. Commercial work accounted for a further 11% with trust and probate work representing a further 10% of the total.

4: The Competition Authority's Main Findings.

In essence the Authority's conclusions may be summarised as follows. Lawyers in Ireland enjoy relatively high incomes which are due to monopoly rents resulting from restrictions on competition. These restrictions on competition are primarily the result of regulatory restrictions imposed by the relevant professional bodies, which have the effect of limiting entry to the legal profession. The Authority report does not quantify the costs of these alleged restrictions of competition.

As Table 1 illustrates, lawyer numbers in Ireland have increased substantially over the past 30 years. Between 1990 and 2003 the numbers of solicitors and barristers almost doubled and there were approximately five times as many practitioners in both professions in 2003 as in 1970.

The numbers joining the bar in recent years were equivalent to around 8-9% of the existing membership. The Bar Council estimates that 15% of new barristers leave the bar within five years of qualifying. On the face of it these figures suggest a fair degree of entry and exit. While the level of entry and exit was lower for solicitors' firms, the Authority nevertheless reported that over the past decade an average of around 70 new solicitor firms were established per annum while around 20 closed.

Table 1: Number of Solicitors and Barristers Selected Years

	Solicitors	Barristers		
		Senior Counsel	Junior Counsel	Total
1970	1,363	56	197	253
1975	1,655	66	226	292
1980	2,139	77	352	429
1985	3,188	103	431	534
1990(a)	3,642	105	644	749
1995	4,355	130	825	955
2000	5,551	192	1,041	1,233
2003	6,593			1,412

(a) Figure for solicitors relates to 1991.
Source, FTC (1990), Indecon, (2003) and Competition Authority, (2005).

Of course this does not mean that the Authority's analysis is wrong. It may well be that the number of lawyers in Ireland would have increased even more and that we would observe higher levels of entry and exit under a different regulatory regime.

Noting that the growth in expenditure on legal services between 1992 and 2003 was in line with overall [nominal] GDP growth, the Authority report states:

> "This increase is surprising given that a service sector would not typically expand at the same rate as an economy experiencing very rapid growth fuelled predominantly by growth in hi-tech sectors." (Competition Authority, 2005, para 2.48)

The Authority, however, failed to advance any evidence in support of this assertion while at the same time, in para 2.49, it notes that "the rate of increase in lawyers per year has typically been less than the annual increase in GDP."

It is possible to identify a number of factors which would have tended to increase the demand for legal services. For example, new housing completions more than doubled between 1996 and 2003, suggesting a significant increase in the level of conveyancing activity. Presumably the rapid growth in GDP which has occurred over the past decade would also generate a significant increase in demand for legal services as the number of commercial transactions rises. Anecdotal evidence suggests that the degree of litigiousness has increased considerably over the past decade. The reintroduction of some controls on solicitor advertising and the establishment of the Personal Injuries Assessment Board are both responses to the rapid increase in personal injuries litigation. The number of solicitors in England & Wales grew by a similar proportion over much of this period.

The Authority also found that average (mean) incomes of lawyers were relatively high, at least by comparison with certain other professions. It also found, however, that there was a considerable dispersion in lawyers' incomes and that the median income was significantly lower than the mean. In other words, the high average (mean) income is accounted for by the fact that a small number of lawyers earn very high incomes while many lawyers do not do so well. For example, junior counsels' average earnings were €94,000 per annum but the median

earnings of junior counsel came to only €46,500. In other words half of all junior counsel had earnings that were equivalent to less than half the average earnings for this group. While one third of junior counsel earned in excess of €100,000, 40% earned less than €30,000, while 10% earned less than €9,000 per annum. The Authority nevertheless concluded:

> "Relatively high incomes are consistent with the increase in demand for legal services not being met by an equal increase in supply. This does not prove that competition is restricted, but is consistent with the existence of restrictions." (Competition Authority, 2005, para 2.57)

There is an alternative explanation for the relatively high earnings of a limited number of legal practitioners, namely that it is a premium reflecting their high skill levels, in the same way that top sports people and rock stars command high earnings, rather than simply the result of restrictions on competition.

