# PRACTICE MANAGEMENT – COSTS FOR THE LEGAL PROFESSION

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"Clear, concise and timely costs disclosure is a good business practice; it minimises the potential for misunderstandings at a later stage, and the possibility of complaints against lawyers where a client feels he or she has been charged more than is fair and reasonable. Early discussions about costs help to educate clients about how the legal process works, and can assist in focusing them on the desired outcome and the way the matter should be progressed to achieve it. This facilitates greater control by clients over their own legal matters and can result in clarity about the shared goals of the client and lawyer." (COAG National Legal Profession Reform, Discussion Paper: Legal Costs, 4 November 2009)

## COAG National Legal Profession Reform

- On 30 April 2009, the Council of Australian Governments (COAG) resolved that the following measures be instituted to reform the regulation of the legal profession:
    - Legislation be drafted providing uniform laws relating to the legal profession across Australia;
    - A specialist taskforce be appointed by the Attorney-General to make recommendations and prepare draft legislation;
    - A consultative group be appointed by the Attorney General to advise and assist the Taskforce.
- Following the COAG meeting, the Taskforce and Consultative Group was created. A Working Group was also created to provide policy, technical, administrative design and advice and secretariat support to the Taskforce.
- The Taskforce has been tasked with designing a "high level regulatory framework" which "creates and supports a national legal profession", "provides clear and accessible consumer protection and is "efficient and effective" and "robust, relevant and effective over time."
- To date the Taskforce has published 7 papers. The papers cover the following topics:
    - Fidelity Cover
    - Trust Accounting
    - Professional Indemnity Insurance
    - Business Structures
    - National Legal Services Ombudsman
    - Legal Costs
    - Regulatory Framework

- The work of the Taskforce has been geared towards drafting legislation that is principles-based rather than proscriptive.
- The move to principle-based legislation marks an important departure from the current legislative framework.
- Principle-based regulation will have a substantial effect on the practice of law in Australia.

## PRINCIPLE BASED REGULATION. [1]

- Principle-based regulation means moving away from reliance on detailed, prescriptive rules and relying more on high level, broadly stated rules or principles to set the standards by which regulated firms need to practice
- Regulators thus worry less about dotted "i"s and crossed "t"s, and instead evaluate practitioners and firms behaviour according to broad principles.
- Principle based regulation is usually considered to have the following features:

    - promulgation of high-level standards that are drafted at a broad level of generality
    - a focus on an outcomes-based approach
    - a commitment to enhanced stakeholder participation in the design of principles
    - increased responsibility of regulated entities' senior management for the implementation of principles within firms
    - reliance on constant improvement of industry best practices and guidance with respect to best practices rather than prescriptive rule-making

### Advantages of Principle-based Regulation

- In general, a principle-based approach requires regulated entities to meet certain high level principles in conducting their operations. Such an approach has the advantage of being flexible for both the regulated and regulator. Principle-based regulation is thus not based on a "one-size fits all" approach.
- A second advantage to principles regulation is its focus on risk. Risk-based regulation is advantageous because it inherently requires regulators to incorporate cost-benefit judgments into their decision-making. Focusing on risk also helps regulators to prioritize their responsibilities and leverage limited resources to their best advantage. Principles-based regulation is thus capable of not over-regulating the "good" and targeting those most at risk.

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* Information in this paper is largely based on a paper by Julia Black, Martin Hopper & Christa Band, "Making a success of Principles-based regulation", (17 May 2007) *Law and Financial Markets Review*, Vol 1, No.3 available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1146977

[1] For further information about principles-based regulation see Julia Black, Forms and Paradoxes of Principles Based Regulation, (23 September 2008), LSE Legal Studies, Working Paper No.13/2008, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1267722; S.Willison, Strategy on principles-based regulation, 2 October 2009, Solicitor's Regulation Authority; Rt Hon Lord Hunt of Wirral MBE, THE HUNT REVIEW OF THE REGULATION OF LEGAL SERVICES, available at http://www.legalregulationreview.com/site.php?s=1

- Principle-based regulation also has a significant advantage over rules-based regimes because it enhances the regulators' ability to work cooperatively with the regulated and other regulators.
- Principle-based regulation can enhance compliance by promoting behaviour, which is congruent with the objectives of regulation.
- Principle-based regulation can focus on the purpose behind the rule rather than just on the derailed provisions.
- Principles are hard to manipulate, making creative compliance difficult.
- Principle-based regulation can lead to a greater degree of substantive compliance with the purpose of the rule, rather than a "box-ticking" approach, as they require firms to think through how to comply; as such they can be directly linked to management-based regulation.
- Principle-based regulation can provide a basis for open dialogue between regulator and regulated firm, facilitating a co-operative and educative approach to supervision, particularly with respect to firms who are well-intentioned, but either ill informed, or simply confused as to what the regulatory provisions require.

