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Legal services reforms and litigation

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Before we consider the effects of market reforms on the future, it might be wise to take stock of the present. In general terms, the legal marketplace is over-supplied. In my view, there are too many qualified lawyers, too many law firms, and too many equity partners.

The background

In the past 20 years, the number of qualified solicitors has doubled. As numbers have risen, the maintenance of professional quality and standards has inevitably been challenged and the number of complaints has increased. At the same time, the nature of legal work has become more standardised and commoditised: it does not now need so many qualified people to perform it – and, indeed, becomes markedly less profitable when they do. For firms to persist with the notion that they should always and only employ solicitors is a short road to financial ruin. To date, the costs of legal services have remained typically too high because of the insistence on employing relatively more expensive people than much of the work requires.

There are around 9,000 law firms in England & Wales, many of which are 'small' (about 8,500 of them have fewer than 10 partners). This degree of fragmentation inevitably means that each firm has to carry a minimum base of establishment and organisational costs. On any view, this duplicates expenses and so again drives the cost of legal services to a level higher than that which would prevail in a more consolidated market. In legal aid, the administrative burden of dealing with a large number of suppliers inevitably adds complexity and cost to the process. The Legal Services Commission has a point!

Historically, partnership has been the professional 'badge of honour'. It was the assumed route for any solicitor of a certain level of experience. Consequently, the owners of many law firms have tended to be technically proficient but entrepreneurially deficient. They have viewed their role as being to provide legal services to clients rather than to build and run a business. Decisions take too long, and are often based on self-interest and self-preservation rather than the best interests of the firm as a whole and its clients. The argument that law is a profession and not a business is a longstanding one – but now pointless. We should do well to remember the comment of Sir David Clementi in his final report who, when referring to the level of complaints for poor service, said: "If certain lawyers continue to reject the notion that they are in business, such complaints will continue until they are indeed out of business". Being in business is neither a negation of professionalism nor necessarily inconsistent with it. Ethics is as much a state of mind as a consequence of business structure. Thus, too many law firms have partners who are not performing the entrepreneurial and leadership roles that businesses require.

In short, they do not earn their profit-share; or put another way, they are being subsidised by other activities and people and, again, drive up the costs of legal services beyond the level at which efficient businesses would be able to provide them.

It is true that many firms are facing up to the implications of underperforming partners and beginning to grasp the nettle. But an inevitable consequence of this is that, with fewer equity partners, law firms might find it more difficult to raise enough capital or debt to resource their practices.

Against this background, litigation becomes an expensive service because the business vehicles for delivering dispute resolution services are themselves over-laden with cost. Formal ADR is also too expensive when provided through those same vehicles. The status quo is difficult to justify and maintain. And so it is that 'consumer'-facing law firms now face themselves with the combined threats of Clementi, Carter, the review of the small claims limit, and home information packs. The most likely outcome is greater consolidation of law firms, with possibly hundreds of small and medium sized firms being taken over or amalgamating. The question for me is not 'whether', but 'how soon', 'to what extent', and 'by whom'? And how will this consolidation be funded – debt or equity?

So what might happen?

The dispute resolution market is itself made up of different segments. Those most likely to be affected by the reforms are the 'consumer' and legal aid segments (and there are areas where the two overlap). The Clementi-driven 'consumer' reforms are likely to attract large, nationally branded, providers: retailers (e.g. the Co-op) and banks (e.g. HBoS) may develop 'own-brand' services that may be provided directly, or white-labelled through collaboration with law firms. There is already a lot of this activity in the marketplace.

However, I suspect that private family and children work could remain relatively unscathed. There is rarely a winner in such disputes, and national brands may not wish to risk their reputation on services that have such significant 'grudge purchase' and negative connotations. For similar reasons, they may wish to steer clear of criminal work.

It is not clear whether these and other brands (such as insurance companies, loss adjusters and public authorities) see any benefits from establishing themselves in the market through the licensed alternative business structures proposed in the Legal Services Bill. I remain to be convinced that they will be tempted, given the degree of influence and control national brand players already exert: unless they feel a need to control service costs to an even greater extent or wish to remove lawyers (and perhaps particularly equity partners) from the cost structure, I doubt that the cost-benefit of licensing will work in their favour in the short to medium term.

Nevertheless, the Government said in the White Paper that it wished to see more disputes settled through one-stop-shop ADR businesses (though the need for this seems to be driven from the supply-side in the absence of much evidence that consumers are actually asking for it). And the Legal Services Commission will also welcome new providers and consolidated, larger-scale, providers in the legal aid market. But are they confusing scale and economies of scale, and assuming that the latter inevitably flow from the former? Market share and market efficiencies are not the same thing, and do not necessarily follow from each other. Given my comments earlier about fragmentation and duplication of costs, it certainly follows that I believe consolidation (scale) is both

desirable and unavoidable in the legal services market. But scale will only inevitably deliver market share.

Economies of scale arise when the unit costs of production fall, and that requires scaleable products and services. In law, not all services are scaleable. Many aspects of publicly funded advice relate to highly technical areas of law, applied to some of the most vulnerable in society. The technicalities of many aspects of social welfare and immigration law, and their application to specific client circumstances, are not yet susceptible to commoditisation and processes – they are not scaleable and could not deliver economies of scale. In a system moving to fixed (or competitively tendered) prices and capacity-based contracts to preferred suppliers, there is a potential mismatch between the complexity of 'consumer' rights and the availability of funding for legal support.

Conclusions

Litigation and ADR are, on the whole, too expensive for the pockets of those who fund them, whether privately or publicly. Consequently, providers of dispute resolution services have to think how best to reduce the cost to the client. Make no mistake: the fees charged for dispute resolution cannot all be maintained at current levels. The only way a reduction can be achieved without changing the way law firms are structured and work is by squeezing the return to the owners – by reducing profits. If that is not acceptable (and there is no reason why it should be), new approaches have to be found. They will come from new entrants changing the business model and methods of delivery (through consolidation, cheaper people and the better use of technology); or they can come from incumbent law firms doing that for themselves. What's your choice: victim or beneficiary?

This paper is based on the keynote address to the Dispute Resolution Section's annual conference in London on 16 November 2006, and subsequently published in the Section's journal, *Solutions*.