Alternatively the problem here may not be so much impediments to entering the market for legal services but the persistently observed phenomenon that lawyers' salaries do not seem to fall as supply increases. Shy (2001) reports that lawyers' fees in the Western hemisphere rose despite increases in the numbers of lawyers throughout the 1980s and 1990s. He shows how increasing lawyer number may actually increase the demand for legal services and result in higher incomes for lawyers as the growth in lawyer numbers results in a supplier induced increase in demand, which is at odds with the Authority's views. Empirical work by Stephen (2001) also suggests that supplier induced demand is a feature in legal services markets. The decision to reintroduce some restrictions on solicitor advertising to restrict so called "ambulance chasing" can be regarded as an attempt to limit solicitors' ability to generate an increase in demand for their services.

In contrast to the Authority, the OECD (2001b) found that "there is little reason for concern that barristers fees are above the competitive level, at least on average". It found that the relatively high exit rate amongst barristers indicated that barristers' incomes, at the lower end were not by comparison with alternative occupations open to such individuals. The OECD (2001a) found that there were more reasons for concern regarding competition among solicitors.

Table 2: Summary of Restrictions Identified by Competition Authority

1. The Existing Regulatory Structure.
2. Monopoly Supply of Legal Education.
3. Restrictions on Business Structures.
4. Restriction on Supply of Conveyancing Services
5. Restrictions on Advertising.
6. Restrictions on Holding Dual Titles.
7. Restrictions on Recognition of Foreign Legal Qualifications.
8. Restrictions on Senior Counsel.
9. Legal Fees and the Taxation of Costs.
10. Miscellaneous Restrictions on Competition.

The Authority found that, most, if not all, of the restrictions on competition derived from the rules of the professional bodies that represent barristers and solicitors. The Authority set out 41 proposals for reform. The restrictions highlighted by the Authority can be grouped under ten broad headings and these are listed in Table 2. Each of these areas is addressed in different chapters in the Authority report. The present paper focuses largely on categories 1-5 in this list.

5: Assessment of the Authority's Findings.

(a) The Existing Regulatory Structure.

The Authority argues that removing the restrictions on competition, which it has identified, would be insufficient because leaving the existing system of self-regulation intact would result in the introduction of new anti-competitive restrictions. According to the Authority self regulation carries with it the potential for anti-competitive restrictions. It argues that self-regulation also gives rise to a conflict of interest as the representative body is likely to place its members' interests above those of consumers. It argues:

> "As long as self-regulatory bodies retain such extensive discretion over the creation and enforcement of rules and regulations governing the supply of the service, there will continue to be a conflict between the interests of buyers and sellers of legal services, in which the suppliers will be inclined to restrict competition as they have done in the past." (Competition Authority, 2005, para 3.52)

Interestingly, however, the Authority cites a survey of solicitors in which a number of respondents stated that the Law Society should focus more on representing its members interests and not on making life difficult for them. (Competition Authority, 2005, para 3.44) Such views seem inconsistent with argument that self regulation puts the profession's interest ahead of the customers.

Self regulation is also seen, by the Authority, as a possible impediment to innovation. The Authority goes on to argue that the combination of regulatory and representative functions may hinder competition in the market for representation services. The latter point reflects a view first articulated by the Authority in legal proceedings against the Irish League of Credit Unions (ILCU) where it argued that the ILCU had restricted competition in the market for "credit union representation services".[14] Thus the Authority argues:

> "Representative bodies that also hold a regulatory role have an advantage over new representative bodies attempting to enter the market for representative services precisely because of the higher standing they enjoy because of their regulatory role." (Competition Authority, 2005, para 3.31).

The Authority therefore proposes that a new State regulatory body, to be known as the Legal Services Commission (LSC), should be established to regulate solicitors and barristers. According to the Authority:

> "Such a regulatory body, provided that its reforms are based on the principles of good regulation, would retain the strengths of the current structure while avoiding its weaknesses."

[14] *Competition Authority v. John O'Regan & Others,* Kearns, J. judgement of 22nd October 2004. The ILCU is an unincorporated body and its directors were nominated as defendants. One of the present authors was an expert witness for the ILCU in the case.

There is a large literature which suggests that state appointed regulators do not avoid capture by regulated firms. Stigler (1975, p.115) argued that "as a rule regulation is acquired by the industry and is designed and operated primarily for its benefit." Furthermore the costs of such external regulation may exceed that of self-regulation as argued above. The Authority's report fails totally to address this issue of regulatory capture. In the real world the choice is not between imperfect self regulation and a perfect State regulator, as the Authority seems to suggest. Regulators suffer from a lack of information and are prone to be misled by those they regulate. Regulators are not disinterested agents who act only in the public interest, regulators pursue their own interests too.