Disadvantages of Principle-based Regulation

- Principle-based regulation is not meant for all markets, especially emerging ones where the certainty of rules is needed by regulators and industry. This approach works best in mature, self-regulated markets where developed relationships between the regulated and regulators exist. Otherwise, the trust and expertise is not present to allow the system to function effectively.
- Principle-based regulation also requires proper training and maintenance. With principle-based regulation, staff must employ their experience and judgment in making sound regulatory decisions.
- Principle-based legislation is more qualitative than quantitative and this adjustment takes time. Early in the transition, staff can occasionally be paralysed by their fear of making the wrong call and this can lead to a regulatory impasse.
- Not all regulation will fit intro the principle-based model. On some occasions the regulation may require fixed rules.
- Guidances drafted to assist interpretation of the principles can be unhelpful if it is not consistent with the purpose of the principle.
- Care must be taken when dealing with principle-based regulation with the methods used to explain or give substance to the principles, to create clarity and consistency.
- An example of how this can go wrong is seen in the UK where speeches given by regulators of the financial services industry extolling the virtues of "mystery calling" (where a number of the regulatory staff would contact a financial services industry provider pretending to be a prospective client and attempt to discover weaknesses in their service delivery). Whereas, this may be a useful tool as the speeches were given by the regulators, it was assumed by the industry that it was a requirement not just a tool. Accordingly, all financial services providers now use this method as they consider it a requirement.

- There is also the problem that the legal profession tends to view anything stated by a regulator as gospel rather than just a suggestion or an alternative way of approaching the problem.

## PRINCIPLE-BASED REGULATION IN PRACTICE

- In New South Wales, the method OLSC has used to address the regulation of an incorporated legal practice is a good example of principle-based regulation in action.
- The Act requires that solicitor/directors ensure the incorporated practice has "appropriate management systems" to render the practice compliant with the Legal Profession Act. As appropriate management systems are not defined, this fits within the rubric of principle-based regulation.
- The OLSC"s approach in defining the 10 elements that management systems should address to be considered appropriate gives guidelines for the profession in meeting the regulatory standards.
- For example, objective 5 of the OLSC's appropriate management system relate to costs disclosure and billing. The objective states as follows:

> "Cost disclosure/billing practices/termination of retainer (providing for shared understanding and appropriate documentation on commencement and termination of retainer along with appropriate billing practices during the retainer)"

- The self-assessment form in relation to objective 5 guides practitioners as to the key concepts that they might want to consider when addressing the objective.
- The key concepts for objective 5 include for example:

    - "The use of established new client engagement procedures including universal use of approved retainer/costs agreements."
    - "Standardised procedures for collecting client data, opening of new files and the recording of data within the firm's accounting and practice management systems with provision for separate client records in the case of multi-disciplinary practices."

- The self-assessment document then provides examples of what an ILP *may* do to evidence compliance with objective five. For example, in relation to "[s]tandardised procedures for collecting client data, opening of new files and the recording of data within the firm's accounting and practice management systems with provision for separate client records in the case of multi-disciplinary practices", the self-assessment form suggests practitioners may want to use a "disclosure policy (eg whether or not taking advantage of exceptions to disclosure, policy about disclosure of costs of non-legal services used in the legal matter) with a process ensuring disclosure is made in accordance with the Act, Rules and Regulation." The self-assessment document also suggests "an up to date File/Matter Register or Practice Management system listing files and individual client files (complying with Rule 13 as to files and file register).