The Authority's arguments that such a reform would be cost effective appear rather weak. It argues that:

> "A Legal Services Commission would not necessarily be more costly than the present system."

It then goes on to state, however, that:

> "Even if there were higher costs, they would likely be associated with a higher degree of transparency and accountability, with attendant benefits." (Competition Authority, 2005, para 3.53)

No evidence is adduced to support such assertions.

At present the law society is subject to some control as rules have to be approved either by the Minister and/or the Oireachtas. The Competition Act, 2002, provides that the CA may give its views on any legislative or regulatory impediments to competition. A simpler and perhaps more cost effective way of ensuring that self-regulation does not lead to the adoption of anti-competitive would be to require that the views of the Authority must be sought on any proposed rule changes before they can be implemented. Such provisions could apply to both the Law Society and the Bar Council.

(b) Monopoly Supply of Legal Education.

The Law Society and the Honourable Society of Kings Inns have a monopoly in the professional education and training of solicitors and barristers respectively. Legislation provides that only the Law Society or a body licensed by it can provide professional education and training for trainee solicitors. To date the Law Society has not licensed any other body to provide such training and education.

The Authority report outlines two broad criticisms in respect of the monopolies enjoyed by the Law Society and Kings Inns in respect of professional education and training of lawyers:

1. Such monopolies eliminate competition in the provision of such education and training so that the cost of such training is likely to be higher than under competition; and
2. They may reduce competition in the legal services market as the representative bodies may have an incentive to restrict entry to the profession by limiting admission to their training programmes.

Certainly in the past there was some evidence of the second type of behaviour. In the mid 1990s it was reported that Kings Inns was turning away students with a II.1 law degree.[15] According to Gilhooly (1999):

> "Where once the Law Society maintained a register of solicitors seeking employment, they now maintain a register of employers seeking solicitors."

The indications are that the number of training places available for aspiring barristers and solicitors has increased significantly in recent years. The Law Society doubled the number of training places available in 2000. The OECD (2001b, p.39) concluded that:

> "High turnover and low income of many practitioners both suggest that entry controls are not restricting competition among barristers."

The Authority did not produce any evidenced of unmet demand for entry to the solicitors' profession. The OECD (2001a), however, found that in the case of solicitors numbers entering were below the free entry level.

The Authority proposes that the proposed LSC would be given responsibility for setting education and training standards for both barristers and solicitors and that the Law Society and Kings Inns, along with other would-be providers of such services would be permitted to apply and meet these requirements. This seems to go further than the OECD (2001a) which recommended that:

> "The control of education and entry of legal professionals should be moved from the self-governing bodies, but close ties as regards quality of entrants and content of education should be maintained."

It would seem that this could be achieved by allowing the Law Society and the Bar Council for setting education and training standards, while other providers of such services who met these requirements would be permitted to provide the actual training and education courses.

(c) Restrictions on Business Structures.

Services of solicitors in Ireland and UK are usually provided through 'firms' whilst those of barristers (advocates in Scotland) are provided by independent self-employed practitioners. In almost no other jurisdiction is there such a formal; separation between parts of the legal profession. Nevertheless in almost all jurisdictions the organisational form has been restricted to partnerships or sole principalships. Some jurisdictions do permit corporate forms but only as long as all shareholders are members of the profession concerned. In most European jurisdictions partnerships between lawyers and other professionals such as accountants, surveyors or estate agents (MDPs) are prohibited. In Ireland and the UK partnerships between solicitors and barristers are also prohibited.

The Authority concludes that various restrictions on the form of business structure that lawyers may use when providing their services are anti-competitive:

1. Barristers may only operate as sole practitioners.
2. Solicitors are not permitted to organise their practices as limited liability companies or as limited partnerships.
3. Barristers and solicitors may not form partnerships.

[15] *Irish Times,* 24.10.1995.

4. Lawyers may not share fee income with non-lawyers which precludes non-solicitors from owning law firms.
5. Restrictions on solicitors forming multi-disciplinary partnerships with members of other professions.