- The appropriate management systems and self-assessment document in Queensland is identical to that of the OLSC's.
- At the OLSC we know that by meeting this standard, incorporated legal practices experience a wide reduction in complaints against them.
- According to the results of a research study we conducted in 2008, together with Dr Christine Parker, of the University of Melbourne, on average the complaint rate (average number of complaints per practitioner per years) for ILPs after self-assessment was two thirds lower than the complaint rate before self-assessment. This is a huge drop in complaints. In addition to the complaints data the study also found that the majority of ILPs assess themselves to be in compliance on all ten objectives from their initial self-assessment (62%). Of the remaining 38%, about half have become compliant within three months of the initial self-assessment. The study further revealed that ILPs have the highest rates of self-assessed compliance with trust accounting obligations and the lowest rates of self-assessed compliance with management systems to ensure good communication and good supervision of practice.

## COMPLAINTS ABOUT COSTS

- In 2006-2007, costs complaints comprised of 24% of all the written complaints received at the OLSC. Of these complaints overcharging continues to be the most complained about issue in relation to costs (9.1%). This has been the case for many years now.
- It is important to remember however that the actual number of complaints about costs are much higher as costs often appear as an additional complaint to a substantive complaint.
- There are a number of reasons why this is so:

    - the continued use of hourly billing as the preferred method of billing, a widespread use of fixed fee arrangements in matters where such an arrangement may not be appropriate (e.g criminal matters);
    - a lack of use of such arrangements in routine matters where it may be appropriate (e.g mortgage transactions, leases);
    - the practise of charging more than one client in simultaneous matters is also contributing to the problem;
    - recent decisions on matters relating to overcharging by the Administrative Decisions Tribunal and the NSW Court of Appeal;
    - a requirement that practitioners only provide ongoing costs reports where there is a substantial increase in costs;
    - no requirement in the Queensland or NSW legislation that a practitioner render a bill at any other time other than at the completion of a matter.

- Under the current system it has become increasing easier for practitioner to charge excessive costs and increasingly difficult for my office to prosecute such complaints.
- Many of the complaints, by and large, concern proportionality. The amount charged by practitioners should be in proportion to the amount rewarded. Often however it is not. Costs charged that are not in proportion to the award lead to unhappy clients and complaints.

## THE CONCEPT OF PROPORTIONALITY – FAIR & REASONABLE COSTS

- The concept of proportionality is a substantive principle of justice in the adversarial system and to this end has been given legislative effect.
- Section 60 of the *Civil Procedure Act 2005 (NSW)* for example, provides that "in any proceedings, the practice and procedure of the courts should be implemented with the object of resolving issues between the parties in such a way that the cost to the parties is proportionate to the importance and complexity of the subject-matter in dispute."
- Basically, the principle requires that the procedures and their costs be measured against the complexity of the issues, the value of the subject matter and the nature of the claim involved. However, the doctrine does not only relate to the practice and procedure of the courts, it also relates to costs.
- The doctrine of proportionality is embodied in the determination by an independent costs assessor of the Supreme Court who is able to have regard to inter alia, "the complexity, novelty or difficulty of the matter" and "the outcome of the matter" in determining whether costs are "fair and reasonable." It is my view in making this determination a cost assessor should examine the costs charged in the matter against the amount ordered by the courts.
- Despite being given legislative imprimatur it appears that the concept of proportionality is not being effectively applied by the profession. This is particularly true in the area of personal injury litigation. My Office has received a number of complaints in which a client has been charged excessive costs compared to the actual amount awarded. In one matter for example, a complainant was charged $52,000 for a matter that settled for $80,000 inclusive of costs on the first day of court. In another matter, a complainant was charged in excess of $30,000 for a simple matter of recovering $4,000 in lost wages.
- There is also the problem that often the courts will make an award or settle a matter "plus costs." The effect of such an order can be illusive to a plaintiff who is unaware of the amount of the costs being claimed.
- One of the main reasons why the concept of proportionality is not being applied effectively is because the concept as interpreted by the legislation is limited.
- The problem is that the legislation does not actually allow an examination of the costs charged compared to the amount ordered.
- The concept of proportionality is only alluded to in legislation, not stipulated as a matter of fact.
- In NSW, for example, there is only one piece of legislation that positively stipulates proportionality. Sections 339 of the *Legal Profession Act 2004* provide for maximum fees of $10,000 in personal injuries cases where the claim is for an amount less than $100,000 and where there is no costs agreement in place. There is however no limitation of costs in NSW for awards greater than $100,000.
- There is also the problem that in NSW there are no charging limits in most matters. Since the deregulation of costs in NSW in 1994 there are very few areas where scales of costs or ceilings of costs are imposed. This can

potentially result in complaints if the practitioner fails to notify their client of significant increases.