Allied to these restrictions are the prohibition on individuals holding the titles of barrister and solicitor simultaneously, the requirement that barristers be members of the law library, must practice full-time at the bar and the prohibition on employed barristers representing their employer before the courts.

Group practice brings the benefits of economies of scale and risk sharing. Whilst legal practice is human capital intensive (rather than physical capital intensive) costs of support services (including IT) can be spread across a number of lawyers in a multi-lawyer firm. Benefits from risk sharing will also accrue where lawyers specialize in areas of the law the demand for which is uncorrelated. In such cases benefits from economies of specialization will also accrue. Furthermore, economies of scope may exist when a client has a range of legal service needs which can be serviced by specialists within the firm or when a legal problem has dimensions involving a range of specialties. Economies of scope are available to the sole practitioner but in the multi-lawyer firm they are combined with economies of specialization. The more complex the issues the more likely that specialists will dominate because the benefits of economies of specialization outweigh the economies of scope to the sole practitioner. Economies of scope or benefits from risk sharing in the multi-lawyer specialist-firm will lead to multi-lawyer firms dominating.

Similar arguments apply where the specialists involved go outside the legal profession in what is often referred to as Multi-Disciplinary Practice (MDP). It has often been argued that clients would benefit from economies of scope where a professional firm included lawyers, accountants, surveyors etc.; so called 'one stop shopping'. The European Court of Justice nevertheless upheld Dutch restrictions which prevented lawyers from forming partnership with accountancy firms.

Thus far we have only considered production costs. We have not considered agency costs which may arise from the asymmetry of information between client and lawyer. The distinction between diagnosis and service supply discussed earlier in this paper may help in the analysis. Earlier we pointed to the moral hazard problem that arises after a lawyer performs the agency function in diagnosing a client's legal problem and recommending a course of action. This arises because it is assumed that the same lawyer will perform the consequent service function. The agency cost increases when it is recognized that there are economies of specialization. Many circumstances will arise under which the lawyer performing the diagnosis function is not the least cost supplier of the service function required. This may be particularly so in the sole practitioner firm.

In a multi-lawyer firm it is, perhaps, more likely that there will be a specialist within the firm who is the least-cost provider of the service function. The probability of this may increase the more lawyers there are in the firm. However, the fewer the number of partners and the more specialized the service function required the more likely that the firm will not be the least-cost supplier. This may even be the more so if the firm is an MDP. Nevertheless, it is likely that

the lawyer performing the diagnostic function will pass the client to a specialist within the firm. First, because the lawyer providing this function will share in the income of the firm generated from the provision of the specialized services; secondly because recommending the client to another firm may mean that the client's future business will also be lost. Thus the case for MDPs rests on whether the benefits from economies of scope exceed the gains from economies of specialisation.

Those within the legal profession who argue against MDPs are often concerned with the question of which professional rules or ethics should be applied to members of the MDP. It is observed that in the European Jurisdictions where MDPs are permitted the commercial law market is increasingly dominated by the legal arms of the major international accounting firms.[16]

A Divided Profession

In England & Wales, Northern Ireland and Scotland as well as the Republic of Ireland and certain states in Australia what is elsewhere a single legal profession is split into two branches: solicitors and advocates/barristers. Solicitors provide legal advice to the public on the whole range of legal matters and have rights of audience in the lower courts. Advocates/barristers have rights of audience in the higher courts and provide consultancy services to solicitors. The rules governing each of the professions prohibit its members from practising as members of the other profession. Judges in the higher courts are drawn almost exclusively from the ranks of advocates/barristers. Although rights of audience in the higher courts in Scotland and England & Wales have changed recently as a consequence of legislation to allow solicitors who meet certain tests of experience in advocacy in the lower courts to appear in the higher courts, there has been no move to fuse the professions. From an economic perspective the question is whether the division into two professions is efficiency enhancing or is a mere restrictive practice.

It should be noted that specialisation in advocacy may exist within a fused profession. Within law firms some practitioners may specialise in court advocacy while others specialise in diagnosis and case management. Some firms may specialise in advocacy, particularly in the criminal field. Outside the criminal field in-house advocates may lack expertise in a particular area of law in spite of having enhanced advocacy skills. The issue then becomes whether or not any benefits from formally separating the roles outweigh the costs.

The separation into two professions can be analysed as a prohibition on vertical integration between successive stages in a production process: the preparation of a case and its prosecution through advocacy in the courts. (Bishop, 1989) The conflict between the diagnostic function and the service function is seen to be particularly severe due to the large benefits which accrue from specialisation in trial advocacy. The existence of a cadre of specialist consultants and litigators (advocates) removes the temptation to supply higher cost in-house advocacy. Not only this, it may provide competition in the downstream market. Thus one benefit of a divided profession is that the client gets higher quality advocacy than would be available from an in-house advocate. However, this benefit is not costless. It may be

[16] Stephen (2000) provides an explanation of this in terms of the internal efficiency of law firms in various jurisdictions.

argued that the cost will be the dead-weight loss to sophisticated buyers of legal services who do not require the intermediation of a solicitor. An additional cost might be the differential transaction costs associated with employing both solicitor and barrister rather than two solicitors within the same firm. This would be the case if economies of scope existed when the two legal advisors were from the same firm/office. An evaluation of the division in the profession cannot be resolved on these *a priori* arguments. It is a question of the relative magnitudes of the costs and benefits. However, their empirical measurement is fraught with difficulty.

Others clearly doubt that the balance lies in favour of division and adduce additional points against division. (Ogus, 1993). If division were efficient why is it that when fusion is not prohibited we invariably observe fusion? Further, enforced division removes choice from informed consumers who might prefer lower quality but cheaper in-house advocacy to high quality but high price external advocacy. On the other hand it may be observed that in some Australian states where there is fusion there is *de facto* separation as some specialist pleaders operate, in effect, as barristers.

There are external effects which may have a bearing on the division issue. The first of these is that the division into two specialist branches allows more effective supervision of lawyer behaviour (particularly in the case of advocates) due to a 'club' effect. However, particularly in a small jurisdiction, this may lead to a conservative approach which is hostile to innovation. The division may also allow the monitoring of the performance of the members of each profession by the members of the other. A further external effect is public capital formation through the production of high quality precedent. The existence of highly specialised and qualified advocates should produce better argued cases and more valuable precedent. Furthermore the recruitment of the judiciary from the ranks of the best of these specialist advocates, not only ensures that those recruited to the bench have proven their worth as trial lawyers but should further ensure high quality precedents. A final external effect is the possible lowering of the cost of judicial administration. Here the main beneficiary is not the client but the trial judge. Poor advocacy places a burden on the trial judge to ensure that the decision reached is not influenced by inadequate advocacy. With highly specialised and skilled advocates this problem does not arise. Advocates can also act as gatekeepers to the courts. They ensure that cases are sifted and well-prepared before reaching the court thus reducing the cost of adjudication.

It is not easy to find empirical evidence to test these propositions concerning the separation of the legal professions. What there is tends to be informal and highly qualitative. It will only be where the stakes are high that the higher cost of specialisation may be worth incurring. This implies that rights of audience in lower courts should not be restricted to specialist advocates. It is an empirical question where the line should be drawn.

Sole Practitioners, Partnerships and Incorporation

A more common organizational restriction in many jurisdiction is that providers of legal services must operate as independent providers or in partnership only with other qualified lawyers. Even where incorporation is permitted restrictions are frequently imposed maintaining unlimited liability and that the directors of the firm must all be lawyers.

However, some US states permit incorporation under limited liability and a form of limited liability partnership has been recently developed in the UK.

Some writers have argued that professional partnership accompanied by unlimited liability is a solution to the moral hazard problem posed by the asymmetry between client and professional. (Fama and Jensen, 1983 a and b). The willingness of one professional to risk his or her wealth by entering into such a partnership with another professional signals to clients the trustworthiness of members of the partnership and provides a guarantee that there will be mutual monitoring among partners. However, it has been argued that little mutual monitoring takes place within UK law firms and that *ex ante* screening of prospective partners is likely to dominate *ex post* monitoring. (Stephen and Gillanders, 1993). The persistence of sole practitioner firms in legal practice also seems to run counter to this signalling function of partnership: around 50% of law firms in the US are sole practitioners and around 40% of solicitors' firms in England & Wales. However, the proportion of sole practitioner firms in the US has been declining for a number of years.

(d) Conveyancing Services.