- The greatest problem however is the ideology behind billing practices.
- Under the costs disclosure system clients are given a document, which sets out an estimate of costs that may be charged at the conclusion of their matter.
- Clients, will more often than not take that estimate to be more like a fixed quote rather than just an estimate. So when the case is completed and the client is handed a bill that is significantly different to the original amount outrage and a complaint will often follow.
- The practitioner is not however entirely to blame. Practitioners are not obliged and have not necessarily adopted the practise of explaining to the client that the amount given is just an estimate, nor are practitioners obliged to explain to the client that that estimate may increase as the matter proceeds.
- Furthermore, practitioners are less likely to inform a client about any changes to the original estimate because the estimate is just that, it is not a fixed quote. In the cases where practitioners do provide regular billing, practitioners also appear to have adopted a practice of not notifying the client of specific costs increases believing that the bills are self-explanatory.

## COAG's PROPOSED LEGISLATIVE PRINCIPLES FOR LEGAL COSTS

- In it's discussion paper on legal costs, published on 4 November 2009, COAG suggested that a number of legislative principles to be included in the scheme.
- In relation to costs disclosure, COAG suggested the following:

    - "Before, or as soon as practicable after, giving instructions to act clients shall receive sufficient written information about the estimated costs of their matter, and the method for calculating that estimate, to reasonably allow them to make informed decisions about the conduct of the matter. This shall also include disclosure in relation to costs where a law practice intends to retain another law practice or expert on behalf of the client;
    - Any significant change to a matter previously disclosed must be notified to the client as soon as reasonably possible after the law practice becomes aware of the change;
    - Costs disclosure should be presented in a concise, clear and accessible format;
    - Legal practitioners should take reasonable steps to ensure that clients understand the information disclosed. In addition, consumers from culturally and linguistically diverse backgrounds should not be disadvantaged as compared to people for whom English is their first language;
    - Clients must be informed about their right to negotiate a costs agreement and to challenge legal costs;
    - Costs agreements are enforceable as a contract between the parties (and any assessment will by reference to the costs agreement if it is a valid agreement complying with the legislation);
    - If a law practice fails to disclose anything required by the legislation, the client will not be required to pay legal costs until they have been assessed. The law practice must not commence or maintain proceedings to recover fees until after the assessment;
    - Sophisticated clients may contract out of the mandatory costs disclosure and assessment regimes."

- In relation to proportionality, the COAG paper suggested as follows:

    - "Legal practitioners and law practices may only charge fair and reasonable costs;
    - A costs agreement is prima facie evidence of what are fair and reasonable costs;
    - Legal costs should be proportionate to the complexity or importance of the issues and amount in dispute;
    - Law practices and their clients may agree to a variety of methods for calculating legal costs;
    - The courts and tribunals may set aside costs agreements, in whole or in part, which are not fair or reasonable;
    - Legal practitioners and law practices must make reasonable endeavours to act promptly and to minimise delay in the legal process and must not otherwise work in a way that unnecessarily increase costs in a matter."

## CAN PRINCIPLES-BASED REGULATION SOLVE THE PROBLEM?

- Remember that principle-based legislation is largely a set of behavioural standards – they are concerned with, for example, the "integrity", "skill care and diligence" and "reasonable care" with which firms conduct and organise their business and the fairness with which firms treat customers.
- Accordingly, principles-based legislation may, for example, require that costs disclosure must be "fair, reasonable and proportionate."
- Principles-based regulation will not only assist in addressing the problem of proportionality but it will also assist in addressing other issues of concern such as informed consent, unconscionable contracts and peer review.
- Principles-based legislation will be able to provide transparency in billing and enable consumers of legal services to understand the billing process from the commencement of a matter to its completion. Principles-based legislation will thus address the problem of information asymmetry and at the end of the day ensure greater consumer protection.