The Authority has criticised legislation which restricts the supply of conveyancing services for payment to solicitors. Legislation permitting building societies to provide conveyancing services to their customers has not been implemented. The Authority proposes a number of measures to increase competition in the market for conveyancing services:

1. Creation of a new profession of licensed conveyancers;
2. Building societies and other financial institutions should be permitted to offer conveyancing services to their customers.

Indecon (2003) reported that conveyancing fees increased with rises in market concentration, i.e. fees were higher in areas where there were fewer solicitors. Another common feature of conveyancing is that solicitors (as well as auctioneers) frequently set prices as a percentage of the house price. Such percentage fees may constitute a form of price discrimination since an increase in the value of the property does not necessarily increase the amount or the complexity of work involved in handling the sale of the property. Economic analysis indicates that the welfare effects of price discrimination are ambiguous and depend on the particular circumstances. The Authority did find, however, that the practice of providing conveyancing services for a fixed fee was growing.

A series of studies[17] of the deregulation of conveyancing services in England & Wales between 1985 and 1992 which focuses on the removal of the solicitors' monopoly of conveyancing services provides some insights. The monopoly was revoked in 1985 and by 1987 the first licensed conveyancers (non-solicitors licensed to provide these services) were offering services in competition with solicitors in some areas.

A survey in 1986 suggested solicitors were reducing fees in anticipation of licensed conveyancer entry. Surveys in 1989 revealed that solicitors' conveyancing fees in a sample of locations where licensed conveyancers had entered were lower than where there were no licensed conveyancers and were less likely to involve price discrimination. These results appear to support the

[17] Reported in Love et. al, (1992), (1995), Stephen et. al. (1994) and Stephen, and Love, (1996).

conventional view that 'monopoly rights' will operate to the disadvantage of clients of lawyers. However, a survey conducted in 1992 and covering the same locations as the earlier surveys showed that fees of solicitors and licensed conveyancers had risen between 1989 and 1992 by more than those in markets where there were no licensed conveyancers and that licensed conveyancers' fee practices were more like those of solicitors than before. There is the suggestion that the threat of entry is a more powerful restraint on solicitors' behaviour than actual entry.

Stephen and Love (1996) have argued that licensed conveyancers have an incentive to maintain relatively high prices for these services. Furthermore, since licensed conveyancers in independent practise produce, essentially, a single service they face higher risks than solicitors[18]. These results are a caution against the presumption that multiple professional bodies necessarily benefit consumers. However, the limited effects of removing a monopoly in a restricted field, as in this case, may not carry over to a more general removal of 'monopoly rights'.

It has been suggested that competition in certain legal service markets might be enhanced by repeat purchasers in these markets acting as agents for inexperienced clients rather than relying on competition between solicitors and licensed conveyancers[19].

Overall the evidence on licensed conveyancers from England & Wales (see above) does not suggest much optimism over the proposal to introduce licensed conveyancers to Ireland.

(e) Advertising Restrictions.

Economic analysis suggests that advertising restrictions increase consumer search costs, and thus lead to higher prices. (Langenfeld and Morris, 1991) Restrictions on advertising are often accompanied by restrictions on other elements which promote competition, e.g. advance quotation of fees, although this is not the case in Ireland. Advertising is a substitute for search activity by consumers. It has the effect of reducing price dispersions. Consequently, removal of restrictions on advertising should enhance competition. Deregulation in many jurisdictions has removed or relaxed the regulations governing advertising by professionals.

Empirical evidence on the effects of restrictions on advertising and their removal has existed for a number of years[20] Although contributors to this literature argue that fees are higher where there are restriction on advertising, this is not always warranted by the evidence provided because many of the studies focus on the fees of advertisers compared to non-advertisers rather than on the impact of advertising on the fees of both advertisers and non-advertisers.[21] One, particularly, sophisticated study of physician advertising in the US contradicts the general findings. (Rizo and Zeckhauser, 1992).

[18] Indeed in both 1989 and 1992 more licensed conveyancers were employed by solicitors' firms than were in private practice competing with solicitors.

[19] For example, Stephen and Love, *supra*, suggest that banks and building societies be permitted to provide conveyancing services through approved panels of solicitors. This has also been suggested by the Director General of Fair Trading in his 2001 report on professions in the UK.

[20] This literature is reviewed in Love and Stephen (1996).

[21] These are discussed in detail in Love and Stephen *ibid*.

The more recent literature on the effects of professional advertising has focussed on the effects of advertising on the fees of all providers in a market. It has been shown that advertising in a market has a general effect in reducing fees. (Schroeter et. al., 1987).

Most empirical studies fail to distinguish between price and non-price advertising. Whilst it has been argued that price advertising can act as a positive signal on quality there is a problem if price advertising is undertaken predominately by low quality suppliers. Here consumers may conclude that those who advertise low fees have been rejected by informed consumers as being of low quality. This will lead to a disincentive to advertise price. This result is supported by low levels of price advertising for legal services which have been observed in the US and UK. For example, studies of solicitor advertising in England & Wales and Scotland[22] have found that while more than half the solicitors surveyed had advertised in some way fewer than 5% had advertised fees, even for a routine service. The Federal Trade Commission found similar differentials between non-price and price advertising across US states.

The FTC (1990) recommended that restrictions on advertising by solicitors should be removed and this was given effect in the Solicitors (Amendment), Act, 1994. This was partially reversed by the Solicitors (Advertising) Regulations 2002, which prohibited certain forms of advertising by solicitors. The justification for this was that certain advertising was seen to have given rise to increased personal injuries litigation, thereby contributing to higher insurance costs.[23] It seems unlikely that restrictions on advertising could discourage only fraudulent claims in which case the intention (unstated) is that legitimate claims would be reduced. The Government appears to have been persuaded to introduce changes because of the avalanche of army deafness claims.[24] The Authority concluded that the current level of restrictions on advertising by solicitors was not anti-competitive.

The Bar Council rules provide that advertising by barristers is strictly limited to placing their names and specialisations on the Bar Council website and in the Law Directory. According to the Authority:

> "The restrictions reduce the information available to buyers of legal services and insulate already well-known barristers from competition from alternative barristers who may be less well known or experienced but of comparative ability. Consequently, advertising restrictions can result in fees for professional services being higher than would be the case in a market without restraints." (para 9.4)

It could be argued that that because barristers are a referral profession that they are selected by repeat purchasers (solicitors) who should be informed purchasers thus reducing the need for advertising. This will of course depend on the methods by which solicitors obtain information on barristers and, indeed, how frequently they engage them. The OECD (2001b) found that the impact of restrictions on advertising by barristers was small while the Competition Authority (2005) has accepted that solicitors are informed buyers of barristers' services.

5: Conclusions.

[22] Love *et al.* (1992) for England & Wales and Stephen, (1994) for Scotland.
[23] *Sunday Business Post,* 27.10.2002.
[24] Irish Times, *24.12.1997.*

The Competition Authority argues that" the legal profession is permeated with serious and disproportionate restrictions on competition." It provides fairly limited evidence in support of this claim. Nevertheless a number of its proposals appear to make sense. We agree, for example, that there may be a case for some opening up of the market for education and training, particularly in the case of solicitors but the Law Society and Bar Council should continue to dictate the content of such education and training. On the other hand the evidence from England and Wales does not suggest much optimism over the Authority's proposal to introduce licensed conveyancers to Ireland, while evidence on the impact of restrictions on advertising by barristers is somewhat mixed.

The Authority's proposal to abolish self regulation of the legal profession and replace it with a State regulatory agency appears somewhat questionable. This undoubtedly represents a major change in the way the legal profession in Ireland is regulated. The Authority's proposal ignores the issue of "regulatory failure". Instead it simply assumes that a State regulatory agency would prove superior to self regulation and would involve no additional cost.

More fundamentally the Authority argues that the existing regulatory regime means that professional bodies representing solicitors and barristers could, in the future, introduce anti-competitive restrictions. As a general rule competition law only interferes with the activities of businesses and representative bodies where there is clear evidence that the law has been broken. There are circumstances where regulatory intervention may be justified in order to prevent an abuse of market power, the case of deregulated utility industries comes to mind. It is not clear that such intervention is appropriate in this instance.

This is not to say that the existing regime of self-regulation cannot be improved upon. In our view this can be achieved far more effectively by a more limited range of reforms. In particular we suggest that the risk that self-regulatory bodies would in the future impose anti-competitive restrictions could be greatly reduced by a requirement that the Law Society and Bar Council obtain the views of the Competition Authority regarding any proposed rule changes.

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